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BANKRUPTCY - RECOVERY OF PREFERENCES - REQUIREMENT THAT DEFENDANT BE PAID A GREATER PERCENTAGE OF HIS CLAIM THAN OTHER CREDITORS

BANKRUPTCY — RECOVERY OF PREFERENCES — REQUIREMENT THAT DEFENDANT BE PAID A GREATER PERCENTAGE OF HIS CLAIM THAN OTHER CREDITORS — In a suit by the trustee in bankruptcy to recover as preferences part payments to defendant within four months of bankruptcy, the trial court refused to rule that the trustee had the burden of proving that each payment had the effect of giving to the defendant a greater percentage of his claim than other creditors would have received if the estate had been liquidated at that time. *Held*, the court's refusal was proper. *Palmer Clay Products Co. v. Brown*, 297 U. S. 227, 56 S. Ct. 450 (1936).

Section 60 (a) of the Bankruptcy Act requires for a voidable preference that the effect of enforcement of the transfer will be to enable the paid creditor to receive a greater percentage of his debt than any other creditors of the same class.[1] The interpretation of this provision has perplexed state

[1] Sec. 60 (a) states: " A person shall be deemed to have given a preference if, being insolvent, he has, within four months before the filing of the petition . . . made a transfer of any of his property, and the effect of the enforcement of such . . . transfer . . . will be to enable any one of his creditors to obtain a greater percent-

and lower federal courts since its enactment, causing a conflict which was not resolved until the decision of the Supreme Court in the principal case. It was clear that where other creditors of the same class were actually paid the same percentage as the defendant or where the defendant had reasonable cause to believe that such was the case, the trustee could not recover the payment.[2] The difficulty arose where the debtor did not make such payments to other creditors, but still retained sufficient assets after the transfer to the defendant so that he would have been able to do so, or where the payee could reasonably believe this to be so. In such a situation, the Court of Appeals for the Eighth Circuit and some state courts held the payments not voidable,[3] relying chiefly upon the language of section 60 (b) which required for a transfer to be voidable that it "then" operate as a preference. The words "will be" in section 60 (a), which some courts had argued showed the intent of Congress, by referring to the future, to make the test depend on the result in actual liquidation in bankruptcy, were said to mean "would be" in event of actual liquidation at the time of transfer. Finally, it was argued that it is unreasonable to charge the payee with prophetic knowledge of the debtor's financial condition at an undetermined future date. In rejecting the view of the eighth circuit, Justice Brandeis, speaking for the Supreme Court, points out that if a partial payment to a creditor is allowed to stand, the paid creditor can prove in bankruptcy for the unpaid balance of his claim, receiving an equal share on it with the other creditors, which, together with the hundred per cent he has received on part of his claim, will constitute a greater percentage of his total claim than other creditors receive.[4] This con-

age of his debt than any other of such creditors of the same class." 44 Stat. L. 666, 1 U. S. C., § 96 (1926).

Sec. 60 (b) states: "If a bankrupt shall have . . . made a transfer of any of his property, and if, at the time of the transfer . . . the bankrupt be insolvent and the . . . transfer then operate as a preference, and the person receiving it . . . shall then have reasonable cause to believe that the enforcement of such . . . transfer would effect a preference, it shall be voidable by the trustee and he may recover the property or its value from such person." 36 Stat. L. 842, 11 U. S. C., § 96 (1910).

[2] In re Varley & Bauman Clothing Co., (D. C. Ala. 1911) 191 F. 459; Pepperdine v. National Exchange Bank, 84 Mo. App. 234 at 242 (1900) (dictum).

[3] Peck & Co. v. Whitmer, (C. C. A. 8th, 1916) 231 F. 893; Haas v. Sachs, (C. C. A. 8th, 1933) 68 F. (2d) 623 (case came up on question whether partially paid creditor could prove for balance); Slayton v. Drown, 93 Vt. 290, 107 A. 307 (1918); Brittain Dry-Goods Co. v. Bertenshaw, 69 Kan. 734, 75 P. 1027 (1904). Remington, the draughtsman of sec. 60 (b), also takes this view. 4 REMINGTON, BANKRUPTCY, 4th ed., § 1812 (1931).

[4] Sec. 57 (g) provides that recipients of voidable preferences cannot claim unless they first relinquish the preferences, but does not prevent creditors receiving partial payments which do not amount to voidable preferences from proving for the unpaid balance. The operation of this section was overlooked by the Court of Appeals for the Eighth Circuit.

Where the part payment is taken by the creditor in full satisfaction of his debt, the difficulty suggested by Justice Brandeis does not arise, because the unpaid balance cannot be proved even if not preferential. Therefore, unless the payment is of a

struction of the provision had previously been adopted by a majority of lower courts,[5] and would seem to be the only sound view in the light of the policy of the preference sections. With the opposite view, not only might the creditor who receives a part payment within four months before bankruptcy ultimately be paid a greater share of his claim than other creditors of the same class, but it would be possible for the clever creditor, by securing a series of part payments, to obtain almost complete satisfaction. Moreover, the court would be compelled to determine the debtor's financial condition and the payee's knowledge thereof at the time of each transfer.[6] Where that rule prevailed, it was seldom wise to attempt to recover part payments. As we understand the decision of the Supreme Court, the trustee has only to prove, in the case of part payment as in the case of full payment, that the debtor was insolvent at the time of the payment and that the creditor had reasonable cause to believe that he was insolvent.

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greater percentage than is left for other creditors, the defendant should be entitled to retain it. This was the situation in Mansfield Lumber Co. v. Sternberg, (C. C. A. 8th, 1930) 38 F. (2d) 614. But, if a larger percentage is paid the defendant, it should be recoverable despite the release of the debtor from further liability. In such event, the question may squarely arise as to whether the value of the assets at the time of transfer or of eventual liquidation should be used as the measuring rod to determine whether the percentage received by defendant was larger than what other creditors would get. This question did not have to be answered in the principal case; but there is language which would seem to indicate that the latter date would be taken, and the speculative process of estimating the value of the assets as of date of transfer avoided.

[5] Commerce-Guardian Trust & Sav. Bank v. Devlin, (C. C. A. 6th, 1925) 6 F. (2d) 518; In re J. R. Palmensberg Sons, Inc., (C. C. A. 2d, 1935) 76 F. (2d) 935, affd. (U. S. 1936) 56 S. Ct. 451; Jentzer v. Viscose Co., (D. C. N. Y. 1934) 13 F. Supp. 540, modified (C. C. A. 2d, 1936) 82 F. (2d) 236; Rubenstein v. Lottow, 223 Mass. 227, 111 N. E. 973 (1916); Eyges v. Boylston Nat. Bank, (D. C. Mass. 1923) 294 F. 286 (semble); In the Matter of Medeiros, (D. C. Haw. 1932) 21 Am. Bankr. Rep. (N. S.) 20. This position is also taken in the proposed revision of the Bankruptcy Act by the National Bankruptcy Conference. National Bankruptcy Conference, Bankruptcy Act (1935, Government Printing Office), § 60.

[6] It is contended by Remington [4 REMINGTON, BANKRUPTCY, 4th ed., § 1814 (1931)] that this determination is no more difficult than proof of insolvency, which is also a prerequisite to a voidable preference. But this overlooks two points: (1) It is usually possible to prove insolvency without as exact and complete an audit as is required to fix the percentage which could be paid—that is to say, assets may be given the highest possible valuation and disputed claims may be counted out, and yet insolvency may appear. (2) There was under the rule in question an additional issue of notice to the payee.