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## NOTES

### Bankruptcy—Creditors' Rights—A Bona Fide Purchaser-Plus Test for Statutory Liens in Bankruptcy

Congress, under constitutional mandate to provide "uniform laws on the subject of bankruptcies,"<sup>1</sup> has in recent decades responded periodically<sup>2</sup> to the threat to national uniformity and federal preemption posed by state-created creditors' rights. These threats most commonly take the form of "statutory liens"<sup>3</sup> which, if unrestricted, could soon have a greater impact on the administration of bankrupt estates than the Bankruptcy Act itself.<sup>4</sup> The difficulty of imposing satisfactory restrictions on statutory liens is indicated as much by the dramatic character of the changes made as by the frequency with which Congress has felt the need to make them. A recent court of appeals decision, *In re J.R. Nieves & Co.*,<sup>5</sup> has cast into high relief some problems inherent in the latest statutory scheme. In addition, the holding in the case portends consequences of the 1966 amendments to the Bankruptcy Act beyond the probable contemplation of their draftsmen.<sup>6</sup>

Section 67c of the Bankruptcy Act regulates the validity of statu-

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<sup>1</sup>U.S. CONST. art. I, § 8.

<sup>2</sup>Act of June 22, 1938, ch. 575, 52 Stat. 840; Act of July 7, 1952, ch. 579, 66 Stat. 420; Act of July 5, 1966, Pub. L. No. 89-495, 80 Stat. 268.

<sup>3</sup>A statutory lien in common understanding is a lien which is given by statute to protect a particular economic class, such as mechanics or tax claimants, and which is in no way dependent on judicial proceedings or consensual security transactions. 4 COLLIER ON BANKRUPTCY ¶ 67.12[5], at 155, & ¶ 67.20[9], at 253 (14th ed. J. Moore & L. King 1968) [hereinafter cited as COLLIER].

A statutory lien is defined by Bankruptcy Act § 1(29a), 11 U.S.C. § 1(29a) (1970), as a lien arising solely by force of statute upon specified circumstances or conditions, but shall not include any lien provided by or dependent upon an agreement to give security, whether or not such lien is also provided by or is also dependent upon statute and whether the agreement or lien is made fully effective by statute . . . .

This definition was added in 1967 "specifically [to] embody the meaning which Congress originally intended in the act and thus to assure that consensual securities are not subjected to any of the tests of validity prescribed by the new section 67c [of the Bankruptcy Act]." H.R. REP. NO. 686, 89th Cong., 1st Sess. 5 (1965) [hereinafter cited as H.R. REP. NO. 686]. The definition, however, has created as much controversy as it has settled. For a discussion of the problems raised by § 1(29a) see King, *Statutory Liens Under New § 67c of the Bankruptcy Act*, 42 REF. J. 11 (1968); Marsh, *Triumph or Tragedy? The Bankruptcy Act Amendments of 1966*, 12 WASH. L. REV. 681, 714-18 (1967); Marsh, Book Review, 13 U.C.L.A.L. REV. 898, 907-08 (1966).

<sup>4</sup>H.R. REP. NO. 686, at 2.

<sup>5</sup>446 F.2d 188 (1st Cir. 1971).

<sup>6</sup>The present §§ 67b-c of the Bankruptcy Act, 11 U.S.C. §§ 107b-c (1970), were enacted by Act of July 5, 1966, Pub. L. No. 89-495, §§ 3-4, 80 Stat. 268.

To readers unfamiliar with bankruptcy literature, it should be pointed out that bankruptcy is a statutory proceeding in a court of special jurisdiction presided over by a professional referee and

tory liens in bankruptcy proceedings.<sup>7</sup> The general purpose of the section is to protect the federal priority scheme against disruption by "spurious liens" and "disguised priorities" enacted by state legislatures at the instance of influential creditor groups.<sup>8</sup> Accordingly, section 67c(1) invalidates three classes of liens.<sup>9</sup> Section 67c(1)(A) takes aim at rights which are not really "liens" at all in traditional usage but payment priorities intended to take effect upon insolvency. Section 67c(1)(C) is a categorical invalidation of landlords' liens, designed to restrict that class of creditors to its section 64a(5) priority status<sup>10</sup> in all events. All other statutory liens must meet the bona fide purchaser test established by

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governed by the Bankruptcy Act, 11 U.S.C. §§ 1-1103 (1970). A great many bankruptcy proceedings go unreported, and the relative dearth of case law on a given topic is not necessarily an indication of its commercial significance. Copious reference to secondary authority is standard technique.

<sup>7</sup>Bankruptcy Act § 67c, 11 U.S.C. § 107c (1970).

<sup>8</sup>H.R. REP. No. 686, at 2.

