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THE TRUSTEE IN BANKRUPTCY AS A SECURED CREDITOR UNDER THE UNIFORM COMMERCIAL CODE

*Frank R. Kennedy**

SUPPOSE A and B both have security interests in property of their common debtor D; A's rights are superior to B's; and D is bankrupt:

(1) If neither A's security interest nor that of B can be avoided on a direct attack by the trustee under the Bankruptcy Act, should A's priority over B outside of bankruptcy enable the trustee to defeat B's security interest in bankruptcy?

(2) If A's security interest can be avoided by the trustee but B's cannot, can the trustee by asserting A's rights against B avoid B's rights without regard to the amount of A's secured debt or the value of the collateral?

A negative answer to both questions has always seemed to me to be the only one compatible with the underlying assumptions of the Bankruptcy Act and one that accords a fair respect to the rights of secured creditors. From time to time, however, there have appeared in print suggestions that an affirmative answer can be given.[1] In par-

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I wish to acknowledge the assistance given me by Mr. A. Rodriguez Bautista, LL.B., University of the Philippines; LL.M., University of Michigan; and now a third-year student in the University of Michigan School of Law, in the preparation of this article.

A special acknowledgment to the late Professor James A. MacLachlan is also appropriate here. As is pointed out in the text accompanying note 24 *infra*, this article is essentially an elaboration of a position he had taken and supported in his treatise on Bankruptcy in 1956. I had intended to show him my manuscript before its publication in this symposium so that it might have the benefit of his critical examination. A tragic accident on April 17, 1967, took his life and prevented my submission of the paper for his scrutiny and suggestions. I am nevertheless deeply indebted to him for the contributions he unknowingly made to this study.

1. See, *e.g.*, COUNTRYMAN, CASES ON DEBTOR AND CREDITOR 453, 489 (1964); Coleman, *The Uniform Commercial Code Applied in Bankruptcy: A Few Important Problems*, 19 ALA. L. REV. 59, 62 (1966); Comment, 39 TEX. L. REV. 616, 620-21 (1961).

Professor Countryman, in a note following Lewis v. Manufacturers Nat'l Bank, 364 U.S. 603 (1961), states:

> [W]here the only consequence of delay in filing is to invalidate a chattel mortgage as to creditors who acquire a lien before filing, and the mortgage is filed before bankruptcy, § 70c will not avail the trustee—and neither will § 70e unless an actual creditor with a provable claim acquired a lien before filing. In re Consorto Construction Co., 212 F.2d 676 (3d Cir. 1954), cert. denied, 348 U.S. 833 (1954).

Actually a United States tax lien and a Pennsylvania lien for unpaid corporation taxes were perfected during the interim between execution and recording of the chattel mortgage under attack in *Consorto*. 212 F.2d at 677. Professor Countryman cites cases holding tax claims to be provable at pp. 506 and 672-73 of his casebook. The possibility

ticular it has been argued that a trustee may avoid utterly any perfected security interest that is subordinated by the Uniform Commercial Code (Code) to the lien of any creditor with a provable claim.[2]

This argument rests on three propositions that are in themselves sound enough:

(1) The trustee is entitled to assert the right of any actual creditor with a provable claim to avoid a security interest (or any other transfer) under section 70e of the act.

(2) The fact that a creditor is secured does not make his claim nonprovable.

(3) Under the doctrine of *Moore v. Bay*,[3] the right of the trustee to avoid a transfer under section 70e is not limited by the amount of the claim of the creditor whose right of avoidance is being enforced.

The thesis of this article is that a trustee cannot exploit the advantage of the lien or security of any creditor *unless* he can avoid it and displace a creditor. Moreover, when he can and does avoid a lien and displace a creditor, he can enforce the rights of that creditor as against any lien or interest otherwise indefeasible in bankruptcy *only* to the extent of the lien or security of the creditor he displaces.

I. The Doctrine of *Moore v. Bay*

Section 70e of the Bankruptcy Act reads in pertinent part as follows:

> A transfer made or suffered . . . by a debtor adjudged a bank-

that the trustee could have utilized the priority of the tax lienors to defeat the chattel mortgage was nevertheless not adverted to in *Consorto*.

Although the commentator in the *Texas Law Review* could find no cases to support his suggestion, he thought it "reasonably clear" that the trustee could avoid a federal tax lien otherwise indefeasible under § 70e if a creditor with a provable claim was also a judgment creditor, mortgagee, pledgee, or purchaser protected by § 6323 of the Internal Revenue Code of 1954. This reasoning would afford the trustee an effective remedy whenever he can find a creditor with a provable claim who is one of the many varieties of persons protected by the Federal Tax Lien Act of 1966. 80 Stat. 1125 (1966), 26 U.S.C.A. § 6323 (Supp. 1967). The commentator does not say whether the judgment creditor, mortgagee, pledgee, or purchaser would be displaced when the trustee asserts his rights in bankruptcy or whether the trustee can effectively assert the rights of the protected person only when there is a surplus.

2. Professor Riesenfeld has recently put the matter as follows:

> A contract creditor who succeeds in squeezing in an attachment lien under section 9-301(1)(b) or (2) will supply the trustee with *Moore v. Bay* powers. Although the creditor is secured and his claim is not allowable, it is a provable claim as required by section 70(e) of the Bankruptcy Act.

Riesenfeld, Book Review, 54 Calif. L. Rev. 1854, 1857 (1966); *accord*, 4 Collier, Bankruptcy ¶ 70.62, at 1494.23 n.86 & 1494.24 (14th ed. rev. 1964) [hereinafter cited as Collier]; 2 Hawkland, A Transactional Guide to the Uniform Commercial Code 683, 695 (1964).

3. 284 U.S. 4 (1931).

rupt under this Act which, under any Federal or State law applicable thereto, is . . . voidable for any . . . reason by any creditor of the debtor, having a claim provable under this Act, shall be null and void as against the trustee of such debtor.

Moore v. Bay[4] involved an avoidance by a trustee of a belatedly recorded chattel mortgage which was voidable under California law only by creditors who extended credit before the recordation. The lower courts had given the mortgage priority over creditors who extended credit after recordation. In a cryptic opinion reversing the decree below, Mr. Justice Holmes said:

> The trustee in bankruptcy gets the title to all property which has been transferred by the bankrupt in fraud of creditors or which prior to the petition he could by any means have transferred, or which might have been levied upon and sold under judicial process against him. Act of July 1, 1898, c. 541, sec. 70. By section 67a claims which for want of record or for other reasons would not have been valid liens as against the claims of the creditors of the bankrupt shall not be liens against his estate. The rights of the trustee by subrogation are to be enforced for the benefit of the estate.[5]

The above quotation was all the Court said about the trustee's right to avoid the chattel mortgage in the case. The first sentence is an oversimplified summary of section 70a of the act. The last sentence quoted is a restatement of the substance of former section 67b. A single sentence was added at the end of the two-paragraph opinion to deal with the distribution of "what thus is recovered for the benefit of the estate." No question has ever been raised as to the correctness of the disposition of this latter issue. However, critics of the decision who believe that the Court failed to realize that this was not the only issue are afforded considerable support by the opinion itself.[6]

In any event, the case now stands for the proposition that if the trustee can find one qualified creditor in a position to avoid a transfer of the bankrupt's property, the trustee's right is not limited by the amount of that creditor's claim.[7] Insofar as section 70e endows the trustee with the standing of a subrogee, the foregoing statement of the doctrine of *Moore v. Bay* contravenes a fundamental attribute of subrogation—that the person subrogated acquires no greater rights than those of the person to whose position he is subrogated.[8] That

4. *Ibid.*
5. Moore v. Bay, 284 U.S. 4, 5 (1931).
6. See MACLACHLAN, BANKRUPTCY 331 (1956) [hereinafter cited as MACLACHLAN]; Scott, *The Meaning of the Provisions for Recordation of a Transfer as Applicable to Preference Under the Bankruptcy Act and a Critique of the Decision of the United States Supreme Court in the Case of Moore v. Bay*, 18 VA. L. REV. 249, 266 (1932).
7. 4 COLLIER ¶ 70.95 (1959).
8. Scott, *supra* note 6, at 267.

indeed is one of the unanswerable criticisms that can be made of the doctrine, but *Moore v. Bay* has survived well laid attacks on its illogicality as well as its inequity,[9] and this paper is not intended to renew them. The argument here is a more modest one, namely, that the anomalous doctrine should not be extended. It is extremely awkward to argue that an illogical rule ought to be circumscribed by considerations of a logical character, but that is the view that this article will seek to sustain.

