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THE STRONG-ARM CLAUSE STRIKES THE BELATED CHATTEL MORTGAGE

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ONCE again the strong-arm clause of section 70(c) of the Bankruptcy Act comes into the limelight of judicial decision by striking down the lien of a chattel mortgagee who belatedly filed his mortgage after execution and delivery. Section 70(c) of the Bankruptcy Act[1] not only gives the trustee the benefit of defenses which are available to the bankrupt, but also contains a most important weapon for attack, the so-called "strong-arm clause."[2] Armed with the rights, remedies and powers of the strong-arm clause, the trustee has endeavored in recent cases to attack as invalid the lien which a chattel mortgagee had obtained upon the bankrupt's property. The problem in these cases was whether the trustee, as an ideal hypothetical creditor by virtue of section 70(c), had a lien which was superior to that of the chattel mortgagee who had filed his mortgage belatedly even though there was no creditor in existence under state law who could contest the validity of the lien, the mortgage having been filed prior to the date of bankruptcy.

I

In *Constance v. Harvey*,[3] the trustee instituted a proceeding before the referee in bankruptcy to set aside a mortgage which had been tardily filed. The facts of the case were substantially as follows: Constance sold a roadside diner to Riley, a resident of the Town of Watervliet, Albany County, New York, and took back a purchase money mortgage. The sale took place on November 23, 1949 and on November 25, 1949 Constance's attorney sent copies of the mortgage for filing to the County Clerk of Albany County and the Town Clerk of Watervliet. The copy sent to the Albany County Clerk was duly filed in his office, but the copy

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1. 11 U.S.C.A. § 110(c).

2. The strong-arm clause reads as follows: "The trustee, as to all property, whether or not coming into possession or control of the court, upon which a creditor of the bankrupt could have obtained a lien by legal or equitable proceedings at the date of bankruptcy, shall be deemed vested as of such date with all the rights, remedies, and powers of a creditor then holding a lien thereon by such proceedings, whether or not such a creditor actually exists." Bankruptcy Act § 70(c), 11 U.S.C.A. § 110(c).

3. 215 F.2d 571 (2d Cir. 1954), cert. denied, 348 U.S. 913 (1955).

sent to the Watervliet Clerk was returned to the attorney with a notation, "filed in Albany County." There was no question but that Watervliet was the proper place of filing under New York law.[4]

At the hearing before the referee the mortgagee's attorney testified that he thought the Watervliet Clerk's notation meant that Riley had changed his residence to Albany where the diner was located. Accordingly, he made no effort to file in Watervliet until October 5, 1950 and this time the Clerk accepted the filing. On October 23, 1951, Riley was adjudicated a bankrupt and Harvey was appointed Trustee. The diner, which was the sole asset of the estate, had been sold by the trustee and Constance demanded a lien on the proceeds to the extent of his mortgage.

In interpreting the New York Lien Law the court observed that since the mortgage was not filed as therein provided, it was void against the creditors of the mortgagor becoming such without notice prior to the filing. Although the statute itself contained no provision for a specific time of filing, New York case law was to the effect that filing must be accomplished within a reasonable time after execution of the instrument.[5] There was no doubt, therefore, but that a delay of ten months constituted an unreasonable time within which to file the mortgage.[6] Based upon these facts the referee and the district court judge held the trustee's title to be superior to that of the mortgagee. The court then analyzed the provisions of section 70(c) of the Bankruptcy Act and observed that this section:

> " . . . clothes the Trustee with the status of a lien creditor as to any property of the bankrupt with respect to which a hypothetical creditor of the bankrupt 'could have obtained a lien by legal or equitable proceedings at the date of bankruptcy.' "[7]

The court further indicated that this status as a lien creditor was not sufficient to avoid the lien of the mortgagee since under New York law the filing of a belated mortgage was good as to all of Riley's creditors who became such subsequent to the filing of the mortgage.[8] In other words, the only creditor under New York law who could set aside such a mortgage would be one who was in existence during the interim period between the execution and the filing of the mortgage,[9] i.e., a creditor who

4. N.Y. Lien Law § 232 reads in part as follows: "Every . . . chattel mortgage . . . or a true copy thereof, must be filed in the town or city where the mortgagor, if a resident of the state, resides at the time of the execution thereof. . . . "

5. Tooker v. Siegel-Cooper Co., 194 N.Y. 442, 87 N.E. 773 (1909).

6. See Karst v. Gane, 136 N.Y. 316, 32 N.E. 1073 (1893).

7. 215 F.2d at 574.