<sup>9</sup>Bankruptcy Act § 67c(1), 11 U.S.C. § 107c(1) (1970), reads as follows:

The following liens shall be invalid against the trustee:

(A) every statutory lien which first becomes effective upon the insolvency of the debtor, or upon distribution or liquidation of his property, or upon execution against his property levied at the instance of one other than the lienor;

(B) every statutory lien which is not perfected or enforceable at the date of bankruptcy against one acquiring the rights of a bona fide purchaser from the debtor on that date, whether or not such purchaser exists: *Provided*, That where a statutory lien is not invalid at the date of bankruptcy against the trustee under subdivision c of section 70 of this Act [11 U.S.C. § 110c (1970)] and is required by applicable lien law to be perfected in order to be valid against a subsequent bona fide purchaser, such a lien may nevertheless be valid under this subdivision if perfected within the time permitted by and in accordance with the requirements of such law: *And provided further*, That if applicable lien law requires a lien valid against the trustee under section 70, subdivision c [11 U.S.C. § 110c (1970)], to be perfected by the seizure of property, it shall instead be perfected as permitted by this subdivision c of section 67 [11 U.S.C. § 107c (1970)] by filing notice thereof with the court;

(C) every statutory lien for rent and every lien of distress for rent, whether statutory or not. A right of distress for rent which creates a security interest in property shall be deemed a lien for the purpose of this subdivision c.

<sup>10</sup>Bankruptcy Act § 64a, 11 U.S.C. § 104a (1970) reads in pertinent part:

The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment shall be . . . (5) debts other than for taxes owing to any person, including the United States, who by the laws of the United States is entitled to priority, and rent owing to a landlord who is entitled to priority by applicable State law or who is entitled to priority by paragraph (2) of subdivision c of Section 67 of this Act [11 U.S.C. § 107c (1970)]: *Provided, however*, That such priority for rent shall be restricted to the rent which is legally due and owing for the actual use and occupancy of the premises affected, and which accrued within three months before the date of bankruptcy.

In general, the theory of bankruptcy is that a legal right to full payment is converted into an

section 67c(1)(B): if at the date of bankruptcy the lien is valid against a subsequent bona fide purchaser, the trustee cannot avoid it. A lien which does not meet this test may still be eligible for post-bankruptcy perfection under the "saving proviso." Three questions must be answered affirmatively in order to sustain the lien against the trustee under the proviso: Was the lien valid as of the date of bankruptcy against a creditor who obtained on that date a lien by judicial or equitable proceedings?<sup>11</sup> Is the lien one required by applicable lien law to be perfected to be valid against a bona fide purchaser? If so, was the lien in fact perfected in accordance with such law?<sup>12</sup>

In effect section 67c(1)(B) gives the trustee, *vis-a-vis* the lienor, the rights of a bona fide purchaser, referring to "applicable lien law" (ordinarily state lien law) to answer the question of relative priority—whether a given lien at a given stage of perfection is valid against a bona fide purchaser. What sort of bona fide purchaser the lien must be perfected against, however, is presumably a question of federal statutory interpretation going to the definition of "bona fide purchaser" as used in section 67c of the Bankruptcy Act.<sup>13</sup> What is a bona fide purchaser within the

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equitable right to a pro rata share of the bankrupt estate. *Katchen v. Landy*, 382 U.S. 323, 336 (1966). Secured claims are to be exempted from this conversion process unless the Bankruptcy Act affirmatively invalidates the security interest. *E.g. In re Brannon*, 62 F.2d 959, 961 (5th Cir.), *cert. denied*, 289 U.S. 742 (1933). Section 64a further alters the pro rata scheme by establishing an order of priorities among unsecured creditors. Ahead of rent claims on the priority scale are (1) claims for administration expenses, (2) claims for three months' wages (up to \$600 per claimant), (3) certain expenses incurred by creditors, and (4) claims for taxes. Bankruptcy Act § 67c(2), 11 U.S.C. § 107c(2) (1970), assures rent lienors a § 64a(5) priority status where the lien invalidated by § 67c(1)(C) is the only right conferred by state law.

<sup>11</sup>Bankruptcy Act § 70c, 11 U.S.C. § 110c (1970) gives the trustee the rights of "a creditor who upon the date of bankruptcy obtained a lien by legal or equitable proceedings upon all property, whether or not coming into possession or control of the court, upon which a creditor of the bankrupt upon a simple contract could have obtained such a lien, whether or not such a creditor exists." The reference in § 67c(1)(B) to § 70 means that to be eligible for post-bankruptcy perfection, the lien must have been valid as of the date of bankruptcy against a hypothetical judgment lien creditor. On the trustee's rights under § 70c, see 4A COLLIER ¶¶ 70.49-70.65; *Lewis v. Manufacturers Nat'l Bank*, 364 U.S. 603 (1961), *noted in* 75 HARV. L. REV. 102 (1961).

<sup>12</sup>If one of the requirements of the applicable law is that the property be seized to be valid against judgment lien creditors, then, by the second proviso to § 67c(1)(B), that requirement is met by filing notice.

