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THE DIVERSITIES OF THE PREFERENTIAL TRANSFER: A STUDY IN BANKRUPTCY HISTORY

GARRARD GLENN*

Various as have been the amendments to our National Bankrupt Act of 1898,—the latest of these processes was in 1926,¹—it has been left with three definitions of a preference as applying to different situations. When the preference is of interest as constituting an act of bankruptcy, an element of the definition is an "intent to prefer" on the debtor's part, if the preference consists of a transfer of assets. But there are two other acts of bankruptcy separately defined, one added in 1926 by way of supplement to the other, which have to do with an insolvent debtor "suffering or permitting" a creditor to obtain a lien through legal proceedings without thereupon "vacating or discharging" it. In one of these definitions the situation is described as involving a "preference" of the judgment creditor, but there is no mention of the debtor's "intent" to bring about such a result. Finally, when the statute proceeds to give the trustee a right of action against the preferred creditor and to require the latter to surrender the preference as a condition of proving in the bankruptcy, "intent to prefer" is conspicuous by its absence.²

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¹As to which, see McLaughlin, *Amendment of the Bankruptcy Act* (1926) 40 HARV. L. REV. 341; Colin, *Analysis of the 1926 Amendments, etc.* (1926) 26 COL. L. REV. 789.

²The relative portions of the Bankrupt Act of 1898 read thus at present:

"Sec. 3. ACTS OF BANKRUPTCY—(a) Acts of Bankruptcy by a person shall consist of his having . . . (2) transferred, while insolvent, any portion of his property to one or more of his creditors with intent to prefer such creditors over his other creditors; [30 STAT. 546 (1898), 11 U. S. C. A. § 21] or (3) suffered or permitted, while insolvent, any creditor to obtain a preference through legal proceedings, and not having at least five days before a sale or other disposition of any property affected by such preference vacated or discharged such preference; or (4) suffered, or permitted, while insolvent, any creditor to obtain through legal proceedings any levy, attachment, judgment, or other lien, and not having vacated or discharged the same within thirty days from the date such levy . . . was obtained. . . . [44 STAT. 662 (1926), 11 U. S. C. A. § 21].

(b) A petition may be filed against a person who is insolvent and who has committed an act of bankruptcy, within four months after the commission of such act. . . ." [30 STAT. 546 (1898), 11 U. S. C. A. § 21].

The third act of bankruptcy remains as originally defined. The fourth was added in 1926 to overcome the effect of *Citizens Bank v. Ravenna Bank*, 234

It is quite true that decisions have deprived this distinction of any importance. Prior to 1910, when the national Act required that the transferee have, not "reasonable cause to believe that the enforcement of such . . . transfer would effect a preference," as the law now reads, but "reasonable cause to believe that it was intended thereby to give a preference,"³ the courts (with a few exceptions) dealt with that phrase as they had construed similar language under the Act of 1867; they considered that "intent to prefer" should be presumed, *prima*

U. S. 360, 34 Sup. Ct. 806 (1914); as to which see Colin, *op. cit. supra* note 1. The present discussion will not take us up that road.

"Sec. 60. PREFERRED CREDITORS.—a. A person shall be deemed to have given a preference if, being insolvent, he has within four months before the filing of the petition, or after the filing of the petition and before the adjudication, procured or suffered a judgment to be entered against himself in favor of any person, or made a transfer of any of his property, and the effect of the enforcement of such judgment or transfer will be to enable any one of his creditors to obtain a greater percentage of his debt than any other of such creditors of the same class. Where the preference consists in a transfer, such period of four months shall not expire until four months after the date of the recording or registering of the transfer, if by law such recording or registering is required or permitted. [32 STAT. 799 (1903), 11 U. S. C. A. § 96].

b. If a bankrupt shall have procured or suffered a judgment to be entered against him in favor of any person or have made a transfer of any of his property, and if, at the time of the transfer, or of the entry of the judgment, or of the recording or registering of the transfer if by law recording or registering thereof is required, and being within four months before the filing of the petition in bankruptcy or after the filing thereof and before the adjudication, the bankrupt be insolvent and the judgment or transfer then operate as a preference, and the person receiving it or to be benefited thereby, or his agent acting therein, shall then have reasonable cause to believe that the enforcement of such judgment or transfer would effect a preference, it shall be voidable by the trustee and he may recover the property or its value from such person. And for the purpose of such recovery any court of bankruptcy, as hereinbefore defined, and any state court which would have had jurisdiction if bankruptcy had not intervened, shall have concurrent jurisdiction." [36 STAT. 842 (1910), 11 U. S. C. A. § 96].

