

Washington Law Review

Volume 25 | Number 1

2-1-1950

Preferences as Affected by Section 60c and Section 67b of the Bankruptcy Act

John Hanna

Follow this and additional works at: <https://digitalcommons.law.uw.edu/wlr>



Part of the [Bankruptcy Law Commons](#)

Recommended Citation

John Hanna, *Preferences as Affected by Section 60c and Section 67b of the Bankruptcy Act*, 25 Wash. L. Rev. & St. B.J. 1 (1950).

Available at: <https://digitalcommons.law.uw.edu/wlr/vol25/iss1/1>

This Article is brought to you for free and open access by the Law Reviews and Journals at UW Law Digital Commons. It has been accepted for inclusion in Washington Law Review by an authorized editor of UW Law Digital Commons. For more information, please contact lawref@uw.edu.

WASHINGTON LAW REVIEW

AND

STATE BAR JOURNAL

VOLUME 25

FEBRUARY, 1950

NUMBER 1

PREFERENCES AS AFFECTED BY SECTION 60c AND SECTION 67b OF THE BANKRUPTCY LAW

JOHN HANNA*

THE GENERAL problem of preferences in bankruptcy in the recent past has been more frequently and more comprehensively discussed in legal periodicals than any other bankruptcy topic.¹ It is not the purpose of this article to supplement what has been written elsewhere on the subject of Section 60a and b. The proper concern of

*Professor of Law, Columbia University School of Law.

¹ The chief attack on Section 60a in its present form, whereby the test of a perfected transfer is its validity against any creditor and any bona fide purchaser, is that the section threatens to invalidate, if it does not, against the trustee security interests on inventories, such as trust receipts, factor's liens, mortgages, or stocks of goods and conditional sales for resale, which are not meant to be good against purchasers in due course of business. The holding and the language of *Corn Exchange Bank and Trust Co. v. Klauder*, 318 U.S. 434 (1943), and of *In re Vardamann*, 52 F. Supp. 562 (E.D. Mo. 1943), justify the most pessimistic conclusions. That some qualification is possible is indicated by *In re Rosen*, 157 F.(2d) 997 (C.C.A. 3rd 1946), *cert. denied*, 330 U.S. 835 (1947). In the *Klauder* case, where the assignee of accounts receivable was defeated by the trustee because of the theoretical possibility in Pennsylvania at that time of the obtaining of a priority by a bona fide second assignee, who first gave notice to the account debtor, under the rule of *Dearle v. Hall*, 3 Russ. 1, 38 Eng. Rep. 475 (1828), the Supreme Court could have held that it was not the bona fide purchase but the additional action that determined the position of the second assignee, and hence that the hypothetical bona fide purchaser test did not help the trustee. It is argued that "buyer in regular course of business" means something different from "bona fide purchaser," and hence that the present law would not invalidate trust receipts and other somewhat similar security interests, particularly when these are filed in accordance with state law and hence not secret.

Following are some of the recent discussions of Section 60a:

Hearings before Bankruptcy Subcommittee of Committee on the Judiciary on H.R. 2412 and H.R. 5834, 80th Cong., 2nd Sess. 19 (1948); *Hearings before Bankruptcy Subcommittee No. 2 of Committee on the Judiciary on H.R. 272 and H.R. 2691*, 81st Cong., 1st Sess. 7 (1949); Burman, *Practical Aspects of Inventory and Receivables Financing*, 13 LAW AND CONTEMPORARY PROBLEMS 555 (1948); Hanna, *Some Unsolved Problems Under Section 60a of the Bankruptcy Act*, 43 COL. L. REV. 58 (1943); Hanna, *Foreword to Koessler, Assignment of Accounts Receivable: Confusion of the*

many members of Congress for the lamentable uncertainties of the position of many secured creditors under the present law gives some reason to hope that before this article appears an amendment to Section 60a will have been adopted, which as to personal property transfers will substitute a hypothetical lien creditor test for the existing hypothetical bona fide purchaser test in the preference section. The wording of the amendment probably will vary considerably from that heretofore so strongly urged by the American Bar Association's special Committee, but the principal reform urged by the Bar Association will be accomplished.

The bill² which apparently has the best chance of passage contains an expression of policy condemning equitable liens in the following language:

The recognition of equitable liens where available means of perfecting legal or statutory liens have not been employed is hereby declared to be contrary to the policy of this section.

