

## The 1950 Amendment to the Preference Section of the Bankruptcy Act and Maryland Law

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## THE 1950 AMENDMENT TO THE PREFERENCE SECTION OF THE BANKRUPTCY ACT AND MARYLAND LAW<sup>†</sup>

By BRIDGEWATER M. ARNOLD\*

The primary purpose of this article is to make the attempt, perhaps hazardous for the author, to see how amended Sec. 60a<sup>1</sup> of the Bankruptcy Act should be applied to various types of property transfers in Maryland under applicable Maryland law. At the time this article is being written only one case<sup>2</sup> has come to the writer's attention which involves the amended Section 60a of the Bankruptcy Act, and applicable Maryland law. Another case involves the Uniform Trust Receipts Act enacted in Virginia. As Maryland also has the Uniform Trust Receipts Act, this case likewise is available for guidance.<sup>3</sup> This means, of course, that much that is written here is an attempt to speculate as to probable future rulings without the comforting buttress of decided cases.

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<sup>†</sup> All references to the Maryland Code in this Article and footnotes are to Flack's Annotated Code of Maryland, 1951, unless otherwise specified, and are hereinafter cited only by Article and Section number. References to the Bankruptcy Act will be to the Section number only of the Bankruptcy Act only, but the first time a citation thereof appears in a footnote, the corresponding United States Code Annotated citation will be given, for the convenience of the reader.

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<sup>1</sup> 11 U. S. C. A. (1953 Cum. Supp.), Sec. 96.

<sup>2</sup> In re Burton, 120 F. Supp. 148 (D. C. Md., 1954), conditional sales.

<sup>3</sup> In re Harvey Distributing Co., 88 F. Supp. 466 (D.C. E.D. Va., 1950) and on appeal Coin Machine Acceptance Corp. v. O'Donnell, 192 F. 2d 773 (4th Cir., 1951). For a case construing Sec. 60a and applicable Arkansas law see In re Watson, 99 F. Supp. 49 (D.C. W.D., Ark., 1951).

On March 18, 1950, Section 60 of the Bankruptcy Act, dealing with preferences to creditors voidable in bankruptcy, was amended. The effect of this amendment was to establish new tests as to when a transfer became perfected for purposes of Section 60 and, it might be added parenthetically, for purposes of the second act of bankruptcy in Section 3.<sup>4</sup> The 1950 amendment to Section 60 is roughly about twelve times as long as the prior statutory material which it replaced and, the author dares predict, likewise about twelve times as complicated to one reading it. This is not said in any spirit of criticism of the 1950 amendment because it seems quite apparent that the groups which labored to work out a solution to a difficult problem, — which necessarily involves many types of property transfers and applicable, but varied, recording statutes, — have sought to reach a balanced, workable and fair result.<sup>5</sup>

It is not the purpose of this article to review the amendments to Section 60 since 1898 and the construction of these amendments by the courts.<sup>6</sup> Suffice it to say, that Congress in the 1938 revision of the Bankruptcy Act decided to strike down the advantages given to certain creditors claiming liens by virtue of the doctrine of relation back, applied to so-called equitable liens exemplified by *Sexton v. Kessler*<sup>7</sup> and "pocket liens" as exemplified by *Carey v. Donahue*.<sup>8</sup> These advantages were necessarily at the expense of general creditors who frequently were unaware, until their debtor was in bankruptcy, that certain assets were, without any notoriety, already dedicated to certain creditors.

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<sup>4</sup> 11 U. S. C. A. (1953 Cum. Supp.), Sec. 21.

<sup>5</sup> See *A Proposal to Amend Section 60a of the Bankruptcy Act*, by J. Francis Ireton, *A 6 Corporate Reorganization Combined with American Bankruptcy Review* 257 (1947), for an enlightening discussion of the problem of preference and an analysis of an earlier proposed draft of a fairly similar amendment to Section 60a.

<sup>6</sup> For this information, see 3 COLLIER ON BANKRUPTCY (14th Ed., 1953), 877 *et seq.*, and Kupfer, *The Recent Amendment of Section 60a of the Bankruptcy Act*, 24 J. Nat'l Assn. of Referees in Bankruptcy 86 (1950).

<sup>7</sup> 225 U. S. 90 (1912).

<sup>8</sup> 240 U. S. 430 (1916).

To do this, Congress in 1938 amended Section 60a to read as follows:<sup>9</sup>

*“A preference is a transfer, as defined in this title, 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 10, 11, 12, or 13 of this Title, the effect of which transfer will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class. For the purposes of subdivisions a and b of this section, a transfer shall be deemed to have been made at the time when it became so far perfected that no bona-fide purchaser from the debtor and no creditor could thereafter have acquired any rights in the property so transferred superior to the rights of the transferee therein, and, if such transfer is not so perfected prior to the filing of the petition in bankruptcy or of the original petition under Chapters 10, 11, 12, or 13 of this title, it shall be deemed to have been made immediately before bankruptcy.”*

The language in italics was known as the “bona-fide purchaser for value” test of perfecting transfers to creditors.

Then came the *Klauder* case<sup>10</sup> decided on March 8, 1943. In this case a bank made advances to a company secured by the company making a concurrent assignment of accounts receivable to the bank. An involuntary petition in bankruptcy was filed against the company on April 18, 1940 and it was subsequently adjudged bankrupt. At the time of bankruptcy the company was indebted to the bank for loans so made on contemporary assignments of accounts receivable as security between January 19, 1940 and April 5, 1940. No notice of the assignments had been given to the debtors of the company whose obligations had been taken as security. Because of this omission the trustee in

<sup>9</sup> 11 U. S. C. A. (1943), Sec. 96(a). Italics supplied.

<sup>10</sup> *Corn Exchange Bank v. Klauder*, 318 U. S. 434 (1943).

bankruptcy challenged the bank's right to the benefit of the security on the grounds it was a voidable preference under Sec. 60, in that, the assignments had not been perfected under the law of Pennsylvania, which was the applicable state law, against a subsequent good-faith assignee for value. The court held the assignments were voidable preferences and that the trustee was entitled to the funds. The Court said:

"This is undoubtedly the effect of a literal reading of the Act. Its apparent command is to test the effectiveness of a transfer, as against the trustee, by the standards which applicable state law would enforce against a good-faith purchaser. Only when such a purchaser is precluded from obtaining superior rights is the trustee so precluded. So long as the transaction is left open to possible intervening rights to such a purchaser, it is vulnerable to the intervening bankruptcy. By thus postponing the effective time of the transfer, the debt, which is effective when actually made, will be made antecedent to the delayed effective date of the transfer and therefore will be made a preferential transfer in law, although in fact made concurrently with the advance of money. In this case the transfers, good between the parties, had never been perfected as against good-faith purchasers by notice to the debtors as the law required, and so the conclusion follows from this reading of the Act that the petitioners lose their security under the preference provision of Sec. 60(b)."<sup>11</sup>

Inasmuch as Maryland had the same common law rule as Pennsylvania requiring notification of the debtor in order to be protected against a subsequent bona fide assignee,<sup>12</sup> the Maryland General Assembly enacted, as emergency legislation, within less than two months after the *Klauder* case was decided, Article 8, Section 2<sup>13</sup> to validate assignments of accounts receivable against third parties without notification of the debtor. Also, some apprehension developed as to whether or not companies extending

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<sup>11</sup> *Ibid.*, 436-7.

<sup>12</sup> *Lambert v. Morgan*, 110 Md. 1, 72 A. 407 (1909).

<sup>13</sup> Md. Laws (1943), Ch. 728, approved May 4, 1943.

credit on trust receipt financing could ever protect themselves in the event of the debtor's bankruptcy despite full compliance with the notoriety provisions of The Uniform Trust Receipts Act.<sup>14</sup> These apprehensions were confirmed by *In re Harvey Distributing Company*.<sup>15</sup> On appeal from this case, the United States Court of Appeals for the Fourth Circuit<sup>16</sup> indicated doubts as to the validity of the District Court's ruling under the 1938 amendment but found it unnecessary to pass upon the question since the 1950 amendment took effect while the case was pending and the United States Court of Appeals decided that the 1950 amendment was applicable, it being practical to apply it as provided in Section 4b of the amendment. This Section provided:

“Effect of This Amendatory Act — . . . b. The provisions of this amendatory Act shall govern proceedings so far as practicable and applicable in cases pending when it takes effect; . . .”<sup>17</sup>

In the statement of “Purposes of the Bill” containing the 1950 amendment to Sec. 60a, it is stated among other things:

“The resultant confusion has cast grave doubt upon the validity of normal business security, in all of the areas covered by trust receipts, factors liens, oil leases, cattle loans, airplane-equipment financing, chattel mortgages, assignments of accounts receivable, conditional sales agreements for resale, etc. Indeed, a bank officer, who appeared as one of the witnesses at the subcommittee hearing, testified that the situation had come to such a pass that his institution was compelled to regard all such types of transaction as unsecured loans, and to rule on them, as to the terms which his bank was willing to enter into them, accordingly.”<sup>18</sup>

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<sup>14</sup> Art. 95½; See 10 Md. L. Rev. 285, 287 (1949).

<sup>15</sup> *Supra*, n. 3.

<sup>16</sup> *Coin Machine Acceptance Corp. v. O'Donnell, et al.*, *supra*, n. 3.