In attempting to understand the operation of section 70e, students are often confused by statements which indicate that, although a general creditor may attack a belatedly perfected security interest, he must first obtain a lien through judicial proceedings. Such statements are frequently encountered in discussions of the pre-Code law of California, Michigan, New York, and other states where creditors extending credit before perfection of a security interest could nevertheless levy on the property after perfection.[10] It was in such states

9. The doctrine has not lacked defenders. See, *e.g.*, 2 GLENN, FRAUDULENT CONVEYANCES AND PREFERENCES 866-67 (rev. ed. 1940); Schwartz, *Moore v. Bay—Should Its Rule Be Abolished?*, 29 REF. J. 67 (1955); Comment, 17 ARK. L. REV. 46, 56 (1962); 45 YALE L.J. 504, 506 (1936). The doctrine relieves the trustee of the burden of justifying the full measure of relief sought under § 70e by proving the identity of all the creditors who could have avoided a transfer but for bankruptcy and proving the amounts of their claims. Moreover, the doctrine has implemented the bankruptcy policy of hostility to secret liens.

The commentator in the *Arkansas Law Review*, cited *supra*, adds that if the creditor to whose position the trustee is subrogated under § 70e gets only a pro rata share of the recovery, "this creditor would justifiably feel shortchanged if a pro tanto recovery in his favor was then distributed among all claimants, leaving him with only a fraction of what he would have recovered had it not been for the intervention of bankruptcy." 17 ARK. L. REV. at 56. The fact of the matter is that, irrespective of the amount of the trustee's recovery under § 70e, any general creditor is not likely to receive a substantial distribution in bankruptcy. All claims entitled to priority under § 64 must be paid in full before anything is available for creditors without priority, and all the general creditors are then required to share pro rata in the balance, if any. In any event the disappointed expectations of the creditor who furnished the trustee his right of avoidance are not a rational justification for enlarging the trustee's right of recovery at the expense of the transferee for the benefit of persons not falling within the ambit of protection of the nonbankruptcy law invoked by the trustee under § 70e.

10. See, *e.g.*, Noyes v. Bank of Italy, 206 Cal. 266, 269-70, 274 Pac. 68, 70 (1929); Ransom & Randolph Co. v. Moore, 272 Mich. 31, 37, 261 N.W. 128, 130 (1935); Button v. Rathbone, Sard & Co., 126 N.Y. 187, 191, 27 N.E. 266, 267 (1891).

Such statements involved no contradiction or confusion in purpose. As the Supreme Court of Michigan explained in Dempsey v. Pforzheimer, 86 Mich. 652, 656, 49 N.W. 465, 466-67 (1891):

> The gist of the reason is that the creditor has no business with the debtor's property until he has obtained possession of it by some legal process that gives him a lien upon it. . . . [S]uch creditors [of the mortgagor] have no right to touch the debtor's property without his consent, without legal process . . . .

Professor Marsh has suggested that the California court in *Noyes* seemed to have "adopted a wholly untenable construction of section 70c of the Bankruptcy Act, *i.e.*, that the trustee could claim to be a creditor who acquired a lien as of some date prior to bankruptcy." Marsh, *Constance v. Harvey—The "Strong-Arm Clause" Re-Evaluated*, 43 CALIF. L. REV. 65, 69 n.20 (1955). On the contrary, the court explicitly recognized "that the trustee acquired a lien status as of the time when the petition in bankruptcy

that *Moore v. Bay* had its principal utility for the trustee. As Professor Gilmore explains:

> [W]e assumed Justice Holmes would have said in *Moore v. Bay* if he had dotted his i's and crossed his t's: § 70(c) merely supplements § 70(e) by conferring lien status on the trustee in his representation of existing or actual creditors if applicable state law provides that only lien creditors can avoid the challenged transaction.[11]

This is not to say, however, that the trustee *must* show that he represents an existing or actual creditor in order to avoid an unperfected security interest under the Code. When the applicable state law invalidates or subordinates a security interest at the instance of a creditor who obtains a lien by judicial proceedings without regard to the date or other circumstances attending the extension of credit, the trustee prevails under section 70c without more.[12]

As an original matter, there is much to be said for the rule that permitted any creditor who extended credit during a period of delay in the perfection of a security interest in the debtor's property to prevail over that interest notwithstanding the fact that perfection preceded the creditor's levy.[13] It ran a good idea into the ground, however, to invalidate a security interest in toto for the benefit of all the unsecured creditors because of a delay which was presumptively prej-

was filed." Noyes v. Bank of Italy, *supra* at 269-70, 274 Pac. at 70. The trustee represented actual creditors whose claims arose before the belated perfection of the mortgage.

11. 2 GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY 1295 (1965) [hereinafter cited as GILMORE]. Professor Riesenfeld submitted a proposal to the National Bankruptcy Conference in 1956 which would have in substance codified the view of the trustee's status under § 70c and e presented in the text. 1956 NATIONAL BANKRUPTCY CONFERENCE SUMMARY OF PROCEEDINGS OF ANNUAL MEETING 68. The Conference approved the proposal in principle. *Id.* at 14. The proposal was not presented to Congress for enactment, presumably because legislation was not thought to be necessary to establish the rule.

12. See 4 COLLIER ¶ 70.51, at 1429 (1959). The Pre-Code law of Washington construed in Pacific Fin. Corp. v. Edwards, 304 F.2d 224 (9th Cir. 1962), allowed only subsequent creditors to take advantage of a delay in the perfection of a conditional sale, and the court rejected an attack on a belatedly filed conditional sale of an automobile to the bankrupt because the trustee could find no actual creditor who had extended credit to the bankrupt after the sale. This kind of problem is avoided by Article Nine of the Code in that a lien creditor is protected against an unperfected security interest without regard to the date of extension of the credit by the lien creditor. See U.C.C. §§ 9-301(1)(b), 9-313(4)(b) & 9-314(3)(b).

13. Any perfection requirement that assures some form of notice to creditors would seem best to serve its purpose if compliance occurs before the creditor changes his position by extending credit. See Project, *California Chattel Security and Article Nine of the Uniform Commercial Code*, 8 U.C.L.A.L. REV. 806, 899 (1961). This was the premise of the pre-Code Michigan law. See, *e.g.*, Ransom & Randolph Co. v. Moore, 272 Mich. 31, 261 N.W. 128 (1935), 14 MICH. ST. B.J. 422 (1935). The case for protecting a creditor who acquired his claim before the execution of the security interest against delay in its perfection was certainly less cogent. The classic explanation was that such a creditor might be lulled into forbearing to enforce collection by the appearance of unencumbered ownership during the delay in perfection. Karst v. Gane, 136 N.Y. 316, 32 N.E. 1073 (1893).

udicial to no more than one or a very few creditors. The risks and attendant inconveniences generated by *Moore v. Bay* could hardly have been overlooked during the formulation of the policy and language of section 9-301 of the Code, which lists the persons who take priority over unperfected security interests.[14] In any event, the Code's adoption of the lien creditor test in section 9-301 was a deliberate rejection of the rule of state law that underlay the ruling of that notorious case.

II. Subrogation of the Trustee to the Rights of a Creditor Holding a Valid Lien

As acknowledged at the outset of the article, the claim of a creditor is provable notwithstanding the fact that it is secured.[15] If one argues from this premise, however, that the trustee may avoid any interest which is inferior to that of any secured creditor with a provable claim, the suggestion is startling in its implications. The repercussions from *Benedict v. Ratner*,[16] *Moore v. Bay*,[17] *Corn Exchange Bank v. Klauder*,[18] and *Constance v. Harvey*[19] would be minor indeed compared to the consequences of according to the trustee the position of the most preferred secured creditor of the bankrupt's estate. In fact, the result would be nothing less than a general avoidance of all junior liens and interests in bankruptcy.[20] Since it

14. Dean Hawkland has suggested that "the draftsmen of the Uniform Commercial Code set out to drastically curtail the doctrine of Moore v. Bay." Hawkland, *The Impact of the Commercial Code on the Doctrine of Moore v. Bay*, 67 Com. L.J. 359, 361 (1962). Professor Gilmore has intimated, however, that the prevailing considerations in the drafting of § 9-301(1)(b) were that (1) protection of lien creditors against unperfected security interests afforded a sufficiently effective sanction to discourage dilatoriness in complying with perfection requirements; and that (2) all legislation dealing with this subject matter drafted in this century protected only lien creditors (and purchasers). 1 Gilmore 489.