This sentence is followed by other language stating that if any applicable law requires a perfection against any third persons except purchasers in regular course of business,³ the transfer shall not be deemed

Present Law, the Impact of the Bankruptcy Act, and the Need for Uniform Legislation, 33 CALIF. L. REV. 40 (1945); Hanna, *Preferences in Bankruptcy*, 15 U. OF CHI. L. REV. 311 (1948); Ireton, *A Proposal to Amend Section 60a of the Bankruptcy Act*, A6 AM. BANKR. REV. 257, 287 (1947); Keffe, Kelly, and Lewis, *Sick Sixty: A Proposed Revision of Section 60a of the Bankruptcy Act*, 33 CORN. L. Q. 99 (1947); Kupfer, *Progress in the Amendment of Section 60a of the Bankruptcy Act*, 13 LAW AND CONTEMPORARY PROBLEMS 624 (1948); Kupfer and Livingston, *Corn Exchange National Bank and Trust Company v. Klaunder Revisited: The Aftermath of Its Implications*, 32 VA. L. REV. 910 (1946); Kupfer and Livingston, *Corn Exchange National Bank and Trust Company v. Klaunder Revisited: A Supplemental Note*, 33 VA. L. REV. 1 (1947).

Livingston and Kearns, *Commercial Financing and the Relation Between Secured and Unsecured Creditors in Bankruptcy*, 13 LAW AND CONTEMPORARY PROBLEMS, 609 (1948); Llewellyn, *Problems of Codifying Security Law*, 13 LAW AND CONTEMPORARY PROBLEMS, 687 (1948); Lowenstein, *Assignments of Accounts Receivable and the Bankruptcy Act*, 1 RUTGERS U. L. REV. 1 (1947); McGowan, *Trust Receipts Under Section 60a*, CREDIT AND FINANCIAL MANAGEMENT, February, 1948, p. 4; McGowan, *Assignability of Documentary Credits*, 13 LAW AND CONTEMPORARY PROBLEMS, 666 (1948); MacLachlan, *Defining a Preference in Bankruptcy*, 60 HARV. L. REV. 233 (1946); Martin, *Substantive Regulation of Security Devices Under the Bankruptcy Power*, 48 COL. L. REV. 62 (1948); Moore and Tone, *Proposed Bankruptcy Amendments: Improvement or Retrogression?*, 57 YALE L. J. 683, 686-692 (1948); Oglebay, *Proposed Revision of Section 60a of the Bankruptcy Act: A Step Backward*, 51 COM. L. J. 263 (1946); Pemberton, *Notice Filing for Assignments of Accounts Receivable*, 13 LAW AND CONTEMPORARY PROBLEMS, 643 (1948); Silverman, *Factoring: Its Legal Aspects and Economic Justification*, 13 LAW AND CONTEMPORARY PROBLEMS, 598 (1948).

² H.R. 2691.

³ "The recognition of equitable liens where available means of perfecting legal or statutory liens have not been employed is hereby declared to be contrary to the policy of this section. If (A) a transfer is for security and applicable law requires a signed and delivered writing, or a delivery of possession, or a filing or recording, or other like

to have been completed until such perfection occurs, even if the action of the parties is sufficient against persons obtaining a lien by legal or equitable proceedings.

The amendment also retains the test of perfection against bona fide purchasers in respect of real estate transfers.⁴

The blanket condemnation of equitable liens and the insistence on the retention of the bona fide test for real estate transactions reflect the opinion of a majority of the members of the National Bankruptcy Conference that it is a desirable function of the Bankruptcy Act to attempt to alter state rules of property and contract in order to enlarge the interests of unsecured creditors. Since the bankruptcy court is a court of equity, the position of Congress in announcing a policy determination hostile to equitable liens is somewhat anomalous. Several writers in referring to equitable liens have contrived an epithet by the use of quotation marks in the expression "judge-made" liens. Equitable liens are nothing more than interests recognized by equity judges. In expressing a judgment as to what is fair and equitable, judges are exercising their historic function of doing justice by supplementing legal rules. Why liens approved as equitable in particular situations should receive the blanket condemnation of Congress is puzzling. That such interests prevail at all in state law is at least some indication that they are also approved by the legislatures which have the power to change them. In fact, by Section 67b the states may still have the power to preserve any of these equitable liens by giving them a statutory status.

The reason generally assigned for the assault against equitable liens is that they are secret. Ignoring the question as to the truth of this assertion for the moment, one may inquire whether it is the business of Congress or the several states to determine whether the claim of a litigant to the protection of a court of equity necessarily should be denied merely because he has not given public notoriety to his claim

overt action as a condition to its full validity against third persons other than a buyer in the ordinary course of trade and if (B) such overt action has not been taken, such transfer is not perfected within the meaning of this paragraph (2). Notwithstanding the first sentence of this paragraph (2), it shall not suffice to perfect such transfer that it is made for a valuable consideration and that both parties intend to perfect it and that they take action sufficient to effect a transfer as against liens by legal or equitable proceedings on a simple contract: *Provided, however,* That where the debtor's own interest is only equitable, he can perfect a transfer thereof by any means appropriate fully to transfer an interest of that character." (H.R. 2691, p. 4.)