<sup>17</sup> Public Law 461, 81st Congress, Ch. 70 — 2nd Session; see also “*Sick Sixty*”, 33 Cornell L. J. 99 (1947).

<sup>18</sup> United States Code Congressional Service — 81st Congress — Second Session 1950, 1987.

This all led up to the enactment of the 1950 amendment to Sec. 60a.<sup>19</sup>

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<sup>19</sup> Sec. 60:

"a. (1) 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 initiating a proceeding under 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.

"(2) For the purposes of subdivisions a and b of this section, a transfer of property other than real property shall be deemed to have been made or suffered at the time when it became so far perfected that no subsequent lien upon such property obtainable by legal or equitable proceedings on a simple contract could become superior to the rights of the transferee. A transfer of real property shall be deemed to have been made or suffered when it became so far perfected that no subsequent bona fide purchase from the debtor could create rights in such property superior to the rights of the transferee. If any transfer of real property is not so perfected against a bona fide purchase, or if any transfer of other property is not so perfected against such liens by legal or equitable proceedings prior to the filing of a petition initiating a proceeding under this Act, it shall be deemed to have been made immediately before the filing of the petition.

"(3) The provisions of paragraph (2) shall apply whether or not there are or were creditors who might have obtained such liens upon the property other than real property transferred and whether or not there are or were persons who might have become bona fide purchasers of such real property.

"(4) A lien obtainable by legal or equitable proceedings upon a simple contract within the meaning of paragraph (2) is a lien arising in ordinary course of such proceedings upon the entry or docketing of a judgment or decree, or upon attachment, garnishment, execution, or like process, whether before, upon, or after judgment or decree and whether before or upon levy. It does not include liens which under applicable law are given a special priority over other liens which are prior in time.

"(5) A lien obtainable by legal or equitable proceedings could become superior to the rights of a transferee or a purchase could create rights superior to the rights of a transferee within the meaning of paragraph (2), if such consequences would follow only from the lien or purchase itself, or from such lien or purchase followed by any step wholly within the control of the respective lien holder or purchaser, with or without the aid of ministerial action by public officials. Such a lien could not, however, become so superior and such a purchase could not create such superior rights for the purposes of paragraph (2) through any acts subsequent to the obtaining of such a lien or subsequent to such a purchase which require the agreement or concurrence of any third party or which require any further judicial action, or ruling.

"(6) The recognition of equitable liens where available means of perfecting legal liens have not been employed is hereby declared to be contrary to the policy of this section. If a transfer is for security and if (A) applicable law requires a signed and delivered writing, or a delivery of possession, or a filing or recording, or other like overt action as a condition to its full validity against third persons other than a buyer in the ordinary course of trade claiming through or under the transferor and (B) such overt action has not been taken, and (C) such transfer results in the acquisition of only an equitable lien, then such transfer is not perfected within the meaning of para-

It will be noted that this amendment establishes two tests<sup>20</sup> as to when a transfer is perfected. This is done by dividing property into two classifications and applying separate tests for each classification. The two classifications are: (1) Real Property; (2) Property Other Than Real Property.<sup>21</sup>

(1) The test for when a transfer of Real Property is perfected is the so-called "bona-fide purchaser for value"

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graph (2). Notwithstanding the first sentence of paragraph (2), it shall not suffice to perfect a transfer which creates an equitable lien such as is described in the first sentence of paragraph (6), that it is made for a valuable consideration and that both parties intend to perfect it and that they take action sufficient to effect a transfer as against liens by legal or equitable proceedings on a simple contract: *Provided, however*, That where the debtor's own interest is only equitable, he can perfect a transfer thereof by any means appropriate fully to transfer an interest of that character: *And provided further*, That nothing in paragraph (6) shall be construed to be contrary to the provisions of paragraph (7).

"(7) Any provision in this subdivision a to the contrary notwithstanding if the applicable law requires a transfer of property other than real property for or on account of a new and contemporaneous consideration to be perfected by recording, delivery, or otherwise, in order that no lien described in paragraph (2) could become superior to the rights of the transferee therein, or if the applicable law requires a transfer or real property for such a consideration to be so perfected in order that no bona fide purchase from the debtor could create rights in such property superior to the rights of the transferee, the time of transfer shall be determined by the following rules:

"I. Where (A) the applicable law specifies a stated period of time of not more than twenty-one 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 twenty-one days, and compliance therewith is had within twenty-one 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.

"(8) If no such requirement of applicable law specified in paragraph (7) exists, 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. A transfer to secure a future loan, if such a 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."

<sup>20</sup> As will appear later on in this article there is a slightly different test for equitable liens, *infra*, p. 343.

<sup>21</sup> Sec. 60a (2).



test. This is substantially the same test that appeared in the 1938 amendment.<sup>22</sup>

(2) The test for when a transfer of Property Other Than Real Property is perfected is the so-called "lien creditor" test.<sup>23</sup> This is defined in Sec. 60a(4) to mean:

"A lien obtainable by legal or equitable proceedings upon a simple contract within the meaning of paragraph (2) is a lien arising in ordinary course of such proceedings upon the entry or docketing of a judgment or decree, or upon attachment, garnishment, execution, or the like process, whether before, upon, or after judgment or decree and whether before or upon levy. It does not include liens which under applicable law are given a special priority over other liens which are prior in time."<sup>24</sup>

Some examples of when one would thus obtain a lien by legal proceedings would be the lien one obtains by placing the writ of *feri facias* in the sheriff's hands or laying a writ of attachment on a judgment.<sup>25</sup>

Unless a shorter period is established by applicable law, Sec. 60a(7)I(A) gives the transferee a period of grace of twenty-one days after the day of actual transfer for a contemporaneous consideration to do the necessary acts to perfect it, such as recording. If this is done, then the transfer is regarded as being made at the time it was actually made, that is, the transferee gets the benefit of relation back and the consideration for the transfer is not regarded as an antecedent debt. If state law sets no special time or a time longer than the twenty-one day period, Sec. 60a(7)I(B) still requires the perfecting to be done within the twenty-one day period of grace.

It is conceivable that the term "applicable law" in Sec. 60a as such could be construed to mean not only State law but also some Federal statute which might be involved because of the nature of the property transferred.<sup>26</sup> How-

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<sup>22</sup> 11 U. S. C. A. (1943), Sec. 96.

<sup>23</sup> Sec. 60a (2).

<sup>24</sup> Note also further limitations prescribed by paragraph (5).

<sup>25</sup> *Prentiss Co. v. Whitman & Barnes Co.*, 88 Md. 240, 41 A. 49 (1898).

<sup>26</sup> As for example, the Ship Mortgage Act, 46 U. S. C. A. (1944), Ch. 25, Secs. 911, *et seq.*; Civil Aeronautics Act, 49 U. S. C. A. (1951), Sec. 523.

ever, in the "Purposes of the Bill", no reference in this connection is made to Federal law but only to State law. In the statement of the objectives of the bill it is said:

"... to provide that no transfer made in good faith, for a new present consideration, shall constitute a preference to the extent of such consideration actually advanced, if the provisions of applicable State law governing the perfection of such transfer are complied with, with an appropriately rigid time limitation (twenty-one days) for such perfection if such limitation is not itself prescribed by the applicable State law."<sup>27</sup>

It might be noted as regards corporate receiverships, Article 23, Section 77(b) provides:

"All preferences, payments and transfers made by the corporation, which would be void or fraudulent under the provisions of the insolvency laws of this State if made by a natural person or under the acts of the Congress of the United States relating to bankruptcy, shall to like extent be fraudulent and void . . ."

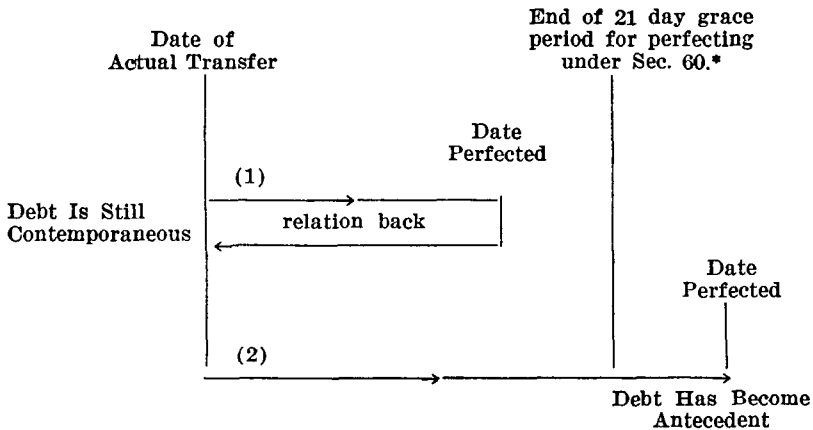
Hence, if this provision is a valid one,<sup>28</sup> Section 60 of the Bankruptcy Act is not only of importance in bankruptcy proceedings, including corporate reorganizations under the Bankruptcy Act, but also in corporate receiverships in which a receiver is appointed pursuant to Article 23.

Most of the problems that hereafter will be discussed would appear to be capable of solution by using the pattern set out below. In the pattern we have (1) a transfer for a contemporaneous consideration perfected within the grace period and (2) a transfer for a contemporaneous consideration perfected beyond the grace period, this latter fact causing the consideration to become an antecedent debt.