The pernicious potentialities of the doctrine derived from *Moore v. Bay* are discussed in MacLachlan 330-35.

15. See 4 Collier ¶ 70.90, at 1729-30 (1959). The reference to *Collier* cited in note 2 *supra* is to a portion of the treatise written by Professor Lawrence King and incorporated into *Collier* in 1964. The text of this article discusses only the portion of *Collier*, cited *supra* in this note, which was contributed in 1959.

16. 268 U.S. 353 (1925); see, *e.g.*, Cohen & Gerber, *Mortgages of Accounts Receivable*, 29 Geo. L.J. 555 (1941).

17. 284 U.S. 4 (1931); see MacLachlan 330-33; Scott, *supra* note 6, at 265-69.

18. 318 U.S. 434 (1943); see, *e.g.*, Keeffe, Kelly & Lewis, *Sick Sixty, A Proposed Revision of Section 60A of the Bankruptcy Act*, 33 Cornell L.Q. 99 (1947); Kupfer & Livingston, *Corn Exchange National Bank & Trust Co. v. Klauder Revisited: The Aftermath of Its Implications*, 32 Va. L. Rev. 910 (1946).

19. 215 F.2d 571 (2d Cir. 1954), *cert. denied*, 348 U.S. 391 (1956). See Marsh, *supra* note 10; Weintraub, Levin, & Beldock, *The Strong-Arm Clause Strikes the Belated Chattel Mortgage*, 25 Fordham L. Rev. 261 (1956).

20. It should be acknowledged here that no one has been so bold as to argue categorically that the trustee should be able to assert the priority of the secured creditor having the topmost lien of any and every kind against the bankrupt's property. My point, hereinafter elaborated, is that if the trustee is allowed to assert the right of a

is practically impossible for a secured party to prevent the attachment of a prior lien of some kind, the hazards posed by bankruptcy for secured creditors would be more fearsome than has ever been acknowledged.

In 1951 the late Professor James MacLachlan raised the question here considered before the National Bankruptcy Conference.[21] At its annual meetings in 1953 and 1954, the Conference approved his proposal for an amendment of section 70e limiting the trustee's rights thereunder to those of an unsecured creditor.[22] The proposed amendment thereafter dropped out of drafts of section 70e considered by the Conference—no doubt for the reason that admittedly no case had presented the question and other problems of more urgency pre-empted the attention devoted to that subdivision.[23] Professor MacLachlan's treatise, which appeared in 1956, included a trenchant discussion of the question,[24] and this article is an elaboration of the position there taken—that the trustee's rights under section 70e are limited to those of an unsecured creditor. Judicial authority, while not extensive, is in accord.[25]

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lien creditor or any other variety of secured creditor to prevail over the rights of any other interest in property of a bankrupt estate without regard to the assumptions implicit in the preservation provisions and the law of subrogation generally, there is no basis in the Bankruptcy Act for distinguishing between the kinds of liens the trustee can use to his advantage. See text following note 53 *infra.*

21. 1951 NATIONAL BANKRUPTCY CONFERENCE SUMMARY OF PROCEEDINGS OF ANNUAL MEETING 39.

22. 1954 NATIONAL BANKRUPTCY CONFERENCE SUMMARY OF PROCEEDINGS OF ANNUAL MEETING 8; 1953 NATIONAL BANKRUPTCY CONFERENCE SUMMARY OF PROCEEDINGS OF ANNUAL MEETING 10.

23. Notably the matter of taming Constance v. Harvey, 215 F.2d 571 (2d Cir. 1954), *cert. denied,* 348 U.S. 391 (1956) which threatened to make § 70e superfluous.

24. MACLACHLAN 335-36. Commentators in accord include Coogan & Vagts, *The Secured Creditor and the Bankruptcy Act: An Introduction* in 1 COOGAN, HOGAN & VAGTS, SECURED TRANSACTIONS UNDER THE U.C.C. 971, 990-91 (1963); 2 GILMORE 1289; Wiseman & King, *Perfection, Filing and Forms Under Article 9 of the Uniform Commercial Code,* 9 WAYNE L. REV. 580, 596 (1963).

25. Michigan Fire Ins. Co. v. Genie Craft Corp., 183 F. Supp. 533, 537 (D. Md. 1960) (trustee denied subrogation under § 70e to priority of federal tax lien); *In re* F. A. Whitney Carriage Co., 173 F. Supp. 709 (D. Mass. 1953) (trustee denied right to assert statutory lien of commonwealth as against mortgagee who allegedly failed to comply with bulk transfer statute); Silverman v. Wedge, 339 Mass. 244, 158 N.E.2d 668 (1959) (same); Sellers v. Hayes, 163 Ind. 422, 72 N.E. 119 (1904) (trustee denied benefit of statutory lien conferred on wholesalers against stock of merchandise of retailer transferred in bulk). The state statutes considered in the *Whitney, Silverman,* and *Sellers* cases cited *supra* declared the transfers to which they applied "fraudulent and void" as against the protected classes of creditors.

Attempts by the trustee to ride on the priority of a federal tax lien over security interests failed in two recent cases when the trustee failed to establish the existence of a tax lien with priority. Phoenix Title & Trust Co. v. Stewart, 337 F.2d 978 (9th Cir. 1964), *cert. denied,* 380 U.S. 979 (1965); Wethered v. Alban Tractor Co., 224 Md. 408, 168 A.2d 358, *cert. denied,* 368 U.S. 830 (1961), 3 B.C. IND. & COM. L. REV. 72 (1961). Neither court indicated that, had the trustee carried the burden of identifying a tax lien with priority, it would have sustained the claimed right of subrogation.

An authority citable for the proposition that the trustee under section 70e may assert the rights of a secured creditor is *Collier on Bankruptcy*,[26] and since I share responsibility for the portion of *Collier* that discusses this matter, an explanation is in order. Three cases are cited therein for support, including notably *Central Chandelier Co. v. Irving Trust Co.*[27] As a footnote accompanying the discussion in *Collier* explains, a secured creditor has a "*provable claim* to its full amount, even though it is *allowable* only as to the excess, if any, of the claim over the value of the security."[28] Thus,

> if a transfer by the bankrupt is voidable as against such a creditor, the literal language of § 70e would enable the trustee to nullify the voidable transfer in its entirety. The secured creditor would ultimately, of course, be entitled to so much of the proceeds as were necessary to satisfy his lien; any excess would be for the estate. The *Central Chandelier Co.* case . . . proceeds on that theory.[29]

The opinion in *Central Chandelier* is, however, almost as cryptic as that in *Moore v. Bay*.[30] A conditional seller of lighting fixtures to a building corporation had sued to enforce its security interest for the unpaid purchase price. During the pendency of this litigation the building corporation went into bankruptcy, and the trustee, having been substituted as defendant, sought to rely on the in-

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26. 4 COLLIER ¶ 70.90, at 1729-30 (1959).

27. 259 N.Y. 343, 182 N.E. 10 (1932). The other cases cited are Brookhaven Bank & Trust Co. v. Gwin, 253 F.2d 17, 23 n.5 (5th Cir. 1958); *In re* Cofax Corp., 96 F. Supp. 420 (S.D.N.Y. 1951). The following cases are then cited after the signal *But cf.*: Otte v. Landy, 143 F. Supp. 893, 900, *aff'd*, 256 F.2d 112 (6th Cir. 1958), discussed in notes 38 & 39 *infra*; Sellers v. Hayes, 163 Ind. 422, 72 N.E. 119 (1904), discussed in note 25 *supra*.