⁴ "A transfer of real property shall be deemed to have been made or suffered when it became so far perfected that no bona fide purchase from the debtor could create rights in such property superior to the rights of the transferee." (H.R. 2691, p. 2.)

or has not conducted his affairs in some different way which would have given him a different sort of property interest. It may well be that his claim is for assets which have swelled a respondent's estate in such circumstances that it would be grossly unfair to add them to the resources subject to the claim of other creditors. The comprehensive charge of secrecy against equitable liens, however, cannot be supported. Not only is there general publicity for certain types of equitable interests, but the very fact of the recognition of equitable interests in many particular cases involves a finding that the adverse claimant has notice of the equitable claim. One must remember that the Bankruptcy Act in its preference sections, by adopting any hypothetical test of perfection of a transfer, gives the trustee a position that may be much superior to that of some or even all of the creditors he represents. It is at least theoretically possible that where a debtor had obtained real estate by fraud, and his victim had only an equitable lien for its restoration, every single creditor may have been aware of the fraud before he became a creditor. Nevertheless, the trustee would acquire the bankrupt's interest free of the equitable claims and would distribute its proceeds ratably to all the creditors.

Secret security interests of creditors of large corporations can scarcely exist irrespective of compliance with recording statutes. Suppose, for example, a debenture issue or term loan agreement contained a provision by which the corporate debtor agreed that no subsequent borrowing should be secured, or, if secured, that the previous unsecured loans should be likewise secured. While the authority is scant, it is at least possible that an equitable interest in the debtor's property is created on behalf of the first creditors. It is unlikely that this contract is recorded. On the other hand, the contract is almost certainly known to everyone dealing with the corporation on any substantial scale. Any debenture issue is likely registered with the Securities and Exchange Commission. The main points of the contract are reported in numerous investment services. To say that whatever equitable security interest may exist should be nullified in any bankruptcy of the debtor as a result of a doctrinaire provision regarding preferences seems to be defeating rather than doing justice. The law of security, in addition to consisting of specialized rules of property and contracts, is made up of rules of equity which supplement, modify or supersede the bargains made by parties. In numerous cases the interests protected are in the category of equitable liens. To take one illustration from suretyship: where the

surety has guaranteed the performance of a contractor, the surety probably has an equitable lien on amounts due from the owner. If the contractor defaults and the surety performs, the amount due should be paid to the surety, subject to certain exceptions. Such an interest in the surety is generally not the subject of record, but it is rarely secret, for one can scarcely be a creditor of the contractor without knowing of the suretyship contract.

The introduction into the bankruptcy law of reference to equitable liens is unfortunate because the term "lien" is one of the most amorphous concepts in law.⁵ The *Restatement of Security* refers to the word "lien" in the following language:

The term "lien" is frequently used in the broad sense of a tie or hold which one person has for the purpose of security upon land, chattels or intangibles in which another has an interest. A lien in this broad sense may

⁵ The word "lien" is derived from Latin through French and means to "tie" or "bind." It signifies a claim attaching to property without satisfying which the owner cannot have a clear title. In other words, it is a charge, enforceable either in law or equity, against identifiable personality or realty. In the broadest sense it includes all security interests, both legal and equitable. Mr. Justice Erle once observed that "the words equitable lien are intensely undefined." *Brunsdon v. Allard*, 2 El. & El. 19, 121 Eng. Rep. 8 (1859). See JONES, LIENS 26 (3rd ed. 1914). Jones remarks that while equitable liens have been regarded as having their origin in trusts, they are better described as analogous to trusts. In security an equitable lien arises when equity will give specific performance of a contract for security. An equitable security lien or a constructive trust will also be recognized when a remedy for a wrong can be afforded by recognizing a property interest in behalf of the wronged party.

Among the best known equitable liens are those for vendor and vendee in real estate transactions, and where there has been a contract to give a mortgage. An illustration of an equitable lien as the result of a wrong would be one allowed against property improved by money obtained by larceny and embezzlement. None of these liens would be good against a bona fide purchaser, but in many states they would be valid against a judgment creditor. While one probably could not assert effectively that the victim of a wrong could have obtained other security, this qualification in the proposed draft of the amendment to Section 60a would not affect the bona fide purchaser test.

The vendor's lien is recognized in between one-third and one-fourth of the states to give a seller of real estate a lien for the unpaid purchase price after transfer of title. Such a situation can arise when the expectation of the vendor is that he will be paid in full in a short time. In states recognizing vendor's liens, a lien for a vendee usually is also enforceable. This is invoked, for example, where a vendee has paid part of the purchase price and the vendor either cannot or will not transfer the real estate covered by the deed or contract.

A possible unfair application of the bona fide purchaser test in respect of an agreement to give a mortgage could occur in several ways, where the lien arising from such an agreement was good against creditors but not against bona fide purchasers. The creditors might all know of the transaction. Even if they did not know, the transaction might not have changed their position in any way. For example, a man in business in Seattle might arrange to buy a summer home at some distant point. He could agree with a lending agency that if the latter would advance the final payment to the seller, he would execute a mortgage as soon as title was transferred. The money is advanced and title transferred to the buyer. Then either the buyer refuses to execute the mortgage, or there is some delay in the execution and the buyer becomes bankrupt in the interval. Even if the buyer executed the mortgage after the delay but before bankruptcy, the mortgage might be considered a preference as security for an antecedent debt. The result in bankruptcy would be that the proceeds of the real estate would go to all the creditors with no priority to the creditor who created the asset.

also be defined as a charge. Thus broadly understood "lien" may be considered as a general term embracing all sorts of security devices, legal or equitable.

