

PROPOSED BANKRUPTCY AMENDMENTS:
IMPROVEMENT OR RETROGRESSION?JAMES WM. MOORE†
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CONGRESS is now considering a revision of that portion of the Bankruptcy Act ¹ covering the major area of ordinary bankruptcy, corporate reorganization, and arrangements. This area was revised by the Chandler Act of 1938,² after approximately six years of study by bankruptcy specialists and two years of study by Congress.³ In that constructive effort the National Bankruptcy Conference played a leading role by coordinating and articulating technical bankruptcy thought. Undoubtedly more study, experience, and careful draftsmanship went into the Chandler Act than into any other amendatory bankruptcy bill, and that Act was and has continued to be a fine tribute to both Congress and the Conference. After a ten-year interim the Conference has again undertaken an extensive revision of the Act and Congressmen Reed and Hobbs have quite properly responded by sponsoring bills to effectuate that objective.⁴ Both the Congress and the Conference are to be

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1. 30 STAT. 544 (1898), as amended 11 U.S.C. (1940), as amended, 11 U.S.C.A. (Supp. 1947). Hereinafter cited by section only.

2. 52 STAT. 840 (1938), 11 U.S.C. §§ 1, 11, 21-9, 32, 33, 35, 41-52, 54, 55, 62, 63, 65-70, 72-81, 91-6, 101-12, 501-676, 701-99, 801-926, 1001-80, 1036, 1101-3 (1940). The Chandler Act amended §§ 1-11, 14, 15, 17-29, 31, 32, 34, 35, 37-42, 44-53, and 55-72. Sections 12, 13, 73, 74, 77A and 77B were amended and incorporated as Chapters X-XIII. 52 STAT. 840 (1938). Two slight changes were made in § 75. *Id.* at 939. Section 76 was repealed. *Id.* at 940. Chapter X was renumbered Chapter IX and a new subdivision 83j added. *Id.* at 939. Chapter XIV on Maritime Commission Liens was added. *Id.* at 938.

3. H.R. REP. No. 1409, 75th Cong., 1st Sess. 1-3 (1937).

4. For a summary of this legislation see pp. 685-6 *infra*, and notes 12-17 *infra*.

The National Bankruptcy Conference, organized in 1932, is composed of representatives of the National Association of Referees in Bankruptcy, the American Bar Association, the Commercial Law League of America, the National Association of Credit Men, the American Bankers Association, and the American Institute of Accountants, as well as otherwise unaffiliated lawyers and law professors. The Conference has been continually active since the time of its formation in investigating and formulating improvements in bankruptcy law. In addition to playing a leading role in the preparation of the Chandler Act of 1938, the Conference collaborated in the revision of the General Orders

congratulated for undertaking a re-examination of the Act and its functioning. Legislation, like court rules, demands a continuing attention to the end that ambiguities may be removed, structural defects cured, and new problems faced.

But basic structural changes should be made only where the proponents clearly establish the need, and major revisions should not be hurried through Congress. A case in point is the promulgation and subsequent revision of the Federal Rules. The Rules were formulated over a period comparable to the incubation time of the Chandler Act, were the cooperative product of many specialists, and became operative at almost the precise time in 1938 as the Chandler Act.⁵ Amendments to the Federal Rules have just become effective,⁶ but a five year study by the Advisory Committee, the Bench and the Bar preceded their promulgation; even more significantly, the amendments made no basic changes, since the need for alteration was not clearly demonstrated. Comparable care is equally imperative in dealing with the complex Bankruptcy Act, and, here too, the proponent of basic change should clearly establish the need.

Since the Chandler Act of 1938 the major developments in the field of bankruptcy and reorganization are several. The enactment of the Referee's Salary Bill,⁷ following several years of study and debate, properly incorporated the referees into the federal judiciary as salaried employees of the government, increased their term of office, and generally strengthened their tenure. This decided gain was made without

and Official Forms in Bankruptcy by the Supreme Court in 1939, collaborated with representatives of the Attorney General's Committee on Bankruptcy Administration in the preparation of the bill which was enacted as the Referee's Salary Act (see note 7 *infra*), and has prepared other bills now pending before Congress. The present members of the Conference's Drafting Committee are Jacob I. Weinstein, Chairman, Peter B. Olney, *ex officio* (Chairman of the Conference), Watson B. Adair, Carl D. Friebohn, Fred H. Kruse, James A. McLaughlin, W. Randolph Montgomery and John Gerdes.

Also pending or recently enacted are, among others, an act relating to railroad reorganization, *e.g.*, Pub. L. No. 478, 80th Cong., 2nd Sess. (April 9, 1948); and competing bills on agricultural composition and extensions, the McCarran-Lemke bill, H.R. 463, 80th Cong., 1 Sess. (1947), and a bill prepared by the National Bankruptcy Conference and introduced by Congressman Reed, H.R. 2451, 80th Cong., 1st Sess. (1947). See Comment, 56 YALE L. J. 982 (1947). Because of the specialized nature of these fields and their severability from the other provisions of the Act, we confine this article to the area covered by the Chandler Act of 1938.

5. The Chandler Act became effective on September 22, 1938, and the Federal Rules of Civil Procedure on September 16. 1 COLLIER, BANKRUPTCY 21 (14th ed., Moore and Oglebay, 1941), hereinafter cited as COLLIER; 3 MOORE, FEDERAL PRACTICE 3447 (1938).

6. FED. R. CIV. P. 86.

7. 60 STAT. 323 (1946), 11 U.S.C.A. §§ 62, 63, 65, 67(b), 68, 71, 79(2), 79(5), 80(a), 81, 82 (repealed), 102(a), 102(b), 104(a), 112, 517, 1024(3), 1033(2), 1059(1), 1059(3) (Supp. 1947). See *The Administrative Office Reports to the Conference*, 21 J.N.A. REF. BANKR. 90 (1947).

changing the underlying policy that bankruptcy administration must pay its own way out of the estates liquidated and reorganized.

The major contribution by the Supreme Court was in two fields: reorganization and preferences. In reorganization, the Court resolved the conflict in theory between corporate reorganization under Chapter X and corporate arrangements under Chapter XI. Corporations of substantial size with publicly held securities may not use Chapter XI, the Court ruled, even though literally within its terms, because their reorganization should be subject to the safeguards of Chapter X and because Chapter XI's ban on interference with stockholders' interests forestalls achievement of fair and equitable arrangements.⁸ The other judicial contribution to reorganization regulation was to establish that valuation must be based upon a fair capitalization of prospective earnings,⁹ and that the absolute priority rule must be carefully and faithfully followed for a reorganization plan to be considered fair and equitable.¹⁰ The Court's addition to the law of preference was the *Corn Exchange National Bank v. Klaunder* decision,¹¹ which faithfully applied Section 60 to hold that a secret lien given for a present consideration was to be tested as of the subsequent time when it became perfected; so tested it was a transfer for an antecedent debt, and because of insolvency was preferential. The Court recognized that present Section 60 is designed to protect general creditors against secret liens; to that end a secret lien, whether given for a present or antecedent consideration, is functionally equivalent to no lien. When the cloak of secrecy is shed, then, as to general creditors, the security becomes a lien for the first time and is to be tested for its preferential qualities at that time. If a lender wants to advance money to a debtor and obtain valid security he may do so by simply exposing his security at that time to the daylight. The bona fide purchaser test effectively defines daylight.

The proposed revision of the Act has been cut up into a number of bills.¹² Two are aimed at destroying the *Klaunder* rule. The American

8. *Securities and Exchange Comm'n v. United States Realty & Improvement Co.*, 310 U.S. 434 (1940).

9. *Group of Institutional Investors v. Chicago, M., St. P. & P. R. R.*, 318 U.S. 523 (1943); *Consolidated Rock Products Co. v. Du Bois*, 312 U.S. 510 (1941); 6 COLLIER ¶11.05.

10. *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106 (1939); 6 COLLIER ¶11.06.

11. 318 U.S. 434 (1943).

12. The A.B.A. bill to amend §60, H.R. 2412, 80th Cong., 1st Sess. (1947), introduced by Congressman Reed on March 6, 1947, is a precursor of the Conference revision. While adopting the A.B.A. bill verbatim with two minor changes, the Conference incorporated it into a fairly comprehensive revision of the entire act, which included a federal accounts receivable filing act as new §70i. In addition, the Conference drafted a bill substantially repealing the Borah Act. A committee print, with analyses of these bills by members of the Conference instrumental in their drafting was

Bar Association bill does that and nothing more.¹³ The Conference bill also does that as to Section 60, but attempts to retrieve some lost ground as applied solely to accounts receivable by proposing a new Section 70i for federal recordation of this security device—the requirements of which go beyond the rule of the *Klauder* case.¹⁴ The Conference also proposes three other measures: (1) a tax bill that substantially alters the present status of tax claims in bankruptcy;¹⁵ (2) a bill to repeal the Borah Act interdiction of fee-fixing agreements;¹⁶ and (3) a bill that rather extensively amends the bankruptcy, corporate reorganization, and arrangement chapters.¹⁷ This last bill is largely clarifying and on the whole non-controversial. Its main defect is that it does not put forward all the amendments that are needed. The other bills are ill advised, with the bills to amend Section 60 leading the list.

SECTION 60 AND ITS ATTACKERS

The Bankruptcy Act aims at an equitable distribution of unencumbered assets among the general creditors. In determining what are unencumbered assets and who are entitled to share them, the general point of cleavage is, of course, the date when the bankruptcy proceeding is initiated. But it is obvious that, if the debtor and certain of his favored and diligent creditors could with impunity deal with his assets up to bankruptcy, only tag ends and remnants of unencumbered assets would remain for the general creditors. Bankruptcy would be only a procedure to rubber-stamp a liquidation already made. To prevent this the Bankruptcy Act gives the trustee varied powers that enable him to reach back and undo much of the debtor-creditor liquidation. The trustee's power to attack preferences is the heart of bankruptcy law, for it is only in bankruptcy that the unsecured creditor generally has

prepared. *Committee Print, Analysis Printed for Use of the Committee on the Judiciary, House of Representatives, 80th Congress* (N.B.C., mimeographed, 1948), hereinafter cited as *N.B.C. Committee Print*. The proposed Conference bill for the revision of the Bankruptcy Act was divided into three bills, H.R. 5693, H.R. 5829, and H.R. 5834, 80th Cong., 2d Sess. (1948). The bill to repeal the Borah Act was introduced separately, H.R. 5828, 80th Cong., 2d Sess. (1948). The Conference bills were introduced in March, 1948. See Notes 14–17 *infra*.

13. H.R. 2412, 80th Cong., 1st Sess. (1947), introduced by Congressman Reed on March 6, 1947.

14. H.R. 5834, 80th Cong., 2d Sess. (1948), introduced by Congressman Hobbs on March 16, 1948.

15. H.R. 5829, 80th Cong., 2d Sess. (1948), introduced by Congressman Reed on March 11, 1948.

16. H.R. 5828, 80th Cong., 2d Sess. (1948), introduced by Congressman Reed on March 11, 1948.

17. H.R. 5693, 80th Cong., 2d Sess. (1948), introduced by Congressman Reed on March 4, 1948.

any relief against preferential transfers.¹⁸ And one of the driving forces behind the Chandler Act was the conviction, born of long experience, that the trustee's power to avoid preferences should be materially strengthened. Accordingly Section 60 was revised extensively in 1938. The first sentence of present Section 60a states that:

"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."

This definition did not state any new principles. Both the American Bar Association and the Conference bills, which propose to revise Section 60, acquiesce in its propriety.¹⁹ The crux of the problem is, however, when shall the transfer be deemed made, *i.e.*, subjected to the test of the accepted principles. A system of bankruptcy could deal with this matter in a number of ways. (1) The rule could be that no transaction is preferential unless it is so at the time the transfer is in fact made. (2) Or, while still testing the other preferential qualities of the transfer as in (1), the running of the four-month period could be tolled until some notoriety is given to the transfer. Although stronger than (1), this test would never interdict a transfer for a present consideration. (3) Finally, all of the elements of a preferential transfer could be tested as of the time of notoriety, except the greater percentage element, with this tested as of bankruptcy.²⁰ The Chandler Act adopted this last rule and defined notoriety in a most effective manner by treating the transfer as made when perfected as against both a creditor and a bona fide purchaser. The latter, the bona fide purchaser test, reversed a forty-year trend of judicial decisions. Until 1938 the trustee's power to avoid preferences was impaired by the judicial doctrine of

18. While state law sometimes gives relief against preferences (3 COLLIER [60.66, 4 *Id.* 102, ¶ 70.88), the truth of the proposition stated in the text has long been recognized by so able a scholar as Professor McLaughlin of Harvard (testimony before House Committee on Judiciary, *Hearings before Committee on Judiciary on H.R. 6439*, 75th Cong., 1st Sess. 120 (1937)), who was most active in securing the enactment of § 60 of the Chandler Act and now, oddly enough, is one of its main detractors.

19. Both bills substitute the phrase, "petition initiating a proceeding under this Act," for the more cumbersome language, "petition in bankruptcy, or of the original petition under Chapters X, XI, XII, or XIII of this Act." This is the only proposed change in the first sentence of § 60a.

20. *Palmer Clay Products Co. v. Brown*, 297 U.S. 227 (1936).