"Sec. 57. PROOF AND ALLOWANCE OF CLAIMS. . . . g. The claims of creditors who have received preferences, voidable under section sixty, subdivision b, . . . shall not be allowed unless such creditors shall surrender such preferences, . . ." [32 STAT. 799 (1903), 11 U. S. C. A. § 93].

³Section 60b, one of the subdivisions which are quoted above as they now read, was until 1910 with the requirement that the transferee, to be held, must have, not reasonable cause to believe that the enforcement of such judgment or transfer shall effect a preference (as the law now reads) but "reasonable cause to believe that it was intended thereby to give a preference." To clear the roadside it may also be noted that: (1) the words "or permitted" at the end of subdivision a, were added in 1926. This change, while important (see McLaughlin, and Colin, *op. cit. supra* note 1) does not bear on the present discussion. (2) Prior to 1903, when Section 57g was amended so as to refer to Section 60b for the definition of a preference, it was held that a creditor who had received a preference could not prove his claim without surrender, although the transfer had been made over four months prior to the filing of the petition. *Pirie v. Chicago Title & Trust Co.*, 182 U. S. 438, 21 Sup. Ct. 900 (1900).

facie, from the debtor's knowledge of his insolvency and the fact of the transfer. And the same rule, drawn from decisions under the earlier Act of 1867, has been applied to the *preference* as an act of bankruptcy; the variations being only between a "conclusive" presumption and one that is open to rebuttal.⁴

And so, if that were all, we could dismiss the words, "intent to prefer", in that one section in the Bankruptcy Act as an accidental left over.

Left overs, however, sometimes intrigue other people besides antiquarians. Fossils, of course, there are; but also we have such things as tonsils, requiring active study and capable of giving trouble. And the interesting thing about these words, "intent to prefer", is that, no matter how strong may be the tendency to eliminate them by statutory amendment or judicial decision, the idea that informs the phrase still lives, and we may see its workings today in situations presented by the modern business failure.

To justify that statement the writer will have to start by mentioning three topics that are apparently unrelated.

First, let us travel from the act of bankruptcy as far as the debtor's discharge. The preferential transfer, although it constitutes an act of bankruptcy, cannot be asserted as grounds for opposing the bankrupt's discharge, and yet the fraudulent conveyance may be availed of equally in both capacities.⁵ But the previous Act of 1867 corresponding with English legislation of that day and of this, dealt equally with both of these wrongs upon creditors, featuring the preferential transfer, indifferently with the fraudulent conveyance, not only as an act of bankruptcy, but as ground for the refusal of a

⁴In *Toof v. Martin*, 13 Wall. 40 (1871); it was declared "conclusive". In *Wager v. Hall*, 16 Wall. 584 (1872), it was described as *prima facie*; to the same effect are decisions under the present statute, prior to the amendment of 1910: *In re Bloch*, 109 Fed. 790 (C. C. A. 2d, 1901); *Alexander v. Redmond*, 180 Fed. 92 (C. C. A. 2d, 1911); *In re General Drug Co.*, 6 F. (2d) 92 (D. Mass. 1925); *Benedict v. Deshell*, 177 N. Y. 1, 68 N. E. 999 (1905). "The result of the transfer, and not the mental attitude of the transferor, is made the test." *Alexander v. Redmond*, *supra*, at 95.

