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Bankruptcy--Section 70c--Recent Reactions To *Constance v. Harvey*

George Sidney Buchanan Jr.
University of Michigan Law School

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BANKRUPTCY—SECTION 70c—RECENT REACTIONS TO *Constance v. Harvey*—The second sentence of section 70c of the Federal Bankruptcy Act, as amended through 1952, reads as follows:

> "The trustee, as to all property, whether or not coming into possession or control of the court, upon which a creditor of the bankrupt could have obtained a lien by legal or equitable proceedings at the date of bankruptcy, shall be deemed vested as of such date with all the rights, remedies, and powers of a creditor then holding a lien thereon by such proceedings, whether or not such a creditor actually exists."[1]

This provision specifies one of the many powers of avoidance that the bankruptcy act gives to the trustee in bankruptcy.[2] Re-

1 66 Stat. 430 (1952), 11 U.S.C. (1952) §110c.

2 Other sections granting powers of avoidance to the trustee are §§60b, 67d, and 70e(1).

newed interest in section 70c has developed recently, primarily because of several significant decisions in the federal courts. It is the purpose of this comment to consider the impact of these developments on the power of the trustee to avoid otherwise valid security devices.

I. *Introduction—Constance v. Harvey*

The main thrust of section 70c is to vest the trustee with the rights of a hypothetical lien creditor as determined by reference to applicable state law. The crucial interpretative question under the provision is: at what time do the trustee's rights accrue? The statute expressly states that the trustee's rights as a lien creditor arise at the date of bankruptcy. But it has been suggested that the interpretative difficulties arise because the section "does not specify when credit is to be deemed to have been extended to the debtor for purposes of the hypothetical lien."[3]

Constance v. Harvey[4] is the most important case to give an answer to the question when the trustee shall be deemed to have become a creditor under section 70c. In this case the bankrupt, some two years prior to the date of bankruptcy, executed a purchase money chattel mortgage to appellant Constance. Constance delayed ten months in recording the mortgage, a delay clearly unreasonable under the applicable New York law. In the bankruptcy proceedings, the referee and the district court sustained the trustee's avoidance of Constance's chattel mortgage lien. On the first hearing the Court of Appeals for the Second Circuit reversed because there was no showing that an actual creditor extended credit to the bankrupt during the interval between the execution of the chattel mortgage and its belated recording.[5] On rehearing, however, the court sustained the referee, reasoning that the status of the trustee under section 70c is not dependent on the existence of actual creditors. The court then went on to say that as an "ideal" hypothetical creditor,[6] the trus-

[3] Editor's comment at 125 following Kleinberg and Masterson, "*Constance v. Harvey*—A Defense," 62 COMM. L.J. 124 (1957).

[4] (2d Cir. 1954) 215 F. (2d) 571, cert. den. 348 U.S. 913 (1955).

[5] At the time of the first hearing the court may have been applying the rule of §70e(1) in which the trustee's rights are expressly dependent on the existence of an actual creditor.

[6] The "ideal" phraseology was used previously by the Second Circuit in the case of Hoffman v. Cream-O-Products, (2d Cir. 1950) 180 F. (2d) 649 at 650.

tee can pretend to be a creditor who extended credit at whatever time is most advantageous to him. The court apparently felt that under section 70c the trustee's rights as a general, as distinguished from a lien, creditor may at the trustee's discretion accrue at any time under applicable state law, and such rights are not tied to the date of bankruptcy. The court then noted that under applicable New York law a chattel mortgage not recorded within a reasonable time can be avoided by any general creditor who has extended credit in the interim, i.e., the period between the date of the mortgage's execution and the date of its belated recording.[7] Combining New York law and its own interpretation of the trustee's rights under section 70c, the court took the final step and held that the trustee, by asserting the rights of an "ideal" hypothetical creditor who had extended credit during the interim and who could have obtained a lien at the date of bankruptcy, could avoid the Constance mortgage. The court expressly stated that its decision was reached even though there was no proof that any actual credit had been extended during the interim.

Criticism of *Constance v. Harvey* has been severe.[8] The most fundamental criticism has been that it fails to preserve the proper balance between the bankruptcy act's two competing policies: equality of distribution and preservation of fairly acquired security interests.[9] It has been argued that the *Constance* holding affords needless protection to non-existent creditors at the expense of chattel mortgagees who are slow to record.[10] It is clear that there is an alternative to the *Constance* interpretation of section 70c. One writer has suggested the proper interpretation to be that the trustee should be regarded as a "creditor without notice who levied legal or equitable process at the time of bankruptcy and

[7] Karst v. Gane, 136 N.Y. 316, 32 N.E. 1073 (1893). When used in this comment the word "interim" means the period between the execution date of the security transaction in question and the date of its recording.