"relation back," which permitted the perfection of a secret security at any time prior to bankruptcy to relate back to the time of the actual transfer in determining whether the transfer was made for an antecedent debt. If originally given for a consideration then present, the transfer was not preferential.²¹ Yet these secret liens were just as injurious to general creditors as if the debtor had made a transfer for an antecedent debt at the time the lien became public. Certainly no one would forthrightly allow the debtor or any creditor to prescribe the order of distribution of an estate in bankruptcy, yet this was in effect accomplished by the debtor and certain of his creditors through the use of secret security devices. Congress tried in 1903, in 1910, and again in 1926 to require the preferential qualities of the transfer to be tested as of the time it became public.²² Each time the Supreme Court disregarded the legislative intent.²³ At last the Chandler Act adopted the unequivocal bona fide purchaser test, and, after some misconstruction in the lower courts,²⁴ the Supreme Court in the *Klauder* decision of 1943 gave the new Section 60a its intended effect: a secret lien is functionally equivalent to no lien.²⁵ Now after this victory following a forty-odd year struggle come the ABA and the Conference bills to reverse the *Klauder* rule.

This retrogression is a product of two factors: alarm, and a partial surrender to secret financing. "Think of the effect on business," we are admonished by certain commentators, "if the headlines of the Wall Street Journal this morning proclaimed: *Supreme Court Voids all Security Devices as Bankruptcy Preferences.*"²⁶ This catastrophe, it is said, is sure to fall upon us unless the *Klauder* rule is repudiated. Accustomed as we are to dire and woeful predictions, this one is colossal. Reserving discussion of the *Klauder* case until we treat the subject of accounts receivable, with which it dealt, we think it a pixilated flight of fancy to fear that the Justice with conservative banking experience who wrote the *Klauder* opinion, would father a rule invalidating all

21. McLaughlin, *Defining a Preference in Bankruptcy*, 60 HARV. L. REV. 233, 236-45 (1946); 3 COLLIER ¶ 60.37.

22. *Ibid.*

23. *Ibid.* And see *Corn Exchange National Bank v. Klauder*, 318 U.S. 434, 438 (1943): ". . . for thirty-five years Congress has consistently reached out to strike down secret transfers, and the courts have with equal consistency found its efforts faulty or insufficient to that end."

24. *E.g.*, *Associated Seed Growers, Inc. v. Geib*, 125 F.2d 683 (C.C.A. 4th 1942); *Adams v. City Bank & Trust Co.*, 115 F.2d 453 (C.C.A.5th 1940).

25. *Corn Exchange National Bank v. Klauder*, 318 U.S. 434 (1943).

26. Keeffe, Kelly, and Lewis, *Sick Sixty: A Proposed Revision of Section 60A of the Bankruptcy Act*, 33 CORN. L. Q. 99 (1947) (italics in original); see also Ireton, *A Proposal to Amend Section 60a of the Bankruptcy Act*, A6 CORP. REORG. 257, 264 (1947): "The assignment of accounts receivable as a means of secured credit is also practically eliminated by the present 60a."

security devices. The other factor, a partial acquiescence in secret financing, is the real answer. Borrowers and lenders have never liked to make their transactions public if they could otherwise protect themselves. Immediately after the *Klauder* decision, persons lending on the security of assigned accounts receivable set out to change the law concerning accounts receivable in many states.²⁷ At the same time change in Section 60 was demanded.²⁸ The American Bar Association obliged with its bill. Ironically, the Conference bill, also originally engendered by the same sources and also duplicating the ABA attack upon Section 60, hits one aspect of secret financing, assignment of accounts receivable, with a vengeance in another way.

Neither the ABA nor the Conference proposal would, of course, immunize all secret liens. But both bills constitute a partial surrender to secret financing by quibbling with notoriety. The second and last sentence of present Section 60a reads:

“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 lieu of this simple and rather straightforward creditor and bona fide purchaser test, the ABA and Conference bills put forward a ver-

27. This pressure resulted in legislation in twenty-nine states. See note 42 *infra*. See also Koessler, *Assignment of Accounts Receivable: Confusion of the Present Law, Impact of the Bankruptcy Act and the Need For Uniform Legislation*, 33 CALIF. L. REV. 40 (1945); Koessler, *New Legislation Affecting Non-Notification Financing of Accounts Receivable*, 44 MICH. L. REV. 563 (1946); Douglas, *Assigned Accounts as Affected by Section 60a of the Bankruptcy Act and the Provisions of State Law with Reference Thereto*, 19 J.N.A. REF. BANKR. 11 (1944). For a discussion of the need for state legislation and arguments in favor of and against validation and recording statutes see AMERICAN BAR ASSOCIATION, SECTION OF CORPORATION, BANKING AND MERCANTILE LAW, Proceedings at Chicago Meeting 15-30 (1944).

28. See Hanna, *Some Unsolved Problems Under Section 60A of the Bankruptcy Act*, 43 COL. L. REV. 58, 69-72 (1943); Foreword by Hanna to Koessler, *Assignment of Accounts Receivable: Confusion of the Present Law, Impact of the Bankruptcy Act and the Need for Uniform Legislation*, 33 CALIF. L. REV. 40 (1945). Anticipating the result reached in the *Klauder* case, the Chicago Bar Association early recommended alteration of § 60. Glenn, *Bankruptcy Liquidations*, AMERICAN BAR ASSOCIATION, SECTION OF COMMERCIAL LAW, Proceedings at San Francisco Meeting 50, 60 (1939). An amendment accepting assignments of accounts from the provisions of § 6 was proposed in 1940, S. 3554, 76th Cong., 2d Sess. (1940); 3 COLLIER 972.

bose, complex lien creditor test. This test which would at once have astonished and delighted Gilbert and Sullivan is set forth in the note.²⁹ A superficially plausible argument advanced in favor of it as a sole

29. Paragraph 60a(2)-(3) of the Conference bill is here set out. Matter added to the ABA bill by the Conference bill appears in italics. Words omitted in the Conference bill are bracketed. In other respects the perfection tests of the two bills are identical and read as follows:

"(2) For the purposes of subdivisions a and b of this section, and subject to the provisions of paragraph (3), a transfer shall be deemed to have been made or suffered at the time when it became so far perfected that no creditor obtaining under applicable law by legal or equitable proceedings on a simple contract a lien on such property without a special priority (whether or not such a creditor exists), could acquire, after such perfection, 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 [original] petition initiating a proceeding under this Act, it shall be deemed to have been made immediately before the filing of such [original] petition: Provided, however, that where real property is transferred for or on account of an antecedent debt, the 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 could acquire, after such perfection, any rights in the property so transferred superior to the rights of the transferee therein. *The rights that such a lien creditor or bona fide purchaser could acquire shall include the rights acquired by the mere fact of obtaining such a lien or making such a purchase, and any further rights that might be obtained by recording any document, or giving notice to any person, or taking any step wholly within the control of such a lien holder or purchaser, with or without the aid of ministerial action by public officials, but such creditor's or purchaser's rights shall exclude those acquired by any acts or transactions subsequent to his obtaining such a lien or making such a purchase which require the agreement or concurrence of any third party, or which require any further judicial ruling.*

"(3) A transfer, wholly or in part, for or on account of a new and contemporaneous consideration shall, to the extent of such consideration and interest thereon and the other obligations of the transferor connected therewith, be deemed to be made or suffered at the time of the transfer, unless the applicable law requires the transfer to be perfected by recording, delivery or otherwise, in order that no creditor described in paragraph (2) could acquire, after such perfection, any rights in the property so transferred superior to the rights of the transferee therein. A transfer to secure a future loan, if such loan is actually made, or a transfer which becomes security for a future loan, shall have the same effect as a transfer for or on account of a new and contemporaneous consideration. If any requirement specified in this paragraph (3) exists, the time of the transfer shall be determined by the following rules:

"I. Where (A) the applicable law specifies a stated period of time of not more than thirty days after the transfer within which recording, delivery, or some other act is required, and compliance therewith is had within such stated period of time; or where (B) the applicable law specifies no such stated period of time or where such stated period of time is more than thirty days, and compliance therewith is had within thirty days after the transfer, the transfer shall be deemed to be made or suffered at the time of the transfer.

"II. Where compliance with the law applicable to the transfer is not had in accordance with the provisions of subparagraph I, the transfer shall be deemed to be made or suffered at the time of compliance therewith, and if such compliance is not had prior to the filing of the petition initiating a proceeding under this Act, such transfer shall be deemed to have been made or suffered immediately before the filing of such petition."

test and against retention of the bona fide purchaser test is this: since the trustee represents general creditors, the type of perfection that should be used is that which would render the transfer immune against attack by a general creditor armed with attachment or other similar judicial lien; the bona fide purchaser test, it is accordingly contended, transcends the proper scope of bankruptcy by subverting property rights established by state law.³⁰ This argument ignores the fundamental difference between the function of state laws regarding creditors' rights and the function of a bankruptcy act. State laws are designed primarily for individual creditor action, with the race to the swift. Bankruptcy, on the other hand, is a proceeding for creditors collectively and aims at an equitable distribution among this group. The theory behind giving the trustee greater powers to avoid transfers and recover assets than any creditor would have under state law is as old as the Bankruptcy Act itself; although the extent to which the theory has been exploited has varied from time to time, the trend has constantly been toward greater power in the trustee. Section 67a empowers the trustee to avoid judicial liens obtained against the property of the insolvent debtor within four months of his bankruptcy. This is in complete defiance of state law promoting the individual creditor's right to a valid judicial lien. The Bankruptcy Act has in Section 67d provided its own standards relative to fraudulent transfers, and is substantially the Uniform Fraudulent Conveyance Act adopted by Congress for bankruptcy purposes. The trustee can by virtue of Section 67d avoid transfers as fraudulent regardless of whether a creditor could do so under local law; particularly in a state which does not have the Uniform Act, the divergence between what the trustee can avoid and what the creditor can attack is quite marked. Section 70c gives the trustee, as of bankruptcy, the status of an ideal lien creditor as to all property in the possession of the bankrupt, and the status of a judgment creditor holding an execution returned unsatisfied as to all other property. No unsecured creditors occupy the former status and not all of them occupy the latter. Section 70e allows the trustee to avoid any transfer which is voidable under applicable state law by a creditor having a claim provable in bankruptcy, and under the doctrine of *Moore v. Bay*³¹ the trustee's quantum of recovery is not limited by the creditor's rights. Thus if a lien is partially voidable by a creditor it is totally voidable for the benefit of the estate by the trustee. And, finally, the whole philosophy behind Section 60 has always been and is, even under the proposed revisions, to give the trustee the power to avoid certain transactions denominated as preferential although no creditor could attack them

30. Foreword by Hanna to Koessler, *op. cit. supra* note 28, at 40; Hanna, *Preferences in Bankruptcy*, 15 U. OF CAL. L. REV. 311, 315, 319-20 (1948); Glenn, *Mercantile Collateral Law—Recent Developments*, 21 J. N. A. REF. BANKER. 24 (1946).

31. 284 U.S. 4 (1931).

under state law. Congress has the power to determine, and has always exercised independence in judging, how far the trustee should be allowed to go in derogation of the rights obtained by a creditor under state law;³² there is no reason to scuttle the bona fide purchaser test because it gives the trustee greater avoiding powers than a general creditor would have under state law.

Under the proposed Gilbert and Sullivan lien creditor test it will again be possible in many jurisdictions for the debtor and a favored creditor to use a secret security interest to achieve the same result they achieved before 1938. As subsequently pointed out, the ABA bill goes even further by immunizing, as against the trustee, secret assignments of accounts receivable in several jurisdictions where such assignments can now be avoided by the trustee under the bona fide purchaser test. As to accounts receivable, the Conference bill retrieves some ground by adding a federal accounts receivable filing act to Section 70, to be applicable in all jurisdictions which do not require filing records of such assignments.³³

Accounts Receivable

As previously noted, the notion that Section 60a should be radically revised was conceived in the field of financing on assigned accounts receivable. The Supreme Court's decision in the *Klauder* case³⁴ was said to threaten all security devices. But let's turn to the record and

32. See Martin, *Substantive Regulation of Security Devices Under the Bankruptcy Power*, 48 COL. L. REV. 62 (1948) *passim*; Oglebay, *Proposed Revision of Section 60a of the Bankruptcy Act: Step Backward*, 21 J. N. A. REF. BANKR. 54, 57 (1947).

33. See pp. 695-6 *infra*.

The Conference bill also proposes revision of subdivision c of § 70, commonly known as the "strong arm" provision, in a manner which is unwieldy and perhaps dangerous both to the bankruptcy trustee and to third persons. Present subdivision c gives the trustee (1) the status of a judicial lien creditor as to property in the possession of the bankruptcy court; and (2) the rights, remedies, and powers of a judgment creditor, with execution returned unsatisfied, as to all other property. The Conference bill would eliminate this distinction between property in possession and property not in possession of the bankruptcy court and give the trustee the status of a judicial lien creditor as to both classes. Present § 70c states an understandable principle as to property in the possession of the bankruptcy court by treating bankruptcy as an "equitable" attachment of that property; and also states an understandable principle as to other property by giving the trustee the status of an ideal creditor for proceeding to recover that property. Thus if the trustee wants to contend that the bankrupt has made a conveyance that is fraudulent by the standards of either § 67d or § 70e, he is armed by § 70c with the rights, remedies and powers of a judgment creditor with execution returned unsatisfied and hence is ready to attack. His comparable status under the proposed revision is far from clear. On the other hand persons who deal in good faith with the transferee are placed in an ambiguous position. So far as they are concerned the bankruptcy of the transferee's grantor is no caveat, yet the proposed revision seems to state that the trustee has a lien upon the transferee's property. Creation of this type of fictional lien is undesirable.