⁵The amendment of 1903, 32 STAT. 797 (1903), added to Section 4b as a ground for refusing a discharge, the fact that the debtor "at any time subsequently to the first day of the four months immediately preceding the filing of the petition, transferred, removed, destroyed or concealed, any of his property with intent to hinder, delay or defraud his creditors." This describes a fraudulent conveyance as defined by 13 ELIZ. c. 7, (1571). *Lansing Boiler Works v. Ryerson*, 128 Fed. 701 (C. C. A. 6th, 1904). The fraudulent conveyance is also named as an act of bankruptcy in Section 3a. See *Githens v. Schiffler*, 112 Fed. 505 (M. D. Pa. 1902).

discharge.⁶ And point is lent to the proposition, it is believed, by the fact that the bill which culminated in our present law provided, as a ground for refusing discharge, that the bankrupt had "given a preference. . . which had not been surrendered to the trustee," but the provision was eliminated while the bill was in committee.⁷

Second, there is the change that the Act of 1898 makes in the legal idea of insolvency. A man is considered, by the law and equity rule, as failing when he is unable to meet his debts as they accrue; such was the test applied to earlier bankrupt acts; such is the present law of an English bankruptcy; such is the rule stated in other statutes and applied by the courts in various connections.⁸ So important, indeed, is this idea that the framers of the Uniform Sales Act say in Section 76, that "whether he is insolvent within the meaning of the Federal Bankruptcy Law or not," yet for all purposes of so vast a subject as the law of sales a person is insolvent "who either has ceased to pay his debts in the ordinary course of business or cannot pay his debts as they become due."⁹ But Congress, in framing the Act of 1898, said that insolvency should be taken as existing whenever the aggregate of the debtor's property (exclusive of property fraudulently transferred or concealed) "shall not at a fair valuation be sufficient in amount to pay his debts." Long ago Chief Justice Shaw pointed out

⁶The English Bankruptcy Act, 4 & 5 GEO. V, c. 59, § 26 (1914), contains the same provisions as to discharge that had appeared in its predecessors, of which more *infra* notes 16, 20. Among others is "That the bankrupt has within three months preceding the date of the receiving order, when unable to pay his debts as they become due, given an undue preference to any of his creditors." See *Feder v. Gotz*, 264 Fed. 619 (C. C. A. 2d, 1920). For the preference as an act of bankruptcy and as a voidable transaction the same elements, the three months period and inability to pay debts as they become due, are prescribed, but there are other requisites too, as we shall see; hence, the definition of preference as a ground for discharge is broader than the requirements in other aspects. Section 29 of the Act of 1867, 14 STAT. 517 (1867), provided, among other grounds for discharge, the case where the debtor "has given any fraudulent preference contrary to the provisions of this act." The earlier Act also made the preference a ground of refusal of a discharge; but only in the case of a voluntary bankrupt; and, he, too could clear himself by obtaining the consent of "a majority in interest of those of his creditors who have been so preferred." 5 Stat. 440, § 2 (1841).

⁷*Feder v. Gotz*, *supra* note 6.

⁸The present English Bankruptcy Act, like its predecessors, describes the preference as embracing every transfer etc. "By any person unable to pay his debts as they become due from his own money." 4 & 5 GEO. V, c. 59, § 44 (1914). Our national Act of 1867 did not define insolvency, but the judicial test applied was inability to pay debts as they mature in the course of business. *Buchanan v. Smith*, 16 Wall. 277, 308 (1872). See also *Toof v. Martin*, *supra* note 4.

⁹This contrast has lately been emphasized. BRITTON, CASES ON BANKRUPTCY (1928) 69 n.

that this test is more favorable to a debtor than the other.¹⁰ That Congress was of the same opinion, but that the new test had come to stay, was shown by the cold reception that was given the American Bar Association's Committee when it proposed a change in this regard.¹¹ In short, the "general and popular meaning" of insolvency, as the Supreme Court described it as long ago as 1871¹² triumphed in 1898 with Congress although it had failed of acceptance in commercial centers.

