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## A Contemporary View of the Conditional Vendor's Right to Reclamation

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extended to also favor post-petition interest. Such an amendment would, of course, overrule the *Saper* decision, and, therefore, is not preferred. A more desirable alternative would be to amend section 17 so as to specifically discharge post-petition interest not paid out of the estate, while continuing the rule of not discharging any unpaid principal. Thus, in the ordinary case, the debtor will not be punished for the usual delays in bankruptcy over which he has no control, and the Government will be in the same position in relation to interest as general creditors.

There should, however, be one exception to the above suggestion. When the estate is not sufficient to pay the entire principal of the tax claim, it would seem that, at some time, interest should again begin to accrue on the unpaid principal. The date of discharge would be an appropriate time for the commencement of accrual. At this date, any further delay is not caused by law, and the time of payment is within the debtor's control. The equities of allowing interest to accrue after this date seem precisely the same as those which justify the granting of interest to the date of payment on ordinary debts out of bankruptcy.

It is submitted that this interest should be the only post-petition interest not discharged.<sup>132</sup> *Bruning*, of course, treated all post-petition interest in the same manner, regardless of differing circumstances and equities. This is a result of the present wording of the act which does not allow any such distinctions to be made. Legislation pointing out the necessary refinements for the courts is to be hoped for.

## A CONTEMPORARY VIEW OF THE CONDITIONAL VENDOR'S RIGHT TO RECLAMATION

### I. INTRODUCTION

The ultimate test of a creditor's security is its ability to withstand an attack by a trustee in bankruptcy. In a Chapter XI proceeding the rights of a secured creditor are not to be "affected," and in a Chapter X proceeding he is "protected" by the absolute-priority rule which requires that he be paid in full

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132. An argument may be made for not discharging post-petition interest in one other situation. Where the estate is not sufficient to pay the entire principal of the tax claim, perhaps interest should run during bankruptcy on that part of the principal which was not paid. Whether this amount should be classified with post-petition interest in general, or with the interest that should be allowed on unpaid principal after bankruptcy, turns on whether the delay caused by law or the insufficiency of the estate is the prime element in the debtor's failure to make prompt payment. In effect, the Government probably will argue that the policy reasons of fairness to the debtor should not apply when he could not have paid in any event since the legal delays of bankruptcy are not working to his detriment. While this argument is well-taken, it does not seem strong enough to violate the suggested rule of not allowing any interest to accrue during bankruptcy proceedings.

before any of the creditors in a lower ranking class are paid.<sup>1</sup> As a practical matter, however, his position is not as invulnerable as might first appear. He may be enjoined, at the discretion of the court, from proceeding to enforce his rights; he may be a member of a class which has voted to take less than the members are entitled to; or the court may decide that his security cannot be applied to his entire claim, in which case the remainder becomes an unsecured debt.<sup>2</sup> One method of circumventing these hazards is for the secured creditor to reclaim his property. In 1935, by virtue of an ingenious juxtaposition of the Bankruptcy Act and local sales law, the Second Circuit Court of Appeals in *In re Lake's Laundry, Inc.*,<sup>3</sup> afforded the conditional vendor this luxury. Since that time, however, the Bankruptcy Act has undergone major revision. Furthermore, the promulgation of the Uniform Commercial Code has invited reassessment of seasoned attitudes with respect to security and secured creditors. In light of these developments, it is now not inappropriate to reopen the *Lake's Laundry* decision.

## II. THE *Lake's Laundry* CASE

In 1935, *Lake's Laundry, Inc.* filed a petition for corporate reorganization pursuant to Section 77B of the Bankruptcy Act.<sup>4</sup> At the time, the company was in possession of certain machinery which it held as conditional vendee. The conditional sale contract provided that title was to remain in the vendor until the price was paid.<sup>5</sup> After reclamation had been granted to the conditional vendor,<sup>6</sup> the debtor appealed. The Second Circuit held that, under the wording of the act,<sup>7</sup> a plan of reorganization could deal only with the "property of the debtor."<sup>8</sup> Since the conditional sale contract, unlike chattel mortgages, reserved title in the vendor, the machinery was not "property of the debtor"<sup>9</sup> and, hence, not intended by Congress to be subject to the jurisdiction of the court in a reorganization.<sup>10</sup>

1. 1 Coogan, Hogan & Vagts, *Secured Transactions Under the Uniform Commercial Code* § 9.02[2][a] at 979 (1963).