34. *Corn Exchange National Bank v. Klauder*, 318 U.S. 434 (1943).

look at the facts of that case. As usual the debtor was in failing circumstances; in this case it had been for two years. It borrowed money and concurrently assigned receivables as security. The assignments in question were all made within four months of the debtor's bankruptcy, and one only six days before bankruptcy. When the assignments were made they were recorded on the debtor's books. This was all the notoriety given to the security transactions, and thus they followed the pattern of secrecy so common in bankruptcy. Under Pennsylvania law, which applied in determining when the transfers were perfected, the assignments were good as against creditors when made. If the trustee was to prevail, it had to be by virtue of the bona fide purchaser test, *i.e.*, that a subsequent good faith assignee could acquire a better title than the first assignee who had loaned the money to the debtor. There are three common-law rules governing the validity of such assignments as between the first and a subsequent assignee: (1) The English rule, followed in some states, allows the assignee who first notifies the account debtor to prevail.³⁵ (2) The New York rule validates the assignment in favor of the first assignee, regardless of notification.³⁶ (3) The Massachusetts rule, adopted by the *Restatement of Contracts*, allows the first assignee to prevail, unless the subsequent assignee collects or obtains a novation from, or a judgment against, the account debtor, or receives a document embodying the obligation. These exceptions are sometimes known as the "four horsemen."³⁷ Pennsylvania followed the English rule. The Supreme Court, affirming the Third Circuit,³⁸ held that since a subsequent assignee, *i.e.*, a bona fide purchaser, who notified could prevail under Pennsylvania law, the assignments had not been perfected prior to bankruptcy, and as tested by Section 60a were for antecedent debts and preferential. Any other decision would not have effected the purpose of Section 60a to force notoriety of security transactions.

The second and other case supporting the brief for revision is *In re Vardaman Shoe Co.*,³⁹ a district court decision. The initial problem was whether Illinois or Missouri law applied to the assignments, which followed the familiar pattern of the *Klauder* case. The assignor's books had been marked, but the account debtor had not been notified. While the contracts of assignment stipulated that Illinois law was to govern, at least some of the contracts were executed in Missouri. This state followed the English rule, which the Supreme Court had applied in the

35. *Dearle v. Hall*, 3 Russ. & M. 1 (Ch. 1827); Comment, 57 YALE L. J. 823, 846, nn. 81, 82 (1948).

36. *Fortunato v. Patten*, 147 N.Y. 277, 41 N.E. 572 (1895).

37. RESTATEMENT, CONTRACTS § 173 (1932); *Salem Trust Co. v. Manufacturers Finance Co.*, 264 U.S. 182 (1924); Comment, 33 YALE L. J. 767 (1924).

38. *In re Quaker City Sheet Metal Co.*, 129 F.2d 894 (C.C.A. 3d 1942).

39. 52 F. Supp. 562 (E.D. Mo. 1943).

Klauder decision. Under Illinois law creditors could not reach assigned accounts, and notification of the account debtor was immaterial in determining the rights of successive assignees; but whether the first assignee's right was absolute (rule [2] above) or whether the subsequent assignee could prevail by meeting one of the conditions of the "four horsemen" (rule [3] above) was not clear in Illinois. The court conceded the applicability of Illinois law for purposes of the decision and, further, assumed that the "four horsemen" rule prevailed in that state. Since a subsequent assignee, or bona fide purchaser, could have prevailed by meeting one of the four conditions of that rule, the trustee was allowed to prevail. The actual result in the case may have been correct as to the assignments executed in Missouri. But even if Illinois law applied, and the "four horsemen" rule was the law in that state, the court nevertheless misapplied the bona fide purchaser test by expanding the test to that of a purchaser who had not only bought in good faith but had done some further act requiring the concurrence of a third party or the judgment of a court.

The *Vardaman* case was discredited *sub silentio* in *In re Rosen*⁴⁰ in an able opinion by Judge Goodrich, writing for the same court that had been affirmed in the *Klauder* case. Judge Goodrich declined to decide whether the applicable state law embodied the "four horsemen" rule, and held that even if it did the trustee could not prevail over the assignee of the accounts: ". . . the favored position acquired by the subsequent assignee . . . [under the "four horsemen" rule] comes not from his status as a bona fide purchaser, but from his activities following his belated assignment."⁴¹

Since the trustee's right to avoid secret assignments as preferences depends upon the applicable state law on perfection, the right varies from state to state. The rule applied in the *Klauder* case has resulted in a spate of state legislation regulating the assignment of receivables.⁴² Fifteen states have enacted "validation acts," adopting the New York rule validating assignments in favor of the first assignor as against both creditors and subsequent assignees, thereby terminating the operation of the *Klauder* rule. Other states have adopted recording or filing acts, which make compliance with their provisions a prerequisite to the validity of assigned accounts as against either bona fide purchasers or creditors; under these acts the *Klauder* rule has vitality. Two states have

40. 157 F.2d 997 (C.C.A. 3d 1946), affirming 66 F. Supp. 174 (D.N.J. 1946), cert. denied *sub nom.* Fisch v. Standard Factors Corp. 330 U.S. 835 (1947).

41. *Id.* at 1001.

42. For summaries and discussions of this state legislation see Comment, 57 YALE L. J. 828, 849-50 (1948); Koessler, *Assignment of Accounts Receivable: Confusion of the Present Law, Impact of the Bankruptcy Act and the Need For Uniform Legislation*, 33 CALIF. L. REV. 40 (1945); Koessler, *New Legislation Affecting Non-Notification Financing of Accounts Receivable*, 44 MICH. L. REV. 563 (1946).

adopted book-marking statutes requiring the fact of assignment to be marked on the assignor's books as a condition to validity; subject to this slight obeisance, the *Klauder* rule is terminated. In some states which have no applicable legislation, the status of assignments of accounts is not clear.

Under the ABA bill to revise Section 60a, secret financing on assigned receivables will be immune except in those states in which a garnishing creditor of the assignor can prevail over the assignee.⁴³ The same is true under the Conference revision of Section 60a. Despite the fact that the impetus behind revision of Section 60 stems from the *Klauder* decision, and although the Conference is cooperating with the ABA to eliminate the case's principles from the broad field of preferences, the Conference bill preserves and fortifies the *Klauder* rule in just the field of the assignment of receivables, by proposing a federal accounts receivable filing act as a new Section 70i. If state law provides for public filing of notices of assignments, no additional filing is necessary under Section 70i; but wherever state law does not so provide, the assignee must file a notice of assignment with the clerk of the federal district court within a stated time. The assignment is invalid against the trustee where there is no compliance with the filing provisions.

Various arguments pro and con have been advanced. In support of non-notification financing it is urged that because of the opprobrium connected with borrowing on accounts, publicity for such borrowing will injure the business man who secures credit in this way; that definiteness of description for recording purposes is difficult; and that the creditor can always secure accurate information from a financial statement.⁴⁴ This view has gained considerable currency: some fifteen states have enacted validation statutes since the *Klauder* decision; and apparently the American Bar Association subscribes to it, for its bill, limited solely to Section 60, immunizes receivable financing in most states from the preference provision. Advocates of recording statutes insist that experience has shown that publicity for accounts receivable financing reflects but does not injure the borrower's credit standing; and that accurate information of assignments of accounts should be available for public inspection, as in the case of other security transactions, for public records are more reliable than the borrower's statements.⁴⁵ Since filing statutes have been successfully employed, it is

43. Few states allow garnishing creditors to prevail over an assignee at common law. State recordation statutes, however, protect creditors as well as subsequent assignees. Comment, 57 *YALE L. J.* 828, 850 (1948).

44. Hanna, *supra* note 28, at 69; AMERICAN BAR ASSOCIATION SECTION ON CORPORATION BANKING AND MERCANTILE LAW, *supra* note 27, at 17-8; Comment, 44 *YALE L. J.* 639 (1935).

45. AMERICAN BAR ASSOCIATION SECTION ON CORPORATION, BANKING AND MERCANTILE LAW, *supra* note 27, at 19; Comment, 57 *YALE L. J.* 828, 834 n. 23, 847 n. 92 (1948).

argued that sufficiently definite description of the assigned accounts is possible.⁴⁶ While such an eminent authority as Professor Glenn contends that each state should be left to deal with the problem as it sees fit and that imposition of substantive uniformity by the Bankruptcy Act is unjustified,⁴⁷ for reasons previously stated an equitable distribution often demands that bankruptcy override local law; here it must do so to prevent the last liquid assets of the estate from being secretly encumbered.

Proposed Section 70i seems grounded upon the theory of preference in that it requires the notice to be filed within ten days of the assignment—that done, the security is treated as presently given; or filed before the assignor became insolvent, or more than four months before bankruptcy.⁴⁸ Yet the proposal departs from the theory of voidable preferences stated in Section 60b, which requires the trustee to show that the preferee had reasonable cause to believe that the debtor was insolvent, by allowing the trustee to invalidate *any* assignment that is not filed within the stated time. Whether the requirement of present Section 60b should be retained is debatable,⁴⁹ but if it is, why should it be omitted from proposed Section 70i which is in effect a preference section aimed solely at one security device?

The proposal also apparently contemplates the validity, as against the trustee, of contracts to assign future receivables, for it speaks of the date when "the assignment is made or the agreement to assign is entered into." The present rule under Section 60, which was the better view even before the Chandler Act, is that an assignment made within, but pursuant to an agreement to assign made before, the four-month period prior to bankruptcy, is a transfer for an antecedent debt and a voidable preference if the other necessary elements exist.⁵⁰ The reason for changing this rule or adding a cumulative rule that diverges from it is not apparent. But on the whole the provisions of Section 70i requiring notoriety in every state for the assignment of accounts is an improvement in the present law under which secret financing on receivables is still possible in many states.

46. The fact that both validation and recording statutes have operated successfully outside bankruptcy can perhaps be explained by the recent suggestion that duplicate assignments are so rare among business men as to have little economic significance. Martin, *supra* note 32, at 82.

47. Glenn, *supra* note 30.

48. The proposed amendment leaves unsettled the rights of the trustee against an assignment recorded within ten days but made to secure an antecedent debt within four months of bankruptcy while the assignor is insolvent.

49. See 3 COLLIER 989.

50. *Grandison v. National Bank of Commerce*, 231 Fed. 800 (C.C.A. 2d 1916), *cert. denied*, 242 U.S. 644 (1916); 3 COLLIER 960.

Equitable Liens

Until 1938 it was possible for the holder of an equitable lien—*i.e.*, a secret lien created in equity to further the parties' intent to create a specific interest in identified property—to prevail over the trustee by recording or taking possession immediately before bankruptcy.⁵¹ And even where the equitable lienor had not taken one of these steps he prevailed against the trustee in any state where an equitable lienor's status excelled that of a lien creditor.⁵² A debtor's financial distress often remained undisclosed; a large creditor could be induced to refrain from enforcing his claim or even to extend further credit on the assurance that in case of bankruptcy his claim would be paid in full as "secured"; this gentlemen's agreement remained secret until the eve of bankruptcy. The result was that other creditors were misled into advancing credit to the failing debtor, and a favored creditor was preferred through collusive assertions, often difficult to disprove, that a lien had been given before the four-month period. This menace to the scheme of equal distribution, which the courts had perpetuated in the face of repeated attempts by Congress to eliminate it, was eradicated by the inclusion in Section 60 of the bona fide purchaser test. Both the ABA and Conference bills by their lien creditor test reinstate equitable liens in bankruptcy in those states where a lien creditor gets only the rights the debtor had in the subject matter of the lien: where the equitable lienor prevails over lien creditors.⁵³

"Relation Back" for Thirty Days

Where applicable state law allows no period for perfection, or allows longer than thirty days, the ABA and Conference bills propose a thirty-day perfection period for transfers made for new and contemporaneous consideration, with the perfection relating back to the time of the transfer. The pernicious doctrine of "relation back," close kin to the equitable lien and with similar potentialities for collusion and overreaching, is permitted to operate within a one-month period. A secret lien during the critical month preceding bankruptcy may be as dangerous as any existing for a longer period; and the time period is far too long. This sort of legislative detail is usually productive of evil. The courts can be trusted to apply the present Section 60a so that a transfer and a subsequent filing, recording, or other perfection, within a time reasonably related to the type of security, will be treated together as a continuing transaction.⁵⁴ The diligent and honest transferee has nothing

51. 3 COLLIER 875-91.

52. See cases cited in Comment, 57 YALE L. J. 823, 840 n. 49 (1948). The "strong arm" clause of §70c gave, and still gives, the trustee the rights of a lien creditor as to property in the possession of the bankrupt.

53. See cases cited in Comment, 57 YALE L. J. 823, 839 n.47 (1948).

54. See *In re Coombs*, 37 F. Supp. 495 (W.D. Mo. 1940); *In re McManus Motors*,

to fear from this type of judicial rule. But to determine diligence by legislative fiat is to invite collusive abuse.