In the footnote to the opinion in *Brookhaven Bank & Trust Co. v. Gwin*, cited *supra*, the court of appeals indicated that the trustee in bankruptcy could have invalidated a belatedly filed chattel mortgage under § 70e by relying on the rights of an intervening judgment lienor. The judgment lien had been obtained over four months before bankruptcy, and the court sustained the judgment creditor's claim to priority over the chattel mortgagee under Mississippi law. The observation regarding the trustee's rights was a dictum, inasmuch as the trustee had abandoned the property to the competing lienors upon learning that the proceeds were insufficient to satisfy the lien of either creditor. The court did not intimate whether it thought the trustee had erred in waiving further claim to the property or whether he might have been able to utilize the judgment creditor's priority had there been a surplus over the amount of the judgment lien.

In re Cofax, cited *supra*, is tenuous authority for allowing the trustee to assert the priority of a tax lienor against the competing lien of a judgment creditor under § 70e. The judgment creditor had served a third-party subpoena on a debtor of the bankrupt over four months before bankruptcy, but the court identified three alternate grounds for rejecting the judgment creditor's claim of a lien: (1) the period of limitations applicable to the lien had run out; (2) the judgment creditor had waived his lien by filing an unsecured claim in the bankruptcy proceeding; and (3) the state and city of New York and the federal government had priority over the judgment creditor's claim of lien, and, as claimants with provable claims, they afforded the trustee a position from which to assert priority. The court did not consider the status of the tax liens independently of their relation to the judgment creditor's claim.

28. 4 COLLIER ¶ 70.90, at 1730 n.28 (1959).

29. *Ibid.*

30. And no lower court opinion in *Central Chandelier* was reported.

validity of the conditional sale as against a mortgagee of the real estate. The mortgagee was entitled to prevail under section 7 of the Uniform Conditional Sales Act,[31] then in force, by virtue of an advance which had been made after the affixation of the fixtures but without actual or constructive notice of the retention of title. The lower courts had ruled for the defendant trustee, and on appeal the vendor challenged the standing of the trustee to rely on the superior rights of the mortgagee as a defense to the action. The court of appeals rejected the vendor's contention on this point with the unenlightening observation that

> the trustee represents . . . all creditors, and is thus interested in preserving the assets of the estate. Incidentally, the trustee is interested in preserving the validity of the mortgage security for the title company and thus reducing a possible deficiency judgment against the bankrupt.[32]

The statement in *Collier* that the trustee may assert a secured creditor's right to avoid a transfer in its entirety, although the trustee could reach only the surplus over the amount required to satisfy the lien,[33] is correct in the light of the doctrine of *Moore v. Bay* which underlies it. Thus, suppose that over four months before bankruptcy a creditor of the bankrupt obtained a lien by an attachment or creditor's bill in a proceeding instituted to avoid a fraudulent transfer of the property subjected to the lien. Although the lien itself would not be avoidable by the trustee, he should be permitted to intervene in the litigation as a co-plaintiff. In the event of successful prosecution of the action to avoid the transfer, the trustee

31. The second sentence of which read in pertinent part as follows:

> If the goods are so affixed to realty at the time of a conditional sale or subsequently as to become part thereof but to be severable without material injury to the freehold, the reservation of property shall be void after the goods are so affixed as against subsequent purchasers of the realty for value and without notice of the conditional seller's title, unless the conditional sale contract . . . shall be filed before such purchase in the office where a deed of the realty would be recorded . . . to affect such realty.

UNIFORM CONDITIONAL SALES ACT § 7.

32. 259 N.Y. at 347, 182 N.E. at 12. One can only speculate as to why the plaintiff did not join the mortgagee as a codefendant with the mortgagor in its action, but in any event it is ordinarily inappropriate for the trustee to seek to vindicate the priority of one secured creditor over that of another. Insofar as the trustee succeeded in reducing the possible deficiency judgment of the mortgagee by preserving the validity of the mortgage, he presumably augmented the deficiency claim of another secured creditor. A more substantial justification for according standing to the trustee to invoke the priority of the mortgage would have been to enable him to avoid the risk of a judgment binding him to honor the conditional seller's priority in the proceeds of the sale of the encumbered property while the estate remained subject to a probable liability to the mortgagee as the holder of a first lien against the same property. Such a rationale, of course, falls considerably short of recognizing that the trustee was subrogated to the priority of the mortgagee or to any right of avoidance of the conditional sale.

33. Quoted in text accompanying note 29 *supra*.

would be able to reach any excess value in the property transferred —that is, if the secured creditor had a provable claim.[34] It would be unnecessary for the trustee to show that the transfer was fraudulent and voidable as to any other creditor, for, in such a case, the trustee would not be relying on the priority of the creditor's lien, but rather on the voidability of the transfer by the creditor. The observation in *Collier*[35] that *Central Chandelier Co.* proceeds on this theory is conjectural, since the court does not disclose any theory or indeed whether it was concerned with any surplus above the amount required to pay the mortgagee. In any event, the situation presented in that case did not afford the trustee any justification for invocation of the theory, since the conditional seller's interest was voidable by the mortgagee not as a creditor but as a subsequent purchaser of the realty for value and without notice of the conditional seller's title.[36] To allow the trustee to take the particularly privileged position of such a purchaser because the purchaser also happened to be a creditor with a provable claim would involve a perversion of the purposes of both the state law and the Bankruptcy Act.[37]

III. The Trustee's Right to Priority Under Section 70e

On a purely semantic level, the mischief that may be generated by subrogating the trustee to secured creditors' rights under section 70e may be confined by insisting that the subdivision does not enable the trustee to assert the *priority* of any creditor with a provable claim over any transferee; rather, the statute enables the trustee only to invoke any rule of law which makes a transfer "fraudulent or voidable for any other reason by any creditor of the debtor."[38] This suggestion admittedly relies heavily on the lexicon of the legislator.

34. Carothers v. Weaver, 220 Ala. 584, 586, 127 So. 151, 152 (1930) (creditor holding indefeasible lien by creditor's bill not displaced but trustee allowed to join in suit on behalf of unsecured creditors to reach any surplus above lien).

35. 4 Collier ¶ 70.90, at 1730 n.28 (1959).

36. "The implication of the second sentence of § 7 is that one not a subsequent purchaser of the realty for value and without notice—*e.g.*, a trustee in bankruptcy—cannot object to a failure of the conditional vendor to comply with the filing requirements prescribed by the sentence." 4 Collier ¶ 70.20, at 1160 n.23 (1959).

37. Candor requires an acknowledgment that the critique of *Central Chandelier* set out in the text is not entirely in accord with the discussion of the same case in the passages of *Collier* which are cited in notes 26–29 *supra*. That discussion was part of a revision of the original version of ¶ 70.90 included in the 14th edition of that work which I prepared in 1959. I can only say that I state the case as it appears to me now.

38. This ground was explicitly taken in rejecting a trustee's attack under § 70e in Otte v. Landy, 143 F. Supp. 893, 900 (E.D. Mich. 1956), *aff'd*, 256 F.2d 113 (6th Cir. 1958), and in Michigan Fire & Marine Ins. Co. v. Genie Craft Corp., 183 F. Supp. 533, 537 (D. Md. 1960). It is also ventured as a basis for denying the trustee a right to prevail over an unperfected security interest in fixtures in Coogan, *Security Interests in Fixtures Under the Uniform Commercial Code*, 75 Harv. L. Rev. 1319, 1339 (1962), reprinted in 1 Coogan, Hogan & Vagts, *op. cit. supra* note 24, at 1804. Mr. Coogan reports

The Code generally eschews saying that any security interest is voidable by another. Thus, section 9-301 is entitled "Persons Who Take Priority Over Unperfected Security Interests." Subsection (1) then lists persons to whose rights an unperfected security interest is *subordinate* and includes therein a "lien creditor without knowledge." The Internal Revenue Code, on the other hand, declares that the federal tax lien shall not be *valid* as against a security interest unless notice is filed.[39] It would be an indefensible interpretation of section 70e to permit the trustee to invoke the position of the holder of a security interest against a subsequently filed tax lien because the latter is invalidated, but deny the trustee the position of a lien creditor who levies before a security interest is perfected because the latter is merely subordinated. The point, however, is that the trustee should be subrogated to *neither* the priority of a lien creditor under section 9-301 *nor* to the right of any of the beneficiaries of the tax notice-filing statute unless the trustee can displace the lien or other interest of the protected party.

