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Bankruptcy--"Strong Arm Clause" Weakened

Harold Dale Brewster Jr.
West Virginia University College of Law

CASE COMMENTS

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Trustee in bankruptcy assumed the status of a hypothetical lien creditor in order to avoid a recorded conditional sale contract covering an automobile in the possession of the bankrupt. Referee declared the contract void and ordered the trustee to sell the automobile free of the lien claimed by the conditional vendor. The conditional vendor appealed to the district court which affirmed the Referee's order. *Held,* reversed. Where there is no actual creditor of the bankrupt in existence as of the date of bankruptcy who could have obtained a lien on the automobile, the trustee can not acquire the status of a hypothetical lien creditor in order to set aside the conditional sale contract. *Pacific Finance Corp. v. Edwards,* 304 F.2d 244 (9th Cir. 1962).

Sections 70(c) and 70(e) of the Bankruptcy Act were enacted to enable the trustee in bankruptcy to secure all of the bankrupt's property for equal distribution among his creditors. COLLIER, BANKRUPTCY MANUAL 927 (2d ed. 1961). These sections were designed to permit the trustee to assume the rights of creditors of the bankrupt in order to set aside liens and transfers that might otherwise deplete the assets of the estate. Section 70(e) gives the trustee the rights of actual creditors of the bankrupt having provable claims as of the date of bankruptcy. Bankruptcy Act § 70(e), 11 U.S.C. § 110(e) (1958). This section permits the trustee to set aside any lien or transfer which is voidable by any actual creditor of the bankrupt. *Moore v. Bay,* 284 U.S. 4 (1931). Section 70(c) permits the trustee to assume the rights, remedies and powers of a creditor who could have obtained a lien under state law upon the property of the bankrupt as of the date of bankruptcy by legal or equitable proceedings, "whether or not such a creditor actually exists." Bankruptcy Act § 70(c), 11 U.S.C. § 110(c) (1958). This section is designed to further protect the general creditors by giving the trustee on the date of bankruptcy the rights which a lien creditor would enjoy in order to enable him to strike down secret liens or invalid transfers. 4 COLLIER, BANKRUPTCY 1383 (14th ed. 1959).

Although seemingly plain, the wording of 70(c), often labeled the "strong arm clause", has been subjected to varied interpretations. The most liberal interpretation was given in *Constance v. Harvey,* 215 F.2d 517 (2d Cir. 1954). In that case the bankrupt gave a chattel mortgage which was not recorded by the mortgagee until several months after execution, but which was perfected prior to bankruptcy. Since under state law a chattel mortgage was void as to interim creditors, the trustee was permitted to avoid the mortgage by assuming the status of a hypothetical creditor who had extended credit during the interim, even though no such creditor actually existed. See also *Conti v. Volper*, 229 F.2d 317 (2d Cir. 1956).

Constance v. Harvey was widely criticized by legal writers as posing a real threat to secured transactions, and for the same reason was finally overruled by the Supreme Court in *Lewis v. Manufacturers Nat'l Bank*, 364 U.S. 603 (1961). The Court in the *Lewis* case denied the trustee the right to become a hypothetical interim creditor with the right to avoid secured transactions where the transaction had been perfected prior to bankruptcy, feeling such an interpretation of 70(c) would unjustly enrich unsecured creditors at the expense of the secured creditors. The trustee was allowed to assume the status of a creditor as of the date of bankruptcy, but not at any earlier time.

The principal case now offers a construction of the "strong arm clause" which tends to neutralize its effectiveness by refusing to allow the trustee to assume the status of a hypothetical lien creditor unless there is in existence as of the date of bankruptcy an actual creditor who could have obtained a lien. By requiring the existence of an actual creditor, 70(c) would give the trustee little more power than he already has under Section 70(e) which enables the trustee to set aside transfers which actual "flesh and blood" creditors of the bankrupt having provable claims could avoid. Such an interpretation would imply that the trustee derives his rights under 70(c) from the existence of an actual creditor, Buchanan, *Recent Reactions to Constance v. Harvey*, 57 MICH.L.REV. 1227, 1238 (1959), when it is intended that he derive his rights not from the creditors of the estate, but from the statute. *In re Farmer's Co-op.*, 202 F. 1008 (D. N.D. 1913).

It would seem that the better interpretation of 70(c) is the one rendered in *McKay v. Trusco Finance Co.*, 198 F.2d 431 (5th Cir. 1952), which allowed the trustee to avoid an unrecorded chattel mortgage although no creditor was shown to have come into existence between the date of execution and the date of bankruptcy. The court held that the right of the trustee to avoid the chattel mortgage was not dependent upon the existence of an actual creditor. Had this more liberal interpretation been followed in the principal case, the conditional sale contract would have been void as to the trustee. Since the transfer had not been perfected under Washington law prior to the date of bankruptcy, a creditor of the bankrupt whose claim arose on that date could have obtained a lien on the property, and the trustee has the rights of such a creditor, whether or not such a creditor actually exists.

The interpretation of 70(c) given in the principal case fails to strike a proper balance between the interests of the secured and unsecured creditors of the bankrupt. If the principal case is followed, 70(c) would serve little useful purpose, since most transfers avoidable under 70(c) would be avoidable under 70(e), and where no actual subsequent creditors are in existence, secret liens or invalid transfers would be permitted to deplete the assets of the estate to the detriment of the general creditors. The proper balance would be struck, however, if the existence of an actual creditor were required only under Section 70(e). 70(e) could be used to avoid any lien or transfer voidable by an actual creditor of the bankrupt regardless of when the transaction was perfected. 70(c) could then be used to avoid any lien or transfer not perfected as of the date of bankruptcy whether or not an actual creditor exists who could have obtained a lien.

Harold Dale Brewster, Jr.

Criminal Law—Presence of Accused at Trial

D was convicted of statutory rape. At the trial, while instructions were being discussed, *D* voluntarily left the judge's chambers. His absence was discovered within four or five minutes. The judge suspended the proceedings and upon *D's* return, the discussion of instructions resumed. On appeal, *D* maintained that his absence constituted reversible error. *Held,* reversed, new trial awarded. W. VA. CODE ch. 62, art. 3, § 2 (Michie 1961), requires that "a person indicted for felony shall be personally present during the trial therefor. . . ." The statute is mandatory and the right of the accused is inalienable. *State v. Vance*, 124 S.E.2d 252 (W. Va. 1962).

The concern regarding presence at trial reached its climax in West Virginia in the instant case. The court reluctantly reversed