The term "possessory lien" is not used in this Chapter in the broad sense just mentioned but in a narrow sense which makes it one of the most limited, if not the most limited, of security interests. The possessory lien is an interest only in chattels. It is somewhat like a pledge but the powers of the lienor are generally less than those of the pledge.⁶

In the sense just used "lien" of course does not mean the common law possessory lien which is the privilege of a bailee to retain a chattel, not bailed for the purpose of security, until some demand of the bailee against the bailor has been satisfied.⁷ The typical possessory lien is that of the artisan who has done work on a chattel at the request of the bailor.⁸

The intrusion of a diatribe against equitable liens in the Bankruptcy Act does not reach any recognized evil. It satisfies no public demand for a variation in property rights in bankruptcy as distinguished from state law. There is no evidence either from statistics or in the opinion of bankruptcy experts that the acceptance in bankruptcy of equitable interests has ever had any significant effect on general creditors. The cases most criticized under the old interpretation of Section 60, with the exception of *Sexton v. Kessler and Company*,⁹ where the agreement for the pledge probably constituted an equitable interest, were cases of unrecorded legal interests where the bankruptcy courts were disregarding the policy of state laws. The rules of these cases, as well as that of *Sexton v. Kessler*, have been changed by the proposed amendments to the Chandler Act just as effectively as by the present wording of the Chandler Act itself. The hostility expressed toward equitable liens in the proposed new draft of Section 60 is due in part to a determination to enlarge estates for the benefit of general creditors, with little

⁶ RESTATEMENT, SECURITY, SCOPE NOTE 157.

⁷ RESTATEMENT, SECURITY, § 59: "Where a bailee has the privilege of retaining a chattel, not bailed for the purpose of securing the payment of a debt or the performance of some other act by the bailor, until some demand of the bailee against the bailor has been satisfied, the interest of the bailee is a possessory lien."

⁸ One effect, not necessarily undesirable, of recent amendments to the Bankruptcy Act may be to encourage informal settlements between creditors and debtors without any sort of court supervision. The Board of Trade of San Francisco settled 527 cases of embarrassed debtors between April 1, 1947, and April 1, 1948, and used bankruptcy in only two of them (1948 Report, Board of Trade, 15). Although the existence of the Securities and Exchange Commission, and the laws under which it operates, are not the entire explanation, it is interesting to observe the tendency toward corporate financing by term loans and private placement of securities since the passage of the Securities Act.

⁹ 225 U.S. 90 (1912).

consideration for justice in particular cases, and in part to theoretical assumptions about secrecy and equitable liens.

The best that can be said for the new wording is that the amendments do remedy the worst defects of the present law and remove the uncertainty about security transactions in connection with inventory financing. It is true that the economic importance of these reforms greatly outweighs that of the occasional unrecorded interests in real estate and equitable interests in land and chattels. The larger transactions in real estate, especially where corporations are concerned, are completely supervised at all stages by experienced lawyers. Compliance with recording requirements is generally complete. These transactions scarcely present a problem for the bankruptcy courts. A considerable part of the more intricate real estate controversies are settled in probate administration. In the matter of rural real estate, the farmer can stay out of the bankruptcy court entirely if he wishes, and in any event Congress will probably continue some legislation along the lines of Section 75. In practice the provisions of Section 60a touching real estate will be invoked only in isolated cases. One might argue that this is an argument for omitting such real estate provisions rather than retaining them as an interference with state law and affording the possibility of injustice in particular cases.

Anyone familiar with the procedure in bringing about federal legislation can understand readily why those interested in inventory financing are willing to compromise with those to whom it is an article of faith that the general creditor should be favored in the bankruptcy laws. Financing agencies that provide working capital to debtors are not concerned with real estate. If they gain their own commendable objectives they have no inclination to enter the lists on behalf of other classes of creditors. Bankruptcy presents highly technical problems. Even conscientious members of Congress, unless as lawyers they have had experience in bankruptcy courts, are scarcely in a position to pass upon the details of proposed amendments. The members of the judiciary subcommittees, especially those who have attended hearings, are better prepared, but even they can be puzzled by conflicting views. Bankruptcy bills have no political significance. The result is that unless organizations and individuals whose position is respected present a substantially unanimous front, it is difficult to get a bankruptcy bill reported favorably by the judiciary committees. Furthermore, even a favorable report will not necessarily ensure the passage of a bill if an

influential Senator or Representative requests a delay for further study and inquiry. For these reasons the draftsmen of any amendment are apt to yield to various additions and compromises so long as their main objective is not endangered. In the case of the amendment to Section 60a, some of the members of the American Bar Association Committee are doubtful about the retention of the bona fide purchaser test for real estate transfers and feel that the condemnation of equitable liens is unnecessary and undesirable. On the other hand, they realize that the proponents of these provisions probably have enough influence to delay if not defeat the amendments which are the chief interest of the committee.