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<sup>27</sup> United States Code Congressional Service — 81st Congress — Second Session 1950, 1988; See also COLLIER ON BANKRUPTCY (14th Ed., 1953), Par. 60.39, 912.

<sup>28</sup> There may be some question whether or not this statute goes so far as to infringe upon the paramount power of Congress to enact bankruptcy legislation. *International Shoe Co. v. Pinkus*, 278 U. S. 261 (1929).



\* Unless Maryland statute specifies a shorter period of time for perfecting.

### PERSONAL PROPERTY

*Pledge of Personal Property.* No recording is required for a pledge of personal property. That delivery to the pledgee is required to perfect it as against "lien creditors" appears to be the common law. In the case of a pledge that comes within the purview of Article 95½, Sections 3 and 15,<sup>29</sup> the pledgee for "new value" is protected for ten

<sup>29</sup> Sec. 3 of Art. 95½, provides:

"(Attempted Creation or Continuance of Pledge Without Delivery or Retention of Possession):

(1) An attempted pledge or agreement to pledge not accompanied by delivery of possession, which does not fulfill requirements of a trust receipt transaction, shall be valid as against creditors of the pledgor only as follows:

(a) to the extent that new value is given by the pledgee in reliance thereon, such pledge or agreement to pledge shall be valid as against all creditors with or without notice, for ten days from the time the new value is given;

(b) to the extent that the value given by the pledgee is not new value, and in the case of new value after the lapse of ten days from the giving thereof, the pledge shall have validity as against lien creditors without notice, who become such as prescribed in Section 8, only as of the time the pledgee takes possession, and without relation back.

(2) Purchasers (including entrusters) for value and without notice of the pledgee's interest shall take free of any such pledge or agreement to pledge unless, prior to the purchase, it has been perfected by possession taken.

(3) Where, under circumstances not constituting a trust receipt transaction, a person, for a temporary and limited purpose, delivers

days from the time new value is given even though he does not take delivery as against "lien creditors."<sup>30</sup> Applicable law therefore, setting a period of time of less than twenty-one days, the transfer should be perfected within the shorter period of time set by Article 95½, Section 3.<sup>31</sup> Hence, if money is advanced or new credit given on October 1st and the creditor takes delivery of the pledge as security therefore on or before October 11th, the transfer should be treated as if it were made on October 1st and is for a present consideration. However, if the pledgee does not take possession until October 12th, the ten-day grace period having elapsed, the transfer should be treated as made on October 12th and the obligation incurred on October 1st becomes an antecedent debt and, the other elements of a voidable preference being present under Section 60a and b, the trustee in bankruptcy may set it aside.

As to a pledge not within the purview of Article 95½, Sections 3 and 15, the common law rule apparently is that it is good, if the pledgee takes delivery any time before there is a "lien creditor".<sup>32</sup> No special time limit being set under such applicable law, Sec. 60a(7)I(B) of the Bankruptcy Act allows a grace period of twenty-one days for perfecting the pledge by delivery. That being the case, if the loan or new credit is given on October 1st and the pledgee takes possession on October 22nd — "within 21 days after," the transfer should be treated as made on October 1st for a present consideration. However, if the pledgee does not take possession until October 23rd, the twenty-one day grace period having elapsed, the transfer should be deemed to be made on October 23rd and the

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goods, documents, or instruments, in which he holds a pledgee's or other security interest, to the person holding the beneficial interest therein, the transaction has like effect with a purported pledge for new value under this section."

Sec. 15 exempts from the Article various personal (non-professional) transactions, 1933 Handbook of the Natl. Conference of Comm'r's, on Uniform State Laws & Proceedings, 250.

<sup>30</sup> For the definition of "new value" and "lien creditor" see Art. 95½, Sec. 1.

<sup>31</sup> Sec. 60a (7) I(A).

<sup>32</sup> BROWN ON PERSONAL PROPERTY (1936), 573; HANNA AND MACLACHLAN, CASES ON CREDITORS' RIGHTS (4th Ed., 1949), Vol. 1, 123; In re Consorto Const. Co., 212 F. 2d 676 (3rd Cir., 1954); In re P. J. Sullivan Co., 247 F. 139 (D.C. N.D. N.Y., 1918).

obligation incurred on October 1st would become an antecedent debt.

*Field Warehousing.* Somewhat related to the idea of a pledge is the use of field warehousing as a security device. In these transactions arrangements are made whereby a warehouse is set up on or near the debtor's premises, usually by the debtor leasing the "warehouse premises" to a corporation perhaps specially created to own and operate the warehouse. The premises to be used as the warehouse are marked off with appropriate signs to give notice to the public that the premises are a warehouse. As the debtor acquires goods to be used in his business they are placed in the warehouse as bailee and warehouse receipts are issued by the warehouse. These warehouse receipts are then delivered to the creditor who holds them as security for his loan or loans to the debtor. Assuming the warehousing arrangement is sufficiently set up to meet court approval, it would seem that the security the creditor receives is the warehouse receipt. The debtor is pledging the warehouse receipt with the creditor as security.<sup>33</sup> This transaction might come under the provisions of Article 95½, Section 3. Hence it would seem the same result would follow as described above involving pledges. Thus if the new value is given by the creditor on October 1st the document,<sup>34</sup> i.e., the warehouse receipt, should be delivered to the creditor on or before October 11th to be perfected within the ten day grace period and get the benefit of relation back so that the present consideration on October 1st does not become an antecedent debt.

If the field warehouse is considered as owned and operated directly by the creditor, then the delivery of the goods themselves to the warehouse would be the delivery which would perfect the pledge and it would seem the problem should once again be determined under the provision of Article 95½, Section 3 as the applicable law with the ten day grace period. In a case of this type, a court, if it is not satisfied with the manner in which the warehouse has been set up and marked and the goods segre-

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<sup>33</sup> Friedman, *Field Warehousing*, 42 Col. L. Rev. 991, 1012 (1942).

<sup>34</sup> For the definition of "document" see Art. 95½, Sec. 1.

gated from the debtor's possession, may decide there has never been a delivery of possession of the pledge to the creditor and invalidate the security interest of the creditor.<sup>35</sup>

*Factor's Lien.* A factor's lien agreement created under the provisions of Article 2, Sections 21-27 is required to be recorded within fifteen days after the execution of the written agreement.<sup>36</sup> If recorded within this time, the factor's lien is effective as against all claims of creditors of the borrower from the time of recording except certain statutory lien creditors specified in Section 24. Applicable law, therefore, setting a period of time of less than twenty-one days, the transfer should be perfected within the shorter period of time set by Article 2, Section 23.<sup>37</sup> Hence, it would seem that if the agreement is executed on October 1st for a contemporaneous consideration it must be recorded on or before October 16th to keep the present consideration on October 1st from becoming an antecedent debt.

At this point it might be noted that Article 2, Section 22 appears to permit the lien to stand as security for future advances which the factor may make after the execution of the agreement. The lien for these future advances should be protected so far as Section 60 is concerned by virtue of the last sentence in Section 60a(8) of the Bankruptcy Act.

A more difficult problem that may arise grows out of the fact that the Factor's Lien Act seems to permit after-acquired property of the borrower to become subject to the factor's lien.<sup>38</sup> Suppose a factor's lien agreement is executed on October 1st covering present inventory and also such goods as the borrower may acquire in the future. The agreement is recorded within fifteen days as required by Article 2, Sections 23 and 24. On October 25th the bor-

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<sup>35</sup> In re Spanish American Cork Products Co., 2 F. 2d 203 (4th Cir., 1924). For a detailed article on "field warehousing" see Friedman, *Field Warehousing*, *supra*, n. 33. See also BIRNBAUM, SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE, (American Law Institute, 1954), 133 and Proposed Uniform Commercial Code, (1952), Secs. 7-205(2), 9-305(2).

<sup>36</sup> Art. 2, Secs. 23, 24.

<sup>37</sup> Sec. 60a (7) I(A).

<sup>38</sup> Art. 2, Secs. 22, 23(c).

rower acquires additional goods which, under the terms of the agreement, become additional security for the loan of October 1st. Will this be regarded as merely an equitable charge which at best might become a legal lien on October 25th? If so, paragraph (6) would seem to be the pertinent part of Sec. 60a of the Bankruptcy Act on this problem. While there may be some question as to the legislative wisdom of enacting a statute which permits a creditor by appropriate language in the agreement to blanket under his lien such property as his debtor may acquire in the future from persons other than the secured creditor himself, it is not the purpose of this article to go into the pros and cons of this problem.<sup>89</sup> The Maryland Factor's Lien law seems to permit this and protect the factor who properly records against all third persons except possibly the purchaser in the ordinary course of business from the borrower. Accordingly, although not free from doubt, it would seem that a lien on the property acquired by the borrower on October 25th should not be invalidated as a preference. Sec. 60a(6) of the Bankruptcy Act says in part:

"The recognition of equitable liens where available means of perfecting legal liens have not been employed is hereby declared to be contrary to the policy of this section. If a transfer is for security and if (A) applicable law requires a signed and delivered writing, or a delivery of possession, or a filing or recording, or other like overt action as a condition to its full validity against third persons other than the buyer in the ordinary course of trade claiming through or under the transferor and (B) such overt action has not been taken, and (C) such transfer results in the acquisition of only an equitable lien, then such transfer is not perfected within the meaning of paragraph (2). . . ."