8. See In re Myers, 24 F.2d 349 (2d Cir. 1928); In re Ideal Steel Wheel Co., 25 F.2d 651 (2d Cir. 1928).

9. The exact effect of a tardily filed chattel mortgage as to subsequent creditors has never been passed on directly by the court of appeals, though the inference may be drawn from

was in existence between November 25, 1949 and October 5, 1950. The trustee's status, the court continued, as a lien creditor with respect to the property in question, could not exist unless the petition was filed prior to October 5, 1950, the date when the mortgage was filed in Watervliet.

Unfortunately, the record on appeal indicated that Riley was *adjudicated* a bankrupt on October 23, 1951, but did not show the date the petition had been *filed*. This date of adjudication was more than one year after the mortgage had been filed. The court was, therefore, unable to determine whether under section 70(c) the belated filing was valid against the trustee. In continuing its analysis of the position of the trustee, the court interpreted section 70(e) of the Bankruptcy Act,[10] emphasizing that under this section the trustee had only such rights as a creditor of the bankrupt would have who existed prior to October 5, 1950, the date such mortgage was filed.[11] Since the record on appeal in no way indicated the existence of such creditor, it was necessary to remand the proceedings to the district court. The instructions were significant. The court below was directed to grant Constance's lien petition if it found that the petition in bankruptcy was filed after October 5, 1950, and that none of the bankrupt's creditors who had a provable claim became such prior to October 5, 1950; otherwise the lien petition was to be dismissed. In effect, the court found that for the trustee to sustain his position, it was necessary that there be an actual creditor having a provable claim in existence prior to the date the mortgage was recorded, provided the mortgage was recorded prior to the filing of the petition in bankruptcy.

In the *Constance* case, since the petition in bankruptcy was not filed until October 23, 1951,[12] more than one year subsequent to the filing of the mortgage, there was a possibility that no prior creditor having a

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the holding in Karst v. Gane, 136 N.Y. 316, 32 N.E. 1073 (1893), that a tardy filing will void the mortgage as to general creditors regardless of when they become such. However, the circuit court, in In re Myers, 24 F.2d 349 (2d Cir. 1928), held that a tardy filing nullified the mortgage only as to creditors who became such prior to the filing, and this holding has been followed by the lower New York courts since that time. See Petition of Planz, 282 App. Div. 552, 125 N.Y.S.2d 750 (3d Dep't 1953). See also Skilton v. Codington, 86 App. Div. 166, 83 N.Y. Supp. 351 (4th Dep't 1903).

10. Bankruptcy Act § 70(c), 11 U.S.C.A. § 110(e), makes null and void as against the trustee any " . . . obligation incurred by a debtor adjudged a bankrupt . . . which, under any Federal or State law applicable thereto, is . . . voidable . . . by any creditor of the debtor, having a claim provable under this title. . . . " Bankruptcy Act § 1 (11), 11 U.S.C.A. § 1 (9), reads in part as follows: " 'Creditor' shall include any one who owns a debt, demand, or claim provable in bankruptcy. . . . "

11. See Zamore v. Goldblatt, 194 F.2d 933 (2d Cir.), cert. denied, 343 U.S. 979 (1952).

12. Communication with the Clerk of the district court indicates that the petition was filed October 23, 1951.

provable claim was in existence at the date of bankruptcy because of the lapse of time. However, Constance moved for a rehearing, and it is this rehearing which raises new problems in connection with the interpretation of section 70(c).

