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Postpetition Transfers in Bankruptcy

Darrell W. Dunham

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Postpetition Transfers in Bankruptcy

DARRELL W. DUNHAM*

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I. INTRODUCTION

Recently, Carl Consumer decided to buy a used car. After reading the classified advertisements in his local newspaper, he called Dave Debtor who had advertised a late model car for sale. Carl inspected the car, and they reached an agreement on price. Carl knew that his state's certificate of title legislation governed the sale of the car,¹ and therefore, prior to tendering his certified check for the purchase price of the car, Carl insisted that he inspect Dave's title to see whether any liens or other title defects were noted. Dave produced a clean certificate and signed his name

1. See, e.g., Uniform Motor Vehicle Certificate of Title and Anti-Theft Act § 1, 11 U.S.C. § 421 (1974, Supp. 1983); ILL. REV. STAT. ch. 95 ½, §§ 3-100 to 210 (1981).

on the back, thereby authorizing the appropriate state official to issue Carl a new certificate of title. Carl did not know, however, that no less than one day prior to the sale Dave had filed a voluntary petition in bankruptcy.

In a dispute between Dave's trustee in bankruptcy and Carl over title to and possession of the car, the trustee likely will prevail.² This will be true even though Carl was unaware of Dave's bankruptcy and even though Dave himself honestly believed that he had authority to sell the car. Bankruptcy law will not recognize a clean certificate of title as the sole defense to a trustee's claim.³ Curiously, however, if Carl in turn sells the vehicle to another bona fide purchaser, that purchaser will likely prevail in a dispute with the trustee.⁴

The 1966 Supreme Court decision in *Bank of Marin v. England*,⁵ a case that engendered considerable commentary,⁶ had a significant impact on Congress and its treatment of this problem. In *Marin*, a drawer drew some checks on its account with the drawee bank in favor of a payee. Subsequent to the drawing of the checks, but before payment by the bank, the drawer filed a voluntary petition in bankruptcy pursuant to the bankruptcy act of 1938 (hereinafter "Chandler Act").⁷ The bank, not knowing of the drawer's bankruptcy, honored the checks in the ordinary course of its business. Subsequently, the drawer's trustee in bankruptcy initiated proceedings against both the drawee and the payee to recover the funds debited from the account. The payee conceded the merit of the trustee's argument, deposited the total amount of the checks

2. See 11 U.S.C. § 549(a)(1)(B) (1982) (amended 1984).

3. *Id.* For further discussion, see *infra* text accompanying notes 241-46.

4. 11 U.S.C. § 550(b)(2) (1982). For further discussion, see *infra* text accompanying notes 473-82.

5. 385 U.S. 99 (1966).

6. See, e.g., Bateman, *Post-Bankruptcy Transfers: An Old Problem In Need Of A New Solution*, 53 CORNELL L. REV. 280 (1968); Boshkoff, *Section 70(d) of The Bankruptcy Act: The Need for Amendment*, 43 IND. L.J. 755 (1968); Note, *Bankruptcy: Bank Which In Good Faith and Without Notice Honors Client's Check After He Is Adjudicated Bankrupt Not Liable To Trustee For Depletion of the Bankrupt's Estate*, 1967 DUKE L.J. 1023; Note, *Bankruptcy: Where Bank Acted Without Actual Knowledge of Depositor's Bankruptcy, It Will Not Be Liable for Cashing Checks Drawn by Depositor Before Bankruptcy and Cashed by Payee Thereafter*, 18 SYRACUSE L. REV. 853 (1967) [hereinafter cited as Note, *Where Bank Acted Without Actual Knowledge*]; Note, *Bankruptcy: Trustee's Title to Bankrupt's Property-Drawee Bank is Liable to the Trustee for Honoring Pre-Bankruptcy Checks After Adjudication Even Though the Bank Acted Without Any Knowledge of the Bankruptcy Proceeding*, 41 N.Y.U. L. REV. 430 (1966) [hereinafter cited as Note, *Trustee's Title*].

7. Chandler Act, ch. 575, 52 Stat. 840 (1938).

into court, and requested contribution from the drawee bank.

The trustee's analysis of the Chandler Act persuaded the Ninth Circuit.⁸ The Chandler Act provided that the trustee was "vested by operation of law with the title of the bankrupt . . . [of] property . . . which prior to the filing of the petition he could by any means have transferred"⁹ The expressed exception to this provision protected transfers occurring only "before adjudication."¹⁰ Under an amendment to the Chandler Act, the filing of a *voluntary* petition in bankruptcy operated as an *automatic* adjudication of bankruptcy.¹¹ In addition, for postadjudication transfers the statute expressly stated that "no transfer by or in behalf of the bankrupt after the date of bankruptcy [is] valid against the trustee."¹² Therefore, under the statute, only the trustee had title to the account; the bank had no authority to honor the checks.

Justice Harlan sought to affirm the Ninth Circuit.¹³ Because the Chandler Act provided that the trustee had title to the bankrupt's property "as of the date of the filing of the petition,"¹⁴ and because there was no other protection to be found in the Act,¹⁵ Harlan argued that the trustee must prevail despite the conceded equities of the bank's case.

Justice Douglas wrote the majority opinion. He agreed with the Ninth Circuit's decision imposing liability against the payee. The payee was a creditor of the estate. By forcing the payee to pay the money back, the Court was merely depriving the payee "preferential treatment."¹⁶ As to the bank, however, he opined that the

8. *Bank of Marin v. England*, 352 F.2d 186 (9th Cir. 1965).

9. Chandler Act, ch. 575, § 70a(5), 52 Stat. 840, 879-80 (1938).

10. Chandler Act, ch. 575, § 70d, 52 Stat. 840, 881-82 (1938).

11. Act of June 23, 1959, Pub. L. No. 86-64, § 1, 73 Stat. 109.

12. Chandler Act, ch. 575, § 70d(5), 52 Stat. 840, 882 (1938).

13. *Marin*, 385 U.S. at 103 (Harlan, J., dissenting).

14. Chandler Act, ch. 575, § 70a, 52 Stat. 840, 879 (1938).

15. Chandler Act section 70d(2) expressly protected persons "holding property of the bankrupt" who paid in "good faith" upon the order of bankruptcy. Chandler Act, ch. 575, § 70d(2), 52 Stat. 840, 881 (1938). This protection, however, was given only for transfers occurring *before* adjudication. Thus, Justice Harlan concluded that Congress's failure to include protection for postadjudication transfers was highly significant. *Marin*, 385 U.S. at 103. For further discussion, see *infra* text accompanying notes 131-34.

16. 385 U.S. at 103. The opinion does not address cases in which the payee is not a creditor, for example, where the check is given in payment for goods. The opinion also stops short of holding that the payees had benefitted from a preference which was therefore voidable under section 60b of the Chandler Act. Chandler Act, ch. 575, § 60a,b, 52 Stat. 840, 869-70 (1938). If the payees received payment after the petition, it seems clear that an essential preference element, that the transfer occur "within four months *before* the filing . . . of the petition," would be missing. *Id.* (emphasis added). For further discussion, see *infra* note 226.

statute must not be read "with the ease of a computer . . . [and] [t]here is an overriding consideration that equitable principles govern the exercise of bankruptcy jurisdiction."¹⁷ Moreover, the trustee's position conflicted with the principle announced by the Court in *Mullane v. Central Hanover Bank & Trust Co.*,¹⁸ which held that one should not be deprived of his property without notice, that was "reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action"¹⁹

In order for the majority to reach this decision,²⁰ it was necessary to resort to principles of "equity."²¹ In addition, the Court's prior opinions indicated that the postpetition transferee should not have been protected. Dictum in the frequently cited case of *Muel-ler v. Nugent*²² states that the filing of the petition in bankruptcy is "a caveat to all the world"²³ that the trustee upon adjudication in bankruptcy has the sole authority to deal with the property of the estate. Subsequent decisions converted the *Mueller* dictum into actual case law,²⁴ and Congress, in passing the Chandler Act, relied on these opinions. Congress severely limited the instances in which relief was accorded to innocent parties who dealt with the bankrupt after adjudication.²⁵

The drafters of the 1978 bankruptcy code were also aware of the result in the *Marin* case and codified it to insulate banks from

17. *Marin*, 385 U.S. at 103.

18. 339 U.S. 306 (1950).

19. *Id.* at 314.

20. The Supreme Court is not the only court to engage in questionable legal gymnastics to reach a result relieving a transferee of the effect of an unauthorized postpetition transfer. Recently, the First Circuit relied on *Marin* to immunize a transferee from conversion liability where the transfer was voidable under section 549. 11 U.S.C. § 549(a)(1)(B) (1982) (amended 1984). See *infra* text accompanying notes 241-46; see also *In re Yellow Cab Co.*, 4 BANKR. CT. DEC. (CRR) 582 (Bankr. E.D. Pa. July 13, 1978), discussed *infra* at note 133.

21. Cf. Countryman, *Justice Douglas: Expositor of the Bankruptcy Law*, 51 AM. BANK. L.J. 127, 148 (1977) ("With the hope that this is a matter on which reasonable men may differ, this writer feels obliged to say that he considers the decision wrong both in its interpretation of the Act and in its consideration of 'equity.'"). Professor Countryman suggested that the decision in *Marin* may unfairly distort the statutory scheme so as to lead to inequitable results in the future.

22. 184 U.S. 1 (1902).

23. *Id.* at 14.

24. See *Andrews v. Patridge*, 228 U.S. 479 (1913); *Everett v. Judson*, 228 U.S. 474 (1913); *Acme Harvester Co. v. Beekman Lumber Co.*, 222 U.S. 300 (1911); see also Bateman, *supra* note 6, at 284-86.

25. See *infra* text accompanying notes 93-107; see also S. REP. NO. 1916, 75th Cong., 3d Sess. 18 (1937); H.R. REP. NO. 1409, 75th Cong., 1st Sess. 34 (1937); Bateman, *supra* note 6, at 289 n.52.

future lawsuits by bankruptcy trustees.²⁶ Nevertheless, Congress did not extend protection to other parties dealing with estate property who were unaware of the bankruptcy.

Both the Uniform Commercial Code²⁷ and case law involving personal property²⁸ provide that purchasers usually assume the risk that their seller does not have authority to transfer title to the property sold. Moreover, the *Mueller* dictum has firm historical support.²⁹

Numerous exceptions to this general rule have been created by case law³⁰ and by statute.³¹ Given the fact that there are numerous

26. 11 U.S.C. § 542(c) (1982). "This subsection codifies the result of *Bank of Marin v. England* . . ." H. REP. NO. 95-595, 95th Cong., 1st Sess. 369 (1977), *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5963, 6325; S. REP. NO. 95-989, 95th Cong., 2d Sess. 84 (1978), *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5787, 5870. This provision is discussed *infra* at text accompanying notes 321-29.

The drafters of the Uniform Commercial Code anticipated a *Marin*-type case and provided that the bank should not be liable unless notice of "legal process is received or served and a reasonable time for the bank to act thereon expires" before the check is paid. See U.C.C. § 4-303(1) (1978). Section 4-303, however, could not have been used to protect the bank because it conflicted with controlling federal bankruptcy statutes. See, e.g., *Jahn v. First Tennessee Bank of Chattanooga (In re Burnette)*, 14 Bankr. 795 (Bankr. E.D. Tenn. 1981) (holding that the bankruptcy code's definition of a "transfer," as set forth in section 11 U.S.C. § 547(e)(2)(A) (1982), controls over provisions in the Uniform Commercial Code that are designed to insulate a "floating lien" on inventory from the trustee's preferential transfer attack); U.C.C. § 9-108 (1978) (providing that a "security interest in the after-acquired collateral shall be deemed to be taken for new value and not as security for an antecedent debt . . ."). The drafters were quite candid in stating the need for section 9-108: "This rule is of importance principally in insolvency proceedings under the federal Bankruptcy Act . . ." U.C.C. § 9-108 comment 1 (1978). This provision, however, did not deter the court in *Burnette*.

27. "A purchaser of goods acquires all title which his transferor had or had power to transfer . . ." U.C.C. § 2-403(1) (1978); see *Marvin v. Connelly*, 272 S.C. 425, 252 S.E. 2d 562 (1979). In the *Marvin* case, the seller of a trailer acquired possession after he had purchased the trailer at his own mechanic's lien sale. He then sold the trailer to the eventual buyer. The trailer had been stolen, and the court held that buyer had bought nothing because his seller did not have title.

28. "[O]rdinarily one who buys from a vendor who has no title obtains none, no matter how much he may pay or how honestly he may buy." *James Talcott, Inc. v. Associates Discount Corp.*, 302 F.2d 443, 447 (8th Cir. 1962); see also *Fosco Leasing Co. v. Cohen (In re Racquet Times, Inc.)*, 8 Bankr. 558, 560 (Bankr. W.D. Okla. 1981) ("One who has no title to goods cannot pass title to even a bona fide purchaser."); BROWN, *THE LAW OF PERSONAL PROPERTY* § 67 (2d ed. 1955) ("A seller cannot transfer better title to a chattel than it possesses.").

29. T.F.T. PLUCKNETT, *A CONCISE HISTORY OF THE COMMON LAW* 452 (5th ed. 1956); 2 F. POLLOCK & F. MAITLAND, *HISTORY OF ENGLISH LAW* 164 (2d ed. 1959).

30. As early as the fifteenth century an exception was recognized for sales in market overt. *Case of Market Overt*, 77 Eng. Rep. 180, 5 Coke 83b (1569); T.F.T. PLUCKNETT, *supra* note 29, at 665; see Hamilton, *The Ancient Maxim Caveat Emptor*, 40 YALE L.J. 1133 (1931); see also 2 W. BLACKSTONE, *COMMENTARIES* 449 (Dawsons of Pall Mall ed. 1966).

Other exceptions were granted when title was merely "voidable" as opposed to "void."

exceptions to the *caveat emptor* doctrine outside of bankruptcy, it is curious that more exceptions are not recognized within bankruptcy. There is no persuasive reason why the Bank of Marin should have been insulated from liability while a purchaser, like Carl Consumer relying on a clean certificate of title, is not. A central concern of this article is that other parties dealing with estate property after a filing of bankruptcy are as deserving of protection as was the Bank of Marin.

With these objectives in mind, a summary of what is to follow is offered: Part II of this article will analyze the scope of any Constitutional restraints on Congress's authority to force innocent transferees to absorb the loss in postpetition transfer cases. The use of the *Mullane* decision by the Supreme Court in *Marin* has caused some student writers to infer that the Court intended to base its decision on the due process clause of the Constitution.³²

Brown, *supra* note 28, at § 70; see also *Jones v. Linebaugh*, 34 Mich. App. 305, 311, 191 N.W.2d 142, 145 (1971) ("[A] person with a voidable title . . . has power to transfer good title to a good faith purchaser . . ."); *Central Nat. Bank of Matoon v. Worden-Martin, Inc.*, 90 Ill. App. 3d 601, 604, 413 N.E.2d 539, 542 (1980) ("Even one with a voidable title possesses power to transfer it as good.").

Still another exception was recognized when the true owner was estopped to deny the title of the purchase. BROWN, *supra* note 28, at § 70; see also *Dresher v. Roy Wilmet Co.*, 118 Ind. App. 542, 82 N.E.2d 260, 262 (1948) ("[W]here a person by his own acts makes it possible for a vendee of personal property to sell the property to a bona fide purchaser for value without notice, the original owner and seller may not recover the property from such bona fide purchaser."); *Guckeen Farmers Elevator Co. v. Cargill, Inc.*, 269 Minn. 127, 134, 130 N.W.2d 69, 74 (1964) ("[W]here a seller has been guilty of laches or conduct injurious to an innocent third party purchasing the goods from his vendee, he will be estopped from recovering them or their value as against such third party.").

31. See, e.g., ILL. REV. STAT. ch. 95 ½, §§ 3-100 to 210 (1981) (certificate of title legislation); U.C.C. § 3-305 (holder in due course of negotiable instrument); U.C.C. §§ 2-403, 9-307(1) (buyer in ordinary course of business).

32. "The move accomplished by *Marin*, was that not only is notice by publication insufficient when the intended recipient is known, but constructive notice resulting from an act, unknown to the intended notice recipient, is inconsistent with the concept of due process." Note, *Bankruptcy—Notice Required—Bank's Liability on Checks Presented Subsequent to Depositor's Filing of Voluntary Bankruptcy Petition*, 16 AM. U.L. REV. 409, 415 (1967). "Moreover, since the constitutional mandate is to provide reasonable notice and since a trustee could normally notify a bankrupt's banks much more easily than he could all creditors and with much less risk of omission, it might be argued that personal notice is required." Note, *Bankruptcy—Transfer of Funds—Drawee Bank Liable to Drawer's Bankruptcy Trustee for Good Faith Payment of Checks After Drawer Files Voluntary Bankruptcy Petition Despite Lack of Notice of Filing*, 52 VA. L. REV. 528, 536-37 (1966); see also Note, *Bankruptcy—Transfers—Drawee Bank Not Liable for Payment of Depositor's Check After His Voluntary Petition in Bankruptcy Where Notice Is Not Given to Bank*, 20 VAND. L. REV. 1152, 1156 (1967) [hereinafter cited as Note, *Drawee Bank Not Liable*], (suggesting that a substantial risk of double liability entitles the bank to reasonable notice).

Arguing that the trustee could give notice fails to account for the fact that a trustee or other custodian usually is not appointed for several days after the filing of the petition. See

Part III presents a discussion of the law prior to the Bankruptcy Reform Act of 1978. This historical overview is offered because some of the 1978 bankruptcy code's treatment of postpetition transfers is merely a recodification of the prior treatment. In those instances where prior treatment was rejected, an understanding of the rejected doctrine will be useful in analyzing present law. Part IV describes the current status of the law. Part V discusses the policy justifications for favoring either the trustee or the innocent third party, and an approach will be offered for resolving these questions. Numerous exceptions to the general rule of *caveat emptor*, which have been recognized by case law and by state statutes, will be discussed to determine whether or not Congress should codify these exceptions into future legislation on postpetition transfers.

II. THE CONSTITUTIONAL RIGHT TO NOTICE

Prior to the result in *Marin*, there was no indication in either the literature or case law that suggested that a congressional statute, that imposed liability on an innocent party due to that party's ignorance of the bankruptcy filing, was unconstitutional. Justice Douglas's reliance on the *Mullane* decision in deciding *Marin* caused some student commentators to infer that the decision may have constitutional underpinnings.³³ The entire excerpt in question reads as follows:

The Court of Appeals held that the bankruptcy of a drawer operates without more as a revocation of the drawee's authority. . . . But that doctrine is a harsh one that runs against the grain of our decisions requiring notice before a person is deprived of property . . . a principle that has been recognized and implied in proceedings under the Bankruptcy Act The kind of notice required is one "reasonably calculated under all the circumstances, to apprise the interested parties of the pendency of the action. . . ." We cannot say that the act of filing a voluntary petition in bankruptcy *per se* is reasonably calculated

11 U.S.C. § 701 (1982) (providing for the appointment of an interim trustee in liquidation cases "[p]romptly" after the "order [of] relief. . . ."). The filing of a voluntary petition immediately "constitutes an order for relief" 11 U.S.C. § 301 (1982). Thus, even if an interim trustee is appointed "promptly," it will be several days before the trustee would be in a position to notify creditors and banks of a bankruptcy. Such notice would have come too late for the Bank of Marin. The bankruptcy court does have the power to appoint an interim trustee at the time of the filing of the petition, 11 U.S.C. § 105(b) (1982), but such appointments are unusual.

33. See *supra* note 32.

to put the bank on notice.³⁴

Marin does not expressly hold that placing liability on the drawee bank would be unconstitutional, but one cannot simply ignore the above language. The reference to cases requiring notice as a constitutional right was more than a throw-in. Therefore, this section explores the constitutional limitations on the scope of Congress's constitutional power to establish bankruptcy laws.

The notice cases cited by the Supreme Court in *Marin* were not fifth amendment cases. Those cases discussed the fourteenth amendment's limitation against the states' attempt to take property without due process of law.³⁵ In the bankruptcy setting, only the due process clause of the fifth amendment can limit the federal government. Nevertheless, the cases citing the two due process clauses of the Constitution do so on an interchangeable basis.³⁶ No objection should be lodged against the Court for citing these fourteenth amendment cases while interpreting the fifth amendment.

It is not surprising that the Court's opinions that discuss the fifth amendment limitation on the bankruptcy power³⁷ concern the rights of creditors in bankruptcy. Although one should not overgeneralize in this area, any student of the cases cannot help but conclude that the Court has been willing to permit sweeping curtailments of creditors' rights. Landlords' claims may be statutorily limited to a fraction of their potential value under nonbankruptcy law.³⁸ Even secured creditors' rights can be statutorily

34. *Marin*, 385 U.S. at 102.

35. *Schroeder v. City of New York*, 371 U.S. 208 (1962), discussed *infra* text accompanying notes 43-45; *Walker v. City of Hutchinson*, 352 U.S. 112 (1956).

36. See *Miller v. Howe Sound Min. Co.*, 77 F. Supp. 540, 547 (E.D. Wash. 1948) ("The language of numerous decisions of the Supreme Court and the way in which the Court, in considering constitutional questions, pertaining to property rights, has indiscriminately cited as sustaining authority cases involving Federal and State statutes clearly indicates that so far as substantive due process is concerned, the principles which apply to the Fourteenth Amendment are applicable also to the Fifth Amendment.") (citing *Carroll v. Greenwich Ins.*, 199 U.S. 401 (1905); *Federal Power Comm'n v. Natural Gas Pipeline Co.*, 315 U.S. 575 (1942); *Wright v. Union Cent. Life Ins.*, 304 U.S. 502 (1938); *West Coast Hotel Co. v. Parrish*, 300 U.S. 379 (1937); *Nebbia v. New York*, 291 U.S. 502 (1934)).

37. "The Congress shall have Power . . . [t]o establish . . . uniform laws on the subject of Bankruptcies throughout the United States" U.S. CONST. art. I, § 7, cl. 4.

38. *Kuehner v. Irving Trust Co.*, 299 U.S. 445 (1937), upholding the constitutionality of a statute limiting to a three-year period a landlord's claim for damages. The present treatment of the landlord's claim is remarkably similar to the statutory formula found constitutional in *Kuehner*. In general, the landlord's claim is limited to "rent reserved . . . for the greater of one year, or 15 percent, not to exceed three years, of the remaining term of such lease, following the earlier of (i) the date of the filing of the petition; and (ii) the date on which such lessor repossessed, or the lessee surrendered, the leased property." 11 U.S.C. §

modified.³⁹ The only limit on Congress's power appears to be that the secured creditor must eventually be paid the reasonable value of his or her property.⁴⁰ With unsecured creditors, on the other hand, it has never been seriously questioned that Congress has the power to simply eviscerate, by means of a discharge, the entire claim.⁴¹ In view of this sweeping power, if our analysis of the notice issue reveals that the fourteenth amendment's due process clause does not require notice in cases such as *Marin*, then clearly the fifth amendment does not require it either.

We now turn to the issue of whether the Constitution requires notice before a party acts in such a way to make it liable? In insisting that the bank receive notice, the Court in *Marin* cited *Mullane*, *Walker v. City of Hutchinson*,⁴² and *Schroeder v. City of New York*.⁴³ All three cases discuss the right of a party in a law suit to be apprised of the pendency of a proceeding where the rights or property of the litigant are subject to adjudication.⁴⁴ All

502(a)(7) (1982); see, e.g., *International Coins & Currency, Inc. v. Barmar Corp. (In re International Coins & Currency, Inc.)*, 18 Bankr. 335 (Bankr. D. Ut. 1982).

39. See *Wright v. Union Central Life Insurance Co.*, 304 U.S. 502 (1937) (allowing debtor, whose property was sold at judicial sale, to keep it beyond state statute's redemption period); *Wright v. Vinton Branch Bank*, 300 U.S. 440 (1937) (allowing debtor the use of the secured creditor's collateral for a three-year period while attempting to reorganize). See generally Comment, *Constitutional Limitations on the Bankruptcy Power: Chapter XII Real Property Arrangements*, 52 N.Y.U. L. Rev. 362, 383-93 (1977).

40. See *United States v. Security Indus. Bank*, 459 U.S. 70 (1982) (giving prospective application only, so as to avoid constitutional questions, to a statute voiding nonpurchase money security interests on debtor's exempt property); 11 U.S.C. § 522(f) (1982).

41. See, e.g., 11 U.S.C. § 727(a) (1982); cf. Rogers, *The Impairment of Secured Creditors' Rights In Reorganization: A Study of the Relationship Between the Fifth Amendment and the Bankruptcy Clause*, 96 HARV. L. REV. 973, 998-1012 (1983) (questioning the different constitutional treatment given secured vis-a-vis unsecured creditors).

42. 352 U.S. 112 (1956).

43. 371 U.S. 208 (1962). Even reliance on *Mullane* assumes the implied overruling of *Hanover Nat'l Bank v. Moyses*, 186 U.S. 181 (1902). *Moyes* held that creditors in bankruptcy were not constitutionally entitled to more than a ten day notice by mail. The Court held that the notice was constitutional given the fact that the bankruptcy proceeding was basically an *in rem* action. Prior to *Mullane*, it was felt that personal service was only required in *in personam* actions. 186 U.S. at 192. The *Mullane* case, however, held that the constitutional sufficiency of notice could not depend on whether the proceeding was characterized as *in rem* or *in personam*. *Mullane*, 371 U.S. at 311-13. Although *Mullane* may have overruled the analysis of *Moyes*, it is by no means clear that the result would have changed in light of *Mullane*. The *Mullane* Court held that in some instances mailed notice was sufficient given the nature of the proceeding and the large number of parties required to be notified. *Id.* at 317-18. This, of course, is typical in a bankruptcy case. In addition, it could be argued that the creditors are within the continuing jurisdiction of the bankruptcy court. See, e.g., *Michigan Trust Co. v. Ferry*, 228 U.S. 346 (1913); RESTATEMENT (SECOND) CONFLICT OF LAWS, § 26 (1971).

44. *Mullane* concerned a state proceeding to aggregate certain trust accounts under

three cases held that there was a constitutional right to receive notice prior to the adjudication of one's rights.

These cases should not be cited to support the proposition that a party is entitled to notice prior to the act that may subject that party to civil liability. The Bank of Marin was not held liable without being given notice and a hearing. No complaint was made about the procedures that were used prior to holding the bank liable. Presumably a complaint was filed, notice was given, and the bank was given an opportunity to defend itself at every stage of the proceeding. Moreover, the filing of the petition and adjudication of bankruptcy of the depositor did not make the Bank of Marin liable. Liability arose when the Bank honored the checks and debited the bankrupt's account. Only at this point was the Bank subject to suit. The constitutional issue in *Marin* was whether or not the Bank could be held liable without prior notice that its action in honoring the check made it subject to liability.

One could argue that the automatic adjudication, that followed from the filing of the petition, was a judicial proceeding that would have entitled the Bank to notice. But this argument is unsound. If *Mullane* was apposite to adjudications in bankruptcy, then the notice would be required *before* the adjudication. But the Bank of Marin did not complain that it failed to receive notice before the filing. It wanted notice before honoring the checks. In *Mullane*, the Supreme Court required that notice be given to those parties whose claims and defenses would have been resolved by an adjudication of the issues in the proceeding.⁴⁵ In bankruptcy, however, creditors lack standing to prevent debtors from filing a petition. Debtors are permitted to file bankruptcy despite the sometimes strenuous objections of their creditors.⁴⁶ Because a debtor's

New York law. 339 U.S. at 307-09. In the process of doing so, the beneficiaries' claims against the trustees for possible negligence or breach of fiduciary duty would have been lost. Both *Walker* and *Schroeder* were condemnation proceedings. In all three cases, the Court held that notice calculated to apprise the defendant of the pending proceedings must, as a matter of due process, be provided. See *Schroeder*, 371 U.S. at 208-09; *Walker*, 352 U.S. at 112-13; Note, *Drawee Bank Not Liable*, *supra* note 32, at 1156.

The doctrine has been extended, to a limited extent, to prejudgment judicial proceedings. See *North Georgia Finishing, Inc. v. Di-Chem, Inc.* 419 U.S. 601 (1975); *Mitchell v. W. T. Grant Co.*, 416 U.S. 600 (1974); see also Countryman, *The Bill of Rights and the Bill Collector*, 15 ARIZ. L. REV. 521 (1973); Kennedy, *Due Process Limitations on Creditors' Remedies: Some Reflections on Sniadach v. Family Finance Corp.*, 19 AM. U.L. REV. 158 (1970).

45. *Mullane*, 339 U.S. at 313-14.

46. See 11 U.S.C. § 301 (1982); *In re Professional Success Seminars Int'l, Inc.*, 18 Bankr. 75 (Bankr. S.D. Fla. 1982). In *Success Seminars*, the creditor moved to dismiss

creditors have no standing to object to the filing of a petition, they are not entitled to notice.⁴⁷

There appears to be no decision in the area of civil law that requires, as a constitutional matter, that pre-act notice be given to defendants before civil liability can be imposed. Notice of possible civil liability before one acts has not been recognized as a protected constitutional right. Distributors of defective products are routinely held strictly liable for any damages caused by the product even though the distributor did not manufacture the product and had no notice of its defective nature. The distributor is liable if he dealt with the product in the regular course of business.⁴⁸ Few credible constitutional objections have ever been raised to the constitutionality of this doctrine.⁴⁹ The distributor is required, usually for insurance purposes, to factor these damages into the cost of doing business.⁵⁰ Similarly, the Bank of Marin could have been required, as a cost of doing business, to assume the financial risk of the bankruptcy of its customers.⁵¹

Even more compelling civil-liability—without-fault—cases than *Marin* have occurred without any consideration of constitutional ramifications. A law in Oregon permitted a guardian to be appointed over the business affairs of a spendthrift.⁵² The guardian was even able to avoid transactions that occurred outside of Oregon to the considerable financial embarrassment of those parties

debtor's chapter seven petition on grounds challenging the form of the petition, the authority of the officer signing the petition, and lack of corporate authority for the filing of the petition. Without reaching the merits of the claims, the court dismissed the motion on the ground that the creditors lacked standing to oppose the petition. *Id.* at 76; *cf. In re Verrazano Towers, Inc.*, 10 Bankr. 387 (Bankr. E.D.N.Y. 1981).

47. In *In re Southern Arizona Smelting Co.*, 231 F. 87 (9th Cir. 1916), the court stated that "[i]t is only after adjudication that the law requires that notice be given by publication and by mail of the first meeting of creditors and of each of the various subsequent steps in administration." *Id.* at 90. The petition establishes the facts of a decree of bankruptcy. Notice to creditors is unnecessary until dismissal is sought. *See generally* Dunham, *Post Judgment Seizures: Does Due Process Require Notice and Hearing*, 21 S.D. L. REV. 78, 92-94 (1976) for an analogous discussion.

48. "[Strict liability] therefore applies to any manufacturer of such a product, to any wholesale or retail dealer or distributor, and to the operator of a restaurant." RESTATEMENT (SECOND) OF TORTS § 402A comment f (1964); *see also* 2 FRUMER & FRIEDMAN, PRODUCTS LIABILITY § 16A(4)(b)(i) (1984).

49. *Cf. Neely & Hines, The Unconstitutionality of The Doctrine of Strict Liability*, 46 INS. COUNSEL J. 289 (1979).

50. *Greenman v. Yuba Power Products, Inc.*, 59 Cal. 2d 57, 63-64, 377 P.2d 897, 900-01, 27 Cal. Rptr. 697, 700-01 (1962).

51. For further discussion, see *infra* text accompanying notes 518-23.

52. OR. REV. STAT. § 126.280 (1961) (repealed 1973); *Olshen v. Kaufman*, 235 Or. 423, 385 P.2d 161 (1963); *see also* *Reeves v. Hunter*, 185 Iowa 958, 171 N.W. 567 (1919).

who were unaware of the spendthrift status of the individual with whom they dealt.⁵³

The doctrine that the death of a principal automatically revokes the authority of the agent can be analogized to the *Marin* case. Both the agent and the party he is dealing with may be unaware of the principal's death, but the agent still lacks authority to bind his principal.⁵⁴ The American Law Institute has sharply criticized this result⁵⁵ but not on constitutional grounds.

Having decided that reliance on *Mullane* and other decisions is misplaced, we may look to the Court's treatment of non-culpable criminal defendants. It has been frequently assumed, but not affirmatively held, that the due process clauses permit the federal government and the states to impose liability without notice.

The Court's citation of criminal law cases does not provide a definitive answer to the question of whether a criminal defendant is entitled to notice. Some matters are reasonably clear, however. For example, the Supreme Court requires that any statute that imposes criminal liability be clear and unambiguous so that any defendant charged under the statute can be apprised of what specific conduct is subject to criminal sanction.⁵⁶ Moreover, as a general constitutional principle, the legislature may impose criminal sanctions on a defendant even though he is either unaware that his actions are criminal or where he is innocently mistaken as to the facts.

For example, it has long been held that a defendant can be convicted of statutory rape even though he honestly believed that

53. *Lilienthal v. Kaufman*, 239 Or. 1, 395 P.2d 543 (1964).

54. *E.g.*, *Ashley v. Andrus*, 486 F. Supp. 1319 (E.D. Wis. 1980); RESTATEMENT OF AGENCY § 120 (1933).

55. See Proceedings of the American Law Institute, 11 A.L.I. Proc. 85-87, 90, 94 (1933). Professor Seavey stated that the rule that the principal's death terminates the agency is "a very shocking result." *Id.* at 85. Mr. Rose was even more bold calling the rule "a relic of remote barbarism." *Id.* at 90.

56. In *Wright v. Georgia*, 373 U.S. 284 (1963), the defendants were charged with breach of the peace for peacefully playing basketball in a city park. The Court held that because the breach of peace statute did not give notice that playing basketball in a city park was a violation of the law, the defendants could not be convicted under the statute. See also *Connally v. General Constr. Co.*, 269 U.S. 385 (1926) (penal statute prescribing that workmen be paid at the "current rate" is unconstitutionally vague); *Lanzetta v. New Jersey*, 306 U.S. 451 (1939) (gang statute held unconstitutionally vague); *cf.* *United States v. National Dairy Products Corp.*, 372 U.S. 29 (1963) (anti-trust statute imposing criminal liability for selling products at "unreasonably low prices" is not unconstitutionally vague). For a useful treatment of the area of criminal liability without fault, see Saltzman, *Strict Criminal Liability and the United States Constitution: Substantive Criminal Law Due Process*, 24 WAYNE L. REV. 1571, 1592-1614 (1978).

the victim was over the age of consent.⁵⁷ Moreover, as a general principle, the government need only prove that the defendant intended his actions. The government need not prove that the defendant was aware that his acts were in violation of the law or that he was not innocently mistaken as to the facts.⁵⁸

The Court's decision in *United States v. Balint*⁵⁹ illustrates these principles. In *Balint*, the defendant was charged with the criminal sale of a narcotic drug. Defendant demurred to the indictment on the grounds that it did not allege that the defendant knew that the sale of the drug was illegal. The Supreme Court held that the defendant was not entitled to protection under the Constitution. Inquiry was limited to whether or not Congress intended to impose criminal liability without fault. A similar result was reached when a defendant was charged with the sale of adulterated cosmetics.⁶⁰ Where a defendant was found to be living in a bigamous state of cohabitation, no constitutional protection was afforded even though he reasonably believed that he had been previously divorced.⁶¹ In criminal cases where the Court has indicated that the defendant should be in some way culpable⁶² or negligent,⁶³

57. See *Anderson v. State*, 384 P.2d 669 (Alaska 1963); *Heath v. State*, 173 Ind. 296, 90 N.E. 310 (1910); Annot., 8 A.L.R.3d 1100 (1966).

58. See, e.g., *United States v. Freed*, 401 U.S. 601 (1971) (holding that a defendant can be criminally charged for the sale of unregistered grenades without an allegation in the indictment that the defendant knew the grenades were unregistered).

59. 258 U.S. 250 (1922).

60. *United States v. Dotterweich*, 320 U.S. 277 (1943).

61. *Williams v. North Carolina*, 325 U.S. 226 (1945).

62. In *Morrisette v. United States*, 342 U.S. 246 (1952), the defendant was charged with the theft of government property under such circumstances that a reasonable person would have believed that the property had been abandoned. Although the Court theorized on the universally accepted principle that the defendant should not be punished unless in some way blameworthy, the narrow issue in *Morrisette* was whether or not Congress intended to make defendants, who honestly believed that they were at liberty to take the property in question, liable. The Court answered the question by reading an intent standard into the statute. The Court unabashedly made no attempt to distinguish *Balint*. The more recent case of *United States v. Park*, 421 U.S. 658 (1975) involved a corporation president who was charged with selling adulterated food. At issue was whether or not a corporate executive could be held to be vicariously liable for a criminal action. Again, the Court interpreted the statute in such a way so that the defendant could only be held liable if he was in some way responsible for and had authority to deal with the fact situation in question. Thus, like *Morrisette*, the narrow question in *Park* was one of statutory interpretation.

63. *United States v. International Minerals & Chem. Corp.*, 402 U.S. 558 (1971). In *International Minerals*, the defendant was charged with the sale of unregistered chemicals (sulfuric and hydrofluosilicic acid). Defendant claimed that it was unaware of a duty to register. The Court declined to hold the defendant strictly liable, *id.* at 563, and also refused to allow the defendant to plead that his ignorance of the law was an excuse. *Id.* But the Court, per Justice Douglas, did employ language suggesting a negligence standard: "But

the narrow issue is one of statutory construction.⁶⁴

The case of *Lambert v. California*⁶⁵ cannot be so easily distinguished. In *Lambert*, however, the defendant was charged with the violation of a statute that required persons with prior felony convictions to register with the police. The defendant defended on the ground that she had no knowledge of this duty to register. She was nevertheless convicted and appealed to the Supreme Court. The majority opinion, written by Justice Douglas, indicated that the Court was aware of the general maxim that ignorance of the law is no excuse, but nevertheless felt compelled on the grounds of due process,⁶⁶ to hold that the defendant could not be convicted unless she was aware of her duty to register.

In addition to *Lambert*, Justice Douglas made statements in other cases that suggested the existence of a constitutional right to notice. In his majority opinion in *United States v. International Minerals Corp.*,⁶⁷ he distinguished the *Balint* line of cases as ones dealing with drugs, weapons, and dangerous chemicals. "Pencils, dental floss, [and] paper clips may also be regulated. But they may be the type of products which might raise substantial due process questions if Congress did not require . . . 'mens rea' as to each ingredient of the offense."⁶⁸ Is not regulating bankruptcy a non-dangerous enterprise? Does it follow that some level of culpability must exist as a condition precedent to civil liability?

On balance, however, it seems that Justice Douglas's opinions in *Lambert* and *International Minerals* are of little value in a case involving civil liability such as *Marin*. Justice Douglas implicitly recognized this when he chose not to cite *Lambert* in the *Marin* opinion. The criminal cases discussed above also demonstrate that

where . . . dangerous or deleterious devices or products or obnoxious waste materials are involved, the probability of regulation is so great that anyone who is aware that he is in possession of them or dealing with them must be presumed to be aware of the regulation." *Id.* at 565; see Saltzman, *supra* note 56, at 1609-10.

64. See *supra* note 62.

65. 355 U.S. 225 (1957).

66. "Where a person did not know of the duty to register and where there was no proof of the probability of such knowledge, he may not be convicted consistently with due process." *Id.* at 229-30; see *Sundstrom v. U.S.*, 419 U.S. 934 (1974). In *Sundstrom*, the defendant did not report for his draft physical when a mailed notice failed to reach him, and his draft board ordered him to report for immediate induction into the armed services. He wrote his draft board and stated that there must be an error because he had not even had a physical. His board ignored his letter and sent a second order. He was convicted for failure to report for induction. The Supreme Court dismissed his petition for *certiorari* without opinion. Justice Douglas dissented from the dismissal, citing both *Lambert* and *Mullane*.

67. 402 U.S. 558 (1971).

68. *Id.* at 564-65.

Justice Douglas could not consistently hold a majority when it came to his belief that criminal liability should not be imposed without notice. The Court resolved most of the cases on the basis of statutory construction. In the civil area, Justice Douglas was never able to command a majority for even one holding.

Lambert was a criminal case. Although the sanction imposed in *Lambert* was relatively light,⁶⁹ the mere stigma of a criminal record was a sufficient distinction by itself. Courts should not extend *Lambert* to civil cases.

Thus, the reader should not infer that there is a constitutional basis to the decision reached in *Marin*. Certainly, *Mullane* and the other cases cited in *Marin* do not stand for the proposition that, as a constitutional matter, notice of potential liability must be given before one acts. Justice Douglas's use of *Mullane* should be considered to lend support only to his "equitable" construction of the statute. Certainly Congress, in drafting the 1978 code, did not see any constitutional significance in the case. Except for the very narrowly drafted exceptions for the banking⁷⁰ and insurance industries,⁷¹ the general proposition of *caveat emptor* continues.⁷²

Lambert poses problems for those who argue that the state is constitutionally unfettered in its ability to define crime and that the Constitution merely limits the procedure of arrest and trial. But *Lambert* appears to run contrary to the grain of the Court's criminal law opinions. Any judge should feel uncomfortable having to rely on that decision to constitutionally prohibit *civil* liability for similarly non-culpable and innocent parties. Justice Frankfurter dissented in *Lambert*, labeling the opinion "an isolated deviation from the strong current of precedent—a derelict on the waters of law."⁷³ Similarly, if Justice Douglas intended that there be a constitutional basis for the opinion in *Marin*, there was no authority to support his view.

