Bankruptcy: Trustee's Title to Bankrupt's Property

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ever, the North Carolina Supreme Court in Rabon would have done well to have considered the warning enunciated by Justice Black in Williams v. City of Detroit:

If we are to overrule, let us do it outright either way, manfully according to the tried rules of judicial process. That is the only way to avoid what Browning and Molitor already have proven; that an appellate court, having determined to reward one litigant only of a distinct and inseparable class of litigants, naively asks for and gets into no end of trouble.81

To reduce the uneven treatment resulting from partially prospective overruling, the preferable solution would have been for the court to have chosen between wholly prospective and retroactive application.32

JAMES A. MANNINO

Bankruptcy: Trustee’s Title to Bankrupt’s Property

In Bank of Marin v. England1 a debtor drew five checks upon his commercial account with the defendant bank. The debtor then filed a voluntary petition in bankruptcy before the checks were presented for payment. Six days after the petition was filed, the bank, having no notice of bankruptcy proceedings, paid the checks when presented by the payee. The bankruptcy trustee sought to require the bank to pay him the amount paid by the bank upon the five checks. The referee found the bank and the payee jointly liable to the bankrupt’s estate for the amount of the checks and the district court enforced this finding. The decision was affirmed by the Court of Appeals for the Ninth Circuit2 holding that a bank that honors checks in good faith without notice of voluntary petition in bankruptcy is liable to the bankruptcy trustee for the amount paid.2 The Supreme Court granted certiorari because of the importance of the question presented, and reversed.

In 1938 Congress passed the Chandler Act amendments to the Bankruptcy Act. These amendments were made necessary by the

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82 See generally Keeton, Creative Continuity In the Law of Torts, 75 Harv. L. Rev. 463 (1962).
2 352 F.2d 186 (9th Cir. 1965).
many uncertainties surrounding the judicial interpretations of the language of the Bankruptcy Act of 1898. The Chandler Act provided in section 70(a) that title would vest in the trustee in bankruptcy by operation of law as of the date the petition in bankruptcy is filed. This section was necessary to effectuate the well settled objectives of federal bankruptcy legislation of protecting the rights of creditors and facilitating the speedy and efficient distribution and settlement of the estate. The Chandler Act also added section 70(d), which enumerates transfers whose validity will be upheld if they take place after petition and before adjudication or before a receiver takes possession of the bankrupt’s property. Section 70(d) protects the transferee of personal property from the bankrupt if the transfer was made in “good faith” and for “present fair equivalent value.” The only provision exempting transactions occurring after adjudication is section 21(g), which allows real property to be freely transferred, but only real estate located in the same county or equivalent district as the bankrupt.

Section 70(d)(2) provides that a person indebted to the bankrupt can pay the indebtedness of the bankrupt without liability to the trustee provided he acts in good faith and before adjudication of

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5 52 Stat. 881 (1938), 11 U.S.C. § 110(d)(1) (1964) reads in part: A transfer of any of the property of the bankrupt, other than real estate, made to a person acting in good faith shall be valid against the trustee if made for a present fair equivalent value or, if not made for a fair equivalent value, then to the extent of the present consideration actually paid therefor, for which amount the transferee shall have a lien upon the property so transferred. . .
6 Bankruptcy Act § 70(d)(3), 52 Stat. 881 (1938), 11 U.S.C. (d)(3) (1964) reads in part: “A person having actual knowledge of such pending bankruptcy shall be deemed not to act in good faith unless he has reasonable cause to believe that the petition in bankruptcy is not well founded. . .”
7 In re Richter, 40 F. Supp. 758 (S.D. N.Y. 1941) (Satisfaction of old debts not present value even though transferees extended new credit); Lehman v. Quigley, 118 N.Y.S.2d 579 (Sup. Ct. 1952) (satisfaction of court judgment on antecedent course of action is not a concurrence of a “present fair equivalent value”).
bankruptcy. Under this section the bank would be protected if it had honored the check after the filing of an involuntary petition but before the adjudication of bankruptcy. However, section 18(f) of the Bankruptcy Act provides that the filing of a voluntary petition constitutes automatic adjudication and thereby renders section 70(d) inapplicable. Thus in the case before us, since this was in effect a post adjudication transfer, the bank would not be protected by section 70(d) (1) or 70(d) (2).

The only other provision in section 70(d) that the bank could have asserted as a defense is the negotiability proviso of 70(d) (5). But since the filing of a voluntary petition constitutes adjudication under section 18(f) it appears that bank payments subsequent to filing must be invalid. In *Rosenthal v. Guaranty Bank & Trust Co.* the court, basing its decision on the negotiability proviso, upheld the validity of a good faith payment by a bank of a bankrupt's checks after adjudication. However, this case has been generally criticized on the grounds that presentation of a check to the drawee bank for payment is not a negotiation. Thus it appears the negotiability proviso should not protect the drawee bank in the *Marin* situation.

Therefore, it appears that a bank paying a check in good faith without notice that the drawer has filed a voluntary petition in bankruptcy will find no protection under section 70(d). The court of appeals recognized the inequities of the situation but concluded that it could not exercise its equitable powers because of section 70(d)'s invalidation of post adjudication transfers. The decision in the lower court put banks in the impossible position of keeping constantly informed of every bankruptcy proceeding involving their...
depositors in every federal court in the country. In addition, the bank would be under the conflicting duty to honor checks drawn on its depositors.