2. *Id.* § 9.02[2][a] at 979, [b] at 981.

3. 79 F.2d 326 (2d Cir.), cert. denied, 296 U.S. 622 (1935).

4. Bankruptcy Act § 77B, ch. 424, 48 Stat. 912 (1934) (now Bankruptcy Act §§ 101-276, 52 Stat. 883 (1938), as amended, 11 U.S.C. §§ 501-676 (1964)).

5. Hereinafter it will be assumed throughout the discussion that the conditional sale contract contains a title retention clause.

6. *In re Lake's Laundry, Inc.*, 11 F. Supp. 237 (S.D.N.Y. 1935).

7. Bankruptcy Act § 77B(b)(10), ch. 424, 48 Stat. 914 (1934) (now Bankruptcy Act § 216(2), 52 Stat. 896 (1938), 11 U.S.C. § 616(2) (1964)).

8. 79 F.2d at 327-28.

9. Similarly, "the reservation of an option, not exercised, to redeem certificates issued against a mortgage . . ." does not make the mortgage itself property of the debtor, *In re National Pub. Serv. Corp.*, 88 F.2d 19, 24 (2d Cir.) (dissenting opinion), cert. denied, 301 U.S. 697 (1937), citing *In re Prudence Bonds Corp.*, 79 F.2d 212, 216 (2d Cir. 1935); nor is stock of the debtor's subsidiary, which is held by the debtor, property of the debtor, see *In re Adolf Gobel, Inc.*, 80 F.2d 849, 851 (2d Cir. 1936).

10. In arriving at its decision, the court was influenced by the fact that Congress had

Five years later, in *In re White Plains Ice Serv., Inc.*,<sup>11</sup> the court of appeals retreated from the outer limits of *Lake's Laundry*.<sup>12</sup> In *White Plains*, limitations were built around the "title theory" and its resulting right of reclamation, demonstrating, as Judge Clark stated in his concurring opinion, that "in practice *In re Lake's Laundry, Inc.* . . . does not force as prompt a surrender of possession to a conditional vendor as some commentators have thought, and that power does exist in a reorganization court to make such stays as are not unreasonable in the light of the vendor's legal priority."<sup>13</sup>

Although the *White Plains* decision is usually taken at face value, *i.e.*, for the proposition that a conditional vendor is entitled to reclaim subject only to reasonable delay, the decision could operate quite easily to undermine the doctrine of *Lake's Laundry* in its entirety. By staying the vendor's right to reclaim, albeit for a reasonable time, the *White Plains* court impliedly admitted that a reorganization court has jurisdiction over property subject to a conditional sale. This certainly contradicts—and implicitly overrules—the "jurisdiction theory" of *Lake's Laundry*.<sup>14</sup> Nonetheless, the conditional vendor's right to reclaim has continued to be recognized on the *Lake's Laundry* decision's alternate ground, the "title theory."<sup>15</sup>

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specifically included conditional sales in the farm reorganization portion of the act, Bankruptcy Act § 75(o)(6), ch. 204, 47 Stat. 1473 (1933), but not in the corporate reorganization section which was cast in more general terms, Bankruptcy Act § 77B(c)(10), ch. 424, 48 Stat. 917 (1934) (now Bankruptcy Act § 113, 52 Stat. 884, 11 U.S.C. § 513 (1964)). 79 F.2d at 328. These sections dealt with the power of the court to stay pending judicial proceedings attempting to deal with property involved in the reorganization proceedings. The court reasoned that, if it could not enjoin proceedings dealing with conditionally sold property, such property must be outside the realm of reorganization. *Ibid.* Issue was taken with this conclusion by Judge Learned Hand, who pointed out in his dissenting opinion that the corporate reorganization section speaks only of liens, "surely the most comprehensive of words." *Id.* at 329.

11. 109 F.2d 913 (2d Cir. 1940).

12. Although the Chandler Act became effective in 1938, it retained all the provisions of the 1898 act here pertinent. Further, while the *White Plains* case involved a petition under Chapter XI, the debtor-in-possession chapter, neither that court nor any subsequent court drew any distinction between corporate and non-corporate proceedings in this regard.

