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Bankruptcy—Section 70c—Lewis Case Extended.—Pacific Fin. Corp. v. Edwards

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to continue. A distributor could continue to refuse to deal except in blocks of films as long as it had other customers with whom it might negotiate. Moreover, the price differential between one film and a block of films was not specifically limited to cost justification. This, the Government contended, would create serious enforcement problems. Also under the district court's decree the distributors would be allowed to continue their common practice of quoting only block prices and would be required to quote an individual price only upon request. The Court, although noting that some of the practices discussed above when viewed alone may not require injunctive relief, provided for additional redress in an effort to prevent any recurrence of the illegal acts. Television stations may now expect individually quoted prices which may not exceed prices of films offered in packages other than for legitimate cost justifications. Thus, the quality of films appearing on television should improve through the rightful operation of free competition.

C. RONALD RUBLEY

Bankruptcy—Section 70c—*Lewis* Case Extended.—***Pacific Fin. Corp. v. Edwards.***[1]—At the date of bankruptcy, April 1, 1960, bankrupt had in his possession an automobile which had been sold to him under a conditional sales contract[2] that was dated October 10, 1959.[3] The purchaser acknowledged delivery of the automobile in the contract. A statute of the state of Washington, where the transaction took place, provides that conditional sales of personal property, when the property is put in the possession of the vendee, shall be absolute as to all bona fide subsequent creditors if within ten days after the taking possession by the vendee a memorandum of the sale is filed.[4] The contract was filed on November 12, 1959. Since $2,616.40 remained unpaid at the date of bankruptcy, Edwards, the trustee in bankruptcy, sought to avoid the contract under his status as lien creditor provided in Section 70c of the Bankruptcy Act.[5] The referee in bankruptcy decreed that the contract was null and void as to the trustee. After an affirmance of the referee's order in the district court, Finance appealed to the Court of Appeals for the Ninth Circuit. HELD: The phrase "upon

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[1] 304 F.2d 224 (9th Cir. 1962).

[2] The contract, which was signed by bankrupt and Strato Motors, was immediately assigned and transferred by Strato Motors to Pacific Finance Corporation (hereinafter referred to as Finance).

[3] By a mutual mistake of the parties thereto the contract was dated October 10, 1959, but the true date of its execution was November 10, 1959 and Finance sought reformation to this effect. Decisions of the Supreme Court of Washington, however, preclude reformation of such contract on the ground of a mutual mistake if such reformation will affect the rights of bona fide general creditors.

[4] Wash. Rev. Code § 63.12.010 (1961).

[5] Bankruptcy Act § 70c, 66 Stat. 429 (1952), 11 U.S.C. § 110(c) (1958) reads in part:

> The trustee, as to all property . . . upon which a creditor of the bankrupt could have obtained a lien . . . 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 . . . whether or not such a creditor actually exists.

which a creditor of the bankrupt could have obtained a lien" referred to an *actual* creditor and since it appeared that there were no creditors of the bankrupt whose claims arose after October 10, 1959, the trustee had no powers to exercise under 70c. The clause "whether or not such a creditor actually exists" was held to refer only to the phrase "creditor then holding a lien thereon."

Although the substantive law of the jurisdiction which governs the property in question determines the nature and extent of the "rights, remedies and powers" exercisable by the trustee in bankruptcy in his status as a lien creditor, the issues of whether and in what circumstances he may acquire such a status is a federal question covered by the Bankruptcy Act.[6] That the trustee enjoys a status of a hypothetical lien creditor[7] who assumes that status at the date of bankruptcy, and not at any anterior point of time seems clear.[8] However, the date at which this hypothetical lien creditor is deemed to have extended credit has been a matter of some dispute.

From 1954 to 1961 the most significant decision in this area was *Constance v. Harvey*.[9] The effect of the *Constance* case was to allow the trustee in bankruptcy to relate back the extension of credit from which he acquired his lien to any point of time prior to bankruptcy. This case was subject to much criticism,[10] for although the purpose of 70c was to protect the estate of the bankrupt against secret liens,[11] under *Constance* the trustee was able to prevail in situations which had occurred years previously where it appeared that no actual creditors were injured. Although, as this note will reveal, this result is still possible under at least one set of circumstances, the wholly inequitable treatment under the *Constance* doctrine has been sharply curtailed.