<sup>13</sup>This distinction as to applicable law is better observed than articulated in the cases. The court in *Nieves*, for example, makes the statement that "[w]hether a given person is a bona fide purchaser (or encumbrancer, pledgee, or transferee) is defined by state law." 446 F.2d at 192 n.6. But it is clear from the citation there to *In re Chesterfield Developers, Inc.*, 285 F. Supp. 689 (S.D.N.Y. 1968), and from the discussion of legislative intent, that the court regards the question of what is meant by "bona fide purchaser" in § 67c(1)(B) as one of federal law. As a general proposition, the meaning of a term in a federal statute is a matter of federal law.

meaning of section 67c(1)(B)? In *Nieves* the First Circuit has held that a bona fide purchaser, as Congress intended the term in prescribing a standard for bankruptcy recognition of statutory liens, is something more than just any innocent purchaser for value. Just how much more, or in just what way this legendary purchaser differs, is now an open question upon which may turn the validity in bankruptcy of many statutory liens.

The respondents in *Nieves* were certain creditors who petitioned to reclaim inventory sold by them to the bankrupt, a Puerto Rican corporation, on open account. They asserted a lien under the Civil Law "vendor's privilege"<sup>14</sup> against so much of the inventory as was in the trustee's possession. The vendor's privilege in Puerto Rico gives a "preferred" status to credits for the purchase price of personal property in the buyer's possession. The Civil Code, by creating a privilege coterminous with the buyer's "possession," protects the seller against even a subsequent bona fide purchaser, so long as the latter has not taken delivery.<sup>15</sup> The referee, however, interpreted the statutory language to confer not a lien but a mere priority under local law, a local priority invalid in bankruptcy.<sup>16</sup>

The district court reversed the referee, concluding that Puerto Rican law gives the seller a security interest in the specific property sold which is enforceable without regard to the buyer's financial condition and that such an interest is in substance a true lien. Applying section 67c(1)(B) the district court held that the lien was valid against bona fide purchasers at the date of bankruptcy and therefore valid against the trustee.<sup>17</sup> On appeal the respondents relied on a Fifth Circuit precedent, *In re*

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<sup>14</sup>With regard to specified personal property of the debtor, the following are preferred:

1. Credits for the construction, repair, preservation, or for the amount of sale of personal property which may be in the possession of the debtor to the extent of the value of the same.

P.R. LAWS ANN. tit. 31, § 5192 (1968).

<sup>15</sup>*Continental Bank & Trust Co. v. McCann*, 151 La. 555, 92 So. 55 (1922); *Capo v. S.A. Panzardi & Co.*, 44 P.R.R. 225, 227-28 (1932).

<sup>16</sup>The referee's ruling was apparently based on a formalistic reading of the Puerto Rican law and a substantive reading of § 1(29a) of the Bankruptcy Act. Concluding that a "privilege" is not a "lien," the referee did not apply § 67c. Although no provision of the Act affirmatively invalidates state priorities, this is the logical result of the exclusive federal priority system established by § 64a. See, e.g., *Halpert v. Industrial Comm'rs*, 147 F.2d 375 (2d Cir. 1945). For a consideration of the Civil Code vendor's privilege as a "statutory lien," see Comment, *Statutory Liens Under Section 67c of the Bankruptcy Act: Some Problems of Definition*, 43 TUL. L. REV. 305, 308-320 (1969).

<sup>17</sup>446 F.2d at 190.

*Trahan*,<sup>18</sup> involving the Louisiana version of the vendor's privilege. The appellate court reversed, however, and held that since a subsequent purchaser could have cut off the seller's rights by taking possession of the goods before the unpaid creditors had levied, the lien was not perfected against bona fide purchasers at the date of bankruptcy. "In our view," said the court, "when Congress spoke of the 'rights' of a hypothetical purchaser, it contemplated a full-blooded, not an anemic, purchaser."<sup>19</sup>

Given the bona fide purchaser-plus test thus established, the respondents' contention that a sequestration<sup>20</sup> of the goods could cut off the rights of purchasers altogether raised the question whether such a levy could stand for the "perfection" permitted by the post-bankruptcy saving proviso. On this issue the court distinguished "perfection" and "enforcement" and held that the sequestration procedure generally available to secured creditors was for the purpose of foreclosure—i.e. lien enforcement—and that the section 67c(1)(B) provisos must be limited to "those state liens in which the laws creating them provide specifically for perfection against bona fide purchasers by recording, seizure, or other means of actual or constructive notice."<sup>21</sup>

A brief history of statutory liens in bankruptcy, and of the evolution of sections 67b and c, is helpful to an understanding of both the problems in the present statute and the significance of the *Nieves* decision.<sup>22</sup> Though irregular, this history is marked by progressive refinements of the distinction between "lien" and "priority" as that distinction bears on the manner in which state law will be permitted to vary the basic scheme of pro rata distribution among all provable claims. The Bankruptcy Act of 1898<sup>23</sup> made no effort to prescribe an exclusive federal priority plan, relying on state law not only to exempt secured creditors from forced participation but also to determine which, if any, unsecured creditors were to be paid off the top. Section 64b(5) gave preferred status to "debts owing to any person who by the laws of the States . . . is

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<sup>18</sup>283 F. Supp. 620 (W.D. La.), *aff'd mem.*, 402 F.2d 796 (5th Cir. 1968), *cert. denied*, 394 U.S. 930 (1969).