[8] See 4 MOORE, COLLIER ON BANKRUPTCY, 14th ed., §70.48, pp. 92-93 (Supp. 1958); Weintraub, Levin, and Beldock, "The Strong-Arm Clause Strikes the Belated Chattel Mortgage," 25 FORD L. REV. 261 (1956); Marsh, "*Constance v. Harvey*—The 'Strong-Arm Clause' Re-Evaluated," 43 CALIF. L. REV. 65 (1955). But see Kleinberg and Masterson, "*Constance v. Harvey*—A Defense," 62 COMM. L.J. 124 (1957).

[9] Marsh, "*Constance v. Harvey*—The 'Strong-Arm Clause' Re-Evaluated," 43 CALIF. L. REV. 65 at 73-75 (1955).

[10] A secondary criticism of the Constance rationale is that it renders nugatory §70e(1), which vests in the trustee the rights of any actual creditor with a provable claim against the bankrupt at the date of bankruptcy. See Marsh, "*Constance v. Harvey*—The 'Strong-Arm Clause' Re-Evaluated," 43 CALIF. L. REV. 65 at 73-75 (1955).

who also extended credit at the time of bankruptcy."[11] This interpretation is supported by other secondary authority, and presents the most consistent and valid specific objection to the *Constance* interpretation. In addition, this interpretation has been incorporated into a proposed congressional amendment of section 70c.[12]

In light of this background it becomes desirable to consider some of the recent state and federal reactions to the *Constance* doctrine.

II. *State Legislative Reaction to Constance v. Harvey*

Analysis of state legislative reaction to the *Constance* case will be limited mainly to chattel mortgage recording statutes.[13] Under most chattel mortgage recording statutes no *Constance* problem can arise because these statutes are designed to protect only *lien* creditors. Under such statutes no creditor can avoid a chattel mortgage unless he has acquired a lien on the property of the mortgagor prior to the recording date of the chattel mortgage. If the date of bankruptcy is after the recording date of the mortgage, the trustee cannot avoid the mortgage under section 70c. The trustee gains nothing by using the *Constance* doctrine because under the applicable state law a creditor cannot avoid the chattel mortgage unless he acquires a lien before the mortgage has been recorded. By the express wording of section 70c, however, the trustee's status as a lien creditor accrues only at the date of bankruptcy which, by hypothesis, is *after* the recording of the mortgage.

Thus only chattel mortgage recording statutes designed to protect *general* creditors from unrecorded mortgages can be involved in a *Constance* situation.[14] While such statutes all have the common design of protecting the general creditor, they differ as to the time within which a chattel mortgagee must record in order to protect his security from general creditors who actually ex-

11 Marsh, "*Constance v. Harvey*—The 'Strong-Arm Clause' Re-Evaluated," 43 CALIF. L. REV. 65 at 74 (1955).

12 H.R. 4158, 86th Cong., 1st sess. (1959). The amendment was favorably regarded by the Subcommittee on Bankruptcy of the Judiciary Committee of the House of Representatives at a hearing on March 5, 1959.

13 A similar analysis could be made of state statutes regulating other types of security transactions, but for ease of presentation the analysis of this comment is limited to statutes regulating the chattel mortgage transaction.

14 An example of such a statute is the New York act involved in the Constance case itself. 32 N.Y. Consol. Laws (McKinney, 1940) §230.

tended credit in the interim between the execution and recording of the mortgage.[15]

Before 1952 and the emergence of section 70c in its present form, eleven states had chattel mortgage recording statutes capable of giving rise to a *Constance* problem.[16] In only one of these states, Michigan, has there been legislative reaction which was clearly prompted by a desire to avoid the effect of *Constance v. Harvey*.[17] Prior to 1956, the Michigan statute[18] as judicially construed required a chattel mortgage to be recorded "immediately" after its date of execution. If the mortgage was not recorded immediately —i.e., simultaneously with its execution—any general creditor who actually extended credit during the interim could avoid the mortgage. The *Constance* rationale works a particularly harsh result under such a statute. The slightest delay in recording by the chattel mortgagee permits the trustee to avoid the mortgage by applying the *Constance* interpretation of section 70c; the trustee merely pretends to be a hypothetical creditor who has extended credit during the period of delay in recording. That the mortgage may have been recorded several years prior to the date of bankruptcy does not defeat the trustee under section 70c when the *Constance* interpretation is applied.