II

The court denied the mortgagee's application for a rehearing and then sua sponte took occasion to correct its original opinion, claiming that it had been mistaken in its interpretation of section 70(c) in holding that it was incumbent on the trustee to show that the petition in bankruptcy had been filed prior to the actual recording of the mortgage, since section 230 of the New York Lien Law,[13] as construed by New York courts, makes an unrecorded chattel mortgage void as to a simple creditor who became such without notice prior to the actual recording.[14] On the other hand, the court continued, the provisions of section 65 of the Personal Property Law of New York[15] makes a conditional bill of sale void only as to creditors who, without notice, have acquired liens on the goods prior to the recording of the contract.

Therefore, the court reasoned, it was not necessary for the trustee to be a lien creditor, since an existing creditor without notice of the chattel mortgage could have obtained such a lien, and under section 70(c), the trustee was entitled to be placed in the position of an ideal hypothetical creditor. This would mean, in effect, that at the date of bankruptcy the ideal hypothetical creditor's position was such that he had all the attributes of a creditor who was in existence during some part of the ten month period during which the mortgage remained unfiled. Since under New York law such a creditor could set aside the lien of the mortgagee, and since under section 70(c) the court held that the trustee was such a creditor, whether or not such creditor actually existed, the trustee prevailed.

This distinction between a simple contract creditor's rights against those of a belated chattel mortgagee, vis à vis, those of a lien creditor against the vendor of an unfiled conditional bill of sale, as constituting a basis for reversal, is unsound. In other words, reversal was based on the theory that it did not make any difference in the case of a chattel mortgage whether the petition was filed before or after the recording of the mortgage, because the mortgage was void against a simple contract creditor without notice existing before recording, and the trustee was such a creditor, albeit hypothetically. However, if the instrument in question

13. N.Y. Lien Law § 230.
14. See notes 6, 9 supra.
15. N.Y. Pers. Prop. Law § 65.

had been a conditional bill of sale, the court would have had to determine whether the conditional bill of sale had been filed prior to the bankruptcy petition, because under New York law an unfiled conditional bill of sale is void only as against creditors obtaining liens prior to recording.[16] Furthermore, the trustee's ideal hypothetical status as a lien creditor comes into existence only at the date of bankruptcy, as the language of section 70(c) clearly indicates.

In both instances, however, whether as a simple contract creditor or as a lien creditor, the trustee's status is ideal and hypothetical; ideal in that he stands in the position of the most favored general creditor who could by legal or equitable proceedings obtain a lien on the bankrupt's property, and hypothetical because that creditor need not exist. Diverse and wholly unintended results flow from this status as an ideal general creditor, and an ideal lien creditor. As an ideal lien creditor, the trustee's rights come into being at the date of bankruptcy, but as an ideal general creditor, the court clothes him with the complete attire of a creditor existing at any time prior to the date of bankruptcy. He is ideal at the date of bankruptcy, and far from being simple, is complex. He is as complex as a creditor who could set aside the lien of a belated chattel mortgage, e.g., a creditor who sold the bankrupt goods or to whom the bankrupt was indebted in any way on a simple contract during the period the mortgage remained unfiled, and as in the case at bar, was in existence between November 23, 1949 and October 5, 1950, a period between one to two years before the date of bankruptcy. This view of the status of the trustee ignores the fact that in a particular case all creditors existing during the period when the mortgage remained unfiled may have been paid prior to the date of bankruptcy.

The language of the act is a clear prohibition against any rights accruing to the trustee prior to bankruptcy. He is vested with all the rights, remedies and powers of a lien creditor as of the date of bankruptcy. It is true that in the course of judicial process, before a creditor can become a lien creditor he must be a general creditor. But by hypothetical thinking it is as consistent to make him both a general and lien creditor at the date of bankruptcy as it is to make him merely a lien creditor. The fallacy of the court's reasoning in the rehearing of the *Constance* case is contained in its strained conclusion regarding the trustee's status, which is supported neither by the language nor the history of section 70(c), nor by the very case cited by the court to sustain its decision, namely, *Hoffman v. Cream-O-Products*.[17]

16. Ibid.
17. 180 F.2d 649 (2d Cir.), cert. denied, 340 U.S. 815 (1950).

III

In the *Hoffman* case, the trustee moved to set aside the lien of a conditional bill of sale. The conditional bill of sale was filed in the proper office pursuant to New York law,[18] but a contemporaneous agreement between the parties referred to in the conditional bill of sale by which the parties specified the purchase price and the time and manner of the payment of the indebtedness was never filed. The court held that the failure to file the contemporaneous agreement invalidated the lien of the conditional vendor because a substantial part of the contract had been omitted.[19] The court relied upon two of its earlier decisions, *In re Master Knitting Corp.*[20] and *White v. Steinman.*[21] In the *Master Knitting* case the court indicated that under New York law a conditional bill of sale was invalid against " . . . any creditor who 'acquires by attachment or levy a lien' before [the] contract [was] filed"[22] and that the trustee in bankruptcy was exactly in such position at the date of bankruptcy.