While it may seem difficult to visualize a legal or even an equitable lien between October 1st and October 25th on non-existent property of the borrower, there would seem

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<sup>89</sup> See Cohen and Gerber, *The After-Acquired Property Clause*, 87 Univ. of Pa. L. Rev. 635 (1939).

to be legislative sanction<sup>40</sup> for an advanced charge on such property for the benefit of the factor against all persons, except possibly a purchaser in the ordinary course of trade, where appropriate notoriety has been given by proper recording and the necessary "overt action" taken, thus eliminating the invalidating element (B) in the Act. Also, it is to be noted that because of timely recording there is no secrecy at the expense of third persons and the transaction does not come within one of the underlying policies of Section 60a of the Bankruptcy Act of striking down secret liens. If such a lien is valid, then the trustee in bankruptcy acquires title to the bankrupt assets subject to liens which are valid under applicable state law, including liens on after acquired property.<sup>41</sup>

Another possible solution, but probably a very doubtful one, to this whole problem of after-acquired property is to take the view that where the state legislature authorizes by statute the creation of a lien on after-acquired property, it should be treated as a statutory lien and, if compliance is had with the requirements of the statute, it is protected under the provisions of Sec. 67b<sup>42</sup> of the Bankruptcy Act. This section provides:

"The provisions of Sec. 60 of this Act to the contrary notwithstanding, statutory liens in favor of employees, contractors, mechanics, landlords, or *other classes of persons* . . . created or recognized by the laws of the United States or of any State, may be valid against the trustee, even though arising or perfected while the debtor is insolvent and within four months prior to the filing of the petition initiating a proceeding under this Act by or against him."

The question is: Is this a statutory lien in favor of "other classes of persons"? Is a factor included in "classes of per-

<sup>40</sup> Art. 2, Sec. 23(c) :

" . . . Such lien shall be valid from the time of such recording, whether such merchandise shall be in existence at the time of the execution of the written agreement creating the lien or shall come into existence subsequently thereto, or shall subsequently thereto be acquired by the borrower. . . ."

<sup>41</sup> *Pearson v. Rapstine*, 203 F. 2d 313 (5th Cir., 1953) ; *Mason v. Citizens Nat. Trust & Savings Bank*, 71 F. 2d 246 (9th Cir., 1934) ; BIRNBAUM, *SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE*, *supra*, n. 35, 103, 104.

<sup>42</sup> 11 U. S. C. A. (1953), Sec. 107(b).



sons"?<sup>43</sup> A broad construction might include a factor, but it seems doubtful.

*Bill of Sale.* Where a bill of sale is executed in a sales transaction<sup>44</sup> and the vendor remains in possession of the chattel, Article 21, Section 49 provides that no property shall pass as against creditors who acquire a lien by judicial proceedings on such personal property unless recorded as therein provided. Article 21, Section 53 provides that bills of sale must be recorded within the county where the vendor resides within twenty days from the date hereof. We assume that this means that the vendee has twenty days to record, exclusive of the date of the bill of sale. If recorded within this time the vendee should be protected against intervening "lien creditors."<sup>45</sup> Here it would seem that if the execution date of the bill of sale is October 1st it must be recorded on or before October 21st to keep the present consideration on October 1st from becoming an antecedent debt.<sup>46</sup> There may appear to be a problem as to whether or not a vendee who takes a bill of sale of goods for a present consideration but fails to record the bill of sale could be deemed a creditor of the vendor. This problem also arises in the case of a sale of land and will be discussed later in connection with the sale of land.<sup>47</sup>

If the bill of sale is used as a vehicle for a mortgage probably the same result would follow, as Article 21, Section 54 provides that a mortgage of personal property shall be executed, acknowledged and recorded as are bills of sale, which would seem to make Article 21, Section 53 ap-

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<sup>43</sup> See McLaughlin, *Aspects of the Chandler Bill to Amend the Bankruptcy Act*, 4 Univ. of Chicago L. Rev. 369, 395 (1937); *White v. Karl Kiefer Machine Co.*, 127 F. 2d 119 (8th Cir., 1942).

<sup>44</sup> Not as a vehicle for a chattel mortgage.

<sup>45</sup> Referring to Art. 24, Secs. 39 and 46, Code of 1860 (Flack's Code [1951], Art. 21, Secs. 49 and 53) in *Kreuzer v. Cooney*, 45 Md. 582, 591 (1877), the court says:

"By having the conveyance recorded within the time prescribed by the statute, the title of the grantee, though the grantor still retains possession, is as perfect, and is protected as effectually as if the sale had been accompanied by delivery."

If this is true as to subsequent purchasers, it should also be true as against "lien creditors".

<sup>46</sup> *Kreuzer v. Cooney*, *ibid.*; *Dorsey v. Smithson*, 6 H. & J. 61 (1823); *Clary v. Frayer*, 8 G. & J. 398 (1837).

<sup>47</sup> *Infra*, p. 335.

plicable. If a petition in bankruptcy, however, were filed before the recording other problems could arise under the fraud provisions of the Bankruptcy Act, particularly Sections 70e and 70c,<sup>48</sup> the “strong arm” clause.<sup>49</sup>

*Chattel Mortgage.* Article 21, Section 49 provides that no personal property whereof the mortgagor shall remain in possession shall pass as against creditors who acquire a lien by judicial proceedings on such personal property unless recorded as therein provided. Article 21, Section 56 provides that a mortgage of personal property shall be valid and take effect, except as between the parties hereto, only from the time of recording. Relying on this statute, the Court of Appeals of Maryland in a case where a chattel mortgage was executed on October 3rd, a garageman obtained a garageman’s lien on October 6th, and the chattel mortgage was recorded on October 14th, ruled that the garageman’s lien was superior to the chattel mortgage. The Court said, “. . . in Maryland at least, a chattel mortgage, unlike a mortgage of real estate, takes effect, except as between the parties, only from the time of recording . . .”<sup>50</sup> In view of Article 21, Section 49 and the language in this case it would seem that a “creditor who obtains a lien through judicial proceedings” before a chattel mortgage is recorded would prevail over the chattel mortgagee despite the fact that the mortgage is recorded within the twenty day period. No particular period of time is given by Section 56 in which the recording is to be made. Hence, up to this point, under Sec. 60a(7)I of the Bankruptcy Act it would seem that the recording should be made within twenty-one days after the date of transfer as in the case of conditional sales of chattels discussed below. However, Article 21, Section 53 provides that bills of sale must be recorded within twenty days from the date thereof. Article 21, Section 54 says that a mortgage of personal property shall be recorded as bills of sale. This may well mean that a chattel mortgage likewise must be recorded within

<sup>48</sup> 11 U. S. C. A. (1953), Sec. 110(e) and (c).

<sup>49</sup> See *In re Cook*, 9 F. Supp. 764 (D.C. Md., 1935).

<sup>50</sup> *Baltimore Bankers Corp. v. Peters, etc.*, 193 Md. 655, 658, 69 A. 2d 491 (1949).

twenty days.<sup>51</sup> Assuming this to be a correct analysis, there would be only a twenty day period of grace instead of twenty-one days, so that if the mortgage is executed on October 1st it should be recorded on or before October 21st to keep the present consideration from becoming an antecedent debt. Here, also, if the petition in bankruptcy is filed before the recording other problems could rise under the fraud provisions of the Bankruptcy Act, particularly Sections 70e and 70c.

Except for mortgages given to certain specified mortgagees as provided in Article 21, Sections 60-73 inclusive, and in the cases of certain corporate mortgagors<sup>52</sup> and perhaps mortgages of future crops,<sup>53</sup> it seems that Maryland does not generally give validity to mortgages of after-acquired property.<sup>54</sup> The whole question of the validity of mortgages of after-acquired property, including future crops, does not appear to be too clear and settled in Maryland and could easily warrant a special article written on this subject alone. Other jurisdictions also have their difficulties with this problem.<sup>55</sup> It is possible that if the court will hold that there is an equitable lien or charge and the mortgage is properly recorded within the time required by Section 60a of the Bankruptcy Act, such a mortgage of after-acquired property will be protected. This result might be worked out under the case of *In re Cook*.<sup>56</sup> On the other hand, if we take the language used in *Grimes v. Clark*,<sup>57</sup> there would be no lien on the after-acquired prop-

<sup>51</sup> Gill v. Griffith, 2 Md. Ch. 270 (1848).

<sup>52</sup> Butler v. Rahm, 46 Md. 541 (1877); Brady v. Johnson and others, Trustees, 75 Md. 445, 26 A. 49 (1892); Diggs v. Fidelity & Deposit Co., 112 Md. 50, 75 A. 517 (1910).

<sup>53</sup> In re Cook, *supra*, n. 49, relying on G. Ober & Sons v. Keating, 77 Md. 100, 26 A. 501 (1893), which established an equitable lien.

<sup>54</sup> First National Bank v. Lindenstruth, 79 Md. 136, 28 A. 807 (1894); Clark v. Grimes, 232 F. 190 (D.C. Md., 1916), *aff'd*, 234 F. 604 (4th Cir., 1916), where, under a recorded mortgage of a future stock of goods, the mortgagee subsequently took possession of after-acquired goods shortly before the mortgagor's bankruptcy, the court held the mortgagee received a preference.

<sup>55</sup> See Cohen and Gerber, *The After-Acquired Property Clause*, 87 Univ. of Pa. L. Rev. 635 (1939).

