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Bankruptcy--State Limitations on the Trustee's Status as Hypothetical Creditor

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CASE COMMENTS

BANKRUPTCY—STATE LIMITATION ON THE TRUSTEE'S STATUS AS HYPOTHETICAL CREDITOR.—The trustee in bankruptcy, acting under the "strong-arm provision" of the Bankruptcy Act, which granted to him all the powers of the most perfect creditor who could exist under state law, whether or not such creditor actually existed, sought to declare void a chattel mortgage filed nine days after its execution. A Michigan statute provided that a chattel mortgage was void as against general interim creditors, except that such creditors could not avoid such mortgage in insolvency proceedings if it was recorded within fourteen days of the date of its execution. *Held,* affirming the court's action vacating the trustee's order, that the state statute did not fatally conflict with the Bankruptcy Act since the powers of the trustee were to be determined by the state law on which Congress had imposed no limit as to the degree to which such powers could be curtailed. *Hertzberg v. Associated Discount Corp.,* 272 F.2d 6 (6th Cir. 1959).

The trustee in bankruptcy derives power from both state law and the Bankruptcy Act. The Bankruptcy Act § 70(e), 30 Stat. 566 (1898), 11 U.S.C. § 110(e) (1952), gives to the trustee all the rights of any creditor of the bankrupt under state or federal law to attack a void transfer. But this section is limited in that it gives to the trustee only the rights of an actual "flesh and blood" creditor with a provable claim, and then only to the extent of the existing rights of such a creditor. *Rockman v. Schilling,* 72 F. Supp. 172 (D.C.N.J. 1947). The trustee's power in bankruptcy is further extended by the Bankruptcy Act § 70(c), 52 Stat. 881 (1938), 11 U.S.C. § 110(c), (1952), which is termed the "strong-arm provision", because it has the effect of giving the trustee the status of an ideal creditor whether such a creditor exists. Perhaps the furthest extension of this section is the case of *Constance v. Harvey,* 215 F.2d 571 (2d Cir. 1954), involving a state statute which provided that a general interim creditor could avoid a mortgage although it was subsequently perfected by recordation. The court stated that the trustees in this situation had all the powers of a "hypothetical creditor" and the trustee did not need to prove that an actual creditor gave credit during the interim. In fact, *Hoffman v. Cream-O-Products,* 180 F.2d 649 (2d Cir. 1950), stated that the trustee is not actually an attacking creditor but an "ideal" one.

It is evident that the hypothetical status of the trustee as a perfect creditor under § 70(c) relies on state substantive law which

is incorporated by reference. Hence, the trustee's powers are limited to those which the state allows a supposed creditor of the bankrupt, who at the date of bankruptcy completed the process for perfection of a lien. *In re Wright Industries,* 93 F. Supp. 58 (N.D. Ohio E.D., 1950). Although the extent of the trustee's rights, remedies, and powers are measured by state law, it nonetheless remains that the determination of the trustee's right to such a status is dependent on the Bankruptcy Act. It is the federal law which controls this aspect of the problem. Valid liens may be created by state legislation, but the state may not limit the duration of such liens by the time of bankruptcy, or extend their duration beyond that time upon any conceivable theory. *Commercial Credit v. Davidson,* 112 F.2d 54 (5th Cir. 1940). Furthermore, both the powers of the trustee and the rights of creditors are determined as of the date of bankruptcy and remain fixed thereafter, regardless of state law. *Lockhart v. Garden City Bank & Trust Co.,* 116 F.2d 658 (2d Cir. 1940).

From the foregoing authorities the conclusion is obvious that § 70(c) gives the trustee in bankruptcy all rights, remedies, and powers of an actual creditor granted to him in respect to § 70(e) plus all those of the hypothetical creditor under § 70(c).

The principal case has certainly curtailed, if not destroyed, the effect of these sections. For it cannot be denied that an actual creditor could have proceeded in the state court any time before the bankruptcy petition was filed and could have avoided the mortgage because by state law it was until this time void as to him. His rights as a "flesh and blood" creditor should pass to the trustee in bankruptcy. Since § 70(c) does not require an actual creditor this right should logically extend to the trustee under the facts in this case. However, such was not the holding. The ultimate result here is to confer upon the state not only the power to determine just what rights, remedies, and powers the trustees in bankruptcy has, but to determine whether the trustee is entitled to the status of a creditor created by state law. Past decisions indicate that this is not the law.

R. M. H.

CONSTITUTIONAL LAW—COURT-MARTIAL—JURISDICTION OVER CIVILIAN DEPENDENTS AND EMPLOYEES.—The United States Supreme Court on January 18, 1960, decided four cases involving the constitutional validity of court-martial trials of civilian personnel