If a creditor should exploit the easy opportunity afforded by the Code to obtain and perfect a security interest against all of the debtor's personal property and fixtures, the trustee could step into the advantageous position occupied by such a creditor as against all inferior interests and liens upon the collateral. Moreover, even that farsighted and hard-fisted creditor could be frustrated by the trustee if the trustee could find a subsequent purchase-money security interest holder who took the precautions prescribed by section 9-312(3) or (4).[40] And the purchase-money secured creditor could be

that *Collier* cites *Central Chandelier Co. v. Irving Trust Co.* as *contra* in the passages discussed in the text accompanying notes 26-29 *supra*, and then notes that the court did not there mention § 70e. As pointed out in the text accompanying note 31 *supra*, the trustee was relying on § 7 of the Uniform Conditional Sales Act, which did not merely confer a priority but purported to make the conditional seller's security interest void as against the mortgagee. Although § 70e was not cited by the court, it is the only provision which would have authorized him to represent the creditors in resisting the suit by the conditional seller.

39. INT. REV. CODE OF 1954, § 6323(a).

40. I have encountered the suggestion that although a lien creditor is merely accorded priority over an unperfected security interest by § 9-301(b) of the Code, the provision is actually an avoidance section and therefore is a state law of the kind contemplated by § 70e of the act. This argument is supposed to draw strength from the following propositions: (1) the Code's requirement that most kinds of personal property security be perfected by notice-filing or the taking of possession in order to prevail as against lien creditors is a rule intended to protect creditors against the misleading appearance of unencumbered ownership in their debtor; (2) the law of ostensible ownership, deriving as it does from Twyne's Case, 3 Coke 80b, 76 Eng. Rep. 809 (Star Ch. 1601), is part of the law of fraudulent conveyances; and (3) any law protecting creditors against fraudulent conveyances or secret liens is a law which Congress intended to be available to the trustee under § 70e.

Whenever applicable state law requires any instrument affecting real estate to be recorded in order to be valid as against a judgment lienor, the trustee would, under

cut out too if the trustee could find a tax lien or any other variety of statutory lien having priority under applicable law, including section 9-310 of the Code.

An unsecured creditor sometimes has priority over a security interest under nonbankruptcy law. Curiously it has seldom been suggested that the trustee in bankruptcy should be able to exploit the priority of such a creditor in order to defeat a security interest. The Bankruptcy Act has its own system of priorities for unsecured creditors. While limited recognition is given to priorities conferred by nonbankruptcy law in section 64a(5),[41] state-created priorities are generally ineffective in bankruptcy. Thus there would be no significant problem of displacement if the trustee were allowed to be subrogated to the priority of an unsecured creditor over a security interest. The suggestion nevertheless runs counter to the uniform construction of the act.[42]

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this kind of argument, be entitled to invoke § 70e if a judgment lien attached to the property after the debtor-owner had executed an instrument of transfer but before it could be recorded. And presumably the trustee would be able to assert the right of the United States as a tax lienor against any prior security interest that is not protected against a judgment lien creditor at the time the tax lien is filed, since the Internal Revenue Code manifestly undertakes to afford the Government all the protection applicable state law gives to judgment lien creditors against secret liens. INT. REV. CODE OF 1954, §§ 6323(a) & (h)(1).

If I understand the argument now being considered regarding the legitimate use of § 70e by the trustee as a subrogee of a lien creditor, the trustee would not be able to step into the shoes of a creditor who acquired his lien before any competing interest attached. In that situation, the lien creditor would prevail because of his priority and not because of any right of avoidance, and the trustee would have no basis for subrogation under § 70e. Although it would not make any difference for any other purpose, it would thus be crucial in the application of this subdivision whether the security interest under attack *attached* before or after the property became subject to the conflicting lien relied on by the trustee.

The cases cited in note 38 *supra* which deny trustees' efforts to assert the priority of tax creditors may be thought to be reconcilable with the argument here considered. The unsuccessful trustee in Michigan Fire & Marine Ins. Co. v. Genie Craft Corp., 183 F. Supp. 533 (D. Md. 1960), was, however, relying on the "ineffectiveness" of an equitable lien asserted by the bankrupt's financier as against a tax lien which arose after the equitable lien was supposed to have attached.

Suppose that after A obtains a security interest in the personalty of D but before the security interest is perfected, B, a creditor of D, with a provable claim, obtains and perfects a security interest in the same collateral. Has B a right of avoidance to which the trustee is subrogated under § 70e, or merely a right of priority which does not pass to the trustee under this section? The argument of this article is that the trustee can avail himself of B's priority if but only if he can avoid B's security interest, for example, as a preference under § 60 or as a fraudulent transfer under § 70e. In such an event the trustee would be limited as subrogee by the amount of B's claim.

41. Section 64a(5) recognizes a limited priority for a landlord when granted by state law and priority for nontax claims of the United States when the conditions of REV. STAT. § 3466 (1875), 31 U.S.C. § 191 (1964) are met. The priority so recognized is the lowest of the five levels provided by § 64, and the fact that nonbankruptcy law may assign first rank to an unsecured claim of the landlord or the Government is ineffective to lift it above the station prescribed in the Bankruptcy Act. 30 Stat. 563 (1898), as amended, 11 U.S.C. § 104(a) (1964).

42. Shortly after the decision of the Third Circuit in *In re* Quaker City Uniform

The most serious objection to allowing the trustee under section 70e to assert the priority of any unsecured creditor with a provable claim over a security interest is that it would enable the trustee to invoke the notorious doctrine of the inchoate lien that has developed in the application of the federal priority statute.[43] Efforts of Government counsel to get the absolute priority afforded their client by the Supreme Court's construction of this statute have been rebuffed by bankruptcy courts,[44] and, except for a wayward Ninth Circuit ruling of a few years ago,[45] the trustee in bankruptcy has been unable to turn the doctrine of the inchoate lien to his advantage.

I have elsewhere elaborated the implications for secured creditors of allowing the trustee to defeat any lien that cannot meet the esoteric test of choateness which has been established by the Supreme Court for the administration of estates of insolvent debtors of the Government outside of bankruptcy.[46] Although the doctrine

Co., 238 F.2d 155 (3d Cir.), *cert. denied,* 352 U.S. 1030 (1956), Referee Wolfe interpreted it to require him to subordinate security interests to the landlord's priority conferred by Pennsylvania law. *In re* George Townsend Co., 31 REF. J. 54 (1956). The ruling was reversed by the district court, 180 F. Supp. 625 (E.D. Pa. 1957). A footnote in the court's opinion, 180 F. Supp. at 626 n.3, mentioned that neither counsel nor the judge could find any support in Pennsylvania law for the proposition that a landlord's priority was superior to a consensual security interest, but the court's ruling rested on the ground that, except as provided in § 67c, § 64 is inoperative until after valid liens are satisfied. The relationship between priorities and liens is discussed generally in 3 COLLIER ¶ 64.02[2] (1966).

43. REV. STAT. § 3466 (1875), 31 U.S.C. § 191 (1964). The doctrine is discussed in Kennedy, *The Relative Priority of the Federal Government: The Pernicious Career of the Inchoate and General Lien,* 63 YALE L.J. 905 (1954), and Kennedy, *From Spokane County to Vermont: The Campaign of the Federal Government Against the Inchoate Lien,* 50 IOWA L. REV. 724 (1965).

44. See, *e.g.,* United States v. Bradley, 321 F.2d 224 (5th Cir. 1963); Adams v. O'Malley, 182 F.2d 925, 927, 930 (8th Cir. 1950); United States v. Sampsell, 153 F.2d 731, 734-35 (9th Cir. 1946); *In re* Van Winkle, 49 F. Supp. 711, 714 (W.D. Ky. 1943).

Insofar as the cases cited herein deal with the priority of the federal tax lien, they are subject to re-examination in the light of the development of the doctrine of the inchoate lien discussed in the articles cited in note 43 *supra* and the enactment of the Federal Tax Lien Act of 1966. 80 Stat. 1125 (1966), 26 U.S.C.A. § 6323 (Supp. 1967). The opinions stand unimpaired insofar as they deal with the relevance of REV. STAT. § 3466 (1875) in bankruptcy. The ruling in United States v. Reese, 131 F.2d 466 (7th Cir. 1942), wherein the court apparently amalgamated the federal priority with the federal tax lien statute, turned out to be an inadvertent precursor of United States v. Security Trust & Sav. Bank, 340 U.S. 47 (1950). The debtor in that case was a bankrupt, but the question therein decided arose in a case consolidating plenary actions of the United States and the state of Illinois to foreclose their tax liens against the bankrupt's property.