The remainder of this article operates on the assumption that it is for Congress and Congress alone to decide who should bear the loss for a bankrupt's unauthorized sale and transfer of his as-

69. Defendant was fined \$250.00 and given probation. *Lambert*, 355 U.S. at 227.

70. See 11 U.S.C. § 542(c) (1982), discussed *infra* at text accompanying notes 321-29.

71. See 11 U.S.C. § 542(d) (1982), discussed *infra* at text accompanying notes 330-71.

72. 11 U.S.C. § 549(a)(1) (1982) (amended 1984). Other exceptions are available for parties relying upon real estate records, 11 U.S.C. § 549(c) (1982) (amended 1984), and for individuals dealing with a debtor while an involuntary petition in bankruptcy is pending. 11 U.S.C. § 549(b) (1982). These exceptions were available under the Chandler Act. See Chandler Act, ch. 575, §§ 21g, 70d(1), (2); 52 Stat. 840, 853, 881.

73. *Lambert*, 355 U.S. at 232 (Frankfurter, J., dissenting).

sets. Until cases such as *Lambert* begin to surface and extend into the civil law, we must assume that *Marin* is merely a case of statutory construction.

III. EVOLUTION OF THE LAW THROUGH THE BANKRUPTCY REFORM ACT OF 1978

This part of the article discusses the interpretation of prior case law and congressional treatment of postpetition transfers. It was not until 1938 that Congress saw the need to provide any comprehensive solution in this area. By enacting the Chandler Act in 1938, Congress decided that postpetition transfers should receive the same treatment under statutory law as they had under prior case law. Part IV, which discusses the Bankruptcy Reform Act of 1978, reveals that this basic treatment of merely codifying prior case law has been left in tact. It is true that certain new provisions provide relief to a limited number of postbankruptcy transferees, but generally, the basic system remains. It is expected that present courts, when interpreting the 1978 bankruptcy code, will apply prior case law decisions in their analysis. Consequently, a familiarity with prior case law is necessary for a complete understanding of the present treatment of postpetition transfers under the new code.

A. *Pre-Chandler Act Caselaw—General Principles*

1. PERSONAL PROPERTY

At the time that the Supreme Court of the United States announced in dictum in *Mueller*, that a filing of a petition is a caveat to the world of the trustee's claim to the bankrupt's assets, there was only one provision in the bankruptcy act that was arguably applicable to postpetition transfer questions. That provision merely provided that the trustee had title to all of the bankrupt's property as of the time of the "adjudication."⁷⁴ Congress had made no attempt to specifically govern postpetition transfer issues, and consequently, the issue was often left to the courts.

In view of the hiatus between filing and adjudication, especially in involuntary cases, case law quickly developed to define the rights of the transferee during this interim period. Courts began to

74. Act of July 11, 1898, ch. 541, § 70a, 30 Stat. 544, 565-66 (codified as revised at 11 U.S.C. §§ 522 (d)(7), (8), 541(a), (b) (1982)); see *Price v. Louisiana Rural Rehabilitation Corp.*, 134 F.2d 548 (5th Cir. 1933).

resort to the fiction that upon adjudication, the trustee's rights related back to the filing of the petition.⁷⁶ The trustee invalidated certain transfers in the interim period. This was especially true in cases where the transfer was preferential in effect.⁷⁶ Technically, they were not preferences because the payments came *after* the petition.⁷⁷ The effect, however, was the same when the prepetition debts were satisfied. On the other hand, many earlier cases validated postpetition transactions that were made in the usual course of business and were not payments for prepetition debts.⁷⁸

In voluntary petition cases, where an adjudication in bankruptcy usually followed the filing of the petition⁷⁹ and in involuntary cases where the transfers occurred after adjudication, courts usually followed the principle enunciated in *Mueller* and set the transfers aside.⁸⁰ It should be emphasized, however, that the courts have given relief for some transfers involving special circumstances. Thus, the Court validated postpetition sales of perishables⁸¹ and gave relief to the good faith purchasers at public sales.⁸²

The most significant of these cases was *Frederick v. Fidelity Mutual Life Insurance Co.*,⁸³ a 1921 Supreme Court decision. The facts of the case were similar to those that followed forty years later in *Marin*. In *Frederick*, a creditor filed an involuntary petition in bankruptcy against a debtor and adjudication followed within the month. Under the provisions of the bankruptcy statute, the trustee was entitled to recover the cash surrender value of an insurance policy.⁸⁴ Subsequently, the bankrupt died and the insurance company paid the face value of the policy to the named beneficiary. At the time of the payment, the insurance company was without notice of the bankruptcy or the trustee's claim.⁸⁵ The Court refused to order the insurance company to pay the cash sur-

75. *E.g.*, *In re Knight*, 125 F. 35 (W.D. Ky. 1903); see Bateman, *supra* note 6, at 283-86.

76. *Grand Rapids Dry Goods Co. v. Ostendorf*, 6 F.2d 506 (6th Cir. 1925); *Reed v. Barnett Nat'l Bank*, 250 F. 983 (5th Cir. 1918); *In re R. & W. Skirt Co.*, 222 F. 256 (2d Cir. 1915).

77. See *infra* note 226.

78. *E.g.*, *In re Retail Stores Delivery Corp.*, 11 F. Supp. 658 (S.D.N.Y. 1935); *In re Latex Drilling Co.*, 11 F.2d 373 (W.D. La. 1926).

79. See S. REP. NO. 320, 86th Cong., 1st Sess. (1959); Bateman, *supra* note 6, at 294-95.

80. *E.g.*, *Rodgers v. A & B Pipe & Supply Co., Inc.*, 162 So. 445 (La. Ct. App. 1935).

81. *Jones v. Springer*, 226 U.S. 148 (1912).

82. *Bryan v. Bernheimer*, 181 U.S. 188 (1901) (purchaser not given title but lower court instructed to accord "equitable" relief).

83. 256 U.S. 395 (1921).

84. Act of July 1, 1898, ch. 541, § 70a, 30 Stat. 544, 565-66 (1898).

85. *Frederick*, 256 U.S. at 397.

render value to the trustee.

The Court, under these facts, refused to apply the *Mueller* doctrine:

It is not enough to sustain the trustee's claim to say that the filing of the petition in bankruptcy was a caveat to all the world, and in effect an attachment and injunction, and that on adjudication title to the bankrupt's property became vested in the trustee [T]he Bankruptcy Act cannot be construed to give the trustee in bankruptcy a right as against the company to demand that the surrender value be made assets of the estate, as by a change in beneficiary, without timely notice to the company of a demand for such a change⁸⁶

The Court's equitable construction of the statute immunized the insurance company from liability.

2. REAL PROPERTY

The applicable principle in cases involving personal property was that the filing of a petition in bankruptcy operated as a *lis pendens* lien upon all of the bankrupt's assets. Thus, good faith purchasers of personal property were usually not protected. The law governing real estate transactions evolved differently, with the good faith purchaser routinely protected.⁸⁷

Early bankruptcy statutes placed a duty upon the trustee to appropriately record notice of bankruptcy within a given time after adjudication. Failure to comply with the statute usually meant that parties who relied upon these real estate records were protected.⁸⁸ The time of adjudication was largely ignored because the primary concern focused on whether or not the transferee had constructive notice. The 1898 congressional treatment did provide for a method of notifying third parties:

A certified copy of the order approving the bond of a trustee shall constitute conclusive evidence of the vesting in him of the title to the property of the bankrupt, [and if recorded shall impart the same notice that a deed] from the bankrupt to the trustee if recorded would have imparted had not bankruptcy pro-

86. *Id.* at 398.

87. *E.g.*, *Beach v. Faust*, 2 Cal. 2d 290, 40 P.2d 822 (1955); *Vombrack v. Faust*, 331 Ill. 508, 163 N.E. 340 (1928); *Derryberry v. Matteson*, 193 La. 624, 192 So. 78 (1939); *see also* *Taylor v. Irwin*, 20 F. 615 (N.D. Iowa 1884) (a case protecting the bona fide purchaser under a statute which imposed a duty to record within six months of bankruptcy).

88. *See* authorities cited *supra* note 87.

ceedings intervened.⁸⁹

This provision simply provided that in recording the order approving bond, all interested parties were to be given notice of the trustee's title. The statute did not address the question of whether or not a bona fide purchaser, who purchased the property prior to the trustee's filing, would prevail against the trustee. The statute clearly required a ruling in favor of the trustee in cases where he filed the order before the transfer to the real property purchaser, but the statute was silent where there had been no such filing. Nevertheless, several cases inferred that Congress intended that the bona fide purchaser should be protected.⁹⁰

One case declined to make this inference. In *Hull v. Burr*,⁹¹ the Supreme Court of Florida ruled in favor of the trustee even though the trustee had not complied with the statute at the time of the transfer. In *Hull*, the bankrupt was named as the defendant in an action for ejectment brought after the filing of bankruptcy. The plaintiff in the ejectment action, unaware of the defendant's bankruptcy, did not name the trustee as a party to the suit. The court, in the ejectment action, ruled in favor of the plaintiff who, after winning the ejectment suit, sold the property to a bona fide purchaser. The plaintiff then sold the property to yet another bona fide purchaser. When the trustee learned about this transaction, he successfully brought suit to reclaim the property. The court conceded that no notice had been recorded as required by the statute, but declared that the statute was "directory only and does not affect the principle that the bankrupt's title passes by operation of law to the trustees in bankruptcy . . . upon . . . adjudication."⁹²

B. The 1938 Amendments—The Chandler Act

1. DESCRIPTION OF THE CHANDLER ACT

Against this background of spotty case law, Congress amended the Bankruptcy Act in 1938. Congress amended the "title" section to give the trustee title as of the date of the filing of the petition⁹³

89. 9 U.S. COMP. STAT. 1916 Ann. 11299, § 21(e); 11 U.S.C. § 44 (1938), amended by 11 U.S.C. §§ 343, 549(c) (1978). Section of 47(c) of the same statute also required that a certified copy of the decree of adjudication be filed within 30 days after adjudication. 11 U.S.C. § 47(c) (repealed 1978).

90. See authorities cited *supra* note 87.

91. 61 Fla. 625, 55 So. 852 (1911).

92. *Id.* at 629, 55 So. at 854.

93. S. REP. NO. 1916, 75th Cong., 3d Sess. 18 (1938); H.R. REP. NO. 1409, 75th Cong., 1st Sess. 34 (1937).

in order to remedy a "serious defect."⁹⁴ As was true of the Bankruptcy Reform Act of 1978, the National Bankruptcy Conference,⁹⁵ a prestigious body of bankruptcy experts, proposed and introduced into the House the initial legislation.⁹⁶ Because they proposed that the trustee's claim to title would date from the filing of a petition, the Conference also recognized a need to specifically validate certain postpetition transfers. The Conference's proposal read very much like the provision ultimately adopted.⁹⁷ The Conference draft affirmatively provided that "no transfer by or on behalf of the bankrupt after the bankruptcy shall be valid against the trustee."⁹⁸ This language became law. The same section also expressly exempted three types of transactions—real estate transactions,⁹⁹ transactions involving negotiable instruments,¹⁰⁰ and transactions made after filing but before the adjudication "to a bona fide purchaser for a present fair equivalent value."¹⁰¹

An adjudication in bankruptcy routinely followed the filing of a voluntary petition,¹⁰² and a subsequent amendment to the Bank-

94. HOUSE COMMITTEE ON THE JUDICIARY, 74th Cong., 2d Sess., ANALYSIS OF H.R. 12889, 229-31 (Comm. Print 1936) [hereinafter cited as ANALYSIS OF H.R. 12889].

95. The Conference was created in 1932 upon the suggestion of Robert A.B. Cook. It was comprised of leading bankruptcy experts from the American Bar Association, Commercial Law League, National Association of Credit Men, and the American Banker's Association. This body was responsible for what is now referred to as the Chandler Act. *Symposium on the Chandler Act*, 43 COM. L.J. 326 (1938).

96. Professor McLaughlin was the principal proponent of the legislation. See McLaughlin, *Amendment of the Bankruptcy Act*, 40 HARV. L. REV. 583, 615-16 (1927) (suggesting an amendment regulating postpetition transfers); see also, Bateman *supra* note 6, at 289 n.52 (discussing the historical background of section 70d of the Chandler Act).

97. The Conference Proposal read:

d. The title acquired by the trustee under this Act shall not invalidate a transfer by or in behalf of the bankrupt, made in the ordinary course of business after the bankruptcy and before the adjudication to a bona fide purchaser for a present fair equivalent value. A person who in good faith pays less than present fair equivalent value for such a transfer shall have a lien upon the property so transferred to the extent of the consideration so actually paid. The party asserting the validity of a transfer under this subdivision shall have the burden of proof. Except as otherwise provided in this subdivision and in subdivision g of section 21 of this Act, no transfer by or in behalf of the bankrupt after the bankruptcy shall be valid against the trustee: Provided, however, That nothing in this Act shall impair the negotiability of currency or negotiable instruments.

ANALYSIS OF H.R. 12889, *supra* note 94, at 229.

98. *Id.*

99. See *infra* text accompanying notes 148-55.

100. ANALYSIS OF H.R. 12889, *supra* note 94, at 229. The text of this provision is set out *infra* note 108. See *infra* text accompanying notes 135-47.

101. ANALYSIS OF H.R. 12889, *supra* note 94, at 229; see *infra* text accompanying notes 120-30.

102. See *generally* text accompanying notes 120-30 (discussing section 70d(1) of the

ruptcy Act provided that the filing of a voluntary petition was an "automatic adjudication."¹⁰³ Therefore, the exception for transfers before adjudication had limited application. It protected only those parties dealing with involuntary bankrupts prior to their adjudication. Thus, authorities studying the Chandler Act and its legislative history concluded that Congress specifically intended to invalidate all postadjudication transfers except those involving real estate.¹⁰⁴

It is curious that the drafters of the Conference proposal offered such an arbitrary solution. The Conference, in urging adoption of its proposal, relied on the *Frederick* case as an example of a situation where a court had "protected bona fide payments."¹⁰⁵ The Conference evidently favored retaining the *Frederick* rule. Recall, however, that *Frederick* was a postadjudication transfer. The transaction described in that case would have been invalidated under the Conference's proposal, and Congress ultimately adopted that proposal with only minor modifications.

Professor McLaughlin in the Conference notes,¹⁰⁶ and in an earlier law review article stated the only justification for the rather stringent rule adopted by Congress in the Chandler Act: "[N]o consistent theory of protected transactions has been developed. The present situation is conducive to confusion and uncertainty, with potentialities for argument, 'bluffing', litigation, expense and delay that have not been fully realized."¹⁰⁷

Thus, although the Conference and Congress were aware of the need to protect bona fide transactions, they decided to limit protection to involuntary bankruptcy cases. Regardless of the bona fides of a transaction, the trustee could invalidate postpetition transfers if the transfer occurred after adjudication. Exceptions

Chandler Act).

103. Act of June 23, 1959, Pub. L. No. 86-64, § 1, 73 Stat. 109 (codified at 11 U.S.C. § 1 (1976) (repealed 1978)).

104. *E.g.*, Bateman, *supra* note 6, at 288-94; Boshkoff, *supra* note 6, at 755-56. Justice Harlan, in a dissenting opinion in *Marin*, reached the same conclusion. 385 U.S. 99, 103 (1966); *see also* Utte v. Manufacturers Hanover Commercial Corp. (*In re* Texlon Corp.), 596 F.2d 1092 (2d Cir. 1979) (Friendly, J.) (striking down a "cross-collateral" agreement as violative of the Chandler Act). The bankruptcy court had approved an agreement between the debtor-in-possession and his bank to the effect that the bank's prepetition debts were to be secured by postpetition estate assets. It was asserted that the bank would not have made the loan necessary for debtor's reorganization effort without making its prepetition debts secure. *Id.* at 1101.

105. ANALYSIS OF H.R. 12889, *supra* note 94, at 230.

106. *Id.*

107. *Id.* McLaughlin, *supra* note 96, at 615.

were limited to real estate.

2. POSTADJUDICATION TRANSFERS

Congress expanded the Conference proposal by enacting section 70d of the Chandler Act,¹⁰⁸ but the general *caveat emptor* principle remained. Unless a statutory exception could be found, "no transfer by or in behalf of the bankrupt after the date of bankruptcy [was to] be valid against the trustee."¹⁰⁹ The lower courts routinely followed the literal language of the statute. For example, trustees were successful in recovering goods, or their value, which a disgruntled seller had obtained via self-help after the buyer's automatic adjudication in bankruptcy.¹¹⁰ The Sixth Circuit held that a former director of the bankrupt corporation could not bring a lawsuit on behalf of the corporate bankrupt which was owned by the corporation but not scheduled at the time of the filing of a petition.¹¹¹ The corporation, having filed bankruptcy, no longer owned the claim. Where a bankrupt failed to schedule certain stock in his petition, a district court held that the trustee could recover the stock dividend from the bankrupt's wife after the bankrupt had

108. d. After bankruptcy and either before adjudication or before a receiver takes possession of the property of the bankrupt, whichever first occurs- (1) A transfer of any of the property of the bankrupt, other than real estate, made to a person acting in good faith shall be valid against the trustee if made for a present fair equivalent value or, if not made for a present fair equivalent value, then to the extent of the present consideration actually paid therefor, for which amount the transferee shall have a lien upon the property so transferred; (2) A person indebted to the bankrupt or holding property of the bankrupt may, if acting in good faith, pay such indebtedness or deliver such property, or any part thereof, to the bankrupt or upon his order, with the same effect as if the bankruptcy were not pending; (3) A person having actual knowledge of such pending bankruptcy shall be deemed not to act in good faith unless he has reasonable cause to believe that the petition in bankruptcy is not well founded; (4) The provisions of paragraphs (1) and (2) of this subdivision shall not apply where a receiver or trustee appointed by a United States or State court is in possession of all or the greater portion of the nonexempt property of the bankrupt; (5) A person asserting the validity of a transfer under this subdivision shall have the burden of proof. Except as otherwise provided in this subdivision and in subdivision g of section 21 of this Act, no transfer by or in behalf of the bankrupt after the date of bankruptcy shall be valid against the trustee: *Provided, however*, That nothing in this Act shall impair the negotiability of currency or negotiable instruments.

Chandler Act, ch. 575, § 70d, 52 Stat. 840, 881-82 (1938).

109. *Id.* § 70d(5), at 882.

110. *Gruner v. Abbott & Cobb, Inc. (In re P & Z Island Farms, Inc.)*, 478 F. Supp. 529 (S.D.N.Y. 1979).

111. *Scharmer v. Carrollton Mfg. Co.*, 525 F.2d 95 (6th Cir. 1975).

assigned the dividend to her.¹¹²

3. PREADJUDICATION TRANSFERS

a. Preadjudication Receivers

Congress set forth conditions under which a postpetition transfer of personal property would be valid. The introductory language to section 70d indicated, under stated conditions, that certain transfers made "either before adjudication or *before a receiver takes possession of the property of the bankrupt*"¹¹³ may be valid. Subsection (4) of section 70d created confusion by stating that even if the transferee met the conditions set forth in section 70d for a protected transfer, protection was not to be given "where *a receiver or a trustee appointed by a United States or state court is in possession of all or the greater portion*"¹¹⁴ of the bankrupt's property at the time of transfer. The use of similar, but not identical wording in the introduction and in subsection (4) created a serious problem of interpretation. What kind of receivers did these provisions apply to? What if a receiver did not take possession of estate property and instead the property was transferred after the petition?

One literal explanation of the introductory language and of subsection (4) was available. The introductory language applied to cases where a bankruptcy receiver secured possession of *all* of the bankrupt's property, whereas subsection (4) applied when a *nonbankruptcy appointed receiver*, appointed either before the petition or before adjudication, acquired possession of *all or the greater portion* of the bankrupt's property. Thus, the introductory language described those receivers appointed by the bankruptcy court who took possession of all of the bankrupt's property. Subsection (4) described receivers appointed by other courts who managed to secure possession of only the greater portion of the bankrupt's assets. Note that the introductory language merely describes a receiver taking "possession of the property of the bankrupt." Given the fact that subsection (4) governs receivers who secure "possession of . . . a greater portion" of the property, a distinction

112. *In re Gursey*, 224 F. Supp. 1008 (S.D.N.Y. 1964); see also *In re Maddux*, 94 F. Supp. 134 (E.D. Tenn. 1949) (holding that the bankrupt could be held in contempt for conveying her dower rights in certain real estate to her daughter where the trustee had obtained an order permitting him to sell the dower interest as an asset of the estate).

113. Chandler Act, ch. 575, § 70d, 52 Stat. 840, 881 (1938). For a complete text of the section, see *supra* note 108.

114. *Id.*

may have been intended. In addition, subsection (4) described "United States or state court" receivers. Arguably a receiver appointed by a bankruptcy court is not one appointed by a *United States* court—a federal district court instead having been intended. Thus, the introductory language applied to bankruptcy receivers, who must take possession of *all* property, and subsection (4) applied to nonbankruptcy receivers, who needed to take possession of only "a greater portion of" the property.

Professor Boshkoff, argued on this basis, that a receiver appointed by a bankruptcy court, who had not secured possession of all of the bankrupt's property, could not set aside a preadjudication postpetition transfer of property which the receiver had not seized.¹¹⁵ The estate should have lost because less than all of the property was seized. Subsection (4) did not operate to prevent the transferee from seeking protection under section 70d because the bankruptcy court had appointed the receiver. Subsection (4) applied only to receivers appointed outside of bankruptcy.

Professor Bateman argued that the two sections should be read to mean that Congress intended to invalidate all preadjudication transactions made subsequent to the appointment of a receiver who had taken possession of the greater portion of the bankrupt's property.

The intended relationship between the two references to possession by a receiver is unclear, but four facts support the conclusion that, read together, these provisions terminate the protected interval whenever any receiver is in possession of the greater portion of the bankrupt's nonexempt property. First, since the provisions serve only to define the end of the protected interval, only the event that will necessarily occur first is material. Second, before a receiver can possess all of the bankrupt's property, he must necessarily possess the greater portion of it. Third, since possession by a receiver of *all* of the property would prevent a postbankruptcy transfer, only possession of the greater portion of the property is relevant to section 70d. Finally, in the absence of any definition in the act of the term "receiver," it should be construed to include both bankruptcy and nonbankruptcy receivers both in the opening phrase of section 70d and in clause (4).¹¹⁶

115. Boshkoff, *supra* note 6, at 756-61.

116. Bateman, *supra* note 6, at 290-91; see also *In re Texlon Corp.*, 596 F.2d 1092, 1097 (1979). (suggesting that a debtor in possession in a Chapter XI could be considered a "receiver" under section 70d(4)).

The Fourth Circuit's decision in *Lake v. New York Life Insurance Co.*¹¹⁷ inspired the controversy between Professors Bateman and Boshkoff. In *Lake*, an insurance company lent the insured-bankrupt money on his insurance policies while an involuntary petition was pending and after the *bankruptcy court* had appointed a receiver. Although the receiver was able to seize most of the bankrupt's assets, he had no knowledge of the insurance contract. The bankrupt promptly put the funds in his wife's account. She then proceeded to preferentially pay off numerous creditors. By the time of the bankrupt's adjudication, most of the funds were gone. It was not until the examination of the debtor, which occurred after his adjudication, that the receiver learned about the insurance policies. The bankruptcy trustee brought suit against the insurance company and recovered the funds.

The Fourth Circuit noted that section 70(d)(5) generally provided that "no transfer by or in behalf of the bankrupt after the date of bankruptcy shall be valid against the trustee."¹¹⁸ None of the other exceptions found in section 70(d) could apply because subsection (4) specifically stated that protection would not be accorded in cases "where a receiver . . . appointed by a United States . . . court is in possession of all or a greater portion of the nonexempt property of the bankrupt." Believing that a bankruptcy court appointed receiver fell within the section, the court reluctantly ruled in favor of the trustee.

Professor Boshkoff labeled this construction of the statute "tortured." He reasoned that the purpose behind subsection (4) was to invalidate transactions in which a nonbankruptcy receiver was appointed. Not only is "the danger of an ill founded petition . . . less . . . but, in any event, even if the petition is dismissed, control of [the bankrupt's] affairs will be returned to the superseded proceeding."¹¹⁹

Regardless of what Congress specifically intended by providing that transfers were to be made after receivers were appointed, the Fourth Circuit in *Lake* held that no distinction should be made as to the type of receiver involved, whether the receiver be appointed by the bankruptcy court, state court, or the United States District Courts outside of bankruptcy. Thus, many transfers occurring before the bankrupt's adjudication could have been invalidated

117. 218 F.2d 394 (4th Cir. 1955).

118. Chandler Act, ch. 575, § 70d(5), 52 Stat. 840, 882 (1938), discussed *supra* at text accompanying notes 93-107.

119. Boshkoff, *supra* note 6, at 759.

where a receiver had been appointed.

b. Non-receiver Cases

i. Section 70d(1)

Section 70(d)(1) set forth a circumstance in which a postpetition, but preadjudication, transfer would be valid. It provided:

(1) A transfer of any of the property of the bankrupt, other than real estate, made to a person acting in good faith shall be valid against the trustee if made for a present fair equivalent value or, if not made for a present fair equivalent value, then to the extent of the present consideration actually paid therefore, for which amount the transferee shall have a lien upon the property so transferred.¹²⁰

Under this section, the transferee was given a defense to the trustee's attempt to set aside transfers occurring both before adjudication and before a receiver could take possession of the property if the transferee was: (1) acting in "good faith," and (2) paid a "present fair equivalent value." If he had not paid a "present fair equivalent value," then he was given a lien to the extent of his consideration, provided, of course, that he was acting in "good faith."

Most of the cases that have discussed the transferee's defense under subsection (1) have attempted to define "present fair equivalent value." Of those, many courts drew a sharp distinction between those creditors whose claims arose before the filing of an involuntary petition and those whose claims surfaced between the interval of the filing of the petition and the adjudication.

In *Lehman v. Quigley*,¹²¹ a debtor paid off a judgment in the interval. A New York trial court ruled that section 70(d)(1) did not accord protection to the judgment creditor. Although conceding the creditor's "good faith," the court ruled that "present fair equivalent value" had not been given. As the court analyzed the authorities that have interpreted this section, it further went on to conclude that the transfer must result in "an increase or exchange of [debtor's] assets" and "not a reduction [in its] liabilities."¹²² Thus, the mere act of paying an antecedent indebtedness that arose before the filing of the petition did not amount to present

120. Chandler Act, ch. 575, § 70(d)(1), 52 Stat. 840, 881 (1938).

121. 118 N.Y.S.2d 579 (N.Y. Sup. Ct. 1952).

122. *Id.* at 852.

fair equivalent value.

The Second Circuit in *Kass v. Doyle*¹²³ rejected the "increase in assets" standard offered in *Lehman*. In that case the bankrupt paid his lawyer a fee for services that were primarily rendered in the interval between the filing of the petition for reorganization and the adjudication. The Second Circuit specifically declined to embrace the *Lehman* court's interpretation of "present fair equivalent value."¹²⁴ The court realized that in rendering legal services the attorney may have performed a valuable service to the bankrupt. It was unlikely that those services resulted in an actual increase in the assets of the debtor.¹²⁵ Nevertheless, the payment of the fee was sustained.

The Chandler Act's definition of "good faith" leads to harsh results. Subsection (3) of 70(d) stated that "a person having actual knowledge of such pending bankruptcy shall be deemed not to act in good faith *unless he has reasonable cause to believe that the petition in bankruptcy is not well founded.*"¹²⁶

There have been cases interpreting "reasonable cause to believe that the petition in bankruptcy is not well founded." The Second Circuit construed this language narrowly and set aside a transfer made in the interval. In *Kohn v. Myers*,¹²⁷ the transferee paid virtually full value for all of the accounts receivable of the debtor. Counsel for the transferee was aware of the pending petition but indicated that he did not believe that the petition was well founded. He had reviewed the court file and found that the petitioning creditors had agreed to amend their petition when confronted with the debtor's apparently meritorious motion to dismiss. Thus, believing that the petition was defective, the transferee argued that its agent had a good faith belief that the petition was not well founded. Further, the transferee stated that at the time of the transfer, it was unaware of the fact that a second amended petition had been filed.

Nevertheless, the Second Circuit voided the assignment. "Once they knew, as they admit they did, that the petition had been filed, they will not be heard to argue that any amendments

123. 275 F.2d 258 (2d Cir. 1960).

124. Interpretation followed in *In re Autocue Sales & Distrib. Corp.*, 167 F. Supp. 672 (S.D.N.Y. 1958); *Lehman v. Cameron*, 124 N.Y.S.2d 490 (N.Y. Sup. Ct. 1953); *see also In re Scranton Knitting Mills, Inc.*, 21 F. Supp. 227 (M.D. Pa. 1937).

125. *Kass*, 275 F.2d at 262.

126. Chandler Act, ch. 575, § 70d(3), 52 Stat. 840, 881 (1938) (emphasis added). For a complete text of section 70d, *see supra* note 108.

127. 266 F.2d 353 (2d Cir. 1959).

thereto raised any doubt about the petition being well founded."¹²⁸ In *Kohn*, a transferee paid full value,¹²⁹ but because of its knowledge that an involuntary petition was pending, the transferee was deemed not to have been acting in "good faith." Notice of challenges to the petition were not sufficient grounds for believing that the petition lacked merit. One other court reached this same result under very similar facts.¹³⁰ Unfortunately, neither of these courts provided any clue as to what grounds would be considered acceptable when determining whether a petition was well founded.

ii. Section 70d(2)

Section 70d(2) of the Chandler Act provided:

d. After bankruptcy and either before adjudication or before a receiver takes possession of the property of the bankrupt, whichever first occurs—

* * *

(2) A person indebted to the bankrupt or holding property of the bankrupt may, if acting in good faith, pay such indebtedness or deliver such property, or any part thereof, to the bankrupt or upon his order, with the same effect as if the bankruptcy were not pending¹³¹

It appears that this section codified the *Frederick* case.¹³² Recall, that in *Frederick* the Supreme Court held that an insurance company that paid the cash surrender value on a life insurance policy after a bankruptcy petition had been filed was not liable to the trustee. The introductory language of the section, however, specifically limited section 70d. Thus, only those good faith payments made after the petition was filed that occurred "before adjudication or before a receiver takes possession of the property" of the bankruptcy estate were protected. If it were not for this limitation on the scope of section 70d(2), the section could have provided the *Marin* court with a simple solution to the problem before it. The facts of *Marin* fit subsection (2) like a hand in a glove.¹³³

128. *Id.* at 357.

129. He paid \$16,817.94 for accounts having a face value of \$16,987.54. *Id.* at 355.

130. *In re Autocue Sales & Distrib. Corp.*, 167 F. Supp. 672 (S.D.N.Y. 1958).

131. Chandler Act, ch. 575, § 70d(2), 52 Stat. 840, 881 (1938). For a complete text of the section, see *supra* note 108.

132. *Frederick v. Fidelity Mut. Life Ins. Co.*, 256 U.S. 395 (1921); For further discussion, see *supra* text accompanying notes 83-86.

133. The majority in *Marin* could not rely on section 70d(2). Justice Harlan's superb dissent pointed out that subsection (2) only applied to preadjudication cases. Thus, he argued that given an express exception in involuntary cases and no exception for voluntary

Section 70d(2) permitted banks, insurance companies, and other payors and bailees who were unaware of the bankruptcy to pay or deliver as if bankruptcy had not occurred. This would remain true so long as neither an adjudication had occurred nor a receiver been appointed. Notwithstanding the courts' narrow construction of "good faith,"¹³⁴ a bank that was unaware of the filing of the involuntary petition against its debtor could still honor checks that were written on the debtor's account. Given section 70d(3)'s limitation to only preadjudication cases, however, the section offered little practical protection to the banks, insurance companies, and other bailees.

4. NEGOTIABLE INSTRUMENTS AND CURRENCY

Section 70d(5) of the Chandler Act provided:

(5) A person asserting the validity of a transfer under this subdivision shall have the burden of proof. Except as otherwise provided in this subdivision and in subdivision g of section 21 of this Act, no transfer by or in behalf of the bankrupt after the date of bankruptcy shall be valid against the trustee: *Provided, however, [t]hat nothing in this Act shall impair the negotiability of currency or negotiable instruments.*¹³⁵

Clearly, Congress intended to provide for some negotiability of paper notwithstanding the intervention of bankruptcy. Construction problems arose, however, in interpreting the statute's use of the phrase "this act" in the proviso protecting negotiable instruments and currency.

One view expressed the idea that "act" merely referred to the Chandler Act. Therefore, the proviso was but another exception to the general rule voiding postpetition, *preadjudication*, transfers. Recall that the Chandler Act was the first congressional statute ex-

cases, where adjudication was automatic, Congress intended that the Bank of Marin should be liable. *Marin*, 385 U.S. at 103; see also Countryman, *supra* note 21, at 148-49 (expressing the view that Congressional limitation of immunity to preadjudication transfers is highly relevant). One court recently reached the bizarre conclusion that section 70d generally governed only involuntary proceedings, where there was a gap between filing adjudication. Section 70d, therefore, had no applicability at all in a case in a voluntary Chapter 11 reorganization case. *In re Yellow Cab Co.*, 4 BANKR. CT. DEC. (CRR) 382 (Bankr. E.D. Pa. July 13, 1978). The court apparently missed the language of section 70d(5): "Except as otherwise provided in this subdivision . . . no transfer by or in behalf of the bankrupt after the date of bankruptcy shall be valid against the trustee. . . ." See *supra* text accompanying notes 93-107.

134. See *supra* text accompanying notes 127-30.

135. Chandler Act, ch. 575, § 70d(5), 52 Stat. 840, 882 (1938) (emphasis added).

pressly invalidating postpetition transfers.¹³⁶ The Chandler Act validated transfers that occurred during the interim between the filing of the petition and the debtor's adjudication of bankruptcy. In the main, only those transfers were given any measure of protection. Thus, the first view suggested that the Chandler Act should have been interpreted to protect only purchasers and transferees of negotiable instruments during the critical gap.

The second view defined "act" more expansively. Nothing in the entire bankruptcy statutes should have been construed to infringe on the transferees, holders, and assignees of negotiable paper. The issue, put simply, was did "this act" refer merely to the Chandler Act or instead to the entire bankruptcy act?

Unfortunately, but predictably, the legislative history of the Chandler Act provided no clue as to which view Congress actually intended.¹³⁷ Section 70d(5) specifically referred to section 21 of "this act." That section was placed in the Chandler bill to protect real estate transferees.¹³⁸ Thus, reference to section 21 supports the first view. By referring to section 21 of "this act," Congress may have intended only the Chandler Act.

Prior to 1938, a number of cases held that a drawee bank would not be liable for honoring checks after the filing of a petition in bankruptcy.¹³⁹ Moreover, one aged opinion from the Supreme Court of Maine protected an entity other than a drawee bank. In *Hersey v. Elliott*,¹⁴⁰ the bankrupt, Wyman, was the payee on a draft. Wyman endorsed the draft over to Hersey after a petition had been filed against Wyman. The draft was endorsed in order to satisfy consideration given Wyman by Hersey before the petition. The court ruled that the endorsement gave Hersey good title even though it occurred after the filing of the petition.

The first definitive judicial interpretation of the Chandler Act

136. See *supra* text accompanying notes 93-101.

137. ANALYSIS OF H.R. 12889, *supra* note 94, at 229. The Committee draft on the negotiability provision was adopted without change. The Committee notes do not address the reason for inserting the negotiability language. *Id.*

138. This provision is discussed *infra* at text accompanying notes 148-55.

139. See *In re Zotti*, 186 F. 84 (2d Cir. 1911), *cert. denied*, 223 U.S. 718 (1911); *Citizens' Union Nat'l Bank v. Johnson (In re Kentucky Automotive Co.)*, 286 F. 527 (6th Cir. 1923); *In re Retail Stores Delivery Corp.*, 11 F. Supp. 658 (S.D.N.Y. 1935); *Stevens v. Bank of Manhattan Trust Co.*, 11 F. Supp. 409 (S.D.N.Y. 1931) (holding that a bank that had notice of an involuntary petition could honor checks before adjudication and did not have to assume that an adjudication would follow.). See *supra* text accompanying notes 120-30, for a discussion of the involuntary case under the Chandler Act.

140. 67 Me. 526 (1878). For a similar result, see *Smoot & Easton v. Moorehouse*, 8 Ala. 370 (1845).

was given in *Rosenthal v. Guaranty Bank and Trust Co.*¹⁴¹ The facts in *Rosenthal* and *Marin* were virtually the same. In *Rosenthal*, a number of checks were issued before the debtor filed a voluntary petition for reorganization. Subsequent to the filing of the petition, the bank honored checks drawn on the account in an amount over \$6,500. Although there was a factual dispute as to whether or not the bank had actual knowledge of the filing of the bankruptcy, which would have deprived the bank of its right to rely on the exceptions listed in section 70d of the Chandler Act, that issue was resolved in favor of the bank. Nevertheless, the trustee asserted that the bank's lack of notice and good faith in paying the checks were not proper defenses to its claim. He argued that only checks honored during the gap between the filing of the petition and the debtor's adjudication should be subject to protection. The court implicitly adopted the more expansive interpretation of the negotiability proviso and gave judgment to the bank. In doing so, the court was impressed by a number of cases, which, prior to the Chandler Act, had ruled in favor of the banks.¹⁴² Thus, the court concluded that Congress had codified these cases in the Chandler Act.

The Supreme Court decision in *Marin* only briefly mentions the possible application of the negotiability proviso. The Ninth Circuit opinion is more instructive.¹⁴³ Counsel for the Bank of Marin urged adoption of the *Rosenthal* rationale. The Ninth Circuit, however, chose to embrace the first view and limited the application of the negotiability proviso to instruments that were transferred between the filing of a petition and adjudication in bankruptcy. With voluntary petitions, there was no interval between filing and adjudication. Thus, the negotiability proviso was inapposite to the *Marin* case. The precedents that the court in *Rosenthal* relied upon for its holdings were dismissed as cases that "all involved payments made after filing of the bankruptcy petition but

141. 139 F. Supp. 730 (W.D. La. 1956). The Second Circuit also looked at the proviso in *Feldman v. Capitol Piece Dye Works, Inc.*, 293 F.2d 889 (2d Cir. 1961). The rather complicated facts of the case reveal that a former officer of the bankrupt created a bank account in his own name from the debtor's funds and drew checks on the account. The bank chose to debit the bankrupt's account rather than the officer's account. The Second Circuit reasoned that the proviso could not aid the bank because the checks "had no valid inception since they lack the signature of an authorized officer." *Id.* at 892.

142. *Rosenthal*, 139 F. Supp. at 734. The court cited *Stevens v. Bank of Manhattan Trust Co.*, 11 F. Supp. 409 (S.D.N.Y. 1931); *Citizens' Union Nat'l Bank v. Johnson*, 286 F. 527 (6th Cir. 1923); *Cunningham v. Lexington Trust Co.*, 259 Mass. 181, 156 N.E. 1 (1927).

143. *Bank of Marin v. England*, 352 F.2d 186 (9th Cir. 1965).

prior to adjudication.”¹⁴⁴ Thus, the precedential value of *Rosenthal* was also dismissed.

As a second ground for concluding that the negotiability proviso failed to protect the Bank of Marin, the court observed that the “presentation of a check to the drawee for payment, and the payment thereof, is not a negotiation of a check.”¹⁴⁵ “Negotiation” as the Uniform Commercial Code and its predecessor, the “Negotiable Instrument’s Law,” technically define it, involves the taking of a negotiable instrument so that one becomes the “holder” thereof.¹⁴⁶ A “holder” in turn is able to enforce payment of the instrument.¹⁴⁷ Because the drawee bank merely pays the instrument, as opposed to receiving payment for it, the transaction was not a negotiation in the strict sense of the term.

The Supreme Court’s position on these points is vague. The Ninth Circuit’s rationales are neither rejected nor accepted. The Supreme Court could have also embraced the reasoning of the *Rosenthal* case by holding that the imposition of liability on the bank would have impaired the negotiability of negotiable instruments. This action would have violated section 70d(5)’s negotiability proviso. In refusing to embrace this argument, the Court implicitly rejected *Rosenthal*. Having chosen to ignore the negotiability proviso, the Court did not have to address the argument that a transfer to a drawer bank is not a “negotiation.”

5. REAL ESTATE

The Chandler Act’s treatment of real estate transfers¹⁴⁸ was a

144. *Id.* at 189 n.3.

145. *Id.* at 189.

146. “Negotiation is the transfer of an instrument in such form that the transferee becomes a holder.” U.C.C. § 3-202(1) (1978).

147. U.C.C. § 3-301; see also Countryman, *supra* note 21, at 151 (discussing the protection afforded a holder who acquires checks of another from the bankrupt without notice of the bankruptcy proceeding).