<sup>19</sup>446 F.2d at 192.

<sup>20</sup>P.R. LAWS ANN. tit. 31, §§ 4711-4715 (1968), provide for enforcement of privileges by judicial sequestration.

<sup>21</sup>446 F.2d at 193-94.

<sup>22</sup>For a more extended historical treatment, see H.R. REP. NO. 686; Kennedy, *Statutory Liens in Bankruptcy*, 39 MINN. L. REV. 697 (1955).

<sup>23</sup>Bankruptcy Act of 1898, ch. 541, §§ 1-70, 30 Stat. 544.

entitled to priority."<sup>24</sup> Section 67d evidenced an intention to protect "holders of valid liens not affirmatively invalidated by the Act."<sup>25</sup>

The increased commercial importance of bankruptcy in the 1930's engendered dissatisfaction with the permissive posture of the 1898 Act toward state priorities, and in 1938 the Chandler Act amended section 64<sup>26</sup> to eliminate them.<sup>27</sup> At the same time section 67 was rewritten to afford greater protection for genuine interests in specific property.<sup>28</sup> New section 67b was a general validation of statutory liens which made express provision for post-bankruptcy perfection. Section 67c, however, by requiring liens on personal property not accompanied by possession of the property to be postponed behind claims for wages and administration expenses, took away much of what section 67b gave.<sup>29</sup> This postponement principle was introduced as a compromise between a policy of recognizing liens (as distinct from priorities) and the Chandler Act's primary concern to eliminate the influence of state law on the federal scheme of distribution provided by section 64a.<sup>30</sup>

The 1952 amendments to section 67 partially abandoned the postponement device in favor of outright invalidation of most of the liens formerly postponed,<sup>31</sup> thereby removing the incentive for the abusive practice of amending state priority statutes to denominate them "liens."<sup>32</sup> The possessory standard was retained, however, "possession" being merely broadened to include levy, sequestration, or distraint. The premium placed on early seizure bankrupted many debtors prema-

<sup>24</sup>*Id.* § 64b(5), at 563 (now amended and codified as Bankruptcy Act § 64a(5), 11 U.S.C. § 104a(5) (1970)).

<sup>25</sup>4 COLLIER ¶ 67.20, at 209. The precise wording of § 67d was: "Liens given or accepted in good faith and not in contemplation of or in fraud upon this Act, and for a present consideration, which have been recorded according to law, if record thereof was necessary in order to impart notice, shall not be affected by this Act." Bankruptcy Act of 1898, ch. 541, § 67d, 30 Stat. 564.

<sup>26</sup>Act of June 22, 1938, ch. 575, 52 Stat. 874.

<sup>27</sup>The limited priority for landlords was, of course, retained. *See* note 10 *supra*.

<sup>28</sup>Act of June 22, 1938, ch. 575, 52 Stat. 875. Some doubt existed before the Chandler Act as to the validity of statutory liens which arose before bankruptcy but were unperfected on the date of bankruptcy. *Compare* *New Orleans v. Harrell*, 134 F.2d 399 (5th Cir. 1943), with *In re Lambertville Rubber Co.*, 27 F. Supp. 897 (D.N.J. 1939), *modified*, 111 F.2d 45 (3d Cir. 1940). *See also* 4 COLLIER ¶ 67.20, at 213 n.10.

<sup>29</sup>Act of June 22, 1938, ch. 575, 52 Stat. 876.

<sup>30</sup>A. WEINSTEIN, *THE BANKRUPTCY LAW OF 1938*, at 144 (1938).

<sup>31</sup>Act of July 7, 1952, ch. 579, §§ 21(c)-(d), 66 Stat. 427.

<sup>32</sup>*See* H.R. REP. NO. 2320, 82d Cong., 2d Sess. 13 (1952); Weinstein, *Amendments to the Bankruptcy Act as Proposed and Pending Before Congress*, 24 REF. J. 28, 32 (1950).

turely.<sup>33</sup> In addition, confining bankruptcy recognition to possessory liens ignored modern commercial realities<sup>34</sup> and produced especially incongruous and inequitable results in situations where creditors had relied on state recording statutes to perfect their liens against even bona fide purchasers, only to find that the Bankruptcy Act, in the case of statutory liens, eschewed modern concepts of recorded notice in favor of the trappings of an earlier era.<sup>35</sup>

Discontent with possession as a standard for validity prompted the 1966 amendments to sections 67b and c.<sup>36</sup> According to the House Report accompanying the bill,

a recent reexamination of the state lien statutes has shown that neither the standard of possession nor the distinction between real and personal property is an entirely satisfactory criterion. Some liens which are genuine property rights are affected and others which were [*sic*] essentially state-created priorities escape.<sup>37</sup>