45. Rialto Publishing Co. v. Bass, 325 F.2d 527 (9th Cir. 1963). The rationale for *Rialto* was substantially revised by the court of appeals sitting en banc in Bass v. Stodd, 357 F.2d 458 (9th Cir. 1966).

46. See Kennedy, *The Inchoate Lien in Bankruptcy: Some Reflections on Rialto Publishing Co. v. Bass,* 17 STAN. L. REV. 793 (1965). The priority statute applies only when such a debtor has committed an act of bankruptcy, but there is no four-month time limit prescribed in the statute. There is a question whether the Government has a provable claim for taxes in bankruptcy, inasmuch as § 63 does not include such a claim in its catalogue of provable claims; this doubt, however, is hardly a serious one. The ruling by the referee on this point in *In re* Cofax Corp., 96 F. Supp. 420 (S.D.N.Y.

of the inchoate lien as it formerly applied in tax lien cases has been significantly modified by the Tax Lien Act of 1966,[47] this legislation does not affect the priority of the United States under the general priority statute;[48] not since the Court launched the doctrine of the inchoate lien nearly forty years ago has it found a lien challenged by the Government in a case under the statute to be sufficiently choate to withstand the federal priority. Therefore, if the trustee could exploit the federal priority under section 70e, the risks assumed by secured creditors would be significantly aggravated: Any unpaid indebtedness to the federal government of any kind and of any amount would afford the trustee a basis for leveling practically every security interest against the property of the bankrupt.[49]

It is entirely possible to recognize that creditors with provable claims may include one who is secured and that the trustee may assert the rights of avoidance of such a creditor without agreeing that the trustee is thereby subrogated to rights that depend on that creditor's security interest rather than on his status as a creditor. Thus a creditor holding a consensual security interest may avoid a fraudulent transfer or one that fails to comply with Article Six of the Code (Bulk Transfers) even if he is ordinarily better advised to rely on his security than on his right of avoidance.[50] Waiver of his security would not prejudice his right of avoidance.[51] On the other hand, the lien creditor who prevails over an unfiled or belatedly filed

1951), is not subject to criticism. See Hartman v. Lauchli, 238 F.2d 881, 888 (8th Cir. 1956), *cert. denied*, 353 U.S. 965 (1957); Ingels v. Boteler, 100 F.2d 915, 918 (9th Cir. 1938), *aff'd*, 308 U.S. 57 (1939); *In re* Mercury Engineering, Inc., 68 F. Supp. 376, 382 (S.D. Cal. 1946) ("A tax or any exaction in the nature of a tax, while not strictly a debt, is none the less a demand or claim of a quasi-contractual nature provable in bankruptcy"); 3 COLLIER ¶ 63.26 (1966).

47. 80 Stat. 1125 (1966), 26 U.S.C.A. § 6323 (Supp. 1967).

48. PLUMB & WRIGHT, FEDERAL TAX LIENS 162-63 (2d ed. 1967).

49. In Otte v. Landy, 143 F. Supp. 893 (E.D. Mich. 1956), *aff'd*, 256 F.2d 112 (6th Cir. 1958), the trustee, in attacking a mortgage given by the bankrupt to secure a purchase-money obligation of $3,150,000, relied in part on an argument that he was entitled under § 70e to assert the priority of the United States for its unpaid tax claims of $160,000. Had the court sustained the argument, it would have served to enable the trustee to invalidate the purchase-money mortgage on a showing of a dollar's worth of debt to the United States. For a less dismal view of the chances for the holder of a consensual security interest to survive competition with the federal priority than is taken in the text, see PLUMB & WRIGHT, *op. cit. supra* note 48, at 161-62.

50. *But cf.* Dabney v. Chase Nat'l Bank, 201 F.2d 635, 639 (2d Cir.), *petition for cert. dismissed on stipulation of counsel*, 346 U.S. 863 (1953):

> [L]ike any other equitable remedy, "avoidance" of the "transfer": *i.e.*, rescission, is a remedy dependent upon balancing the relative interests involved, and in a case where the injured party has another and a complete remedy and where rescission will deprive the wrongdoer of rights which are his in spite of his wrong, a court of equity will not grant rescission.

51. Buffum v. Peter Barceloux Co., 289 U.S. 227, 234 (1933). One may indeed be estopped from asserting rights as a secured creditor and as an unsecured creditor in respect of the same property when both positions are mutually inconsistent. *Ibid.*

security interest under section 9-301 of the Code does so only by virtue of the priority of his lien. Waiver or avoidance of his lien would defeat his right to prevail over the security interest. Insofar as one secured creditor prevails over another under any rule determining the validity or priority of liens *inter se,* it would be a wholly arbitrary and fanciful result for the priority or validity of one of them to be used as the basis for destroying the rights of the other in what remains of the collateral after the first lien has been wholly satisfied. A rule giving A priority over B should not, after it has served to protect A against B, be reloaded to knock out B altogether for the sake of claimants who were never intended to be protected by the rule giving A priority. Such perversion of the purposes of state law to the end of enlarging bankruptcy estates should not be enforced by the courts unless compelled in unmistakable terms by the Bankruptcy Act. No such compulsion is to be found in section 70e.[52]

The proponents of the view that the trustee may be subrogated to the rights of a secured creditor for the purpose of avoiding a transfer under section 70e have supposed only that the trustee might step into the shoes of a judicial lien creditor or tax lienor.[53] But is there any warrant for distinguishing between the right of subrogation to the position of such a creditor and the right to assert the position of a creditor whose priority rests on his being the first to perfect a consensual security interest? Clearly the source and nature of the lien of a secured creditor is a matter of indifference in determining the provability of his claim. Accordingly it appears that if the trustee *can* assert the rights that inhere in the secured status rather than the creditor status of such a creditor, he can elect to take the

52. An analysis of the role of § 70e substantially in accord with the text is found in the opinion of Judge Learned Hand in Dabney v. Chase Nat'l Bank, 201 F.2d 635, 639-40 (2d Cir.), *petition for cert. dismissed on stipulation of counsel,* 346 U.S. 863 (1953):

> It seems likely that the proper interpretation of the section [70e] is that it applies only to occasions where the "Federal or State law" "under" which the "transfer" is "avoided" directly nullifies it *ex proprio vigore,* and not indirectly by creating rights (*e.g.* a lien) out of some transactions between one creditor and the bankrupt which the "transfer" would defeat, if it were valid; in short that the "creditor's" right must be conferred upon him simply because he is a creditor. One can see how the Bankruptcy Act might wish to provide that the benefit of such a "law" should redound to the benefit of all creditors; but to go further seems to us to impute to Congress a most improbable intent. Suppose, for example, that the bankrupt borrows money from A upon an agreement that A shall have as security a one half interest in the bankrupt's stock in trade, or the whole interest in a specified part of that stock; and that the bankrupt then "transfers" the stock to B, who takes with notice of the agreement. A can "avoid" the "transfer" as to his interest in the stock; but may the bankrupt's trustee reclaim as part of the estate, not only that half, but the half which A [the bankrupt?] was free to "transfer" and B to receive? If so B has lost what he was confessedly free to acquire as a penalty for taking from A what he was not free to acquire.

53. See notes 1-2 *supra.*

position of whatever secured creditor is most advantageously placed in order to level all liens and interests inferior to him, whatever their source and character.

The difficulty with recognizing subrogation of the trustee to the rights of the holder of any valid lien of any variety is the same, and it is fundamental: Section 70e was intended to enable the trustee to bring into the estate for distribution property which the debtor has put beyond his reach but which the creditors could have reached by appropriate action but for bankruptcy. The subdivision has been interpreted in the light of this entirely intelligible purpose, and even *Moore v. Bay* is consistent with the limitation that the rights of the trustee by subrogation be derived from unsecured creditors. To vest him with the special rights, whether of priority or avoidance, belonging to secured creditors whom he does not represent and whom he cannot displace requires an attribution to Congress of an irrational design to invalidate all but one layer of liens against bankrupt estates.

IV. Subrogation of the Trustee to the Rights of a Creditor Holding a Voidable Lien

There is no departure from the Bankruptcy Act if the right of the trustee to be subrogated to the position of a secured creditor is confined to those cases in which the secured creditor can be displaced by avoidance of his lien. It is nonetheless submitted that, with a single qualification hereafter noted,[54] invocation of the doctrine of *Moore v. Bay* to enable the trustee to extend the priority of the secured creditor without limitation is incompatible with the design of the act.