148. Section 21g of the Chandler Act reads:

A certified copy of the petition with the schedules omitted, of the decree of adjudication or of the order approving the trustee’s bond may be recorded at any time in the office where conveyances of real property are recorded, in every county where the bankrupt owns or has an interest in real property. Such certified copy may be recorded by the bankrupt, trustee, receiver, custodian, referee, or any creditor, and the cost of such recording shall be paid out of the estate of the bankrupt as part of the expenses of administration. Unless a certified copy of the petition, decree, or order has been recorded in such office, in any county wherein the bankrupt owns or has an interest in real property in any State whose laws authorize such recording, the commencement of a proceeding under this Act shall not be constructive notice to or affect the title of any subsequent

decided improvement over the prior statute.¹⁴⁹ The earlier provision merely gave the trustee authority to file a copy of the order approving bond that the courts interpreted as necessary to defeat a bona fide purchaser of realty. The Chandler Act also permitted a creditor to record the petition as well as the trustee's bond.¹⁵⁰ This allowed a creditor to give notice of bankruptcy in involuntary cases upon the filing of the petition. The prior act, on the other hand, provided that only the order approving the trustee's bond could be recorded. Usually, however, a trustee was not appointed until after *adjudication*, which, in involuntary cases could take several months.¹⁵¹

The Chandler Act also codified the weight of prior case law by stating that "unless a certified copy of the petition, decree, or order of the bona fide purchaser has been recorded . . . commencement of a proceeding under this Act shall not be constructive notice to or affect the title of any subsequent bona fide purchaser or owner of real property."¹⁵² Accordingly, cases construing the Chandler Act reached the intended result of protecting the bona fide purchaser whenever notice was not filed.¹⁵³

Finally, an exception to the filing requirement was inserted for real estate located in the county where the petition in bankruptcy was filed: "Provided, however, [t]hat this subdivision shall not apply to the county in which is kept the record of original proceed-

bona-fide purchaser or lienor of real property in such county for a present fair equivalent value and without actual notice of the pendency of such proceeding: *Provided, however*, That where such purchaser or lienor has given less than such value, he shall nevertheless have a lien upon such property, but only to the extent of the consideration actually given by him. The exercise by any court of the United States or of any State of jurisdiction to authorize or effect a judicial sale of real property of the bankrupt within any county in any State whose laws authorize the recording aforesaid shall not be impaired by the pendency of such proceeding unless such copy be recorded in such county, as aforesaid, prior to the consummation of such judicial sale: *Provided, however*, That this subdivision shall not apply to the county in which is kept the record of the original proceedings under this Act.

Chandler Act, ch. 575, § 21g, 52 Stat. 840, 853 (1938).

149. 9 U.S. COMP. STAT. 1916 Ann. p. 11299, § 21(e); 11 U.S.C. § 44, discussed *supra* text accompanying notes 89-92.

150. See *supra* note 148 for the text of the statute.

151. See *supra* text accompanying notes 120-30.

152. Chandler Act, ch. 575, § 21g, 52 Stat. 840, 853 (1938). For the text of the section, see *supra* note 148.

153. *E.g.*, *Roach v. Terry*, 263 Ark. 778, 567 S.W.2d 286 (1978); *Viersen v. Boettcher*, 387 P.2d 133 (Okla. 1963); *cf.* *Price v. Louisiana Rural Rehabilitation Corp.*, 38 F. Supp. 196 (W.D. La. 1941) (holding that the bankrupt may not enforce a postbankruptcy lease agreement).

ings under this Act.”¹⁵⁴ Although this proviso is not offered as a model of clarity, one court held for the trustee when the real estate was located in the county where the petition was filed.¹⁵⁵

6. IMPLIED REVOCATION OF AUTHORITY

It seems clear that the drafters of the Chandler Act had considered and resolved most cases that dealt with outright transfers of real or personal property. In some cases, however, agents were involved.

Thus far we have assumed that in cases involving agency relationships, perhaps without justification, the principal's bankruptcy automatically revoked the authority of the agent. For example, in *Marin*, a deposit contract gave the bank authorization to debit the bankrupt's account.¹⁵⁶ The Chandler Act did not expressly revoke the bank's authority to honor checks, and the court could have decided the case on that basis. The Supreme Court, however, resolved the case in the bank's favor on another ground.¹⁵⁷

The Ninth Circuit¹⁵⁸ discussed in detail this issue that the Supreme Court in *Marin*¹⁵⁹ only briefly mentioned. In an amicus brief, the California Banker's Association suggested that the filing of bankruptcy should not in and of itself operate as a revocation of the bank's authority to act.¹⁶⁰ At the time the depositor filed bankruptcy, he had authorized the Bank of Marin to honor checks which had been drawn on the depositor's account. The trustee argued that the filing of the petition revoked the bank's authority—an argument accepted by the Ninth Circuit.¹⁶¹ No statutory provision, however, specifically stated that the filing of a petition in bankruptcy served to revoke the authority of agents to act on the principal's instructions. Indeed, cases decided prior to the Chandler Act validated certain transactions that were made pursu-

154. Chandler Act, ch. 575, § 21g, 52 Stat. 840, 853 (1938). For a complete text of the section, see *supra* note 148.

155. *In re Kabbage*, 93 F. Supp. 515 (N.D. Ohio 1950).

156. *Marin*, 352 F.2d at 191.

157. *Marin*, 385 U.S. at 99.

158. 352 F.2d at 191.

159. 385 U.S. at 101.

160. *Id.*

161. *Id.* The court relied on *Harrison State Bank v. First Nat'l Bank*, 116 Neb. 456, 218 N.W. 92 (1928), *Guthrie Nat'l Bank v. Gill*, 6 Okl. 560, 54 P. 434 (1898), and *BAILEY, BRADY ON BANK CHECKS* 25 (3rd ed. 1962) for its holding. The court did not discuss existing authority, *infra* note 162, which indicates that the agent's ability to act for his principal continues.

ant to contractual authority.¹⁶²

Former section 70(b)¹⁶³ of the Chandler Act empowered the trustee to revoke "executory contracts." It seems clear that the contract between the depositor and the bank was executory.¹⁶⁴ Generally, automatic rejection of the contract did not occur until several days after the filing of the petition.¹⁶⁵ If the trustee decided to reject such a contract, did it then follow that all activities entered into during the interim period before the rejection were void and invalid? The language which adopted the rejection of executory contracts did not specifically provide that all actions prior to the rejection were void.¹⁶⁶

In a desire to reach an equitable result the Supreme Court in *Marin* may have overlooked a decisive argument in support of its result. There was nothing in the Bankruptcy Act specifically stating that the filing of a petition in bankruptcy automatically revoked an agent's contractual authority. The act could have been interpreted to require the continuation of the agent's authority until notice of bankruptcy.

C. Title and Related Concepts

Recall that the dictum in *Mueller v. Nugent*,¹⁶⁷ along with subsequent cases,¹⁶⁸ generally established the rule that upon the filing of a petition, the trustee in bankruptcy had title to all of the bankrupt's property. Parties dealing with the bankrupt did so at their own peril. The Chandler Act gave the trustee in bankruptcy, as of the filing of the *petition*, "title" to all of the property of the

162. "[T]he company, having in good faith performed the contract according to its terms, without notice that the contract called for a condition changing the terms, cannot be called upon to make the further payment denied by the trustee." *Frederick v. Fidelity Mutual Life Insurance Co.*, 256 U.S. 395, 399 (1921); *see also In re Zotti*, 186 F. 84 (2d Cir. 1911); *In re Mertens*, 144 F. 818 (2d Cir. 1906); *In re Retail Stores Delivery Corp.*, 11 F. Supp. 658 (S.D.N.Y. 1935); *Stevens v. Bank of Manhattan Trust Co.*, 11 F. Supp. 409 (S.D.N.Y. 1931).

163. Chandler Act, ch. 575 § 70, 52 Stat. 840, 880-81 (1938).

164. An executory contract was defined as one "on which performance remains due to some extent on both sides." *See infra* text accompanying notes 214-15. The obligation of the bank to honor checks is a continuing one as long as the depositor writes checks.

165. Section 70b in general provided that the trustee shall have 60 days after adjudication or 30 days after qualification to assume the contract. "Any such contract or lease not assumed or rejected within such time . . . shall be deemed to be rejected." Chandler Act, ch. 575, § 70b, 52 Stat. 840, 880-81 (1938). BANKR. RULE PROC. 607 modified the time for automatic rejection by eliminating the 60-day period after adjudication.

166. Chandler Act, ch. 575, § 70b, 52 Stat. 840, 880-81 (1938).

167. 184 U.S. 1 (1902).

168. *See supra* note 24 and accompanying text.

estate.¹⁶⁹ As seen above, only a limited class of postpetition transferees (principally those relying on real estate records and parties who dealt with a debtor who was defending an involuntary petition in bankruptcy) were protected.¹⁷⁰ Postpetition transferees, having no hope of avoiding the rigid application of postpetition transfer rules, sought new theories to avoid the harsh results.

The most common defense offered by such transferees was to argue that at the time of the bankruptcy filing, "title" had already passed. The case of *Congleton v. Schreihof*,¹⁷¹ provides an example of a transferee's ability to resist the trustee's claim of title. In that case a petition in bankruptcy was filed against the debtor on August 17th, and an adjudication followed a month later on September 17th. On October 10th, the bankrupt's sister was given a deed to real property as repayment for an old \$500 debt. Under the controlling bankruptcy statute, the trustee took title of all property as of the date of the adjudication.¹⁷² Therefore, the trustee argued that the postadjudication transfer should be set aside under the *Mueller* dictum. The sister nevertheless prevailed on the theory that she had taken title to the property more than a month before the adjudication. The bankrupt had executed the deed to his sister on August 8th and later recorded it on August 9th. The court reasoned that, in order for title to pass, actual delivery of the deed to the grantee on October 10th was not necessary under state law.

In *Congleton*, the transferee prevailed because title had passed prior to the filing of the petition. Passage of title was a complete defense to the trustee's postpetition transfer claim. A discussion of the concept of passage of title and related issues therefore is necessary to a complete understanding of postpetition transfer questions.

1. TITLE RULES

Under prior law, the third party claimant was usually a buyer of property who had advanced partial payment to the seller-bankrupt. In order to avoid the unenviable position of being treated as

169. "The trustee . . . shall . . . be vested by operation of law with the title of the bankrupt as of the date of the filing of the petition" Chandler Act, ch. 575, § 70a, 52 Stat. 840, 879 (1938).

170. See *supra* text accompanying notes 120-30 and 152-55.

171. 54 A. 144 (N.J. Ch. 1903).

172. Act of July 1, 1898, ch. 541, § 70a, 30 Stat. 544, 565-66 (1898); see Bateman, *supra* note 6, at 283-87; McLaughlin, *supra* note 96, at 612-14.

a mere general creditor of the bankrupt's estate, the buyer sought to reclaim the goods on the grounds that he held title. If bankruptcy had not intervened, the buyer stood an excellent chance of succeeding under state law. If the claimant could establish that the title did pass to the goods, even though as of the time of the filing of the petition the bankrupt still had possession of them, then he would have made significant progress in avoiding unsecured status.

The cases in this area generally approach the question of title as one of intention between the parties. It was therefore held that title cannot pass regardless of surrounding circumstances if the parties did not intend title to pass as part of their contract.¹⁷³ Where there was no clear evidence of the parties' actual intention, courts have generally looked to surrounding circumstances in order to ascertain the parties' intent. This analysis proved to be highly fictional because the courts were attempting to ascertain the parties' intentions when the parties had never given it much thought. Unfortunately, rather elaborate rules developed in order to determine when title passed. It was believed that these rules would help ascertain the parties' "intent."¹⁷⁴

As a general rule it appears that partial payment of the purchase price was not sufficient to award title to the purchaser.¹⁷⁵ Appropriation of the property to the contract, however, usually by segregating it,¹⁷⁶ tagging it,¹⁷⁷ or specifically identifying it was held to be sufficient.

173. *In re Autler*, 27 F. Supp. 299 (S.D.N.Y. 1939); *In re National Boat & Engine Co. (In re Fisher)*, 198 F. 407 (D. Me. 1912).

174. See, e.g., *In re Clairfield Lumber Co.*, 194 F. 181 (E.D. Ky. 1911). In *Clairfield* the court described at least four different classes of cases giving rise to various presumptions of the parties' intent.

175. *Id.* at 189.

176. *Hiller v. Cornille & De Blonde*, 228 F. 670 (5th Cir. 1915) (title had passed to cottonbales, which had been weighed, marked and set aside in the name of the buyer); *Williamson v. Richardson*, 205 F. 245 (9th Cir. 1913) (title had passed to bales of hops, which had been inspected, marked and accepted by the buyer); *In re Union Hill Preserving Co.*, 1 F.2d 415 (W.D.N.Y. 1924) (title had passed to fruit, which had been set apart in the bankrupt's warehouse and marked for the claimant); cf. *In re Lincoln Industries*, 166 F. Supp. 240 (W.D. Va. 1958) (title could not pass until the goods had been "unconditionally appropriated to the purchaser"); *In re Clairfield Lumber Co.*, 194 F. 181 (E.D. Ky. 1911) (mere stacking of lumber without identifying it is not sufficient to pass title). See generally *Thompson v. Fairbanks*, 196 U.S. 516 (1905) (Defendant was given a chattel mortgage which described the property and was recorded. Bankrupt intended that the acquired property should be covered by the mortgage.).

177. *Allen v. Hollander*, 128 F. 159 (D. Mass. 1904); cf. *In re Glover Specialties Co.*, 18 F.2d 314 (D. Conn. 1927) (reclamation of golf clubs denied because clubs were not "tagged or otherwise marked"); *McKey v. Pinckard (In re Ricketts)*, 234 F. 285 (7th Cir. 1916) (claimant of paintings had not indicated ownership on the back of the paintings).

Certainly, if the goods had been paid for and delivered to the buyer, the buyer stood an excellent chance of defeating the trustee on the grounds that title had passed. With certain property, however, actual physical delivery was extremely difficult if not impossible. Thus, the courts equated certain outward manifestations of constructive delivery with actual delivery.¹⁷⁸ In this regard, delivery to the purchaser's bailee was regarded as sufficient.¹⁷⁹ When goods were the subject of documents of title¹⁸⁰ or equivalent paper, delivery and possession of the document was the equivalent of actual delivery.¹⁸¹

On passage of title, goods that were the subject of state-enacted certificate of title legislation were the object of special rules. The case of *In re Lawson*¹⁸² uniquely illustrates the distinction between certificate and non-certificate goods. In that case the bankrupt acquired an interest in a boat and trailer. The bankrupt's transferor held a certificate of title for the trailer but did not tender it to the bankrupt when the goods were delivered. The boat and accessories were not subject to certificate of title legislation. The bankrupt then borrowed \$3,500 from Ferguson who in turn borrowed \$3,500 from Dilliard. When Ferguson and Dilliard be-

178. *In re McCartney*, 218 F. 717 (D. Idaho 1914). In *McCartney*, the bankrupt sold lumber to the claimant, but bankruptcy intervened before logging began. The court held that the purchase and erection of a sawmill on the bankrupt's land was sufficient evidence of delivery to avoid the effect of a state statute voiding transactions made by sellers who maintain possession and control of the property. See *infra* text accompanying notes 185-95.

179. *Willen v. Schillicci*, 285 F. 12 (5th Cir. 1922); cf. *In re Wein*, 13 F.2d 426 (D. Mass. 1926) (disallowing the bailee's claim to the goods). In the case of a bailee, more than possession is required to establish the bailee's title.

180. *In re Will v. Connell Co.*, 278 F. 288 (N.D. Ala. 1921); see also *Lovell v. Isidore New & Son*, 192 F. 753 (5th Cir. 1912). In *Lovell*, the bankrupt-seller forged a spurious bill of lading and fraudulently secured prior payment for the goods. When bankruptcy was filed, the bankrupt held the true bill of lading, and the goods, although in the hands of the carrier, had not been shipped. The court observed:

While creditors are entitled to the protecting shield of law, the rights of innocent purchasers are guarded and protected with equal jealousy. Under some circumstances the bankruptcy statutes clothe the trustee with power to set aside conveyances, good as between the bankrupt and a purchaser. But ordinarily, in the absence of fraud, or of a state statute declaring the conveyance void, or unless it contravenes some provision of the bankruptcy acts, a conveyance, based upon a valuable consideration and good as between the parties, will be permitted to stand. As to such conveyance, . . . the trustee occupies no better position than the bankrupt. He stands simply in the bankrupt's shoes.

192 F. at 760-61.

181. *Taney v. Penn Nat'l Bank*, 187 F. 689 (3rd Cir. 1911) (under applicable state law, warehouse receipt for stored whiskey in possession of bankrupt operates as delivery of whiskey).

182. 201 F. Supp. 710 (W.D. Va. 1962).

came alarmed about the bankrupt's financial condition, they took possession of the boat, its motor, and trailer and then credited the bankrupt with \$1,000 on the \$3,500 loan. Although Ferguson and Dilliard repeatedly demanded a certificate of title to the trailer, they never received one. In the meantime, Ratcliff testified that he and the bankrupt jointly owned the boat, motor, and trailer. He stated that subsequent to Ferguson's taking possession of the property, a blank certificate of title was given to him endorsed by the bankrupt's transferor, the original owner of the trailer. This certificate was given to a finance company that had lent Ratcliff money against the boat, motor, and trailer.

The judge, comparing his solution to that reached by Solomon,¹⁸³ held that Ratcliff was entitled to the trailer and that Ferguson and Dilliard were entitled to the boat and motor. Because the trailer was subject to certificate of title laws, title could only be transferred to the trailer by acquiring a certificate.¹⁸⁴ Because the boat and motor were not subject to the state's certificate of title laws, delivery plus partial cancellation of the indebtedness were sufficient to transfer title to them. Thus, one who is attempting to take title to certificate of title goods should at a minimum secure possession of the certificate endorsed by the transferor.¹⁸⁵

2. FRAUDULENT CONVEYANCES

Even if a claimant was successful in convincing a bankruptcy judge that he held title to the goods that were in possession of the bankrupt as of the date of the filing of the petition and adjudica-

183. *Id.* at 715.

184. *Cf. Continental Fire Trucks, Inc. v. John Grappone, Inc. (In re Continental Fire Trucks, Inc.)*, 33 Bankr. 713 (Bankr. D. Mass. 1983) (holding that title passed on delivery notwithstanding seller's retaining the certificate of origin).

185. *Mann v. Belle-Bland Bank (In re Schalk)*, 451 F. Supp. 268 (E.D. Mo. 1978); *cf. Associates Discount Corp. v. Plattenburg (In re Easy Living, Inc.)*, 407 F.2d 142 (6th Cir. 1969); *Farmers & Merchants Bank v. Patterson (In re Law)*, 1 Bankr. 557 (Bankr. W.D. Va. 1979). In *Law*, the bankrupt, at the time of the petition, had not signed over the certificate of title to a motor home to a purchaser. The court held for the purchaser. The court conceded that "because of noncompliance with the 'mandatory' provisions of the *Virginia Code* regarding transfer of title, the legal title to the mobile home remains in the Bankrupt, even though the alleged transferee has possession and has been paying monthly installments on the note." *Id.* at 559. The court reasoned that the vehicle was no longer property of the estate where the contract for its purchase was executory and the trustee had not affirmed the contract within the time period required by the bankruptcy act. Thus, because the contract was rejected, the purchaser was entitled to the mobile home. *See Chandler Act*, ch. 575, § 70b, 52 Stat. 840, 880 (1938). The court's conclusion that the purchaser should keep the goods as a result of the rejection of the contract is dubious. *See infra* discussion note 409.

tion, the claimant could still be reduced to the status of an unsecured creditor if the trustee proved that the entire transaction was a fraudulent conveyance. The landmark Star Chamber proceeding in *Twyne's case*¹⁸⁶ held that it was fraudulent to the seller's creditors for the seller to sell property while at the same time retaining possession. In that case and in subsequent cases, creditors convinced the courts that the debtor's holding out of ostensible ownership of property was prejudicial to them. Thus, judicial lien creditors of sellers were frequently successful in setting aside sales as fraudulent where the seller had retained possession of the goods.¹⁸⁷

Several commentators have questioned the basic premise in *Twyne's case*: that the seller's creditors rely on the seller's ostensible ownership of the goods.¹⁸⁸ Nevertheless, the courts and legislatures in the United States have routinely followed the precedent set in *Twyne's case*.

Perhaps the United States's most noteworthy extension of *Twyne's case* was articulated by the Supreme Court in *Benedict v. Ratner*.¹⁸⁹ In *Benedict*, the debtor filed bankruptcy, and Ratner claimed a security assignment, of all present and future accounts. The agreement had been signed more than four months before the debtor's bankruptcy.¹⁹⁰ Both lower courts ruled that the delivery of a written list of the accounts three days before the filing of the petition ripened Ratner's interest into a perfected title.

The Supreme Court held that the transaction should be set aside as an unlawful preference or alternatively, as a fraudulent conveyance under the laws of New York.¹⁹¹ Reservation and dominion over the accounts by the debtor was inconsistent with the

186. 3 Co. 80b, 76 Eng. Rep. 809 (Star Chamber 1601); see Gordon, *The Prepaying Buyer: Second Class Citizenship Under Commercial Code Article 2*, 63 NW. U.L. REV. 565, n.1 (1968).

187. E.g., *Huseby v. Kilgore*, 32 Wash. 179, 201 P.2d 148 (1948) (judgment creditors); *Foss v. Towne*, 98 Vt. 321, 127 A. 294 (1925) (attaching creditors); cf. *Staver Carriage Co. v. Richardson*, 303 Ill. App. 629 (1916) (goods replevied before judicial lien attached).

188. Gordon, *supra* note 186, at 576-81; see Note, *Bankruptcy and Article Two of the Uniform Commercial Code: The Right to Recover the Goods Upon Insolvency*, 79 HARV. L. REV. 598 (1966) [hereinafter cited as Note, *Bankruptcy and Article Two*]; Note, *The Uniform Commercial Code and An Insolvent Seller's Possession of Goods Sold*, 104 U. PA. L. REV. 91, 97-106 (1955).

189. 268 U.S. 353 (1925).

190. *Id.* at 357.

191. *Id.* at 365; see Act of July 1, 1898, ch. 541, § 60, 30 Stat. 544, 562, amended by Act of Feb. 5, 1903, ch. 487, § 13, 32 Stat. 797, 799-800; Act of June 25, 1910, ch. 412, § 11, 36 Stat. 838, 842.

assertion that title had been given to Ratner. The debtor's grant of unrestricted dominion over the goods which rendered ownership *more* than ostensible troubled the Court.¹⁹² The entire transaction was entered into without the filing of any notice and without any effective means for third parties to learn of the arrangement between the debtor and Ratner. In reaching this conclusion, the Court held that under New York law the transaction was conclusively fraudulent. The debtor's putative reservation of dominion over the intangible property was inconsistent with the effective disposition or creation of a lien on it.

Although some jurisdictions hold that the presumption of fraud is conclusive (fraud in law),¹⁹³ under the majority position only a rebuttable presumption of fraud (fraud in fact) exists, which the debtor can overcome by showing a lack of fraudulent intent.¹⁹⁴

The Chandler Act gave the trustee in bankruptcy the power to use state fraudulent conveyance law in order to attack fraudulent transfers. State law gave lien creditors standing to assert that conveyances were fraudulent.¹⁹⁵ Under the Chandler Act, the trustee had the power of a lien creditor who held a lien on all of the debtor's property.¹⁹⁶ Another section of the Chandler Act gave the trustee the power to set aside transfers "voidable" under state law, provided that the trustee could find an actual creditor who had standing under state law to attack the voidable fraudulent conveyance.¹⁹⁷ Thus, even if the postpetition transferee could have established that he held title at the time of bankruptcy, if the bankrupt had possession of the property at the time of filing, the trustee could have attacked the transaction as fraudulent under the rationale in *Twyne's case*.

192. *Benedict*, 268 U.S. at 360, 363. The assignment of the accounts receivable to Ratner was made to secure an existing loan of \$15,000 and to secure further advances. Yet, the debtor was not required to reduce the loan by the amounts collected until the creditor demanded payment.

193. *E.g.*, CAL. CIV. CODE § 3440 (West 1981) amended by CAL. CIV. CODE § 3440 (West Supp. 1984); *Callahan v. Union Trust Co.*, 315 Pa. 274, 172 A. 684 (1934); *Hiser v. Walbaum*, 129 Ill. App. 82 (1906); GA. CODE § 28-201 (1980); OKLA. STAT. ANN. tit. 24, § 6 (West 1951).

194. *E.g.*, *Tousley v. First Nat'l Bank*, 155 Minn. 162, 193 N.W. 38 (1923); *Wooley v. Crescent Auto. Co.*, 83 N.J.L. 244, 83 A. 876 (Sup. Ct. 1912); *Holley v. A.W. Haile Motor Co.*, 188 A.D. 798, 177 N.Y.S. 429 (1919); § 28; KAN. STAT. ANN. § 33-103 (1981); see Note, *supra* note 188 at 94-97.

195. See *supra* note 188.

196. Chandler Act, ch. 575, § 70c, 52 Stat. 840, 881 (1938); *e.g.*, *In re Lincoln Industries*, 166 F. Supp. 240 (W.D. Va. 1958) (trustee prevailed because he had the power of a lien creditor).

197. Chandler Act, ch. 575, § 70e, 52 Stat. 840, 882 (1938); *e.g.*, *In re Ricketts*, 234 F. 285 (7th Cir. 1916).

3. THE U.C.C. APPROACH

The drafters of the U.C.C. clouded the picture by confusing the rights held by the claimant and the trustee. The Code innocently began its treatment by declaring that, as a general rule, "title passes to the buyer at the time and place at which the seller completes his performance with reference to physical delivery of the goods" ¹⁹⁸ Further, Article 2 appears to significantly change the traditional rules of fraudulent conveyances. Section 2-402(2) provides that a creditor may treat the retention of goods by the seller as fraudulent "under any rule of law of the state where the goods are situated, except that retention of possession in good faith and current course of trade by a merchant-seller for a commercially reasonable time after a sale or identification is not fraudulent." ¹⁹⁹ The Code does not give any indication as to what is a "commercially reasonable time."

Article 2's grant of "special property interests" to non-possessing buyers is confusing. The drafters of Article 2 correctly criticized the concept of "title" as a formula for dispute resolution and drafted instead a statute where the concept of title had only a limited influence on the rights of the parties. ²⁰⁰ As seen earlier, the process of determining title caused courts to resort to arbitrary fictions that frequently had little to do with the underlying issue of whether the seller's creditors or the buyer should prevail as to the goods. For example, under the Code, the buyer's right to insure the goods has nothing to do with where title rests. ²⁰¹ With this purpose in mind, the drafters gave buyers "special property interests" in goods that are in the hands of the seller where the buyer does not have title to or possession of them. The U.C.C. gives the buyer a right to require specific performance of the contract where "goods are unique or in *other* proper circumstances." ²⁰² Furthermore, a buyer is given a right to replevy goods under stated conditions. ²⁰³

198. U.C.C. § 2-402(2); see *Thermo-Sentinel Corp. v. Clad Metals, Inc.*, 426 F. Supp. 1179 (W.D. Pa. 1977); *Hunter v. S.K. Austin Co. (In re Beck)*, 25 Bankr. 947 (Bankr. N.D. Ohio 1982) (title passed on delivery even though seller was not paid); *Reeves v. Pillsbury Co.*, 229 Kan. 423, 625 P.2d 440 (1981) (title did not pass when fungible goods were not delivered).

199. U.C.C. § 2-402(2).

200. U.C.C. § 2-401 states that "[e]ach provision of this Article with regard to the rights, obligations and remedies of the seller, the buyer, purchasers or other third parties applies irrespective of title to the goods except where the provision refers to such title."

201. U.C.C. § 2-501.

202. U.C.C. § 2-716(1) (emphasis added); see U.C.C. § 2-716(1) comment 2.

203. U.C.C. § 2-716(3) (buyer may replevy identified goods if cover is reasonably

Section 2-702(2), under stated conditions, permits a seller of goods to reclaim them if the buyer is insolvent at the time the goods are received.²⁰⁴ Its validity is of considerable interest to bankruptcy judges that are forced to decide postpetition transfer cases where the seller has successfully "reclaimed" the goods after the filing of the petition in bankruptcy. If the seller's section 2-702(2) right to reclamation is enforceable against the estate, the trustee's postpetition transfer remedy becomes moot.

U.C.C. section 2-502 gives the prepaying *buyer* a special property interest in goods that are purchased from an insolvent seller. The section provides:

(1) Subject to subsection (2) and even though the goods have not been shipped a buyer who has paid a part or all of the price of goods in which he has a special property [interest] . . . may on making and keeping good a tender of any unpaid portion of their price recover them from the seller if the seller becomes insolvent within ten days after receipt of the first installment on their price.

(2) If the identification creating his special property has been made by the buyer he acquires the right to recover the goods only if they conform to the contract for sale.²⁰⁵

It is doubtful that the drafters of the Code intended to impose upon the buyer the nearly insurmountable burden of proving that the seller became insolvent "within 10 days of receipt of the first installment." Nevertheless, one court has held that the drafters meant precisely what they said and denied a recovery based on the buyer's failure to offer proof.²⁰⁶

unavailable).

204. U.C.C. § 2-702(2) provides:

(2) Where the seller discovers that the buyer has received goods on credit while insolvent he may reclaim the goods upon demand made within ten days after the receipt, but if misrepresentation of solvency has been made to the particular seller in writing within three months before delivery the ten day limitation does not apply

See, e.g., *National Ropes, Inc. v. National Diving Serv., Inc.*, 513 F.2d 53 (5th Cir. 1975) (even though financial statement of buyer was misleading, the seller must still prove buyer insolvent at the time of the written misrepresentation to reclaim goods under section 2-702(2)); *Liles Bros. & Son v. Wright*, 638 S.W.2d 383 (Tenn. 1982) (seller's failure to demand return of goods within ten days of receipt by insolvent buyer did not preclude a section 2-702 remedy—postdated check was a written representation of solvency sufficient to give rise to ten-day limitation exception); *Kennett-Murray & Co. v. Pawnee Nat'l Bank*, 598 P.2d 274 (Okla. Ct. App. 1979) (seller had a right to reclaim goods within ten days of receipt by buyer when buyer ceased to pay his debts in the ordinary course of business).

205. U.C.C. § 2-502.

206. *First Citizens Bank & Trust Co. v. Academic Archives, Inc.*, 10 N.C. App. 619, 179

The difficulty of proving insolvency caused Congress in 1978 to create a rebuttable presumption of insolvency against the transferee.²⁰⁷ Although it is difficult for the transferee to prove the fact of insolvency, establishing the precise time when a seller first "becomes insolvent" may be impossible.

Subsection (1) of section 2-402 subordinates the claims of the seller's *unsecured* creditors to the claim of a section 2-502 reclaiming buyer.

(1) Except as provided in subsection . . . (2) . . . rights of *unsecured creditors* of the seller with respect to goods which have been identified to a contract for sale are subject to the buyer's rights to recover the goods under this Article (Section 2-502 . . .).²⁰⁸

Note that subsection (1) is made subject to the exceptions "as provided in subsection (2)." Subsection (2), recall, permitted a fraudulent conveyance remedy under stated conditions.²⁰⁹ The inference is inescapable that the 2-502 reclaiming buyer is subject to the seller's secured creditors and those creditors who bring suit on a fraudulent conveyance theory.

Thus, the reclaiming buyer would have lost to the trustee for two reasons: first, the Uniform Commercial Code, section 2-402(1), appeared to make the reclaiming buyer's remedy subject to non-code fraudulent conveyance law. Second, although section 2-402(1) provided that the buyer's 2-502 remedy was superior to the rights of *unsecured* creditors, the trustee's claim, given his secured creditor status, should have prevailed.²¹⁰ Thus, in the merchant case, if a bankrupt-seller retained goods beyond a commercially reasonable

S.E.2d 850 (1971); see also Skilton, *The Secured Party's Rights in a Debtor's Bank Account under Section 9-306(4)(d) of the Uniform Commercial Code*, 1978 S. ILL. U. L.J. 60, n.62. ("Literally construed, this section deserves to be placed in the category of the 'humor of the Uniform Commercial Code.'").

207. 11 U.S.C. § 547(f) (1982) provides that "the debtor is presumed to have been insolvent on and during the 90 days immediately preceding the date of the filing of the petition." Recently, however, the Senate has proposed that reasonable cause to believe insolvency must be found to exist in preference cases but proposed that the transferee shoulder the burden of proof. S. 445, 98th Cong., 1st Sess. p. 12-13 (1983), text which was incorporated into S. 1013, 98th Cong., 1st Sess. (1983).

208. U.C.C. § 2-402(1) (emphasis added).

209. See *supra* text accompanying note 199; see Countryman, *Buyers and Sellers of Goods in Bankruptcy*, 1 N.M.L. Rev. 435, 446-47 (1971); Gordon, *supra* note 186, at 570-71; Note, *Bankruptcy and Article Two*, *supra* note 188, at 602-03.

210. See *supra* note 194. See generally *Lewis v. Manufacturers Nat'l Bank*, 364 U.S. 603 (1961) (creditor's chattel mortgage was not void against trustee because trustee becomes lien creditor as of time of filing).

time, the trustee could keep the goods regardless of the buyer's section 2-502 claim.²¹¹ In non-merchant cases, any retention was subject to a fraudulent conveyance attack. In addition, the trustee had the claim of a lien creditor on all of the bankrupt's property.²¹² If the buyer had taken the property after bankruptcy, the trustee could still have recaptured it as a postpetition transfer.

The trustee had two additional theories with which to respond to the section 2-502 claimant. First, under section 70b, the trustee had the right to reject all existing executory contracts.²¹³ "Executory contract" was defined as a contract on which performance to some extent remains due on both sides.²¹⁴ In a section 2-502 case, the buyer usually tenders part of the purchase price before the seller-bankrupt delivers the goods. It seems that this contract would have been executory within the meaning of the section.²¹⁵ By simply filing a notice of rejection of the contract,²¹⁶ the buyer's attempts to reclaim under section 2-502 could have been extinguished. In this instance, federal law should supersede the Uniform Commercial Code.

211. See *In re Hardwick & Magee Co.*, 11 U.C.C. Rep. 1172 (Bankr. E.D. Pa. 1972) (reclaiming goods to the seller's trustee when the goods were retained for an unreasonable amount of time); cf. *Martin Marietta Corp. v. New Jersey Nat'l Bank*, 612 F.2d 745, 748-49 (3d Cir. 1979) (The court stated in dictum, that a buyer having a special property interest in goods because they had been identified to the contract should defeat a secured party). The opinion suggests that the buyer could qualify as a buyer in ordinary course of business and defeat the secured party under U.C.C. § 9-307(1). See *infra* note 512 (defining a buyer in ordinary course of business).

212. See *supra* note 194.

213. See *supra* notes 164-65.

214. Countryman, *Executory Contracts in Bankruptcy, Part I*, 57 MINN. L. REV. 439, 460 (1973); see *Crittenden v. Lines*, 327 F.2d 537 (9th Cir. 1964); cf. *Ozark-Mahoning Co. v. American Magnesium Co. (In re American Magnesium Co.)*, 488 F.2d 147, 152, *reh'g denied*, 491 F.2d 1272 (5th Cir. 1974) (suggesting that an executory contract is one where something remains to be done on the part of *only one* party).

215. See *National Sugar Ref. Co. v. C. Czarnikow, Inc. (In re National Sugar Ref. Co.)*, 27 Bankr. 565 (Bankr. S.D.N.Y. 1983) (holding that the unpaid seller's rights under Article 2 of the U.C.C. to stop goods in transit, § 2-702(1), and to reclaim the goods, § 2-702(2), is subject to the bankrupt's right to affirm or reject the executory contract for sale of goods); cf. *Farmer & Merchants Bank v. Law (In re Law)*, 1 Bankr. 557 (Bankr. W.D. Va. 1979) (holding that the trustee of a bankrupt seller was required to specifically affirm an executory contract in order to defeat the claim of a buyer who did not have title); Note, *Bankruptcy and Article Two*, *supra* note 188, at 604 (arguing that the buyer's 2-502 claim would not overcome the trustee's section 70b authority).

216. Chandler Act, ch. 575, § 70b, 52 Stat. 840, 880-81 (1938); BANKR. RULE 607. Both provisions provide that the contract would be automatically rejected without action of the trustee. The trustee, however, should have formally rejected the contract to avoid any arguments that the contract was in force until its rejection. See *supra* text accompanying notes 163-66.

When for some reason the executory contract argument failed or the trustee unwittingly assumed the contract, a serious question remained as to whether or not the section 2-502 claim would have been a statutory lien attackable under section 67c²¹⁷ of the Chandler Act as a disguised priority in favor of creditors preferred by the state legislatures. Section 2-502's companion section, section 2-702(2),²¹⁸ prompted considerable debate among the commentators and in case law.²¹⁹ Those favoring the superiority of section 2-702(2) as against the bankrupt's trustee argued that a buyer who bought goods on credit at a time when he was insolvent was committing common law fraud against the seller. As such, section 2-702(2) could be considered a mere codification of the old common law rules and therefore should not have been treated as a disguised priority or preference violative of old section 67c.²²⁰

Happily for the commentator, Congress mooted the issue by generally codifying the seller's 2-702(2) reclamation right.²²¹ Thus,

217. Act of July 5, 1966, Pub. L. No. 89-495, §§ 3, 4, 80 Stat. 268 (1966).

218. For a complete text of the section, see *supra* note 204.

219. See, e.g., Braucher, *Reclamation of Goods from a Fraudulent Buyer*, 65 MICH. L. REV. 1281 (1967) (an overview of the debate as to whether the seller's reclamation right under section 2-702 was effective against the buyer's trustee in bankruptcy); Countryman, *supra* note 209 (same); Kennedy, *The Interest of a Reclaiming Seller Under Article 2 of the Code*, 30 BUS. LAW 833 (1975) (same). Those favoring the trustee argued that the section 2-702 right of reclamation arose by force of statute, therefore, it was invalid as a statutory lien as proscribed by section 67c 1(A) of the prior Bankruptcy Act, Pub. L. No. 89-495, §§ 3, 4, 80 Stat. 268 (1966), or that section 2-702 reclamations were disguised state priorities, violative of the spirit of the priorities sections of the prior act. See *In re Federal's, Inc.*, 402 F. Supp. 1357 (E.D. Mich. 1975) (holding section 2-702 reclamations ineffective as against the trustee in bankruptcy); *In re Good Deal Supermarkets, Inc.*, 384 F. Supp. 887 (D.N.J. 1974) (same). Those supporting the validity of section 2-702 reclamations argued that the seller's right to reclaim was a valid state-created ownership right that had its origin in common law fraud and misrepresentation. Thus, a section 2-702 reclamation was merely a codification of common law remedies, and it did not rise solely by force of statute. Further, it was argued that the debtor did not truly own the property but held merely a voidable title. The property never passed to the estate upon which a priority distribution could be made. See *Alfred M. Lewis, Inc. v. Holzman (In re Telemart Enterprises, Inc.)*, 524 F.2d 761 (9th Cir. 1975); *In re Federal's, Inc.*, 553 F.2d 509 (6th Cir. 1977) (cases holding section 2-702 reclamations valid as against the trustee in bankruptcy).

220. See generally Braucher, *supra* note 219, at 1281-88 (common law and historical background of U.C.C. § 2-702).

221. The conflict respecting reclamation rights which exist between U.C.C. § 2-702(2) and the Bankruptcy Act has been substantially settled by 11 U.S.C. § 546(c) (1982) of the new Bankruptcy Code. Section 546(c) defines the rights of a seller under § 2-702(2) in the event of an intervening bankruptcy and subjects the trustee, under stated conditions, to the seller's right of reclamation. 11 U.S.C. § 546(c) (1982) provides:

(C) The rights and powers of the trustee . . . are subject to any statutory right or common-law right of a seller, in the ordinary course of such seller's business, of goods to the debtor to reclaim such goods if the debtor has received such

even a historical analysis of the complicated issue of whether the reclaiming seller's claim was a statutory lien would unduly prolong what may already be an unduly exhaustive article.

Some attention, however, should be given to whether or not the prepaying buyer's right of reclamation is a statutory lien. If it is to stand, a showing must be made that the seller was committing common law fraud. The fraud theory is perhaps more debatable in the case of insolvent sellers. There are no cases that award a buyer the goods on the theory that an insolvent seller is committing fraud by accepting part payment.

Even if the above arguments fail, the trustee can rely on the comment to section 2-502, which requires compliance with the filing requirements of Article 9 in order to defeat the rights of the trustee in bankruptcy. The comment states:

The question of whether the buyer also acquires a security interest in identified goods and his rights to the goods when insolvency takes place after the ten day period provided in this section depends upon compliance with the provisions of the Article on Secured Transactions (Article 9).²²²

In *In re Tennecomp Systems, Inc.*,²²³ the bankruptcy judge used this comment to strike the claimant's section 2-502 claim and to set a transfer of the property aside as preferential. *Tennecomp* was decided after the promulgation of the new Bankruptcy Code but relied on the trustee's power to set aside preferences, a power that also existed before 1978.

In *Tennecomp*, the bankrupt seller agreed to build a computer for the buyer at a contract price of approximately \$235,000. At the time that the petition was filed, approximately 90% of the purchase price had been paid pursuant to the terms of the contract. One day before the voluntary petition in bankruptcy was filed, the computer was shipped to the buyer. The buyer, however, did not receive the computer until three days after the petition.

goods while insolvent, but-

(1) such seller may not reclaim any such goods unless such seller demands in writing reclamation of such goods before ten days after receipt of such goods by the debtor; and (2) the court may deny reclamation to a seller with such a right of reclamation that has made such a demand only if court- (A) grants the claim of such a seller priority as an administrative expense; or (B) secures such claim by a lien.

222. U.C.C. § 2-502 comment 2.

223. *Bell v. Public Serv. Co. (In re Tennecomp Sys., Inc.)*, 12 Bankr. 729 (Bankr. E.D. Tenn. 1981).

The trustee, not knowing whether to treat the transaction as a preference, which applies to transfers occurring before bankruptcy, or as a postpetition transfer, wherein the transfer occurs after bankruptcy, argued both theories to the bankruptcy court. The buyer could not win on a theory that it had title to the property because the provision in the contract provided that title did not transfer until "initial operation of the equipment."²²⁴ Thus, the buyer was left with its 2-502(2) argument.

The bankruptcy judge struck down the buyer's section 2-502 claim on the grounds that Article 9 had not been complied with. He believed that the section's comment required that the buyer's "special property" interest in the goods be perfected pursuant to Article 9.²²⁵ Then, without indicating why he chose to do so, the court set the transfer aside as preferential. It thought perhaps that the bankrupt's dispossession of the goods *before* the petition was filed sufficed to meet the statutory requirement that the transfer be made within 90 days *before* the filing of the petition.²²⁶ If he

224. *Id.* at 732.