Security Interests in Goods Held by Debtor for Resale

Recently the fear has been expressed that the bona fide purchaser test will enable the trustee to invalidate properly filed or recorded trust receipts, factor's liens, chattel mortgages on goods held for resale and similar legitimate security devices.⁵⁵ Since the debtor's purchaser in the ordinary course of trade can obtain an interest superior to that of the security holder, even though the latter has given full notoriety to the transaction,⁵⁶ it is said that the trustee, by virtue of the bona fide purchaser test, can prevail. It is highly improbable that any court would reach that result. Section 60a should be interpreted in the light of its legislative history as striking at secret liens, previously protected by the doctrine of "relation back," not at legitimate security devices which have been given the full notoriety prescribed by state law, and which, by their very function, are designed to enable the debtor to have possession and the power of sale and hence are never perfectible as against the ordinary purchaser. Nor would the "plain meaning" rule of interpretation preclude this view, for a distinction can readily be drawn between the traditional concept of the bona fide purchaser and that of the buyer in the ordinary course of trade.⁵⁷ But if in the business world the fear of another interpretation, unrealized in nearly ten years of decisions under the Act, is real, then the simple solution is to add a clause exempting this type of security from the bona fide purchaser test, and not to recast entire Section 60a.⁵⁸ The uncertainty which

27 F. Supp. 113 (D. Mass. 1939). Some state courts have recognized execution and recording as a continuous transaction in applying state recording statutes. 32 IOWA L. REV. 760, 764 n.23 (1947).

55. Hanna, *op. cit. supra* note 28 at 73; Ireton, *op. cit. supra* note 26 at 263-5 (1947); Keeffe, Kelly, and Lewis, *op. cit. supra* note 26 at 100-3; McLaughlin, *op. cit. supra* note 21 at 251.

56. *E.g.*, UNIFORM TRUST RECEIPTS ACT §9-2(a).

57. *Cf.* Frankfurter, *Some Reflections on the Reading of Statutes*, 47 COL. L. REV. 527, 540-5 (1947); UNIFORM TRUST RECEIPTS ACT §1 (distinguishes between "buyer in the ordinary course of trade" and "purchaser").

58. The Conference also harbors the fear that courts will test the trustee's right to prevail by the rights of a creditor with special priority, such as one injured by an automobile, under a peculiar state law, who has a right against the vehicle, or a government unit with a tax priority. The ABA and Conference bills accordingly refer to a creditor "without special priority." McLaughlin, *op. cit. supra* note 21, at 255-6. This fear is largely fanciful, but can be allayed by adding a short limiting clause to the present section. Similarly the fear that other courts will test the trustee's rights by the rights of a purchaser or creditor who has done some further act requiring the concurrence of third parties or the judgment of a court, as did the court in *In re Vardaman Shoe Co.*, 52 F. Supp. 562 (E.D. Mo. 1943) (now discredited, see p. 649 *supra*), can be put at rest by a qualifying clause added to the present language.

would be launched by the proposed statutory language⁵⁹ would thus be avoided as would, more importantly, the evils inherent in weakening the preference provision by elimination of the bona fide purchaser test.

TAX CLAIMS

A bankrupt's tax liability to the federal or state government is now unaffected by his discharge under Section 17a(1) or by the confirmation of an arrangement or plan. Tax liens are also unaffected by bankruptcy, except those which are on personal property and unaccompanied by possession, and in this restricted area are only subordinated to administration expenses and wage claims entitled to priority.⁶⁰ Under Section 64a, which deals with priorities, all current taxes, *i.e.*, taxes which accrue during bankruptcy administration, are entitled to a first priority as one of the expenses of administration,⁶¹ and all taxes which became due and owing prior to bankruptcy and are not secured by lien have a fourth priority. Because the expenses accorded a third priority are seldom incurred,⁶² pre-bankruptcy tax claims are usually payable immediately after expenses of administration and wage priorities. And pre-bankruptcy tax claims may accumulate over long periods of time. Apart from state tax claims, which are barred only by local statutes of limitations, an example from the federal field will illustrate. The Internal Revenue Code now allows the Federal Government three years after a return is filed in which to assess income, estate or gift⁶³ taxes. The tax may be collected by distraint or by a proceeding in court begun within six years of the date of assessment.⁶⁴ Upon an adjudication of bankruptcy all deficiencies must be immediately assessed.⁶⁵ Claims un-

59. Compare with the American Bar Association's present position an earlier recommendation: "The law is clear now. The states are deciding rapidly how to adapt their local law to their particular needs in the light of the *Klauder* case. To amend this part of the section now will only muddy the waters." AMERICAN BAR ASSOCIATION: SECTION OF CORPORATION, BANKING AND MERCANTILE LAW, Proceedings at Cincinnati Meeting, Report of Committee on Bankruptcy and Liquidations 77-9 (1945).

60. Section 67(c).

61. 3 COLLIER ¶64.105 n.36.

62. Given a third priority by § 64a(3) are expenses incurred by creditors in successfully opposing a discharge or the confirmation of an arrangement or a wage-earner plan or in collecting evidence which results in the conviction of any person for an offense under the Act.

63. INT. REV. CODE §§ 275(a), 874(a), 1016(a). The income tax chapter provides periods other than three years for certain situations. *Id.* §§ 275(b), 275(c), 275(d), 275(e), 275(g). Also, the taxpayer and the Commissioner may agree in writing upon a time for assessment. *Id.* § 276(b). All three chapters, income, estate and gift tax, provide that in case of a false or fraudulent return with intent to evade tax or a failure to file a return, collection of the tax "may be begun without assessment, at any time." *Id.* §§ 276(a), 874(b)(1), 1016(b)(1).

64. INT. REV. CODE §§ 276(c), 874(b), 1016(b).

65. *Id.* §§ 274(a), 1015(a).

paid in bankruptcy distribution may be collected by distraint or by court action sought within six years after the termination of the bankruptcy proceeding.⁶⁶ Thus the Treasury is normally permitted a maximum of nine years to assess and collect; if bankruptcy intervenes, an additional six years, beginning at the termination of the proceeding, is allowed for a claim unpaid in bankruptcy.

Tax claims, both secured and unsecured, therefore, occupy an excellent position under the present Bankruptcy Act.

Before turning to the more controversial provisions of the Bankruptcy Conference tax bill, one should note two provisions dealing with the bankruptcy court's power over pre-bankruptcy taxes. Present Section 64a(4) provides "that no order shall be made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court." This is retained intact in the Conference bill. Present Section 64a(4) also provides "that, in case any question arises as to the amount or legality of any taxes, such question shall be heard and determined by the court." This provision has been emasculated and its meaning obscured by judicial dicta stemming from a case concerning post-bankruptcy taxes, to which Section 64a(4) dealing with pre-bankruptcy taxes clearly does not apply, and further involving railroad reorganization, to which the applicability of Section 64 in its entirety is questionable.⁶⁷ The Conference tax bill wisely proposes to eliminate the latter provision from Section 64 and would add a paragraph to Section 2 empowering the court to hear and determine questions "arising as to the amount or legality of any tax, whether or not previously assessed, which has not prior to bankruptcy been contested before and adjudicated by a judicial or administrative tribunal of competent jurisdiction, or, if such question has been so contested and adjudicated and the time for appeal or review has not expired, to authorize the receiver or trustee to prosecute such appeal or review." Placed in Section 2, which deals generally with the powers of courts of bankruptcy, this salutary provision, which protects the estate from erroneous assessments without unduly shifting all tax determinations into the bankruptcy forum, will be applicable to both pre- and post-bankruptcy

66. *Id.* §§ 274(b), 1015(b).

67. *Arkansas Corporation Comm'n v. Thompson*, 313 U.S. 132 (1941). The case actually decided that where the tax liability of the estate had been determined by a judicial or quasi-judicial state tribunal, the bankruptcy court could not review that determination. But the Court's remark to the effect that "there is nothing in the history of bankruptcy or reorganization legislation to support the theory that Congress intended to set the federal courts up as super-assessment tribunals over state taxing agencies," *id.* at 145, has induced doubts as to whether the decision's application would be limited to determinations by judicial or quasi-judicial state agencies. And when the question arose again in *Gardner v. New Jersey*, 329 U.S. 565, 578 (1947), the Court did not dispel these doubts.

taxes and to all proceedings under the Act. Thus the scope of present Section 64a(4) is enlarged and its applicability to railroad and corporate reorganizations—a presently doubtful matter—clarified.

Under the Conference bill, current taxes are still entitled to a first priority as expenses of administration, and tax liens will continue to be unaffected by bankruptcy, except those on personal property, unaccompanied by possession. As to these the principle of present Section 67c is continued for the purpose of subordinating them to the first and second priorities, but the Conference bill goes further and restricts these liens in the amount of their payment to claims for taxes which have become due and owing within one year. The more drastic attack upon the status of tax claims is, however, this: unsecured tax claims which have been due and owing for more than one year prior to bankruptcy are (1) relegated to the status of general unsecured debts and (2) discharged with other claims. Taxes accruing during the year prior to bankruptcy are not affected by the bill; they continue to have a fourth priority, and unpaid portions are not released by discharge.

The present bill is not the first attack upon the status of taxes in bankruptcy. In 1937 the provision in Section 17 exempting federal tax claims from discharge was deleted in the House version of the Chandler Bill⁶⁸ but was restored by the Senate.⁶⁹ Urged also to eliminate the exemption from discharge of state taxes, the House apparently felt restrained by constitutional limitations.⁷⁰ The same obstacle troubled the Conference; although it recognized the desirability of releasing state tax claims by discharge, it did not then recommend the change.⁷¹ But the basis for the constitutional doubt has been minimized since 1937 by the Supreme Court's repudiation of the cases upon which the doubt was predicated.⁷² In the light of the Court's present position on state immunity from federal action,⁷³ and because of the paramount nature of the bankruptcy power,⁷⁴ state taxes could probably be validly discharged. Indeed, the Conference's comment to the present bill does not even acknowledge the existence of any constitutional problem.

The Senate, when rejecting the House amendment to the Chandler bill discharging federal taxes, was influenced by the Treasury's conten-

68. H. R. REP. No. 1409, 75th Cong., 1st Sess. 27, 67 (1937).

69. 83 CONG. REC. 8684 (1938).

70. *Hearings before Committee on Judiciary on H. R. 8046*, 75th Cong., 1st Sess. 67-8 (1937).

71. *Id.* at 68.

72. *Ibid.* Congressman Chandler voiced the fear at the hearings, referring to *Collector v. Day*, 11 Wall. 113 (1870), and *Ashton v. Cameron County Water Improvement District No. One*, 298 U.S. 513 (1936). The former was overruled by *Graves v. New York ex rel. O'Keefe*, 306 U.S. 466 (1939), and the latter virtually overruled by *United States v. Bekins*, 304 U.S. 27 (1938).

73. *Cf. New York v. United States*, 326 U.S. 572, 586 *et seq.* (1946).

74. See WARREN, *BANKRUPTCY IN UNITED STATES HISTORY* 9, 154-9 (1935).

tion that discharge of taxes in bankruptcy would permit widespread tax avoidance,⁷⁵ a contention which the Department has asserted in opposing later proposals for the discharge of tax claims.⁷⁶ The Conference and other critics of the present discharge exception urge that the debtor's discharge does not now enable him to get a fresh start, since unpaid tax claims can be collected at any time within six years after bankruptcy; they argue, moreover, that little income is realized by the Government from these stale tax claims in any event.⁷⁷ The Treasury has also opposed suggestions that the priority of tax claims be limited to those which became due and owing within one year prior to bankruptcy on the grounds that the effect of such a limitation would be loss of needed revenue and imposition on the Treasury of an insurmountable handicap to tax administration.⁷⁸ The Conference bill would undoubtedly have the latter effect on income tax administration, especially in view of its provisions that taxes upon or measured by net income, shall be deemed "due and owing . . . at the time when the amount of such net income . . . is ascertainable, whether or not it has been ascertained"; and that tax deficiencies are deemed due and payable "as of the last day of the tax period to which they relate regardless of the date of assessment."⁷⁹ By this definition income taxes are due and owing on the last day of the calendar or fiscal year, as the case may be, although returns for that year are not due until two and one-half months later.⁸⁰ The Treasury would have to assess all income tax deficiencies within nine and one-half months of the final date on which returns are due—unless tax liability were admitted by the bankrupt—in order to have a non-dischargeable tax claim entitled to a fourth priority. Statistics showing the speed with which returns are now processed by the Treasury disclose the impracticability of assessing all deficiencies within that time.⁸¹ Even if such speed were possible, the Government would as a practical matter be able to protect itself only as to deficiencies which the taxpayer did not choose to dispute. In determining the tax liability of any sizeable business enterprise disagreements between the taxpayer and the Collector are inevitable. A taxpayer's exhaustion of the intra-departmental remedies for adjustment of differences would usually leave the Government, although suc-

75. 83 CONG. REC. 9106 (1938).

76. See Olive, *Taxes in Bankruptcy Proceedings*, 25 TAXES 5, 8 (1947).

77. *Ibid.*

78. *Id.* at 6-8.

79. These provisions are included in the Conference bill as an amendment to § 1, new ¶ 2½.

80. INT. REV. CODE § 53(a).

81. ANNUAL REPORT OF COMMISSIONER OF INTERNAL REVENUE 26, 122-7 (1947); ANNUAL REPORT OF COMMISSIONER OF INTERNAL REVENUE 14-22, 113-7 (1945); ANNUAL REPORT OF SECRETARY OF TREASURY 204-6 (1946).

cessful, with a claim due and owing for more than one year,⁸² and a taxpayer's election to litigate in the Tax Court would invariably have the same result.⁸³ Such tax claim would be entitled to no priority and would be dischargeable.

