NOTES AND COMMENTS

BANKRUPTCY

BANKRUPTCY PREFERENCES — TIME OF DETERMINING — VOIDABILITY

Sections 60 (a) and 60 (b) of the Bankruptcy Act, 11 U.S.C.A. 96 (a) and 96 (b) deal with preferences. Sec. 60 (a) defines a preference and Sec. 60 (b) lays down the test for determining whether or not the preference is voidable at the instance of the trustee in bankruptcy. In *Palmer Clay Products* v. *Brown*, 80 L.Ed. 466, 56 S. Ct. 450 (1936) a payment on account was received by a creditor within four months of the bankruptcy of the debtor, at a time when the debtor could have paid all his creditors the same proportion of their claims. It was held that the payment was preferential.

Where the transfer is for a present consideration it cannot operate as a preference, even though the debtor is then insolvent, for the estate of the bankrupt would not be diminished or depleted to the prejudice of the creditors. *Samples* v. *Getman-McDonnell-Summers Drug Co. et al.* 14 Fed. (2d) 170 (D.C. Okl. 1926); *Johnson* v. *Burke Manor Bldg. Corp.* 48 Fed. (2d) 1031 (C.C.A. 7th 1931); *In re Finley* 6 Fed. Supp. 105 (D.C. N.C. 1933); *Goldstein* v. *Rusch* 56 Fed. (2d) 10 (C.C.A. 2d 1932); *McClure* v. *Heim-Overly Realty Co.* 71 Fed. (2d) 100 (C.C.A. 8th 1934).

When a transfer is made for a past consideration, three theories have been advanced for determining whether or not a preference is created. 3 U. of Ch. L. Rev. 138; 20 Va. L. Rev. 583. One line of cases has held that no preference has been given if at the time of the transfer the debtor could have paid all the other creditors of the same class the same proportion of their claims, *Haas* v.*Sachs* 68 Fed. (2d) 623 (C.C.A. 8th 1933);*Doggett* v. *Chelsea Trust Co.* 73 Fed. (2d) 614 (C.C.A. 1st 1934); *Latrobe et al. v. J. H. Cross Co.* 29 Fed. (2d) 210 (D.C. Pa. 1928). Other courts have held such a transfer to be preferential if it would be so at the time the insolvent was adjudged bankrupt. *Commerce-Guardian Trust & Savings Bank* v. *Delvin* 6 Fed. (2d) 518 (C.C.A. 6th 1925); *Swift* v. *Higgins* 72 Fed. (2d) 791 (C.C.A. 9th 1934). And it has been argued that the preferential character should be determined at the date of final distribution of

the bankrupt estate. See *W. S. Peck & Co.* v. *Whittmer*, 231 Fed. 893 (C.C.A. 8th 1916); *Slayton* v. *Drown*, 93 Vt. 290, 170 Atl. 307 (1919); Remington, 3rd Ed. Sec. 1813, 20 Va. L. Rev. 583.

The *Palmer* case, has settled this conflict, the court there saying: "Whether a creditor has received a preference is to be determined, not by what the situation would have been if the debtor's assets had been liquidated and distributed among his creditors at the time the alleged preferential payment was made, but by the actual effect of the payment as determined when bankruptcy results." This decision, however, will be nullified, if a bill now in the Judiciary Committee of the House of Representatives becomes law. This bill, H.R. 10382, in effect adopts the third theory set out above that the preferential character should be determined at the date of final distribution of the bankrupt estate.

A closely related problem of preferences was presented in *Hartford Accident & Indemnity Co.* v. *Coggin*, 78 Fed. (2d) 471 (C.C.A. 4th, 1933) where an unrecorded mortgage was given in North Carolina more than four months before bankruptcy. Recording was made or possession was delivered within four months. The state law permitted but did not require recording except as to judgment creditors or subsequent purchasers without notice. The court held that the transfer could not be avoided by the trustee in bankruptcy. While such a preferential transfer is an act of bankruptcy under Sec. 3 (a) 2, 11 U.S.C.A. 21 (a) 2, and is actionable for a period of four months subsequent to the possession or recording under Sec. 3 (b), 11 U.S.C.A. 21 (b), Collier on Bankruptcy, 3rd Ed., p. 182b; Glenn on Liquidation, Sec. 199; c.f., Remmington on Bankruptcy 4th Ed., Sec. 197, it is not so clear that it is voidable under Sec. 60 (b). This section provides that, "If a bankrupt shall . . . . have made a transfer of any of his property, and if at the time of the transfer . . . . or of the recording or registering of the transfer if by law recording or registering thereof is required, and the transfer shall then operate as a preference, it shall be voidable by the trustee."

In *Carey* v. *Donohue*, 240 U.S. 430, 36 S. Ct. 386, 60 L. Ed. 726, L.R.A. 1917A 295 (1916), it was said that unless recording was required in order to make a transfer valid as against those concerned in the distribution of the bankrupt's estate, that is, as against creditors including those whose position the trustee is entitled to take by virtue of Sec. 47 (a) 2, 11 U.S.C.A. 75 (a) 2, such a transfer cannot be avoided if made prior to the four months period.