<sup>56</sup> *Supra*, n. 49.

<sup>57</sup> *Supra*, n. 54, 234 F. 604, 608, where a recorded mortgage of after-acquired property, was involved:

"Nor on the whole are we persuaded that the equities of Grimes" (the mortgagee) "are superior to those of other creditors. He was

erty and recordation would give it no validity as against third persons. In this situation, there is no transfer of the after-acquired property at the time the consideration is given and any subsequent act by the mortgagee to perfect the transfer by taking possession or receiving a supplemental mortgage would be a transfer for an antecedent debt and, other necessary elements being present, should be set aside as a preference.<sup>58</sup>

*Conditional Sale of Chattel.* Article 21, Section 74 provides that every note, sale or contract for the sale of goods and chattels, or of any item of furnishing or equipment which is affixed to real property, wherein the title thereto, or a lien thereon, is reserved until the same be paid in whole or in part, or the transfer of title is made to depend upon any condition therein expressed and possession is to be delivered to the vendee, shall, in respect to such reservation and condition, be void as to creditors who acquire without notice a lien by judicial proceedings on such goods or chattels, or in case of any item affixed to real property on such real property, until such note, sale or contract be in writing, signed by the vendee and be recorded.<sup>59</sup>

No particular period of time is given as to when the recording is to be made. Hence, under Section 60a(7)I of the Bankruptcy Act the recording should be made within twenty-one days after the date of the delivery to the vendee. So, if the article is delivered to the vendee on October 1st, the conditional sale should be recorded on or before October 22nd to keep the present consideration from becoming an antecedent debt. Here, also, if a petition in bankruptcy is filed before the recording, other problems

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bound to know that under Maryland law his mortgage would not be a lien upon or give him any right to seize the goods afterwards purchased by Baker; and dealers who sold to Baker on credit were presumably aware that the supplies they furnished would not be subject to Grimes' mortgage."

<sup>58</sup> For a discussion of this problem see COLLIER ON BANKRUPTCY (14th Ed., 1953), par. 60.50, 972.

<sup>59</sup> Also in regard to conditional sales it should be noted that the Bankruptcy Act, Sec. 1(30), 11 U. S. C. A. (1953 Cum. Supp.), Sec. 1(30), provides:

" . . . the retention of a security title to property delivered to a debtor shall be deemed a transfer suffered by such debtor."

could arise under the fraud provisions of the Bankruptcy Act, particularly Sections 70e and 70c.<sup>60</sup>

*Trust Receipt.* The Uniform Trust Receipts Act<sup>61</sup> provides that the entruster's security interest in goods, documents or instruments under the written terms of a trust receipt transaction, shall without any filing of a statement of trust receipt financing be valid as against all creditors of the trustee, with or without notice, for thirty days after delivery of the goods, documents or instruments to the trustee, etc. Article 95½, Section 8 further provides that the entruster's security interest shall be void as against "lien creditors,"<sup>62</sup> that is, creditors who have a lien through judicial proceedings, who become such after such thirty day period and without notice of such security interest and before filing. Article 95½, Section 13 provides for the filing with the State Tax Commission of a "Statement of Trust Receipt Financing" in reference to goods and documents. No such filing is apparently required with reference to instruments<sup>63</sup> in trust receipt transactions but it would appear that the same results will follow as to instruments as they would to goods and documents, in view of the thirty day grace period given to all three types of security interest. It would seem that as no provision is made for public notoriety in the case of instruments, if the entruster is to be protected against "lien creditors" after the thirty day period, he would have to take possession of the instruments from the trustee.

Section 60a(7)I of the Bankruptcy Act provides that where the applicable law specifies a period of time of more than twenty-one days, and compliance therewith is had within twenty-one days after the transfer, the transfer shall be deemed to be made at the time of the transfer. Here then, is a situation where the entruster, although he complies with state law, may run afoul of Section 60a of

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<sup>60</sup> For an enlightening pioneer opinion by Chief Judge William C. Coleman of the United States District Court for Maryland construing the 1950 amendment to Section 60a of the Bankruptcy Act in conjunction with the Maryland conditional sale recording statute, see *In re Burton*, 120 F. Supp. 148 (D.C. Md., 1954).

<sup>61</sup> Art. 95½, Sec. 8.

<sup>62</sup> For the definition of "lien creditor", see Art. 95½, Sec. 1.

<sup>63</sup> For the definition of "instruments" see *ibid.*

the Bankruptcy Act because the grace period allowed by Section 60a(7)I(B) is less than that permitted by the applicable Maryland statute. If the trust receipt transaction occurs on October 1st and the entruster in the case of goods and documents files a statement with the State Tax Commission on or before October 22nd, the transfer should be treated as if it were made on October 1st and for a present consideration. However, if the entruster does not file until October 23rd, the twenty-one day grace period having elapsed, the transfer should be deemed made on October 23rd and the obligation incurred on October 1st is treated as an antecedent debt. Apparently in the case of instruments, where there is no provision for filing, the entruster should take possession on or before October 22nd.

The filing of a "Statement of Trust Receipt Financing" gives the required notoriety and is valid for a period of one year.<sup>64</sup> Under the Uniform Trust Receipts Act<sup>65</sup> the filing of the statement of trust receipt financing in the State Tax Commission Office does not of itself create a security interest in the entruster. It is necessary that a trust receipt itself must be executed covering the particular entrusted goods.<sup>66</sup> The purpose of the filing is merely to give notice of possible trust receipt transactions and it is not necessary that the trust receipt itself be filed.<sup>67</sup> Hence, if a statement is filed on October 1st and a trust receipt is executed for a present granting of credit on November 1st it would seem that under Section 60a of the Bankruptcy Act the trust receipt lien should be valid even though it is on property acquired subsequent to the filing of the statement of trust receipt financing with the State Tax Commission. In other words, the notoriety obtained by filing on October 1st should be adequate to cover future acquired property.

*Consignment.* Ordinarily a consignment is nothing more than a bailment for sale but with no obligation on the con-

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<sup>64</sup> Art. 95½, Sec. 13(4).

<sup>65</sup> Art. 95½.

<sup>66</sup> *In re Yost*, 107 F. Supp. 432 (D.C. Md., 1952, Chesnut, J.).

<sup>67</sup> *In re Nickulas*, 117 F. Supp. 590 (D.C. Md., 1954), *aff'd.*, *Tatelbaum v. Refrigeration Discount Corp.*, 212 F. 2d 877 (4th Cir., 1954).

signee to purchase.<sup>68</sup> Title to the goods remains in the consignor even though possession is in the consignee. As no debtor-creditor relation exists between the consignee and the consignor there is normally no basis for a preferential transfer within the confines of Section 60 of the Bankruptcy Act. However, Maryland enacted Article 2, Sections 18-20 inclusive, in 1922. These sections provide that any person engaged in any mercantile, trading or manufacturing business as agent shall, prior to commencing such business, file in the clerk's office a certificate in writing under oath, disclosing the true name and address of the principal, etc. This certificate is to be recorded in the "Agency Record." If any person conducting such business as agent shall fail to file the certificate, any creditor of such person has the right to sue and upon obtaining judgment all the goods, etc. used or acquired in said business shall be liable to seizure and sale under execution in satisfaction of the judgment.

Considering the fact that these sections have been in the Code for over thirty years, there is a surprising paucity of decisions construing them and whether or not they apply to the consignor-consignee relationship still seems to be a question.<sup>69</sup>

If these statutes do apply to consignments and there has been a failure to comply with the recording provision

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<sup>68</sup> In re Sachs, 31 F. 2d 799, 800 (D.C. Md., 1929).

<sup>69</sup> In re Eichengreen, 18 F. 2d 101 (D.C. Md., 1927), a manufacturer shipped shoes to a dealer under a written agreement which was not recorded. Upon the dealer's bankruptcy, the manufacturer sought to reclaim the shoes, which were over 50% of the dealer's stock, contending the written agreement was a consignment agreement. The Court held the agreement appeared to be a conditional sale agreement and, not being recorded, the manufacturer could not reclaim the shoes. The court said, however, that if the agreement was a consignment as contended by the manufacturer, the manufacturer still could not reclaim the shoes because of the failure to file a certificate under the Factors Act, Art. 2. On appeal it was decided in *Reliance Shoe Co. v. Manly*, 25 F. 2d 381 (4th Cir., 1929), that the agreement was a conditional sale contract and therefore it was unnecessary to decide whether the Maryland statute in regard to agents and factors would apply to this case. Subsequently, in *In re Sachs*, *supra*, n. 68, an owner entrusted two cars to the bankrupt for purpose of sale, the bankrupt to keep all the proceeds above a certain price. The Trustee in bankruptcy claimed the funds representing the two cars. The court held that the cars were held on consignment and considered Art. 2, Sec. 18, but decided that Art. 2, Sec. 9, appeared to expressly exempt from the operation of Art. 2, Secs. 18-20, goods consigned as were the two cars in this case. See also *In re Nickulas*, *supra*, n. 67.

it would seem that if the consignee goes into bankruptcy the consigned goods in his possession at the time would pass to the trustee in bankruptcy by virtue of the fraud provisions of the Bankruptcy Act, particularly Section 70 a, c, e.<sup>70</sup> Whether or not, Article 2, Sections 18-20 inclusive, could change the consignor-consignee relationship sufficiently to create a creditor-debtor relationship that might make Sec. 60 of the Bankruptcy Act operative is problematical, but there may be such a possibility.<sup>71</sup>

*Assignment of Accounts Receivable.* Article 8, Section 2 provides that all written assignments and all written assignments in the nature of a pledge, of accounts receivable and amounts due or to become due on open accounts or contracts shall be valid and legal and shall pass the title of such accounts receivable to the assignee without the necessity of notice to the debtor and the transfer of the title shall take effect and be valid and enforceable against all persons as of the date thereof. There is no further act required such as recording or book-marking.