In 1956 the Michigan legislature amended the state's chattel mortgage recording statute. The amendment, Act 153, effective through the first nine months of 1957, attached to the previous statute a proviso that no chattel mortgage, if recorded within 14

15 Some "Constance" statutes, as in New York and Missouri, fix the interim period if the chattel mortgage is not recorded "within a reasonable time." Other "Constance" statutes, as in California, fix the interim period if the chattel mortgage is not recorded "immediately" after its execution. Thus, the latter type of statute protects any general creditor who has extended credit during the interim, no matter how short the delay in the recording of the mortgage.

16 The eleven states were *Alabama,* Ala. Code (1940) tit. 47, §123; *California,* Cal. Civ. Code Ann. (Deering, 1949) §2957; *Michigan,* Mich. Comp. Laws (1948) §566.140; *Mississippi,* Miss. Code Ann. (1942; Rec. 1956) §§868-869; *Missouri,* Mo. Rev. Stat. (1949) §443.460; *New Jersey,* N.J. Stat. Ann. (1940) §§46: 28-5 and 46: 28-10; *New York,* 32 N.Y. Consol. Laws (McKinney, 1940) §230; *South Carolina,* S.C. Code (1952) §60-101; *South Dakota,* S.D. Code (1939) §39.0408; *Utah,* Utah Code Ann. (1953) §9-1-1; *Wyoming,* Wyo. Comp. Stat. Ann. (1945) §59-105.

17 The New Jersey statute was amended in 1953. The immediate recording required by the statute is now defined as any recording within five days from the execution date of the chattel mortgage. One of the amendment's effects is to protect any mortgage, recorded within the five-day period, from avoidance by the trustee's use of the Constance interpretation of §70c. There is no indication to what extent a desire to avoid the effect of Constance v. Harvey prompted the 1953 New Jersey amendment.

18 Mich. Comp. Laws (1948) §566.140. The pre-1956 statute is construed in General Motors Acceptance Corp. v. Coller, (6th Cir. 1939) 106 F. (2d) 584.

days after its execution, shall be void as against creditors of the mortgagor in "insolvency proceedings."[19] In the case of *In re Perry,*[20] a federal district court held that the term "insolvency proceedings" as used in Act 153 included federal bankruptcy proceedings. However, the question whether Act 153 as construed was an invalid encroachment on an area pre-empted by the Federal Bankruptcy Act was not considered in the *Perry* case. This question arose in the recent case of *In the Matter of Freedman.*[21] The facts of this case presented a typical *Constance v. Harvey* situation, and the court assumed without deciding that the *Constance* case was good law. The court held that in the absence of Act 153 the trustee, under the *Constance* interpretation of section 70c, could have avoided the chattel mortgage in question. But, the court also held that Act 153 eliminated in insolvency proceedings the right of an interim creditor, and therefore the right of the hypothetical interim creditor under section 70c, to avoid a chattel mortgage recorded within 14 days from its execution date. The court upheld the validity of Act 153 against the trustee's assertion that it conflicted with section 70c of the bankruptcy act. This decision was based on the familiar doctrine that Congress intended that the powers it granted to the trustee under section 70c were to be determined by reference to applicable state law including, in the court's opinion, Act 153 which determined the rights of interim creditors in insolvency proceedings. It was felt that Act 153 was not directed solely at bankruptcy proceedings because it also regulated the rights of creditors in state insolvency proceedings.

Although the result of the court's decision is to avoid the harsh effects of the *Constance* construction of section 70c, the reasoning in upholding Act 153 as construed in the *Perry* case appears to be questionable. It seems established that the federal bankruptcy act has "suspended" the operation of state insolvency statutes and permits collateral attack upon all subsequent proceedings taken under those laws.[22] Thus the area in which state law may regulate the relations between an embarrassed debtor and his creditors is restricted mainly to statutory regulation of proceedings available

19 Mich. Comp. Laws (1948) §566.140 as amended by Act 153, Mich. Public Acts, 1956. The express wording of the amendment is: "Provided, however, that any such [chattel] mortgage shall not be void in the case of insolvency proceedings as against the creditors of the mortgagor if filed within 14 days from the date thereof. . . ."