225. In concluding that the perfection and filing requirements of Article 9 control over the special property interest given reclaiming buyer's under section 2-502, the bankruptcy judge was clearly correct. U.C.C. § 2-402(3)(a) provides that "[n]othing in this Article shall be deemed to impair the rights of creditors of the seller under the provisions of the Article on Secured Transactions (Article 9)." In addition, in cases where the debtor has possession of the goods in question, the reclaiming buyer must comply with both the notice and perfection requirements of Article 9. U.C.C. § 9-113 provides:

A security interest arising solely under the Article on Sales (Article 2) is subject to the provisions of this Article *except that to the extent that and so long as the debtor does not have or does not lawfully obtain possession of the goods*

(a) no security agreement is necessary to make the security interest enforceable; and (b) no filing is required to perfect the security interest; and (c) the rights of the secured party on default by the debtor are governed by the Article on Sales (Article 2) (emphasis added).

See, e.g., First Nat'l Bank of Arizona v. Carbajal, 132 Ariz. 263, 645 P.2d 778 (1982), subordinating the unpaid cash seller's Article 2 special property claim because of failure to comply with Article 9. The question addressed was whether or not the trustee in bankruptcy, who was not an Article 9 secured creditor, but rather had the power of a lien creditor, *see supra* note 198, was in the same position as the secured creditor. U.C.C. § 9-301(1)(b) (1972 version) was somewhat helpful in that it provided that "an unperfected security interest is subordinate to the rights of . . . a person who becomes a lien creditor before the security interest is perfected." It is not clear whether the drafters intended to subordinate only Article 9 security interests or whether section 9-301(1)(b) was intended to subordinate Article 2 security interests as well. Research revealed one case holding that an unperfected Article 2 special property claim was subordinate to the trustee's lien creditor power. Imperial Chem. Indus. Ltd. v. Slaner (*In re Duplan Corp.*), 455 F. Supp. 926 (S.D.N.Y. 1978).

226. Judge Bare's opinion in *Tennecomp* is not the only opinion that struggled with the distinction between postpetition transfers and preferences. Judge Doyle's opinion in *Zestee Foods, Inc. v. Phillips Foods Corp.*, 536 F.2d 334 (10th Cir. 1976), demonstrates the kind of precision other opinions frequently lack. In *Zestee*, *Zestee* caused garnishee summons to be

had instead chosen to emphasize the time of the transferee's *receipt* of the goods, the transaction could have been attacked as a postpetition transfer.²²⁷

In summary, despite the efforts of the drafters of the Uniform Commercial Code, most buyers were left with only title arguments to defend against the trustee's claim that a postbankruptcy taking of the goods should be set aside as a postpetition transfer. Even assuming that the buyers could establish that they had title to the goods, if the bankrupt-seller retained the goods beyond a commercially reasonable time, the trustee would have a fraudulent conveyance remedy under state law which would have defeated the buyer's claim. If the seller was not a merchant, any retention made the buyer's claim vulnerable. If title had not passed to the buyer, section 2-502(2) was of little value to the buyer in bankruptcy. Arguments based on section 2-502(2) would almost certainly have failed on the alternative grounds that the burden of proof was insurmountable, that a section 2-502 claim was subordinate to the trustee's right to foreclose a judicial lien, that the trustee could reject the contract as being executory, that the entire section constituted a voidable statutory lien, or that the buyer had not complied with Article 9.

IV. THE BANKRUPTCY REFORM ACT OF 1978

A. Introduction

The Bankruptcy Reform Act of 1978 (hereinafter "bankruptcy

served on Jewett and Sherman who were indebted to the debtor. The summons was served subsequent to the filing of an involuntary petition but before bankrupt's adjudication. Jewett and Sherman admitted indebtedness and requested an order telling them whom to pay. Although the parties felt the issue was whether or not service of summons created a preference, Judge Doyle thought otherwise. A necessary element to setting aside a transfer as being preferential is that the transfer occur within the specified period *before* the filing of the petition. Because the transfer occurred after the petition, it could not be preferential. The court said, "We are not saying that there could never be a transfer as a result of a garnishee summons. We are saying that there was not a preferential transfer here. Since the purported transfer occurred after the filing of the petition it was abortive." 536 F.2d at 336; *see also* Carlson v. United Mo. Bank (*In re Newcomb*), 32 Bankr. 96 (Bankr. W.D. Mo. 1983) (where monies were paid into escrow to be transferred upon the United States being affirmed in district court of a judgment creditor, because affirmance came within 90 days preceding bankruptcy, the transfer was preferential); *In re Perpall*, 271 F. 466 (2d Cir. 1921) (where the court analyzed a transfer occurring after the petition under the bankruptcy act's preference statute).

227. In a latter part of this article it is argued that the transferee's interest in estate property should be vulnerable to the trustee's avoidance power as a condition precedent to setting aside a transfer as a postpetition transfer. *See infra* text accompanying notes 247-59.

code") constitutes the second major statutory treatment of postpetition transfer problems. The 1978 code codifies the result in *Marin*²²⁸ and includes the old rules that allow the trustee to set aside postpetition transfers.²²⁹

Section B looks at the 1978 code's treatment of these areas. Section C briefly returns to the title problem. The language changes in the code's title section as well as the changes made in codification of the reclaiming seller's section 2-702(2) rights necessitate a brief return to those questions. Finally, Section D looks at the unusual, new section 550.²³⁰ That section limits the trustee's ability to recover from subsequent postpetition transferees.

B. *Postpetition Transfers Under the Bankruptcy Reform Act*

1. INTRODUCTION

The following treatment of the postpetition transfer issue par-

228. 11 U.S.C. § 542(c) (1982); see *infra* text accompanying notes 311-29.

229. 11 U.S.C. § 549 (1982) (footnote omitted) provided:

(a) Except as provided in subsection (b) and (c) of this section, the trustee may avoid a transfer of property of the estate-

(1) that occurs after the commencement of the case; and

(2) (A) that is authorized under section 303(f) or 542(c) of this title; or
(B) that is not authorized under this title or by the court.

(b) In an involuntary case, a transfer that occurs after the commencement of such case but before the order for relief is valid against the trustee to the extent of any value, including services, but not including satisfaction or securing of a debt that arose before the commencement of the case, given after the commencement of the case in exchange for such transfer, not withstanding any notice or knowledge of the case that the transferee has.

(c) The trustee may not avoid under subsection (a) of this section a transfer, to a good faith purchaser without knowledge of the commencement of the case and for present fair equivalent value or to a purchaser at a judicial sale, of real property located other than in the county in which the case is commenced, unless a copy of the petition was filed in the office where conveyances of real property in such county are recorded before such transfer was so far perfected that a bona fide purchaser of such property against whom applicable law permits such transfer to be perfected cannot acquire an interest that is superior to the interest of such good faith or judicial sale purchaser. A good faith purchaser, without knowledge of the commencement of the case and for less than present fair equivalent value, of real property located other than in the county in which the case is commenced, under a transfer that the trustee may avoid under this section, has a lien on the property transferred to the extent of any present value given, unless copy of the petition was so filed before such transfer was so perfected.

(d) An action or proceeding under this section may not be commenced after the earlier of -

(1) Two years after the date of the transfer sought to be avoided; and

(2) the time the case is closed or dismissed.

230. 11 U.S.C. § 550 (1982); see *infra* text accompanying notes 425-93.

allels the earlier discussion of the Chandler Act. Issues are addressed in this section in the same sequence as in the Chandler Act. In some cases, the new code resolves old issues in the same manner, while in other instances novel solutions are offered. Part two of this section discusses the cases that are labeled "general rule cases." Part three looks at transfers occurring between filing of involuntary petitions and "adjudication."²³¹ Part four looks at a salient omission—namely the failure to protect transferees of both negotiable instruments and currency. Part five investigates new code sections 542(c)²³² and 542(d)²³³—that codify the result in *Marin*. Part six looks at the new code's treatment of real estate transfers. Part seven briefly discusses the revocation of authority argument mentioned in *Marin* and relied on by other cases.

2. CAVEAT EMPTOR

Throughout this discussion the "general rule" of *caveat emptor*, that a transferee of personal property takes only that interest held by his transferor,²³⁴ has been continually restated. Transferor's bankruptcy disables the transferor from giving title to estate property. Section 541(a)(1) provides that the debtor's estate acquires "all legal or equitable interests of the debtor in property"²³⁵ The principle of *caveat emptor* was ultimately retained in personal property cases. Moreover, in retaining the *caveat emptor* doctrine, Congress rejected a less stringent doctrine suggested by the Bankruptcy Commission that would have given postpetition transferees limited protection.

a. The Commission Proposal

As was true with the amendments to the Chandler Bill over 35 years earlier, the Bankruptcy Code of 1978 was the progeny of a Bankruptcy Commission.²³⁶ The Commission was made up of a

231. Recall that under the old bankruptcy act that a debtor could be involuntarily "adjudicated" a bankrupt. Chandler Act, ch. 575, § 4(b), 52 Stat. 840, 845 (1938); see *supra* text accompanying notes 120-30. New code section 303(h) speaks in terms of "ordering relief" in an involuntary case. "[T]he court shall order relief against the debtor in an involuntary case" 11 U.S.C. § 303(h) (1982).

232. 11 U.S.C. § 542(c) (1982); see *infra* text accompanying notes 306-24.

233. 11 U.S.C. § 542(d) (1982); see *infra* text accompanying notes 330-38.

234. See *infra* text accompanying notes 392-428.

235. 11 U.S.C. § 541(a)(1) (1978); see *infra* text accompanying notes 388-400.

236. The Commission on the Bankruptcy Law of the United States was established by Public Law 91-354 on July 24, 1970. Act of July 24, 1970, Pub. L. No. 91-354, 84 Stat. 468 (1970). The Commission was formed to study, analyze, evaluate, and recommend changes

panel of bankruptcy lawyers, academicians, and judges. A report was issued in 1973²³⁷ and a bill was later introduced.²³⁸ Although a group of bankruptcy judges offered their own bill,²³⁹ the "judges" bill and the Commission bill did not significantly differ in areas germane to this article.

The Commission recommended that the transferee be insulated from liability if he could establish three crucial facts. First, the transfer was prior to the filing of a notice in the local records which gave notice of real estate and personal property transactions. Second, the transferee did not know of the filing of the petition. And third, the transferee gave "a reasonably equivalent value."²⁴⁰

both in the substance and administration of bankruptcy.

Public Law 91-354 created a Commission consisting of nine members. Those members were Harold Marsh, Chairman, Wilson Newman, Charles Seligson, Senator Quentin Burdick, Senator Marlow Cook, Representative Don Edwards, Representative Charles Wiggins, Judge Edward Weinfeld, and Judge Hubert Will. The Commission staff consisted of, among others, an Executive Director, a Deputy Director, a research specialist and an administrative officer. Frank R. Kennedy, a prominent professor from the University of Michigan Law School, and a reporter for the Rules Committee of the Judicial Committee was appointed as Executive Director.

Public Law 91-354 as enacted provided for a two year life for the Commission. The Commission did not formally commence its operations until May of 1971, nearly 10 months after it was established. Therefore, Congress extended the life of the Commission by Public Law 93-56 through July of 1973. Act of July 1, 1973, Pub. L. No. 93-56, 87 Stat. 140 (1973). After conducting four public hearings and forty-four days of Commission deliberation, a two part report was submitted to Congress on July 30, 1973. REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. DOC. NO. 93-137, 93d Cong., 1st Sess. (1973). Part I consisted of an evaluation of bankruptcy administration with recommendations for change. Part II embodied a proposed bankruptcy statute with explanatory notes. The Commission's statutory proposal was introduced as a bill in the House of Representatives in 1973. H.R. 10792, 93d Cong., 1st Sess. (1973). A comparable bill was introduced in the Senate at that time. S. 4026, 93d Cong., 1st Sess. (1973). In 1974, a competing bill, proposed by the National Conference of Bankruptcy Judges was also introduced into the House. H.R. 16643, 93d. Cong., 2d. Sess. (1974). Scant legislative action was taken during the 93d Congress with respect to the proposed bankruptcy bills. However, an intense study of the proposed bankruptcy legislation occurred during the 94th Congress. The Commission's proposal was reintroduced during that session. H.R. 32, 94th Cong., 1st Sess. (1975). The competing bill by the bankruptcy judges was also reintroduced. H.R. 31, 94th Cong., 1st Sess. (1975). In the Senate, the Commission's bill was also resubmitted, S. 236, 94th Cong., 1st Sess. (1975), as was the bankruptcy judges' proposal, S. 235, 94th Cong., 1st Sess. (1975). For further discussion on the history of the Commission, see Klee, *Legislative History of the New Bankruptcy Law* 28 DE PAUL L. REV. 941, 942-43 (1979) reprinted in, 54 AM. BANKR. L.J. 275, 276-78 (1980).

237. REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. DOC. NO. 137, 93d Cong., 1st Sess. (1973).

238. H.R. 31, 93d Cong., 2d Sess. (1974).

239. H.R. 32, 93d Cong., 2d Sess. (1974).

240. Proposed section 4-605(a) reads:

Postpetition Transfers. Except as provided in section 4-208(c), a trustee may

The Commission recommended that the rule of *caveat emptor* be abandoned in bankruptcy. Parties dealing with the debtor in good faith and who paid good value must be given constructive notice of the bankruptcy in order for the trustee to defeat postpetition transfers. The Chandler Act exception for bona fide purchasers of real estate was to be extended to all good faith transferees.

b. The 1978 Code

Congress rejected the Commission's recommendation. The final bill subjected the transferee to liability even though he may not have had actual or constructive notice of the transferor's bankruptcy. Code section 549(a)(1) simply stated that "the trustee may avoid a transfer of property²⁴¹ of the estate . . . that occurs after the commencement of the case; and . . . that is not authorized under this title or by the court."²⁴² *Caveat emptor supremis*. Exceptions to the general rule are dealt with below. Although Congress did allow some exceptions, most of the cases construing section 549 have held that the estate could recover postpetition transfers under this section.²⁴³ One court adhered to this result

recover property of the estate transferred after the filing of a petition unless (1) the transfer was prior to the filing of notice pursuant to subdivision (c), (2) the transferee did not know of the filing of the petition, and (3) the transferee gave a reasonably equivalent present value. If the transferee would be protected under this subdivision but for the fact that he gave less than a reasonably equivalent value, he shall nevertheless be reimbursed for the present value given.

REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, *supra* note 237, at 162. The Commission's opinion to protect a transferee paying "reasonably equivalent present value" was not intended to mark a substantive change from the Chandler Act's protection for preadjudication parties paying "present fair equivalent value." The report said: "The use of 'reasonably equivalent' for 'fair equivalent' is intended as a clarification and not a change of substance. Undoubtedly the courts will reach the same result, but 'reasonably equivalent' seems a more accurate and realistic term than 'fair equivalent.'" *Id.* at 163.

241. If estate property is not transferred, section 549(a) is not violated. See *Westinghouse Credit Corp. v. Page (In re Page)*, 6 COLLIER BANKR. CASES 776 (D.D.C. 1982). The debtor should not be able to avoid section 549(a) by simply notifying its creditors to pay the postpetition transferee instead of paying the debtor. *Cohen v. Kern (In re Kennesaw Mint, Inc.)*, 32 Bankr. 799, 802 (Bankr. N.D. Ga. 1983).

242. 11 U.S.C. § 549(a)(1) (1982) (amended 1984).

243. *E.g.*, *McLemore v. Citizens Bank (In re Tom McCormick Enter., Inc.)*, 26 Bankr. 437 (Bankr. M.D. Tenn. 1983) (bank's unilateral withdrawal of funds from a special "going out of business sale" account to satisfy prepetition debt invalid under section 549(a)(1)); *Brown v. Swartz (In re Swartz)* 18 Bankr. 454 (Bankr. D. Mass. 1982) (trustee recovers excess of debtor's postpetition loan against the loan value of eight life insurance policies); *Doane v. Appalachian Power Co. (In re Doane)*, 19 Bankr. 1007 (Bankr. W.D. Va. 1982) (postpetition payment to utility of prepetition debt invalid); *Bulk Trans., Inc. v. United States (In re Bulk Trans., Inc.)*, 23 Bankr. 538 (Bankr. E.D. La. 1981) (postpetition payment

even though the holding may have practically terminated the debtor's attempts to reorganize.²⁴⁴

In *In re Jepsco Building Materials, Inc.*,²⁴⁵ a Chapter 11 debtor-in-possession was able to recover a postpetition payment for goods sold and delivered to the debtor before the filing of the bankruptcy. In that case, a supplier received a \$19,000 payment after filing a Chapter 11 petition for materials delivered before bankruptcy. The supplier claimed that it did not know that the certified check that it was given came from estate funds. In fact, the supplier previously had difficulties in receiving payment for supplies and had insisted that the debtor's chief officer and shareholder pay for all future supplies. At the time of the postpetition payment, the supplier had no knowledge that the paid funds came from the estate. The check itself had not been drawn on the debtor's account but rather had been drawn on the officer's account. The estate had deposited the necessary funds into the officer's account.²⁴⁶

The court applied section 549(a) and entered judgment against the supplier in the amount of \$19,000. The supplier's lack of notice and good faith were simply irrelevant.

In applying section 549, courts should recognize that Congress did not give the trustee the power of a lien creditor, the power to set aside preferences, or the like. Trustees, debtors, and debtors-in-possession should look to other sections of the code to recapture transfers which have postpetition elements.

*In re Laird*²⁴⁷ is an example of the misapplication of section 549. In *Laird*, the debtor's attorney, Gifford, recovered a \$6,700 arbitration award on behalf of the debtor against Crinitis before the filing of the petition. Crinitis paid \$6,700 into court in order to

to I.R.S. of prepetition tax liability invalid).

244. *B & W Enters., Inc. v. Goodman Oil Co. (In re B & W Enters., Inc.)*, 713 F.2d 534 (9th Cir. 1983), rejected various arguments that sought to permit postpetition payments for prepetition debts to a trade creditor vital to debtor's reorganization. See also *Otte v. Manufacturers Hanover Commercial Corp. (In re Texlon Corp.)*, 596 F.2d 1092 (2d Cir. 1979) (rejecting a similar effort for a bank); cf. *In re VanGuard Diversified, Inc.*, 31 Bankr. 364 (Bankr. E.D.N.Y. 1983) (approving, under stated conditions, a "cross-collateralization" loan to cover prepetition debts in favor of a bank).

245. *Jepsco Bldg. Materials, Inc. v. Bostwick Steel Lath Co. (In re Jepsco)*, 15 Bankr. 122 (Bankr. S.D. Fla. 1981).

246. The transferee may have had a valid defense as a "subsequent transferee" under section 550(b), but the court did not address the argument. See *infra* text accompanying notes 473-82.

247. *Krupp, Meyers and Hoffman v. Doyle (In re Laird)*, 6 Bankr. 273 (Bankr. E.D. Pa. 1980).

satisfy the award. The payment, however, was made after the debtor filed for bankruptcy. Gifford had an attorney's lien on the funds received, but under the controlling state law no lien accrued until the fund came into existence. The court ruled that funds did not come into existence until the \$6,700 was paid into court, making the money part of the bankruptcy estate.²⁴⁸ Because the lien could not have existed until the fund existed, the lien was vulnerable to attack under section 549.²⁴⁹

The estate's claim to property should be subject to all equities recognized under state law.²⁵⁰ Nothing in the legislative history of section 549 suggests that the section gave trustees an avoidance power enabling them to cut off existing claims to, or equities in, the transferred property. If the debtor himself had no ability to defeat Gifford's claim for fees at the time the petition was filed, the estate should equally be without the power under section 549.

For example, perhaps under Pennsylvania law, a lien creditor, who acquired a lien upon filing of the petition, could have served a writ of garnishment upon Crinitis thereby defeating Gifford's claim. If so, then the trustee would have been able to prevail under section 544(a), which accords the trustee at the time of the filing of the petition the rights of a lien creditor on all the debtor's property.²⁵¹ The point is that the estate cannot use section 549 as the court in *Laird* did. Under section 549, the estate has no avoidance power, unlike other sections such as 544,²⁵² 544(b),²⁵³ 547²⁵⁴ and 548.²⁵⁵

248. *Id.* at 277.

249. *Id.*

250. See *infra* text accompanying notes 403-05.

251. 11 U.S.C. § 544(a)(1) (1982) provides:

(a) The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by-

(1) a creditor that extends credit to the debtor at the time of the commencement of the case, and that obtains, at such time and with respect to such credit, a judicial lien on all property on which a creditor on a simple contract could have obtained a judicial lien, whether or not such a creditor exists.

252. *Id.*

253. Section 544(b) generally provides that the trustee may avoid transfers made by the debtor which are "voidable under applicable law by a creditor holding an unsecured claim." 11 U.S.C. § 544(b) (1982).

254. Section 547 generally permits the estate to set aside preferential transfers. 11 U.S.C. § 547 (1982).

255. Section 548 permits the estate to set aside fraudulent conveyances made within one year of the filing of the petition. 11 U.S.C. § 548 (1982).

The case of *In re Florida Consumer's Furniture Warehouse, Inc.*,²⁵⁶ represents a correct application of section 549. The defendant sold and delivered oriental rugs to the debtor on consignment. Defendant did not file a notice as required by the Florida Uniform Commercial Code²⁵⁷ which would have perfected his claim to the rugs without becoming subject to defeasance by a lien creditor. When defendant learned of the debtor's bankruptcy, he removed the unsold rugs from the debtor's store. Bankruptcy Judge Britton *first* ruled that the trustee could defeat the defendant's claim under section 544(a)(1)²⁵⁸ which, recall, gives the estate the power of a lien creditor. Then, after having removed the defendant's claim to the rugs, he ordered them returned to the estate as a postpetition transfer under section 549.

Although the above approach may appear to be hypertechnical, it is far from clear that Gifford should have lost in the *Laird* case. Gifford's claim to the arbitration award may have been superior under state law to that of a garnishing creditor's, who served a writ on the garnishees *before* they paid the funds into court. If so, Gifford should have prevailed. If the estate could not defeat Gifford's claim under its power as a lien creditor or under other sections, it certainly could not under section 549.²⁵⁹

256. *Gennet v. Oriental Rug Agency, Inc.*, (*In re Florida Consumer's Furniture Warehouse, Inc.*), 9 Bankr. 7 (Bankr. S.D. Fla. 1981).

257. See FLA. STAT. §§ 672.326(2), (3) (1981) (the rugs being delivered primarily for resale are deemed to be "on sale or return").

258. *Gennet*, 9 Bankr. at 9. For text of Section 544(a)(1), see *supra* note 251.

259. See also *A & S Sales & Leasing, Inc. v. Belize Airways Ltd.* (*In re Belize Airways Ltd.*), 7 Bankr. 601 (Bankr. S.D. Fla. 1980); *Steinberg v. National Bank & Trust Co.*, (*In re Independence Land Title Corp.*), 9 Bankr. 394 (Bankr. N.D. Ill. 1981); *Goldstein v. Beeler* (*In re Rose*), 25 Bankr. 744 (Bankr. E.D. Mo. 1982). In *Belize Airways*, a conditional seller did not comply with filing requirements to give the creditors of the conditional buyer notice. Although the seller's interest almost certainly could have been invalidated under section 544(a)(1), the opinion seemed to imply that the seller's claim was invalid under section 549 due to the fact that the seller took possession of the property being sold *after* the filing of bankruptcy.

In *Independence Land Title*, the debtor borrowed funds from a bank so that it could buy a motor vehicle from Wade, the president of debtor-corporation, on March 18, 1980. Debtor gave Wade the loan proceeds and Wade gave debtor the car and certificate of title. Bankruptcy was filed subsequently on March 27, 1980. The Bank was not successful in getting its lien validated on the certificate of title under the applicable Illinois Certificate of Title law, ILL. REV. STAT. ch. 95½ § 3-202(b) (1979), until May 15, 1980. While the decision initially discussed the belated notation on the certificate as a possible preference, the opinion, again, implies that the notation was invalid under section 549.

The broad language in *Independence* is deceptive when it implies that all postpetition attempts to perfect a security interest are invalid under section 549. Section 546(b) permits secured parties to file a notice after bankruptcy if something remains to "accomplish such perfection" under applicable law. 11 U.S.C. § 546(b) (1982). The 1978 code's preference

3. INVOLUNTARY CASES

a. A Brief Review of the Chandler Act

Under former section 70d(1),²⁶⁰ creditors and transferees dealing with the debtor in the "gap" between filing of the involuntary petition and adjudication were protected as long as they were acting in "good faith" and paid "fair equivalent value."²⁶¹ "Good faith" permitted the transferee to know about the involuntary petition as long as he had "reasonable cause to believe that the petition in bankruptcy [was] not well founded"²⁶² Under cases such as *Kohn v. Myers*,²⁶³ a party who inspected the bankruptcy file was charged with knowledge of subsequent additions to it.

section generally allows a secured party ten days to perfect a security interest in collateral after the interest is granted in order to immunize it from a section 547 preferential transfer attack. See 11 U.S.C. § 547(e)(2)(A) (1982), providing that a "transfer is made . . . at the time such transfer takes effect between the transferor and transferee, if such transfer is perfected at, or within ten days after, such time." In the *Independence* case, the security interest was given on March 18th and bankruptcy followed on March 27th. If the bank had been able to note its lien by giving the section 546(b) notice on March 28th, which is within the ten day period specified under section 547(e)(2)(A), then the trustee should not have been able to set aside the bank's interest. Language in the *Independence* case suggested that all attempts to perfect a lien after the filing of a petition were void under section 549, which directly conflicts with the provisions of section 546(b).

The *Rose* case illustrates a similar problem. In that case the transferee obtained a pre-judgment garnishment on the cash proceeds from the sale of real estate. Bankruptcy intervened within the crucial 90 day period following the garnishment thereby making the transferee's lien susceptible to attack as a preferential transfer under section 547. 11 U.S.C. § 547(b) (1982). The transferee, upon stipulation of the parties, successfully got the state court to release the funds to him. The bankruptcy judge set aside the transfer as a preference. The district judge affirmed but did so on the grounds that the transaction violated section 549 as a postpetition transfer. Again, the opinion seemed to imply that *any* transfer of funds occurring after the filing of bankruptcy was void under section 549. If, however, the transferee had been able to get his prejudgment lien *before* the crucial 90 day preference period, the transferee ultimately should have prevailed. See, e.g., *Sid Kumines, Inc. v. Wolf (In re Wolf)*, 13 Bankr. 167 (Bankr. D. Mass. 1981), (holding that an attachment lien acquired before the beginning of the 90 day period was immune from the trustee's preference attack); *Barr v. National Aircraft Servs., Inc., (In re Cosmopolitan Aviation Corp.)*, 34 Bankr. 592 (Bankr. E.D.N.Y. 1983) (receipt of the funds after bankruptcy filing should not change the result).

In the *Rose* case, the transferee's actions were in violation of 11 U.S.C. § 362(a) (1982) which generally provides that all attempts to enforce creditors' claims are automatically stayed. Transferees that violate the automatic stay may be subject to various contempt of court sanctions. Violation of the automatic stay, however, should not defeat the transferee's claim to the funds.

260. See *supra* note 120.

261. For the text of the section and further discussion, see *supra* text accompanying notes 120-30.

262. Chandler Act, ch. 575, § 70d(3), 52 Stat. 840, 881 (1938); see *supra* text accompanying notes 126-30.

263. 266 F.2d 357 (2d Cir. 1959); see *supra* text accompanying notes 127-30.

Even if the transferee was acting in good faith, Chandler Act courts held that satisfaction of prepetition debts did not constitute the payment of "fair equivalent value."

Under the Chandler Act, there was confusion concerning the correct interpretation of section 70d(4) language which withdrew protection in cases where a "United States or State court" receiver had been appointed. Section 70d(4) appeared to conflict with the introductory language to section 70d which protected only those transfers occurring "before a receiver takes possession of the property of the bankrupt."²⁶⁴ One commentator suggested that the introduction should apply only to bankruptcy court receivers, with section 70d(4) applying to nonbankruptcy receivers appointed by federal and state courts.²⁶⁵

b. The Commission Bill

The proposed Commission section 4-208(c)(1), entitled "Transactions Prior to Granting Relief," provided:

(c) After the filing of an involuntary petition and before entry of an order granting relief . . .

(1) persons selling to or buying from the debtor in the ordinary course of his business, notwithstanding their knowledge of the petition, shall be allowed to retain the money or other property acquired and shall have allowable claims for the value of the bargained for exchange to the extent not received at the time of the entry of an order granting relief. . . .²⁶⁶

The Commission proposal was a significant departure because it mandated that transfers of estate property be in the "ordinary course of business" of the debtor. Thus, under the Commission proposal, a bulk transferee would likely be subject to suit by the trustee.²⁶⁷ The Commission also recommended that the transferee's knowledge be considered irrelevant. Even if the transferee thought

264. For text of the section, see *supra* note 108; see *supra* text accompanying notes 113-19.

265. Boshkoff, *supra* note 6, at 756-61; see also Bateman, *supra*, note 6 at 290-91 (discussion of introductory language of section 70d compared with language of section 70d(4)).

266. REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. Doc. No. 93-137 Part II, 93d Cong., 1st Sess. 78 (1973).

267. U.C.C. § 6-102(1) defines "bulk transfer" as "any transfer in bulk and *not in the ordinary course of the transferor's business* of a major part of the materials, supplies, merchandise or other inventory . . . of an enterprise subject to this Article." (emphasis added). See, e.g., *Murdock v. Plymouth Enters., Inc. (In re Curtina Int'l, Inc.)*, 23 Bankr. 969 (Bankr. S.D.N.Y. 1982), holding that a "close-out" sale of all of the debtor's inventory was not in the ordinary course of business.

that the petition had merit, he would have been protected if he otherwise met the requirements of the section.²⁶⁸ Finally, although the section did mention "selling" and "buying," there was no express provision that required the transferee to pay "value."

Whether the failure to require the transferee to pay value (much less "fair equivalent value") was intentional, or an oversight, is unclear. It certainly could be argued that a sale at a fraction of the true value is not in the "ordinary course" of business.

Commission section 4-605, the general provision governing postpetition transfers, expressly excepted section 4-208(c) from its provisions.²⁶⁹ Thus, in cases where the transferee paid less than full value for the debtor's property, there was no other section that supervened section 4-208(c).²⁷⁰

c. The 1978 Code

The drafters of the 1978 code did not totally adopt the Commission recommendations for involuntary cases. Section 549(a) expressly excepted from the trustees' power to avoid postpetition transfers those cases provided for in subsection (b).²⁷¹ Section 549(b) provides:

(b) In an involuntary case, a transfer that occurs after the commencement of such case but before the order for relief is valid against the trustee to the extent of any value, including services, but not including satisfaction or securing of a debt that arose before the commencement of the case, given after the commencement of the case in exchange for such transfer, notwith-

268. Cf. *Kohn v. Meyers*, 266 F.2d 353 (2d Cir. 1959); see *supra* text accompanying notes 126-30.

269. REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. Doc. No. 93-137 Part II, 93d Cong., 1st Sess. § 4, 162 (1973). For a complete text of section 4-605(a), see *supra* note 240.

270. Commission section 4-605(a) indicated that transferees, who paid "reasonably equivalent present value," would be protected under stated conditions if they received a postpetition transfer. The Commission proposal then stated: "If the transferee would be protected under this subdivision but for the fact that he gave less than a reasonably equivalent value, *he shall nevertheless be reimbursed for the present value given.*" (emphasis added). To see the text of this section, see *supra* note 240. Note, however, that section 4-605(a) "excepted" out of its provisions section 4-208(c). *Id.* Given the fact that Commission section 4-605 permitted the trustee to recover property from transferees who paid less than full value, failure to provide similar relief under section 4-208(c) in the involuntary case is further evidence that the Commission intended that the transferees who paid less than full value should be protected.

271. "Except as provided in subsection (b) . . . , the trustee may avoid a transfer of property of the estate" 11 U.S.C. § 549(a) (1982) (amended 1984) (emphasis added). For a complete text of section 549, see *supra* note 229.

standing any notice or knowledge of the case that the transferee has.²⁷²

The reader should note that the 1978 code speaks in terms of "order for relief" while the Chandler Act provided for an "adjudication."²⁷³ For the purposes of this article, the terms are synonymous. Under the 1978 code, when an "order for relief" is entered, the debtor's assets are within the exclusive jurisdiction of the bankruptcy court.²⁷⁴

The intention of the drafters in employing the word "value" seems clear. The section expressly provides that transferees who receive estate property in exchange for "services" are protected.²⁷⁵ Moreover, the statute omits the requirement that there be a "contemporaneous exchange." Doubtless, the drafters were aware of the preferential transfer sections under both the old act²⁷⁶ and the 1978 code,²⁷⁷ but they chose not to set aside preferential transactions where the debt arose *after*²⁷⁸ the filing of an involuntary petition.

For example, assume that an involuntary petition was filed on January 1st and that the entry of order for relief followed on March 1st. In the meantime, on January 15th, Red Painter began painting Debtor's house and completed the job on February 1st. If Debtor paid Red on February 20th, the trustees could not set aside that payment. Red had given "value," which the section defines as "services," and he gave his services *after* the filing of the petition. The fact that the February 20 payment was for an antecedent debt was irrelevant.

Note also, in the above example, that Red was protected to the "extent" of his value. Thus, if Red's bill was \$5,000, but in satisfaction of the debt, Debtor gave Red title and possession to his \$15,000 Mercedes, the trustee might be able to take back the

272. 11 U.S.C. § 549(b) (1982).

273. See *supra* note 108 for text of former section 70d.

274. Involuntary cases are commenced under section 303 of the 1978 code. See 11 U.S.C. § 303 (1982). Section 541(a) provides that "[T]he commencement of a case under section . . . 303 of this title creates an estate." 11 U.S.C. § 541(a) (1982).

275. Thus, the case of *Kass v. Doyle*, 275 F.2d 258 (2d Cir. 1960), discussed *supra* text accompanying notes 123-25 was affirmed.

276. See Chandler Act, ch. 575, § 60, 52 Stat. 840, 869-71 (1938) (entitled "Preferred Creditors").

277. See 11 U.S.C. § 547(b) (1982) (permitting the trustee to set aside payments made on account of an "antecedent debt" made within 90 days of the filing of a petition).

278. Several courts have analyzed postpetition transfers as preferences. See *supra* note 226.

Mercedes, while Red should have a lien to the extent of \$5,000.

The 1978 code also drops the requirement of "good faith." With the abolition of "good faith" as a vehicle for deciding these cases, the courts are no longer required to construe the old act's statutory definition of "good faith" as "reasonable cause to believe that the petition is not well founded." In addition, given the prior courts' tortured definition of "reasonable cause,"²⁷⁹ creditors dealing with debtors who are resisting involuntary petitions should feel more secure about the validity of their transactions with the debtor.

The 1978 code does retain the old requirement that the "value given" must not be satisfaction of an old, prepetition debt.²⁸⁰ The Chandler Act decisions have interpreted "present fair equivalent value" as requiring a postpetition debt. This interpretation of case law has been placed into the 1978 code. The drafters provided double insurance against the debtor's satisfaction of a prepetition debt by requiring that the "value" given by the transferee not include "satisfaction or securing of a debt that arose before the commencement of the case," and that the "value" be "given after the commencement of the case."

*In re International Teldata Corp.*²⁸¹ (the only reported case to date construing section 549(b)) was decided on the ground that section 549(b) permitted the trustee to set aside transfers that occurred after the satisfaction of prepetition debts. In *Teldata*, a single creditor attempted to force the debtor into involuntary bankruptcy. The debtor pointed out that the 1978 code required at least three creditors to join in the petition if the debtor had twelve or more creditors.²⁸² The code generally provided that creditors whose claims could be avoided under the avoidance provisions of the bankruptcy code should not be included in the determination of the twelve creditors.²⁸³ Specifically, the section provided that creditors whose transfer was "voidable under section . . . 549" should not be included as part of the twelve.²⁸⁴

The debtor argued that he had numerous creditors—far more than twelve. The petitioning creditor successfully countered

279. See *supra* text accompanying notes 126-30.

280. See *supra* text accompanying notes 121-25.

281. 12 Bankr. 879 (Bankr. D. Nev. 1981).

282. 11 U.S.C. § 303(b) (1982). Subsection (1) provides that there should be three creditors joining in the petition. Subsection (2) provides, however, that only one creditor is needed if the debtor has less than twelve creditors.

283. *Id.*

284. *Id.*

debtor's argument, pointing out that none of the debtor's other creditors could be counted because the debtor had made postpetition payments to all of them in payment for prepetition indebtedness. The court ruled that all of those creditors would be excluded because the payments made to them were voidable under section 549(b).

d. Comment

By discarding the "good faith" requirement, the drafters struck a balance between the rights of transferees who deal with the debtor and the debtor's creditors. Prior law was slanted too much in favor of the trustee. Until the order for relief is entered, the bankruptcy courts should not assume that the involuntary petition has merit. Under the Chandler Act, courts second-guessed the transferees' intent as to whether or not the transferees thought the petition had merit.²⁸⁵ If, indeed, a court determines that the petition has merit, it may appoint a receiver. Until that time, a debtor should be able to operate his business with a minimum of interference.

The 1978 code did not follow the policy of the Chandler Act, which enabled the trustee to set aside transfers that occurred before adjudication but after a general receiver had been appointed. Undoubtedly, problems of interpretation with respect to provisions that refer to receivers under the Chandler Act influenced the decision to protect postpetition transferees, when an involuntary petition was filed and a receiver appointed.²⁸⁶ Those problems, however, were the result of ambiguous language and not the result of enunciated policy.²⁸⁷ As a practical matter, these cases can only occur if the receiver is unsuccessful in collecting all of the debtor's property. (If the receiver has all of the property, debtor has nothing to transfer). If a transferee is without notice of the appointment of a receiver, his lack of notice is an equity in his favor. But this reason alone is insufficient to justify protection. Those parties who deal, after the filing of a voluntary petition, with bankrupt debtors will be subject to the trustee's right to set

285. See *supra* text accompanying notes 126-30.

286. A general receiver is one appointed by a court of chancery under its equitable powers, independent of statute, to take possession of and preserve the funds or property in litigation. *Naslund v. Moon Car Co.*, 345 Mo. 465, 467-68, 134 S.W.2d 102, 105 (1939).

287. The Chandler Act was unclear as to whether the appointment of receivers by the bankruptcy court alone, or by other courts as well, cut off protection for good faith postpetition transferees in involuntary cases. See *supra* text accompanying notes 113-19.

aside the transfer under section 549(a).²⁸⁸ If there is a distinction between the two types of transferees, it is that in the section 549(a) case, bankruptcy has occurred, while in the involuntary case only a receiver has been appointed.

In cases where a judge believes that the debtor's affairs are in such distress that a receiver is needed to prevent dissipation of the estate, a recapture provision for postpetition transfers becomes necessary. In both cases, where a voluntary petition has been filed and where a receiver has been appointed, there has been a finding that the debtor's assets must be gathered and administered. The debtor should not be in a position, merely because his receiver was unaware of the existence of assets, to fritter away some of these assets and thereby defeat his creditors.

Similarly, the Commission proposal, which left unprotected those transfers that were not made in the "ordinary course" of business, deserved more consideration. The Commission's proposal struck a balance between allowing the debtor to operate his business, and at the same time protecting creditors' rights should the involuntary petition have merit. Under the 1978 code, in the interval between filing and the order of relief, debtors are able to liquidate assets and dissipate the funds by means of sales not in the ordinary course of business. In an analogous context, bulk transferees, due to the unusual nature of the sale, are required to insure that the transferor's creditors are given notice before the sale is consummated.²⁸⁹ Similarly, in bankruptcy cases, quick liquidation-type sales should alert the buyer of the need for inquiry.

It is true that the present code permits the estate to set aside the transfer if less than full value has been paid, but the transferee is given a lien to the extent of the consideration given.²⁹⁰ For ex-

288. See *supra* text accompanying notes 241-46.

289. U.C.C. § 6-104(1)(a) provides in part that "a bulk transfer . . . is ineffective against any creditor of the transferor unless [t]he transferee requires the transferor to furnish a list of his existing creditors" Section 6-105 further provides that the bulk transfer "is ineffective against any creditor of the transferor unless at least ten days before he takes possession of the goods or pays for them . . . [t]he transferee gives notice of the transfer"

290. Section 549(b) does not expressly give the transferee a lien. The section does provide that the transfer "is valid against the trustee to the extent of any value . . . given" The section does not state how a court should resolve a case where there is a transfer before the entry of the order for relief for only one-half of value. Since the section only validates the transfer to the "extent of any value," it follows that the entire transfer cannot be valid. The most plausible solution would be to give the transferee a lien on the property to the "extent" of his value which will be satisfied upon a subsequent sale, which, hopefully, will attract a higher price than originally paid by the transferee.

ample, assume that Debtor transfers his \$20,000 Mercedes to Tom Transferee during the gap for \$10,000. Under present section 549(b), the trustee could recover the car, but Tom would have a \$10,000 lien. If the \$10,000 given to the debtor cannot be traced and is therefore missing, there is a \$10,000 loss to the estate. Under the Commission's proposal, the sale would probably not have been in the ordinary course of business and would have therefore been void.²⁹¹ Tom would forfeit his \$10,000 consideration, but the fact that he was paying less than full value should have alerted him to be wary. Under present section 549(b), Tom need not be acting in "good faith," he may be fully aware of the filing of the petition and still be protected.