13. 109 F.2d at 915 (concurring opinion). (Footnote omitted.) The stay was originally granted to permit a determination of the status of the property, and was continued to fix the amount actually owing to the vendor and to give the debtor a reasonable time to pay it. But this was "all the grace the debtor can possibly claim . . ." *Id.* at 915 (concurring opinion). This result had been predicted in *In re Burgemeister Brewing Co.*, 84 F.2d 388 (7th Cir. 1936) (*per curiam*), where the court, after holding that the conditional vendor was entitled to reclamation from a reorganization vendee, stated: "What is said here is not intended to limit the power of a court of equity with jurisdiction of the res, to determine when and in what manner one seeking to recover a part of such res shall enforce his remedy." *Id.* at 389.

14. See note 10 *supra* and accompanying text.

15. See *Barth Equip. Co. v. Perlstein*, 128 F.2d 253 (2d Cir. 1942); *In the Matter of Newjer Contracting Co.*, 154 F. Supp. 567 (D.N.J. 1957); *In re Pagliaro*, 99 F. Supp. 548 (N.D. Cal. 1951), *aff'd per curiam sub nom. Costello v. Golden*, 196 F.2d 1017 (9th Cir. 1952).

Yet, as Judge Learned Hand, in *Lake's Laundry*, pointed out—lamenting the “barren distinction” between chattel mortgages and conditional sales<sup>16</sup>—the majority opinion would surely “prevent the reorganization of many . . . smaller companies who get their capital in this way.”<sup>17</sup> Consider, for example, a taxicab company which has gone into reorganization, only to have its cabs reclaimed by the conditional vendor. In this extreme example, the debtor, left with no business to reorganize, would be forced into straight bankruptcy. More common are cases where conditionally sold property is so essential to the continued operation of the business that reclamation constitutes the deciding factor in determining whether reorganization succeeds or fails.<sup>18</sup> Nevertheless, subject only to the court’s interpretation of “reasonable delay,”<sup>19</sup> the debtor may still be deprived of possession while most in need of the property.

### III. THE BANKRUPTCY ACT

Thirty-one years later, it is difficult to justify *Lake's Laundry's* reverential treatment of the conditional sale contract by recourse to any intent of Congress express or implied in the Bankruptcy Act itself. A detailed examination of the act leads almost inevitably to Judge Hand’s solitary conclusion that “‘title’ is a formal word for a purely conceptual notion . . .”<sup>20</sup> and that Congress did not intend to isolate or sanctify the security of a conditional sale transaction.<sup>21</sup>

#### A. *Reorganization Proceedings*

Influenced by the serious financing problems confronting many of the nation’s smaller aircraft companies, Congress, in 1957, provided that conditional vendors of certain types of aircraft and related equipment would not be affected by a corporate reorganization *if* they specifically retained the right to repossess in the conditional sale contract.<sup>22</sup>

Congress evidently felt that this additional protection would encourage manufacturers and dealers to extend credit to such companies.<sup>23</sup> Previously,

16. 79 F.2d at 328 (dissenting opinion).

17. *Id.* at 329 (dissenting opinion).

18. See *In re Sun Cab Co.*, 67 F. Supp. 137, 139 (D.D.C. 1946). Compare *In re Adolf Gobel, Inc.*, 80 F.2d 849 (2d Cir. 1936). Advancing the position in favor of retaining the *Lake's Laundry* rule intact, the Gobel court stated: “The argument that section 77B has for its object reorganization, and grants to the court power to enjoin any action in the state court which renders reorganization more difficult, is . . . without merit. . . . Though facility in reorganization is desirable, it is not the sole consideration.” *Id.* at 852-53.

19. *Power & Combustion, Inc. v. Wilson*, 298 F.2d 937, 940 n.4 (4th Cir. 1962) (reasonable time not to exceed thirty to sixty days absent extraordinary circumstances); *In the Matter of Newjer Contracting Co.*, 154 F. Supp. 567 (D.N.J. 1957).

20. 79 F.2d at 328 (dissenting opinion).

21. *Id.* at 329 (dissenting opinion).

22. Bankruptcy Act § 116(5), 71 Stat. 617 (1957), 11 U.S.C. § 516(5) (1964). Under this provision, the contract, in addition to providing for the retention of title, would also have to state specifically that the property therein described was not to be subject to any subsequent reorganization in which the vendee might become involved.