Section 60c

The possible disastrous applications of Section 60a of the Chandler Act since the Supreme Court decision in *Corn Exchange Bank v. Klauder*¹⁰ has led to considerable study as to the mitigating effects of other sections. One suggestion has been that if a creditor makes an advance against security which because of lack of perfection is a voidable preference, and thereafter makes other advances intended to be similarly secured, he can set off all subsequent advances against the value of the security. Suppose, for example, in a state following the rule of *Dearle v. Hall*¹⁰ a creditor makes an advance of \$10,000 against \$50,000 in assigned accounts. He thereafter makes a further advance of \$30,000, nominally against the same security. Between this latter date and bankruptcy he discovers that the debtor is insolvent. The security is in fact never perfected and is deemed to have been perfected immediately before bankruptcy. Under the rule of the *Klauder* case there is a voidable preference and the trustee can recover the assigned accounts or their proceeds. Can the creditor require a subtraction of \$30,000 as a setoff?

Section 60c of the Chandler Act, unchanged since its original enactment in 1898, reads as follows:

If a creditor has been preferred, and afterward in good faith gives the debtor further credit without security of any kind for property which becomes a part of the debtor's estate, the amount of such new credit remaining unpaid at the time of the adjudication in bankruptcy may be set off against the amount which would otherwise be recoverable from him.

The meaning of this subsection must be sought in part at least in its

¹⁰ *Supra* note 1.

history. Prior to 1903¹¹ Section 57g as interpreted by the Supreme Court required a secured creditor who had been preferred, even if the preference was not voidable, to surrender the preference if his claim was to be allowed.¹² To alleviate the harshness of this rule, in addition to such setoffs as might be allowed under Section 60c the bankruptcy courts adopted the so-called "net result" rule for running accounts. Where payments were made in the regular course of business within four months of bankruptcy but other goods were sold in good faith without knowledge of insolvency, so that the net result was to enlarge the bankrupt's estate, the payments received within four months had no preferential effect.¹³ Since the amendment of Section 57g to require the surrender of voidable preferences only, the net-result rule may be regarded as obsolete. Even if Section 60c is designed to accomplish some of the same ends as the net-result rule, it is not necessary to have a running account to invoke Section 60c, which can apply to isolated transactions. The present law, as is stated by Collier,¹⁴ is that there is neither a duty to surrender under Section 57g nor a right of setoff under 60c unless the preference is voidable.¹⁵

One point of interpretation of Section 60c may be confidently concluded at the outset. It is not necessary for the setoff claimant to show that the asset he transferred became a part of the bankrupt estate. Congress said "debtor's" estate, not "bankrupt's" estate. Had it meant that the asset must be available to the trustee, it could have used the latter term or some such phrase as "debtor's estate passing to the trustee."¹⁶

It should be noted next that Section 60c requires that the creditor to be entitled to a setoff have acted in good faith. In *Kaufman v. Tredway*, Mr. Justice Brewer, speaking for the court, said:

¹¹ Act of February 5, 1903, 32 STAT. 797.

¹² *Carson, Pirie, Scott & Co. v. Chicago Title & Trust Co.*, 182 U.S. 438 (1901). See also 3 COLLIER, BANKRUPTCY, §§ 57.19 and 60.67 (14th ed. 1941 and supp.). But see *Willcox v. Goess*, 92 F.(2d) 8 (C.C.A. 2d 1937), cert. den., 303 U.S. 647 (1938); *Walker v. Wilkinson*, 296 F. 850 (C.C.A. 5th 1924).

¹³ *Jacquith v. Alden*, 189 U.S. 78 (1902); *Yaple v. Dahl-Millakan Grocery Co.*, 193 U.S. 526 (1904).

¹⁴ 3 COLLIER 251 (14th ed.).

¹⁵ The problem of setoff of mutual debts and credits under Section 68 is in practice chiefly of importance between banks and their depositors.

¹⁶ *Kaufman v. Tredway*, 195 U.S. 271 (1904). The trial court held that the claimant must show either that the money or property in question remain in the debtor's estate until bankruptcy, or that it is used to pay creditors entitled to priority. The Supreme Court rejected this contention. The Court pointed out that to make the creditor show the disposition of the property by the debtor would defeat in many cases the purposes of the subsection.