White v. Steinman also dealt with a conditional bill of sale which was held to be invalid as against the trustee. The argument was raised that section 70(c) of the Bankruptcy Act did not apply because it had been enacted in 1938 after the conditional bill of sale had been executed, and that, accordingly, the conditional vendor was being divested of his property rights. The court indicated that there was no basis for this argument because the section did nothing further than afford a remedy to a trustee in bankruptcy, and moreover, included as additional matter, the hypothetical creditor clause. It was pointed out that the status of the trustee as a hypothetical creditor, although included in the amendment, gave the trustee no greater rights than he had under section 47(a)(2).[23]

The reasoning in all the cases, therefore, preceding *Constance v. Harvey* was that the strong-arm clause of section 70(c) did not effect any changes in the former section 47(a)(2). In addition, excluding the rehearing in the *Constance* case, the application of the strong-arm clause of section 70(c) was always based upon the trustee's rights as a lien creditor. An examination of the cases decided under section 47(a)(2), and

18. See note 15 supra.

19. 180 F.2d at 650. The court on this point relied upon its previous decision in Empire State Chair Co. v. Beldock, 140 F.2d 587 (2d Cir.), cert. denied, 322 U.S. 760 (1944).

20. 7 F.2d 11 (2d Cir. 1925).

21. 120 F.2d 799 (2d Cir.), cert. denied, 314 U.S. 659 (1941).

22. 7 F.2d at 12.

23. "Indeed, the words, 'whether or not such a creditor actually exists', which were added by Section 70, sub. c. of the Chandler Act to Section 47, sub. a (2), 11 U.S.C.A. § 75, sub. a (2), of the former Bankruptcy Act, as it had stood since the Amendment of 1910, gave the trustee no more than the 'remedies . . . of a creditor holding a lien by legal or equitable proceedings' which already were open to him under Section 47." 120 F.2d at 802.

the history of the section, reveals that it was intended to vest the trustee with all the rights, remedies and powers of a lien creditor at the date of bankruptcy. If the strong-arm clause is to be interpreted as vesting the trustee with all the rights of a general ideal hypothetical creditor, then such rights a fortiori must be deemed to exist, as in the case of a lien creditor, only at the date of bankruptcy.

IV

The case which necessitated the enactment of section 47(a)(2) of the Bankruptcy Act was *York Manufacturing Co. v. Cassell.*[24] The bankrupt in that case had entered into a conditional sales agreement with York, the conditional vendor. The interpretation of the recording statute of Ohio[25] relating to conditional sales was to the effect that such contract was void as against lien creditors of the purchaser who levied prior to the filing. The contract was not filed prior to the initiation of bankruptcy proceedings. The question which the Supreme Court had to determine in the *York* case was a simple one, to wit: Did the adjudication in bankruptcy of the conditional vendee operate in effect as an attachment or other lien on the property of the bankrupt, so as to deprive the conditional vendor of its lien? The Court answered the question in the negative, pointing out that under the Bankruptcy Act as it existed in 1906,[26] the trustee was vested with no better right or title to the bankrupt's property than the bankrupt had at the date of the filing of the petition in bankruptcy. Accordingly, the trustee was placed in the "shoes of the bankrupt,"[27] which meant that since the contract was good between the parties it was good as against the trustee.[28]

The weakness of the trustee's position as against unrecorded condi-

24. 201 U.S. 344 (1905).

25. Ohio Rev. Stat. § 4155.

26. 11 U.S.C.A. § 110(a) (1898).