On the other hand there are certain kinds of taxes which are relatively simple in their operation. Among these are taxes for which the bankrupt is a collector for the government, *e.g.*, taxes withheld by the bankrupt-employer from his employee's wages, and social security taxes payable both by him and his employees. The Internal Revenue Code's provisions for collection of income tax at the source⁸⁴ and the Federal Insurance Contributions Act⁸⁵ require the employer to withhold a certain amount, to be computed as prescribed, from the employee's wages as and when paid. Every employer must make a return in the month following the close of each quarter of the calendar year, showing and remitting the amounts withheld.⁸⁶ In the case of withheld income tax, if the employer withholds more than \$100 each month, he is required to pay the funds withheld to a depository, authorized by the Secretary of the Treasury, within ten days after the close of each calendar month.⁸⁷ In administering these taxes and others where computation is simple and the likelihood of disputed assessments is slight, returns could be processed within one year from the due date. As applied to taxes of this nature the Conference bill may well be a workable improvement on the present law. And where the bankrupt's income had been wholly or largely subject to withholding, the Government would lose little by the Conference bill.

The desirability of some sort of limitation on tax priorities in bankruptcy has become increasingly evident in recent years. Under the

82. 9 MERTENS, LAW OF FEDERAL INCOME TAXATION §§ 49.32, 49.34, 49.36, 49.38, 49.55, 49.63-77 (1943). Normally, an appreciable period passes before the deficiency is discovered. See note 81, *supra*. The taxpayer is then sent a 30-day letter, giving him 30 days in which to file a protest. If the deficiency is not settled with the Internal Revenue Agent in charge or, on the taxpayers request, at a hearing before the appropriate office of the Technical Staff Division, the agent in charge issues a 90-day letter (notice of deficiency). If the taxpayer is then unable to settle with the Technical Staff Division he may file an appeal in the Tax Court within that 90 days.

83. Filing an appeal with the Tax Court now suspends the running of the statute of limitations on assessment and collection. 53 STAT. 87, INT. REV. CODE § 277 (1940).

84. 57 STAT. 126, INT. REV. CODE §§ 1621-32 (1943).

85. 53 STAT. 175 (1939), as amended, 53 STAT. 1381 (1939), as amended, INT. REV. CODE §§ 1400-32 (1947).

86. U. S. Treas. Reg. 116, § 405.601 (1944); U. S. Treas. Reg. 91, § 401.402 (1936), as amended 26 CODE FED. REGS. § 401.402 (1939). The employer who must use a depository (note 87 *infra* and accompanying text) attaches receipts issued by the depository in payment of withheld funds. U. S. Treas. Reg. 111, § 405.605 (1944).

87. U. S. Treas. Reg. 116, § 405.605 (1944).

much criticized⁸⁸ Section 64a(4) of the present Act, tax arrearages frequently reach so high a total that they far exceed the value of the estate, and leave nothing for general creditors. The likelihood of this result is partially responsible for the indifference frequently shown by general creditors toward bankruptcy administration—an indifference inimical to a bankruptcy administration bottomed upon creditor control. Where taxes far exceed assets, it is small wonder that creditors will not advance money for the investigation of concealment and fraud, even in such a fantastic case as the one in which a bankrupt with debts totalling a quarter of a million dollars reported assets of two hundred dollars, and claimed these as exempt.⁸⁹ The Conference hopes that the effect of the limitation on tax priority will be that tax officials will attempt to collect their claims promptly, will thus reveal the debtor's tax delinquency before it becomes too serious, and so enable other creditors to take protective steps. Money and goods supplied by creditors who, unaware of the debtor's tax arrearages, continue to extend credit, are oftentimes used by the bankruptcy trustee to pay pre-bankruptcy tax claims.⁹⁰ While all priorities may reap a similar benefit from a kindred use of a creditor's money and goods, priorities other than taxes are more easily discoverable, can be anticipated, and are not so disproportionate to the value of the estate to be distributed.

Elimination of priority for taxes accrued before a certain date would improve bankruptcy administration and would effect a more prompt disclosure of the financial skidding that ends with bankruptcy. A corresponding limitation on the present immunity from discharge is probably advisable, since limiting priority alone would often leave the discharged debtor with a heavier tax load than he now bears. But the proponents of a bill which effects such a drastic change have the burden of showing their measure to be not only desirable from the bankruptcy standpoint but administratively feasible tax-wise as well. An act to accomplish this alteration in existing law should be preceded by a careful study of auditing, assessment and other problems of both federal and state taxing authorities in dealing with a variety of taxes. An estimate, based upon available statistics, should be made of the amount of federal and state income which would be lost by the change. Finally, attention should be given to safeguarding government from the use of bankruptcy for tax avoidance. Among the desiderata such a study

88. Olive, *Taxes in Bankruptcy Proceedings*, 25 TAXES 5 (1947); Montgomery, *Recent Developments and Proposed Reforms in Respect to Tax Claims in Bankruptcy*, 19 J. N. A. REF. BANKR. 31 (1944); Musgrave, *The Tax Priority Bugaboo*, A6 CORP. REORG. 43 (1945); Furst, *Tax Problems in Bankruptcy and Reorganization*, 66 N.J.L.J. 173 (1943), reprinted with introductory comment *sub nom. Tax Situation in Bankruptcy*, 18 J.N.A. REF. BANKR. 17 (1943).

89. *Referee M. W. O'Rieley Retires*, 18 N.J.A. REF. BANKR. 63 (1944).

90. Furst, *op. cit. supra* note 88 at 173, 18 N.J.A. REF. BANKR. at 18.

would reveal would probably be that of providing different time limitations for different kinds of taxes. If the tax is relatively simple to compute, as it is where the bankrupt is liable as a tax collector, the one year period may give tax officials adequate time for assessment and collection. For more complex taxes, such as the federal income tax, the period should be longer, and probably suspended during the time the taxpayer is making use of administrative or judicial machinery to dispute the assessment. The Conference has not successfully carried this burden of showing the feasibility of its bill from the standpoint of tax collection and a revision of the tax provisions of the Bankruptcy Act should accordingly be postponed.

THE BORAH ACT REPEAL BILL, H.R. 5828

The Borah Act of 1937:⁹¹ (a) prohibits agreements between parties in interest or their attorneys fixing the amount of fees or other compensation to be paid such persons in federal receivership, reorganization or bankruptcy proceedings when such costs are to be paid from the assets of the estate; (b) prohibits the judge from approving such fixed allowances; (c) makes it unlawful for the judge to appoint as receiver or trustee any person related to him by consanguinity or affinity, within the fourth degree; and (d) makes a violation of any of these provisions a crime. The Conference by H.R. 5828 proposes to emasculate that Act by striking out provisions (a) and (b), retaining (c),⁹² and so sharply limiting the criminal provisions of (d).

Senator Borah, when introducing his bill, epitomized the need for the measure as follows:

“We have found out through investigation that the heart of the misdoings with reference to receivership cases was that attorneys get together and agree upon large fees, agree upon a receiver, agree upon receivers’ fees, agree upon the compensation of all parties concerned, and the result is that they simply divide up the carcass and there is nothing left for creditors or anybody else.”⁹³

Congress had attempted to cure these “cryingevils”⁹⁴ in 1934, by including in Section 77B,⁹⁵ the new corporate reorganization statute, a provision requiring the court to regulate the amounts of compensation

91. 50 STAT. 810 (1937), 28 U.S.C. §§ 531, 572a (1940).

92. The Conference bill also amends subdivision (c) to make it applicable to referees, as well as to judges.

93. 81 CONG. REC. 8393 (1937).

94. See *Realty Associates Securities Corp. v. O'Connor*, 295 U.S. 295, 299 (1935); 83 CONG. REC. 8681 (1938); 81 CONG. REC. 9517 (1937).

95. 48 STAT. 912, as amended, 11 U.S.C.A. § 207 (Supp. 1935).

paid out of the estate in 77B proceedings.⁹⁶ Prior to that time interested parties, by employing a deposit agreement or by providing in the plan that the reorganization manager should fix the amounts of compensation,⁹⁷ made it extremely difficult, if not impossible, for courts to control the fees paid from the estate.⁹⁸ Although the provision in Section 77B limited the effectiveness of deposit agreements and fee provisions in plans by making it the duty of the judge to disregard them if he found that the compensation provided for was excessive, fee fixing agreements were generally still successful. Because "petitions for allowances were presented at the last stage of the proceeding when conflicting factions had united in support of the successful plan,"⁹⁹ and because there was little or no opposition to assist the court in valuing the services performed,¹⁰⁰ judges tended to acquiesce in the recommendations of the parties. In 1937, Congress attacked this evil of exorbitant allowances by striking at its root, the fee fixing agreement.

The need for the measure was thought by its sponsors to be apparent in 1937 and its retention has since been recommended by the Judicial Conference of Senior Circuit Judges and the SEC.¹⁰¹ If substantial repeal of the Borah Act is justified now it must be either because the reform was unnecessary in 1937 or because conditions have changed since that time to such an extent that the restriction is no longer necessary. Neither proposition has been established. The Conference now asserts that the primary purpose of the Borah Act was to prevent a judge from allowing fees without giving all persons interested in the estate notice and opportunity to be heard; a purpose now effected by Section 58a(8), which, applicable to Chapter X, makes adequate provision for notice and hearing.¹⁰² But the stated purpose of the Borah Act is to reach the private agreements between the parties which were regarded as "the heart of the misdoings." While Congressman Chandler mentioned the evasion of hearings as one facet of the problem,¹⁰³ his

96. Former §§ 77B (c) (9).

97. Medill, *Fees and Expenses in a Corporate Reorganization under Section 77B*, 34 MICH. L. REV. 331, 340-1 (1936).

98. *United States v. Chicago, M., St. P. & P. R.R.*, 282 U.S. 311 (1931); Note, 49 HARV. L. REV. 1111, 1199 (1936).

99. SEC, *Memorandum: Proposed Legislation for the Repeal of the Borah Act* 6 (unpublished 1944), submitted to the Judicial Conference of Senior Circuit Judges in 1944.

100. SEC, REPORT ON THE STUDY AND INVESTIGATION OF THE WORK, ACTIVITIES, PERSONNEL AND FUNCTION OF PROTECTIVE AND REORGANIZATION COMMITTEES 244-5 (1940).

101. REPORT OF JUDICIAL CONFERENCE OF SENIOR CIRCUIT JUDGES 10 (1944). The SEC filed a memorandum with the Judicial Conference. See note 99 *supra*.

102. N.B.C., *Committee Print* 65. See also Williston, Black, and Kurtz, *Fees in Reorganization Proceedings*, 18 J.N.A. REF. BANKR. 36, 38 (1944).

103. H.R. REP. NO. 1524, 75 Cong., 1st Sess. 1 (1937).

report to the House,¹⁰⁴ as well as Senator Borah's description of the bill,¹⁰⁵ show a much broader purpose than that now suggested by the Conference. When the Congressional purpose was merely to require notice and hearing, precisely that was achieved in the Chandler Act. Moreover, Senator O'Mahoney, who sponsored the Chandler bill in the Senate, made it clear that the Borah Act still had a function.¹⁰⁶ A short answer to the argument of the Conference is that if Congress meant only to require notice and hearing it chose a strange way of stating its meaning. The Conference does not state in the comment to its bill that reform was unnecessary in 1937. But that proposition is implicit in its second argument. The so-called agreement, says the Conference, would be merely a recommendation to the court, binding on no one, and an aid to the court in fixing fees, as are the recommendations of the SEC.¹⁰⁷ This argument overlooks the pre-Borah Act history that demonstrates the coercive effect of such agreements upon the courts. Nothing in the Borah Act prohibits individual recommendations as to the amounts of compensation properly allowable. In fact it promotes individual, instead of agreed-upon advice to the court. The plea for freedom of recommendation misses the mark.

The Borah Act continues to perform a useful function in forbidding fee-fixing agreements that make it difficult for the court to scale down excessive demands. While public opinion no longer spotlights the problem of excessive reorganization expenses, it is partly because the Borah Act has done much to mitigate the evil. The need for the law is as great now as when enacted.

ADDITIONAL AMENDMENTS NEEDED TO SUPPLEMENT CONFERENCE'S NON-CONTROVERSIAL BILL

The Conference aptly characterizes its proposed bill, H.R. 5693, as non-controversial in character. But it is too limited. Summarizing its coverage in an Appendix,¹⁰⁸ we now deal with matters not within its scope—many of them non-controversial and all proper to be dealt with by any extensive revision of the Act.

The definition of insolvency in Section 1a(19) should be amended to exclude all of the debtor's exempt property in determining the aggregate value of his assets. No sound reason can be advanced for including exempt property, which creditors cannot reach either in or out of bankruptcy, in determining the insolvency of a person for bankruptcy purposes.¹⁰⁹ The definition would then accord with insolvency as defined

104. H.R. REP. No. 1524, 75 Cong., 1st Sess. (1937).

105. 81 CONG. REC. 8393 (1937).

106. 83 CONG. REC. 8681 (1938).

107. N.B.C.J. *Committee Print* 65-6.

108. P. 717 *infra*.

109. See 1 COLLIER 71-2.

in Section 67d(1) (d), the Bankruptcy Act's spearhead against fraudulent transfers.