In 1961 the case of *Lewis v. Manufacturers Nat'l Bank of Detroit*[12]

[6] See In re Consorto Constr. Co., 212 F.2d 676 (3d Cir. 1954); McKay v. Trusco Fin. Co., 198 F.2d 431 (4th Cir. 1952); Robbins v. Bastian, 135 F.2d 298 (8th Cir. 1943); In re Wright Indus., Inc., 93 F. Supp. 58 (N.D. Ohio 1950); Commercial Credit Co. v. Davidson, 112 F.2d 54 (5th Cir. 1940).

[7] Hoffman v. Cream-o Prod., 180 F.2d 649 (2d Cir. 1950), cert. denied, 340 U.S. 815 (1950).

[8] Bailey v. Baker Ice Mach. Co., 239 U.S. 268 (1915); In re Consorto Constr. Co., supra note 6, at 678-79; Lockhart v. Garden City Bank & Trust Co., 116 F.2d 658 (2d Cir. 1940).

[9] 215 F.2d 571 (2d Cir. 1954), cert. denied, 348 U.S. 913 (1955) where, under a particular New York transaction, the court found that since an existing creditor without notice of a chattel mortgage could have obtained a lien at the date of bankruptcy and the trustee has the position of an "ideal" hypothetical creditor, his position must prevail over that of the chattel mortgage holder—even though no such creditor actually existed. The concept set forth in this case was favored in some cases, e.g., Towers v. Curry, 247 F.2d 748 (9th Cir. 1957), England v. Sanderson, 236 F.2d 641 (9th Cir. 1956), but was rejected in others, e.g., In re Billings, 170 F. Supp. 253 (W.D. Mo. 1959), In re Am. Textile Printers Co., 152 F. Supp. 901 (D.N.J. 1957).

[10] MacLachlan, The Impact of Bankruptcy on Secured Transactions, 60 Colum. L. Rev. 593 (1960); Marsh, Constance v. Harvey—The "Strong-Arm Clause" Re-Evaluated, 43 Calif. L. Rev. 65 (1955); Weintraub, Levin, Beldock, The Strong Arm Clause Strikes the Belated Chattel Mortgage, 25 Fordham L. Rev. 261 (1956); Comment, 57 Mich. L. Rev. 1227 (1959).

[11] Marsh, supra note 10, at 65, 75.

[12] 364 U.S. 603 (1961).

was decided by the Supreme Court of the United States. In this case a mortgagee recorded a chattel mortgage four days after it was executed. Five months later a petition in bankruptcy was filed. The law of Michigan, where the transaction took place, provided that a chattel mortgage was void against creditors of the borrower who became such in the period between execution and recordation unless the mortgagee took possession of the chattel or unless the mortgage was recorded immediately. There was no evidence of any actual extension of credit during this period. The Supreme Court held that:

> [T]he rights of the creditors, existing or hypothetical, to which the trustee succeeds under Section 70c are to be ascertained as of the time when the bankruptcy petition is filed and not at an anterior point of time. The trustee acquires the 'status of the creditor' as of the time when the petition in bankruptcy is filed. The holding in *Constance v. Harvey*, which would allow the trustee to upset security transactions entered into years before the bankruptcy as long as he could posit a hypothetical situation in which a creditor might have had such a right, is not to be followed.[13]

Although the decision in the *Lewis* case did not explicitly state when the trustee's creditor is deemed to have extended credit, the result reached necessarily dictates that credit is extended and the lien acquired on the date of the filing of the petition in bankruptcy. The Court in the *Constance* case was concerned only with the trustee's status as a lien creditor on the date of bankruptcy. It was not particularly concerned that the creditor status of the trustee was deemed to have arisen at a time prior to the date of bankruptcy. To overrule *Constance*, the Supreme Court had to determine when credit can be deemed to have been extended since under Michigan law the extension of credit had to be within a particular time before the trustee could claim superior rights. The Court stated that "the trustee acquires the status of a creditor as of the time when the petition in bankruptcy is filed." In the light of the *Constance* holding, and in view of the fact that the Court did not use the words "status as a lien creditor," the extension of credit must be deemed to have occurred on the date of bankruptcy. This conclusion has the support of most authors who have written on the subject.[14]