27. "Under the provisions of the bankrupt act the trustee in bankruptcy is vested with no better right or title to the bankrupt's property than belonged to the bankrupt at the time when the trustee's title accrued. At that time the right, as between the bankrupt and the York Manufacturing Company, was in the latter company to take the machinery on account of default in the payment therefor. The trustee, under such circumstances, stands simply in the shoes of the bankrupt, and, as between them, he has no greater right than the bankrupt." 201 U.S. at 352.

28. Cf. Security Warehousing Co. v. Hand, 206 U.S. 415 (1907), where the court in contrasting the problem at bar discussed its earlier decision in the York case and indicated that had there been a lien creditor in existence at the date of bankruptcy, the result would have been that the trustee could have set aside the unfiled conditional bill of sale under the provisions of § 67(c) of the Bankruptcy Act of 1898. This section is substantially the same today, and empowers the trustee to set aside and preserve, for the benefit of the estate, judicial liens created at a time when the bankrupt was insolvent, and within four months of the date of bankruptcy.

tional bills of sale, as indicated in the *York* case, was sufficiently apparent to stultify the sound operation of the Bankruptcy Act against secret liens. In order to overcome this decision, an amendment to section 47(a) of the Bankruptcy Act of 1898 was adopted, adding a new subdivision (2) which provided: " . . . and such trustees, as to all property in the custody or coming into the custody of the bankruptcy court, shall be deemed vested with all the rights, remedies, and powers of a creditor holding a lien by legal or equitable proceedings. . . . "[29]

There is no doubt as to the intent of the congressional draftsmen in framing section 47(a)(2). Specific reference is made in their explanatory notes to the Supreme Court decision in the *York* case, and their intention to overcome the effect of that decision. The draftsmen recognized the anomalous situation created by the *York* case whereby lesser state officers and even lien creditors could set aside a secret lien, while the trustee, even though a representative of all the creditors, had no such right.

"Thus, the evil of secret liens has been continued. It is this evil and the injustice worked upon creditors who rely upon the debtor's apparent ownership against which the bankruptcy law has set its face."[30]

We come now to the first significant case interpreting section 47(a)(2), *Bailey v. Baker Ice Machine Co.*[31] In that case the factual setting was not as simple as that presented in the *York* case. Baker sold the bankrupt an ice making and refrigerating machine pursuant to a conditional bill of sale. Approximately three months after the contract was signed, the conditional bill of sale was filed in the appropriate county register's office in accordance with the provisions of the statute of Kansas.[32] Hardly two months thereafter, a voluntary petition in bankruptcy was filed. Baker thereupon instituted a proceeding to recover the machine. The issue narrowed itself down to whether the belated filing of the conditional bill of sale invalidated the lien as against the trustee under the provisions of section 47(a)(2). In order to determine this question, the Court had to refer to the law of Kansas relating to the filing of conditional bills of sale. The Court's examination of the Kansas statute indicated that the conditional bill was valid as between the parties, but void as against a creditor of the vendee " . . . who fastens a lien upon the property by

29. As to property not in custody or not coming into possession of the bankruptcy court, the trustee was vested with the rights, remedies and powers of a judgment creditor holding an execution duly returned unsatisfied. Bankruptcy Act § 47 (a)(2), 11 U.S.C.A. § 75 (a)(2) (1910).

30. 45 Cong. Rec. 2275-77 (1910).

31. 239 U.S. 268 (1915).

32. Kan. Gen. Stat. § 5237 (1909).

execution, attachment or like legal process before the contract is filed for record."[33]

Obviously if there had been a creditor in existence during the interim period in which the lien had remained unrecorded, who had fastened a specific lien upon the property by execution, attachment or other legal process, the trustee could have availed himself of this creditor's rights, as was indicated in *Security Warehousing Co. v. Hand.*[34] However, the trustee went a step further, contending that he had the status of a creditor having such a lien by virtue of the provisions of section 47(a)(2). He contended that those rights existed during the period when the conditional bill of sale remained unrecorded, some three months before bankruptcy. This position the Court rejected as untenable. The Court concluded that the trustee had the status of a lien creditor holding a lien at the date of bankruptcy, and not at any time anterior thereto. Based upon this clear-cut decision we can, therefore, conclude that section 47(a)(2) conferred upon the trustee the status of a lien creditor with all the rights of such a creditor arising as of the date of bankruptcy, whether or not such creditor actually existed.[35] However, in order to ascertain the rights, remedies and powers of such a lien creditor to invalidate a conditional bill of sale or secret lien, such as an unfiled mortgage or equitable lien, the court must in each instance examine state law to determine under what circumstances a lien creditor at the date of bankruptcy could invalidate the unrecorded instrument by state court process.[36]