This being so, Section 60a(8) of the Bankruptcy Act provides, that if there is no requirement of applicable law requiring perfecting by recording, delivery or otherwise as specified in Sec. 60a(7), a transfer for or on account of a new and contemporaneous consideration shall be deemed to be made at the time of the transfer. Therefore, if there is a written assignment of accounts receivable on October 1st, it would seem that the transfer takes place on October 1st, and, if it is for a present consideration, no problem of it becoming an antecedent debt would be involved. There might be a question here as to whether or not the Maryland statute implies that there must be a delivery of a written assignment to the assignee. If so, it is possible the twenty-one day grace period for such delivery would be applied.

A problem arises as to an assignment of future accounts. This conceivably creates only an equitable charge

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<sup>70</sup> As to the possibility of fraud as to subsequent creditors in principal-agent relationship see *Albert v. Lindau*, 46 Md. 334, 346 (1877).

<sup>71</sup> See *COLLIER ON BANKRUPTCY* (14th Ed., 1953), par. 60.44, 948.



on the future accounts<sup>72</sup> and, if that is all, would probably be struck down under the provision of Section 60a(6) of the Bankruptcy Act as merely an equitable lien which could be perfected into a legal lien only by a subsequent assignment when the accounts become extant. However, the "applicable law" of Maryland<sup>73</sup> appears to protect such an assignment even against a bona-fide purchaser for value. The statutory language is:

" . . . All written assignments . . . of accounts receivable and amounts due or to become due . . . shall be valid . . . and the transfer of the title shall take effect and be valid and enforceable (sic) against all persons as of the date thereof . . . "

Accordingly, it would seem that an assignment of future accounts receivable for a contemporaneous consideration should not be invalidated as preferences under Section 60 of the Bankruptcy Act.

#### REAL PROPERTY

It will be recalled that the 1950 Amendment to Section 60a of the Bankruptcy Act adopts the "bona-fide purchaser for value" test of perfecting a transfer where real property is involved.

*Sale of Real Property.* Deeds of real property must be recorded as provided in Article 21, Section 1 (1954 Supp.) and Article 21, Section 21 provides that where there are two or more deeds conveying the same lands or chattels real, the deed or deeds which shall be first recorded according to law shall be preferred, if made bona-fide and upon good and valuable consideration. This section is made applicable to all deeds of mortgage, and to all other deeds or conveyances to the validity of which recording is necessary.

The statute sets no specific period of time within which to record.<sup>74</sup> Section 60a(7)I(B) of the Bankruptcy Act provides that where applicable law provides no stated

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<sup>72</sup> Page, *Latent Equities in Maryland*, 1 Md. L. Rev. 1, 28 (1936).

<sup>73</sup> Art. 8, Sec. 2.

<sup>74</sup> Art. 21, Sec. 24.

period of time for recording there is a twenty-one day period of grace after the transfer for perfecting it.

Hence, if a deed is executed on October 1st for a present consideration and is recorded on or before October 22nd, the transfer should be treated as if it were made on October 1st and is for a present consideration. However, if the deed is not recorded until October 23rd, the twenty-one day grace period having elapsed, the transfer should be deemed to be made on October 23rd, and the obligation incurred on October 1st becomes an antecedent debt.

Whether or not a vendee of real estate who paid contemporaneous value could be regarded as a "creditor" may possibly seem debatable. To be a "creditor" the vendee would have to have a claim provable in bankruptcy.<sup>76</sup> If the vendor has already delivered a deed to the vendee and the latter has withheld it from record it may be a little difficult to see how the vendee could have a claim provable in bankruptcy. However, a creditor paid off in full prior to his debtor's bankruptcy may still be a creditor having a claim provable in bankruptcy if he is deprived of the transfer which gave him a preference.<sup>76</sup> It is quite possible to reason that the grantor of real property, having been paid for the real property, is in the position of a debtor to the grantee until the real property is transferred. Although personal property was involved, the case of *Stieff v. Wilson*<sup>77</sup> may help to illustrate the method by which the vendor becomes the debtor of the vendee. In that case in December, 1924, vendor sold an H-Model piano to vendee, the piano to be delivered in June, 1925, which was not done. However, subsequently the vendor acquired an L-Model piano under a conditional sale contract from X. Vendor delivered the L-Model piano to vendee which was accepted by vendee in fulfilment of the December, 1924 contract. The conditional sale contract under which the vendor acquired the L-Model piano was not recorded. X sought to replevin the L-Model piano from the vendee. The court in protecting the vendee as a bona-fide purchaser

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<sup>76</sup> For the definition of "creditor", see Bankruptcy Act, Sec. 1(11).

<sup>76</sup> Sec. 57(g), 11 U. S. C. A. (1943), Sec. 93(g).

<sup>77</sup> 151 Md. 597, 135 A. 407 (1926).

for value who purchased without notice of X's unrecorded reservation of title said:

"A purchaser who receives delivery in compliance with an antecedent payment seems, in principle, to be in exactly the situation of a creditor who takes the chattel in satisfaction of an antecedent debt or pre-existing claim."<sup>78</sup>

Also, an eminent authority, Collier on Bankruptcy,<sup>79</sup> says:

"A transfer made for a consideration contemporaneous with its execution, but perfected later, will likewise be judged as of the later date (when the consideration had become an antecedent debt) unless the delay in recording was not more than the time allowed by Sec. 60a(7) as a grace period . . . Thus it can be seen that Sec. 60a puts a premium on prompt performance of whatever act is necessary under local law to perfect a transfer of real property good against the world."

Accordingly, if a vendee purchases real estate, and pays a present consideration for it but does not record the deed until after the twenty-one day grace period, then in the event the vendee had reason to believe his vendor was insolvent when he actually did record, and a petition in bankruptcy is filed within four months of the recording, it would seem that the trustee could set aside the transfer as a preference under Sections 60a and b of the Bankruptcy Act. It is presumed that the vendee could file a claim in bankruptcy as a general creditor for the consideration paid.<sup>80</sup>

*Mortgage of Real Property.* Mortgages of real property and deeds of trust in the nature of a mortgage must be recorded as provided by Article 21, Section 1 (1954 Supp.),<sup>81</sup> and mortgages must be recorded within six months<sup>82</sup> from their date. Recording within the six months period will

<sup>78</sup> *Ibid.*, 602.

<sup>79</sup> (14th Ed., 1953), par. 60.41, 925, 928.

<sup>80</sup> Such a transaction in Maryland probably could not be avoided by the trustee under Sec. 70 of the Bankruptcy Act and the "strongarm clause", because of *Cramer v. Roderick*, 128 Md. 422, 98 A. 42 (1916); see also *Caltrider v. Caples*, 160 Md. 392, 153 A. 445 (1931).

<sup>81</sup> See Art. 21, Sec. 37.

<sup>82</sup> Art. 21, Sec. 18.

protect the mortgagee against the rights of intervening creditors during this period<sup>83</sup> but not against the rights of an intervening bona-fide purchaser for value. Article 21, Section 21, providing that where there are two or more deeds conveying the same lands or chattels real, the deed or deeds which shall be first recorded according to law shall be preferred, if made bona-fide and upon good and valuable consideration, is likewise applicable to deeds of mortgage. Although courts and statutes at times treat a mortgage of real estate as if it were personal property,<sup>84</sup> the author assumes that for purposes of Section 60a of the Bankruptcy Act it will be regarded as a transfer of real property. Treating, then, such a mortgage as being a transfer of an interest in real property, under the provisions of Section 60a(2) of the Bankruptcy Act, the "bona-fide purchaser for value" test of perfection is required. As no particular period of grace is given as to bona-fide purchaser for value by Article 21, Section 21, the mortgagee under Section 60a(7)I(B) of the Bankruptcy Act should have a twenty-one day period of grace for perfecting his transfer. Hence, if the mortgage of real estate is executed on October 1st it should be recorded on or before October 22nd to get the benefit of the relation back. If not recorded until after October 22nd then the mortgagee should lose the benefit of relation back and the present consideration given for the mortgage on October 1st should be treated as an antecedent debt when the mortgage was recorded after October 22nd and, other elements of a voidable preference being present, the transfer should be avoided by the trustee in bankruptcy.

Mortgages to secure future advances<sup>85</sup> apparently would be governed by the same rule as ordinary mortgages<sup>86</sup> for purposes of Section 60a of the Bankruptcy Act with the twenty-one day period of grace for perfecting by recording. Section 60a(8) of the Bankruptcy Act provides:

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<sup>83</sup> *Knell v. Green St. Build. Assn.*, 34 Md. 67 (1871).

<sup>84</sup> Art. 66, Sec. 20; *Sumwalt v. Tucker*, 34 Md. 89 (1871).

<sup>85</sup> Art. 66, Secs. 2, 3. See *Watkins, Maryland Mortgages for Future Advances*, 4 Md. L. Rev. 111 (1940).