Further, Congress provided that the creditor act in good faith. Thus it excluded any arrangement by which the creditor, seeking to escape the liability occasioned by the preference he has received, passes money or property over to the debtor with a view to its secretion until after the bankruptcy proceedings have terminated, or with some other wrongful purpose. It meant that the creditor should not act in such a way as to intentionally defeat the bankrupt act, but should let the debtor have the money or property for some honest purpose. Requiring that it should become a part of the debtor's estate excluded cases in which the creditor delivered the property to a third person on the credit of the debtor, or delivered it to him with instructions to pass it on to some third party. The purpose was that the property which passed from the creditor should in fact become a part of the debtor's estate, and that the credit should be only for such property.¹⁷

While the learned Justice condemned an intentional act to defeat the Bankruptcy Act, the context shows he was thinking of collusion between debtor and creditor or other conduct intended to deplete the estate. It does not follow that acts done with the purpose of avoiding the technical application of rules of preference when the creditor is fairly contributing to the enlargement of the estate are forbidden by the good faith requirement.

The subsection also makes clear that the claim to be set off must be without security.

The simple theory of the subsection is that if a creditor once depletes the bankrupt estate by taking a preference and later adds assets to the debtor, the latter can be balanced against what he would otherwise have to return.¹⁸

The suggestion that Section 60c can be interpreted to change the effect of Section 60a of the Chandler Act in its present form does not seem warranted by the words of Section 60c nor by the decisions under it. If, for example, as in the illustration originally stated, a creditor advances a small sum against a large security which is not perfected in accordance with the requirements of the Bankruptcy Act, subsequent advances are made either with or without security. If without security, they can be set off *not against the whole value of the security but against the security interest which is set aside as a preference*. If a debt of \$5,000 is secured by a pledge of \$20,000, the security interest in the creditor is \$5,000. The balance is the debtor's. It does not need

¹⁷ *Id.* at 274. See 4A REMINGTON, BANKRUPTCY, § 1719 (5th ed. 1943).

¹⁸ Walker v. Wilkinson, 296 F. 850 (C.C.A. 5th 1924); *In re Evansville Brown Co.*, 29 F.(2d) 643 (C.C.A. 7th 1928); Rogers v. American Halibut Co., 216 Mass. 227, 103 N.E. 689 (1913); Talty v. Ross, 14 F.(2d) 240 (D. Mass. 1926); *In re Morrow*, 134 F. 686 (1901); *In re Bailey*, 110 F. 928 (D. Vt., 1901).

the aid of the preference section for the trustee to recover \$15,000. If the creditor advances \$15,000 after the preference without security, the net security recoverable by the trustee is \$15,000, that is, he recovers \$5,000 on the first preference, but the creditor can set off against that \$5,000 of the subsequent advances. The creditor can thus gain no advantage by making subsequent advances. If the new advances are secured by the original security, the mere fact that these are also technical preferences, and can be set aside, does not justify the conclusion that the second advances are made without security. Between the parties there is security. Any other interpretation which would let the creditor set off \$15,000 against the total value of the security would make the perfection rules of preference meaningless. The result of an original advance of \$5,000 secured by an unperfected transfer of \$20,000 in security, followed by \$15,000 against the same security, would be that the trustee could set aside the entire security interest of the creditor as a preference, assuming that the security was not perfected within four months of bankruptcy against a bona fide purchaser and that the other conditions for avoiding a preference under Section 60b were present.

Section 67b

Section 67b is new in the Chandler Act, but is a re-enactment of Section 67d¹⁹ and a restatement of the principles of decisions under it. Section 67b reads as follows:

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 or of the original petition under chapter X, XI, XII, or XIII of this Act, by or against him. Where by such laws such liens are required to be perfected and arise but are not perfected before bankruptcy, they may nevertheless be valid, if perfected within the time permitted by and in accordance with

¹⁹ § 67d: "Liens given or accepted in good faith and not in contemplation of or in fraud upon this Act, and for a present consideration, which have been recorded according to law, if record thereof was necessary in order to impart notice, shall, to the extent of such present consideration only, not be affected by this Act."

See, e.g., *Courtney v. Fidelity Trust Co.*, 219 F. 57 (C.C.A. 6th 1914); *Martin v. Orgain*, 174 F. 772 (C.C.A. 5th 1909); *In re New York-Brooklyn Fuel Corp.*, 11 F.(2d) 802 (C.C.A. 2nd 1926); *Sholseth v. Bergen Mfg. Co.*, 56 S.D. 112, 227 N.W. 483 (1929).

the requirements of such laws, except that if such laws require the liens to be perfected by the seizure of property, they shall instead be perfected by filing notice thereof with the court.

The subsection poses several interesting problems which are not considered in this discussion. These include the basic question as to how far the bankruptcy court is bound by state law as to the nature of a lien recognized by the state, and the frequent controversy as to whether applicable law has established a priority or a lien.²⁰ It is obvious that if a valid lien exists, a proceeding to enforce it by court help will not give rise to a voidable lien by legal proceedings.