20 (S.D. Mich. 1958) 157 F. Supp. 910.

21 (S.D. Mich. 1959) 168 F. Supp. 25.

22 International Shoe Co. v. Pinkus, 278 U.S. 261 (1929).

at common law, such as composition and general assignment.[23] Act 153 appears, therefore, to be a patent attempt by a state legislature to regulate the rights of creditors in federal bankruptcy proceedings; as indicated in the *Perry* case the phrase "insolvency proceedings" can reasonably have no other reference than to bankruptcy proceedings.[24]

Even if it is conceded that Act 153 was intended to regulate the rights of creditors in such state proceedings as composition and general assignment, the act should be invalid so long as it is construed to apply to bankruptcy proceedings as well. It matters not whether Act 153 is directed solely at bankruptcy proceedings or is so directed in combination with an intent to regulate the rights of creditors in certain state proceedings. In either case the act represents an encroachment on the power of Congress to regulate the rights of the trustee under section 70c that is forbidden by the supremacy clause of the Constitution.[25] If construed to apply only to state proceedings, Act 153 would raise no federal question; nor would the act, so construed, affect the trustee's rights as a hypothetical creditor under section 70c. Thus, a major error of the *Freedman* case is the failure of the court to distinguish between the admitted power of state law to regulate the rights of creditors in state proceedings and the lack of power in state law to dictate what standard of reference shall be used to determine the rights of the trustee in federal bankruptcy proceedings.

Act 153 was short-lived, however; in 1956 a second amendment to the Michigan chattel mortgage recording statute was passed. This amendment, Act 233, became effective as of September 1957, repealed Act 153, and provided instead "that no purchase money mortgage shall be void as against creditors of the mortgagor if filed within 14 days from the date of execution of such mortgage. . . ."[26] Unlike Act 153, Act 233 applies only to purchase money chattel mortgages,[27] but as to this type of mortgage the act defines the rights of creditors in all proceedings to which Michigan

[23] Johnson v. Star, 287 U.S. 527 (1933).

[24] "The law seems to be well established that the words insolvency and bankruptcy are synonymous terms in ordinary usage, meaning, and common understanding." In re Perry, (S.D. Mich. 1958) 157 F. Supp. 910 at 915.

[25] U.S. CONST., art. VI, cl. 2. The power of Congress to regulate bankruptcy is derived expressly from U.S. CONST., art I, §8, cl. 4.

[26] Mich. Comp. Laws (1948) §566.140 as amended by Act 233, Mich. Public Acts, 1957.

[27] This limitation is probably the result of the policy consideration that purchase money chattel mortgages are entitled to the same favorable treatment as are purchase money mortgages on realty.

law is applicable. Unlike Act 153, Act 233 evidences no intent to encroach on the power of Congress to define the rights of the trustee in bankruptcy proceedings.

Of primary interest is the fact that Act 233 adopts the "fixed-period" statutory device to regulate priority between creditors of the mortgagor and the chattel mortgagee. Michigan is in the minority group of states in which the courts have construed chattel mortgage recording statutes to protect interim general creditors.[28] This policy of protecting interim general creditors conflicts with any attempt of complete avoidance of the problems raised by the *Constance* interpretation of section 70c. To the extent that a state protects interim general creditors, the trustee will be able to take advantage of the *Constance* interpretation of section 70c. Thus, even as to purchase money mortgages, Act 233 does not completely avoid the effect of the *Constance* construction of section 70c. If a purchase money mortgage is not recorded within the 14-day period fixed by the act, the trustee can avoid the mortgage by asserting the rights of a hypothetical creditor who has extended credit prior to the recording date of the mortgage. Act 233 does, however, reach an equitable compromise between the state's policy of protecting interim general creditors and the desirability of avoiding the effects of the *Constance* interpretation of section 70c, through use of a relation-back device. The priority of any purchase money mortgage recorded within the 14-day period is related back to the execution date of the mortgage. Thus, Act 233 accomplishes three things. First, as to recordings not within the 14-day period, the act preserves the state policy of protecting interim general creditors. Second, as to recordings within the 14-day period the act avoids completely the effects of the *Constance* interpretation of section 70c. And third, through use of the "fixed-period" and "relation-back" devices, the act gives to the diligent mortgagee a certainty of protection not available under the pre-1956 Michigan statute.