<sup>86</sup> Art. 21, Secs. 1, 21.

“ . . . A transfer to secure a future loan, if such a 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.”

An assignment of a mortgage of real estate for a term of more than seven years, if not recorded is invalid to pass the legal title.<sup>87</sup> As no particular time is stipulated for the recording of the assignment it would appear that there should be a twenty-one day grace period as in the case of recording the original mortgage itself.<sup>88</sup>

An interesting question for speculation is whether or not a release of a mortgage could become involved in the problem of a preference in bankruptcy. The effect of the release is to transfer the record title of the real estate back to the mortgagor, assuming it has not been done by operation of the defeasance clause in the mortgage by payment on the due day.<sup>89</sup> If the mortgagor does not have the release recorded and the mortgagee goes into bankruptcy, will the courts work out a theory that the mortgagee is in the position of a debtor to the mortgagor until the title is transferred back to the mortgagor? It may be that a preference might be worked out somewhat analagous to the way it could be worked out in the vendor-vendee relationship when the vendee fails to record the deed within the time required, as suggested above. If this be so, as no particular time is required for recording a release of a mortgage it would seem that the period of grace would be twenty-one days; hence, if the mortgage is paid off on October 1st the release should be recorded on or before October 22nd. However, this being a release of a mortgage on real property the question arises, even assuming that the release is regarded as a transfer of an interest in real

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<sup>87</sup> *Lester v. Hardesty*, 29 Md. 50 (1868) ; Art. 21, Secs. 1, 40, 41.

<sup>88</sup> *Supra*, p. 337. Although it is possible that Art. 8, Sec. 2, may be applicable to the assignment of a mortgage, the author believes it is highly doubtful if this section of the Code is applicable to the transfer of the security, although it may have application to the money due on the theory that it is an assignment of the amounts due or to become due on a contract.

<sup>89</sup> See WALSH ON MORTGAGES (1934), 170. See *Brown v. Stewart*, 56 Md. 421 (1881) ; *Howard v. Hobbs*, 125 Md. 636, 645, 94 A. 318 (1915).

property<sup>90</sup> and would have to be perfected so that it could not be defeated by a bona-fide purchaser for value, is it possible to have a bona-fide purchaser for value under these circumstances? The only transfer that the holder of the mortgage not released of record could make would be to assign the mortgage to a third person for value. But such an assignee as against the mortgagor is not protected as is the ordinary bona-fide purchaser for value. The Court of Appeals of Maryland has said:

“The assignee of a mortgage does not stand in the position of a purchaser without notice, as against the mortgagor, and those claiming under him, notwithstanding the assignment may have been taken without notice of the defenses against the enforcement of the mortgage. The transfer of a mortgage is so far within the rule which applies to other *choses in action*, that where the assignment is made without the concurrence of the mortgagor, as in this case, the assignee takes the mortgage, and the debts secured by it, upon the same terms, and subject to the like equities and defenses that it was subject to in the hands of the assignor. The mortgagor cannot be prejudiced by the assignment; and the recording Acts made no difference . . .<sup>91</sup>

Also the Court of Appeals of Maryland has stated:

“But here, the mortgage having been satisfied before the day of payment, and there being, consequently, no forfeiture, by the express terms of the condition, the mortgage ceased to be operative, and is declared to be void. In such case, according to all the authorities, the land returns to the mortgagor, without any re-conveyance or release, by the simple operation of the condition, free and clear of the mortgage . . . And, according to our decisions, . . . substantially the same result follows, whether the payment or

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<sup>90</sup> Apparently in Maryland if a mortgage debt is satisfied, either before or after default, the mortgage is discharged although failure to release the mortgage of record may leave a cloud upon the mortgagor's title. *James Morgan's Lessee v. Davis*, 2 H. & McH. 9 (1781); *Brown v. Stewart*, *ibid*; *Dentzel v. City & S. Ry. Co.*, 90 Md. 434, 45 A. 201 (1900).

<sup>91</sup> *Cumb. Coal & Iron Co. v. Parish*, 42 Md. 598, 614 (1875). See also *Central Bank v. Copeland*, 18 Md. 305 (1862); *Hunter v. Chase*, 144 Md. 13, 123 A. 393 (1923).

satisfaction be before or after the day of payment fixed by the mortgage. It is the full satisfaction that operates to extinguish the mortgage title."<sup>92</sup>

While failure to record the release might be misleading to creditors of the mortgagee in that he might appear to have an ostensible asset, which in fact he does not have, it would seem that the trustee should not be able to recover the property under the theory of preference.

#### PETITION IN BANKRUPTCY FILED BEFORE TERMINATION OF "GRACE PERIOD"

If no "perfecting" of the transfer is done at all either within the necessary time to get relation back or tardily so there is no relation back, Section 60a(7)II of the Bankruptcy Act provides that such transfer shall be deemed to have been made or suffered immediately before the filing of the petition.

This raises an interesting question: What happens if the petition in bankruptcy is filed before the grace period for perfecting a transfer has expired? For example: A land mortgage is executed on October 1st and under our analysis of the applicable law the mortgagee has until October 22nd to record in order to keep the present consideration on October 1st from becoming an antecedent debt. But before he records, the petition in bankruptcy is filed on October 10th. Will the courts say that the transfer is made immediately before the filing of the petition on October 10th, thus making the consideration given on October 1st an antecedent debt, or will the courts give the creditor the benefit of relation back without recording, or will the creditor still be given time to perfect by recording after the petition in bankruptcy?

It is obvious that the intervening petition in bankruptcy has cut into the grace period which it is the policy of Section 60 to grant a creditor who has given a contemporaneous consideration. It does not seem proper that the creditor under these circumstances should be penalized if the grace period has not elapsed prior to the filing of

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<sup>92</sup> *Brown v. Stewart*, *supra*, n. 90, 430.

the petition. One solution might be to interpret the last sentence of Section 60a(2)<sup>93</sup> with Section 60a(7)II<sup>94</sup> to mean that the transfer is perfected on October 10th just before the petition is filed and, this being within the grace period, relation back should be allowed so as to treat the transfer as if it were perfected on October 1st. In other words, under the circumstances, construe the word "made" to mean "perfected" and then take the view that the transfer was perfected within the required time. Another solution to this problem, suggested by an outstanding authority<sup>95</sup> is for the creditor to record within the grace period even though after the petition in bankruptcy has been filed, and treat it as perfected within the statutory grace period. Or it is possible that a court might take the view that the transfer was made on October 10th immediately before the petition was filed, and that there having been no actual recording at this time there is no "perfecting" and no relation back, so that therefore the consideration given on October 1st has become an antecedent debt on October 10th. This last construction in the opinion of the writer of this article would be a rather harsh and drastic application of Section 60a.

In this connection, it should be noted that although the courts may decide to give a creditor the benefit of the "grace period" where there is an intervening petition in bankruptcy during the "grace period" for purposes of Section 60 of the Bankruptcy Act, there may be situations where the creditor will still lose his security because of the provisions of Section 70, particularly Sections 70e and 70c. For example, a conditional sale contract is executed and the vendee takes possession of the chattel on October 1st.

<sup>93</sup> "If any transfer of real property is not so perfected against a bona fide purchase, or if any transfer of other property is not so perfected against such liens by legal or equitable proceedings prior to the filing of a petition initiating a proceeding under this Act, it shall be deemed to have been made immediately before the filing of the petition."

<sup>94</sup> "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."

<sup>95</sup> COLLIER ON BANKRUPTCY (14th Ed., 1953), par. 60.51, 982.



Subsequently, on October 10th, a petition in bankruptcy is filed by or against the vendee. On October 15th the vendor records the conditional sales contract as provided by Maryland law.<sup>96</sup> No period of time being set by this statute when recording must be made, under Section 60a the vendor would have a twenty-one day period of grace, or until October 22nd, in which to record and get the benefit of relation back. However, under Article 21, Section 74 an unrecorded conditional sale contract is void as to creditors who acquire without notice a lien by judicial proceedings on such chattel. Section 70e(1) of the Bankruptcy Act provides that:

“A transfer made or suffered or obligation incurred by a debtor adjudged a bankrupt under this Act which, under any Federal or State law applicable thereto, is fraudulent as against or voidable for any other 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.”

Although there may be no actual “lien creditor” at the time the petition in bankruptcy is filed as required by Maryland law to defeat the unrecorded conditional sale, nevertheless, the Bankruptcy Act in Section 70c,<sup>97</sup> the so-called “strong arm” clause, supplies the judicial lien by stating that the trustee, as to all property, (of the bankrupt at the date of bankruptcy) whether or not coming into possession or control of the court, . . . shall be deemed vested as of (the date of bankruptcy) with all the rights, remedies, and powers of a creditor then holding a lien thereon by (legal or equitable proceedings), whether or not such a creditor actually exists. So, in the example given, although the trustee in bankruptcy might not be able to pick up the marbles as a preference under Sec. 60 it would appear that he could do so under Sec. 70 of the Bankruptcy Act.<sup>98</sup>

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<sup>96</sup> Art. 21, Sec. 74.

<sup>97</sup> 1950 Amendment. Parenthetical material supplied.