Third, what is the object of bankrupt laws, and do they impose any duty upon the debtor? That has been answered at various times. The law, to quote a modern writer, "has two important purposes, to prevent preferences and to give discharges."¹³ And the object of any such statute, whether it be called a bankruptcy or an insolvent law is, to quote Shaw, C. J.:

"To require a debtor as soon as he has reason to believe himself insolvent, and before he has frittered away his property by schemes which appear plausible, to put himself and his assets at once into the hands of the law with a view to two objects, one, to make an equal distribution amongst all his creditors; the other, to pay every creditor as large a part of his whole debt as the means of the debtor will allow."¹⁴

And in our time Learned Hand, J., justified a decision excluding a claim on the ground that it was barred by the statute of limitations, despite the fact that, as between the creditor and the bankrupt, the case had been taken out of the statute by a partial payment made on the eve of bankruptcy, and despite the offer of the claimant to restore the amount thus received, by this reasoning:

"[T]he defense to the debt still remains a valuable right, which will pass to the bankrupt's creditors. The whole presupposition of the rules against fraudulent conveyances is that from the time a debtor knows that he is insolvent he holds all his property subject to the interests of his creditors. While he

¹⁰Thompson v. Thompson, 4 Cush. 127 (Mass. 1849).

¹¹In 1907 the Committee was authorized to propose an amendment that would adopt as the definition of insolvency "proof of inability to pay debts in the due course of business as they accrue. (This to be limited to commercial classes)." (1907) 31 A. B. A. REP. 602. But this suggestion, to quote the Committee's report of the following year, "met no favor whatsoever at the hands of the subcommittee of the House. The great panic of October, 1907 seemed to have crystallized sentiment against such a definition. The committee accordingly recommends that further effort be abandoned to procure an amendment to the Bankrupt Act in this respect." (1908) 32 A. B. A. REP. 507, 508.

¹²Toof v. Martin, *supra* note 4.

¹³McLaughlin, *op. cit. supra* note 1, at 358.

¹⁴Fernald v. Gary, 12 Cush. 596, 597 (Mass. 1854).

may continue its management in the genuine interest of both them and himself, he loses all right to diminish its value to them. Certainly there is no reason why his disability should not extend to the destruction of any defense he may have to an otherwise valid claim."¹⁵

The resultant of these ideas may be thus expressed: To say that a principal object of bankruptcy legislation is to prevent preferences, is another way of expressing the age-old feeling against the "race of diligence", which can take the form, not merely of the creditor hurrying his suit to judgment, but of the debtor choosing, for reasons of his own, voluntarily to pay one creditor and not another. As to an insolvent person, then, our impulse would be to impose upon him the duty (a) to put his assets in the hands of a court for distribution, and (b) meanwhile to conserve his assets and treat all creditors alike. That idea shaped itself in the course of bankruptcy legislation; but there was not a uniform result. Yet therein, it is believed, are linked the very diversities we have today, and in the process is to be found their rationale. This puts us to our history.

We must start with a paradox. The preference is closely connected in idea with the act of bankruptcy, but the connection is traceable far beyond the time when the preference had taken shape as a feature of bankruptcy laws. For the preference necessarily involves the idea of a time-zone preceding the initiation of actual proceedings against the debtor. The earliest bankruptcy laws of England fixed such a zone, and in the process also settled the original character of the "act of bankruptcy". They did not, however, forbid preferential transfers. Yet the preference, although born later, was related both to the time zone and to the acts of bankruptcy defined by these old statutes. Let us see how this came about.

It is hard today for one to realize the historical connection of bankruptcy with imprisonment for debt, as writers like Holdsworth have featured it, but all one has to do is to read the original definition of "acts of bankruptcy". They bring to mind characters of a later date, Thackeray's Altamont in *Pendennis*, or the real Beau Brummell exiled in Boulogne. From the time of the Tudors, indeed, until the English bankruptcy and insolvency laws were revised and combined in 1869, the statutory "acts of bankruptcy" of English legislation picture the plight of a desperate man, unable to pay or renew debts of early maturity, and therefore absconding or drawing

¹⁵*In re Salmon*, 239 Fed. 413, 415 (S. D. N. Y. 1916). As for the two cases cited by Judge Hand in support, see *HOLBROOK & AIGLER, CASES BANKRUPTCY* (2d ed. 1927) 274 n.; but *Blood v. Kane*, 130 N. Y. 514, 29 N. E. 994 (1892), enforces the duty of a trustee or executor to plead the statute.