Act 233 raises the broader question of the desirability of protecting interim general creditors under any circumstances. An inherent weakness of recording statutes that protect general creditors is persuasively stated in the case of *In re Consorto Constr. Co.*[29] In discussing such statutes the court points out that chattel

[28] See note 16 supra for a list of the eleven states whose statutes have been construed to protect interim general creditors.

[29] (3d Cir. 1954) 212 F. (2d) 676.

mortgagees can easily frustrate the attempt to protect general creditors. If a mortgage is not recorded within the time required by state law, the mortgagee can cut off the priority of interim general creditors by the simple device of re-executing the "old" mortgage and recording this "new" instrument at once.[30] Since the "new" mortgage *is* recorded within the time required by state law, it creates a lien in favor of the mortgagee that is good against all general creditors. Priority rights of the general creditors are then determined by reference to the "new" instead of the "old" mortgage. To require such re-execution of the old instrument as a basis for effective recordation is aptly termed "worthless formalism" by the court in the *Consorto* case.[31] Thus, the specter of *Constance v. Harvey* can have beneficial results in those states with *"Constance-type"* statutes. First, it may encourage such states to amend their recording statutes to reach a more workable compromise between the policy of protecting general creditors and the desire to avoid the effects of the *Constance* construction of section 70c. And second, such states may be encouraged to consider the broader policy question of the desirability of protecting general creditors under any circumstances.

III. *Federal Judicial Reaction to Constance v. Harvey*

Federal judicial reaction to the *Constance* case has been infrequent but generally negative. The reaction has been of two types: cases which assume without deciding that the *Constance* rationale is sound but then refuse to extend it to new factual situations,[32] and cases which expressly repudiate the *Constance* interpretation of section 70c. With the exception of one case, however, this repudiation has been in the form of mere dictum.

The Fifth Circuit has recently decided two cases in which it refused to extend the *Constance* doctrine. In *General Motors Acceptance Corp v. Saliba,*[33] it was ruled that a state statute can retroactively affect the rights of the trustee as a hypothetical creditor under section 70c. The court held that the trustee's rights un-

[30] Apparently no court has ever held that the "new" mortgage is in substance the "old" mortgage, so that the priority of general creditors should therefore be determined by reference to the old mortgage.

[31] In re Consorto Constr. Co., (3d Cir. 1954) 212 F. (2d) 676 at 679.

[32] A good example of this type of case is In the Matter of Freedman, (S.D. Mich. 1959) 168 F. Supp. 25, note 21 supra, discussed at length in part II of this comment.

[33] (5th Cir. 1958) 260 F. (2d) 262.

der section 70c are to be determined by reference to state law as it existed at the time of bankruptcy, thereby rejecting a possible extension of the *Constance* rationale which would allow the trustee to assert the rights of a hypothetical creditor under the state law as it existed at the time of the security transaction in question.[34] In the second Fifth Circuit case, *Brookhaven Bank and Trust Co. v. Gwin,*[35] the court assumed that the *Constance* case was good law and that the trustee could have avoided the chattel mortgage in question. The contest in this case did not involve the trustee but was between the chattel mortgagee and an interim lienor, the trustee having relinquished all claim to the chattel. In upholding the priority of the interim lienor the court made it clear that the *Constance* rationale works only for the trustee's benefit and could not be relied upon by other contestants to settle the status of the chattel mortgage.[36] Thus, the court again declined to extend the *Constance* rationale by refusing to allow persons other than the trustee to benefit derivatively from his rights as a hypothetical creditor under section 70c.

The remaining cases involving section 70c are of varying degrees of helpfulness in determining whether there is a judicial trend toward repudiation of *Constance v. Harvey*. Since the 1950 amendment to section 70c, several federal courts have discussed the provision in general terms, but many of these discussions have not been directed toward determining the effect of the 1950 amendment, nor have they referred to the *Constance* rationale or involved cases with factual situations similar to that in the *Constance* case.[37] These cases, therefore, are of little value in appraising federal judicial reaction to the *Constance* interpretation of section 70c.

34 ". . . [I]t would be a distortion of the intent and effect of Sec. 70, sub. c, . . . to hold that, under the facts of this case, it enshrines the preferential position . . . of the trustee, over the holder of the conditional sales contract beyond the power of the legislature of Georgia to change it." General Motors Acceptance Corp. v. Saliba, (5th Cir. 1958) 260 F. (2d) 262 at 264.