Thus the 1966 amendments substituted a bona fide purchaser test for the anachronistic possessory standard. The provisions for post-bankruptcy perfection were deleted from section 67b and inserted into section 67c(1)(B) "in the interest of clarity."<sup>38</sup> The Report continues, "It is believed that these amendments, in addition to implementing the distributive scheme of the Bankruptcy Act, will provide a standard which is clear and more easily applicable than exists under present law."<sup>39</sup>

Law review writers differ as to whether the new standard is in fact "clear and more easily"<sup>40</sup> applied. Much of the criticism has centered on the ambiguities underlying the two distinct but related issues presented in *Trahan* and *Nieves*: (1) whether the saving proviso of section 67c(1)(B) is to be read broadly to include, as "perfection," any method of cutting off the rights of subsequent purchasers or is to be limited to

<sup>33</sup>See *Hearings on H.R. 5796 Before Subcomm. No. 2 of the House Comm. on the Judiciary*, 83d Cong., 2d Sess. 7, 17, 22 (1954); H.R. REP. NO. 2212, 83d Cong., 2d Sess. 3-4 (1954).

<sup>34</sup>See Kennedy, *supra* note 22, at 708.

<sup>35</sup>*Id.* at 709 & n.61.

<sup>36</sup>Bankruptcy Act §§ 67b-c, 11 U.S.C. §§ 107b-c (1970), enacted by Act of July 5, 1966, Pub. L. No. 89-495, §§ 3-4, 80 Stat. 268.

<sup>37</sup>H.R. REP. NO. 686, at 5.

<sup>38</sup>*Id.* at 12.

<sup>39</sup>*Id.* at 6.

<sup>40</sup>Compare Marsh, *Triumph or Tragedy? The Bankruptcy Act Amendments of 1966*, 42 WASH. L. REV. 681 (1967), with Kennedy, *The Bankruptcy Amendments of 1966*, 41 REF. J. 5 (1967) reprinted in 1 GA. L. REV. 149 (1967), and King, *supra* note 3.



lien statutes which specify *acts of perfection* as distinguished from *procedures for enforcement*, and (2) how many and what sort of purchasers are included within section 67c(1)(B)'s bona fide purchaser test. On the first question, one authority has commented,

It may be argued, of course, that these provisions for distraint warrants provide methods of "enforcing" rather than "perfecting" the tax liens; and, therefore, such liens cannot be "perfected" against a bona fide purchaser and would be invalid under section 67c(1)(B). All such a ruling would force a state to do is to provide for a separate warrant expressly labelled a method of "perfecting" the tax lien and even though never used, its mere availability would validate the tax lien under section 67c(1)(B). It is difficult to believe that any court would engage in such pointless semantics at the present day.<sup>41</sup>

Others<sup>42</sup> have reasoned that in the interest of giving effect to an otherwise ineffectual invalidation provision the post-bankruptcy perfection language should be given an interpretation under the new section 67c different from that given the substantially identical language in former section 67b.<sup>43</sup> But those who take this view are confronted with

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<sup>41</sup>Marsh, *supra* note 40, at 704 n.58. Marsh concludes that as bad as the old statute may have been, the new one is worse because it results in the validation of virtually every conceivable kind of statutory lien. The heart of the problem, as Marsh sees it, is the transposition of the post-bankruptcy saving provisions from a validating section to an invalidating section containing a different invalidating principle, with the result that "the proviso appears to negative the basic provision; the new section 67c(1)(B) means, for all practical purposes, nothing." *Id.* at 723. It is evident that Marsh's criticism rests on an assumption regarding the very point at issue in *Nieves*: "Any type of lien, statutory or otherwise, which is not valid against a bona fide purchaser and cannot be made so by any action of the lienor, but which is still enforceable, is a very strange creature indeed, if not entirely mythological." *Id.* at 703. In view of this assumption, Marsh never reaches the primary issue in *Nieves*—the meaning of bona fide purchaser as used in § 67c(1)(B).

<sup>42</sup>Kennedy, *supra* note 40, at 9; King, *supra* note 3, at 14; King, *Post-Bankruptcy Perfection of Statutory Liens*, 72 COM. L.J. 346 (1967).

<sup>43</sup>There was authority under former § 67b that "[w]hen a lien arises under the laws of a state before bankruptcy, and further steps to be taken with reference to it are steps in its enforcement or its collection rather than in its creation, such a lien remains valid in bankruptcy." *New Orleans v. Harrell*, 134 F.2d 399, 402 (5th Cir. 1943) (concurring opinion), *cited with approval* in 4 COLLIER ¶ 67.26, at 355-56 n.2. After suggesting several alternative readings, Professor King decides upon the use of bar orders as the best provisional resolution, until § 67c can be "amended after careful scrutiny of the particular state statutes involved." King, *Post-Bankruptcy Perfection of Statutory Liens*, 72 COM. L.J. 346, 348 (1967). Significantly, one of the alternatives King rejects is very similar to that adopted by the *Nieves* court: reading the first proviso of § 67c(1)(B) as applying only to statutes "granting a grace period permitting the lien to relate back to some date before bankruptcy." *Id.* King disapproves of this alternative because "[i]t is not altogether clear that [this solution] would even accomplish the actual intention to permit postbankruptcy perfection where such is considered advisable for a specific group." *Id.*