23. H.R. Rep. No. 944, 85th Cong., 1st Sess. (1957).

such protection had been afforded to one other type of property, rolling-stock equipment.<sup>24</sup>

Two conclusions follow. First, had Congress intended, as *Lake's Laundry* contended, to "exclude [from reorganization proceedings] property in the possession of the debtor whose rights therein were only those of a conditional vendee,"<sup>25</sup> there would have been no need to legislate anew for the benefit of these particular industries. Secondly, if the right to repossess flowed automatically from the conditional sale contract itself, as *Lake's Laundry* implied, the addition of a condition precedent of specifically reserving this right in the contract would serve to impose rather than to relieve burdens on hard pressed vendors.

### B. *In General*

While other sections of the act do not directly concern reclamation within reorganization proceedings, the history of these sections persuasively points to a definite legislative intent inconsistent with that enunciated in *Lake's Laundry*.

#### 1. The Voidable Preference

In 1915, *Bailey v. Baker Ice Mach. Co.*<sup>26</sup> established that a conditional sale could not be a voidable preference under the act as the statute then existed. The act defined preference as "a transfer of any of his [the debtor's] property, and the effect of the enforcement of such . . . transfer will be to enable any one of his creditors to obtain a greater percentage of his debt than any other of such creditors of the same class."<sup>27</sup> Transfer was defined as "the sale and every other and different mode of disposing of or parting with property, or the possession of property, absolutely or conditionally, as a payment, pledge, mortgage, gift, or security."<sup>28</sup> Hence, if there were no transfer of the debtor's property, there could be no preference and, a fortiori, no voidable preference. The *Bailey* court interpreted such words as "disposing of" and "parting with" as requiring an act by the debtor; failing to find the requisite act in a conditional sale, the court found no transfer and, thus, no preference.<sup>29</sup> This reasoning,<sup>30</sup> fettered by a restrictive definition of "property of the debtor," if allowed to continue, would emasculate the powers of the trustee to collect the bankrupt estate.<sup>31</sup>

24. Bankruptcy Act § 77(j), 49 Stat. 922 (1935), 11 U.S.C. § 205(j) (1964).

25. 79 F.2d at 328.

26. 239 U.S. 268 (1915).

27. Bankruptcy Act § 60a, ch. 541, 30 Stat. 562 (1898) (amended by 52 Stat. 869 (1938), as amended, 11 U.S.C. § 96(a)(1) (1964)).

28. Bankruptcy Act § 1(25), ch. 541, 30 Stat. 545 (1898) (now Bankruptcy Act § 1(30), 52 Stat. 842 (1938), as amended, 11 U.S.C. § 1(30) (1964)).

29. 239 U.S. at 274.

30. See also *In re Johnson*, 282 Fed. 273 (N.D. Iowa 1922); *In re Bennett*, 264 Fed. 533 (W.D. Mo. 1920).

31. E.g., Bankruptcy Act §§ 60, 67, 70, 52 Stat. 869, 875, 879 (1938), as amended, 11 U.S.C. §§ 96, 107, 110 (1964). It should be noted at this point that all of these provisions are

Thus, as part of the sweeping revisions in the act made in 1938, the definition of transfer was changed to read:

"Transfer" shall include the sale and every other and different mode, direct or indirect, of disposing of or of parting with property or with an interest therein or with the possession thereof or of fixing a lien upon property or upon an interest therein, absolutely or conditionally, voluntarily or involuntarily, by or without judicial proceedings, as a conveyance, sale, assignment, payment, pledge, mortgage, lien, encumbrance, gift, security, or otherwise . . . .<sup>32</sup>

Unfortunately, this amendment did not convince everyone that a conditional sale was capable of being a voidable preference,<sup>33</sup> although, on the strength of this broader definition, the holding of *Bailey* was to some extent avoided.<sup>34</sup> With the avowed purpose of clarifying any latent ambiguities remaining after 1938,<sup>35</sup> the definition was subsequently amended in 1952 to provide that "the retention of a security title to property delivered to a debtor shall be deemed a transfer suffered by such debtor."<sup>36</sup>

One of the essential elements of a voidable preference is the diminution of the bankrupt's estate.<sup>37</sup> Thus, once it is conceded that a conditional sale can be a voidable preference, a conditional sale, by definition, must include the element of diminution. If the removal of property constitutes a diminution of the bankrupt's estate, the property must have been part of his estate to begin with, or, in other words, "property of the debtor." Significantly, prior to either amendment, Judge Learned Hand had advocated to no avail in *Lake's Laundry*, which was a section 77B proceeding, the adoption by the court of a definition of "property" which would "include all legally protected interests" of the debtor.<sup>38</sup> Of course, once conditionally sold property is recognized as "property of the debtor," *Lake's Laundry* collapses.