Finally, in cases where a transfer is in the ordinary course of business, the new definition of "value" is an improvement. The old act protected transferees that paid "present fair equivalent value."²⁹² 1978-code transferees are protected to the "extent" that they pay "value." Thus, transferees who pay partial value in the ordinary course of business do not forfeit their consideration because a court, in hindsight, decides that less than full value has been paid. At a minimum, in such cases, a lien should be provided to the extent that consideration is less than full value.

4. NEGOTIABLE INSTRUMENTS AND CURRENCY

a. Review of the Chandler Act

The drafters of the Chandler Act included language in section 70d(5), dubbed the "negotiability proviso," indicating that the courts should accord protection to parties relying upon a negotiable instrument. The Chandler Act stated "[t]hat nothing in this Act shall impair the negotiability of currency or negotiable instruments."²⁹³

The Ninth Circuit's *Marin* decision held that this proviso should not insulate drawee banks from liability where the debtor-bankrupt drew checks on an account which the drawee-bank honored after bankruptcy.²⁹⁴ This conclusion was reached in part because the honoring of a check by a drawee bank is technically not a "negotiation,"²⁹⁵ and in part because the negotiability pro-

291. See *supra* note 270 and accompanying text.

292. For the text of the section, see *supra* note 108.

293. Chandler Act, ch. 575, § 70d(5), 52 Stat. 840, 882 (1938).

294. *Marin*, 352 F.2d at 189 (9th Cir. 1956).

295. *Id.* at n.4.

viso only protected preadjudication transfers.

Under one view of the Chandler Act, negotiations were valid where the instrument was negotiated to an actual holder. By way of example, assume that the debtor-bankrupt was the payee of a note. Subsequent to his filing of a voluntary petition and adjudication he negotiated the note to "H," a holder-in-due course, i.e. H paid value without knowledge of the filing of bankruptcy. Assume further that H in turn negotiated the note to H-2, who again paid value without notice of bankruptcy.

In the above example, a case could have been made to the effect that the postpetition negotiation of the note by the bankrupt would have been valid and the bankruptcy trustee would have had no action against H.²⁹⁶ Furthermore, if there was no action against H, there should have been no action against H-2, who would have taken all of his rights.²⁹⁷

b. The Commission Bill

Section 4-605 of the Commission Bill did not contain any express language that protected transferees of negotiable instruments.²⁹⁸ Transferees receiving estate property were to be immunized from liability if (1) the transfer was made prior to the filing of a notice in those records designed to accord notice to third parties;²⁹⁹ (2) the transferee had no knowledge of the bankruptcy;³⁰⁰ and (3) the transferee paid "reasonably present equivalent value."³⁰¹ If the first two conditions were satisfied but the transferee had paid less than reasonably equivalent value, the transferee was to "nevertheless be reimbursed for the present value given."³⁰²

If, in the example above, H did not know of the bankruptcy, then the payment of \$9,000 for a note due in one year should be considered the giving of reasonably "*present* equivalent value."³⁰³

296. See *supra* text accompanying notes 135-44.

297. Under Article Three of the Uniform Commercial Code's "shelter principle," the "transfer of an instrument vests in the transferee such rights as the transferor has therein . . ." U.C.C. § 3-201(1) (1978).

298. REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. Doc. No. 93-137, Part II, 93d Cong., 1st Sess. 192 (1973).

299. See *id.* at § 4-605(a)(1). For the text of the section, see *supra* note 240.

300. *Id.* at § 4-605(a)(2). For the text of the section, see *supra* note 240.

301. *Id.* at § 4-605(a)(3). For the text of the section, see *supra* note 240.

302. *Id.*

303. Payment of present value for an obligation due in the future must contemplate a reasonable rate of interest. See, e.g., *In re Overstreet*, 23 Bankr. 712, 714 (Bankr. W.D. La. 1982), where the bankruptcy court refused to confirm a Chapter 13 plan which did not meet the section 1325 requirement that a secured creditor be paid the "value, as of the effective

If, however, the transfer came after the filing of the constructive notice, then the transferee would lose to the trustee. The transferee could not have looked to the instrument alone but would have had to undertake a record search as well.

H-2, a subsequent transferee, would have been protected under Commission section 4-609.³⁰⁴ Thus, the trustee's claim would have stopped with H, the first holder. In fact, the Commission justified its decision not to include explicit protection for those relying on negotiable instruments by alluding to the protection given subsequent transferees under section 4-609:

The present Act has a special rule for negotiable instruments and currency. The provision is very confusing and appears unnecessary. Adequate protection is given transferees of postpetition transferees, including those that are holders of negotiable instruments, as a result of recommendations of the Commission relating to subsequent transferees. The net effect of the recommendations is that the first transferee who is a holder in due course may retain the instrument if he gave a reasonably equivalent present value; if he gives less, he is protected *pro tanto*. The second transferee who is a holder in due course is protected, and the equivalency of the value is immaterial. The provision in the present Act placing the burden of proof on the transferee, and presumably a person indebted to the debtor, a depository, or bailee, is dropped. This rule is applicable only to personal property, and it does not seem justifiable to place on the transferee the burden of establishing good faith and reasonably equivalent value.³⁰⁵

It is far from clear why the Commission's decision not to make a special exception for persons taking currency and negotiable instruments was regarded as "unnecessary." The subsequent holders would prevail, even though the initial holder paying full value and acting in good faith, would have lost to the trustee in cases where a notice was on file. The Commission proposal in effect would have required parties dealing with negotiable paper and currency to conduct record searches before taking the paper, something completely alien to the concept of negotiability.³⁰⁶ In addition, a sharp

date of the plan" of the collateral securing the debt. The Chapter 13 debtor's plan provided for no rate of interest in valuing the collateral and therefore failed to meet the section 1325 requirement.

304. See *infra* text accompanying notes 443-62.

305. See REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. Doc. No. 93-137, Part II, 93rd Cong., 1st Sess. 192 (1973).

306. U.C.C. § 3-304(5) provides that "the filing or recording of a document does not of

distinction must be made between negotiable paper and currency. Although it may be true that the protected status of a holder in due course of negotiable paper has eroded considerably,³⁰⁷ nevertheless there has been no movement to undermine the protection given transferees of currency.

c. The 1978 Code

The 1978 code takes the drastic step of totally withdrawing protection for those parties taking notes and currency from the debtor after the filing of a voluntary petition in bankruptcy. The 1978 code does embrace the Commission proposal protecting parties subsequently acquiring the paper,³⁰⁸ but section 549(a)(1), which is discussed above, governed the initial transferee's liability.³⁰⁹ The 1978 code gives no exception from the trustee's pervasive power to set aside postpetition transfers due to the good faith of the transferee.

It is not clear from the legislative history whether the drafters of the 1978 code intentionally chose to withdraw protection for those parties relying upon currency and negotiable instruments.³¹⁰ The Commission considered the negotiability problem and chose to offer only limited protection, i.e. that a notice be filed. The legislative history of the 1978 code makes no reference to negotiable instruments at all, much less does it provide a detailed statement as to why protection was denied and the Commission's proposal rejected. It is possible that the failure to provide protection was a mere oversight. This is conceivable due to the fact that the Commission bill does not expressly mention "negotiable paper" or

itself constitute notice within the provisions of this Article to a person who would otherwise be a holder in due course." See, e.g., *Citizens Valley Bank v. Pacific Materials Co.*, 263 Or. 557, 503 P.2d 491 (1972) (filing of a security interest in accounts receivable does not defeat rights of a holder in due course to enforce a note negotiated to it by the debtor); *National Sec. Fire & Casualty Co. v. Mazzara*, 289 Ala. 542, 268 So. 2d 814 (1972) (recording of real estate deed did not give notice to holder in due course of a check).

307. Federal Trade Commission Rule 433 virtually emasculates the holder-in-due course doctrine in consumer transactions. 16 C.F.R. § 433 (1977); see Garner and Dunham, *FTC Rule 433 and The Uniform Commercial Code: An Analysis of Current Lender Status*, 43 Mo. L. Rev. 199 (1978).

308. The 1978 code provides that "any immediate or mediate good faith transferee" of the initial transferee who initially received estate property from the debtor is protected from an action against him by the trustee. 11 U.S.C. § 550(b)(2) (1982). For further discussion, see *infra* text accompanying notes 473-82.

309. See *supra* text accompanying notes 241-46.

310. A search of the legislative history, principally the joint House and Senate report, reveals no discussion of the negotiability problem. See H.R. REP. No. 595, 95th Cong., 1st Sess., 375 (1977); S. REP. No. 989, 95th Cong., 2d Sess., 90 (1978).

"currency." One can look to the Commission's comments in order to fully understand the Commission's intent regarding the treatment of negotiable instruments and currency. Perhaps the drafters of the code, in preparing section 549, overlooked the comments and the attendant negotiability problem. The motive, or lack of motive, for withdrawing protection is not stated.

5. SECTION 542(c)—THE *Bank of Marin* EXCEPTION

a. Review of the Chandler Act

In the *Marin* case, the Supreme Court held that the depositor's trustee in bankruptcy could not sue a depository bank for the postpetition payment of checks drawn on the bankrupt's account. The payee of the check in question was required to pay back the funds he received.³¹¹

The Supreme Court protected the bank by giving the Chandler Act an "equitable" construction.³¹² The Chandler Act provided protection for certain good-faith parties "holding property of the bankrupt" under section 70d(2).³¹³ Section 70d(2), however, accorded protection in cases where the transfer was made before adjudication. In cases where a voluntary petition was filed (and adjudication was therefore automatic³¹⁴), no protection was available. Hence, an "equitable" construction was needed to reach the desired result.

b. The Commission Proposal

The Commission proposal, entitled "Protection of Debtors and Bailees of the Debtor," read as follows:

A person who is indebted to the debtor or who is holding money or property subject to withdrawal or order of the debtor and who, in good faith and prior to knowledge of the filing of a voluntary petition or an order directing relief pursuant to an involuntary petition, pay (sic) such indebtedness or delivers or transfers property of the debtor is not liable to the trustee if such delivery or transfer would have been authorized but for the filing of the petition.³¹⁵

311. *Marin*, 385 U.S. at 103.

312. *Id.*; see *supra* text accompanying notes 16-25.

313. Chandler Act, ch. 575, § 70d(2), 52 Stat. 840, 881 (1938); see *supra* text accompanying notes 131-34.

314. See Act of June 23, 1959, Pub. L. No. 86-64, § 1, 73 Stat. 109.

315. REPORT OF COMMISSION OF THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R.

This section was to apply³¹⁶ after the "order for relief" and therefore was to have a different application than section 70d(2).³¹⁸ The Commission recognized that undoubtedly the Supreme Court would have invalidated any attempt to limit protection to transfers before entry of the order of relief.³¹⁷ Therefore, the Commission reasoned that transfers made by banks and bailees after the order of relief, but without knowledge of the petition, should be valid.

Under the Commission proposal, knowledge of the filing of an involuntary petition would not have subjected the bank to liability. Only knowledge that a voluntary petition had been filed or that the order for relief in an involuntary case had been entered would have subjected the bank to liability. The Commission also recommended that protection be extended to other parties in addition to banks. If the holding in *Marin* has any merit, the scope of protection should apply not only in favor of banks but also to other debtors and bailees of the bankrupt. It certainly would be difficult to defend a decision that limited protection only to banks because it is known that bailees and other debtors are in similar positions.

The Commission's proposal did not protect the actual transferee. For example, assume that farmer-bankrupt procured a negotiable warehouse receipt by delivering grain to a warehouse. The bankruptcy trustee then filed a constructive notice, and the farmer made a postpetition transfer of the receipt to transferee "T." T in turn, presented the receipt to the warehouse, which gave T the grain.

In the above example, the warehouse would have been protected under the Commission proposal,³¹⁸ but the trustee would have been able to recover against T.³¹⁹ This mirrors the result reached in *Marin*. In *Marin*, the drawee who honored checks presented for collection by the payees was protected; the payees,

Doc. No. 93-137, Part II, 93d Cong., 1st Sess. 162 (1973).

316. "Section 70d(2) protects a debtor of the bankrupt, e.g. a bank, insurance company, or a bailee of his property who pays indebtedness or delivers property in good faith, but only with respect to payments and deliveries *prior to adjudication*." *Id.* at 165.

317. "Despite the language in § 70d, the Supreme Court has extended protection to a drawee bank after adjudication. *Bank of Marin, v. England*, 385 U.S. 99 (1966)." *Id.*

318. It seems clear that the warehouse was "holding money or property subject to withdrawal or order of the debtor" and it paid "in good faith prior to knowledge of the filing of a voluntary petition." *Id.* at 163.

319. The transfer of the receipt would have fallen under Commission section 4-605(a). T would have been protected only if: 1) a public notice of bankruptcy had been filed; 2) T did not know of the filing of the petition; and 3) T gave "reasonably equivalent value." *Id.* at 162. For a complete text of the section and accompanying discussion, see *supra* notes 236-40 and accompanying text.

however, were not.³²⁰

c. Section 542(c)

Section 542(c) reads:

[A]n entity that has neither actual notice nor actual knowledge of the commencement of the case concerning the debtor may transfer property of the estate, or pay a debt owing to the debtor, in good faith . . . to an entity other than the trustee, with the same effect as to the entity making such transfer or payment as if the case under this title concerning the debtor had not been commenced.³²¹

Section 542(c)'s language appears to broaden the number of parties that are protected, at least more are protected than under the Commission proposal. The code speaks in terms of "entities" which "pay debts" or "transfer property of the estate." This language is certainly broad enough to include banks³²² and bailees³²³ of the debtor's property.

The section protects only those parties holding "property" of the estate. One case has held that the section does not cover a governmental unit's transfer of a tax *claim*. A transfer of a *claim* against the estate was held not to be the same as *property* of the

320. *Marin*, 385 U.S. at 102-03.

321. 11 U.S.C. § 542(c) (1982).

322. See *Paralelo 42 Corp. v. First Nat'l Bank (In re Paralelo 42 Corp.)*, 18 Bankr. 433 (Bankr. S.D. Fla. 1982). In *Paralelo*, a debtor in possession had opened two bank accounts with a bank. One account had been closed prior to the filing of the petition. Nevertheless, thirteen checks drawn on the closed account before the filing of the petition were honored after the filing by the bank on the account that was still open. The bankruptcy court held that, under the terms of the deposit contract, Florida law permitted the bank to honor checks drawn on one account from funds in a separate account. Given the fact that the bank had no knowledge of the filing of bankruptcy, the court held that the bank was protected under section 542(c) as well.

Although the facts of the *Paralelo* case are somewhat unusual, the court correctly applied section 542(c). The bank was, in fact 1) an entity transferring property of the estate; 2) with no notice or knowledge of the filing of bankruptcy; and 3) acting in good faith. The thrust of the section is to permit banks to continue their usual banking practices until actual notice of bankruptcy. Assuming that the court correctly interpreted Florida law to the effect that there was nothing irregular about honoring checks drawn on one account from another account, the decision seems to support the goal of section 542(c). An opposite holding would have thwarted the bank's usual banking practice.

323. See, e.g., *Larimore v. United States (In re Russell)*, 34 Bankr. 49 (Bankr. M.D. Fla. 1983) (indicating that section 542(c) could protect the I.R.S.'s return of an overpayment to the debtors). Unfortunately for the I.R.S., however, the debtors had notified the I.R.S. in writing of their bankruptcy, thereby giving the I.R.S. actual knowledge of bankruptcy and taking it out of section 542(c)'s protection. The I.R.S.'s claim that it was entitled to *formal* notice of the bankruptcy proceeding underwhelmed the court.

estate.³²⁴

Section 542(c) should not insulate parties who take estate property after the petition. Only parties *holding* estate property at the time of the petition are protected. Recently, the First Circuit Court of Appeals appeared to hold that section 542(c) also protects postpetition transferees of estate property.

In *In re Smith Corset Shops, Inc.*,³²⁵ the First Circuit applied section 542(c) in a way that gave a postpetition transferee a defense against a debtor-in-possession's conversion claim. In that case, a tenant filed bankruptcy seeking relief under the reorganization provisions of Chapter 11 of the 1978 code. Subsequent to the petition, the debtor's landlord, who had no knowledge of the bankruptcy, entered the premises and removed estate property pursuant to a state statute allowing seizures in distress for nonpayment of rent. The debtor sued the landlord for conversion and demanded that the property be returned. The landlord indicated that he would return the goods if the conversion suit was dismissed, while at the same time he notified the bailee, to whom the landlord had delivered the goods, to release them to the debtor. The debtor contended that this refusal to unconditionally return the property constituted a conversion.

The First Circuit drew an analogy between the landlord and the Bank of Marin and held that the landlord had a defense to the conversion suit under section 542(c). Moreover, the court determined that the policy enunciated in section 542(c) provided a defense, even though the landlord failed to unconditionally release estate property after it learned of the petition. The court seemed to be impressed with the landlord's good faith, so much so that it notified the bailee of the goods to release them to the debtor. In response to the insistence that the conversion suit be dropped, the court stated that the landlord's attempt "to secure the termination of the conversion action contemporaneously with release of the goods was (not) sufficiently serious interference with the owner's control to constitute a conversion"³²⁶

Whatever one thinks of the First Circuit's use of the *Marin* precedent, it should be emphasized that there was no finding in the case that the landlord was able to keep the property. One would assume that the property was eventually returned. Regretta-

324. *Young v. Critton (In re Young)*, 14 Bankr. 809 (Bankr. N.D. Ill. 1981).

325. 696 F.2d 971 (1st Cir. 1982).

326. *Id.* at 978.

bly, the debtor's attorney stated in a letter that the debtor had in fact never recovered the property.³²⁷ The original taking of the goods was in violation of section 549(a)(1). At a minimum, the landlord had a duty to return the property. Section 542(c) should not be construed to reach a different result.

The 1978 code expressly rejects the assertion that the transferee is immune from liability. Sections 549(a)(1) and 549(a)(2)(A) make clear that the recipient of the section 542(c) transfer is liable to the estate:

[T]he trustee may avoid a transfer of property of the estate—
(1) that occurs after the commencement of the case; and (2) (A)
that is authorized under section 542(c) of this title.³²⁸

Recall the example where a warehouse honored a warehouse receipt given to the warehouse without knowledge of bankruptcy and transferred grain that was the subject of the receipt to its holder. The warehouse would not be liable for conversion—section 542(c)—but the holder could be sued on a postpetition transfer under section 549(a)(1) and 549(a)(2)(A). Under section 549(a)(1) and (2), the trustee may avoid even those transfers authorized by section 542(c). Section 542(c) only immunizes from liability banks and other bailees who are the transferors of property. No immunity is given to the transferee.

The case of *In re Shepherd*³²⁹ illustrates this relationship between section 542(c) and section 549. In *Shepherd*, the debtor had authorized his employer to deduct funds from his salary and pay those funds over to his credit union in order to reduce an outstanding indebtedness. These deductions continued after the filing of a bankruptcy petition. Both the employer and the creditor were unaware of the filing of bankruptcy.

The bankruptcy judge ruled that section 542(c) protected the employer, while the estate could recapture the transferred funds from the credit union under section 549. The employer was clearly a debtor of the bankrupt and therefore qualified for protection under section 542(c). Although the transfer of funds to the credit union was authorized under section 542(c), the estate under section 549(a)(1)(2)(A), could set aside transfers authorized under section 542(c).

327. Letter from Marshall F. Newnar, Esq. to Darrell Dunham, June 7, 1983.

328. 11 U.S.C. § 549(a) (1982) (amended 1984).

329. 12 Bankr. 151 (Bankr. E.D. Pa. 1981).

d. Section 542(d)

The insurance industry was apparently not satisfied with the general protection afforded debtors and bailees of the bankrupt under section 542(c). In certain cases, life insurance contracts or state statutes require insurance companies to make a premium payment or an automatic loan from the loan value of the policy in order to prevent forfeiture due to a failure to make premium payments.³³⁰ As an example, assume a debtor misses a premium payment on his life insurance contract. Assume further that the policy has an outstanding loan value that exceeds the amount of the missed premium. This situation would place the policy in danger of being forfeited. Some policies and statutes require the insurance company to automatically loan the debtor funds from the policy's loan value in order to make the premium payment and save the policy from forfeiture.³³¹ If such a loan is made after a bankruptcy filing in order to keep the policy current, is the insurance company protected?³³²

330. These automatic loan requirements may be created by contract or by statute. *See, e.g., Haut v. Franklin Life Ins. Co.*, 430 Pa. 230, 241 A.2d 440 (1968) (cases construing an automatic loan provision in the policy); *Prudential Ins. Co. v. Tennen*, 383 So. 2d 735 (Fla. 3d DCA 1980); *Security Mut. Life Ins. Co. v. Arenstein*, 26 N.Y.2d 379, 258 N.E.2d 908, 310 N.Y.S.2d 491 (1970); *see also Meyers v. State Farm Life Ins. Co.*, 416 S.W.2d 10, 18 (Mo. Ct. App. 1967) (construing Missouri's non-forfeiture insurance statutes); Mo. REV. STAT. §§ 376.630, 376.660 (1959). *See generally* COUCH ON INSURANCE 2D, §§ 32:157, 32:170 (1961).

331. *Id.*

332. In some cases, of course, the loan value or cash surrender value may be exempt from the trustee's claim. Debtors may exempt insurance policies that are exempt under "state law." *See* 11 U.S.C. § 522(b)(2)(A) (1978). Although most state law insurance exemptions are expansive in coverage, usually a blanket exemption is not available. Vukowich, *Debtors' Exemption Rights Under the Bankruptcy Reform Act*, 58 N.C.L. REV. 769, 785-86 (1980). The Illinois exemption, for example, does not cover policies where the debtor's estate is the beneficiary or cases where a non-spouse of independent means is the beneficiary. *See Schriar v. Mose (In re Schriar)*, 284 F.2d 471 (7th Cir. 1960); ILL. REV. STAT. ch. 110, § 12-1001(f) (1982). In addition to the state law exemptions, the drafters of the bankruptcy code enacted a comprehensive list of federal exemptions that debtors can elect as an alternative to the nonbankruptcy exemptions. *See* 11 U.S.C. § 522(d) (1982). In particular, section 522(d)(8) provides that the debtor may exempt:

(8) The debtor's aggregate interest, not to exceed in value \$4,000 less any amount of property of the estate transferred in the manner specified in section 542(d) of this title, in any accrued dividend or interest under, or loan value of, any unmaturing life insurance contract owned by the debtor under which the insured is the debtor or an individual or whom the debtor is a dependent.

11 U.S.C. § 522(d)(8) (1982) (emphasis added). Thus, if an automatic premium payment protected by section 542(d) is made, the debtors insurance exemption is reduced by the amount of the automatic loan.

The reader should also note that Congress empowered state legislatures to enact legislation preventing debtors domiciled in that state from electing the federal bankruptcy exemp-

The 1978 code section 542(d) provides:

(d) A life insurance company may transfer property of the estate or property of the debtor to such company in good faith, with the same effect with respect to such company as if the case under this title concerning the debtor had not been commenced, if such transfer is to pay a premium or to carry out a nonforfeiture insurance option, and is required to be made automatically, under a life insurance contract with such company that was entered into before the date of the filing of the petition and that is property of the estate.³³³

Due to its component parts, the statute is limited in its effect. First, only a "life insurance company" can be protected. Second, it must be acting in "good faith." Third, the transfer must be made to "pay a premium or to carry out a nonforfeiture option." Fourth, the insurance company must be required to "automatically" make the payment. Finally, the life insurance policy must be the "property of the estate" and must have been "entered into before the date of the filing of the petition."

One wonders why the insurance industry felt that it needed the protection of section 542(d) at all. Cases such as *Frederick v. Fidelity Life Insurance Co.*,³³⁴ for example, would fall within the protection of section 542(c). In *Frederick*, the life insurance company made a postpetition transfer of the cash surrender value of a life insurance contract to the debtor after bankruptcy was filed. The Supreme Court held, given the company's lack of knowledge of bankruptcy, the company should be protected from suit. A *Frederick*-type case falls squarely within section 542(c). The company was a "debtor" of the bankrupt and would be paying the cash surrender value in "good faith."

Typically, the legislative history³³⁵ and other commentary³³⁶ is silent as to the need for a separate section. But two distinctions do

tions. 11 U.S.C. § 522(b)(1) (1978). The constitutionality of state "opt out" legislation has been questioned, but to date no court has ruled that the opt out provision is unconstitutional. See, e.g., *In re Sullivan*, 680 F.2d 1131 (7th Cir. 1982); *Rubenstein v. Sachs (In re Locarno)*, 23 Bankr. 622 (Bankr. D. Md. 1982); Koffler, *The Bankruptcy Clause and Exemption Laws: A Re-examination of the Doctrine of Geographic Uniformity*, 58 N.Y.U. L. REV. 22 (1983); Comment, *Bankruptcy Exemptions: Whether Illinois's Use of the Federal 'Opt Out' Provision is Constitutional*, 1981 So. ILL. L.J. 65.

333. 11 U.S.C. § 542(d) (1982).

334. 256 U.S. 395 (1921); see *supra* text accompanying notes 83-86.

335. H.R. REP. No. 595, 95th Cong., 1st Sess. 369-70 (1977); S. REP. No. 989, 95th Cong., 2d Sess. 84 (1978).

336. E.g., 4 COLLIER ON BANKRUPTCY § 542-15 (15th ed. 1982).

exist in the forced premium loan case which may explain the insurance industry's paranoia. First, in the technical sense, an insurance company making a policy loan is not a "debtor" of the owner until an election is affirmatively made to take the loan. Some cases applying state judicial enforcement statutes have held that there is no indebtedness until the owner elects to borrow against the policy or to cash it in.³³⁷ To be protected under section 542(c), the company must be a "debtor" of the bankrupt.

The second distinction is more convincing. The forced premium transaction is essentially a bookkeeping transfer of funds within the insurance company itself. The books are changed to reflect that the premium has been paid and the loan values are reduced. A perceptive bankruptcy trustee might be tempted to argue that the insurance company is nevertheless a "transferee" of the funds. Thus, section 549 would permit the trustee to set aside "transfers" that are nevertheless authorized under section 542(c). Recall that under section 549(a)(1)(2)(A) the trustee may set aside even those "transfers" that are authorized under section 542(c).³³⁸ The trustee has no authority to set aside transfers authorized under section 542(d). This argument would have placed the bankruptcy court in a statutory quagmire, requiring the court to choose between the policy of section 542(c) and that of section 549, a case the insurance industry may have wished to avoid. Thus, the industry may have insisted that a separate section 542(d) be created.

6. REAL PROPERTY TRANSACTIONS

a. Review of the Chandler Act

The law on real property transactions evolved quite differently from personal property transactions. Case law prior to 1938 generally protected bona fide purchasers of realty who made the purchase after the filing of bankruptcy,³³⁹ and this case law was codified into the Chandler Act.³⁴⁰ The Chandler Amendment did, however, require purchasers to check an additional record before purchasing realty. If the realty was located in the county where a petition in bankruptcy was filed, the filing of such a petition gave

337. *E.g.*, *Morphet v. Morphet*, 19 Ill. App. 2d 304, 152 N.E.2d 492 (1958) (garnishment); *Fidelity Coal Co. v. Diamond*, 322 Ill. App. 229, 54 N.E.2d 240 (1944) (creditor's bill).

338. *See supra* text accompanying notes 328-29.

339. *See supra* note 87.

340. Chandler Act, ch. 575, § 21g, 52 Stat. 840, 853 (1938). For the complete text of the section, *see supra* note 148.

constructive notice to purchasers of real property.³⁴¹ Thus, purchasers in those particular counties had to check, in addition to state records, bankruptcy filings in the federal courthouse.

b. The Commission Bill

The Commission bill did not propose separate treatment for different types of transferees. All were to be treated the same whether they were transferees of tangible or intangible personality, transferees of negotiable paper or currency, or transferees of realty.

The real property transferees, like the others, were to be protected if: 1) the transfer occurred before the filing of a notice; 2) the transferee was unaware of the bankruptcy filing; and 3) "the transferee gave a reasonably equivalent present value."³⁴² Even if less than "reasonably equivalent value" was given, the transferees were to be "reimbursed for the present value given,"³⁴³ assuming that the transfers occurred before the filing of a notice and were made without notice of bankruptcy.

As to realty, the Commission bill indicated that notice was to be filed "in the office or offices designated by *state law* for the filing or recording of a document in order to perfect a security interest in . . . real property, or fixtures."³⁴⁴ Thus, the Commission proposal was a reaffirmation of the prior law that bona fide purchasers should prevail against the trustee even if the transfer took place after the filing of a bankruptcy petition.

There is one salient change; the filing of a petition would act as constructive notice to purchasers of realty located in the county where the petition was filed. The statute required filing as provided under "state law." If the Commission bill had been passed, those who searched for records of realty transactions could have limited their search to state records only.³⁴⁵

c. The House Bill and the Senate Bill

Unlike the treatment of other postpetition issues, the House bill³⁴⁶ and Senate bill³⁴⁷ introduced in 1977 contained significant

341. *Id.*; see *In re Kabbage*, 93 F. Supp. 515 (N.D. Ohio 1950).

342. *Supra* note 298, at 162. For a complete text of the section, see *supra* note 240.

343. *Id.*

344. *Id.* at § 4-605(c)(1) (emphasis added).

345. Unless, of course, the mere rendition of a judgment operates as a lien in which case record searchers must search for federal court judgments as well. See *infra* note 375.

346. H.R. 8200, 95th Cong., 1st Sess. (1977).

347. S. 2266, 95th Cong., 1st Sess. (1977).

variations from the final product.

House bill section 342 (b) read:

(b) The filing of a copy of the petition in a case under this title in the office where conveyances of real property are recorded in a county in which is located real property in which the estate has an interest is constructive notice of the commencement of such case with respect to transfers of real property located in such county. A judicial sale of real property in which the estate has an interest, located other than in the county in which such case is commenced, is not affected by the commencement of such case unless such constructive notice has been given as provided in this subsection in the county in which such real property is located.³⁴⁸

Senate bill section 342(b), (c) read:

(b) The filing of a copy of the petition in a case under this title in the office where conveyances of real property are recorded in a county in which is located real property in which the estate has an interest is constructive notice of the commencement of such case with respect to transfers of real property located in such county. A sale of real property to a purchaser without either actual or constructive notice of the commencement of the case is not affected by this title.

(c) A judicial sale of real property in which the estate has an interest, located other than in the county in which such case is commenced, is not affected by the commencement of such case unless such constructive notice has been given as provided in this subsection in the county in which such real property is located.³⁴⁹

Both bills indicated that a filing in the county where the real estate was located provided constructive notice. A bankruptcy filing in the county where the realty was located would not have amounted to constructive notice under the Commission proposal.³⁵⁰ Prior law specifically required title searches in the county where the bankruptcy court was located in order to check the bankruptcy filing.³⁵¹

The approach suggested by the Senate and House also raised two additional questions. First, would actual knowledge of a bank-

348. H.R. 8200, 95th Cong., 1st Sess. 39-40 (1977).

349. S. 2266, 95th Cong., 1st Sess. 38-39 (1977).

350. See *supra* text accompanying notes 344-45.

351. See *supra* text accompanying notes 154-55.

ruptcy filing by a private purchaser of realty bar that purchaser from protection? The House bill was silent on this question, but the Senate bill affirmatively stated that sales would not be valid in favor of purchasers having "actual or *constructive* notice of the commencement of the case."

The second issue was even more perplexing: would actual notice of the commencement of a bankruptcy case defeat the title of a *judicial* purchaser? Both bills appeared to indicate that actual knowledge would not have defeated the rights of the judicial purchaser, only the filing of a notice giving constructive knowledge would have defeated that purchaser's rights. The bills, in identical language, provided that the judicial sale was valid "unless . . . constructive notice has been given."³⁵² Given the Senate bill's provision that actual notice would defeat the purchaser of realty whose claim to the property was from a private sale, the inference was inescapable that the Senate and House intended that actual knowledge of the commencement of a case would not have defeated a judicial sale purchaser. Neither bill affirmatively stated that actual notice would defeat the judicial purchaser, unlike the Senate bill, which did so in the case of a private purchaser.

The distinction between purchasers of realty from judicial and private sales is based on the dubious rationale of a need to protect the integrity of judicial sales and to encourage high bids in this arena. This disparate treatment is discussed below.³⁵³

d. Section 549(c) of the 1978 Code

The 1978 code's treatment of real property transactions marked a return to the format and policy of the Chandler Act. A separate section for real property transactions was created. Similarly, bankruptcy filings still gave rise to constructive notice for purchasers of real property, when such property was located in the county where the bankruptcy petition was filed. Section 549(c) of the 1978 code read:

The trustee may not avoid under subsection (a) of this section a transfer, to a good faith purchaser without knowledge of the commencement of the case and for present fair equivalent value or to a purchaser at a judicial sale, of real property located

352. H.R. 8200, 95th Cong., 1st Sess. (1977); S. 2266, 95th Cong., 1st Sess. (1977).

353. See Rochelle, III & Feder, *Unauthorized Sales of a Debtor's Property: The Rights of a Purchaser Under Section 549 of the Bankruptcy Code*, 57 AM. BANKR. L.J. 23, 34 (1983), discussed *infra* text accompanying notes 368-71.

other than in the county in which the case is commenced, unless a copy of the petition was filed in the office where conveyances of real property in such county are recorded before such transfer was so far perfected that a bona fide purchaser of such property against whom applicable law permits such transfer to be perfected cannot acquire an interest that is superior to the interest of such good faith or judicial sale purchaser. A good faith purchaser, without knowledge of the commencement of the case and for less than present fair equivalent value, of real property located other than in the county in which the case is commenced, under a transfer that the trustee may avoid under this section, has a lien on the property transferred to the extent of any present value given, unless a copy of the petition was so filed before such transfer was so perfected.³⁵⁴

Under the 1978 code, section 549 provided that the trustee under section 549 could not avoid transfers of real property made "to a good faith purchaser without knowledge of the commencement of the case" where "present equivalent value" had been paid. The trustee could set aside real estate transfers if a copy of the petition was filed in the appropriate records for real estate. As was true under the Commission bill, good faith transferees paying less than "present equivalent value" were provided a lien³⁵⁵ on the property to the extent of the value given.

The protection given the good faith transferee extended only to "real property located other than in the county in which the case is commenced." Record searchers in counties where bankruptcy petitions were filed had to continue to check the bankruptcy filings before title was approved.³⁵⁶ The reason for rejecting the provisions of both the House and Senate bills in this regard was not stated.

The issues discussed above were clear-cut and basically old hat. In addition, however, note that the drafters of the 1978 code also chose to extend protection to a new type of transferee. Section 549(c), in addition to the good faith purchaser, also protected "a

354. 11 U.S.C. § 549(c) (1982) (amended 1984).

355. The Commission proposal suggested that transferees that give less than full value be "reimbursed" to the extent of value given. See *supra* note 240 for the complete text of the section. The 1978 code expressly provides for a "lien." In both instances, however, the effect should be the giving of a lien on the property. See *supra* note 290.

356. See *Mongiove v. Browne* (*In re Mongiove*), 9 Bankr. 34 (Bankr. S.D. Fla. 1980) (holding that due to the fact that the debtor's Chapter 13 petition was filed in the county where purchased real property was located, section 549(c) does not protect a judicial sale purchaser).

purchaser at a judicial sale." In this respect the 1978 version of section 549(c) carried forward the suggestion of the House and Senate bills. Allowing protection for judicial purchasers caused problems for the bankruptcy courts which has apparently caused Congress to rethink its position.³⁵⁷

A typical fact pattern that has confronted bankruptcy courts can be described as follows: Secured party commences foreclosure proceedings. Sometime prior to the judicial purchaser's receipt of a judicial deed, the debtor files bankruptcy in order to secure the benefits of the automatic stay provisions set out in section 362³⁵⁸ of the 1978 code. The secured party (who may³⁵⁹ or may not be³⁶⁰ aware of the bankruptcy filing) presses forward with the foreclosure, and the purchaser pays good value for the property while being completely unaware of the filing of bankruptcy.³⁶¹

Some courts correctly relied upon section 549(c)'s unambiguous language and ruled that the purchaser prevailed.³⁶² Problems

357. See *infra* text accompanying notes 372-81 (discussing Senate Bill 445).

358. 11 U.S.C. § 362(a) (1982). Specifically, section 362(a)(1) stays enforcement of judicial proceedings against the debtor. Section (a)(2) stays the enforcement of judgments, section (a)(3) stays acts to obtain possession of estate property, and section (a)(4) stays actions to enforce liens.

359. *E.g.*, *Russell v. Equibank (In re Russell)*, 8 Bankr. 342 (Bankr. W.D. Pa. 1980); *In re Wheeler*, 5 Bankr. 600 (Bankr. N.D. Ga. 1980); see also *In re Wilson*, 19 Bankr. 45 (Bankr. E.D. Pa. 1982) (holding the sheriff in contempt of court for issuing a deed to the property, where the unfortunate sheriff had relied upon the legal opinion of the secured party's attorney that he might issue the deed and not violate the bankruptcy laws).

360. *Federal Nat'l Mortgage Ass'n v. McGowan (In re McGowan)*, 19 Bankr. 952 (Bankr. E.D. Pa. 1982); *Advance Mortgage Corp. v. Dennis (In re Dennis)*, 14 Bankr. 125 (Bankr. E.D. Pa. 1981).

361. *Cf. Lugo v. De Jesus (In re De Jesus)*, 20 Bankr. 19 (Bankr. D.P.R. 1982) (holding that a judicial purchaser who had been orally informed of the bankruptcy prior to the sale was not protected under section 549(c)). The holding in *De Jesus* is questionable. The judicial purchaser's knowledge of bankruptcy does not deprive him of protection. See *infra* text accompanying notes 368-71.

362. *E.g.*, *Stone Mountain Acceptance Corp. v. Colevins (In re Colevins)*, 13 Bankr. 645 (Bankr. N.D. Ga. 1981) (holding that a judicial purchaser who was unaware of the bankruptcy filing prevails over the debtor); *cf. Federal Nat'l Mortgage Ass'n v. McGowan (In re McGowan)*, 19 Bankr. 952 (Bankr. E.D. Pa. 1982). In *McGowan*, the mortgagee bid in its debt at the foreclosure sale. The court held, without discussion, that the mortgagee qualified for "judicial purchaser" protection under section 549(c). A distinction should be made between cases like *Colevins* and cases like *McGowan*. The purchaser in *Colevins* gave new value and is more deserving of protection. The mortgagee in *McGowan* simply substituted an antecedent debt for title to the property. See *In re Penfil*, 40 Bankr. 474, 477 (Bankr. E.D. Mich. 1984) (holding that a mortgage bidding in the amount of the debt did not pay "present fair equivalent value"). Secured parties can be amply protected by reinstating their security on the property and requiring that they be "adequately protected" as required by section 362(d)(1). See 11 U.S.C. § 362(d)(1) (1978). See generally *Price, Adequate Protection Under the Bankruptcy Act of 1978*, 71 Ky. L. J. 727 (1982-83). The need for a distinc-

arose, however, when the sheriff or secured party learned of the bankruptcy and refused to tender a deed to a purchaser who had nevertheless paid good value. In the meantime, the trustee recorded a copy of the petition in the state records. The statute plainly indicated that a purchase from a judicial sale was not protected if a bona fide purchaser could have acquired "an interest that is superior to the interest of [the] . . . judicial sale purchaser"³⁶³ as of the commencement of the case.

The case of *In re Russell*³⁶⁴ demonstrates the problems section

tion is even more compelling in cases where the property sold at judicial sale is necessary to successfully reorganize the debtor in a Chapter 11 or Chapter 13 case. The mortgagee should not be able to defeat the reorganization plan by buying the property at its own foreclosure sale.

A third group of cases may occur where the creditor buys the property and assigns its rights to a third party. In *Administrator of Veterans Affairs v. Bernard (In re Bernard)*, 9 BANKR. CT. DEC. (CRR) 601, 21 Bankr. 287 (Bankr. E.D. Pa. 1982), a judgment creditor bid-in its judgment at execution sale and then assigned its bid to the Veteran's Administration. The court held that the VA was entitled to the protection of section 549(c). Because the VA was merely the assignee of the creditor's bid, it would seem that the VA ordinarily would be in no better a position than the creditor. Thus, because the creditor should not be protected as a "judicial purchaser," for it merely bid-in its old debt, the VA, arguably, should not have been protected either. It does seem, however, that the VA, as a "subsequent transferee" would be entitled to the more limited benefits of section 550(b), which immunizes subsequent transferees of estate property from the trustee's avoidance powers. For further discussion concerning section 550(b), see *infra* text accompanying notes 473-82.

363. 11 U.S.C. § 549(c) (1982) (amended 1984). For a text of the section, see *supra* text accompanying note 354; see also *Advance Mortgage Corp. v. Dennis (In re Dennis)*, 14 Bankr. 125 (Bankr. E.D. Pa. 1981), (The court held that the purchaser is not protected under section 549(c) because a hypothetical bona fide purchaser under Pennsylvania law could have defeated the purchaser's interest. The purchaser had not received a deed to the property pursuant to the judicial sale, and the court ruled that the delivery of a properly acknowledged deed was necessary to protect the purchaser against a subsequent bona fide purchaser.).