35 (5th Cir. 1958) 253 F. (2d) 17.

36 "As has just been indicated, however, subdivisions (c) and (e) of Section 70 operate in favor of the trustee. We have been cited to no case, nor have we found any, holding that either of those subdivisions can be used as a basis for determining relative priorities between two lien holders as against whom the trustee claims no right." Brookhaven Bank and Trust Co. v. Gwin, (5th Cir. 1958) 253 F. (2d) 17 at 23.

37 See In re Valley City Furniture Co., (S.D. Mich. 1958) 161 F. Supp. 39; In re Ripp, (7th Cir. 1957) 242 F. (2d) 849; Kerry v. Schneider, (9th Cir. 1956) 239 F. (2d) 896; United States v. Eiland, (4th Cir. 1955) 223 F. (2d) 118; In re Driscoll, (S.D. Cal. 1954) 127 F. Supp. 81; In re Kranz Candy Co., (7th Cir. 1954) 214 F. (2d) 588.

In other cases the factual situations were such that the *Constance* construction of section 70c could probably have been applied to avoid the security transaction involved, but this construction apparently was not urged and was clearly not referred to in any of the decisions.[38] It could be argued that these cases represent an implied repudiation of the *Constance* rationale, but any such conclusion would clearly rest on a weak foundation.

A third series of cases contains dicta from which a more substantial implied repudiation of the *Constance* rationale can be drawn. Since none of these cases involved facts similar to the *Constance* case, however, the dicta found in these decisions can at best be regarded as mere expressions of judicial dissatisfaction with *Constance v. Harvey*. Typical of this group of cases is *McKay v. Trusco Finance Co.*,[39] in which the Fifth Circuit implied that if the security transaction involved had been recorded before the date of bankruptcy, the trustee could avoid the transaction only by asserting the rights of an actual creditor under section 70e(1) of the Bankruptcy Act,[40] and that the trustee would not be allowed under section 70c to assert the rights of a hypothetical creditor who extended credit in the interim.

In the quite recent case of *In the Matter of Billings*,[41] a Missouri federal district court was faced with facts and a state statute much like those in the *Constance* case. The court expressly held against the *Constance* interpretation of section 70c. This case involved a purchase money chattel mortgage given by the bankrupt to the Borden Company and not recorded until 14 days after its execution. Under Missouri law interim general creditors can avoid a chattel mortgage which is not recorded within a reasonable time.[42] After holding that a 14-day delay was unreasonable, the referee held that the trustee by using the *Constance*

38 See Exchange National Bank of Colorado Springs v. Hough, (10th Cir. 1958) 258 F. (2d) 785; In re Cotter, (S.D. Mich. 1953) 113 F. Supp. 859, affd. sub nom. Emery v. Union Inv. Co., (6th Cir. 1954) 212 F. (2d) 183.

39 (5th Cir. 1952) 198 F. (2d) 431 at 435. See also In the Matter of Luckenbill, (E.D. Pa. 1957) 156 F. Supp. 129.

40 52 Stat. 882 (1938), 11 U.S.C. (1952) §110e(1). The case of In re American Textile Printers Co., (D.C. N.J. 1957) 152 F. Supp. 901, is cited in 4 MOORE, COLLIER ON BANKRUPTCY, 14th ed., §70.51, p. 100 (Supp. 1958), as holding contrary to the Constance case. The Textile case, however, did not involve a Constance problem because the applicable state statute protected only lien creditors and not general creditors.

41 (W.D. Mo. 1959) 170 F. Supp. 253.

42 Mo. Rev. Stat. (1949) §443.460. The Missouri statute is construed in connection with §70e(1) in the case of In re Alton Milk Co., (W.D. Mo. 1957) 157 F. Supp. 23.

construction of section 70c could avoid the chattel mortgage, it being unnecessary to prove that actual creditors had extended credit in the interim. The district court, assuming also that a 14-day delay was unreasonable under Missouri law, reversed the decision of the referee on the grounds that *Constance v. Harvey* was an incorrect interpretation of section 70c. In reaching its decision the court stated that the trustee could not assert the rights of a hypothetical creditor who extended credit in the interim because no actual creditors had extended credit in the interim.[43] Throughout its discussion of the trustee's rights under section 70c the court stressed the fact that no rights of actual creditors had intervened between the execution date of the chattel mortgage and the date of its recording.