Section 2, which deals with courts of bankruptcy and their jurisdiction, should be amended in two respects. Introductory paragraph (a) should be expanded to give the bankruptcy court jurisdiction in admiralty in addition to the jurisdiction at law and in equity which it now has. Failure to give the bankruptcy court admiralty jurisdiction is an anomaly that results in confusion or is disregarded by the federal judge who has power to sit as an admiralty court regardless of the mysteries that surround him when sitting as a court of bankruptcy.¹¹⁰ Clause (1) dealing with venue should provide that improper venue is not ground for dismissal and, in addition, that any proceeding may be transferred to a more convenient forum.¹¹¹ This latter suggestion would be in line with Section 118 of Chapter X; both suggestions follow the treatment accorded venue in civil actions by the proposed Judicial Code Revision.¹¹²

While acts of bankruptcy have been criticized as anachronistic,¹¹³ they have been imbedded in our bankruptcy jurisdiction so long that their displacement by some other standard, such as financial status, would be a novel cure worse than the evil. If instead the acts of bankruptcy are meshed more carefully with the avoiding sections of the Act¹¹⁴ they will serve a useful purpose in setting rather objective standards as to when a debtor is fit for involuntary bankruptcy. To accomplish this end the first three acts of bankruptcy should be revised. The first act, insofar as it deals with a fraudulent transfer, should not be restricted, as it now is, to an "intent to hinder, delay, or defraud his creditors or any of them." It should denounce as fraudulent any transfer coming within the purview of Sections 67d and 70e, the avoiding sections of the Act dealing with fraudulent transfers. And the intent of the debtor to prefer should be eliminated from the second act. Such an intent, is not an element of a preferential transfer as defined in Section

110. See 1 COLLIER ¶2.10.

111. Section 32 does not fill this need. It provides for the transfer of cases pending in different courts of bankruptcy which involve the same person or different members of a partnership, where each court has jurisdiction, to another court having jurisdiction. There is no power to transfer cases to a more convenient forum which does not have venue, as there is in Chapter X cases by virtue of § 118.

112. H.R. 3214, 80th Cong., 1st Sess. §§ 1404, 1406 (1947). Section 1404(a) permits transfer of a civil action to any other district or division where it might have been brought, "for the convenience of parties and witnesses, in the interest of justice." Section 1406(a) requires the district court to transfer a case where venue is laid improperly to "any district or division in which it could have been brought."

113. See Treiman, *Acts of Bankruptcy: A Medieval Concept in Modern Bankruptcy Law*, 52 HARV. L. REV. 189 (1938).

114. See 3 COLLIER 749-50 and nn.69 and 70 for a discussion of the failure of the acts of bankruptcy to mesh with the avoiding sections.

60a. While the courts have used an objective standard in defining "intent to prefer,"¹¹⁵ this element in the second act of bankruptcy remains needlessly troublesome, and from the point of view of an equitable distribution among creditors the debtor's intent is wholly irrelevant. If these changes were made, a conforming change would be needed in the last sentence of Section 3b insofar as it deals with intent as related to the first and second acts of bankruptcy. Some change is also needed in the second sentence of Section 3b which provides that the four-month period, within which an involuntary petition may be filed with respect to the first and second acts of bankruptcy, "shall not expire until four months after the date when the transfer . . . 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." Language paralleling this creditor and bona fide purchaser test is found in Section 60a, which deals with preferences, and in Section 67d(5) which deals with fraudulent transfers. As to the latter section, the Conference's non-controversial bill proposes to eliminate the creditor test since a fraudulent transfer is never perfected as against a creditor until the applicable statute of limitations has barred creditor relief—which may be many years—although the transfer is a matter of public record and good as against a bona fide purchaser.¹¹⁶ Certainly a conforming change needs to be made in Section 3b. And if the test of perfection relative to preferences is changed in Section 60a a like conforming change must, of course, be made in Section 3b. Under Section 67a a judicial lien obtained within four months of bankruptcy while the debtor is insolvent is voidable by the trustee. The third act of bankruptcy deals with judicial liens but is so drafted that the act of bankruptcy may not be committed until thirty days after the judicial lien has attached. If a bankruptcy petition is filed more than three months thereafter, although within four months, as literally it may be under Section 3b, the debtor may be adjudged a bankrupt because of his failure to vacate the judicial lien although it is evident that the trustee cannot invalidate the lien. This incongruity has led many courts to hold that the bankruptcy petition alleging the third act of bankruptcy is not timely unless the lien is within the avoiding time limit of Section 67a.¹¹⁷ This matter should be clarified in line with these holdings.¹¹⁸ While revising Section

115. *E.g.*, *Shingleton v. Armour Boulevard Corp.*, 107 F.2d 440 (C.C.A.8th 1939); *In re Richenell Fabric Mfg. Co.*, 31 F. Supp. 645 (E.D. Pa. 1940).

116. *Lind v. O. N. Johnson Co.*, 204 Minn. 30, 282 N.W. 661 (1933) (statute of limitations does not begin to run until time of creditor's judgment against debtor). *But cf.* *Buttles v. Smith*, 281 N.Y. 226, 22 N.E. 2d 350 (1939) (statute begins to run at time of fraudulent conveyance).

117. *E.g.*, *Storrie v. McAlester Fuel Co.*, 133 F.2d 1003 (C.C.A.10th 1943); 1 COLLIER ¶ 3.313 and cases cited n.10.

118. The third act should not be available unless the lien can be avoided under § 67a,

3 and in the interests of certainty the fifth act of bankruptcy should be clarified in line with the great weight of authority that the receivership there dealt with is a general equity receivership.¹¹⁹

The 1938 revision of Section 5 on partnerships quite generally adopted the entity theory of partnership, the result being a more workable section.¹²⁰ But the question as to when a partnership is insolvent is still an unsettled one, important in two situations: (1) where a voluntary partnership petition is filed by fewer than all of the general partners;¹²¹ and (2) where an involuntary petition is filed against the partnership alleging an act of bankruptcy of which insolvency is an element.¹²² If the aggregate theory of partnership is followed the partnership is not insolvent, despite the excess of partnership liabilities over partnership assets, so long as there is one solvent general partner. If the entity theory is followed the partnership is insolvent when its liabilities exceed its assets. While the weight of authority and the more recent decisions adhere to the aggregate theory,¹²³ we feel that the entity theory should be followed. This does not mean that the substantive liability of the general partners is affected in the slightest; their personal liability will remain unaffected. It merely means that the partnership is a fit subject for bankruptcy when the assets devoted to its business are less than its debts unless the partners are willing to cure the deficiency by additional contributions of capital.

Both original and appellate jurisdiction need attention. While Section 23, which deals with plenary jurisdiction, might well be clarified,¹²⁴

although corresponding provisions should not be made in the first and second acts. It is fairly simple to determine whether a lien will be voidable under § 67a, but attempting to show that a fraudulent transfer or a preference could be avoided as against an alleged fraudulent transferee or preference would inject controversial issues into the determination of whether an act of bankruptcy has been committed.

119. See, e.g., *Elfast v. Lamb*, 111 F.2d 434, 436 (C.C.A. 2d 1940) (suffering appointment of receiver under New York Martin Act to administer property fraudulently obtained for purpose of returning it to persons defrauded does not constitute fifth act of bankruptcy): "That to constitute an act of bankruptcy the receiver must be a general one has been the rule laid down in numerous decisions."

"A receivership in foreclosure does not constitute an act of bankruptcy." 1 COLLIER ¶ 3.502.

120. 1 COLLIER ¶ 5.03; cf. Comment, 49 YALE L. J. 908 (1939).

121. Sections 5b and 18b.

122. The act complained of must be a partnership act, an application of the entity theory. *Mills v. J. H. Fisher & Co.*, 159 Fed. 897 (C.C.A.6th 1908).

123. *Mason v. Mitchell*, 135 F.2d 599 (C.C.A.9th 1943); *Tom v. Sampsell*, 131 F.2d 779 (C.C.A.9th 1942), cert. denied, 318 U.S. 786 (1943); see *Francis v. McNeal*, 228 U.S. 695, 700 (1913); 1 COLLIER ¶ 5.06 n.3.

124. Section 23 was originally drafted to deal with district courts and circuit courts, subsections a and c dealing exclusively with the latter. Although circuit courts were abolished in 1911, the section retained its original peculiar cast, which tends to be con-

a much more important problem is how to deal adequately with summary jurisdiction and integrate it with plenary jurisdiction. The bankruptcy court has summary jurisdiction: (1) where given it by the Act; (2) where the controversy involves property which is in the actual or constructive possession of the bankruptcy court; and (3) where the defendant consents.¹²⁵ On a consent rationale, summary jurisdiction was early sustained where, in a proceeding brought by the trustee, the defendant, although in possession of property under a substantial adverse claim, did not object to the jurisdiction either by a pre-pleading motion or in the answer. He was held to have consented to jurisdiction by first proceeding on the merits.¹²⁶ This salutary principle was largely destroyed by *Cline v. Kaplan*,¹²⁷ which seems to hold that, where summary jurisdiction must rest upon consent of the defendant, he may litigate on the merits, and his formal objection to jurisdiction is timely if made before entry of the final order by the bankruptcy court. This rule should be repudiated by statute and the earlier judicial rule adopted. In addition, provision should be made for transfer of the summary proceeding to the civil docket and disposition of the case there whenever (1) the defendant's objection to summary jurisdiction is or should have been sustained, and (2) there would be federal jurisdiction, as provided in Section 23, were the proceeding an original plenary action.

One other related matter needs attention. Under Section 57g the trustee may object to the allowance of a claim on the ground that the creditor has received a voidable preference or a fraudulent lien or transfer. Since there is summary jurisdiction in the bankruptcy court to allow or disallow the creditor's claim, it is held that the court has summary jurisdiction to determine whether the creditor is the recipient of a voidable preference or fraudulent transfer or lien, but that the court does not acquire jurisdiction to enter an affirmative judgment in favor of the trustee for the recovery of the preference or the property fraudulently conveyed.¹²⁸ This rule, which makes two law suits grow where

fusing. However, the meaning of the section has been largely settled by decision. *Schumacher v. Beeler*, 293 U.S. 367 (1934). Still in need of clarification is the question of jurisdiction over causes of action arising after the petition is filed, as where the bankruptcy receiver or trustee sues or is sued on a contract made by him or for some act committed by him. 2 COLLIER ¶ 23.16.

125. 2 COLLIER ¶¶ 23.05-08.

126. *Moonblatt v. Kosmin*, 139 F.2d 412 (1943). General Order 37 makes the Federal Rules generally applicable in bankruptcy proceedings. *Oglebay, Some Developments in Bankruptcy Law*, 18 J.N.A. REF. BANKR. 9, 13 (1943). "It must be remembered that the 'jurisdiction' we are now discussing can be conferred by consent; it does not go to jurisdiction of the subject-matter over ordinary civil actions, formerly at law or in equity, which cannot be conferred." 2 COLLIER ¶ 23.08 n.63 (Supp. 1946).

127. 323 U.S. 97 (1944). The case is criticized in *Oglebay, op. cit. supra* note 126 at 75.

128. 2 COLLIER 514-7. This is the usual holding, although a few cases seem to say that

one would amply suffice, should be repudiated in either of two ways: give summary jurisdiction to enter an affirmative judgment; or allow the creditor to have the matter transformed into a plenary suit and transferred to the civil docket.

The 1938 revision of Sections 24 and 25 greatly simplified appellate jurisdiction and procedure.¹²⁹ Section 24, however, still requires a difficult distinction to be drawn at times between a proceeding in bankruptcy and a controversy arising in a proceeding in bankruptcy, since as to the former both interlocutory and final orders are appealable, while as to the latter the order must be final.¹³⁰ The distinction is sometimes overlooked,¹³¹ is always difficult to make when pertinent, and serves no useful purpose. Appellate jurisdiction would not be appreciably enlarged if an interlocutory order in a controversy arising in a proceeding in bankruptcy were made appealable.

Under Section 25 the time for taking an appeal in non-plenary litigation varies from a minimum of thirty days to a maximum of forty days depending upon the service of a notice of the entry of the order. Prior to the recent amendments of the Federal Rules the general time for an appeal in a civil action, which included a plenary action brought by the receiver or trustee pursuant to Section 23,¹³² was three months from the entry of the judgment.¹³³ Under the amendments, which have now become effective, the time for appeal is in general reduced to sixty days in government cases and thirty days in other cases.¹³⁴ Normally then the time for appeal under the Federal Rules is thirty days and in the interest of uniformity the time prescribed in Section 25 should be conformed to the Federal Rule.

The requirements of Section 59b relative to the type of claims which the petitioning creditors must have are too onerous. First there is a

the court does acquire such jurisdiction. *Florance v. Kresge*, 93 F.2d 784 (C.C.A.4th 1938); *Flora Realty & Investment Co. v. Steem Electric Corp.*, 128 F.2d 338 (C.C.A.8th 1942); *In re Gillespie Tire Co.*, 54 F. Supp. 336 (W.D.S. Car. 1942). Even though it is held that filing a claim does not confer jurisdiction, the referee's order is *res adjudicata* as to the fact that a preference was given. 3 COLLIER 193-4 n.38, 1030-2. But that order does not establish the amount of the preference. *Feiring v. Gano*, 114 Colo. 567, 168 P.2d 901 (1946).

129. WEINSTEIN, *THE BANKRUPTCY LAW OF 1938*, 64-8 (1938).

130. *Goldie v. Carr*, 116 F.2d 335 (C.C.A.9th 1940).