Cf. In re Wheeler, 5 Bankr. 600 (Bankr. N.D. Ga. 1980) (holding that a purchaser at a judicial sale who had received a deed prior to actual knowledge of a bankruptcy filing was not protected). The court reasoned that at the time of the filing of the petition the deed had not been delivered; and therefore, the subsequent delivery was void in violation of the automatic stay. 11 U.S.C. § 362 (1982). "That is, there was, at the time that the automatic stay went into effect, property of the estate in the real estate in question." *Wheeler*, 5 Bankr. at 604. The court apparently overlooked the provision in the statute that required that the rights of the judicial purchaser be tested against a hypothetical bona fide purchaser at the time "a copy of the petition was filed in the office where conveyances . . . in such county are recorded." 11 U.S.C. 549(c) (1982) (amended 1984). In *Wheeler*, the purchaser received a deed barely an hour after the filing of the petition. At that time, a copy of the petition probably had not been filed in the county. The result in the *Wheeler* case could have been achieved without ignoring the provisions of the statute by noting that the secured party itself was the "purchaser" at the judicial sale. It is questionable that a secured party bidding-in the value of its debt should be protected under section 549(c) in the same way that a purchaser giving new value is. See *supra* discussion note 362.

364. *Russell v. Equibank (In re Russell)*, 8 Bankr. 342 (Bankr. W.D. Pa. 1980).

549(c) posed in cases of judicial foreclosure. In that case, a secured party pressed forward with a mortgage foreclosure despite knowledge that the debtors had filed a bankruptcy petition. Calisti purchased the property at the foreclosure sale for approximately one-twentieth of the debtor's original purchase price.³⁶⁵ Nevertheless, Calisti, unlike the mortgagee, was unaware of the bankruptcy filing. Before a sheriff's deed could be issued, the bankruptcy court issued a rule to show cause why the sale could not be set aside.

The court held for the debtors and ruled that Calisti was not protected by section 549(c). While the court conceded that, under state law, Calisti had acquired an interest in real property, that interest was not "so far perfected" that it could not have been defeated by a bona fide purchaser who made the purchase as of the commencement of the case as required by the statute. Calisti had not yet received a deed, and therefore his interest was in jeopardy. Thus, Calisti's rights were subordinated to those of the debtors in possession. The court's reasoning on this point is helpful in understanding the problem:

Accordingly, the innocent purchaser is not entitled to the protection of section 549(c). The Court is prevented under the Bankruptcy Code in cases involving postpetition transfers from assessing the relative equities of the parties. Section 549(c) outlines a method that arbitrarily chooses between the interests of the innocent purchaser and the creditors of the debtor. The debtor-in-possession, who is accorded the status of a bona fide purchaser, takes priority over a purchaser at a judicial sale, if the debtor-in-possession intervenes to vacate the sale prior to the purchaser's compliance with the technical requirements of state law. 11 U.S.C. § 549(c) (amended July 10, 1984).³⁶⁶

In the *Russell* case, Calisti was not even permitted to recover his purchase price. Moreover, it appears that this was a correct interpretation of section 549(c). Although the last sentence of that section provided for a lien "to the extent of any present value given," the lien was given only to "good faith purchasers," not to judicial purchasers.

The *Russell* case also illustrated a gross inconsistency within the Bankruptcy Code itself. In deciding to proceed with the foreclosure sale, the secured party violated the Bankruptcy Code's au-

365. The debtors had purchased the property for approximately \$77,000 in 1977. Calisti was the high bidder for \$3,200 at sale held on April 7, 1980. *Id.* at 343.

366. *Id.* at 345.

tomatic stay provisions. Actions taken in violation of the stay are "void."³⁶⁷ Yet, section 549(c) provided that judicial purchasers were given title to property purchased under a proceeding that was void.

Section 549(c) of the 1978 code carried forward the original 1977 Senate proposal³⁶⁸ that actual knowledge by a judicial purchaser of a bankruptcy filing would not defeat his title. Furthermore, a literal reading of the statute indicated that a purchaser having such knowledge needed only to pay a fraction of the true value of the property and would still be protected. Section 549(c) protected: 1) "a good faith purchaser without knowledge of the commencement of the case" who paid "present fair equivalent value" and 2) a "purchaser at a judicial sale." The requirements that the purchase be made in good faith or that he pay value were not imposed on the judicial purchaser. Thus, one court in dictum observed that "it does not appear from a reading of section 549(c) that knowledge of the filing of a bankruptcy case is a consideration where the purchase is made in a judicial sale."³⁶⁹ Nor did it appear that he had to pay any significant value. It only appeared that he had to be a "purchaser," whatever that entailed.

However bizarre this result may appear to be, recall that it is precisely the result proposed by the Senate in 1977. Thus, a purchaser at a judicial sale paying only a fractional value should have been protected under the 1978 section because this was precisely the result that Congress intended.

The wisdom of making any distinction between the judicial and non-judicial purchaser was based on a desire to protect the integrity of judicial sales. Rumors abound at such sales and the attendant fears that people will not bid. Mr. William Rochelle and Ms. Gwen Feder observed:

If the rule were otherwise, bidding at judicial sales would be chilled any time there was a rumor that the owner of the property had filed a petition. Rumors about bankruptcy must be taken seriously because petitions are often filed on the eve of a foreclosure sale. If the bidding were chilled and the rumor

367. See generally *Borg-Warner Acceptance Corp. v. Hall*, 685 F.2d 1306, 1308 (11th Cir. 1982) (actions taken in violation of automatic stay are void and without effect); *In re Johnson*, 18 Bankr. 755 (Bankr. S.D. Ohio 1982) (creditor's lack of "official" notification from court of debtors' Chapter 7 case was no defense to finding that a violation of automatic stay occurred); 2 COLLIER ON BANKRUPTCY § 362.11 (15th ed. 1983).

368. See *supra* text accompanying notes 346-53.

369. *In re Edwards*, 2 BANKR. CT. DEC. 2D (CRR) 1027 (Bankr. W.D. La. 1980).

proved false, whoever purchased the property would enjoy a windfall at the expense of the foreclosing mortgagee, the owner, and the prospective bidders who had dropped out as a consequence of the rumor. Indeed, to purchase the property at a bargain price, an unscrupulous bidder at a foreclosure sale could spread a false rumor that the property owner had filed a petition.³⁷⁰

There is a basic flaw in their analysis. It assumes that such purchasers are currently protected. *Caveat emptor*, however, governs judicial sales, as the purchaser routinely assumes the risk of failure of title or sale irregularity.³⁷¹ There is wisdom in this lack of protection. Until non-bankruptcy law changes in this regard, there is little need for protection where failure of title is due to a filing of bankruptcy. This is especially true when the trustee can establish that the purchaser had *actual* knowledge of the filing. Even less sympathy can be mustered for a purchaser who not only has knowledge of the bankruptcy filing, but based on this knowledge, bids only a fraction of the property's actual worth.

e. The 1984 Amendment

On February 3, 1983, a bill was introduced in the Senate entitled the "Omnibus Bankruptcy Improvements Act of 1983."³⁷² Most of the amendments are technical in nature,³⁷³ but there are also occasional changes in the substantive import of particular sections. In fact, a substantial amendment has been made to section 549(c). As amended July 10, 1985, section 549(c) reads:

(c) The trustee may not avoid under subsection (a) of this section a transfer of real property to a good faith purchaser without knowledge of the commencement of the case and for present fair equivalent value unless a copy or notice of the petition was filed, where a transfer of such real property may be recorded to per-

370. Rochelle, III & Feder, *Unauthorized Sales of a Debtor's Property: The Rights of a Purchaser Under Section 549 of the Bankruptcy Code*, 57 AM. BANKR. L.J. 23, 34-35 (1983).

371. See *infra* authorities cited note 379.

372. S. 445, 98th Cong., 1st Sess. (1983), the text of which was incorporated into S. 1013, 98th Cong., 1st Sess. (1983).

373. For example, the 1978 version of section 549(c) talked about the place where real estate conveyances "are" recorded. The new amendment describes the place where conveyances "may" be recorded. The old section described transfers that were "so far perfected" while the amendment substitutes "so perfected." The reader may also note that the second sentence of section 549(c) used to give the transferee a lien under stated conditions for transfers that "the trustee may avoid under this section." See *supra* text accompanying note 354. The amendment retains the lien but omits the quoted language.

fect such transfer, before such transfer is so perfected that a bona fide purchaser of such property, against whom applicable law permits such transfer to be perfected, could not acquire an interest that is superior to the interest of such good faith purchaser. A good faith purchaser without knowledge of the commencement of the case and for less than present fair equivalent value has a lien on the property transferred to the extent of any present value given, unless a copy or notice of the petition was so filed before such transfer was so perfected.³⁷⁴

There were two significant changes made in section 549(c). First, the reference to "real property other than in the county in which the case is commenced" was omitted. Secondly, and more importantly, the protection given judicial sale purchasers was withdrawn.

The problem regarding realty located in the county where bankruptcy is filed has a curious history. Under the Chandler Act, such a filing gave notice to purchasers. The Commission proposed that such bankruptcy filings do not give notice, but the drafters of the 1978 code refused to follow this recommendation and legislated that such filings gave constructive notice. The 1984 amendment once again reversed this position. It provides that bankruptcy filings do not give constructive notice to purchasers of real estate in the county where the bankruptcy petition is filed.

It seems that the Commission's and Senate's position was stronger. First, the rights of the purchaser who checks state real estate records should not have to depend on the location of the property. Second, the basic rationale for the real estate exception is based on a desire to protect parties who rely upon state real estate records in the same way as former purchasers have historically done. Requiring the check of an additional record seems to defeat the purpose for the exception. In addition, the extra burden involved in checking another record of the purchaser's agent far outweighs the convenience to the estate of not having to make a state real estate filing at all. Federal courthouses are not always situated next to the office or courthouse where state filings are made. Title searchers doing business in the county of the federal courthouse must check those records that searchers in adjacent counties are not required to check. Of course, in a few states the mere recovery of a judgment has the effect of a lien on real estate.³⁷⁵ There is no filing requirement. In those states, federal judg-

374. S. 445, 98th Cong., 1st Sess. 93-94 (1983), the text of which was incorporated into S. 1013, 98th Cong., 1st Sess. 125-26 (1983).

375. IND. CODE § 34-1-45-2 (1982); KAN. STAT. ANN. § 60-2202(a) (1983); *see also In re*

ments operate as a lien as well.³⁷⁶ Title searchers, while at the federal courthouse, can also check bankruptcy filings. But these states are the exception, and a uniform bankruptcy policy suggests that there be just one filing policy governing all bankruptcies.

The argument for removing the protection afforded to purchasers at judicial sales is even more compelling. In many cases it is the debtor's desire to stop a foreclosure sale that is the *raison d'être* for the bankruptcy filing. Therefore, Congress provided that judicial creditors were stayed from foreclosing on the debtor's property.³⁷⁷ The 1984 amendment also removes the logical inconsistency that one can attain clear title from a sale that is void. Recall that sales in violation of the automatic stay are void.³⁷⁸

Purchasers at judicial sales are on notice that the rule of *caveat emptor* applies to such sales.³⁷⁹ If the sale is declared void, the purchaser is subrogated to the position of the foreclosing creditor.³⁸⁰ Although such a policy discourages high bids at judicial sales, the law in this area is well established. Judicial purchasers are therefore on notice that in case of sale irregularity, they may have purchased nothing. Accordingly, they may be subordinated to the foreclosing creditor's judgment, which may amount to a mere right to file a bankruptcy claim.

At a minimum, if the protection given to judicial purchasers is to continue, Congress should make clear that parties who bid the value of their security are not necessarily "purchasers" as defined in the section. Such secured parties should be protected by reinstating their lien. Section 549(c) should not permit secured party

Fornabai, 227 F. Supp. 928, 931 (D.N.J. 1964) (construing N.J. STAT. ANN. § 2A:16-1 (West 1982) to accord a lien upon docketing of the judgment).

376. 28 U.S.C. § 1962 (1977) makes a federal court judgment a lien on property "in the same manner, to the same extent and under the same conditions" as a state judgment. See, e.g., *Hamilton Steel Prod., Inc. v. Yorke*, 376 F.2d 463 (7th Cir. 1967); *Knapp v. McFarland*, 462 F.2d 935 (2d Cir. 1972); *Sun Bank v. Snell (In re Cone)*, 11 Bankr. 925 (Bankr. M.D. Fla. 1981).

377. Section 362(a)(2) stays "the enforcement, against the debtor or against property of estate, of a judgment obtained before the commencement of the case." 11 U.S.C. § 362(a)(2) (1982).

378. See authorities cited *supra* note 365.

379. See Annot., 68 A.L.R. 659 (1930); FREEMAN, *Freeman on Executions* §§ 301, 335 (1878); see also, *Dixon v. City Nat'l Bank*, 81 Ill. 2d 429, 410 N.E.2d 843 (1980) (at an execution sale, absent fraud, misrepresentation or mistake of fact, doctrine of caveat emptor applies); *Henry v. Slack*, 86 Ga. App. 198, 71 S.E.2d 96 (1952) (a purchaser at a judicial sale is bound to take notice of an excessive levy); *Martens v. Martens*, 234 Iowa 519, 12 N.W.2d 201 (1944) (maxim of "caveat emptor" applies to a sale under execution).

380. See *Dixon v. City Nat'l Bank*, 81 Ill. 2d 429, 433, 410 N.E.2d 843, 845 (1980). Note, *Real Property: Implied Warranty on Execution Sale*, 6 CORNELL L.Q. 205 (1921).

purchasers, who have not given new value, to defeat the purpose of the automatic stay.³⁸¹

7. IMPLIED REVOCATION OF AUTHORITY

Recall that the Court in *Marin* also suggested that the filing of bankruptcy should not, in and of itself, revoke the bank's authority to honor checks.³⁸² In a prior section of this article that discussed the Chandler Act, it was suggested that this concept could have been extended to various agency relationships.³⁸³ The doctrine that the filing of bankruptcy does not automatically revoke the agent's authority did enjoy a following in several lower federal court cases. All of these cases, however, involved bank-checks and insurance policies.³⁸⁴

With the promulgation of the 1978 code, is there anything left of the defense that the agent may continue to act for the bankrupt principal until the agent receives notice of bankruptcy? This defense has possible application in cases not falling within the narrowly drafted exceptions for banks, insurance companies, and other bailees codified in sections 542(c)³⁸⁵ and (d).³⁸⁶ One clear case where such an argument would be of value would be the classic situation of the bankruptcy of an undisclosed principal who does not bother to tell his agent of his bankruptcy. Does the agent continue to have authority, or is his authority automatically revoked by the principal's bankruptcy?

What little evidence is available about Congressional intent suggests that the agent's authority expires upon the filing of the petition. Congress was acutely aware of the *Marin* case, to the extent that it drafted section 542(c) in 1978 to cover its precise facts. Presumably, then, it must have also been aware of the alternative rationale that the bank's authority to honor the checks should continue.³⁸⁷ It, nevertheless, chose to legislate a different solution by giving the banks a carefully drafted exception that would fit its precise needs. It certainly could be argued that in selecting a narrow solution to the problem, Congress thereby rejected any possi-

381. See *infra* note 476.

382. *Marin*, 385 U.S. at 102.

383. See *supra* text accompanying notes 156-66.

384. See cases cited *supra* note 162.

385. See *supra* text accompanying notes 321-29.

386. See *supra* text accompanying notes 330-38.

387. Recall that several cases held that the bank or insurance company's authority was not revoked by the debtor's bankruptcy filing. See cases cited *supra* note 162.

ble broader resolution. Congress could have provided that an agent's authority continued until he received notice of the bankruptcy.

The above rationale may well extend the sometimes artificial process of determining Congressional "intent" beyond all bounds of propriety. The suggested solution, however, may in fact further existing policy. In regard to section 549(a), Congress has enunciated a policy that favors the estate over the good faith postpetition transferee. Innocent transferees who deal with the debtor's agent have no additional equities that justify special treatment over those transferees who deal with the debtor directly. Regardless of an agent's participation, courts should be reluctant to carve out a judicial exception to the intended results that are achieved by application of section 549(a).

C. "Title"

Section 541(a)(1) marks a significant departure from the Chandler Act's definition of estate property:

Such estate is comprised of all the following property, wherever located: (1) . . . all legal or equitable interests of the debtor in property as of the commencement of the case³⁸⁸

Section 541(a) offers a significant departure in light of Congress's decision to absorb all property of value into the estate,³⁸⁹ and because of its decision to abandon "title" as the point of demarcation. Under prior law,³⁹⁰ the trustee had to establish that, at

388. 11 U.S.C. § 541(a)(1) (1982).

389. See, e.g., *Samore v. Graham* (*In re Graham*), 24 Bankr. 305 (Bankr. N.D. Iowa 1982). In *Graham*, the estate was able to recover the debtor's \$150,000 investment in a pension fund that was tax exempt under the Employee Retirement Income Security Act (ERISA). The court reached this result even though the pension fund could not be assigned or alienated. *Contra In re Harter*, 10 Bankr. 272 (Bankr. N.D. Ind. 1981). The *Harter* case, unfortunately, relied upon authority interpreting the Chandler Act and concluded that military retirement benefits were not "property" of the estate because the funds were needed for the bankrupt's "fresh start." The fresh start approach, however, is rejected in the new code's legislative history. H.R. REP. NO. 95-595, 95th Cong., 1st Sess. 368 (1977); see also *Abney v. Hicks* (*In re Hicks*), 22 Bankr. 243 (Bankr. N.D. Ga. 1982) (holding that a contingent remainder in real estate is property of the estate); *General Motors Acceptance Corp. v. Morgan* (*In re Morgan*), 23 Bankr. 700, 9 BANKR. CT. DEC. (CRR) 926 (Bankr. E.D. Pa. 1982) (holding that the bankrupt's equity of redemption in a repossessed automobile is property of the bankruptcy estate).

390. The trustee usually employed section 70a(5) of the Chandler Act to bring property into the estate. That provision generally required that the property in question be subject to judicial powers, assignable, or transferable. Chandler Act ch. 575, § 70a(5), 52 Stat. 840, 880 (1938).

the date of the filing of the petition, the property: 1) could have been levied upon and sold under judicial process, or otherwise be seized, impounded, or sequestered,³⁹¹ or 2) was assignable by the debtor.³⁹²

Additionally, the Supreme Court in interpreting prior law had developed a special bankruptcy definition of "property." Interests that ordinarily would have been considered property were held not to be "property" in bankruptcy. The statute was interpreted with the aim of giving the bankrupt a "fresh start."³⁹³

The Court's decision in *Lines v. Frederick*³⁹⁴ exemplifies the bankruptcy definition of "property." In *Lines*, the Court held that accrued vacation pay accountable for prepetition work did not come into the estate. The Court reasoned that these funds may have been necessary to enable the bankrupt to start a new financial life. Both the House and Senate reports to new section 541(a)(1), however, leave no doubt as to how the 1978 code is to be interpreted: "Paragraph (1) . . . has the effect of overruling *Lines v. Frederick*."³⁹⁵

For our purposes, however, the 1978 code's disinclination to accept the concept of "title" requires an even more thorough inves-

391. See *Suskin & Berry, Inc. v. Rumley*, 37 F.2d 304 (4th Cir. 1930), where the court addressed the issue of whether a testamentary interest should pass to the trustee. The court held that the bankrupt's interest did not pass to the trustee because it was merely a contingent remainder and thus, under the law of the state, could not be levied upon or sold for the debts of the remainderman. Further, the court found that the will created a valid spendthrift trust which could not be reached by the creditors of the beneficiary-bankrupt. See also *In re Berry*, 247 F. 700 (E.D. Mich. 1917), where land acquired by the bankrupt through contract of purchase by debtor and his wife was an interest by the entirety in real property. As such, state law prohibited the interest from being levied upon and sold under judicial process. Consequently, such interest could not pass to the trustee in the bankruptcy proceeding.

392. See *Chicago Board of Trade v. Johnson*, 264 U.S. 1 (1924) (holding under a predecessor statute to the Chandler Act, that a seat on the Chicago Board of Trade belonged to the estate, even though an exchange rule permitted any exchange member to block the transfer if an outstanding debt had not been paid). The Court noted that the statute provided that the estate took the property if transferable "by any means." Since the seat was transferable, under stated conditions, it belonged to the estate. See also *In re Quaker Room*, 90 F. Supp. 758 (S.D. Cal. 1950) (holding that a liquor license which was transferable only by permission of the state liquor authority belonged to the estate); cf. *Christison v. Jones*, 83 Ill. App. 3d 334, 405 N.E.2d 8 (1980) (holding that a claim for legal malpractice did not belong to the estate because it was not assignable under state law).

393. *Burlingham v. Crouse*, 228 U.S. 459, 473 (1913).

394. 400 U.S. 18 (1970); cf. *Kokoszka v. Belford*, 417 U.S. 642 (1974) (tax refund based upon prepetition earnings constitutes "property"); *Segal v. Rochelle*, 382 U.S. 375 (1966) (loss carryback refund based upon prepetition losses is "property" of the estate).

395. H.R. REP. No. 95-595, 95th Cong., 1st Sess. 367-68 (1978); S. REP. No. 95-989, 95th Cong., 2nd Sess. 82-83 (1978).

tigation. Certainly the drafters of the Bankruptcy Code were aware of the reduced emphasis given "title" in the Uniform Commercial Code,³⁹⁶ as well as the increased reliance upon "special property interests."³⁹⁷ Was the abandonment of "title" intended as a sign of approval for the special property rights that are permitted under the Uniform Commercial Code?

The present bankruptcy code was initially the product of the Bankruptcy Reform Commission.³⁹⁸ The "Commission Bill" provided that the debtor's bankruptcy estate was to be comprised of "all property of the debtor as of the date of the petition."³⁹⁹

Although the reason for the changes in language from the Commission Bill and present section 541(a)(1) is not set forth in the legislative history, both bills are consistent in abandoning "title" and bringing "all property" into the estate. The Commission Report indicated that the word "title" was not employed "as a matter of style."

As a matter of style, the concept of "vesting title by operation of law" is replaced by the statement that certain property is "property of the estate." Property of the estate is basically property owned by the debtor at the date of the petition⁴⁰⁰

The legislative history does not specifically address the validity of U.C.C. special property claims over goods that are property of the estate. But, the Senate and House Reports do mention the cash seller's "trust" interest under the federal Packer's and Stockyard's Act.⁴⁰¹

This section . . . also will not affect various statutory provisions that give a creditor of the debtor a lien that is valid outside as well as inside bankruptcy or that creates a trust fund for the benefit of a creditor of the debtor. See Packers and Stockyards

396. For example, Professor Kennedy, thoroughly familiar with the U.C.C., served as executive director for the Commission. See, e.g., Kennedy, *The Trustee in Bankruptcy Under The Uniform Commercial Code: Some Problems Suggested by Articles 2 and 9*, 14 RUTGERS L. REV. 518 (1960).

397. See *supra* text accompanying notes 198-204.

398. See *supra* note 236.

399. See REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. Doc. No. 93-137 Part II, 93rd Cong., 1st Sess. § 4-601 (1973).

400. *Id.* at 149.

401. Packers and Stockyards Act § 206, 7 U.S.C. § 196 (1978); see *In re Frosty Morn Meats, Inc.*, 7 Bankr. 988, 996-97, 1005-07 (Bankr. M.D. Tenn. 1980) (upholding the validity of the "trust" challenged by the stockyard's trustee in bankruptcy in a proceeding under the Chandler Act, where the trustee claimed that the trust was void as a statutory lien under section 67c(1) of the Chandler Act). See discussion at text accompanying notes 217-20. For further discussion, see *infra* text accompanying notes 416-24.

Act section 206, 7 U.S.C. § 196.⁴⁰²

If Congress can statutorily protect cattlemen who sell to insolvent stockyards, it would seem to follow that state legislation could protect innocent buyers who have special property interests in goods held by bankrupt sellers. Specifically, a prepaying buyer of goods, who, upon learning of the seller's bankruptcy, retrieves them from his insolvent-seller, may under the new code be immunized from the trustee's postpetition transfer claim on the grounds that he already had a "special property" claim. Thus, the trustee's suit to set aside the transfer and reclaim the goods would be useless.

Professor Countryman has observed that bankruptcy judges will inevitably be forced to look to state law notions of "property" to define the extent of the trustee's interest in that property.⁴⁰³ He also argued that under the Chandler Act the trustee's interest should generally be subject to those claims and interests that state law indicated was superior to the debtor's interest.⁴⁰⁴ The Commission, moreover, based its final product on the views of Professor Countryman.⁴⁰⁵ Thus, it would seem to follow that, in looking to section 541(a)(1) alone, a bankruptcy court should entertain a buyer's reclamation petition based on section 2-502 of the Uniform Commercial Code.

The trustee may nevertheless prevail based on the same arguments discussed under the Chandler Act. First, the 1978 code retains and strengthens the trustee's power concerning executory contracts.⁴⁰⁶ Professor Countryman's definition of an executory

402. H.R. REP. NO. 95-595, 95th Cong., 1st Sess. 367-68 (1977); S. REP. NO. 95-989, 95th Cong., 2d Sess. 82-83 (1978).

403. See *Butner v. United States*, 440 U.S. 48 (1979) (holding that a state law governed the mortgagee's right to receive rents and profits when the mortgagee had filed bankruptcy after the mortgagee foreclosed). "Uniform treatment of property interest by both state and federal courts within a State serves to reduce uncertainty, to discourage forum shopping, and to prevent a party from receiving 'a windfall merely by reason of the happenstance of bankruptcy'." *Id.* at 55 (citing *Lewis v. Manufacturers Nat'l Bank*, 364 U.S. 603, 608-09 (1961)). See generally Countryman, *The Use of State Law in Bankruptcy Cases (Part I)*, 47 N.Y.U. L. REV. 407 (1972) (problems posed and recommendations aimed at dealing with incorporation of state law in bankruptcy cases).

404. "[The Chandler Act] only purports, at the most, to give the trustee the interest of the bankrupt." Countryman, *supra* note 403, at 436.

405. REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. DOC. NO. 93-137, Part II, 93d Cong., 1st Sess. 148-49 (1973).

406. 11 U.S.C. § 365 (1982). Among the new sections are section 365 (b)(1) which permits the trustee to cure defaults and assume contracts under which the debtor is in breach, and section 365 (e)(1) which makes ipso facto clauses, i.e., clauses which provide that the contract is void upon the filing of bankruptcy, invalid.

contract: "contracts on which performance remains due to some extent on both sides,"⁴⁰⁷ is embraced in the legislative history.⁴⁰⁸ Thus, where a bankrupt seller has not completed the manufacture of the goods in question and the buyer has paid only part of the purchase price, the buyer's section 2-502 reclamation claim, if the contract is rejected, is subject to defeasance. The contract would be "executory" under Professor Countryman's definition.⁴⁰⁹

407. *E.g.*, *Hassett v. Revlon, Inc. (In re O.P.M. Leasing Servs., Inc.)*, 23 Bankr. 104 (Bankr. S.D.N.Y. 1982); *see supra* notes 214-15.

408. H. REP. No. 95-595, 95th Cong., 1st Sess. 347 (1977); S. REP. No. 95-989, 95th Cong., 2nd Sess. 58 (1978).

409. The case law that is available for study on this question conforms to the position that unperfected contracts for the sale of goods are executory. *See Abbott v. Blackwelder Furniture Co.*, 33 Bankr. 399, 404 (Bankr. W.D.N.C. 1983), stating that "the 'special property interest' may also be classified as a voidable executory contract." In *National Sugar Refining Co. v. C. Czarnikow, Inc. (In re National Sugar Refining Co.)*, 27 Bankr. 565 (Bankr. S.D.N.Y. 1983), the court held that the right of a seller, under U.C.C. § 2-702(2), to stop goods in transit, where the buyer was insolvent, did not conflict with section 365 on executory contracts. The court reasoned that the section 2-702(2) right to stop goods in transit merely "suspended" the contract and did not abrogate it. The case seemed to assume, however, that, even though title to the goods had passed, under section 2-702(2), the seller's claim to return of the goods would have prevailed over the debtor's ability to reject the executory contract under section 365. The court's assumption probably was valid because the seller's section 2-702(2) special property claim was codified into the bankruptcy code in new code section 546(c). 11 U.S.C. § 546(c) (1982); *see infra* text accompanying note 428. If, however, a prepaying buyer was attempting to claim goods identified to the contract but the contract had been rejected, the *National Sugar* case would be easily distinguishable. Section 2-502, giving the buyer, as opposed to the seller, a special property claim has not been codified into the new bankruptcy code. *See infra* text accompanying note 424. Once a contract is rejected the contracting party's consideration is not returned, rather the party is given a claim in bankruptcy. Section 365(g) provides that "rejection of an executory contract . . . constitutes a breach of such contract . . ." 11 U.S.C. § 365(g) (1982). The legislative history indicates that the effect of the section is "to treat rejection claims as prepetition claims." H.R. REP. No. 95-595, 95th Cong., 1st Sess. 349 (1977); S. REP. No. 95-989, 95th Cong., 2d Sess. 68 (1978); *see Investors Dev. Co. v. Forum Homes, Inc. (In re Investor's Dev. Co.)*, 7 Bankr. 772, 6 BANKR. CT. DEC. (CRR) 1415 (Bankr. D.N.J. 1980).

One court has paid some attention to the potentially unjust result that can arise when the estate rejects an executory contract at the same time it keeps the promisee's consideration. *See Tavormina v. Brake (In re Beverly Mfg. Corp.)*, 29 Bankr. 513 (Bankr. S.D. Fla. 1983). In that case the debtor's attorney had a lien on certain shares of stock to secure performances rendered in the past and to be rendered in the future. The trustee noted that when the contract was not assumed within the 60 day period required by statute that it was automatically rejected. *See also* 11 U.S.C. § 365(d)(1) (1982), providing that contracts not affirmatively assumed within the 60 day period following the entry of the order for relief are automatically rejected. Thus, the trustee argued that he was entitled to keep the stock while not paying the debtor's attorney for his services. The court commented that the result suggested by the trustee would be "completely inequitable." 29 Bankr. at 515.

Cases construing former section 70b, Chandler Act, ch. 575, § 70b, 52 Stat. 840, 880-81 (1938), generally hold that the unfortunate promisee is entitled only to a damage claim in bankruptcy. *See In re Mercury Homes Dev. Co.*, BANKR. CT. DEC. (CRR) 837, 18 COLLIER BANKR. CAS. (MB) 435, BANKR. L. REP. (CCH) ¶ 669,72 (Bankr. N.D. Cal. 1978); *Samuels v.*

Second, as the *Tennecomp Systems* case demonstrates,⁴¹⁰ the section 2-502 property right is subject to defeat by a trustee exercising his power as a lien creditor under the 1978 Bankruptcy Code. Section 544(a)(1)⁴¹¹ of the Bankruptcy Code vests the estate with the power of a lien creditor on all of the bankrupt's property as of the date of the filing of the petition. The *Tennecomp* decision held that in order to prevail against the trustee, the buyer must comply with the attachment and notice requirement of Article 9 of the Uniform Commercial Code.⁴¹²

Third, it was further suggested that the buyer's right under section 2-502 was void as a statutory lien. Section 545(d)(1) of the 1978 code permits the trustee to invalidate "statutory lien[s] . . . to the extent that such lien first becomes effective against the debtor . . . when the debtor becomes insolvent."⁴¹³ Recall that section 2-502 gives the buyer a right to review the goods "if the seller becomes insolvent within ten days after receipt of the first installment on their price."⁴¹⁴ The seller's right to reclaim under section 2-702 has received perhaps the most attention of the courts and commentators.⁴¹⁵ Under the Chandler Act, two esteemed bankruptcy experts took opposite positions as to the vulnerability of section 2-502 regarding a statutory lien.⁴¹⁶ Thus, the question

E.F. Drew & Co., 292 F. 734 (2d Cir. 1923). The *Mercury Homes* case held that the vendee of a rejected land sale contract was limited to his damage claim in bankruptcy. This result has been legislatively overruled by the new code. 11 U.S.C. § 365(i) (1978); Cf. *In re Brethern's Home*, 5 BANKR. CT. DEC. (CRR) 658, 21 COLLIER BANKR. CAS. (MB) 166 (Bankr. S.D. Ohio 1979) (holding that the indigent residents of a retirement home were to be given continued life care even though their contracts were rejected). See generally Countryman, *Executory Contracts in Bankruptcy: Part II*, 58 MINN. L. REV. 479, 533 (1974) (discussing judicial analysis of the trustee's option with respect to employment contracts).

410. 12 Bankr. 729, (Bankr. E.D. Tenn. 1981), see *supra* text accompanying notes 223-27.

411. 11 U.S.C. § 544(a)(1) provides:

(a) The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by-

(1) a creditor that extends credit to the debtor at the time of the commencement of the case, and that obtains, at such time and with respect to such credit, a judicial lien on all property on which a creditor on a simple contract could have obtained a judicial lien, whether or not such a creditor exists

11 U.S.C. § 544(a)(1) (1982).

412. 12 Bankr. 429, 436-37, (Bankr. E.D. Tenn. 1981); see *supra* note 225.

413. 11 U.S.C. § 545(1)(d) (1982).

414. U.C.C. § 2-501(1).

415. See *supra* note 219.

416. Compare Kennedy, *supra* note 219, at 839-45 (favoring the seller) with Country-

might seem to be an open one under the 1978 code as well.

The House and Senate reports to section 541(a)(1) quoted earlier do suggest, however, that certain kinds of trust claims are not voidable as statutory liens:

Situations occasionally arise where property ostensibly belonging to the debtor will actually not be property of the debtor but will be held in trust for another. For example, if the debtor has incurred medical bills that were covered by insurance, and the insurance company had sent the payment of the bills to the debtor before the debtor had paid the bill for which payment was reimbursement, the payment would actually be held in a constructive trust for the person to whom the bill was owed [P]roposed [section] 11 U.S.C. § 545 . . . will not affect various statutory provisions that give a creditor of the debtor a lien that is valid outside as well as inside bankruptcy, or that creates a trust fund for the benefit of a creditor of the debtor.⁴¹⁷

The case of *In re Frosty Morn Meats, Inc.*,⁴¹⁸ recently upheld the validity of the cattleman's trust fund, as provided in the Packers and Stockyards Act, against a claim that it was void as a statutory lien under section 67c(1) of the Chandler Act. Former section 67c(1), like present section 545, voided a lien "which first becomes effective upon the insolvency of the debtor."⁴¹⁹ The District Judge incorporated all of Bankruptcy Judge Bare's opinion and held that the cattlemen's trust was valid when tested against the trustee's attack. The judge embraced Judge Bare's analysis that Congress had not created a "lien" but instead had created a "trust."⁴²⁰ "Although a person may become bankrupt, property which is held by the person in trust belongs to the beneficiary of the trust."⁴²¹

Is the Uniform Commercial Code's "special property" interest more like a lien or more like a trust? Under non-code law, the prepaying buyer is not entitled to a constructive trust on goods purchased and identified in the contract.⁴²² The medical bills example

man, *Buyers and Sellers of Goods in Bankruptcy*, 1 N.M.L. L. Rev. 435, 451-59 (1971) (favoring the trustee).

417. H.R. REP. No. 95-595, 95th Cong., 1st Sess. 367-68 (1977); S. REP. No. 95-989, 95th Cong., 2nd Sess. 82-83 (1978).

418. 7 Bankr. 988 (Bankr. M.D. Tenn. 1980).

419. Chandler Act., ch. 575, § 67c(1), 82 Stat. 840, 877 (1938).

420. *In re Frosty Morn Meats, Inc.*, 7 Bankr. 988, 1006 (Bankr. M.D. Tenn. 1980).

421. *Id.*

422. It has been suggested that a prepaying buyer should recover against an insolvent seller under a constructive trust theory. Consequently, failure on the part of the purchaser to successfully advance a section 2-502 reclamation claim may not preclude the recovery of the property still in the bankrupt's possession. See generally Schrag & Ratner, *Caveat*

that Congress found persuasive, however, is very much like the prepaying buyer's claim. The goods themselves, like the medical payments, may very well have been manufactured or set aside especially for the buyer.⁴²³

Some significance should be attached, however, to the fact that Congress chose to immunize only the seller's right to reclamation in response to the trustee's attack. The 1978 version of section 546(c) permits, under stated conditions, the seller of goods to an insolvent buyer to reclaim those goods.⁴²⁴ It may well be that the

Emptor-Empty Coffer: The Bankruptcy Law Has Nothing to Offer, 72 COLUM. L. REV. 1147 (1972) (victims of consumer abuse have miniscule hope of obtaining redress from bankrupt retailer). If a constructive trust is recognized under nonbankruptcy law, then one can probably be imposed against specified assets and those assets would not become part of the bankruptcy estate. See 4A COLLIER ON BANKRUPTCY § 70.25(2) (14th Ed. 1978). Something more than a mere debtor-creditor relationship must be established, however. See *Thunderbird Motor Freight Lines, Inc. v. Penn-Dixie Steel Corp.* (*In re Penn-Dixie Steel Corp.*), 10 Bankr. 878 (Bankr. S.D.N.Y. 1981) (carrier not entitled to imposition of constructive trust on an amount owed for freight charges, but rather must be treated as an ordinary unsecured creditor); *In re Faber's, Inc.*, 360 F. Supp. 946 (D. Conn. 1973) (a constructive trust will not be imposed upon cash deposits for undelivered carpet which consumers had given to a bankrupt retail carpet dealer).

423. Cf. *Abbott v. Blackwelder Furniture Co.*, 33 Bankr. 399 (Bankr. W.D.N.C. 1983), holding that the prepaying buyer's 2-502 claim was voidable under section 545. The court also gave a narrow construction to the "trust" theory requiring that it should be limited to bailment, fraud, breach of fiduciary duty, and the unjust enrichment cases.

424. 11 U.S.C. § 546(c) (1982) provides:

(c) The rights and powers of the trustee . . . are subject to any statutory right or common law right of a seller, in the ordinary course of such seller's business, of goods to the debtor to reclaim such goods if the debtor has received such goods while insolvent, but:

(1) such a seller may not reclaim any such goods unless such seller demands in writing reclamation of such goods before ten days after receipt of such goods by the debtor; and (2) the court may deny reclamation to a seller with such a right of reclamation that has made such a demand only if the court:

(A) grants the claim of such a seller priority as an administrative expense, or (B) secures such claim by a lien.

The section requires that: 1) seller sell in the "ordinary course of business;" 2) that the debtor receive the goods "while insolvent;" and 3) that seller make a written demand for reclamation within ten days after debtor's receipt of the goods. See *Ateco Equip., Inc. v. Columbia Gas of Pennsylvania* (*In re Ateco Equip., Inc.*), 18 Bankr. 917 (Bankr. W.D. Pa. 1982), holding that there was no right to reclamation where seller did not make the written demand as required by section 546(c). The court rejected seller's argument that a written demand was not necessary under U.C.C. § 2-702(2) and therefore was unnecessary upon buyer's bankruptcy. See generally Mann & Phillips, *Section 546(c) of the Bankruptcy Reform Act: An Imperfect Resolution of the Conflict Between the Reclaiming Seller and the Bankruptcy Trustee*, 54 AM. BANKR. L.J. 239 (1980); Weintraub & Resnick, *A Seller's Right to Reclaim Goods Under the Bankruptcy Code—A Look at Current Cases*, 14 U.C.C. L.J. 376 (1982) (assessing the success of section 546(c) in resolving the issues raised by battle between the reclaiming seller and the trustee).

drafters gave no attention to the potential vulnerability of section 2-502 claimants, and therefore the failure to address the question is of no consequence. It seems, however, that the effect of giving special treatment to section 2-702(2) without providing similar treatment to section 2-502, the companion section, is significant.

Having guided ourselves through section 2-502 and other relevant sections of the 1978 code, we can now turn to section 550, the remedial section. Recall that this digression was necessary due to the fact that those parties dealing with the debtor after a petition is filed may well resort to "title" and "special property" defenses in order to defeat the trustee's claim that they have taken estate property after the filing of a petition.

D. *Liability of the Transferee*

Section 550 is divided into two parts, the liability of the "initial transferee," and the potential liability, if any, of those transferees dealing with the initial transferees. These types of transferees are defined as "subsequent," "mediate," or "immediate" transferees. For example, assume that a debtor makes a postpetition transfer to T-1 which is in violation of section 549(a). As defined by the 1978 code and the Bankruptcy Commission, T-1 would be the "initial transferee." If T-1 in turn transfers to T-2, T-2 would be a "subsequent"⁴²⁵ or "immediate" transferee. If T-2 transfers to T-3, T-3 is a "mediate" or again a "subsequent" transferee.⁴²⁶

1. THE COMMISSION PROPOSAL

The Commission combined into one section, the treatment of

425. The Commission proposal defined those parties dealing with the initial transferee as "subsequent transferees." REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. DOC. NO. 93-137 Part II, 93 Cong., 1st Sess. § 4-609(b), 179 (1973).

426. The Commission proposal further defines a subsequent transferee as "a transferee of the initial transferee of the debtor and . . . any immediate or mediate transferee of such a transferee." *Id.* at § 4-609(b)(3). The 1978 code speaks in terms of "immediate" and "mediate" transferees of the initial transferee. 11 U.S.C. § 550(a)(2), (b)(2) (1982). The legislative history does not provide any rationale for dropping the adjective "subsequent." Senate Bill 445 recently passed the Senate and was assigned to the House Judiciary Committee. That bill amends sections 550(a)(2) and (b)(2) by striking out "immediate and mediate" and returns to the Commission language of "subsequent." S. 445, 98th Cong., 1st Sess., 94-95 (1983) (incorporated into S. 1013, 98th Cong., 1st Sess.). The legislative history of Senate Bill 445 indicates that many of the amendments are introduced for purposes of "clarity." It seems clear that the Commission and the 1978 code intended to accord different treatment for those dealing with estate property after the initial transfer by the debtor.

all transferees whose transfers were subject to attack under the various avoidance provisions. Proposed section 4-609⁴²⁷ was to govern transferees receiving preferential transfers, fraudulent conveyances, postpetition transfers, and other transfers where the transaction was subject to avoidance.⁴²⁸ The discussion that follows applies to transactions that could have been set aside as either preferential, fraudulent, or by any other avoidance power approved by the Commission.