<sup>98</sup> If the petition in bankruptcy is filed before the grace period expires, the trustee in bankruptcy probably could not take advantage of the strong-arm clause because under Maryland law protection appears to be afforded against “lien creditors” during the grace period in the following situations: trust receipt transactions, Art. 95½, Sec. 8; pledges and field warehousing, Art. 95½, Sec. 3; unrecorded bill of sale in sales transaction, Art. 21, Sec. 53, *Kreuzer v. Cooney*, 45 Md. 582 (1877); unrecorded deed of real

## EQUITABLE LIENS

Section 60a(6) of the Bankruptcy Act opens with a policy statement —

“The recognition of equitable liens where available means of perfecting legal liens have not been employed is hereby declared to be contrary to the policy of this section” (and then continues) “If a transfer is for security and if (A) applicable law requires a signed and delivered writing, or a delivery of possession, or a filing or a recording, or other like overt action as a condition to its full validity against third persons other than a buyer in the ordinary course of trade claiming through or under the transferor and (B) such overt action has not been taken, and (C) such transfer results in the acquisition of only an equitable lien, then such transfer is not perfected within the meaning of paragraph (2).”

This seems to clearly indicate that Congress does not wish the courts to revert back to creating and protecting equitable liens where it was possible to have perfected them into legal liens, as was done in *Sexton v. Kessler*.<sup>99</sup> It is also to be noted that the test of “perfecting” these equitable liens is slightly different from the other tests mentioned above. It is, in effect, the “bona-fide purchaser for value” test, excepting a buyer in the ordinary course of trade,<sup>100</sup> and applies to both real property and property other than real property. However, if what apparently would be vulnerable as an equitable lien for want of “perfecting” is perfected within the “grace period” provided for by paragraph (7) of Section 60a, then it should not be stricken down as an equitable lien because Section 60a(6) provides “. . . That nothing in paragraph (6) shall be construed contrary to the provisions of paragraph (7).” An illustration perhaps might be a pledge of goods governed by the provisions of Article 95½, Section 3. On October

estate, *Cramer v. Roderick*, 128 Md. 422, 98 A. 42 (1916); *Caltrider v. Caples*, 160 Md. 392, 153 A. 445 (1931); unrecorded mortgage of real estate, *Knell v. Green St. Bulld. Assn.*, 34 Md. 67 (1871).

<sup>99</sup> 225 U. S. 90 (1912).

<sup>100</sup> The influence of the Uniform Trust Receipts Act which protects purchasers in the ordinary course of trade regardless of the notoriety of public filing would seem to be present in this test.

1st L lends B \$1,000 and B promises to pledge certain goods with L as security but fails to do so and a petition in bankruptcy is filed against B on October 15th. This might create an equitable lien in favor of L but as he had not perfected it as required by paragraph (6) by taking delivery of possession before the petition, and the other elements of a voidable preference being present, the trustee in bankruptcy should be able to avoid the equitable lien.<sup>101</sup> However, if B delivers the goods to L on or before October 11th then under applicable law<sup>102</sup> it would be valid against "lien creditors", having been perfected within the grace period permitted by Section 60a(7) of the Bankruptcy Act.

On the other hand, if a debtor's own interest is only equitable, he can make a valid transfer of such an interest if care is taken to perfect such transfer by any means appropriate fully to transfer an interest of that character under applicable provisions of the Bankruptcy Act.<sup>103</sup> This perhaps could be illustrated by the situation where a debtor, owning a piece of real property in Maryland subject to a first mortgage, executes a second mortgage on the debtor's equity of redemption. The legal title to the land being in the first mortgagee the debtor has only an equitable interest in the land that he can transfer as security for the second mortgage debt and the second mortgagee therefore can receive only an equitable lien or equitable mortgage on the property. Thus, in this illustration, if the debtor executes and delivers a second mortgage to the second mortgagee on October 1st for a contemporaneous loan and the mortgagee records the mortgage deed on or before October 22nd, i.e., within the grace period, the second mortgagee, even though he has only an equitable lien, should be protected under the provisions of Sec. 60a(6) because the debtor can perfect a transfer by any means fully to transfer an interest of that character.

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<sup>101</sup> In this situation the trustee might also prevail by virtue of Sec. 70 of the Bankruptcy Act.

<sup>102</sup> Art. 95½, Sec. 2.

<sup>103</sup> 60a(6) of the Bankruptcy Act.

"... *Provided, however,* That where the debtor's own interest is only equitable, he can perfect a transfer thereof by any means appropriate fully to transfer an interest of that character. . . ."

### THE FOUR MONTHS PERIOD

One of the elements necessary to make a voidable preference is that the transfer of the debtor's property be made within four months before the filing of the petition in bankruptcy.<sup>104</sup> Under the 1950 amendment to Section 60a it appears that although a transfer of property is made more than four months prior to the petition in bankruptcy but is not perfected within the grace period as required by Section 60a until a time within four months of the petition in bankruptcy, such transfer may be deemed to have been made within four months of bankruptcy and, other requirements of a voidable preference being present, may be set aside by the trustee in bankruptcy. For example, a debtor transfers property to a creditor as security for a new and contemporaneous consideration on March 1st, and under applicable Maryland law and Section 60a(7) of the Bankruptcy Act there is a grace period of twenty-one days for perfecting the transfer by recording. The creditor records the instrument on March 15th within the twenty-one day grace period. Debtor files a petition in bankruptcy on July 10th. Measuring back four months from July 10th would give us the date of March 10th, so that any transfers made to creditors on or after March 10th, other necessary elements being present, might be set aside as a preference. However, in this case the transfer having been perfected by having the instrument recorded within the grace period, the creditor gets the benefit of relation back and the transfer is deemed to be made on March 1st, more than four months prior to the petition in bankruptcy and could not be set aside as a voidable preference by the trustee in bankruptcy. However, let us take the same transaction except that the creditor records the instrument on March 23rd. This recording, being after the grace period of twenty-one days has elapsed, the creditor does not get the benefit of relation back, and the transfer is deemed to be made on March 23rd and the contemporaneous consideration given on March 1st has now the status

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<sup>104</sup> Sec. 60a(1).

of an antecedent debt. Accordingly, this transfer having been made within the four months period prior to the petition in bankruptcy, other necessary elements being present, could be avoided as a preference by the trustee in bankruptcy.

Again take the same transaction, except that on March 1st the creditor takes the property as security for an antecedent debt, and not for a contemporaneous consideration, and he records the instrument on March 9th. Under Section 60a(2) the transfer is deemed to be made on March 9th and as the four months period does not start running until March 10th, this transfer should not be set aside as a preference. If, however, this creditor did not record until March 15th, the transfer would be deemed to have been made on March 15th, there being no grace period and relation back because the security was given for an antecedent debt on March 1st and not for a contemporaneous consideration. The grace period and relation back rule under Sec. 60a applies only when there was a contemporaneous consideration at the inception of the transfer.<sup>105</sup> This being the case, in this last example, the transfer having taken place within the four months period prior to the petition in bankruptcy, if the other necessary elements of a voidable preference are present, the trustee in bankruptcy could set aside this transfer as provided in Sec. 60b of the Bankruptcy Act. Finally, in this connection, it might be noted that if the creditor failed to record the instrument at any time the transfer would be deemed to have been made immediately before the filing of the petition in bankruptcy which would, of course, be within the four months period.<sup>106</sup>

#### CONCLUSION

The 1950 amendment to Section 60a of the Bankruptcy Act is a highly technical piece of legislation which is complicated by the fact that in its application it is also necessary to look to "applicable law" which is normally the

<sup>105</sup> Sec. 60a(7). See COLLIER ON BANKRUPTCY (14th Ed., 1953), par. 60.39, 912.

<sup>106</sup> Sec. 60a(2) and (7) II.

statutory and case law of the particular state involved. Except for a trust receipt transaction<sup>107</sup> and a conditional sale transaction<sup>108</sup> the writer has found no reported cases in which have been involved the 1950 amendment to Section 60a and applicable Maryland law. This is not surprising, of course, due to the comparatively recent enactment of the amendment and also the relatively few bankruptcies giving rise to opinions that have occurred during the fairly prosperous period between 1950 and the summer of 1954 when this article was written. If there were more uniformity in the recording statutes of Maryland the problem would be somewhat simplified. For example, the author is not aware of any reason today why bills of sale, chattel mortgages and conditional sales contracts should have different rules as to the time in which they should be recorded. Any historical reasons why bills of sale and, presumably chattel mortgages, shall be recorded within twenty days from the date thereof,<sup>109</sup> with the ensuing confusion this causes as to the rights of third persons, whereas no particular time is set for recording conditional sale agreements, would seem to have no validity today in an age of good roads and swift and easy transportation. Except incidentally, no reference has been made to the Proposed Uniform Commercial Code because Maryland has not, up to the present time, enacted this Code.<sup>110</sup> If at some time in the future Maryland should enact this Code then, of course, some of the material in this article about property other than real property would become obsolete.<sup>111</sup>

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<sup>107</sup> *Coin Machine Acceptance Corp. v. O'Donnell*, 192 F. 2d 773 (4th Cir., 1951).

<sup>108</sup> *In re Burton*, 120 F. Supp. 148 (D.C. Md., 1954).

<sup>109</sup> Art. 21, Secs. 53, 54.

<sup>110</sup> At the time of this writing, 1954, only Pennsylvania has enacted the Uniform Commercial Code.

<sup>111</sup> See BIRNBAUM, *SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE* (American Law Institute, 1954), for a detailed discussion and as a particular example, p. 121.