While there is language in the *Lewis* case which was cited by both counsel for Finance and the court of appeals to support the conclusion in the instant case,[15] it is submitted that the cited language was dictum and should be treated as such. The actual holding of the *Lewis* case, based on the facts, would not support the result reached in the principal case.

It would appear that the construction which 70c received in the instant case—if it is the true construction—reduces the usefulness of section

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[13] Comment, 2 B.C. Ind. & Com. L. Rev. 372, 373 (1961).

[14] Marsh, supra note 10, at 74-75; Comment, 57 Mich. L. Rev. 1227, 1230 (1959); Comment, 2 B.C. Ind. & Com. L. Rev. 372 (1961).

[15] Brief for Appellants, pp. 16-17; 304 F.2d at 229.

70e[16] if an actual subsequent creditor existed under circumstances similar to those in the present situation. If such a creditor actually exists the trustee can "step into his shoes" under the provisions of 70e which provide that any transfer voidable under state or federal law by *any* creditor of the debtor having a provable claim under the Bankruptcy Act shall be null and void as to the trustee. Since under the rule of the principal case, if an actual creditor exists, 70c will automatically give the trustee a lien of that creditor, exercise of 70e powers in a similar situation would be impractical.[17] To return vitality to 70e the interpretation of 70c found in the *Lewis* case would seem to be correct.

Once one has accepted the above positions the result reached in the instant case seems clearly wrong. The trustee's hypothetical creditor, since he is considered to have extended credit on the date of bankruptcy, would have to be considered a subsequent creditor and as such would, under the Washington statute, have the power to avoid the contract here in question.[18]

It is significant to note that under the Uniform Commercial Code a court which properly construed 70c would give the trustee in bankruptcy rights superior to those of the conditional contract holder in circumstances similar to those in the instant case.[19]

DAVID W. CARROLL

Constitutional Law—Jurisdiction over Foreign Corporation—Sales to an Independent Distributor within the Forum.—***Sanders Associates, Inc. v. Galion Iron Works & Mfg. Co.***[1]—Sanders, a Delaware corporation with its principal place of business in New Hampshire, contracted with Galion, an Ohio corporation, to develop an automatic attachment for the latter's road grading equipment. Sanders brought an action in the United States District Court for New Hampshire against Galion for breach of the contract. In addition to this contract, Galion's only other contacts with the state arose

[16] Bankruptcy Act § 70e, 66 Stat. 429 (1952), 11 U.S.C. § 110e (1958).

[17] Under section 70e, transactions are not automatically void as to the trustee. This section merely creates a power of avoidance which the trustee must exercise in a proper court. Collier, Bankruptcy Manual §§ 70.46 to .50 (2d ed. 1961). Under section 70c, the trustee automatically acquires a lien without any court action. Id. § 70.30.

[18] See Comment, 55 Nw. U.L. Rev. 783 (1961), where there is a discussion of the *Lewis* case as applied to a Washington statute which is similar to the one involved in the instant case.

[19] UCC § 9-302(1)(d) provides in part:

> (1) a financing statement must be filed to perfect all security interests except the following . . .
>
> (d) a purchase money security interest in consumer goods; but filing is required . . . for a motor vehicle required to be licensed. . . .

UCC § 9-301(2) gives the secured party 10 days after the collateral comes into possession of the debtor to file and thus perfect his interest.

This result, however, would not be reached under the Massachusetts Uniform Commercial Code (Mass. Gen. Laws Ann. ch. 106, § 9-302) (1958) which does not require filing to perfect security interests in consumer goods, and makes no exception for motor vehicles required to be licensed.

[1] 304 F.2d 915 (1st Cir. 1962).