427. Proposed section 4-609 read in its entirety as follows:

(a) *Liability of Initial Transferee.* Whenever under this Act property transferred by the debtor is recoverable for the benefit of the estate, the trustee is entitled to a judgment against the initial transferee (subject to any provisions giving such transferee a right to be reimbursed for the value paid by him) for either (1) the return of the property in specie, or (2) damages equal to the value thereof at the date of the judgment (or, if the property has been transferred or destroyed prior to the date of the judgment, the value thereof at the date of such transfer or destruction) plus, if the property transferred was money, interest at the legal rate from the date of the transfer. The transferee shall have the right to elect to pay the monetary judgment rather than return the property.

(b) *Liability of Subsequent Transferees.*

(1) The trustee may not recover property referred to in subdivision (a) from a subsequent transferee of the initial transferee who purchases for value in good faith without knowledge of the voidability of the initial transfer, or from a transferee of such a transferee.

(2) Unless protected by paragraph (1) of this subdivision, a subsequent transferee of property referred to in subdivision (a) is liable to the trustee as though he were the initial transferee under subdivision (a).

(3) A subsequent transferee within this subdivision (b) means (A) a transferee of the initial transferee of the debtor, including a purchaser at a judicial sale of property of the debtor and (B) any immediate or mediate transferee of such a transferee.

(c) *Single Recovery.* A trustee who recovers against more than one transferee under subdivisions (a) and (b) shall be entitled only to a single satisfaction.

(d) *Improvements.*

(1) Notwithstanding subdivisions (a) and (b), a transferee of recoverable property may retain the property as security for payment of the lesser of (A) the cost of any improvements to the property by the transferee reduced by the amount of any profits realized from the property and (B) the increase in value of the property as a result of the improvements.

(2) For the purpose of this subdivision, improvements include physical additions and changes, repairs, payment of taxes and other debits secured by and discharging encumbrances against the recoverable property that are superior to the rights of the trustee, and costs of preservation.

REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. DOC. NO. 93-137, Part II, 93d Cong., 1st Sess. § 4-609(a) at 178-79.

428. The initial clause of proposed section 4-609 stated: "Whenever under this Act property transferred by the debtor is recoverable for the benefit of the estate" *Id.*

a. Initial Transferees

Commission section 4-609(a) provided:

(a) *Liability of Initial Transferee.* Whenever under this Act property transferred by the debtor is recoverable for the benefit of the estate, the trustee is entitled to a judgment against the initial transferee (subject to any provisions giving such transferee a right to be reimbursed for the value paid by him) for either (1) the return of the property in specie, or (2) damages equal to the value thereof at the date of the judgment (or, if the property has been transferred or destroyed prior to the date of the judgment, the value thereof at the date of such transfer or destruction) plus, if the property transferred was money, interest at the legal rate from the date of the transfer. The transferee shall have the right to elect to pay the monetary judgment rather than return the property.⁴²⁹

Under this proposed section, the estate would have been able to recover transferred property or collect damages equal to the value of the property. The damages would have been computed as of the date of judgment. If the property was destroyed prior to judgment, then damages would have been calculated from the date of the transfer. If money was transferred, then interest was to have accrued as of the date of transfer. In cases that did not involve money, the transferee had the choice of either returning the property to the trustee or paying its monetary equivalent.

The Commission indicated that in some cases the transferee would be reimbursed for the value paid. The Commission also recommended that the initial transferee be reimbursed for any "improvements."⁴³⁰ "Improvements" were to include "physical additions and changes, repairs, payment of taxes . . . and costs of preservation."⁴³¹ Moreover, the Commission recommended that the trustee could receive a judgment to the extent of any increase in the value of the property after the voidable transfer. The trustee could recover "damages equal to the value thereof *at the date of judgment.*" If, however, the initial transferee realized a profit while in possession of the property, this profit was to be deducted from any recoupment⁴³² granted the transferee for improvements.⁴³³

429. *Id.* at 178.

430. *Id.* at § 4-609(d). For a complete text of the section, see *supra* note 427.

431. *Id.* at § 4-609(d).

432. "Recoupment" was chosen as opposed to "set-off" or "credit" because it most accurately described the remedy the Commission chose to give the transferee. Recoupment generally means a right to reduce the plaintiff's recovery because of some claim arising out

Three salient points invite attention. First, in most cases the value of the property was to be computed as of the date of judgment. Second, the transferee was given the choice of returning the property or its money value. Third, the initial transferee was to keep his profits, except in cases where the transferee was seeking a recoupment for improvements.

In regard to the first point, the Commission notes stated that section 4-605(a) was based on the provisions of former section 60b⁴³⁴ of the Chandler Act, which governed preferential transfers.⁴³⁵ Section 60b, however, contained no express provision stating on which day damages were to be calculated. Neither was there any mention of the date of the preferential transfer nor the date of judgment.⁴³⁶ The Commission was candid in admitting that the case law interpretation of section 60b provided an award for value at the time of transfer and not at the time of judgment as recommended.⁴³⁷

As to the second point, usually the trustee has the right to elect either conversion (a forced sale of the property) or trespass to

of the same transaction. A set-off usually means an independent right, liquidated in nature arising out of an unrelated event. *See* J. COUND, J. FRIENDENTHAL & A. MILLER, *CIVIL PROCEDURE CASES AND MATERIALS* 505-06 (2d ed. 1974); *see also* *Household Fin. Corp. v. Hobbs*, 387 A.2d 198 (Del. Super. Ct. 1978) (a recoupment is defensive in character, does not provide affirmative relief, and must generally arise out of the same transaction originally sued upon); *Beneficial Fin. Co. v. Swaggerty*, 86 N.J. 602, 432 A.2d 512 (1981) (a recoupment may be utilized only to reduce or extinguish the plaintiff's recovery, set-off may be awarded for any amount to which the defendant is entitled).

433. REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. Doc. No. 93-137, Part II, 93d Cong., 1st Sess. § 609(a)(2), 179 (1973).

434. Chandler Act, ch. 575, § 60b, 52 Stat. 840, 870 (1938).

435. "Subdivision (a) is derived from § 60b, but § 60b only expressly deals with initial transferees who dispose of recoverable property." REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. Doc. No. 93-137, Part II, 93d Cong., 1st Sess., 180 (1973).

436. Specifically, former section 60b provided: "[t]he trustee may recover the property, or, if it has been converted, its value from any person who has received or converted such property. . . ." Chandler Act, ch. 575, § 60b, 52 Stat. 840, 870 (1938).

437. "Subdivision (a) also varies from § 60b, which allows the recovery of the value presumably at the date of transfer by the initial transferee, without qualification." REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. Doc. No. 93-137 Part II, 93d Cong., 1st Sess., 180 (1973); *see* *Klein v. Tabatchnick*, 459 F. Supp. 707 (S.D.N.Y. 1978), holding that damages should be calculated at the date of the preferential transfer in a case where the property (corporate warrants) had been rendered worthless by lapse of time. *Cf. In re Hygrade Envelope Corp.*, 272 F. Supp. 451 (E.D.N.Y. 1967) (The value of a preference may be determined either on the basis of the market value of the assets at the moment of the assignment or the extent of the depletion of the bankrupt's estate at that moment.); *Virginia Nat'l Bank v. Woodson*, 329 F.2d 836 (4th Cir. 1964) (damages determined by the diminution of the bankrupt's estate at the time of the preferential transfer).

chattels and return of the property.⁴³⁸ Former section 60b permitted the trustee to elect between the recovery of the property or its value.⁴³⁹ The Commission's granting the transferee the election was somewhat novel.

The Commission made a curious distinction between profits earned by the transferred property and the transferred property itself. To illustrate, assume that Widget stock is conveyed to T-1 after the filing of a voluntary petition and the transfer is therefore in violation of section 549. Assume further that Widget pays a 10% dividend between the time of the petition and the trustee's action for return of the stock or its value. The trustee takes the stock, but who gets the dividend?

The Commission proposal mentioned "profits" only once in connection with any recoupment given the transferee for improvements.⁴⁴⁰ Specifically, the Commission recommended that the trustee's recovery be offset by any improvements, but the transferee's improvements were to be "reduced by the amount of any profits realized from the property"⁴⁴¹

According to the Commission's definition of "improvements," it is difficult to imagine a case where any improvements could be made to the Widget stock. If a gold statue of King Tut was transferred instead of stock, however, a different situation would arise. Storage fees and paid personal property taxes would be considered "improvements."⁴⁴² Under the Commission proposal, T-1 would be allowed to recoup the cost of his improvements but would be required to deduct from the cost of these improvements any accumulated profits.

The Commission apparently intended that T-1 could keep his profits in the event that he made no claim for improvements, but

438. See generally PROSSER, *LAW OF TORTS* 80 (4th ed. 1971) (for a discussion of the elements of trespass and conversion).

439. *Irving Trust Co. v. Conte*, 22 F. Supp. 94 (S.D.N.Y. 1937) (the trustee has the election of whether to recover the property or to recover the value of the property at the time of transfer). Former section 70e, which permitted the trustee to set aside transactions which were voidable under nonbankruptcy law, provided that "[t]he trustee shall reclaim and recover such property or collect its value" Chandler Act, ch. 575, § 70e(2), 52 Stat. 840, 882 (1938).

440. REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. Doc. No. 93-137, Part II, 93d Cong., 1st Sess. § 4-609(d)(1), 179 (1973). For a complete text of the section, see *supra* note 427.

441. *Id.* at § 4-609(d)(1).

442. *Id.* Section 4-609(d)(2) specifically states that payment of taxes are improvements. I generously place storage fees in the category of "costs of preservation." For a complete text of the section, see *supra* note 427.

the Commission specifically stated that he was not entitled to profits where a claim for "improvements" was made. Thus, we can infer that except in a case of "improvements," the transferee could have kept his profits.

The wisdom behind letting a transferee who made no improvements keep his profits, while requiring a deduction of profits for those transferees who pay taxes, storage fees, or maintain the property escapes imagination. Profits are unrelated to improvements and vice versa. Neither should be tied to the other. The Commission proposal unwisely discouraged parties from making "improvements."

b. Subsequent Transferees

The governing language for subsequent transferees is found in Commission section 4-609(b)(1):

(b) Liability of Subsequent Transferees. (1) The trustee may not recover property referred to in subdivision (a) from a subsequent transferee of the initial transferee who purchases for value in good faith without knowledge of the voidability of the initial transfer, or from a transferee of such a transferee.⁴⁴³

Subsection (b)(2) provided that subsequent transferees failing to meet the tests of subsection 4-609(b)(1) would receive the same treatment as an initial transferee under subsection (a).⁴⁴⁴ Subsection (b)(3) further defined "immediate" transferees as those who first take from the initial transferee and "mediate" transferees as those who take from the immediate transferee. The Commission provided that both "mediate" and "immediate" transferees fall into the general category of "subsequent" transferees.⁴⁴⁵ Therefore, subsection (b)(1) provided that subsequent transferees were to be protected from the trustee's avoidance powers to set aside preferences, fraudulent conveyances, postpetition transfers and the like if: (1) they purchased for value; (2) were acting in good faith; and (3) were without knowledge that the transfer might be voidable.

The Commission chose not to elaborate on what was meant by "value." Terms such as "full value" or "present equivalent value"

443. H.R. Doc. No. 93-137, Part II, 93d Cong., 1st Sess. 179 (1973).

444. "Unless protected by paragraph (1) of this subdivision, a subsequent transferee of property referred to in subdivision (a) is liable to the trustee as though he were the initial transferee under subdivision (a)." H.R. Doc. No. 93-137, Part II, 93d Cong., 1st Sess. § 4-609(a), (b)(2), 179 (1973).

445. See *supra* note 426.

were deliberately omitted, immunizing subsequent transferees who paid less than full value from attack.

The Commission chose to rely on judicial interpretations in defining "good faith."⁴⁴⁶ Section 67d(1)(e)(1) of the Chandler Act, which governed fraudulent conveyances, gave limited protection to certain transferees who acted in "good faith."⁴⁴⁷ The Commission would not protect a transferee "if . . . [he] knew facts that would lead a reasonable person to believe that the property was recoverable."⁴⁴⁸ It is suggested that "good faith" could not have been present where the transferee was aware that he was paying a sum significantly less than the full value of the property.⁴⁴⁹

The third requirement of the Commission test, that the subsequent transferee be "without knowledge of the voidability of the transfer," is more troubling. The Commission notes do not provide any guidance. This language is susceptible to the interpretation that the transferee must subjectively believe that the transfer is subject to avoidance. Given the vagaries of the bankruptcy laws, it is conceivable that a postpetition transferee could in fact know of the prior bankruptcy but still believe that the transfer was valid notwithstanding bankruptcy.

This suggested construction, however, appears to be intertwined with the prior requirement that the subsequent transferee act in "good faith." It is difficult to imagine a transferee acting *with* "knowledge of the voidability of the transfer" while at the same time acting in "good faith." Thus, in order to give meaning to the requirement that the postpetition transferee not be aware of the voidability of the transfer, the Commission may have intended that more than a mere knowledge of the filing of bankruptcy be necessary.⁴⁵⁰ A transferee could be acting in good faith while at the

446. H.R. Doc. No. 93-137, Part II, 93d Cong., 1st Sess. 180 (1973).

447. Chandler Act, ch. 575, § 67d(1)(e)(1), 52 Stat. 840, 877 (1938).

448. H.R. Doc. No. 93-137, Part II, 93d Cong., 1st Sess. 180 (1973); *see Chorost v. Grand Rapids Factory Showrooms*, 77 F. Supp. 276 (D.N.J. 1948), *aff'd*, 172 F.2d 327 (3rd Cir. 1949) ("good faith" presupposes not only a lack of knowledge of the fraud but also a lack of knowledge of such facts as would put a reasonably prudent person on inquiry).

449. *See supra* text accompanying notes 289-92.

450. The third point of the Commission test demonstrates a weakness of the amalgamation approach of combining the treatment of liability for various types of transferees. Presumably, if it were a preferential transfer case, a subsequent transferee would not be acting in good faith if he knew that the original transfer was made in anticipation of bankruptcy in order to prefer a creditor. One court seems to have extended the "good faith" definition to the old test under former section 60b of requiring that the immediate transferee have reasonable cause to believe that the original transferor was insolvent. *See Jones v. Calhoun First Nat'l Bank (In re Greenbrook Carpet Co., Inc.)*, 22 Bankr. 86 (Bankr. N.D.

same time aware that a petition in bankruptcy has been filed. A transferee could not be acting in good faith while aware that the transaction was voidable.

The most significant proposal with respect to postpetition transfers was the one offered by the Commission that suggested that subsequent good faith transferees who met the three point test should enjoy immunity from the trustee's avoidance power.⁴⁵¹ The Commission indicated that this policy was but an extension of prior law under the Chandler Act.⁴⁵²

Specifically, the Commission cited former section 21g,⁴⁵³ which provided that a bona fide purchaser of real property who was not given constructive notice of bankruptcy could defeat a trustee.⁴⁵⁴ Again the Commission, citing former section 60b of the Chandler Act,⁴⁵⁵ excepted from preference liability "a bona fide purchaser from or a lienor of the debtor's transferee for a present fair equivalent value."

The Commission also cited former section 67a, which gave the trustee the power to set aside judicial liens acquired within four months of bankruptcy.⁴⁵⁶ Section 67a(3) provided that bona fide purchasers of the property at judicial and non-judicial sales were protected.⁴⁵⁷ And again, under section 67d, the trustee was empow-

Ga. 1982) (confusing "good faith" with having knowledge that the original transfer was insolvent). In fraudulent conveyance cases, good faith requires that the transferor be unaware that the conveyance was made with intent to defraud creditors. In any event, "knowledge of the voidability of the transaction" should imply a level of culpability on the part of the subsequent transferee. It is hard to see why mere knowledge that a prior transferor had filed bankruptcy implies the knowledge that subsequent transactions are voidable. Numerous parties and many lawyers have failed to grasp the fundamental principle of loss shifting occurring to the subsequent transferee if someone in the prior chain of title had no authority to transfer title.

451. See *infra* text accompanying notes 525-42.

452. "This section is derived from §§ 21g, 60b, 67a(3), 67d(6), and 70d(1) and (5) of the present Act. Those sections partially spell out the relative rights of the trustee and initial and subsequent transferees. The treatment of initial and subsequent transferees varies in each of the sections; some variation is justifiable as to initial transferees, but it is not as to subsequent transferees." H.R. Doc. No. 93-137, Part II, 93d Cong., 1st Sess. 179 (1973).

453. *Id.* For the text of the section 21g, see *supra* note 148.

454. See *supra* text accompanying notes 148-53.

455. Chandler Act, ch. 575, § 60b, 52 Stat. 840, 870 (1938); see *Cross v. Wagenmaker*, 329 Mich. 100, 44 N.W.2d 888 (1950).

456. Chandler Act, ch. 575, § 67a, 52 Stat. 840, 875-76 (1938).

457. "That the title of a bona fide purchaser of such property shall be valid, but if such title is acquired otherwise than at a judicial sale held to enforce such lien, it shall be valid only to the extent of the present consideration paid for such property." *Id.* at 876; see *Bryan v. Jackson*, 178 Va. 123, 116 S.E.2d 366 (1941) (finding that a purchaser from the bankrupt's wife, to whom the bankrupt had transferred property within the four months prior to bankruptcy, was protected as a bona fide purchaser for a present fair equivalent value).

ered to set aside certain fraudulent conveyances. The Commission noted that while section 67d gave the trustee an action against the debtor's transferee, any further transfer was immunized from attack in cases that involved bona fide purchasers and lienors who gave full value.⁴⁵⁸

In cases where real property, judicial liens acquired within four months of bankruptcy and fraudulent conveyances were involved, the Commission was correct. Subsequent transferees acting in good faith were protected under prior law. But in order to support its position, the Commission also cited 70d(1) and 70d(5), which governed postpetition transfers.⁴⁵⁹ Recall that section 70d(1) protected good faith transferees dealing with the debtor between the filing of a petition and the debtor's adjudication of bankruptcy.⁴⁶⁰ Because with voluntary petitions, adjudication was automatic,⁴⁶¹ section 70d(1) was effectively limited to involuntary cases. Section 70d(5) also provided that the Chandler Act was not to impair the negotiability of currency or negotiable instruments.⁴⁶²

Other than cases that involved negotiable instruments and currency, there was nothing in section 70d(1) which immunized subsequent transferees of personalty where the transfer occurred after adjudication. The Commission proposal offered a significant extension of protection for those parties not involved in the initial postpetition transfer, but who were subsequent transferees of the property.

2. BANKRUPTCY CODE

The most striking change from the Chandler Act was Congress's acceptance of the Commission's recommendation to combine the treatment of all transferees into one section. Section 550 of the 1978 code governs the liability of such transferees.⁴⁶³ Recall

458. If the conveyance was fraudulent, title was "void against the trustee, except as to a bona fide purchaser, lienor, or obligee for a present fair equivalent value" Chandler Act, ch. 575, § 67d(6), 52 Stat. 840, 878 (1938). And further, in cases where "consideration was less than fair," transferors who took "without fraudulent intent" were given a lien to the extent of payment. Chandler Act, ch. 575, § 67(d), (e), 52 Stat. 840, 877 (1938); see *In re Kentucky Book Mfg. Co.*, 30 F. Supp. 400 (W.D. Ky. 1939).

459. See *supra* note 452.

460. See *supra* text accompanying notes 120-30.

461. *Supra* note 11.

462. See *supra* text accompanying notes 135-47.

463. 11 U.S.C. § 550 (1982) provides:

(a) Except as otherwise provided in this section, to the extent that a transfer is avoided under section 544, 445, 547, 548, 549, or 724(a) of this title, the trustee may recover, for the benefit of the estate, the property transferred, or, if

that the Chandler Act, depending on the particular type of transfer involved, appeared to give disparate treatment regarding liability. The protection accorded a subsequent transferee, for example, could well have depended on whether the original transfer was set aside as a preference, fraudulent conveyance, or postpetition transfer.

a. Initial Transferees

Bankruptcy Code section 550(a)(1) governs the liability of initial transferees where the transfer is found to amount to either a preference, fraudulent conveyance, postpetition transfer, or the like. It states:

(a) Except as otherwise provided in this section, to the extent that a transfer is avoided under . . . this title, the trustee may

the court so orders, the value of such property, from-

(1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or

(2) any immediate or mediate transferee of such initial transferee.

(b) The trustee may not recover under section (a)(2) of this section from-

(1) a transferee that takes for value, including satisfaction or securing of a present or antecedent debt, in good faith, and without knowledge of the voidability of the transfer avoided; or

(2) any immediate or mediate good faith transferee of such transferee.

(c) The trustee is entitled to only a single satisfaction under subsection (a) of this section.

(d) (1) A good faith transferee from whom the trustee may recover under subsection (a) of this section has a lien on the property recovered to secure the lesser of-

(A) the cost, to such transferee, of any improvement made after the transfer, less the amount of any profit realized by such transferee from such property; and

(B) any increase in value as a result of such improvement, of the property transferred.

(2) In this subsection, "improvement" includes -

(A) physical additions or changes to the property transferred;

(B) repairs to such property;

(C) payment of any tax on such property;

(D) payment of any debt secured by a lien on such property;

(E) discharge of any lien against such property that is superior or equal to the rights of the trustee; and

(F) preservation of such property.

(e) An action or proceeding under this section may not be commenced after the earlier of-

(1) one year after the avoidance of the transfer on account of which recovery under this section is sought; and

(2) the time the case is closed or dismissed.

recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property, from—

- (1) the initial transferee of such transfer or the entity for whose benefit such transfer was made⁴⁶⁴

The drafters adopted the Commission's recommendation giving a lien to good faith transferees to the extent of any improvements made in the property, along with any increase in value due to the improvement.⁴⁶⁵ "Improvements" were defined as physical additions, repairs, payment of taxes, payment of secured claims on the property, and other efforts to preserve the property.⁴⁶⁶

Again, the drafters embraced the Commission's proposal that the lien given the transferee for improvements be reduced by "the amount of any profit realized by (the) transferee from (the) property" ⁴⁶⁷ It seems, by implication, that the transferee is able to

464. 11 U.S.C. § 550(a)(1) (1982).

465. 11 U.S.C. § 550(d) (1982). Recently, the Senate passed Senate Bill 445 which offers technical and clarifying amendments to the 1978 Code. Among the sections addressed were sections 550(d)(1)(A) and (B). Subdivision (A) is discussed *infra* note 467. The amendment struck the word "value" in subdivision (B) and the language "the value of such property" was substituted. The bill was designed to clarify the original language by specific language referring to inflation in value of the property transferred. S. 445, 98th Cong., 1st Sess., 94-95 (1983). Thus, the amendment gives the transferee a lien "to secure the lessor of any increase in the value of such property as a result of such improvement."

466. Section 550(d)(2)(D) provides that improvement shall include the "payment of any debt secured by a lien on such property," and subsection (E) further defines improvements as "discharge of any lien against such property that is superior or equal to the rights of the trustee." 11 U.S.C. § 550(d)(2) (1982) (amended 1984). The question raised by these two subdivisions is whether or not there is any difference between payment of a debt secured by a lien and discharging the lien itself. The new amendment discussed *supra* at note 430, combines subsections (D) and (E) into one section worded as follows: "(D) Payment of any debt secured by a lien on such property that is superior or equal to the rights of the estate." 11 U.S.C.A. § 550(d) (Supp. 1984).

The discharge of a lien is an improvement. The case of *Beck v. Amato (In re Amato)*, 10 Bankr. 120 (Bankr. S.D. Fla. 1981), involved a case where a recoupment for an improvement was clearly available. In that case, the debtors fraudulently conveyed, in violation of section 548, certain real estate to their daughter. The real estate conveyed was subject to a contract for deed in which the debtors were the vendees. After the fraudulent conveyance, the daughter took over the contract and made several payments on it. The court ruled that while the trustee could recapture the property, since the daughter was acting in good faith, she would have a lien for improvements to the extent that she made payments on the contract. *Cf. Home Life Ins. Co. v. Jones (In re Jones)*, 20 Bankr. 988 (Bankr. E.D. Pa. 1982) (noting that the payment of *junior* liens by a first mortgage could be recouped as an improvement increasing value).

467. 11 U.S.C. § 550(d)(1)(A) (1982) (amended 1984). For a complete text of this section see *supra* note 463. By inserting the language "or accruing to" after "by," the new amendment to section 550(d)(1)(A) gives the transferee a lien "to secure the lesser of (A) the cost, to such transferee, of any improvement made after the transfer, less the amount of profit by or accruing to such transferee from such property." It seems clear that this amend-

keep any profit derived from the property when no improvements are made, but when improvements are made, no profits can be gained.

The drafters of the 1978 code gave the court the right to elect whether the property or its value should be paid to the estate. Thus, the drafters chose to ignore the traditional theory of giving the plaintiff the election of remedies⁴⁶⁸ and instead adopted the Commission's theory of giving the transferee the election of remedies.⁴⁶⁹

It is generally assumed that the bankruptcy court is a court of equity.⁴⁷⁰ Traditionally, the equity chancellor had the limited power to grant only a "clean-up remedy."⁴⁷¹ Section 550(a) departs from historical solutions by giving the suitor the right to elect remedies. In addition, the section is totally lacking in any standards that guide the court in deciding which remedy to grant.⁴⁷²

b. Subsequent Transferees

Subsection 550(a)(2) appears to reject the Commission's recommendation of protecting subsequent transferees by permitting the trustee to recover from "any immediate or mediate transferee of such initial transferee."⁴⁷³ Subsection (b) severely limits the scope of subsection (a)(2), providing that:

ment was intended to cover cases involving stock dividends, interest, and the like, where the profit was not earned "by" the transferee but nevertheless "accrued" to him by virtue of ownership of the property.

468. See *supra* note 438.

469. See *supra* text accompanying notes 438-39.

470. *Katchen v. Landy*, 382 U.S. 323, 336 (1966); *Pepper v. Litton*, 308 U.S. 295, 304 (1939); *Local Loan Co. v. Hunt*, 292 U.S. 234, 240 (1934).

471. See *Whitlock v. Hause*, 694 F.2d 861, 863 (1st Cir. 1982); see also *In re Newman*, 14 Bankr. 1014 (Bankr. S.D.N.Y. 1981) (holding that a jury is not available where the legal relief falls within the "clean-up" doctrine). See generally *McCLINTOCK, McCLINTOCK ON EQUITY* § 52 (1948) (analyzing court's powers to retain jurisdiction to give complete relief).

472. "[Section 550(a)] changes the law under the old Act; there is no 'conversion' requirement and the trustee may recover the value of the property transferred if the court so orders. However, there are not guidelines for when the court may permit or order recovery of the property's value." *Chrysler v. Mersman Tables, Inc. (In re The Furniture Den, Inc.)*, 12 Bankr. 522, 526 (Bankr. W.D. Mich. 1981); cf. *A & S Sales & Leasing, Inc. v. Belize Airways Ltd. (In re Belize Airways Ltd.)*, 7 Bankr. 601 (Bankr. S.D. Fla. 1980) (holding that when the property had been transferred to a subsequent transferee, the court had no choice but to award a judgment for the value of the property); *Tavormina v. Brummer (In re Centre De Tricots De Gaspé Ltee)*, 24 Bankr. 93, 96 (Bankr. S.D. Fla. 1982); *Klein v. Tabatchnick*, 459 F. Supp. 707 (S.D.N.Y. 1978) (holding that the trustee may recover the value of the property where the property has been converted in such a way that it cannot be returned in substantially as good condition as when the bankrupt had it).

473. 11 U.S.C. § 550(a)(2) (1982).

(b) The trustee may not recover under section (a)(2) of this section from—

(1) a transferee that takes for value, including satisfaction or securing of a present or antecedent debt, in good faith, and without knowledge of the voidability of the transfer avoided; or

(2) any immediate or mediate good faith transferee of such transferee.⁴⁷⁴

Although section 550(a)(2) permits the estate to recover from “immediate” or “mediate” transferees, subsection (b) makes subsection (a)(2) inapplicable to such transferees when they pay value in good faith and are without knowledge of the voidability of the transfer. Thus, in reality, the drafters embraced the Commission’s recommendation that subsequent transferees be protected where they (1) paid value; (2) were acting in good faith;⁴⁷⁵ and (3) were without knowledge of the voidability of the original transfer.

Section 550(b) provides that the payment or securing of antecedent indebtedness constitutes value. Recall that the Commission did not attempt to further define value. The drafters of the 1978 code clarified the issue by including as “value” the satisfaction or securing of present or antecedent debts.

The drafters’ position, that cancellation of antecedent indebtedness constitutes value, is subject to criticism. Consider two cases. In case one, T-2, a subsequent transferee, receives a postpetition transfer of a widget from T-1, the initial transferee, by paying \$10,000 cash. If the subsequent transferee acts as an innocent third party and without knowledge proceeds in good faith, he may well be deserving of protection.

In case two, T-2 merely cancels an outstanding \$10,000 debt in

474. 11 U.S.C. § 550(b) (1982).

475. See *In re Jones v. Calhoun First Nat’l Bank (In re Greenbrook Carpet Co., Inc.)*, 22 Bankr. 86 (Bankr. N.D. Ga. 1982) wherein a bankruptcy court denied protection to a subsequent transferee on the grounds that it was acting in bad faith. The court accepted a New York state court’s definition of “good faith” as “a failure to deal honestly, fairly and openly.” 22 Bankr. at 90 (quoting *Southern Indus., Inc. v. Jeremias*, 66 A.D.2d 178, 183, 411 N.Y.S.2d 945, 949 (1978)).

It seems that the *Greenbrook* opinion mistakenly equates bad faith with a “reasonable cause to believe insolvency,” which was a requirement to the establishment of a preference under the old Act and remains a requirement in insider cases under the 1978 code. See 11 U.S.C. § 547(b) (1978). Under state law, the mere fact that one has notice that a transferor is preferring him over the transferor’s other creditors does not subject the transfer to attack. “[I]t is long-settled in commercial law that a debtor may voluntarily prefer one creditor over another” *Strickler v. Thomas (In re Thomas)*, 7 Bankr. 389, 392 (Bankr. W.D. Va. 1980).

exchange for the widget. In this case, there has been no reliance on the fact that T-1 had apparent authority to transfer the widget.⁴⁷⁶ If T-2's title is defeated, he has an action for breach of warranty of title against T-1 and his \$10,000 claim would be reinstated,⁴⁷⁷ leaving T-2 in the same position that he occupied before the transfer.

The drafters' result gives T-2 a windfall at the expense of the creditors of the bankruptcy estate. In rare instances, true reliance (as opposed to cancelling an old debt) on the initial transferee's authority to transfer may be established.⁴⁷⁸ Occasionally there may be a change of circumstances, such as a change in financial condition of the initial transferee, making it inequitable to merely reinstate the claim of a subsequent transferee.⁴⁷⁹ In most cases, it

476. A number of courts have considered the question of whether or not a judgment lien creditor should be considered a bona fide purchaser. The courts dealing with the issue are split. See Annot., 4 A.L.R. 434 (1919). Those holding against the judgment creditor are based on the rationale that a party who merely cancels an antecedent indebtedness has not relied on the record in reducing his claim to judgment and therefore is not entitled to protection.

"A conveyance of real or personal property as security for an antecedent debt does not, upon principle, render the transferee a bona fide purchaser, since the creditor parts with no value, surrenders no right, and places himself in no worse legal position than before. The rule has been settled, therefore, in very many of the states, that such a transfer is not made upon a valuable consideration, within the meaning of the doctrine of bona fide purchaser."

Sparrow v. Wilcox, 272 Ill. 632, 639, 112 N.E. 296, 298 (1916) (quoting *POMEROY*, 2 EQUITY JURISPRUDENCE § 749 (3d ed.)). But see *Wight v. Chandler*, 264 F.2d 249 (10th Cir. 1959). "[U]nless a controlling statute provides otherwise, the cancellation of a pre-existing debt constitutes sufficient consideration for the conveyance of property; and that one who cancels and extinguishes a pre-existing debt as consideration for the conveyance to him of property becomes a purchaser for value." 264 F.2d at 251.

477. U.C.C. § 2-312(1) provides for a breach of warranty of title in sale of goods cases. Unless explicitly excluded, or the circumstances are such as to indicate otherwise, there is in every contract for the sale of goods a warranty that the goods will be delivered free from encumbrances. See *Wright v. Vickaryous*, 611 P.2d 20 (Alaska 1980). In real property cases, where the transfer is by warranty deed, a warranty of title is given. See *Maxwell v. Redd*, 209 Kan. 264, 496 P.2d 1320 (1972).

478. A judgment creditor who goes to the trouble and expense of obtaining his judgment, in view of the condition of the record, is generally in a different position from one who obtains his judgment, but seeks to make the same out of property subsequently acquired by the judgment debtor, in which case he has neither gained nor lost anything or been misled in any way, either in obtaining his judgment or by the action of the judgment debtor, hence he is not in the position of a bona fide purchaser for value.

Sparrow, 272 Ill. at 641-42, 112 N.E. at 299 (1916). In the unusual case where a creditor can establish that he took the trouble and expense of reducing the antecedent indebtedness to judgment based upon a belief that the defendant owned the property in dispute, true reliance may be established.

479. See, e.g., U.C.C. § 3-502(1)(b) governing the liability of a drawer on a check where there has been a delay in notice of dishonor and presentment of the instrument. The section provides that the drawer is excused from liability on the check only if the "drawee or payor

seems like nothing would be lost by simply returning the parties to their respective positions that they occupied before the second transfer to the subsequent transferee.

The reader should also look at the potential liability of the transferee when there are even further transfers. Such "immediate" and "mediate" transferees who take from the subsequent transferee are protected under 550(b)(2) if they acted in good faith.⁴⁸⁰ They need not have paid value and they may even be aware of the filing of the petition. Thus, in the above example, if the widget is again transferred to T-3, T-3 is protected if he acted in good faith.

In reaching this result, the legislative history indicates that Congress was applying the "shelter" principle⁴⁸¹ to subsequent transferees and allowing T-3 to acquire whatever rights T-2 had. If the Trustee could not defeat T-2, he should not be able to defeat T-3. If, however, T-1 reacquires the widget from T-2, he may not be acting in good faith.⁴⁸²

bank becomes insolvent during the delay is deprived of funds maintained with the drawee or payee bank to cover the instrument" Cases could arise where a subsequent transferee cancelled out an antecedent debt in exchange for the transfer of estate property. If in the delay between the time of transfer and the trustee's action to recover the property, the initial transferee becomes insolvent, the subsequent transferee may be able to show that he would have been able to collect the debt if he had not taken the property and cancelled the debt.

480. "The trustee may not recover . . . from . . . any immediate or mediate good faith transferees of such transferee." 11 U.S.C. § 550(b)(2) (1982); *see* *Coleman v. Home Savings Assoc.* (*In re Coleman*), 21 Bankr. 832, 836, 9 BANKR. CT. DEC. (CRR) 364 (Bankr. S.D. Tex. 1982) (dictum); 4 COLLIER ON BANKRUPTCY § 550.03 (15th ed. 1981).

481. *See, e.g.*, U.C.C. § 3-201 ("Transfer of an instrument vests in the transferee such rights as the transferor has therein . . .").

482. The phrase 'good faith' in this paragraph is intended to prevent a transferee from whom the trustee could recover from transferring the recoverable property to an innocent transferee, and receiving retransfer from him, that is, 'washing' the transaction through an innocent third party. In order for the transferee to be excepted from liability under this paragraph, he himself must be a good faith transferee.

H.R. REP. NO. 95-595, 95th Cong., 1st Sess. 376 (1977); S. REP. NO. 95-989, 95th Cong., 2d Sess. 90 (1978).

It is questionable whether or not the good faith requirement of section 550(b) will have general applicability in postpetition transfer cases. Doubtless the drafters of the Code were aware of the comments to U.C.C. § 3-201 when they expressed their concern about "'washing' the transaction through an innocent third party." *See* U.C.C. § 3-201 comment 3. It is interesting to note that two examples given by the U.C.C. drafters involve cases where a party acquires negotiable instruments by fraud and then reacquires them from a holder in due course, possibly avoiding a claim of fraud. Query, could an initial transferee who acquires estate property in violation of section 549 be sheltered under section 550(b)(2)? Take for example, the case of the initial transferee who was completely unaware of the bankruptcy filing and was duped into taking the property by the debtor. If he subsequently

c. Case Law Construction of Section 550

In *In re Furniture Den, Inc.*,⁴⁸³ the court indicated that section 550 would be given a strict construction. In that case T-1, a judgment creditor, successfully recovered over \$3,000 from the debtor as the result of an execution proceeding arising within 90 days after the filing of bankruptcy. The court quickly determined that the payment of the \$3,000 was preferential and therefore void under section 547.⁴⁸⁴ T-1, however, actually received only \$2,200 in funds. Approximately \$800 was deducted for judicial expenses and T-1's attorney fees.⁴⁸⁵

T-1 argued that cases that construed former section 60b allowed preferred creditors to deduct sales expenses from any recovery up to the value of the property. He asserted that the trustee should recover only \$2,200. He reasoned that the trustee would have had to employ his own attorney, and therefore sales expenses would have been incurred anyway. These expenses then were deducted from the trustee's recovery under the Chandler Act. The court acknowledged that the status of the law under the Chandler Act permitted credit for such expenses⁴⁸⁶ but failed to find such authority in section 550.⁴⁸⁷

The court also rejected the transferee's claim that he had discharged an attorney's lien on the property and therefore had "improved" it as defined by that section. "It is hard to see how discharge of the attorney's lien on the transferred funds would improve their value when the attorney's lien would not have attached but for the preferential transfer itself."⁴⁸⁸

In the *Furniture Den* case, the court could have reached the same result without implying that authority for the recoupment or credit must be found within section 550 itself. The transferee's re-

transfers the property to subsequent transferee and then reacquires it upon a threat from the subsequent transferee, can it be said that the initial transferee was acting in bad faith? Note that "good faith" is *all* that the section appears to require.

Perhaps the above is a needless exercise in the trivial. It seems clear that the initial transferee could still be sued for the value of the property at the time of transfer. *See supra* text accompanying notes 468-72. But the transferee may still have a defense as to the property itself under section 550(b)(2) because he is acting in good faith.

483. 12 Bankr. 522 (Bankr. W.D. Mich. 1981).

484. *See* 11 U.S.C. § 547(b) (1982) (setting forth the elements needed to establish a preferential transfer).

485. 12 Bankr. at 523.

486. The court relied on *Wolcott v. Commercial Inv. Trust, Inc.*, 7 F. Supp. 809 (S.D.N.Y. 1934).

487. 12 Bankr. at 527.

488. *Id.*

liance on cases under prior law that gave a credit for attorney fees and other expenses expended for the *sale* of the property was obviously misplaced. In *Furniture Den*, the transferee paid the attorney a one-third contingent fee for collecting the debt. It is difficult to see how fees expended in the collection of monies that are subsequently returned to the estate in any way benefits the estate or saves any significant expenses.

The case of *In re Curtina International Inc.*,⁴⁸⁹ exemplifies a more equitable construction of section 550. In that case, Bankruptcy Judge Swartzberg ruled that under Article 6 of the Uniform Commercial Code, a creditor could void a bulk sales transaction that did not fully comply with state bulk sales law. It was also voidable in its entirety by the trustee under section 544b⁴⁹⁰ of the 1978 code. The bulk sale brought \$67,000 to the debtor-transferor, but almost \$45,000 of those funds were on deposit in the debtor's account at the time of filing of bankruptcy.

Judge Swartzberg ruled that the trustee's recovery was to be reduced by the \$45,000. Although nothing in section 550 expressly required this credit, to rule otherwise would have given the estate a \$45,000 windfall. Section 550(c) provides that the trustee is only entitled to a "single satisfaction."⁴⁹¹ That provision was probably intended to prevent the trustee from recovering judgments against both T-1 and T-2.⁴⁹² The *Curtina* case squarely fits section 550(c)'s policy of preventing the estate from receiving a windfall. In any event, however, perhaps a further amendment to section 550 would be useful to codify the result in *Curtina*.⁴⁹³

489. *Murdock v. Plymouth Enter., Inc. (In re Curtina Int'l, Inc.)*, 23 Bankr. 969 (Bankr. S.D.N.Y. 1982).

490. 11 U.S.C. § 544(b) (1982) generally provides that the trustee may recover from the estate a transfer which is subject to avoidance by an actual creditor under applicable non-bankruptcy law. In the *Curtina* case, the court applied the landmark case of *Moore v. Bay*, 284 U.S. 4 (1931) and set aside the entire bulk sales transfer. Subsequent cases construing *Moore* hold that the trustee's avoidance power is not limited by the amount of the claim of the creditor who is in a position to avoid the transfer. Once it is established that a creditor can avoid the transaction, the entire transfer is set aside. The House and Senate Reports make clear that the drafters of the new bankruptcy code intended to carry forward the doctrine of *Moore* into present law. H.R. REP. No. 95-595, 95th Cong., 1st Sess. 370 (1977); S. REP. No. 95-989, 95th Cong., 2d Sess. 85 (1978).

491. 11 U.S.C. § 550(c) (1982). For a complete text of section 550, see *supra* note 463.

492. See H.R. REP. No. 95-595, 95th Cong., 1st Sess. 376 (1977). "Subsection (c) is a further limitation on recovery. It specifies that the trustee is entitled to only one satisfaction, under subsection (a), *even if more than one transferee is liable.*" (emphasis added)

493. A simple amendment to section 550 permitting the transferee a credit to the extent that the bankruptcy estate retains the proceeds from the sale of estate property would codify the result.