V

The problem now presented is whether this concept of the trustee as a lien creditor under section 47(a)(2) has in any way been varied by the subsequent amendments to the Bankruptcy Act. The Chandler Act of 1938[37] took the strong-arm clause from section 47, dealing with duties of the trustee, where as a logical matter it did not properly belong, and transferred it to section 70(c) which deals with title to property. The changes made at the time in no way altered the substance of the clause, but were either a clarification of phraseology or embodiment of decisions contained in case law interpreting the clause.[38]

33. 239 U.S. at 275.

34. 206 U.S. 415 (1907). See note 28 supra.

35. See Albert Pick & Co. v. Wilson, 19 F.2d 18 (8th Cir. 1927); Peacock v. Fairbairn, 45 Idaho 628, 264 Pac. 231 (1928).

36. See In re Seward Dredging Co., 242 Fed. 225 (2d Cir.), cert. denied, 245 U.S. 651 (1917).

37. Act of June 22, 1938, c. 575, 52 Stat. 840 (codified in scattered sections of 11 U.S.C.A.).

38. H.R. Rep. No. 1409, 75th Cong., 1st Sess. 34-35 (1937).

There seems to be no doubt that the strong-arm clause of section 70(c), as its name indicates, did not by amendment change the trustee's status as a lien creditor. In an illuminating article discussing section 70(c) of the Bankruptcy Act, Professor MacLachlan indicates that the amendments to the Chandler Act of 1938 effectuated no change in the clause:

"This was merely a change in form and was not designed to alter the effect of the amendment of 1910."[39]

Since the Chandler Act there have been the amendments of 1950 and 1952.[40] These were clarifying and explanatory amendments, in no way enlarging the trustee's status as a lien creditor, except to include the coverage of property not within the bankrupt's possession at the date of bankruptcy. It, therefore, appears from the history of section 70(c) that its basic purpose is to give the trustee a lien on all property of the bankrupt including such property " . . . in which the bankrupt has an interest . . . "[41] at the date of bankruptcy. In order to ascertain the nature of the lien it is necessary to ascertain what rights, remedies and powers a creditor would possess, by virtue of legal or equitable proceedings, under the applicable state law.

Admittedly, if a trustee has all the rights of a lien creditor obtained through legal or equitable proceedings, he has encompassed within those rights such lesser rights which would be obtainable by a judgment creditor,[42] or even a general unsecured creditor.[43] This reasoning is axiomatic when we consider the judicial process necessary to obtain a lien, to wit: The existence of a general claim, its ripening into a judgment, and the execution issued upon the judgment resulting in a lien; or a general claim upon which a lien is obtained by virture of a provisional remedy of attachment or garnishment before judgment and its subsequent perfection. However, if this concept is sound, namely, that the greater includes the lesser, or the lien creditor's rights include general creditors' rights, we must then compare these respective rights, and ascertain whether the decision in *Constance v. Harvey* observed this principle.

By virtue of the explicit language of section 70(c), the lien creditor's rights come into existence at the date of bankruptcy. The general creditors' rights, if they are not to exceed the boundaries of the trustee's rights as a lien creditor, must not go beyond these confines. However, the *Constance* case gave the trustee the rights of a general creditor

39. MacLachlan, 24 Ref. J. 107 (1950).
40. 11 U.S.C.A. § 110.
41. MacLachlan, op. cit. supra note 39 at 107.
42. In re Calhoun Supply Co., 189 Fed. 537 (N.D. Ala. 1911).
43. See Comment, 34 Yale L.J. 891, 893 (1925).

whose claim arose at some period prior to bankruptcy, even though no such creditor did in fact exist.