131. *Long Beach v. Metcalf*, 103 F.2d 483 (C.C.A.9th 1939). The court was in possession of property in a summary proceeding by the trustee which was essentially a quiet title action, clearly a controversy in a proceeding in bankruptcy. An appeal was allowed from an order overruling defendant's motion to dismiss for want of jurisdiction.

132. 2 COLLIER ¶¶ 24.10, 25.02.

133. 26 STAT. 829 (1891), 43 STAT. 940 (1925), 28 U.S.C. § 230 (1940).

134. FED. R. CIV. P., 73(a). The district court may extend the time for appeal not exceeding 30 days "upon a showing of excusable neglect based on a failure of a party to learn of the entry of the judgment of the district court." Government cases are those "in which the United States or an officer or agency thereof is a party."

requirement that the claims be "fixed as to liability," which taken in conjunction with the somewhat parallel language in Section 63a(1) creates an inference that the claims must be established by a judgment or an instrument in writing. This misleading inference can be cured by providing that the provable claims "be matured and not contingent."¹³⁵ The motivation behind the further requirement that the claims be "liquidated as to amount" was to avoid the necessity of determining a contest collateral to the principal issue.¹³⁶ But the language goes far beyond the proper objective. Thus *A* may not be qualified to be a petitioning creditor where his unsecured claim is unliquidated although there is no doubt that far more than \$500 is due him,¹³⁷ or where he has a large claim that is partially secured and the value of the security cannot be stated with certainty, although it is clear that its value could not possibly reduce *A*'s unsecured claim to \$500.¹³⁸ This should be remedied. And where the creditors are less than twelve in number Section 59b literally allows only one creditor to be a petitioner, although there is no sound reason why more than one should not be allowed to join as petitioners. In computing the number of the debtor's creditors for the purpose of determining how many creditors must join as petitioners, Section 59e should be coordinated with Section 56c by excluding from the computation those creditors holding claims of \$50 or less.¹³⁹

Without departing from the general policy underlying Section 64a(2) which limits the priorities for wages to those earned within three months of bankruptcy, an exception should be made to protect wage earners in cases where bankruptcy supersedes some prior insolvency proceeding. For example, if the debtor-employer files a bankruptcy petition his employees are protected by the second priority. If on the other hand, he makes a general assignment and almost four months later his creditors precipitate him into bankruptcy, the wage earners lose all or part

135. Before 1938 contingent claims were unprovable under § 63a and could not be the basis of an involuntary petition under § 59b. The Chandler Act made contingent claims provable under § 63a(8). The words "fixed as to liability" were added in § 59b to continue the old rule under that section. This language is criticized in Morgan, *Section 59b of the Chandler Act: An Impediment to Involuntary Bankruptcy Proceedings*, 37 ILL. L. REV. 215, 217-8 (1942).

136. *Analysis of H.R. 12889*, 74th Cong., 2d Sess. 184 (1936). See 3 COLLIER ¶ 59.14 (Supp. 1946).

137. Cf. Morgan, *op. cit. supra* note 135, at 217.

138. See *In re Central Illinois Oil & Refining Co.*, 133 F.2d 657, 660 (C.C.A. 7th 1943).

139. 3 COLLIER ¶ 59.20. See *Security Bank & Trust Co. v. Tarlton*, 294 Fed. 698 (W.D. Tenn. 1923), for an example of the plight of one large creditor where there are more than eleven other creditors with inconsequential claims. In that case the court refused to count the creditors with trifling claims. Other courts have counted such creditors because § 59e does not specifically exclude them. *E.g.*, *Grigsby-Grunow Co. v. Hieb Radio Supply Co.*, 71 F.2d 113 (C.C.A.8th 1934).

of their priority for wages, due solely to the shift from one liquidating forum to another.¹⁴⁰

Section 67d(3) needs restatement. This paragraph denounces as fraudulent any transfer made with intent to use the consideration to effect a voidable preference. The provision was written into the Act in 1938 as a purported restatement of the rule of *Dean v. Davis*,¹⁴¹ which presented an extreme situation. The debtor, fearing arrest because of forged notes which had been given to a bank persuaded his brother-in-law to take up the notes in return for the debtor's promise to mortgage all his property to secure the advance. The debtor was known by his brother-in-law to be hopelessly insolvent; due to acceleration clauses in the debtor's notes to his relative the latter had the right to proceed to enforce his mortgage immediately and did so. The Supreme Court stressed the fact that this was not a good faith commercial transaction to enable the debtor to continue his business, but a device to enable the debtor to make a preferential payment with bankruptcy in contemplation. Section 67d(3) literally embraces not only the *Dean v. Davis* situation but any situation where the debtor is insolvent, borrows money, and gives security, with the intent to use the money to pay off some of his unsecured creditors. This latter situation should not be denounced as fraudulent inasmuch as the debtor is making a bona fide attempt to carry on his business; insofar as he makes preferential payments Section 60 gives his creditors adequate protection. In one respect Section 67d(3) imposes an unsound limitation on the *Dean v. Davis* doctrine. The section requires the preferential payment to be voidable which means that the referee must have had reasonable cause to believe that the debtor was then insolvent. If the debtor mortgages his property in contemplation of bankruptcy with intent to use the proceeds to make preferential payments it should be wholly immaterial whether the preferences are voidable; if anything, the estate needs greater protection in the case where the preference is not voidable.

Section 67d(6) should be revised to afford the trustee the right to preserve a fraudulent lien for the benefit of the estate. Prior to the Chandler Act of 1938, former Section 67b gave the trustee a general right to preserve voidable liens.¹⁴² The Act of 1938 eliminated that

140. *E.g.*, *Strom v. Peikes*, 123 F.2d 1003 (C.C.A.2d 1941); *In re Ko-ed Tavern*, 129 F.2d 806 (C.C.A.3d 1942). Also desirable would be a corresponding amendment to the general priority statute, REV. STAT. § 3466 (1875), 31 U.S.C. § 191 (1940), which gives absolute priority to debts due the United States where the debtor is insolvent or the estate of the deceased debtor is insolvent. Wage claims given priority by state law should be allowed ahead of debts due the United States. The hardship produced by the present statute is illustrated by *United States v. Emory*, 314 U.S. 423 (1941).

141. 242 U.S. 438 (1917); 4 COLLIER ¶ 67.38.

142. 4 COLLIER ¶ 67.41. Former § 67f, which provided for the avoidance of liens obtained through judicial proceedings while the debtor was insolvent within the four-month

provision and gave the trustee a right to preserve both voidable preferential¹⁴³ and judicial liens;¹⁴⁴ it inadvertently failed, however, to give the trustee the same right to preserve liens voidable under Sections 67d and 70e.¹⁴⁵ The Conference proposes to cure this omission by an amendment of Section 70e, but fails to make a similar proposal as to Section 67d. A similar amendment of Section 67d(6) is in order.

A more summary and less elaborate corporate reorganization procedure should be afforded for small corporations. Superficially Chapter XI offers such a procedure,¹⁴⁶ but since under Chapter XI neither secured debt nor stockholders' interests can be affected¹⁴⁷ the chapter is largely abortive as to corporations. The small corporation which needs relief from secured debt and is such a going concern that it deserves rehabilitation rather than liquidation must come within the elaborate provisions of Chapter X.¹⁴⁸ And many corporations, large or small, which need relief only from unsecured debt, find Chapter XI a delusion. Under its provisions, the court is barred from dealing with stockholders' interests, and therefore the arrangement must be at the expense of creditors, to the advantage of stockholders, and hence cannot meet the absolute priority standard demanded by the requirement that the arrangement be fair and equitable.¹⁴⁹ Only where the stock is closely held and all the holders either can be said to contribute value in the form of experience or managerial talent to the concern or will voluntarily make other contributions can the arrangement meet the strict absolute priority test.¹⁵⁰ A small improvement can be made by incor-

period, also gave the trustee power to preserve the lien he had avoided for the benefit of the estate. The Chandler Act retained this provision, moving it to § 67a(3). Under the amendment of § 60b by the Act of 1938 the trustee is given comparable power to preserve avoidable preferential lien or title.

143. Section 60b. See note 142 *supra*; 3 COLLIER ¶ 60.65.

144. Section 67a(3). See note 142 *supra*; 4 COLLIER ¶ 67.16.

145. As to the omission in § 70e, see 4 COLLIER ¶ 70.92.

146. Under Chapter XI the debtor may be permitted to retain control of its property, § 342, must formulate a plan before the petition is filed, and submit it with the petition, § 323, and may solicit acceptances at any time. See Montgomery, *Chapter XI of the Bankruptcy Act*, 15 J. N. A. REF. BANKR. 16 (1940).

147. Sections 306 (1), 356, 357.

148. Among other things, a Chapter X petition must state "the specific facts showing the need for relief under this chapter and why adequate relief cannot be obtained under chapter XI of this Act." § 130(7). Sections 141 and 143 of chapter X require the judge to dismiss the petition if he is not satisfied that it was filed in good faith. Section 146 of Chapter X provides that a petition shall not be deemed to have been filed in good faith if, *inter alia*, adequate relief would be obtainable under Chapter XI or if "it is unreasonable to expect that a plan of reorganization can be effected." See also note 152 *infra* as to some of the safeguards provided by Chapter X. For a brief discussion of the relationship between Chapters X and XI, see 6 COLLIER ¶ 0.12.

149. *Securities and Exchange Comm'n v. United States Realty & Improvement Co.*, 310 U.S. 434 (1940), see note 8 *supra* and accompanying text.

150. *Case v. Los Angeles Lumber Products Co.*, 303 U.S. 106 (1939); see note 10 *supra* and accompanying text.

porating a provision in Chapter XI, comparable to Section 147 in Chapter X, to allow a corporate petition, improperly filed under Chapter XI because adequate relief can only be obtained in Chapter X, to be transferred to that chapter. But what is especially needed is to provide, within the framework of Chapter X, a summary method of reorganization for the small corporation that is comparable in speed and facility to the arrangement procedure of Chapter XI. A corporation whose scheduled indebtedness does not exceed, for example, \$3,000,000¹⁵¹ might well be treated as a small corporation, and allowed to remain in possession of its property, propose a plan and solicit acceptances immediately upon the initiation of the reorganization proceeding. Reference of the plan to the Securities and Exchange Commission for report could still be retained as a safeguard, but after the requisite acceptances of the plan are obtained a speedy confirmation hearing should be possible. Such a summary reorganization procedure should, of course, be made subject to the court's power to transform it into a regular reorganization, appoint an independent trustee, and have the plan formulated under all the present elaborate safeguards found in Chapter X.¹⁵² This chapter was written primarily with the large corporation in mind and its carefully designed provisions should not be relaxed as to such a corporation. They should also be held in reserve for the small corporation where there is evidence of managerial fraud, or where there is likelihood of overreaching on the part of any class of creditors or stockholders due to the financial complexities of the corporation. The time and expense demanded by the present reorganization procedure of Chapter X are justified in the case of the large corporation and for the small corporation just described. But a speedier and cheaper reorganization procedure should be available for the small and honestly managed corporation with a simple capital structure.

CONCLUSION

The Chandler Act of 1938 has proved to be an excellent piece of legislation, carefully conceived and well drafted. While no one doubts that this legislation can be improved, and that after ten years an undertak-

151. \$3,000,000 is the figure which determines whether the SEC shall pass on the plan under Chapter X. If the scheduled indebtedness exceeds that sum, the SEC must examine the plan and report on it. The judge may submit the plan to that agency even if the scheduled indebtedness is less than that amount. Section 172. This figure was apparently selected with a view to delineating the small cases in which "the situation is so simple that it is wholly manageable by the court." *Hearing before Committee on Judiciary on H.R. 6439*, 75th Cong., 1st Sess. 178 (1937). The figure was reduced from an original \$5,000,000, H.R. REP. No. 1409, 75th Cong., 1st Sess. 45 (1937).

152. These include the appointment of a disinterested trustee, § 156, an investigation of the affairs of the debtor, § 167, the formulation of a plan by the trustee, § 169, *cf.* § 168, examination of the plan by the SEC, §§ 172-3, and judicial regulation of creditors' committees, § 176.

ing of the task is in order, nevertheless the same unhurried and disinterested care should go into the amending process that went into the original formulation. Proponents of substantial change must assume the burden of demonstrating the desirability of their proposals. The bills to amend Section 60 are the product of unwarranted alarm, aid secret financing, and are an uncertain retreat to pre-Chandler days. The bona fide purchaser test as expounded by the Supreme Court in the *Klauder* case and by the Third Circuit in the *Rosen* case is sound and should be retained. The proposal to add as Section 70i a federal filing act for the assignment of accounts receivable is salutary in hitting at secret financing. The provisions of the tax bill are impracticable, but when put in feasible form they may be properly interwoven into an extensive revision. The Borah Act should be retained. The Conference's non-controversial amendments and those which we propose by way of supplementation can properly await the final completion of the overall revision. Piecemeal revision of the Bankruptcy Act is not desirable and an adequate overhauling of the Act is not feasible at this session of Congress.

APPENDIX

So-called non-controversial amendments proposed by H.R. 5693

(Where feasible, new matter is shown in italics.)