At the time of the *Carey* v. *Donohue* decision and until 1926, sections 60 (a) and 60 (b) read alike in that neither section had any

provision as to permissive recording. In 1926 Congress amended section 60 (a) to provide for permissive recording. By its terms Sec. 60 (a) refers only to the running of the four months period in identifying the transfer as a preference. It does not state what preferences are voidable. Accordingly, the provision regarding required recording in Sec. 60 (b), which alone states what preferential transfers are voidable, is not affected by the broadening of the scope of Sec. 60 (a) to include permissive recording. If in fact the greater power to avoid preferences now exists in favor of the trustee, by virtue of the amendment to Sec. 60 (a), it does not appear to have been successfully exercised. The reported cases with some few exceptions, stay well within the rule of *Cary* v. *Donohue, supra. Stover* v. *Valley Nat. Bank,* 48 Fed. (2d) 54 (C.C.A. 3rd 1931); *Bank of Wadesboro* v. *Little* 71 Fed. (2d) 513 (C.C.A. 4th 1934); *Northern Bond & Mortgage Co.* v. *King,* 24 Fed. (2d), 156 (C.C.A. 7th 1928); *In re Gibson et al,* 65 Fed. (2d) 921 (C.C.A. 6th 1933); *In re Cunningham* 64 Fed. (2d) 296 (C.C.A. 4th 1933); *First Nat. Bank of Lincoln* v. *Live Stock Nat. Bank* 31 Fed. (2d) 416 (C.C.A. 8th 1929); *Lewis* v. *Ornstein* 12 Fed. (2d) 652 (C.C.A. 2nd 1926); *Credito Y Ahorro Ponceno* v. *Gorbia,* 25 Fed. (2d) 817 (C.C.A. 1st 1928); McLaughlin, Amendments of the Bankruptcy Act, 40 Harv. L. Rev. 374, 377.

As stated above, a few courts have refused to follow the rule of the Carey case. They contend that sections 60 (a) and (b) should be read together. This contention leads to the result that, where recording of a transfer is permitted by state law, the transfer is voidable by the trustee, if recording is so delayed as to take place within four months of filing the petition in bankruptcy. These courts say that unless such a construction is given to the 1926 amendment to Sec. 60 (a) it is a nullity. *In re Jackson,* (Dist. Ct., W.D. Ark. Fort Smith Div.) 9 Fed. Supp. 719 (1935); *Matter of Bowles* (Ref., Dist. Ct. Nebr. Omaha Div.) 14 Am. B.R. (N.S.) 133 (1928), and see *Foltz* v. *Davis* 68 Fed. (2d) 495 (C.C.A. 7th 1934); and *Matter of Wood* (Western Div. of Texas, Ref.) 21 Am. B.R. (N.S.) 502 (1932). The effect of the proposed legislation H.R. 10382, *supra,* is the adoption of this minority holding.

The *Hartford* case, therefore, in holding that a preferential transfer made prior to four months of filing the petition in bankruptcy but recorded on possession taken within four months of such filing is not voidable by the trustee in bankruptcy, though the North Carolina law permitted recording, follows the rule of the *Carey* case and is in line with the majority of the cases in point.

No other section of the Bankruptcy Act seems available to the trustee. If the transfer has been effected prior to bankruptcy, he has no lien under Sec. 47 (a) 2; and his derivative powers under Sec. 70 (e), 11 U.S.C.A. 107 (e), to exercise the rights of creditors under state law would be applicable only to transfers made prior to four months of bankruptcy and voidable under state law.

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JUSTIN H. FOLKERTH.

PRIORITY OF MUNICIPAL CORPORATIONS IN BANKRUPTCY

The City of Lincoln, Nebraska, a municipal corporation, sought priority in its claim of $45,000 with interest against the Lincoln Trust Company, bankrupt. The City based its contention on Sec. 64b(7) of the Bankruptcy Act and also claimed that the bankrupt had custody of the fund as a trust fund. The district court and the circuit court decided that the city was not within Sec. 64b(7) and the circuit court held that there was no trust fund. *Held:* that a city as a municipal corporation is entitled to priority under Sec. 64b(7) if as a matter of local law the municipality was accorded priority. The case was remanded to try the issue of local law. *City of Lincoln, Neb. et al.* v. *L. A. Ricketts, Trustee, etc.*, 56 S. Ct. 507 (U.S. Law Wk. Mar. 3, 1936, Index 607).

For an adequate understanding of this problem, the history of state and federal priority in bankruptcy is necessary. The United States is accorded priority in insolvent debtor's estates by R.S. Sec. 3466-67 (31 U.S.C.A. 191-192) and sureties are subrogated to this priority by R.S. Sec. 3468 (31 U.S.C.A. 193). This statute is the same in substance as that passed as early as 1797. It has been held that the United States has no sovereign prerogative of priority but its priority is derived solely from Congressional enactment. *United States* v. *The State Bank of North Carolina*, 6 Pet. 29, 8 L. Ed. 308 (1832). The Supreme Court has held that R.S. Sec. 3466-68 is in *pari materia* with the Bankruptcy Act and that the Bankruptcy Act of 1898 relegates the priority of R.S. Sec. 3466-68, if recognized at all in bankruptcy (which point the court did not have to decide under the circumstances), to fifth place in payment of claims under Sec. 64b(5) of the Bankruptcy Act of 1898 (Now 64b(7). *Guarantee Title and Trust Co.* v. *Title Guarantee and Surety Co.*, 224 U.S. 152 (1912).

Contrary to the view of some writers and lower courts, but support-