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BANKRUPTCY - RIGHT OF TRUSTEE AGAINST CLAIMANT OF VENDOR'S LIEN

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BANKRUPTCY — RIGHT OF TRUSTEE AGAINST CLAIMANT OF VENDOR'S LIEN — More than four months before bankruptcy the vendor sold an automobile truck to the bankrupt grocer under an unrecorded conditional sales contract, and a part of the purchase money, represented by an installment note, is still owing. The appellant was assigned the contract and note before the first installment became due. The truck was turned over to the trustee in bankruptcy, who sold it and holds the proceeds. Appellant filed a claim in bankruptcy asserting a statutory purchase money lien.[1] *Held*, that the lien of the vendor prevails over the trustee. *Commercial Credit Co. v. Davidson*, (C. C. A. 5th, 1940) 112 F. (2d) 54.

Prior to 1910 the Supreme Court held that in regard to property held by the bankrupt the trustee stood in the shoes of the bankrupt.[2] By the amendment of 1910 the trustee was given the rights, remedies and powers of a creditor holding a lien by legal proceedings[3] on the theory that it is unfair to require creditors to surrender their rights to the trustee, when the latter is unable to cut off secret interests binding against the debtor, but which the creditors can avoid.[4] Where absence of notice was necessary to avoid a lien, the federal courts still protected such interests where all creditors had notice, but as the claimant of the secret lien was given the burden of proof, notice has not been a factor in

[1] "The vendor of personal property shall have a lien thereon for the purchase-money while it remains in the hands of the first purchaser, or of one deriving title or possession though him, with notice that the purchase-money was unpaid." Miss. Code (1930), § 2239.

[2] In York Mfg. Co. v. Cassell, 201 U. S. 344, 26 S. Ct. 481 (1905), an unrecorded instrument was held valid against a trustee in bankruptcy, although it would have been void against creditors.

[3] 36 Stat. L. 840 (1910), amending 30 Stat. L. 557, § 47a (2) (1898).

[4] "It is this evil [secret liens as exemplified by the York case] and the injustice worked upon creditors who rely upon the debtors' apparent ownership against which the bankruptcy law has set its face. The proposed amendment, whilst correcting the defect named, at the same time carefully guards the rights of all parties." S. REP. 691, 61st Cong., 2d sess. (1910), p. 6.

many cases, for impracticability of proof.[5] In 1938 the trustee was by the words of the Chandler Act given the rights of a lien creditor even though no such creditor existed.[6] This appears to be nothing more than a codification of the existing case law, for it does not make the trustee a lien creditor without notice of secret liens. However, in the principal case no mention is made of other creditors, which might be an indication that the court no longer will make the rights of the trustee to upset such a lien conditional on the existence of creditors able to upset the lien. Undoubtedly a determination of the rights of the trustee is a federal question, but as the act makes his title subject to pre-existing statutory liens,[7] it is necessary to look to the state law for a definition of the rights of a judgment creditor and to mark out the scope of the statutory lien.[8] Ordinarily a prior equity such as that claimed in the principal case is cut off only by a purchaser for value without notice.[9] At common law a creditor does not qualify, although he is without notice, since satisfaction of a debt is not deemed a giving of value.[10] However, in a case on all fours with the principal case, the Mississippi Supreme Court held that the lien of a creditor obtained by legal proceedings without notice is superior to that of the unpaid vendor.[11] The Pennsylvania courts have adopted a similar rule in regard to secret liens.[12] It is submitted that the constuction of this statute is properly a matter of Mississippi law and is binding upon the federal courts.[13] The problem of notice to the trustee was summarily dismissed by the circuit court of appeals,[14] but as his interest under the lien statute is defined by the state law there is no escape from the conclusion that notice to the trustee in his official capacity would subordinate his interest

[5] In re Master Knitting Corp., (C. C. A. 2d, 1925) 7 F. (2d) 11. *Contra*: 4 REMINGTON, BANKRUPTCY, 4th ed., § 1547 (1935), declaring that the trustee is given independent rights and is a sort of ideal creditor.

[6] 52 Stat. L. 881, § 70c (1938), 11 U. S. C. (Supp. 1939), § 110c.

[7] 52 Stat. L. 876, § 67b (1938), 11 U. S. C. (Supp. 1939), § 107b.

[8] "More specifically in this case, we determine under state law whether the purchase-money lien creditor would have had priority over a creditor then holding a lien thereon by legal or equitable proceedings." Principal case, 112 F. (2d) 54 at 55.

[9] Hauselt v. Harrison, 105 U. S. 401 (1881); In re Interborough Consolidated Corp., (C. C. A. 2d, 1923) 228 F. 334.

[10] Cases cited in note 9, supra.

[11] Pearson v. Moore Dry Goods Co., 146 Miss. 225, 110 So. 709 (1927) (the creditor was remitted to the bankruptcy court, but the state court clearly held that the lien was invalid against the trustee by construction of the state statute as an essential element in the decision).

[12] Wm. Wilson & Son Silversmith Co.'s Estate, 150 Pa. 285, 24 A. 636 (1892); In re Wilson, 4 Pa. 164 (1846).

[13] Conceding that the state court had no authority to enforce the lien, it nevertheless decided the case correctly by construction of the lien statute, and the federal courts are bound by the interpretation of state legislation by the highest tribunal of the enacting state. Bandini Petroleum Co. v. Superior Court, 284 U. S. 8, 52 S. Ct. 103 (1931).

[14] "So far as this is a federal question, it cannot rest upon any such shifting basis as whether the trustee had notice of the lien." Principal case, 112 F. (2d) 54 at 56.

to that of the unconditional vendor.[15] In the principal case the trustee in bankruptcy could not be charged with notice of the vendor's lien, and a determination in his favor would be more in keeping with the intention of Congress that the creditors of the bankrupt should be protected against secret encumbrances.[16]

[15] Notice to the trustee in his official capacity would necessarily have to be founded upon lis pendens, for his lien dates from a time prior to the assumption of such capacity. In a Mississippi case where a conditional vendor sought to recover the purchase price from the debtor and the sheriff seized the property before the petition in bankruptcy, the trustee was charged with notice of the vendor's interest. Campbell Paint & Varnish Co. v. Hall, 131 Miss. 671, 95 So. 641 (1923), citing Norris v. Trenholm, (C. C. A. 5th, 1913) 209 F. 827.

[16] See note 4, supra. Also Southern Dairies v. Banks, (C. C. A. 4th, 1937) 92 F. (2d) 282 at 285. To give effect to the amendment it can no longer be contended that the trustee succeeds only to the rights of the bankrupt. "The trustee in bankruptcy not only took the title of the bankrupt, but was vested with all of the rights of a creditor holding a lien by legal or equitable proceedings. . . ." Valier & Spears Milling Co. v. Foote, (D. C. Miss. 1921) 277 F. 519 at 521. See also In re Wright & Weissinger, (D. C. Miss. 1921) 277 F. 514.