The Supreme Court, conceding that this transfer is not protected by section 70(d), circumvented sections 70(a) and 18(f) by basing their decision on the due process requirement of notice, and overriding equitable considerations. The Court's first contention is that the bankruptcy of a drawer does not, without more, revoke the drawee's authority. The Court holds that notice, "reasonably calculated, under all the circumstances, to apprise the interested parties of the pendency of the action" is required before one can be deprived of his property. Therefore, the Court was unwilling to say that the mere filing of a voluntary petition was sufficient to put the bank on notice. In the present Bankruptcy Act there are but limited provisions for the giving of notice to the public of the bankruptcy proceeding. Under section 58(d) all notice to creditors is at the discretion of the court, and creditors may not be entitled to personal notice since bankruptcy proceedings are considered actions in rem. However, in Mullane v. Central Hanover Bank & Trust Co. the Supreme Court held that personal notice to holders of trust interests involved in the adjudication was necessary to meet due process requirements. The Mullane decision, although not in a bankruptcy setting, states that the difference between in rem and in personam proceedings does not exist when dealing with the due process rights of notice and opportunity to be heard. The Court in Marin, in adopting the Mullane view, rejects the formalistic concept of an in rem proceeding by notice to the world and requires reasonable notice to the bank before liability will be imposed. The Court does not indicate what will constitute reasonable notice. It would seem that notice by publication is the least that will be required and certainly this will not impose an onerous burden on the trustee since he can easily ascertain where the bankrupt's funds are being held.

The Court also refuses to read sections 70(d)(5) and 18(f)

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19 Uniform Commercial Code § 3-506.
21 Id.
"with the ease of a computer" and invokes the equitable power under section 2(a) of the act to reach an equitable result. It is clear that a bankruptcy court is a court of equity and may exercise these equitable powers in granting or withholding relief in its administration the bankrupt's estate. However, these equitable powers may only be exercised where the result produced will not be inconsistent with the Bankruptcy Act. Sections 70(d) and 18(f) clearly indicate the Congressional intention to invalidate post-adjudication transfers. It is also clear that the payment of funds after adjudication frustrates one of the main objectives of the Bankruptcy Act—preserving the estate for the benefit of creditors. However, even if it is concluded that equitable relief, in the form of validation of the transfer, is foreclosed by the act, an equitable result may still be achieved and the estate preserved by simply adjusting the liabilities as between the bank and the creditor. This is, in effect, what the Court did. They preserved sections 70(d) and 18(f) "by imposing liability on the payee of the checks as if he has received a voidable preference or other voidable transfer."

Aside from the inherent in equities in holding the bank liable in this situation there are other compelling reasons for making the trustee go only against the payee creditor. If the transaction with the bankrupt constituted a voidable preference under section 60(a)-(b) of the act then multiple litigation may be avoided by suing the payee first. This would be true in most cases because the subsequent presentment of the check to the bank should be sufficient evidence of bad faith to allow the drawee bank to be indemnified for the money paid out. Therefore in this situation, by suing the payee first there will be no need for an indemnity suit.

- 52 Stat. 842 (1938), 11 U.S.C. § 11(a), reads in part: "... courts of bankruptcy are hereby invested ... with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction. . . ."
- 4 COLLIER, BANKRUPTCY ¶ 70.67, at 1500 (14th ed. 1964).
- 52 Stat. 869 (1938), as amended, 11 U.S.C. 96(a)-(b) (1964): A voidable preference is a payment of an antecedent debt within four months of bankruptcy with reasonable cause to believe the debtor is insolvent.
If the transfer were not a voidable transfer or if joint liability were imposed there are still several ways to adjust the liability. It does not seem that the liability should depend on whether payment was in the form of check or cash. If this were payment of an antecedent debt by cash it would not be a valid transfer since such a payment is not for "present fair equivalent value."

If joint liability were imposed in this situation the payee creditor would be in a better position than the bankrupt's other creditors. If the bank pays first and has no right of indemnity against the creditor, then the creditor, to the extent of the bank's contribution, will be favored over the other creditors. On the other hand, the bank's loss would be total unless by subrogation it were allowed to participate in the distribution of the bankrupt's estate. The right of subrogation here would depend on whether this transaction was viewed as if the bank, by paying the judgment, had paid the creditor's claim and thus stood in his position as an unsecured creditor. But if the creditor were to pay the entire judgment, he would still be able to share in the bankrupt's estate as an unsecured creditor.

The Court in Marin adopted the simplest and most equitable solution in this situation by limiting the trustee to an action against the payee. This would result in the payee bearing the entire loss resulting from distribution by the bankrupt estate. In a situation, as here, where the bank has had no notice of the bankruptcy proceeding this is simply a restoration to the status quo.

FRANCIS X. HANLON

Constitutional Law—Is the Restricted Cross-Examination Rule Embodied in the Fifth Amendment?

In the historic Supreme Court decision of Malloy v. Hogan it was established that the fifth amendment guarantee of freedom from self-incrimination is imposed on the states by way of the fourteenth amendment. The recent case of Spevak v. Klien emphasized the scope of this determination by holding that no group or classifica-

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33 See note 9 supra.
34 See, 40 MINN. L. REV. 499 (1956).
2 U.S. CONST. amend. V provides in part that no person "shall be compelled in any criminal case to be a witness against himself. . . ." For ex-