the bolt against the sheriff's officers; "outer doors" being immune to civil process. The enactments of both Henry VIII and Elizabeth¹⁶ were plainly intended to create a special status for that man. Having thus been set apart by his own act from the body of the commonwealth, the statute provided a special court for the settlement of questions that related to the insolvent trader's new sphere, precisely as the enlistment of the soldier subjects him to the discipline of military courts.¹⁷ The acts of bankruptcy, therefore, that fixed the status of the person who should be "reputed, deemed and taken for a bankrupt" were the doing of such things as: (1) departing the realm (2) beginning to keep one's house or otherwise absent oneself (3) taking sanctuary (4) suffering oneself to be taken in execution on any fictitious claim (5) suffering oneself to be outlawed or yielding oneself to prison, or (6) departing from one's dwelling house; all "to the intent or purpose to defraud or hinder . . . creditors, . . . of the just debt or duty of such creditor or creditors."¹⁸ Upon it being established to the Lord Chancellor's satisfaction, on evidence adduced upon a petition filed by one or more creditors, that their debtor's conduct had taken any of these forms, the Chancellor appointed commissioners who were empowered to take and distribute the bankrupt's assets, real and personal, among his creditors.

It was not clear, indeed, whether the date of this statutory shift of title was the filing of the petition, the Chancellor's order, or earlier. But, just as he did with the Statute of Fraudulent Conveyances (passed at the same session of Parliament) in the case of Twyne, so Coke put the Elizabethan Bankruptcy Act upon the man with his *Case of Bankrupts*.¹⁹ That was trover for goods transferred to defendant by the debtor, after he had committed an act of bankruptcy but before the bankruptcy petition had been filed. The commissioners in bankruptcy "sold to the plaintiffs jointly the said goods", and the question was "whether the sale of the said commissioners, notwithstanding the said gift and delivery to Tibnam (the defendant) be good or not." The decision was in the affirmative. Otherwise, says Coke, "it would be unequal and unconscionable, and a great defect in the law, if, after that he hath utterly discredited himself by becoming a bankrupt, the law should credit him to make distribution of his

¹⁶34 & 35 HEN. VIII, c. 4 (1542); 13 ELIZ. c. 5 (1570).

¹⁷See *In re Grimley*, 137 U. S. 157, 11 Sup. Ct. 54 (1890); *Rex v. Rotherfield Grays*, 1 B. & C. 345 (1823). The idea of status persists in England, disabilities attaching to the bankrupt being sufficient to bar discovery from the respondent in aid of an original petition for adjudication of bankruptcy. *In re A Debtor*, [1910] 2 K. B. 59; WILLIAMS, BANKRUPTCY (13th ed. 1925) 734.

¹⁸Statute of Elizabeth, *supra* note 16.

¹⁹2 Co. 25b (1592).

goods to whom he pleased, being a bankrupt man and of no credit. . . . And the Court resolved that the proviso concerning gifts and grants bona fide, makes no gifts or grant good which the bankrupt makes after he becomes bankrupt."

Thus originated the idea of the "relation back" of the title to the bankrupt's effects. At that early day there were no assignees or trustees,²⁰ title to assets vesting in commissioners who occupied really the dual position of referee and trustee. But what we must note is the thought expressed by Coke, that a "bankrupt man" was not to be trusted with the disposition of his effects, and that consequently the intention of the statute was to refer the title of the commissioners (assignees later) to the date of the act of bankruptcy.

We may now relate to this study the idea that insolvency means, not so much a valuation of assets as mere inability to pay debts as they fall due. The *ex post facto* stretch of the assignee's title to the date of the act of bankruptcy was drastic enough, and indeed was so unjust as to cause amendments that protected persons who meanwhile dealt with the bankrupt in good faith.²¹ But one needs no vivid imagination to see how a debtor, just before leaving for France or locking himself in for a siege, might think it a good thing to pay or secure a particular creditor. The same reasons of gratitude or expectations of favours to come would be present then as they are to the debtor of today, who is at least happy in the thought that the sight of a process server does not mean a visit to debtor's prison. There we have the preferential transfer.