The situation thus created is anomalous. The trustee as an ideal hypothetical lien creditor, as we have already shown in *Bailey v. Baker Ice,* could not set aside a conditional bill of sale which had been belatedly filed because the Court held that his status as a lien creditor existed at the date of bankruptcy and not at a date anterior thereto. It would, therefore, be illogical for the trustee occupying the lesser status of an unsecured creditor, to hold rights superior to those enjoyed in his position as an ideal lien creditor. Not only was the decision on the rehearing in the *Constance* case incorrect on the question of the interpretation of section 70(c), but the inequity of such a situation was recognized in the subsequent case of *Conti v. Volper*[44] by the referee in bankruptcy and the district court.

VI

In the *Conti* case the facts were undisputed. The bankrupt had executed and delivered its chattel mortgage to the mortgagee on February 24, 1953, but the instrument was not filed until June 9, 1953, almost four months thereafter. There was no doubt that the chattel mortgage was filed an unreasonable time after its execution and delivery, so as to render it void under New York law against simple contract creditors of the bankrupt without notice of the lien, who were in existence prior to the filing.[45]

Relying upon the authority of *Constance v. Harvey,* the trustee offered no proof to establish the existence of a creditor of the bankrupt prior to the filing of the mortgage on June 9, 1953. Both the referee and the district court judge[46] held that they were bound by the authority of *Constance v. Harvey* to hold that the trustee was an "ideal hypothetical creditor" and accordingly, actual proof of the existence of a creditor prior to the filing of the mortgage was unnecessary. The court criticized the holding in the *Constance* case and commented in part as follows:

> "I find it difficult to reconcile the present decision with the equitable purposes of the Bankruptcy Act, but agree with the referee that the opinion in the Constance case seems to compel such a result; until a possible reconsideration of the subject by a reviewing court, the present duty is clear to deny the petition to review."[47]

As attorneys for the trustee in bankruptcy, the authors deemed it essential, upon the appeal by the mortgagee to the United States Court of Appeals, to re-evaluate the principles of the *Constance* decision in

44. 132 F. Supp. 205 (E.D.N.Y. 1955), aff'd, 229 F.2d 317 (2d Cir. 1956).
45. See notes 5, 9 supra.
46. 132 F. Supp. 205 (E.D.N.Y. 1955).
47. Id. at 205-06.

order to obtain a sound determination on an important aspect of bankruptcy administration. It was pointed out that the precedent, history, and purpose of section 70(c) required a reversal of the rehearing of *Constance v. Harvey,* and an affirmance of the original decision in that case.[48] This position was strengthened by the appearance during this time of two law review articles. In an analysis of the differences between the trustee's rights and powers under section 70(c) and section 70(e), Professor Seligson thus criticized *Constance v. Harvey*:

"But there is nothing in Section 70c that justifies the conclusion that the trustee would be vested with the rights of a simple contract creditor whose claim had arisen prior to and no longer existed when the petition was filed."[49]

In another article, Professor Marsh warned of the dangers inherent in the *Constance* holding:

"The court held in effect that under the strong-arm clause the trustee could 'play like' he extended credit at whatever time was most advantageous to him. This indecision of the court illustrates the inherent difficulty of this question, but . . . the court was right the first time."[50]

Notwithstanding the revisitation of *Constance v. Harvey* by appeal in *Conti v. Volper,* the United States Court of Appeals for the Second Circuit, affirmed the determination of the district court:

"*Constance v. Harvey,* 2 Cir., 1954, 215 F.2d 571, reluctantly followed by Judge Byers, may seem to reach an inequitable result, but Section 70, sub. c, of the Bankruptcy Act, 11 U.S.C.A. § 110, sub. c, provides: 'The trustee, as to all property, whether or not coming into possession or control of the court, upon which a creditor of the bankrupt could have obtained a lien by legal or equitable proceedings at the date of bankruptcy, shall be deemed vested as of such date with all the rights, remedies, and powers of a creditor then holding a lien thereon by such proceedings, whether or not such a creditor actually exists'; and it is difficult to see how such plain language could be disregarded."[51]