IV. CRITIQUE OF THE 1978 ACT

This final section investigates the efforts made by the drafters of the 1978 reform. This critique follows the order used above. First, this critique addresses the code's substantive treatment of postpetition transfers. Second, an examination is made of the remedial provision—section 550. After critiquing the work of the 1978 drafters, the author offers a solution to many of the problems encountered above.

A. *A Theory of Avoiding Postpetition Transfers*

The bankruptcy law treatment of parties dealing with the debtor after a petition has been filed reveals that, since the turn of the century, Congress and the courts have been generally willing to follow the principle of *caveat emptor*, i.e. upon the filing of a petition in bankruptcy, the debtor lacks authority to transfer any assets of the bankruptcy estate. Given the transferor's lack of authority, the transferee ordinarily does not take title. The buyer assumes the risk of any problems in the seller's title or the genuine lack of good faith in the entire transaction.⁴⁹⁴

After reaching this basic conclusion, however, we have seen that the courts and Congress have riddled this general rule with exceptions. Bona fide purchasers of real estate were protected.⁴⁹⁵ Other parties dealing with the debtor who were truly innocent, lacked knowledge of the bankruptcy, and did not have the means of ascertaining such knowledge were also protected.⁴⁹⁶ The Supreme Court in *Marin* took the extraordinary step of protecting the innocent and blameless bank despite the clear legislative intent that no exception was to be given. Other courts, desiring to protect innocent parties at the expense of bankruptcy creditors, have reached similar results despite the clear intent of the bankruptcy statutes.⁴⁹⁷

Two mutually exclusive concerns seem to control Congress and the court's purpose in these exceptions. The first of these cases involves situations where non-bankruptcy law (usually state law) has created a system whereby buyers and other transferees are pro-

494. See *supra* authorities cited notes 27-28.

495. See *supra* authorities cited note 87.

496. *E.g.*, *Frederick v. Fidelity Mutual Life Ins. Co.*, 256 U.S. 395 (1921) discussed *supra* at text accompanying notes 83-86.

497. *E.g.*, *In re Smith Corset Shops, Inc.*, 696 F.2d 9711 (1st Cir. 1982) discussed *supra* at text accompanying notes 325-26; *In re Yellow Cab Co.*, 4 BANKR. CT. DEC. (CRR) 382 (E.D. Pa. 1978), discussed *supra* note 133.

tected from defects in the title and the authority of the transferor.

The most salient example of this is the bona fide purchaser of real estate. The original Congressional treatment in this area simply gave the bankruptcy trustee title to all of the bankrupt's property.⁴⁹⁸ No exception was mentioned for real estate, although the provision did permit the trustee to record evidence of title. The courts would not tolerate a case where the rights of a bona fide purchaser, who relied on the state real estate records, could be cut off by the filing of bankruptcy by the purchaser's transferor. The Chandler Act adopted this protection,⁴⁹⁹ and it has been carried forward into present law.⁵⁰⁰ Even though Congress had nothing to do with the creation of the now well-established system of real estate conveyances, the reliance interest of such purchasers was honored at the expense of the creditors of the bankruptcy estate.

It is possible to require title searchers of real property, prior to closing real estate deals, to check the bankruptcy filings in the nearest federal court. There would be no practical limit as to how far back the purchaser would be required to check these bankruptcy records. Moreover, bankrupts file their petitions only at the place of their domicile.⁵⁰¹ If they own real estate in a district other than that of their domicile, it would be impractical to require purchasers to check the records of areas other than where the property is located.

In the majority of cases, where the bankrupt's real property is located in the district of his domicile, the practice of requiring such a record search would be unwise. State law encourages purchasers to check only *one* set of records—those located in the county where the realty is domiciled. Drafting a new set of rules for title searchers in order to accommodate the administration of bankruptcy, while constitutional, would unfairly extend the bankruptcy power to the detriment of the unwitting real property purchaser.

The present bankruptcy code does not afford protection to any

498. 9 U.S. COMP. STAT. 1916 Ann. 11299, § 21e, discussed *supra* at text accompanying notes 89-92.

499. Chandler Act, ch. 575, § 21g, 52 Stat. 840, 853 (1938), discussed *supra* at text accompanying notes 148-55.

500. 11 U.S.C. § 549(c) (1982) (amended 1984), discussed *supra* at text accompanying notes 354-71.

501. See 28 U.S.C. § 1472(1) (1982) providing that a case "may be commenced in the bankruptcy court for a district - (1) in which the domicile, residence, principal place of business . . . of the person or entity that is the subject of such case have been located for the 180 days immediately preceding such commencement"

other set of transferees who may have been encouraged by non-bankruptcy laws to rely on the validity of the transaction. This is unfortunate.⁵⁰² If the present framework for postpetition transfers remains, other transferees, equally deserving of the real estate, will make a deal with the debtor, pay good value, and receive nothing.

For example, the exception for purchasers of negotiable instruments and the transferees of currency should have continued. The protection should also have been extended to purchasers who take negotiable documents by due negotiation.⁵⁰³ The same status should be afforded to purchasers of securities.⁵⁰⁴ Recent authorities

502. Even the all-powerful IRS's secret lien, *see* 26 U.S.C. § 6321 (1982), for unpaid taxes is subordinated to the rights of innocent parties. Unfiled tax liens are subordinate to bona fide purchasers, 26 U.S.C. §§ 6523(a), (b)(6) (1982), secured parties, 26 U.S.C. §§ 6323(a)(h)(1) (1982), judgment lien creditors, 26 U.S.C. § 6323(a) (1982), and mechanics lienors, 26 U.S.C. §§ 6323(a), 6323(h)(2). Even a filed tax lien is invalid against purchasers of investment securities, 26 U.S.C. § 6323(b)(1) (1982), purchasers of motor vehicles, 26 U.S.C. § 6323(b)(2), and buyers in ordinary course of business. 26 U.S.C. § 6323(b)(3) (1982).

503. U.C.C. § 7-502 provides:

(1)[A] holder to whom a negotiable document of title has been duly negotiated acquires thereby:

- (a) title to the document;
- (b) title to the goods;
- (c) all rights accruing under the law of agency or estoppel, including rights to goods delivered to the bailee after the document was issued; and
- (d) the direct obligation of the issuer to hold or deliver the goods according to the terms of the document free of any defense or claim by him except those arising under the terms of the document or under this Article. In the case of a delivery order the bailee's obligation accrues only upon acceptance and the obligation acquired by the holder is that the issuer and any indorser will procure the acceptance of the bailee.

(2) Subject to the following section, title and rights so acquired are not defeated by any stoppage of the goods represented by the document or by surrender of such goods by the bailee, and are not impaired even though the negotiation or any prior negotiation constituted a breach of duty or even though any person has been deprived of possession of the document by misrepresentation, fraud, accident, mistake, duress, loss, theft or conversion, or even though a previous sale or other transfer of the goods or document has been made to a third person.

E.g., *R.E. Huntley Cotton Co. v. Fields*, 551 S.W.2d 472, 21 U.C.C. REP. SERV. 1157 (Tex. Civ. App. 1977).

504. U.C.C. § 8-302 provides in part:

(1) A "bona fide purchaser" is a purchaser for value in good faith and without notice of any adverse claim:

- (a) who takes delivery of a certificated security in bearer form or in registered form, issued or indorsed to him or in blank;
- (b) to whom the transfer, pledge, or release of an uncertificated security is registered on the books of the issuer;

(2) "Adverse claim" includes a claim that a transfer was or

have suggested that the death-knell of the doctrine of the holder in due course of the negotiable instrument has arrived.⁵⁰⁵ Cases that rely on the negotiability of such instruments are rare and in any event are not of commercial necessity. There is some evidence that the drafters were in fact aware of the full import of the Chandler Act's treatment of the holder in due course and purposely chose to discard it in the case of postpetition transfer case.⁵⁰⁶

Even if one wishes to debate the continued validity of the holder in due course doctrine, there is no justification for preventing a postpetition transferee from relying on the debtor's ability to transfer *currency*.⁵⁰⁷ As the law presently exists, it is more than a theoretical possibility that a trustee in bankruptcy may be able to recover the cash that the debtor used to buy a widget or other item after the petition was filed. Protection has been omitted from the 1978 code.⁵⁰⁸ It may not be too long before some trustee attempts

would be wrongful or that a particular adverse person is the owner of or has an interest in the security.

(3) A bona fide purchaser in addition to acquiring the rights of a purchaser . . . also acquires his interest in the security free of any adverse claim.

E.g., *Ogilvie v. Idaho Bank & Trust Co.*, 99 Idaho 361, 582 P.2d 215, 24 U.C.C. REP. SERV. 1267 (1978).

505. *E.g.*, Hansford, *The Holder-In-Due-Course—An Endangered Species?*, 37 ALA. L. REV. 540 (1976) (detailing the demise of the doctrine in consumer transactions); Rosenthal, *Negotiability—Who Needs It?*, 71 COLUM. L. REV. 375 (1971) (suggesting that holder-in-due-course status for depository banks be severely curtailed).

506. Professor Frank Kennedy served as Executive Director for the Bankruptcy Commission, described *supra* note 236. In response to an inquiry from this author on the Commission's position on the holder-in-due-course question he stated:

You are also correct, I believe, in your reading of § 4-605 to withhold protection of a post petition holder in due course if the notice authorized by § 4-605(c) had been filed I think you are right that § 549 of the Bankruptcy Code does not protect a holder in due course who has not given present value after the filing of the petition. Notes 3 and 4 accompanying the Commission's proposed § 4-605 show that we thought a good deal about the holder in due course, but I do not recall encountering any discussion in the legislative history of the Bankruptcy Reform Act, of the need to accord any particular protection to holders in due course. Nor do I now recall any discussions with the staffs of the House and Senate Judiciary Committees regarding such holders. There may have been an oversight. On the other hand, the position of the holder in due course has undergone serious erosion, at least in academic circles in recent years.

Letter to Darrell Dunham from Professor Frank R. Kennedy, April 23, 1983. The Commission notes that Professor Kennedy refers to are discussed *supra* at text accompanying notes 304-07. Commission section 4-605 required, *inter alia*, that the trustee file a notice before he could successfully set aside a postpetition transfer. See *supra* note 305.

507. Both the Commission and the drafters of the new code for some reason omitted protection for transferees of currency. See *supra* text accompanying notes 298-310.

508. See *supra* text accompanying notes 308-310.

to invalidate a cash transaction, and not long thereafter some court may reach a *Marin*-type result.

Modern technology of automatic electronic tellers and the like has created all the characteristics of a cash transaction.⁵⁰⁹ As was true with the credit card, certain transferees, principally retailers, are more likely to enter into a deal if it is an electronic fund transfer case because it takes on all of the aspects of a cash transaction.

Certificate of title transactions also belong in this category. Numerous states have now created legislation, principally involving motor vehicles, encouraging transferees to look at certificates of title prior to purchasing the vehicle.⁵¹⁰ If the title is clean, the buyer usually can be assured that no third party will upset the transaction.⁵¹¹ The universal acceptance of certificate of title transactions would further the interests of the commercial community by validating transfers that occur after a petition in bankruptcy is filed.

One other party who relies on nonbankruptcy law deserves protection. Buyers in the ordinary course of business are generally

509. Sections 902 through 920 of the Consumer Credit Protection Act, 15 U.S.C. § 1693 (1978), and Federal Reserve Board Regulations promulgated under section 904, govern electronic fund transfers. These sections provide:

The term 'electronic fund transfer' means any transfer of funds . . . which is initiated through an electronic terminal, telephonic instrument, or computer or magnetic tape so as to order, instruct, or authorize a financial institution to debit or credit an account. Such term includes, but is not limited to, point-of-sale transfers, automated teller machine transactions, direct deposits or withdrawals of funds, and transfers initiated by telephone.

C.C.P.A. § 903(a)(6); 15 U.S.C. § 1693a(6) (1978). Such transactions are treated alike because they all involve an automatic electronic debit of the consumer's account. The transferee cannot be said to in any way rely on the credit of the consumer.

Federal regulation of the credit card industry has transformed many cash-like transactions, where the transferee was able to rely on the credit card alone, into true credit transactions. Under the Fair Credit Billing Act, specifically 15 U.S.C. § 1666(i) (1979), consumers may refuse to pay the credit card issuer when the consumer is unsatisfied with the original transaction. The card issuer, after investigation, usually will refuse payment to the transferee and the consumer and transferee will be forced to resolve the dispute between themselves.

510. Approximately 35 states have some form of certificate of title act. Of these, some provide for notation on certificates of title on only a first lien, others on all liens, and still others on no liens at all. About 13 states have no certificate of title act of any kind. The following are a sampling of states which have substantially adopted the Uniform Certificate of Title Act: ALA. CODE §§ 32-8-1 to 32-8-87 (1975); ME. REV. STAT. ANN. tit. 29 §§ 2350-2477 (1973); MASS. GEN. LAWS ANN. ch. 90D, §§ 1 to 38 (West 1971); N.H. REV. STAT. ANN. §§ 261:1 to 261:39 (1967); R.I. GEN. LAWS 1956, §§ 31-3.1-1 to 31-3.1-38 (1971); see Uniform Motor Vehicle Certificate of Title and Anti-Theft Act § 1, 11 U.L.A. 421 (1974 & Supp. 1983).

511. *E.g.*, General Fin. Corp. v. Hester, 141 Ga. App. 28, 232 S.E.2d 375 (1977).

protected under the Uniform Commercial Code⁵¹² from various claimants to the purchased property. Thus, buyers who give new value and purchase in the ordinary course of business will usually take free of any claims against the goods. A buyer in ordinary course of business may defeat the rights of owners who entrust their property to merchants,⁵¹³ goods that the owner has made the object of a negotiable document,⁵¹⁴ and lenders who rely on inventory as collateral.⁵¹⁵ It is generally felt that in order to serve legitimate commercial needs, protection for the buyer in the ordinary course of business is required.⁵¹⁶

If there is a legitimate criticism of the reliance approach, it is that Congress would be allowing state legislatures to weaken the effect of the bankruptcy code. With each of the examples mentioned above, however, the balancing process between the rights of the transferee and the party claiming the property has already taken place.⁵¹⁷ Each of these exceptions to the *caveat emptor* principle was created in order to promote commerce by strengthening the validity of protected transactions. To say, for example, that the cash transaction would be valid except in the case of bankruptcy is to defeat the very purpose for the cash transaction.

Congress may not agree with the conclusions reached for each of the cases mentioned above. It is clear, however, after looking at the legislative history supporting the 1978 Act, that Congress gave no consideration whatsoever to the creation of further exceptions beyond the bona fide purchaser of real estate exception. When an

512. U.C.C. § 1-201(9) defines a buyer in ordinary course of business:

"Buyer in ordinary course of business" means a person who in good faith and without knowledge that the sale to him is in violation of the ownership rights or security interest of a third party in the goods buys in ordinary course from a person in the business of selling goods of that kind but does not include a pawnbroker. All persons who sell minerals or the like (including oil and gas) at well-head or minehead shall be deemed to be persons in the business of selling goods of that kind. "Buying" may be for cash or by exchange of other property or on secured or unsecured credit and includes receiving goods or documents of title under a pre-existing contract for sale but does not include a transfer in bulk or as security for or in total or partial satisfaction of a money debt.

See also Skilton, *Buyer in Ordinary Course of Business under Article 9 of the Uniform Commercial Code (And Related Matters)*, 1974 Wis. L. REV. 1 (1974).

513. U.C.C. § 2-403(2).

514. U.C.C. § 7-503(1)(a).

515. U.C.C. § 9-307(1).

516. See Skilton, *supra* note 512, at 3-4.

517. One of the first recording statutes enacted in America was passed on October 7, 1640, by the General Court of the Massachusetts Bay Colony. MASS. COL. REC., I, 306-07. However, as far back as 1535, English law, under the Statute of Enrollments compelled a public registry of real property transactions. 27 Hen. VIII, c. 16 (1535).

exception to the rule of *caveat emptor* is pervasive, Congress should give serious consideration to the inclusion of that exception into section 549.

Except for the reliance cases, the case law reveals that the courts have been sympathetic to the inability of certain transferees to check the bankruptcy records before entering into a transaction. "Business necessity" appears to be the basis for the result in both *Marin* and *Frederick*.⁵¹⁸ Drawee banks are not in a position to call the bankruptcy court and check files prior to making a decision as to whether they should honor a check. Similarly, insurance companies, it is believed, are not in a position to check bankruptcy filings prior to making a loan on the value of a debtor's insurance policy. Congress saw merit in these arguments and codified the holdings of both *Marin* and *Frederick* into the statute.⁵¹⁹

Although the arguments advanced by the banks and insurance companies have some appeal, upon further reflection they do not withstand scrutiny. For example, recall that in *Marin* the payee of the check absorbed the total loss while the Bank of Marin was exculpated from liability. Justice Douglas's opinion justified this distinction on the dubious rationale that the payee had received a preferential payment.⁵²⁰

Compare, however, the case of the local supermarket that receives hundreds of checks daily. Is the local supermarket in any better position to check the bankruptcy filings prior to its decision to take a check in payment of goods? If a distinction can be made between the supermarket and drawee bank-insurance company situation, it has to be on the ground that the supermarket is well aware that a certain amount of all of its checks will "bounce." Nevertheless, supermarkets, as a cost of doing business, allow their customers to write checks. Therefore, they absorb the loss in those few cases where the checks do in fact bounce.

The banks and insurance companies, however, will likely argue that they should not be forced to factor into their business expenses the possibility that a depositor will file bankruptcy. Nevertheless, nonbankruptcy law requires the banks to absorb the loss

518. *Frederick v. Fidelity Mutual Life Ins. Co.*, 256 U.S. 395 (1921), discussed *supra* at text accompanying notes 83-86.

519. 11 U.S.C. § 542(c) (1982), discussed *supra* at text accompanying note 321-29.

520. *Marin*, 385 U.S. at 103 (1966). Justice Douglas overlooks, of course, those postpetition transferees who pay new value instead of cancelling out an old debt. It is not clear from the opinion whether he was intending to make a distinction between creditors receiving preferential treatment and transferees giving new value. More likely, he was simply seeking to justify preferred treatment for the Bank of Marin.

where they innocently allow a midnight deadline to expire,⁵²¹ or more importantly, where in good faith they pay a check where the drawer's signature has been skillfully forged.⁵²² Thus, even drawee banks cannot be totally confident that in deciding to honor a check, they will be free from liability when the check is not authorized. The banks can and do insure themselves against this kind of loss in cases where the check represents a large sum.⁵²³ It seems

521. U.C.C. § 4-302(a) provides that "the bank is accountable for the amount of . . . a demand item . . . in any case where it . . . does not pay or return the item or send notice of dishonor until after its midnight deadline" "Midnight deadline" is defined as "midnight on its next banking day following the banking day on which it receives the relevant item" See generally *Blake v. Woodford Bank and Trust Co.*, 555 S.W.2d 589 (Ky. 1977) (bank's failure to return checks reserved on December 24, before midnight on December 26, was basis for liability).

522. U.C.C. § 3-418, codifying the holding of *Price v. Neal*, 3 Burr. 1354 (1762). *Price v. Neal* held that a drawee that accepted an instrument and paid it when the drawer's signature was forged was bound by his acceptance and payment. The comments to section 3-418 justify this result on the grounds "that it is highly desirable to end the transaction on an instrument when it is paid rather than reopen and upset a series of commercial transactions at a later date when the forgery is discovered." U.C.C. § 3-418 comment 4.

523. The forgery provisions of the blanket bond insurance policy issued to some banks in the southern Illinois area reads as follows:

Forgery and Unauthorized Signatures and Endorsements

Loss because of forgery or alteration of any check, draft, acceptance, withdrawal order or receipt for the withdrawal of funds or property, certificate of deposit, letter of credit, warrant, money order or order upon a public treasury; and loss:

(a) by reason of the transfer, payment or delivery of any funds or property, the establishment of any credit or the giving of anything of value on the faith of any written instructions or advices directed to the insured and authorizing or acknowledging such transfer, payment, delivery or receipt of funds or property, which instructions or advices purport to have been signed or endorsed by any customer of the insured or by any other banking institution but which instructions or advices either bear the forged signature or endorsement of, or have been altered without the knowledge and consent of, such customer or banking institution (telegraphic, cable or teletype instructions or advices, as aforesaid, sent by a person other than the insured's customer or banking institution represented as having sent such instructions or advices shall be deemed to bear a forged signature); or

(b) by reason of the payment by the insured of any promissory note which is payable at any office of the insured to which this bond applies, or which is or purports to be a note payable at such office, under instructions of any depositor thereof, and which is actually paid by the insured out of funds on deposit with it, and which proves to be forged or altered or which bears a forged endorsement; or

(c) by reason of having accepted, paid or cashed any check or withdrawal order which bears an unauthorized signature or endorsement. It shall be a condition precedent to the insured's right of recovery for loss under this coverage that the insured shall have on file signatures of all persons authorized to sign such check or withdrawal order.

Any check or draft

that insurance companies that lend against the loan value of a policy could insure themselves and do the same. It is questionable whether there are any potential situations in which the loss suffered as a result of the practical inability to check bankruptcy records is so severe that the loss cannot be absorbed as a cost of doing business, either by insurance or otherwise.

B. Section 550

We previously looked in some detail at section 550 of the 1978 code. Recall that in general, section 550(a) provided that the initial transferee, whose transfer could be avoided by the trustee, would suffer the loss. A lien was given to the extent of any improvements that the transferee had made in the property. In certain instances one could quibble with the solution offered by the 1978 drafters,⁵²⁴ but in general there was nothing in section 550 that was startling or created severe problems.

The consolidation of the treatment accorded subsequent transferees in section 550, however, is novel. The liability of all transferees depends upon the particular avoidance power that was in question under the Chandler Act.⁵²⁵ Presently, all such subsequent transferees are protected if they pay value, act in good faith, and are without notice of the voidability of the transfer.⁵²⁶ The Commission notes blithely indicate that there was no basis for the Chandler Act's approach to making the liability of the subsequent transferee depend upon the particular avoidance power involved.⁵²⁷ But by suggesting that all subsequent transferees be protected, it is clear that the Commission had fraudulent conveyance cases in mind. The mere use of the language "knowledge of the voidability of the transaction"⁵²⁸ suggests that the Commission, and therefore

(1) made payable to a fictitious payee and endorsed in the name of such fictitious payee, or (2) procured in a face to face transaction with the maker or drawer thereof (or with one acting as agent of such maker or drawer) by anyone impersonating another, and which is made or drawn payable to the one so impersonated and endorsed by anyone other than the one impersonated, shall be deemed to be forged as to such endorsement.

Mechanically reproduced facsimile signatures shall be deemed to be handwritten signatures.

524. The 1978 code's treatment of the profits made by the initial transferee is questionable. See *supra* text accompanying notes 465-67.

525. See *supra* text accompanying note 473.

526. 11 U.S.C. § 550(a) (1982), discussed *supra* at text accompanying notes 473-75.

527. H.R. Doc. No. 93-137, Part II, 93rd Cong., 1st Sess. 179, set out *supra* note 452.

528. 11 U.S.C. § 550(b)(1) (1982). It is interesting to note that the Commission rationalized the extension of protection for all subsequent transferees by citing a noted authority in

Congress, had not fully thought through the results that would follow. This language makes sense in the fraudulent conveyance cases where, for example, the subsequent transferee, "T-2," was aware of the facts and circumstances of the initial transfer, and therefore was aware that the debtor made the transfer with actual intent to defraud his creditors.

The language of one opinion under the 1978 code suggests that if T-2 has knowledge that the initial transfer to T-1 was *preferential*, then no protection should be given to a subsequent transferee.⁵²⁹ Under nonbankruptcy law, however, debtors have a right to prefer their creditors.⁵³⁰ It is generally felt that neither unethical conduct nor bad faith is necessarily present upon the receipt of a preference. If the initial transferee is not acting in bad faith when receiving a preference, it is difficult to see how a subsequent transferee could be acting either in bad faith or with knowledge that the initial transfer was voidable. Recall that to be preferential with respect to bankruptcy, the transfer must occur *before* the filing of the bankruptcy petition.⁵³¹ Thus, in many cases the subsequent transferee will receive the transferred property before bankruptcy is filed by the initial transferee. In these cases, given the status of non-bankruptcy law, it is difficult to see how any bad faith or knowledge of voidability exists. Yet one court held that it did.⁵³²

The trouble with the consolidation approach is that it forces fraudulent conveyance principles into postpetition transfer and other types of cases. Consider the following example: Debtor makes a fraudulent conveyance to T-1 with actual intent to defraud his creditors. T-1 in turn conveys the property to a bona fide purchaser, who, by definition, is acting in good faith. In this hypothetical, T-1 has in fact acquired actual title to the property. Debtor's creditors must resort to a court of equity to disgorge T-1 of title and revest it in Debtor.⁵³³ Even in cases where T-1 is aware

the area of fraudulent conveyances: "The protection is extended, however, to all subsequent transferees to avoid litigation and unfairness to innocent purchasers. See 1 GLENN, FRAUDULENT CONVEYANCES AND VOIDABLE PREFERENCES § 259(a), at 444-45 (Rev. ed. 1940)." H.R. Doc. No. 93-137, Part II, 93rd Cong., 1st Sess. 180.

529. *In re Greenbrook Carpet Co., Inc.*, 22 Bankr. 86 (Bankr. N.D. Ga. 1982), discussed *supra* note 475.

530. *See supra* note 475.

531. *See supra* note 226.

532. *In re Greenbrook Carpet Co., Inc.*, 22 Bankr. 86 (Bankr. N.D. Ga. 1982) discussed *supra* note 475.

533. "[T]he creditor, upon a finding of fraudulent conveyance, may set aside the transfer and regain the property or cash value to the amount of the debt." *Tcherepnin v. Franz*,

of the debtor's fraudulent intent, T-1 still has the power to give good title to a bona fide purchaser, T-2.⁵³⁴ Only in cases where T-2 was acting in bad faith and was aware of the debtor's fraudulent intent will the courts permit the debtor's creditors to recover the property from T-2.⁵³⁵

The postpetition transfer case is in no way analogous to the fraudulent conveyance hypothetical set out above. The law of theft, or unauthorized transfers of property under a security interest, is more to the point. If a debtor transfers property that is subject to a security interest in favor of a lender to T-1, usually T-1 has acquired only encumbered title to the property and can convey only encumbered title to T-2.⁵³⁶ This would be true regardless of T-2's good faith or lack of knowledge as to the voidability of the original transfer to T-1.⁵³⁷ Additionally, this same result would inure if T-1 were acting innocently and in good faith.⁵³⁸ The true owner of the property or the lender would have a right to pursue both T-1 and T-2 either for conversion or for the return of the property.⁵³⁹

Perhaps Congress was justified in treating these cases alike for the simple reason that one cannot justify the disparate results reached under nonbankruptcy law. In the lender case, however, the lender wins not because T-1 is in a better position to prevent the

489 F. Supp. 43, 45 (N.D. Ill. 1980) (emphasis added) (citing *Levy v. Rendle Contracting & Dock Bldg. Co.*, 9 F. Supp. 1009 (D. Mass. 1935); *Bartel v. Zimmerman*, 293 Ill. 154, 127 N.E. 373 (1920); *Buffum v. Barceloux Co.*, 289 U.S. 227 (1932)). However, a creditor cannot without the aid of legal process, appropriate to payment of his debt property fraudulently conveyed by the debtor. *Wagner v. Trout*, 124 Cal. App. 2d 248, 268 P.2d 537 (1954).

534. See *Love v. Elliot*, 350 So. 2d 93 (Fla. 1st DCA 1977). The fraudulent grantee of mineral deed had no right to transfer the deed. Yet a bona fide purchaser for value without notice from the fraudulent grantee received good title. See also *Mathis v. Blanks*, 212 Ga. 226, 91 S.E.2d 509 (1956) (bidder at alleged fraudulent sale had notice of fraud, but one who purchased from the bidder without notice of the fraud was protected).

535. See *Kantola v. Hendrickson*, 52 Idaho 217, 12 P.2d 866 (1927) (purchaser for value, who takes from fraudulent grantee with notice of fraud, acquires title subject to infirmities); *Clarkson v. McCoy*, 215 Iowa 1008, 247 N.W. 270 (1933) (purchaser had sufficient notice to prevent him from claiming as a bona fide purchaser when he purchases with notice of proceedings to set aside the former conveyance as fraudulent).

536. See *supra* authorities cited notes 27-28.

537. *E.g.*, U.C.C. § 9-306(2) generally provides that "a security interest continues in collateral notwithstanding sale, exchange, or other disposition thereof"

538. See *Exchange Bank of Osceola v. Jarrett*, 180 Mont. 33, 588 P.2d 1006 (1979). In the *Jarrett* case a debtor financed a farm tractor in Florida through the Exchange Bank of Osceola. Debtor sold the tractor to an Iowa implement dealer (T-1) who in turn sold the tractor to a Montana farmer (T-2). There were no facts to indicate that either T-1 or T-2 was aware of Exchange Bank's security interest. The court nevertheless held that the bank's suit for conversion against T-2 must be sustained.

539. See *supra* notes 438-39.

loss but simply because the law encourages lenders to make loans. In order to encourage the lender to make the loan, the law guarantees the lender that his security interest will remain in force notwithstanding the sale of the collateral to a bona fide purchaser. Furthermore, in cases involving personal property, buyers and other transferees are traditionally aware of the fact that they take no better title than that held by the transferor.

If the rationale is to encourage lenders, as opposed to punishing the negligence or culpability of the initial transferee, it becomes apparent that T-2's position is no stronger than that of T-1. Recall in the *Jepstow* case⁵⁴⁰ T-1 was not only unaware of the fact that he was receiving estate property but took measures to insure that he was receiving something other than estate property.⁵⁴¹ Although he acted innocently and in good faith, the initial transferee lost against the estate. Under present law, if the initial transferee had transferred the estate property to a subsequent transferee, who was also acting in good faith, the subsequent transferee would have prevailed.⁵⁴² Yet, there should be no distinction between the liability of T-1 and T-2.

In the postpetition transfer cases we are dealing with the bankruptcy of the debtor as opposed to the granting of a security interest. In cases where a voluntary petition is filed, however, the debtor is granting the trustee *title* to *all* of his property as opposed to granting a mere security interest in particular property. Congress has chosen to condition the debtor's right to relief upon the estate receiving *all* of his non-exempt property. In exchange for the right to seek relief under the bankruptcy laws, Congress desired that unauthorized transactions made by the debtor not diminish the estate.

C. A Suggested Solution

How then is one to resolve the dilemma of the completely innocent transferee like the one found in the *Jepstow* case? The Uniform Commercial Code tolerates the result of secured creditors who defeat the rights of good faith purchasers of secured property. But by means of various filing and other perfection requirements, it seeks to limit such results to those that are statistically

540. 15 Bankr. 122 (Bankr. S.D. Fla. 1981), discussed *supra* at text accompanying notes 245-46.

541. *Id.* at 123.

542. 11 U.S.C. § 550(b) (1982), discussed *supra* at text accompanying notes 473-75.

infrequent.⁵⁴³

In some states, a judgment creditor is given a lien on all of the judgment debtor's assets merely by delivering a writ of execution to a sheriff.⁵⁴⁴ A subsequent levy placed on certain assets of the judgment relates the lien back to the time of delivery of the writ. Nevertheless, in those cases where a bona fide purchaser has purchased property in the interim, the courts tend to protect the bona fide purchaser.⁵⁴⁵

543. U.C.C. § 9-302(1) generally requires that secured parties file a financing statement to perfect a security interest in personal property. While Article 9 does make several exceptions to this requirement, those exceptions which permit the unfiled secured party to defeat a subsequent purchaser of the goods in question are comparatively rare. *See, e.g.*, section 9-306(3)(a) (1972 version), providing that a secured party is automatically perfected for 10 days in collateral which was acquired with the cash proceeds of the original collateral. Section 9-103(1)(d) generally provides that a security interest may be brought into a jurisdiction and remain perfected for a period of four months if, when the goods came into the jurisdiction, they were perfected under the law of the state from where they came. Thus, since the goods are perfected, a buyer of the goods would be "subordinate to" the secured party. U.C.C. § 9-301(1)(c). During the four month period, there would be no constructive notice on file in the state where the goods are now located. Additionally, in those cases where the secured party is to perfect by filing at the debtor's "residence," *see generally* U.C.C. § 9-401(1), under the 1972 version of Article 9, a change in the debtor's residence does not render the filing ineffective. U.C.C. § 9-401(3) (1972 version). In this case, a purchaser of the collateral will likely make a record check at the place of the debtor's new residence and find no notice of the secured party's security interest. *See, e.g.*, *International Harvester Corp. v. VOS*, 95 Mich. App. 45, 290 N.W.2d 401 (1980). Finally, section 9-402(7) (1972 version) generally provides that in cases where the debtor so changes his name that record searchers searching under the new name are given no notice of the secured party's interest, the secured party is nevertheless still perfected as to the collateral. The secured party is unperfected only as to collateral acquired by the debtor four months after the name change. *Cf. King v. Williams (In re Conger Printing Co., Inc.)*, 18 U.C.C. REP. SERV. 224 (Bankr. D. Or. 1975) (holding that a secured party, who at the time of filing is aware of the debtor's impending name change, violated its duty under U.C.C. § 1-203 to act in "good faith" and was therefore unperfected).

In the cases listed above, Article 9's provisions giving the secured party perfected status, endanger the rights of one purchasing the collateral. Purchasers of such collateral defeat only those secured parties holding "unperfected" security interests. U.C.C. § 9-301(1)(c). Nevertheless, cases involving the purchase of non-cash proceeds with cash proceeds, the removal of collateral from one jurisdiction to another, and changes in residence or name so that the original filing does not give notice, are sufficiently rare that in most cases parties dealing with the debtor usually are given notice under Article 9's provisions.

544. DEL. CODE ANN. tit. 10, § 5081 (1982); *see* ILL. REV. STAT. ch. 110, § 12-111 (1982).

545. *E.g.*, *Flemming v. Thompson*, 343 A.2d 599 (Del. 1975). In *Flemming*, a debtor sold a mobile home to a mobile home dealer, who in turn sold it to a buyer in ordinary course of business. *See supra* note 512, discussing the buyer in ordinary course of business. In the meantime, debtor's judgment creditor delivered a writ of execution to the sheriff, but the goods were sold before the sheriff could levy on them. The court held for the buyer of the home, reasoning that the debtor held at least voidable title. Therefore, under section 2-403 (1), the buyer cut off the rights of the judgment creditor.

U.C.C. § 2-403(1) provides:

(1) A purchaser of goods acquires all title which his transferor had or had power

Even the all-powerful Internal Revenue Service, which has persuaded Congress to grant it a lien on all property of the taxpayer upon mere assessment of the lien,⁵⁴⁶ cannot enforce its lien against most good faith purchasers of the property.⁵⁴⁷ Although the Restatement of the Law of Agency continues to recognize the rule that the authority of the agent is extinguished upon the unknown and unascertainable death of the principal,⁵⁴⁸ Commentators have criticized the resulting injustices that it causes.⁵⁴⁹

Thus, although there is an obvious need to freeze the assets of the estate to maximize the dividends for estate creditors, at a minimum, bankruptcy laws should require that all available steps be taken to reduce the number of such cases. Student writers who have discussed the *Marin* decision have suggested that as a condition of filing bankruptcy, a voluntary bankrupt give notice to the debtor's bank that bankruptcy has been filed.⁵⁵⁰ Recall that the Bankruptcy Commission embraced this idea in part and suggested that a notice be filed in the real estate records and U.C.C. filings in order to defeat the rights of all initial and subsequent transferees.⁵⁵¹

In voluntary cases, that comprise the vast majority of the cases filed, Congress should consider placing the duty on the debtor to notify third parties as a condition of seeking relief under the bankruptcy code. State recording records are available to give third parties notice. There is no reason why the bankruptcy laws should not require the debtor to use them. For example, the debtor should be required to file a notice in the real estate records, to make a U.C.C. filing both centrally and locally, to send a written

to transfer except that a purchaser of a limited interest acquires rights only to the extent of the interest purchased. A person with voidable title has power to transfer a good title to a good faith purchaser for value.

Most of the "voidable title" cases involve cases of fraud or the like. The court, however, in order to protect the purchaser, chose to emphasize the second sentence of subsection (1) rather than the first. In the *Fleming* case, the Delaware statute gave the creditor a lien as of time of delivery of the writ. See DEL. CODE ANN. tit. 10, § 5081 (1982). But the court could not bring itself to rule against the bona fide purchaser.

546. 26 U.S.C. § 6321 (1982).

547. Section 6323(a) provides that the I.R.S.'s lien "shall not be valid as against any purchaser, holder of a security, interest, mechanic's lienor, or judgment creditor until notice thereof . . . has been filed." 26 U.S.C. § 6323(a) (1982). See *supra* note 502 for further discussion.

548. RESTATEMENT OF AGENCY § 120 (1933).

549. See *supra* note 55.

550. See Note, *Where Bank Acted Without Actual Knowledge*, *supra* note 6, at 859; Note, *Trustee's Title*, *supra* note 6, at 435.

551. See *supra* text accompanying note 240.

notice of his bankruptcy to all banks and insurance companies with which he has funds, to note the filing of bankruptcy on all certificates of title, and to attach the original of those certificates to his bankruptcy schedules.⁵⁵² The court should be given assurance that the debtor has complied with the bankruptcy laws by insisting that the debtor certify in his schedules that notice has been given.

Some cases will still need to be resolved under section 549. Frequently, bankruptcy needs to be filed immediately in order to secure the benefit of the automatic stay and thereby prevent secured creditors from closing down the debtor.⁵⁵³ Present rules permit the debtor to file the petition and then, within the following fifteen days, file the schedules, provided that the petition is accompanied with a creditor list and addresses.⁵⁵⁴

In that period, there is potential for mischief. Some may argue that when many large and sophisticated business debtors are present, the number of required notice filings may be exorbitant. Usually, however, large and sophisticated business debtors are represented by equally sophisticated bankruptcy lawyers, thoroughly schooled in commercial law. If counsel for the major lending institutions know all of the various places to file in order to take a blanket security interest, then Chapter 11 bankruptcy lawyers can quickly acquire the same expertise if they do not already possess it.

The present treatment of involuntary cases should continue.⁵⁵⁵ The present bankruptcy code correctly continues the basic policy of prior law, namely that the debtor should be allowed to continue in business until his creditors are able to establish that they are entitled to relief under the bankruptcy laws.

If, however, the debtor fails to defeat the petitioning creditors and an "order for relief" is entered against him, the debtor will be less than enthusiastic about giving and filing the notices suggested

552. Professor Nadler originally suggested this idea. See NADLER, *THE LAW OF BANKRUPTCY* § 171 (1948).

553. The automatic stay is one of the fundamental debtor protections provided by the bankruptcy laws. It gives the debtor a breathing spell from his creditors. It stops all collection efforts, all harassment, and all foreclosure actions. It permits the debtor to attempt a repayment or reorganization plan, or simply to be relieved of the financial pressures that drove him into bankruptcy. H.R. REP. NO. 95-595, 95th Cong., 1st Sess. 340 (1977).

554. BANKR. RULE 1007(c).

555. My principle objection to present policy is that the estate has no claim for postpetition transfer made after a general receiver is appointed but before the entry order of relief. See *supra* discussion notes 281-83.

above. A half-measure would be to permit the petitioning creditors to make these filings after the order for relief is entered and then to be reimbursed as an administrative expense of the bankruptcy estate.⁵⁵⁶

Admittedly, the proposed solution in involuntary cases is only a half-measure, and in some cases the unauthorized actions of the debtor will victimize postpetition transferees. It is surprising, however, in reading the cases, how many of the postpetition transfer situations involve transactions and transfers that did not occur immediately after the filing of a petition. The majority of such cases, then, should result in the transferees receiving at least some kind of constructive notice.

V. CONCLUSION

The reader may not have fully agreed with the author's decision to analyze turn of the century cases and statutes as a prerequisite to the discussion of the present law on postpetition transfers. Modern decisions that reach incorrect conclusions, however, may have been decided differently if courts were fully apprised of the history of the postpetition transfer issue in bankruptcy law.⁵⁵⁷

In conclusion, it now seems clear that Congress and the courts have been attempting to grapple with an insoluble problem. There is a compelling need to freeze the assets of the estate upon the filing of a petition in bankruptcy to maximize the estate for the benefit of the debtor's creditors. Parties who receive property while paying value and acting on good faith, however, are obviously deserving of protection. In the postpetition transfer cases, one interest cannot be accommodated without sacrificing the other.

In general, insofar as nonbankruptcy law protects the good faith transferee, it seems that present bankruptcy laws should protect the transferee as well. But the courts and Congress should be mindful of the fact that the basic rule of *caveat emptor* still governs transactions involving personal property, and therefore the

556. Section 503(b)(1)(A) permits reimbursement as an administrative expense "the actual, necessary costs and expenses of preserving the estate . . . rendered after the commencement of the case." 11 U.S.C. § 503(b)(1)(a) (1982). Administrative expenses are then accorded first priority when the estate is distributed to creditors. 11 U.S.C. § 507(a)(1) (1982).

557. The opinions in *In re Smith Corset Shop, Inc.*, 696 F.2d 971 (1st Cir. 1982), discussed *supra* at text accompanying notes 323-27, and *In re Yellow Cab Co.*, 4 BANKR. CT. DEC. (CCR) 382 (Bankr. E.D. Pa. 1978), discussed *supra* note 133, may have been improved by a more thorough understanding of the history of this problem.

courts should not provide *ad hoc* relief to good faith transferees and bailees dealing with the debtor. Thus, given the likelihood that future transferees who deal with the debtor will be victimized by his unauthorized behavior, the bankruptcy laws should provide the debtor with every incentive, by coercion if necessary, to notify his creditors and other parties that he has filed bankruptcy.