the second question—whether a lien perfected against some but not all subsequent purchasers, and ineligible for post-bankruptcy perfection, is perfected against section 67c(1)(B)'s hypothetical purchaser. Of special interest, for example, has been the possibility that the trustee might hypothesize a super-priority purchaser to defeat a federal tax lien on automobiles, securities, or inventory held for sale in the ordinary course of a merchant's business. The matter has been raised and discussed in a number of articles and hesitant speculations have been offered as to the probable outcome.<sup>44</sup>

Such were the legislative and academic contexts in which the *Trahan* court was asked to consider the Louisiana vendor's privilege. The court responded to both by ignoring them. The entire issue was dismissed with the summary and undocumented assertion that "section 67c(1)(B) does not require the assumption that a bona fide 'purchaser' be in possession of the thing sold which is subject to the vendor's privilege," followed by a cryptic citation to several provisions of the Louisiana Civil Code.<sup>45</sup> The court went on to say that even if section 67c(1)(B) were construed to require perfection against a purchaser in possession, the privilege was valid since the seller "can enforce its privilege against a bona fide purchaser if the property is seized in the possession of the original vendee (by the filing of notice)."<sup>46</sup>

The same judicial reluctance to confront what would seem to be an inevitable problem of statutory interpretation may be observed in *In re Chesterfield Developers, Inc.*,<sup>47</sup> a case decided about the same time as *Trahan*. The New York mechanic's lien involved in *Chesterfield* protected the lienor against subsequent purchasers

unless the instrument [of conveyance between the lien debtor and his purchaser] contains a covenant by the grantor that he will receive the consideration for such conveyance and will hold the right to receive such consideration as a trust fund to be applied first for the purpose of paying the cost of the improvement . . . .<sup>48</sup>

The debtor-in-possession attempted to hypothesize such a purchaser, inviting the court to say either that the possibility of a covenanting

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<sup>44</sup>Kennedy, *supra* note 40, at 7; King, *supra* note 3, at 13; Plumb, *Federal Tax Liens and Priorities in Bankruptcy—Recent Developments*, 74 COM. L.J. 225, 231 (1969).

<sup>45</sup>283 F. Supp. at 626.

<sup>46</sup>*Id.* at 628.

<sup>47</sup>285 F. Supp. 689 (S.D.N.Y. 1968).

<sup>48</sup>N.Y. LIEN LAW § 13(5) (McKinney 1966).

purchaser was sufficient for the debtor or that the possibility of a non-covenanting purchaser was sufficient for the lienor. The court declined the invitation, delicately sidestepping the issue with a rhetorical question—"assuming, now, the presence of the covenant, has not the hypothetical bona fide purchaser recognized the superiority of the lien?"—and offering that "it would seem highly inequitable to allow the fiction of the hypothetical bona fide purchaser to be used to defeat liens such as the instant one."<sup>49</sup>

*Nieves* then is the first reported case which clearly confronts<sup>50</sup> the issue. The root of the problem is in the statute. To be valid, a lien must be perfected "against one acquiring the rights of a bona fide purchaser." The difficulty stems from the use of the indefinite article. Does "a" bona fide purchaser mean *any* bona fide purchaser or *all* bona fide purchasers? Is the burden on the trustee to show that there is no bona fide purchaser against whom the lien is perfected, or must the lienor show that there is none against whom the lien is *not* perfected?

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<sup>49</sup>285 F. Supp. at 691-92.

<sup>50</sup>The question is not entirely new to bankruptcy. Before amendment in 1950, § 60 employed a hypothetical bona fide purchaser test to time a transfer of property. The transfer was deemed complete as of the date it became perfected against subsequent bona fide purchasers. If such perfection occurred within four months of bankruptcy the transfer was preferential, assuming the other elements of § 60a. The question was raised whether the test would enable the trustee to avoid legitimate security interests in collateral held for resale, whether it was possible ever to perfect a security interest in goods held for resale since such a security interest could always be defeated by a buyer in the ordinary course. See McLaughlin, *Defining a Preference in Bankruptcy*, 60 HARV. L. REV. 233, 251 (1946); Hanna, *Some Unsolved Problems Under Section 60A of the Bankruptcy Act*, 43 COLUM. L. REV. 58, 73 (1943); Moore & Tone, *Proposed Bankruptcy Amendments: Improvement or Retrogression?*, 57 YALE L.J. 683, 698 (1948). In *Coin Machine Acceptance Corp. v. O'Donnell*, 192 F.2d 773, 776 (4th Cir. 1951), Moore and Tone were quoted with apparent approval:

Section 60, sub. a, should be interpreted in the light of its legislative history as striking at secret liens, previously protected by the doctrine of relation back, not at legitimate security devices which have been given full notoriety prescribed by state law, and which, by their very function, are designed to enable the debtor to have possession and the power of sale and hence are never perfectible as against the ordinary purchaser. Nor would the "plain meaning rule" of interpretation preclude this view, for a distinction can readily be drawn between the traditional concept of the bona fide purchaser and that of the buyer in the ordinary course of trade.