Although the result of the *Billings* case is sound, it appears that the underlying reasoning is perhaps incorrect. To say that no hypothetical creditor on the date of bankruptcy could avoid the chattel mortgage because no rights of actual creditors intervened in the interim is to say that the trustee's rights under section 70c are derivative rights, dependent on the existence of actual creditors. This is clearly contrary to the language of the statute.[44] The strongest argument against the *Constance* interpretation does not make the trustee's rights under section 70c turn upon the existence or non-existence of actual creditors. It is instead based on the proposition that any rights accruing to the trustee under section 70c must be rights which accrue at the date of bankruptcy and not at some prior hypothetical time. With reference to the time when the trustee's rights as a lien creditor accrue, this proposition is not open to question.[45] The result should be the same with reference to the trustee's rights as a general creditor under section 70c.[46] When a debtor-creditor relationship is established im-

[43] ". . . There was no 'perfect' or 'ideal' hypothetical creditor on the day of bankruptcy, because no rights had intervened between the time of the execution of the chattel mortgage and the date of its filing, and could not therefore, on the day of bankruptcy, have asserted any right to the property." In the Matter of Billings, (W.D. Mo. 1959) 170 F. Supp. 253 at 258.

[44] Section 70c expressly states that the trustee can assert the rights of a hypothetical creditor "whether or not such a creditor actually exists." 66 Stat. 430 (1952), 11 U.S.C. (1952) §110c.

[45] Section 70c expressly states that the lien of the hypothetical creditor arises "at the date of bankruptcy." 66 Stat. 430 (1952), 11 U.S.C. (1952) §110c. See also Bailey v. Baker Ice Machine Co., 239 U.S. 268 (1915).

[46] See Weintraub, Levin, and Beldock, "The Strong-Arm Clause Strikes the Belated Chattel Mortgage," 25 FORD. L. REV. 261 at 265, 269, 270-271 (1956). The writers stress

portant legal rights accrue to the creditor, rights which in many cases depend upon the time that credit was extended.[47] The trustee under section 70c should not be allowed to assert the rights of a hypothetical general creditor when the rights asserted depend upon the creation, prior to the date of bankruptcy, of a hypothetical debtor-creditor relationship.

It is not the absence of actual creditors in the hypothetical class which makes the *Constance* construction of section 70c unsound. Rather, it is unsound because it unreasonably denies protection to security transactions perfected prior to the date of bankruptcy. If the trustee under section 70c is regarded as a hypothetical creditor *who extended credit at the date of bankruptcy,* a proper balance would be struck between the competing policies of equality of distribution and the preservation of fairly acquired security interests.

IV. *Conclusion*

State legislatures can profitably use the *Constance* case as a springboard for reviewing the policy which underlies their respective recording statutes dealing with chattel security transactions. State legislation should be framed so as not to encroach upon the congressional power to establish the standard of reference used to define the trustee's powers under section 70c. If a state wishes both to preserve its policy of protecting general creditors and to avoid the harsh results of the *Constance* interpretation of section 70c, constructive legislation is possible. The state can utilize the fixed-period device which allows the holder of a security interest, by perfecting the security transaction within the fixed period, to relate his priority back to the execution date of the transaction involved.

Federal judicial reaction to *Constance v. Harvey* appears to establish a trend toward repudiation of the *Constance* interpretation of section 70c. While this reaction is sound, the federal courts should carefully weigh the reasons they give for this repudiation. The most persuasive reason is not one which makes rejection of

the fact that §70c historically was intended to confer rights on the trustee only at the date of bankruptcy and not at some prior hypothetical time.

47 An example of such rights are those of priority. The numerous state statutes which make the creditor's priority turn upon his status as a prior, interim, or subsequent general creditor show the importance attached to the time that the debtor-creditor relationship arose.

the *Constance* rationale turn upon the existence or non-existence of actual creditors. Rather, rejection should be based on the policy consideration that section 70c was not intended to permit the trustee to assert the rights of a hypothetical creditor accruing prior to the date of bankruptcy. Much confusion would be removed from this area by a congressional amendment to section 70c stating expressly that the hypothetical creditor referred to is a creditor extending credit at the date of bankruptcy. Until such an amendment, however, the *Constance* case should continue to have a catalystic effect in those states with "*Constance-type*" statutes. This effect may nevertheless be beneficial if it produces constructive reappraisal of state statutes and careful analysis by the federal courts of the trustee's powers under section 70c.

George Sidney Buchanan, Jr., S.Ed.