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contained in the straight bankruptcy (Chapters I-VII) portions of the act. However, they are all applicable to Chapter X corporate reorganizations. Sections 60 and 70c are made expressly applicable, and § 70e is clearly impliedly applicable. 4 Collier ¶¶ 70.48[6], .69, at 1517-18.

32. Bankruptcy Act § 1(30), 52 Stat. 842 (1938), as amended, 11 U.S.C. § 1(30) (1964).

33. See 2 Glenn, *Fraudulent Conveyances and Preferences* § 518 (rev. ed. 1940).

34. Cf. *Corn Exch. Nat'l Bank & Trust Co. v. Klauer*, 318 U.S. 434, 438 n.11 (1943).

35. "Notwithstanding the apparently sweeping language of the present [1938] definition of transfer, there is a chance that it would be held insufficient to cover the security interest reserved in the grantor by conditional sale . . . transaction with the debtor, because such interests are not the results of transfers made by the debtor, although they usually perform the same function as a transfer made by him for the purpose of security. *Bailey v. Baker Ice Machine Co.* . . . held that a conditional sale to the debtor could not be a preferential transfer, because it was not made by the debtor. Since the amendment of section 60, it is clear that a preferential transfer may be suffered by the debtor, but the generality of the present [1938] definition is clarified by the declaration that such a reserved interest may be a transfer suffered by the debtor." H.R. Rep. No. 2320, 82d Cong., 2d Sess. 4 (1952).

36. Bankruptcy Act § 1(30), 66 Stat. 420 (1952), 11 U.S.C. § 1(30) (1964).

37. 3 Collier ¶ 60.20 and cases cited therein.

38. 79 F.2d at 329 (dissenting opinion).

## 2. Section 70

Nowhere else in the act does the unique status afforded a conditional vendor under *Lake's Laundry* find congressional endorsement. Thus, under subdivision c of section 70,<sup>39</sup> the trustee is put into the position of a hypothetical judgment lien creditor. If, under the appropriate state law, a judgment lien creditor prevails over the vendor, then the trustee also prevails.<sup>40</sup> Similarly, under section 70e(1),<sup>41</sup> if there is a creditor in existence<sup>42</sup> against whom the failure to perfect renders the reservation of title ineffective, then the trustee may avoid the transaction and retain the property regardless of any attempt at reclamation.<sup>43</sup> *Lake's Laundry* notwithstanding, it is the observance of the technicality of perfection, rather than a retention of title provision in the contract, which renders the conditional sale—and any other security interest—invulnerable to attack.<sup>44</sup>

C. *The Effect on Lake's Laundry*

Considering the manifest intent of Congress to legislate away distinctions between conditional sales and other forms of security,<sup>45</sup> except in two cases involving unusual economic situations,<sup>46</sup> it is remarkable that *Lake's Laundry* is accepted without serious challenge.<sup>47</sup> Can it be that the courts since 1935, with an excess of conservatism, have been reluctant to create an inference from the establishment of a voidable preference, not before the court, to hold that conditionally sold property should be considered "property of the debtor" in all contexts?<sup>48</sup> It would seem that, in the absence of any declared con-

39. Bankruptcy Act § 70c, 66 Stat. 430 (1952), 11 U.S.C. § 110(c) (1964).

40. See, e.g., *First Nat'l Bank v. Phillips*, 261 F.2d 588 (5th Cir. 1958); *Earhart v. Callan*, 221 F.2d 160 (9th Cir.), cert. denied, 350 U.S. 829 (1955).