The question was moot at the time of decision in the *O'Donnell* case, since the 1950 amendments to § 60a had changed the test with respect to personal property to one of perfection against subsequent judgment lien creditors. It seems fair to ask, however, whether statutory liens on the same collateral ought suffer any greater vulnerability in bankruptcy than consensual security interests. Cf. *Rosenberg v. Rudnick*, 262 F. Supp. 635 (D. Mass. 1967); *In re Portland Newspaper Publishing Co.*, 271 F. Supp. 395 (D. Ore. 1967).

In adopting the bona fide purchaser-plus interpretation, the *Nieves* court relied on the status of a non-possessory purchaser under Puerto Rican law. The court discovered that a purchaser before delivery has only a contract right for damages against the seller and has no rights against even an attaching creditor.<sup>51</sup> "Additional support" is found in the definition of bona fide purchaser in section 1(5) of the Act, which includes "bona fide encumbrancer or pledgee." "Using a pledgee as the test, one must conclude under either Louisiana or Puerto Rico law, that, since the pledge is superior to the seller's lien, the lien is therefore invalid in bankruptcy against the trustee unless saved by the § 107c(1)(B) provisos."<sup>52</sup> On the question of post-bankruptcy perfection, the court concluded,

It is obvious that *every* state lien must have some means of enforcement and that attachment to effectuate enforcement must prevent purchasers from buying. Therefore, to allow the use of a general procedural right of sequestration—or the enforcement of the lien—to act as "perfection" makes § 107(c)(1)(B) meaningless.<sup>53</sup>

The import of *Nieves* for the federal tax lien has already been suggested. The decision is particularly noteworthy in this regard since the Federal Tax Lien Act was enacted at the same time as the amendments to section 67c. Section 6323(b) of the Federal Tax Lien Act

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<sup>51</sup>446 F.2d at 192. Also cited for the proposition that "ownership" of goods identified to a contract of sale is in the vendor before delivery is *Varcancel v. Sanchot Bonet*, 61 P.R.R. 207, 211 (1942), which taxed such undelivered goods to the vendor. In a footnote the *Nieves* court pointed out that "as these creditors themselves concede, it seems that in Louisiana ownership passes to the buyer *before* delivery." 446 F.2d at 192 n.5 (emphasis by the court). The citation to *Varcancel* and the asserted differences between the law of Louisiana and that of Puerto Rico suggest an alternative basis for the *Nieves* holding, viz., that under Puerto Rican law there is no such thing as a purchaser not in possession, no such thing as a sale before delivery. But this interpretation of the holding seems negated by other language in the opinion. "Louisiana cases are relevant because Louisiana provides for a seller's lien similar to Puerto Rico's Art. 1822 lien. . . . In both jurisdictions a bona fide purchaser from the debtor must take possession of the goods in order to cut off the seller's lien." 446 F.2d at 191. "An Art. 1822 lien must therefore be tested to see whether it 'is so tenuous that it can be defeated by transfer to a bona fide purchaser.' In this context the *Trahan* court's assumption that the hypothetical bona fide purchaser has not taken possession of the goods does not seem to square with the language of § 107(c)(1)(B), which speaks of 'one acquiring *the rights* of a bona fide purchaser.'" *Id.* at 192 (emphasis by the court) (footnotes omitted). These statements indicate that the court regards the buyer under an executory contract of sale to be a "purchaser" under any law and that *Trahan* is being rejected rather than distinguished.

<sup>52</sup>446 F.2d at 192-93 (footnotes omitted). Bankruptcy Act § 1(5), 11 U.S.C. § 1(5) (1970) reads: "Bona fide purchaser" shall include a bona fide encumbrancer or pledgee and the transferee, immediate or mediate, of any of them . . . ."

<sup>53</sup>446 F.2d at 193 (emphasis by the court).

creates several categories of super-priority purchasers who are protected against even a filed tax lien.<sup>54</sup> Under the rule in *Nieves* it would seem impossible for the government to perfect against a trustee in bankruptcy a lien on, *inter alia*, motor vehicles or property subject to sale in the ordinary course of business. Certainly a lien on such property is no less subject to defeat under the Federal Tax Lien Act than under the Puerto Rican vendor's privilege. Yet it seems fair to ask whether it was the intent of Congress in enacting either section 6323(b) or section 67c(1)(B) that a concession (the creation of the super-priority purchaser or bona fide purchaser-plus) intended primarily for a merchant's patrons should, because of the trustee's status as a hypothetical purchaser, benefit the merchant's general creditors as well.