This the bankruptcy legislation of the time did not invalidate, because the title of the assignees stretched back only to the act of bankruptcy. Things done before the commission of the act of bankruptcy were invalid (and also the favorite Tudor-Stuart punishment of pillory and ear-clipping was awarded) if they amounted to "fraudulent or deceitful" concealment of assets.²² But nothing was said by legislature or courts with regard to the preferential transfer. To quote one who was a good legal historian as well as judge, "the now all too common transaction where a failing debtor pays his all to one or more creditors to the exclusion of the others, in England went on unchallenged by the wronged creditors, and that, too, for nearly one hundred and fifty years after the 21st of James I, already referred to."²³

²⁰5 ANNE c. 22 (1707). The reader will find a summary of English legislation in WILLISTON, *CASES ON BANKRUPTCY* (2d ed. 1903) 2 n.

²¹See *In re Hirth*, [1899] 1 Q. B. 612; *In re Gunsbourg*, [1920] 2 K. B. 426.

²²21 JAMES I, c. 19, § 7 (1623).

²³*In re Hall*, (1901) 4 A. B. REP. 671, 679. (Referee Hotchkiss).

But the learned judge was wrong, it is believed, in describing this situation as "hardly conceivable". The reason for the delay in development of the idea that the preference was wrong, lay in the fact that justification of the idea was meanwhile lacking. That will be apparent, it is believed, to anyone who considers the rationale of the preference as a wrongful act. It could be wrong only if it involved the violation of a duty owed by the bankrupt to his creditors; but in order to create this duty it was fair to seek for some corresponding benefit which the legislature had conferred upon the bankrupt.

No such point was made by Lord Mansfield, the author of the rule, originally judge-made, that a preferential transfer, if traceable solely to the volition of the bankrupt, was "not a payment in the regular and common course of dealing and business," and was "a fraudulent transaction and therefore void with respect to the other creditors."²⁴ But the justification, it is suggested, lies in the fact that intervening legislation had provided for the discharge of the bankrupt from his debts; the new idea being, as stated by Lord Hardwicke, that he should emerge from his bankruptcy freed from all his liabilities, a thing that the framers of the early statutes never contemplated.²⁵ And the intimate connection between two such apparently unrelated things as the bankrupt's discharge and the preferential transfer will be found at this point.

The older statutes provided for the discharge only upon the consent of a majority, at least, of the creditors, a feature which still found place in our national Act of 1841²⁶ with respect to a voluntary bankrupt. It is easy to see the creditors, under such a system, refusing a discharge to one who had made a payment which he could not justify to their commercial minds as relating to "the regular and common course of dealing and business." The preferential transfer later found its way into the statutes themselves,²⁷ and the matter of

²⁴Worseley v. De Mattos, 1 Burr. 467, 482 (1758).

²⁵4 ANNE c. 17 (1706); 4 & 5 ANNE c. 22 (1706). *Ex parte Groom*, 1 Atk. 115, 120 (1744).

²⁶5 STAT. 440, 442 (1841).

²⁷At almost the same time the preferential transfer was mentioned by name, and forbidden, on both sides of the water in laws that dealt with particular classes of bankruptcy. The English Insolvency Acts (which really were laws for the voluntary bankruptcy of insolvent non traders) when they were revised in the first quarter of the last century, specifically dealt with preferences; and so did the English Bankruptcy Act of 1869, which took the place of that legislation as well as of the old bankruptcy laws. See *In re Hall*, *supra* note 23. In New York, preferences on the part of an insolvent corporation were forbidden by a statute, dating to 1825, which now figures as N. Y. CONS. LAWS, c. 59 (STOCK CORP. LAW) § 15. *Caesar v. Bernard*, 156 App. Div. 724, 141 N. Y. Supp. 659 (1st Dept.

the debtor's discharge was liberalized from dependency on creditors' consent to a matter of right. But in the system thus modernized we find the requirement, present in the English law of today, although absent from our existing statute, that discharge must be refused the bankrupt who has been guilty of a preferential transfer. Of that we spoke at the beginning of this article; of the divergency between our Act of 1898 and present day English legislation we will speak later. At present let us note: First, the bankrupt's right to a discharge is logically connected with the preferential transfer as first conceived. Second, if our present Bankruptcy Act has made a departure in that respect, the departure necessarily marks a change in American views, not merely as to the nature of the preference, but as to its ethical significance.