41. Bankruptcy Act § 70e(1), 52 Stat. 882 (1938), 11 U.S.C. § 110(e)(1) (1964).

42. Section 70c does not require that such a creditor actually exist.

43. This is a very brief discussion of an immensely complicated topic which is beyond the scope of this comment. See generally 4 *Collier* §§ 70.19, .57, .84.

44. The fact that the states have diverse recording statutes has led to great non-uniformity in the application of the Bankruptcy Act. Hence, the doctrine of *Lake's Laundry* may allow a vendor in New York to reclaim his property, while a vendor under an identical contract in Kentucky would be denied reclamation. See 4 *Geo. Wash. L. Rev.* 419, 422-23 (1936).

45. See note 35 *supra*.

46. See notes 22 & 24 *supra* and accompanying text.

47. Cf. *Power & Combustion, Inc. v. Wilson*, 298 F.2d 937 (4th Cir. 1962); *Mickel-Hopkins, Inc. v. Frassinetti*, 278 F.2d 301 (4th Cir. 1960).

48. Of course, a court can deny a petition for reclamation in cases involving a defective perfection under § 70, without ever reaching the question of "property of the debtor"; or find a preference and deny the petition without ever looking beyond the face of the statute. Nevertheless, a court presented with a petition for reclamation which cannot be defeated as improperly recorded or as a voidable preference could find cogent reasons in the act to deny a petition which threatens an otherwise promising reorganization. It is in this context that the doctrine of *Lake's Laundry* will probably meet its ultimate demise.

gressional intent, the history of "transfer" in bankruptcy law,<sup>49</sup> undermining the "barren distinction" between conditional sales and other forms of security,<sup>50</sup> coupled with the recent amendment to the Bankruptcy Act dealing with aircraft and rolling-stock equipment,<sup>51</sup> raises a strong presumption that *Lake's Laundry* is no longer reliable as a barometer of legislative intent or a delineator of the boundaries of "property of the debtor."

#### IV. THE INFERENCE FROM STATE LAW—THE UNIFORM COMMERCIAL CODE

The determination of the quality of the security which a creditor holds and related problems are all governed by state law in bankruptcy proceedings.<sup>52</sup> When *Lake's Laundry* was decided, the distinction between conditional sales and other types of security interests was sanctioned by a long history of statutory and common law.<sup>53</sup> That this distinction is still valid in the majority of states which have adopted the Uniform Commercial Code<sup>54</sup> is a proposition of considerable doubt.

##### A. Section 9-102

By definition, article 9 "applies to security interests created by contract including pledge, assignment, chattel mortgage, chattel trust, trust deed, factor's lien, equipment trust, *conditional sale*, trust receipt, other lien or *title retention contract* . . . intended as security."<sup>55</sup> In a move reminiscent of the development of the meaning of "transfer" in the Bankruptcy Act,<sup>56</sup> this section seeks to obliterate obfuscating legal distinctions in any transaction creating a "security interest" regardless of the terminology chosen by the parties themselves.<sup>57</sup> Since the *Lake's Laundry* court ostensibly credited its preferred treatment of the conditional vendor to state law,<sup>58</sup> a bankruptcy court following that decision in a state which has adopted the Uniform Commercial Code is on an anachronistic doctrinal perch.

##### B. Section 9-202

The most cogent reason for the ultimate demise of *Lake's Laundry* is codified by another section of article 9 which provides that "each provision of this

49. It should be noted that "transfer" also appears in §§ 67 and 70 of the act. 52 Stat. 875, 879 (1938), as amended, 11 U.S.C. §§ 107, 110 (1964). The changes of the definition discussed in notes 27-38 and accompanying text also apply to these sections and helped to codify the already existing law that conditional sales were within their scope.

50. 79 F.2d at 328-29 (dissenting opinion).

51. See notes 22-24 and accompanying text.

52. 4 Collier ¶ 70.19, at 1122. However, the bankruptcy court is not bound to follow state law where the court deems state law to be in conflict with the Bankruptcy Act. Id. ¶ 70.06, at 977.

53. 79 F.2d at 328.

54. As of January 1, 1966, 30 states have adopted the Uniform Commercial Code.

55. Uniform Commercial Code § 9-102(2). (Emphasis added.)

56. See notes 28, 32, 35 & 36 supra and accompanying text.

57. In re Jeavons, —F. Supp. —(N.D. Ohio 1965).

58. 79 F.2d at 328.