<i>Section amended</i>	<i>Proposed change</i>
	Definitions
1a (24)	"Petition" redefined to mean a document, filed with court or clerk, " <i>initiating a proceeding</i> " under the Act, and thus clearly includes an "original" petition under the reorganization and arrangement chapters.
(30)	"Transfer" expanded to include " <i>the retention of a security title to property delivered to a debtor.</i> " Purpose is to make preference section unequivocally applicable to conditional sales and similar security devices. This is not a change in the law as presently interpreted. 3 COLLIER ¶ 60.43; cf. ¶ 60.44.
	Creation of Courts of Bankruptcy and Their Jurisdiction
2a (21)	Turnover and accounting by non-bankruptcy receiver or trustee appointed more than four months prior to petition also to be required in proceedings under § 77; § 2a (21) now refers only to Chapters X and XII. Original omission of reference to § 77 was inadvertent.
	Duties of Bankrupts
7a (8)	Permits bankrupt to show either <i>place of business</i> or residence of creditor in his list of creditors.

Suits against Bankrupt

- 11a Proviso requiring vacating stay of suit against bankrupt if he has been adjudicated bankrupt, has been discharged or has had composition confirmed within six years, amended to require vacating stay only if bankrupt has been discharged or had composition confirmed in proceeding *commenced* within six years. Thus commencement of prior bankruptcy proceeding is determinative date, and adjudication as bankrupt is immaterial.

Granting of Discharge

- 14c (5) *Commencement* of prior proceeding resulting in discharge or confirmation of plan or composition within six years bars discharge. Thus commencement of prior proceeding, when rights of former creditors became fixed, is determinative date instead of actual discharge or confirmation.
- 14e Bankrupt's failure to appear at "hearing upon *the objections to his application for a discharge*," instead of "hearing upon his application for a discharge," bars discharge. Clarifying.

Process

- 18a Insofar as service is not specifically regulated by § 18a, it is to be made in the same manner as in "a civil action," instead of in "a suit in equity."

Evidence

- 21k Parties entitled to rights and remedies granted by "*Rules of Civil Procedure . . .*" instead of "rules of equity practice."

Offenses—Statute of Limitations

- 29d In case of concealment of assets, statute of limitations is made to run from *waiver or loss of right to discharge* as well as from granting of discharge. To cure an omission. 2 Collier ¶ 29.14.

Duties of Referees

- 39a (9) Eliminates requirement that referee report completion of arrangements and wage earner plans to court. Clarifying changes also.

Records of Referees

- 42a Requires records to be kept as prescribed by Supreme Court instead of as "kept in equity cases." The better approach would have been to give the power of prescription to the Director of the Administrative Office of the United States Courts, subject to the approval of the Judicial Conference of Senior Circuit Judges, in line with Federal Rule 79(a).

Proof and Allowance of Claims

- 57j (1) (Newly numbered.) Interest on debt due state or federal government for amount of pecuniary loss sustained by government in transaction out of which penalty or forfeiture arose not allowed after bankruptcy.
- (2) (New paragraph.) Interest on taxes not allowed after bankruptcy; except where estate is solvent. This exception might properly be made applicable also to paragraph (1), although it is

not too important since the debts embraced therein are not dischargeable under § 17. 1 COLLIER §§ 17.05, 17.13. The proposed change in the law as to interest on taxes is clarifying and in line with a sound, but not judicially accepted, construction of the present Act. 3 COLLIER § 63.16.

- 57n " . . . except in proceedings under Chapters X, XI, XII, and XIII of this Act" infants and insane persons without guardians, and without notice of bankruptcy proceeding, now have six additional months to file claims. The "except" clause is deleted as useless and perhaps confusing due to the general inapplicability of § 57n to the proceedings covered by it.

Notices

- 58a (8) Creditors to be given notice of applications by "*committees*" for compensation for services rendered as well as applications by receivers, ancillary receivers, marshals, trustees and attorneys.

Debts Which May Be Proved

- 63c A verbal change is made to conform to the redefinition of "petition" in § 1a(24).

Debts Which Have Priority

- 64a (1) Filing fees advanced to a voluntary bankrupt are made reimbursable and accorded a first priority. Expenses incurred by the trustee "*in connection with the criminal prosecution of an offense punishable under this Act or an offense concerning the business or property of the bankrupt punishable under other laws, federal or state*" are made compensable and given first priority. This meshes with present § 29e(1) and is clarifying. Where in a proceeding under another chapter of the Act it is ordered that bankruptcy be proceeded with, expenses of the ensuing bankruptcy are given priority over unpaid administration costs and expenses of the superseded proceeding and suspended bankruptcy proceeding, if any. This changes the present law, 6 COLLIER § 12.05[4], and probably is desirable as promoting an effective final consummation of the proceeding.

- 64b Repealed because of its inadequacies. See 3 COLLIER § 64.601 and Supplement. Thus priority is eliminated of debts contracted between grant of a discharge and subsequent revocation. Section 64b accorded a priority to debts contracted in the interim between the confirmation of an arrangement and its annulment. This problem is now dealt with by new §§ 239, 379, 484, and 668, *infra*.

Liens and Fraudulent Transfers

- 67a (1), (2), b, c Subdivisions a, b, and c deal respectively with the avoidance of judicial liens, the recognition of statutory liens, and the subordination and restriction in the amount of payment of statutory liens in certain very limited situations. Verbal changes are made in these subdivisions to conform to the redefinition of "petition" by § 1a(24). H.R. 5829 would amend § 67c to invalidate unenforced liens on personal property unaccompanied by possession, except liens for taxes, wages, and rent. See p. 701 *supra*.

67d (2), (3), (4), (5) Subdivision d deals with fraudulent transfers and, with the exception of paragraphs (3) and (5), is a substantial adaptation of the Uniform Fraudulent Conveyance Act. 4 COLLIER ¶¶ 67.29, 67.38, 67.40. Paragraph (3) is supposedly a restatement of the rule of *Dean v. Davis*. See p. 714, *supra*. Verbal changes are made in paragraphs (2)–(5) to conform them to the redefinition of “petition” by § 1a(24). Paragraph (5) states when a fraudulent transfer is deemed perfected. The words “and no creditor” are deleted from the bona fide purchaser and creditor perfection test since a fraudulent transfer is never perfected as against a creditor until the statute of limitations has barred creditor relief. Thus a transfer is deemed made when it becomes so far perfected that no bona fide purchaser from the debtor can obtain rights in the property superior to the transferee, or, if not so perfected, then immediately before the initiation of a proceeding under the Act. If this change is to be made here then a similar change should be made in § 3b dealing with the running of the four-month period relative to the first act of bankruptcy—a fraudulent transfer. See p. 709, *supra*. There is still a failure to provide that the trustee may preserve the transfer or obligation for the benefit of the estate as he may presently do under §§ 60b, and 67a(3), and as it is proposed to allow him to do under amended § 70e(2), *infra*. See pp. 714–15, *supra*.

Taking Possession of Property

69d Conformed to § 2a(21) by including “an assignee for the benefit of creditors of a bankrupt, or an agent authorized to take possession of or to liquidate any of the property of a bankrupt” as among those who must account to the bankruptcy court. This is only a clear statement as to what was the necessary intent of the Act. 4 COLLIER ¶ 69.06, n.1.

Title to Property

- 70a A verbal change is made relative to the time when the trustee's title vests to conform the subdivision to the redefinition of “petition” by § 1a (24).
- 70e (2) Subdivision e allows the trustee to invalidate a transfer or obligation which, under federal or state law (normally the latter), is voidable by a creditor having a claim provable in bankruptcy. The amendment would allow the trustee to preserve the transfer or obligation for the benefit of the estate and thus cure, in part, an omission in the present Act. See 4 COLLIER 354, 1501.
- 70h Repealed. Subdivision “i” relettered to read “h.” Present subdivision h, which is marked for repeal along with present § 64b, provides that when an arrangement or wage-earner plan is set aside, or discharge revoked, the trustee, upon appointment and qualification, is vested with title to the bankrupt's property as of the date of the final decree setting aside the arrangement or wage-earner plan or revoking the discharge. Where confirmation of an arrangement under either Chapter XI, XII or XIII is set aside and an order entered directing that bankruptcy be proceeded with, new §§ 379, 484, and 668 vest the trustee with title to the debtor's property as of that time. New § 239 is not clear as to the bankruptcy trustee's title where a corporate reorganization plan is not

finally consummated. Presumably he would take title to property of the debtor at the time the proceeding was first initiated and also to property acquired by the reorganization trustee or the debtor continued in possession, as the case may be, between the time the proceeding was initiated and the time when the order is entered directing that bankruptcy be proceeded with. See 6 COLLIER ¶¶ 8.04, 12.05[2], [3]. But this matter could properly be clarified. Where a discharge is revoked the fair inference from the repeal of §§ 64b and 70h is that the trustee, if there still be one, does not take title to property acquired by the debtor subsequent to bankruptcy and that creditors whose claims arose during the interim between bankruptcy and revocation do not have provable claims, except to the very limited extent stated in § 63b, and hence do not share in the distribution.

Relettering subdivisions and renumbering sections is ill-advised mechanically; it makes references to sections and subdivisions in cases and secondary materials obsolete and confusing. Here no subdivision should be substituted for "h", "i" should be left alone, and, if an accounts receivable filing act is to be added as proposed in the Conference preference bill, see pp. 695-6 *supra*, it should be lettered "j." This criticism applies to the proposed renumbering of §§ 379 and 380, and 484 and 485, and 668.

CHAPTER X. CORPORATE REORGANIZATIONS

Confirmation of Plan by Court

- 221b Newly added subdivision b provides that court shall, after proper notice, fix a time when the trustee or debtor in possession shall cease to operate the business, and when the debtor or other corporation designated in the plan shall commence operation. In the words of Mr. Gerdes it is highly desirable that there be a definite time "at which rights vest under the plan sufficiently to make it equitable: (1) to compel those who extend new credit to the reorganized debtor or new entity to look to such reorganized debtor or new entity for the satisfaction of their claims instead of giving such creditors the preferred status of holders of debts of administration of the estate; and (2) to cut off further right to amend or modify the plan as to matters materially and adversely affecting the rights of creditors or stockholders by the ordinary procedure for the amendment of a plan under section 222." *N. B. C. Committee Print* 49-50 (1948). The newly added subdivision b to § 221, the amendment to § 222, and new § 239 provide the definite time and resolve the conflicting approaches created in the Equitable Building reorganization. See *Knight v. Wertheim & Co.*, 158 F.2d 838 (C. C. A. 2d 1946).

Alteration or Moderation of Plan

- 222 Time to materially alter or modify a plan made to end at date fixed in § 221b. This changes the present law, see 6 COLLIER ¶ 11.11, for the reasons stated under § 221b, *supra*. A clarifying change is also made relative to a non-material alteration or modification.
- 238 (3) Allowance of Claims After Order to Proceed with Bankruptcy
Filing period for claims not already filed changed from three to six months after first date set for first meeting of creditors. This conforms to § 57n.

239 Effect of Order to Proceed with Bankruptcy—Unsecured Debts
(New section.) When after final time fixed under § 221b, judge orders bankruptcy proceeded with, unsecured debts incurred after time fixed in order under § 221b share on parity with prior unsecured debts of the same class that are provable in bankruptcy; the amount of these prior debts is reduced to the amount provided for them in the plan. Chapters I to VII of Act, so far as consistent with this section, are made applicable to determine rights and liabilities of creditors who incurred debts after time fixed in order under § 221b; for purposes of such application, order directing that bankruptcy be proceeded with is regarded as date of bankruptcy.

Orders to Be Transmitted to Securities
and Exchange Commission

265a (11) Clarifying change.

CHAPTER XI. ARRANGEMENTS

355 Allowance of Claims upon Order to Proceed with Bankruptcy
Filing period for claims not already filed changed from three to *six* months after first date set for first meeting of creditors. This conforms to § 57n.

379 and 380 No Adjudication against Wage Earner or Farmer without
Consent and Final Decree upon Dismissal of Petition
Renumbered to read "380" and "381". For criticism see under § 70h *supra*.

379 Effect of Order to Proceed with Bankruptcy
(New Section.) Paragraph (1) replaces what is needed to be saved from § 70h, repealed, and provides that where after confirmation of arrangement, court orders bankruptcy proceeded with, trustees is vested with title to debtor's property as of date of entry of order. Paragraph (2) replaces, at the revised level of sharing in the bankruptcy distribution, debts incurred after confirmation (matter formerly dealt with by § 64b, repealed); and paragraph (3) makes provisions of Chapters I to VII of the Act generally applicable. These two paragraphs are patterned upon § 239, *supra*.

CHAPTER XII. REAL PROPERTY ARRANGEMENTS BY PERSONS OTHER THAN CORPORATIONS

459 Allowance of Claims upon Order to Proceed with Bankruptcy
Filing period for claims not already filed changed from three to *six* months after first date set for first meeting of creditors. This conforms to § 57n.

484 and 485 No Adjudication against Wage Earner or Farmer without
Consent and Final Decree upon Dismissal of Petition
Renumbered to read "485" and "486." For criticism see under § 70h *supra*.

484 Effect of Order to Proceed with Bankruptcy
(New Section.) Identical to new § 379, *supra*.

CHAPTER XIII. WAGE EARNERS' PLANS

- 644 Allowance of Claims upon Order to Proceed with Bankruptcy
Filing period for claims not already filed changed from three to six months after first date set for first meeting of creditors. This conforms to § 57n.
- 668 Exclusive Method of Adjudication
Renumbered to read "669." For criticism of renumbering see under § 70h *supra*.
- 668 Effect of Order to Proceed with Bankruptcy
(New Section.) Except for substituting the word "plan" for "arrangement" the new section is identical to §§ 379 and 484, *supra*.