The expression "recognized" in the phrase "statutory lien created or recognized" seems to refer to the lien consequences of certain statutory provisions, although a lien is not in terms given by statute. Thus a statute may provide that a levying officer's fees shall be paid out of the proceeds of a sale on execution and this is construed as fixing a lien.²¹

Since this article is primarily concerned with the possible effect of Section 67b on the application of Section 60a to certain forms of security, particularly those on inventory, what is here considered is the scope of the words "statutory liens." It is obvious that if trust receipts and factors' liens, or for that matter conditional sales and chattel and real estate mortgages, are statutory liens, they may be valid in spite of Section 60a. Section 67b requires no perfection against bona fide purchasers but only against the position of the trustee as of the date of the petition. This means that any statutory lien is valid against

²⁰ *Manley v. Hood*, 37 F.(2d) 212 (C.C.A. 4th 1930); *Halpert v. Industrial Comm. of N.Y.*, 147 F.(2d) 375 (C.C.A. 2d 1945). See also Note, 51 *YALE L. J.* 863 (1942).

²¹ *In re Famous Furniture Co.*, 42 F.(2d) 777 (E.D., N.Y., 1942). "Recognized" may also be significant as indicating that if a state court or other non-bankruptcy court has "recognized," that is, decided, that the effect of a state or other statute is to create a lien, this determination should not be questioned by the bankruptcy court. The bankruptcy court presumably would still have jurisdiction to define the term "statutory lien," much as it may define "banking corporation" and "insurance corporation," although the influence of the state attitude would be considerable. For example, if a state regarded a trust company as a banking corporation, the bankruptcy court would likely follow the state's viewpoint. If the state said a laundry company was a banking corporation, or a single partnership for insurance risks was an insurance corporation, the bankruptcy court would be likely to disagree. The editors of *COLLIER* suggest that the distinction in Section 67b is between liens recognized by statute and "judge-made" liens, by which they understand liens recognized by equity courts merely because the parties have contracted for them. 3 *COLLIER*, § 60.47 (14th ed.). If this is true, the term "statutory lien" may have a broad definition indeed. *Cf. Boteler v. Ingalls*, 308 U.S. 57, 521, 637 (1939). See also *In re 671 Prospect Ave. Holding Corp.*, 105 F.(2d) 960 (C.C.A. 2d 1939).

Since Section 67 refers specifically to liens acquired in legal proceedings, although these are at least in part statutory, it is obvious such liens are not included in the term "statutory."

the trustee if as to property in the possession and control of the bankrupt at the date of the petition the lienor would have prevailed against a judgment creditor, and as to property not in his possession, against a creditor with an execution returned unsatisfied.²²

Three concepts of statutory lien may be considered. It may mean (and this is suggested by the context when employees, contractors, mechanics and landlords are specified) that in addition to tax liens, the only liens covered by the term are those to which a party becomes entitled without any further action on his part to obtain the lien. He must be in the relationship out of which the lien arises and presumably he could waive the lien, but so long as he conforms to certain conditions of the relationship, he need do nothing more to become a lienor. Thus a material man who supplies gravel for a construction project usually has a mechanic's lien of some sort merely because he contributes the material for the building. Furthermore, this lien did not exist at common law. It is wholly the creature of the statute.

A second possible meaning of statutory lien is that in addition to the liens described in the foregoing paragraph it includes all liens made legal by statute, whereas without the statute they would only be equitable liens. In other words, if the common law recognized a lien in favor of a party who, by contract or otherwise, became entitled to it, this is not a statutory lien. If the parties by contract could formerly give a lienor only an equitable interest but the statute now gives him a legal interest, there is a statutory lien. An agreement to pledge without delivery of the pledged chattel creates an equitable lien in the promisee. If a statute should call this a legal interest, with the varied priority consequences of such an enactment, the intended pledgee would have a statutory lien.

An excellent example of the sort of lien that would be called statutory under this conception is the modern factor's lien as created by statute in New York and elsewhere.²³ The factor contracts for his lien but he obtains a legal lien if he conforms with the statute, whereas formerly at common law no lien would have arisen.²⁴

²² An agister would likely be in the same category. By the common law as interpreted in most states, he had no lien. Today he usually has a lien by statute. For example, one who feeds cattle has a lien for their feeding. The mere fact that this lien also requires a retention of possession, which is not a common characteristic of statutory liens, does not seem enough to take the agister's lien out of the statutory class.

²³ N.Y. PERS. PROP. LAW, § 45.

²⁴ It is probably unnecessary to mention to lawyers that the modern factor often has no resemblance to the common-law factor or commission merchant. The modern factor is a financing agency, not a selling agent. The statutory landlord's lien has a common-law background.