Thus, suppose that during a day's delay in the perfection of a mortgage of a $10,000 chattel to secure a present advance of $10,000, a creditor with a $1,000 claim attached the asset. If bankruptcy should ensue within four months, the trustee could avoid the attachment lien under section 67a on a showing that the bankrupt was insolvent at the time of the attachment. Avoidance of the lien, however, would be bootless for the estate if the result is simply to remove a limitation on the enforcement of the mortgage. To protect the estate against such an eventuality, that is, having the avoidance redound to the benefit of junior lienors or other persons not intended to be benefitted by the administration of the estate in bankruptcy, Congress provided in section 67a for preservation of the $1,000 lien for the benefit of the estate. The attaching creditor would be in no position

54. See text accompanying note 69 *infra*.

to complain of losing his lien to the estate because his lien conflicted with the policy of the Bankruptcy Act embodied in section 67a. Nor would the secured creditor be in a position to complain of the preservation since he would not be prejudiced thereby. Nonetheless, the argument has been made that in the situation presented, if the attaching creditor has a provable claim, the trustee should be able to invoke section 70e as against the chattel mortgage and he should not be limited by the $1,000 claim of the attaching creditor when he proceeds under this section.[55] The argument, however, makes the preservation provision superfluous in the situation for which it was designed.[56]

The preservation clauses of sections 60b, 67a(3), 67d, and 70e are no more than provisions authorizing the trustee to be subrogated to the rights of a person who can no longer enforce them under the Bankruptcy Act, when unconditional avoidance of such rights would not benefit the estate. Such a situation is presented when a voidable lien or other interest is superior to another lien or interest that is indefeasible by the trustee. It would be a perversion of the purpose of the avoidance provisions of the act for the trustee to strike down a lien or other interest for the benefit of persons who are not intended beneficiaries of the trust being administered in bankruptcy and against whom the voidable lien or other interest is entirely valid. But it would be an invidious and patently unintended construction of the act to allow the trustee to preserve the priority of a lien or other interest voidable under the act as against the holder of an interest otherwise indefeasible but to insist that as trustee he is in no way limited by the amount of the lien or interest preserved. Under such a construction the trustee takes everything if he can take

55. The argument is suggested rather than supported in COUNTRYMAN, CASES ON DEBTOR AND CREDITOR 454, 522-23 (1964), and Loiseaux, *Federal Tax Liens in Bankruptcy*, 15 VAND. L. REV. 137, 145-46 (1961).

A case made to order for exploitation of the view of the trustee's rights of unlimited subrogation to the priority of the holder of a lien voidable under the act is *In re* Andrews, 172 F.2d 996 (7th Cir. 1949). Here a chattel mortgage securing a $3,200 claim became voidable by the trustee under § 70e by virtue of a delay in the effectiveness of the filing of the mortgage. A junior chattel mortgage securing a claim of $10,500 was indefeasible by the trustee but was not permitted to take advantage of the gap in the perfection of the senior mortgage because the junior mortgagee was in no way prejudiced thereby. The collateral sold for $14,100. The court apparently limited the trustee's recovery under § 70e to $3,600. Although the trustee was represented by counsel of acknowledged competence, no effort was apparently made to invoke *Moore v. Bay* as a weapon against the junior mortgage. No criticism of counsel is intended. On the contrary, as I have tried to show in this article, employment of that case for such a purpose would turn its doubtful doctrine against innocent parties for no other reason than that their collateral was subject to another rival lien or interest voidable by the trustee in bankruptcy.

56. See 4 COLLIER ¶ 67.16.

anything. This is of course the oft-repeated and oft-rejected objection directed at the doctrine of *Moore v. Bay*. Here, however, the doctrine is being used to defeat utterly the rights of persons who by hypothesis do not fall under the condemnation of any provision or policy of the act; it is only fortuitous that their rights attach to property subject to a competing lien or interest voidable by the trustee. It is one thing to insist that such persons not enjoy a windfall in the event of bankruptcy. It is another to say that Congress has demanded from such persons a sacrifice of their rights to the Moloch of Bankruptcy.

Prior to the Chandler Act, there were three provisions in the Bankruptcy Act which authorized subrogation of the trustee to the priority rights of creditors displaced by the trustee. All of these provisions were in section 67. Section 67b read as follows:

> Whenever a creditor is prevented from enforcing his rights as against a lien created, or attempted to be created, by his debtor, who afterwards becomes a bankrupt, the trustee of the estate of such bankrupt shall be subrogated to and may enforce such rights of such creditor for the benefit of the estate.[57]

Section 67c, which is one of the precursors of present section 67a, provided that

> if the dissolution . . . [of any lien thereunder] would militate against the best interests of the estate of such person the same shall not be dissolved, but the trustee of the estate of such person, for the benefit of the estate, shall be subrogated to the rights of the holder of such lien and empowered to perfect and enforce the same in his name as trustee with like force and effect as such holder might have done had not bankruptcy proceedings intervened.[58]

Finally, an overlapping provision in section 67f, also one of the precursors of present section 67a, nullified liens obtained through legal proceedings but qualified such nullification by a clause authorizing the court

> on due notice, [to] order that the right under such levy, judgment, attachment, or other lien shall be preserved for the benefit of the estate; and thereupon the same may pass to and shall be preserved by the trustee for the benefit of the estate as aforesaid.[59]

It was thus clear that the trustee might step into the shoes of any creditor who *but for* bankruptcy could have enforced rights against any lien or other interest created by his debtor. However, no one

57. 30 Stat. 564 (1898).
58. 30 Stat. 564 (1898).
59. 30 Stat. 565 (1898).

seems to have suggested before 1938 that the trustee could also step into the shoes of any creditor who *notwithstanding* bankruptcy could enforce rights against any lien created by the debtor or of any creditor whose lien was not voidable under section 67c or section 67f.[60]

The subrogation provision of old subdivision b was eliminated in the Chandler Act's recast of section 67, with this less than adequate legislative explanation: "The substance of subdivision b is . . . covered by the provision in the expanded section 60b, which confers upon the trustee the subrogated right to retain the benefits of an avoided preferential lien."[61] As noted above, subdivisions c and f of old section 67 were merged in the new section 67a. Inexplicably no preservation provisions were included in the other avoidance sections until 1952, when preservation provisos were inserted in sections 67d and 70e.[62] The legislative reports accompanying the amendment of section 70e explained the purpose of the preservation proviso as that of "subrogating the trustee to the rights of the transferee . . . so that the benefits intended for the estate would not be passed on to junior interests not entitled thereto."[63]

When subdivisions c and f of old section 67 were merged into the new subdivision a in 1938, the preservation clause of old subdivision f rather than the language of subrogation used in old subdivision c was carried over into new section 67a(3). However, since the effect of an order preserving a lien for the benefit of the estate is precisely the same as an order authorizing subrogation of the trustee to the rights of the holder of a voidable lien, no significance is to be attached to this stylistic choice.[64]

The language of former section 67c was explicit in limiting the trustee's rights as subrogee to those of the holder of the lien dissolved by the subdivision. It is inherent in the notion of subrogation, however, that the person subrogated acquires no greater rights than

60. *Cf.* REMINGTON, BANKRUPTCY 179 (Students' ed. 1911):

[T]here still exist those cases where a chattel mortgagee has filed his mortgage *after* a levy by some creditor upon the property and before the bankruptcy court has seized the property, in which event, only by virtue of subrogation to the creditor's lien would the trustee be able to invalidate the chattel mortgage; such subrogation, however, only being possible where the legal proceedings had created the lien within the four months preceding the bankruptcy.

61. H.R. REP. No. 1409, 75th Cong., 1st Sess. 32 (1937).

62. 66 Stat. 429, 430 (1952).