Nothing short of a general survey of statutory liens in all fifty states would support an intelligent statement of the impact of *Nieves* on the state liens to which section 67c is primarily directed.<sup>55</sup> Suffice it to say that statutory liens which fail to specify acts of perfection against bona fide purchasers are of doubtful validity against a trustee in bankruptcy, as are those which purport to be valid against subsequent purchasers but permit exceptions in favor of purchasers under certain conditions. In North Carolina the county's (or municipality's) lien against realty for ad valorem taxes has always been considered valid in bankruptcy. But if the tax collector accepts a check in payment of taxes, and a subsequent purchaser acquires an interest in real property in reliance either upon the receipt issued to the taxpayer or upon the duplicate or stub on file in the tax collector's office, the purchaser's interest takes priority over the lien.<sup>56</sup> Where payment on a check drawn in favor of the taxing unit for taxes on real property is stopped because of bankruptcy proceedings, may the trustee hypothesize such a purchaser to avoid the property tax lien? Moreover, the *Nieves* rule does not in terms resolve the difficulty inherent in the open-endedness of the section 67c(1)(B) provisos. For example, the lien on realty for state taxes in North Carolina is invalid "against bona fide purchasers for value, and as against duly recorded

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<sup>54</sup>INT. REV. CODE of 1954, § 6323(b).

<sup>55</sup>For a survey of statutory liens in 16 selected states see Marsh, *supra* note 40, at 701-04. Most of the liens discussed there, the validity of which the author concludes is unaffected by § 67c(1)(B), would be invalidated under the interpretation of that section by the *Nieves* court.

<sup>56</sup>N.C. GEN. STAT. § 105-357(b)(1) (1971 Advance Legislative Service Pamphlet No. 12).

mortgages, deeds of trust and other recorded *specific* liens” unless a certificate of tax liability or a tax judgment has been docketed.<sup>57</sup> Arguably an undocketed lien is valid against the trustee under section 70c;<sup>58</sup> if so, the lien may be perfected against bona fide purchasers by docketing after bankruptcy since the law creating it “provide[s] specifically for perfection against bona fide purchasers by recording.” But how long after bankruptcy proceedings have been initiated may the taxing unit delay? The *Nieves* rule does not speak to this problem. Will the next step in the judicial construction of section 67c(1)(B) be a further limitation of the proviso to liens with period-of-grace-with-relation-back recording provisions?

Conceding the shortcomings of the 1966 amendments, the interpretation given them by the First Circuit is of doubtful wisdom in light of the policy evidenced by legislative history; and, even viewed as an effort to make the best of a badly drafted law, the result in *Nieves* must be disapproved. The bona fide purchaser test represents a deliberate response to the inequities of the possessory standard. Possessory liens are by their very nature invulnerable to defeat by subsequent transactions between the debtor and third parties. The 1966 amendments were designed to accommodate the development in lien law generally of record notice as a substitute for notice by actual or constructive possession. If Congress had intended to validate only those liens which were not subject to defeat by *any* kind of purchaser, there would have been little reason to offer protection to non-possessory liens. In substituting the bona fide purchaser test, it was contemplated that statutory liens would enjoy greater validity, and it was not intended thereby to establish a more rigorous standard. Whatever the statutory deficiencies, *Nieves* does not remedy them. On the contrary, the decision threatens to undermine legislative intent by renewing incentives to prematurely foreclose many liens, effecting a partial return to the repudiated possessory standard.

More fundamentally troublesome is the notion that some bona fide purchasers are section 67c bona fide purchasers and others are not and that it devolves upon the court to say who is and who is not a section 67c bona fide purchaser. In a word, a bona fide purchaser-plus could be almost anyone—any purchaser whose existence is acknowledged by

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<sup>57</sup>N.C. GEN. STAT. § 105-241 (1965) (emphasis added).

<sup>58</sup>Since the hypothetical judgment lienor under § 70 has a lien on “all property,” his rights are subordinate to a lienor whose lien is on *specific* property of the debtor.

applicable lien law to limit in some way the rights of a lienor—and the breadth of possibilities does not augur well for uniformity in the administration of bankrupt estates. The *Trahan* rule has at least the advantage of certainty and, pending a clarification of the standard by still further amendment, is the better provisional resolution.<sup>59</sup>

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<sup>59</sup>Professor Marsh, for his ingenuity, deserves the last word. Even though he neglects to discuss the particular ambiguity involved in *Trahan* and *Nieves*, he clinches his argument that the 1966 amendments to § 67c fall short of the intended goal of securing the supremacy of federal priorities by proposing an illustrative wage-lien act that “neatly sidestep[s] all of the little traps laid in the new section 67c(1).” Marsh, *supra* note 40, at 733. Marsh’s hypothetical lien is as valid under *Nieves*’s interpretation as under *Trahan*’s. Thus, although a proper construction of § 67c will avoid most of the inequities of the former possessory standard, viewed in terms of the ultimate objective of drafting a § 67c which is airtight against “disguised priorities,” the 1966 amendments are no more successful than those that had gone before.