In this connection it may be well to ask if the draftsman of the Chandler Act had any thought of the distinction sometimes made between "title" security and "lien" security. As everyone knows, the original notion of the real estate mortgage was that it was the conveyance of an estate, usually the fee, on condition. The chattel mortgage was a conveyance of ownership, with an obligation to reconvey when the security purpose was satisfied. A conditional sale is the retention of ownership for purposes of security. In most states the modern real estate mortgage is a lien defined by statute. In a somewhat lesser number of states, the same thing is true of the chattel mortgage. In a few states the lien aspects of the conditional sale are recognized.

A third possible definition of statutory lien is that it means any lien which is defined and regulated by statute, whether or not such a lien was recognized at common law.²⁵ If it be objected that such an interpretation would greatly restrict the application of Section 60a and b, it may be noted that Section 67b obviously intends some degree of mitigation of the preference section. What that degree is should be found in the words of the statute.

The judicial authority is meager and scarcely justifies any dogmatic assertions as to the scope of statutory liens. On the whole it points in the direction of a fairly broad interpretation. It seems to support the contention I have made elsewhere, that at least factor's liens of the sort allowed by New York law, and trust receipts²⁶ are statutory liens. It seems not unlikely that other security interests may come within the same category.²⁷

*Commercial Credit Company v. Davidson*²⁸ involved a claim against a trustee in bankruptcy for a purchase money lien on personal property in the hands of the first purchaser at the date of his bankruptcy. The Mississippi statute gives the vendor a lien while the chattel sold remains in the hands of the first purchaser or of one deriving title through him with notice that the purchase money was unpaid.²⁹ The lien was obviously not perfected against a bona fide purchaser. The

²⁵ If this idea were rejected generally it might still be accepted in part. For example, a state may have held that a conditional sale of goods for resale or a chattel mortgage on a stock of goods was illegal as a fraudulent conveyance. Then a statute is passed making such floating charges on inventory good under certain conditions. Has the state now created a statutory "lien"?

²⁶ The Supreme Court of California classifies trust receipts as creating a lien. *Prima v. Bank of Italy*, 194 Cal. 195, 225 Pac. 441 (1924). Certainly if the trust receipt is a lien as distinguished from title security, it is a statutory lien.

²⁷ See *In re Van Winkle*, 49 F. Supp. 711 (W.D. Ky. 1943). The actual decision involved a surety's equitable lien on retained percentages.

²⁸ 112 F.(2d) 54 (C.C.A. 5th 1940).

²⁹ § 2239, Miss. CODE (1930).

Fifth Circuit Court of Appeals held it good against the trustee. C. J. Holmes said:³⁰ "The lien relied on here is not contractual . . . ; it arose solely by virtue of the Mississippi statute."³¹

A decision which, in the opinion stating it, seems to adopt a generous interpretation of the scope of Section 67b, is *White v. Karl Kiefer Machine Co.*³² Under Missouri law a conditional seller could treat the unpaid purchase price as a lien upon the chattel sold, notwithstanding the reservation of title. The conditional sale contract was properly filed, so that the actual decision is only one that a lien obtained by judicial action to enforce a prior valid lien is not nullified by Section 67a. Judge Reeves expressly characterized the Missouri unpaid seller's lien as a statutory lien: "Accordingly," he said,³³ "the vendor would have a right to perfect his lien, even within four months of bankruptcy."

On the interesting and important question of the trust receipt as a statutory lien, Judge Yankwich,³⁴ after referring to several other statutory liens, said: "An example of such lien, recognized by a Circuit Court of Appeals for the Ninth Circuit under California law, is the so-called 'trust receipt' created under the Uniform Trust Receipts Act of California."³⁵

The Chandler Act of 1935 has not had a long history, and much of its short life has been during a period when bankruptcy cases were not numerous. We may well expect further decisions relating to the provisions of Section 60c and Section 67b. That the latter section is a more important qualification of the former than has been yet recognized is likely. What one can say with assurance is that, as the law now stands, the states can do much to nullify the application of Section 60a simply by naming creditors' interests statutory liens. What the reaction of the draftsmen of the Bankruptcy Act would be to such a policy is another problem.

³⁰ 112 F.(2d) 54, 57 (C.C.A. 5th 1940).

³¹ While a lien acquired by legal proceedings which merely enforces a statutory lien is not nullified by Section 67a, a nice question is whether the same result follows when the lien by judicial proceedings is for the enforcement of an equitable lien. For a holding that the second lien prevails against the trustee, see *Mulhern v. Albin*, 163 F.(2d) 41 (C.C.A. 8th 1947).

³² 127 F.(2d) 119 (C.C.A. 8th 1942).

³³ *Id.* at 120. Cf. Clark, J., *In re 671 Prospect Ave. Holding Corp.*, 105 F.(2d) 960, 961 (C.C.A. 2nd 1939): "This [question of lien on chattels under real estate mortgage] must be determined in accordance with local law."

³⁴ *In re Rand Mining Co.*, 71 F. Supp. 724, 727 (S.D. Cal. 1947).

³⁵ The learned judge cited *In re Boswell*, 96 F.(2d) 239 (C.C.A. 9th 1939).