63. H.R. REP. No. 2320, 82d Cong., 2d Sess. 16 (1952); S. REP. No. 1395, 82d Cong., 2d Sess. 19 (1952).

64. There was another difference between former subdivisions c and f which disappeared in the merger: Subrogation was apparently automatic under subdivision c on a finding that dissolution "would militate against the best interests of the estate," whereas an order of preservation under subdivision f was discretionary, as it is under present subdivision a. This difference was of more theoretical than actual significance.

those of the person to whose position he is subrogated.[65] Although judicial declaration or exposition of these truisms does not abound, no case construing the preservation clauses of the Bankruptcy Act has been found to cast any doubt upon them.[66]

The addition of the preservation clauses in 1938 and 1952 constitutes convincing evidence that Congress has not adopted the view that the trustee may utilize section 70e as brigaded by *Moore v. Bay* whenever he can find a creditor with a provable claim and a lien prior to other liens. If the trustee could step into the shoes of a prior lienor without being limited by the amount of his lien, the addition of these clauses would have been largely gratuitous legislation.[67] On the contrary, however, the legislative explanations indicate an apprehension of a need to be served by the amendments which is entirely consonant with the scheme of the act herein elaborated.[68] The absence of any acknowledgment or intimation that the trustee had an

65. DIXON, SUBROGATION 20 (1862); 5 POMEROY, EQUITY JURISPRUDENCE (4th ed.) AND EQUITABLE REMEDIES (2d ed.) 5198 (1919); SHELDON, THE LAW OF SUBROGATION 8 (2d ed. 1893).

66. See, *e.g.*, Rock Island Plow Co. v. Reardon, 222 U.S. 354 (1912); First Nat'l Bank v. Staake, 202 U.S. 141 (1906). In the last cited case, attachment liens securing claims of $40,000 were preserved pursuant to former § 67f for the benefit of the estate of a bankrupt who had sold the property for $500,000 in stock after the attachment but before the bankruptcy. The Court pointed out that the effect of the order of the preservation was that "so much of the value of the property attached as is represented by the attachments passes to the trustee for the benefit of the entire body of creditors . . . ." 202 U.S. at 146.

67. According to this view of § 70e, there is no need for a preservation provision when the holder of an avoided lien or other interest has a provable claim. The avoidance under §§ 60 or 67 eliminates the embarrassment created by his claim of lien or other interest as against the trustee, and § 70e enables him to devastate inferior liens and interests.

68. See text accompanying note 60 *supra.* See also H.R. REP. No. 2320, 82d Cong., 2d Sess. 14, 15, 16 (1952); Duberstein, *Highlights of Bankruptcy Amendments*, 27 REF. J. 21 (1952). It is nevertheless arguable that the preservation provisions were not necessary to prevent proceedings for avoidance from redounding to the benefit of the holders of junior indefeasible interests. See *In re* Edward Bibinger, Inc., 12 App. Div. 2d 237, 239, 210 N.Y.S.2d 319, 321 (1961) (assignee allowed to assert priority or an unfiled mortgage as against subsequent indefeasible mortgage, without statutory authorization therefor, to avoid "unearned windfall" to junior mortgagee—senior mortgage consumed the entire property); *cf. In re* Andrews, 172 F.2d 996 (7th Cir. 1949) (security interest voidable by trustee under § 70e not preserved as against indefeasible junior security interest, but windfall prevented by allowing holder of voidable lien to collect out of fund allocated to junior lienor). Preservation of liens postponed by former § 67c(1) for the benefit of claims entitled to priority under §§ 64a(1) & (2) was effectuated without express statutory authority in California State Dep't of Employment v. United States, 210 F.2d 242 (9th Cir. 1954). See also Jordan v. Hamlett, 312 F.2d 121, 124 (5th Cir. 1963); *In re* American Zyloptic Co., 181 F. Supp. 77 (E.D.N.Y. 1960). The necessity of legislation to prevent escalation by junior interests in consequence of avoidance is asserted in *In re* Espelund, 181 F. Supp. 108, 112 (W.D. Wash. 1959); Sachs, *Trustee's Rights of Subrogation to Creditor's Liens*, 15 REF. J. 105 (1941). The view espoused by these authorities, like the official explanations cited *supra,* do not comport with the suggestion that the trustee can be subrogated to the priority of any creditor with a voidable lien under § 70e and can cram down all inferior interests without limit.

alternative remedy more potent than that being provided by the amendments is eloquent evidence of an understanding that no such remedy was available.

It should nevertheless be clear that the trustee is not bound by the limits of a voidable lien if he otherwise has a right of recovery under section 70e. Thus, suppose that within four months after a creditor has obtained a lien by attachment, creditor's bill, or judgment, against property fraudulently transferred, the debtor becomes bankrupt. Although the trustee may be able to get the lien preserved for the benefit of the estate pursuant to section 67a(3), he is not bound to choose that remedy if section 70e affords him a larger recovery. That proposition had been established before the advent of *Moore v. Bay* and stands independently of it.[69] The significance of *Moore v. Bay* in this situation is that, as indicated above, the trustee may avoid the lien of the creditor under section 67a and, relying on the same creditor's right to avoid the transfer under section 70e, recover the fraudulently transferred property without being limited by the amount of that creditor's claim. This result is simply an illustration of the anomalies that flow from the doctrine of *Moore v. Bay.*

SUMMARY

1. The trustee may under section 70e avoid any security interest that is voidable by a creditor with a provable claim against the estate, for example, on the ground that the security interest is a fraudulent transfer, irrespective of whether the creditor's claim is also allowable or secured.

2. Under the doctrine of *Moore v. Bay,* the trustee is not restricted in his recovery under section 70e by the amount of the claim of the creditor whose right of avoidance he asserts under this subdivision.

3. If an unsecured creditor of the estate has merely a right of priority over a security interest as distinguished from a right of avoidance, the trustee is not entitled to assert the right of priority in derogation of a secured creditor's rights in the collateral.

4. The trustee may under section 70c assert all the rights of

69. In Campbell v. Calcasieu Nat'l Bank, 12 F.2d 981 (5th Cir.), *cert. denied,* 273 U.S. 720 (1926), a creditor had obtained a lien by judgment in proceedings to avoid a mortgage as fraudulent. The judgment lien was held voidable under former § 67f and subject to preservation under the same subdivision, but the court properly pointed out that the trustee's rights under that subdivision were not exclusive of his right to avoid the mortgage in toto pursuant to § 70e. *Accord,* Campbell v. Dalbey, 23 F.2d 229 (5th Cir. 1928). Although both these rulings antedated *Moore v. Bay,* the court's opinions seem to have anticipated it by assuming an unlimited right of recovery under § 70e.

priority as well as of avoidance against the holder of a security interest that could have been asserted by a creditor who obtained a lien by judicial proceedings on the date of bankruptcy against the property subject to such security interest.

5. If a security interest may be avoided only by a creditor who had extended credit at some critical juncture and who had obtained a lien by judicial proceedings against the property subject to the security interest in question, the trustee may avoid the security interest only if there is an actual creditor with a provable claim against the estate who extended credit at the critical time before bankruptcy, but he need not have acquired a lien by judicial proceedings.

6. If the trustee's avoidance of a security interest pursuant to section 60, 67a, 67c(1), or 67d would redound to the benefit of the holder of a junior security interest otherwise indefeasible by the trustee or to any person or persons other than the general creditors, the trustee may obtain an order preserving the voidable security interest for the benefit of the estate.

7. When a security interest is preserved for the benefit of the estate under section 60b, 67a, 67c(2), or 67d, the trustee is limited in his recovery to the amount of the claim of the creditor whose security interest is preserved.

8. When a security interest is preserved for the benefit of the estate under section 70e, the amount of the secured creditor's claim is no more a limit on the trustee's recovery than it is in a case when the trustee seeks and obtains avoidance under that subdivision.

9. If a secured creditor of the estate has priority over another secured creditor in the collateral subject to their security interests, the trustee is not entitled to assert the right of priority of the one against the other if the prior interest is not voidable and thus not preservable for the benefit of the estate.

10. If a secured creditor with a provable claim against the estate has a right to avoid the security interest of another independently of any claim of priority dependent on his security, the trustee may assert the right of avoidance, subject to the secured creditor's right to enforce his security interest if indefeasible by the trustee.

11. A lien creditor's right against an unperfected security interest under section 9-301 of the Code is a right of priority which the trustee is not entitled to assert under section 70e.

12. The priority of a lien obtained by judicial proceedings over a security interest (as provided by section 9-301(1)(b) of the Code) may be preserved for the benefit of the estate if the lien so obtained thereafter becomes voidable under section 67a of the Bankruptcy Act.