CONCLUSION

The United States Court of Appeals for the Second Circuit has now twice stated its interpretation of section 70(c) of the Bankruptcy Act. Secured lenders and anyone claiming through them must beware of the rights, remedies and far reaching powers of the strong-armed trustee in bankrutpcy. In brief, it is submitted that the status given a trustee by the court's interpretation of section 70(c), as an ideal hypothetical creditor who can reach back to a date anterior to the filing of a bankruptcy

48. See Brief for Appellee, Conti v. Volper, 229 F.2d 317 (2d Cir. 1956).

49. Seligson, Annual Survey of American Law, Bankruptcy, 30 N.Y.U.L. Rev. 558, 561 (1955).

50. Marsh, Constance v. Harvey—The "Strong-Arm Clause" Re-Evaluated, 43 Calif. L. Rev. 65, 68 (1955).

51. 229 F.2d at 317-18.

petition, is unsound and constitutes an erroneous interpretation of the section. It is significant that the decision in *Constance v. Harvey* has been recently disapproved by a resolution of the National Bankruptcy Conference.[52]

It would, therefore, appear that nothing short of an amendment to section 70(c) will rectify the error contained in the opinion on the rehearing of the *Constance* case and the *Conti v. Volper* holding. We hazard a proposal that the strong-arm clause of section 70(c) should be amended as follows:

"The trustee, as to all property, whether or not coming into possession or control of the court, upon which a creditor of the bankrupt, *without relation back to a date anterior to the date of bankruptcy*, could have obtained a lien by legal or equitable proceedings at the date of bankruptcy shall be deemed vested as of such date with all the rights, remedies, and powers of a creditor then holding a lien thereon by such proceedings, whether or not such a creditor actually exists."[53]

Such an amendment to the strong-arm clause will rectify the error of *Constance v. Harvey* rehearing and its perpetuation in the *Conti* case, in the following ways:

1. The trustee's rights, remedies and powers under section 70(c) will not relate back to destroy the lien of a belated mortgage and the amendment will harmonize the statute with the history and interpretation of the act.

2. The inequity resulting to the secured lender from the invalidation of a belated filing where no creditor exists, will be eliminated.

3. The clear line of distinction between the provisions of sections 70(c) and 70(e) will be maintained, and the procedure to set aside a belated filing will be controlled by section 70(e),[54] which will determine the validity of the lien of a belatedly filed security device depending upon the existence of a creditor during the period the mortgage or other security device remained unfiled; and the rights, remedies and powers of

52. See Summary of Proceedings, National Bankruptcy Conference, 1956 Annual Meeting, Resolution No. 36: "RESOLVED, that it is the sense of the National Bankruptcy Conference that the trustee in bankruptcy gets his standing under Section 70c as of the date of the filing of the petition, with no privilege of relation back and without prejudice to such rights as the trustee might have under Section 70e or any other provision of the Bankruptcy Act."

53. Id. at p. 57 where Prof. MacLachlan suggests among other amendments to Section 70(c): "The trustee in bankruptcy shall have as of the date of bankruptcy (and without the benefit of any fiction of relation back prior to bankruptcy) the rights and powers of: (1) a creditor. . . . "

54. See also Bankruptcy Act § 60 (a), 11 U.S.C.A. 96(a), where notwithstanding the fact that a belated filing may be good under state law because of the non-existence of a creditor, it might still be invalid as a preference.

the trustee standing in the shoes of such creditor will be determined by state law.[55]

55. See Kupfer, Secured Claims in Bankruptcy Proceedings, 28 N.Y. State Bar Bulletin 40, 46 (1956), where, in an analysis of security devices, the author criticizes the results of Moore v. Bay, 284 U.S. 4 (1931). This doctrine holds that a trustee who has set aside a lien for belated filing under § 70 and has shown the existence of one creditor, no matter how small, can obtain the entire security for the benefit of the estate, even though only one creditor has been harmed by the belated filing. This may also be the time to re-evaluate Moore v. Bay, supra. But see, Schwartz, Moore v. Bay—Should Its Rule Be Abolished?, 29 Ref. J. 67 (1955). See also op cit. supra note 50 at 49.