The original idea of the preference, as the writer hopes he has now made plain, has to do with the bankrupt's duty, a duty arising from the privilege of being discharged from liabilities, and constituting a condition to that discharge. And so, when a debtor reaches the point where he must contemplate the commission of an "act of bankruptcy" (which means that he is insolvent, since as we have seen, "acts of bankruptcy" are nothing but the reflexes of an insolvent man) he must be treated as under a duty to keep his estate intact for his creditors on a basis of equality. Consequently, while he can do all things that will not result in a diminution of his estate, he cannot use any of it to pay or secure a favoured creditor.

Now the interesting consequence of this duty idea is that in course of time it separated English thought from American as effectually as did estates tail or primogeniture. The process was long, but it was sure. Today an English decision on the law of preference must be taken with caution in our courts, for it is projected upon a different background. The same thing is just as true of early American decisions, and other decisions that are not so old. Let us see how that came about.

If we walk but a few steps with the suggestion that an insolvent man is under a duty to his creditors, we will meet the principle that wrongdoing implies some sort of free will. Let us consider the point as presented in two cases; one that cannot occur today, but the other of modern application. A creditor demands payment with the threat that otherwise he not only will sue, but will begin by the issuance of mesne process and thus imprison the debtor. Or suppose that a

1913); *aff'd*, 209 N. Y. 570, 103 N. E. 1122 (1913). The first of our national Bankrupt Acts, that of 1800, was silent on the subject, like the contemporary statutes of England, but the Act of 1841 is explicit.

defaulting trustee is threatened with imprisonment if he does not restore the trust out of his own pocket. When he pays in either instance, has he been guilty of a preference? Not if "preference" connotes a driving force that originates with the debtor. There we have one way of looking at it. Then let us take another. Shall we approach the preference from a pragmatic standpoint wholly, and require only to know whether, at the given moment, the debtor is insolvent, allowing no concession to the circumstances that drove him to the actual transfer, unless, indeed, there was such a case of duress that the debtor himself could have legally treated the transfer as not his act and deed? In other words, should "intent to prefer" describe intention as we commonly think of it, or should we deal with this as a class of cases deserving the formula that a man intends the consequences of his act, and let it go at that?

There was the choice. The consequences would be different according to which road the courts might take. It would not be merely a matter of inserting a few words in future statutes on the subject of the preferential transfer; the task in the future would be to frame bankruptcy laws that would include, not only a definition of a particular wrong upon creditors, but such things as acts of bankruptcy and the debtor's discharge. And, underlying the option adopted would be the temper of a people as determined by their economic folkways.

Into such a subject the writer does not propose to go further than to attempt an outline of what happened in the two countries; England, where the preference doctrine originated prior to the Revolution, and our country, where it formed a starting point for bankruptcy legislation and case law.

And first, then, as to England, whose courts, almost immediately upon their adoption of the preference rule, were put to a choice between the two ideas, the preference as a matter of free will and the preference from the standpoint of the balance sheet. In a case also decided in Lord Mansfield's day the bankrupt preferred a creditor, but he did it under the apprehension, although mistaken, that the transferee was about to bring suit and seize him under a *capias*. The decision was this:

"A bankrupt when in contemplation of his bankruptcy cannot by his voluntary act favour any one creditor; but if under fear of legal process he gives a preference, it is evidence that he does not do it voluntarily. And though the defendant in this case had taken no steps to secure himself in case he was called upon, yet the bankrupt acting from mistake was under the same misapprehensions of legal process, as if the defendant had actually threatened her; so that her executing the warrant of attorney

was not a voluntary act, but the effect of fear, however groundless that might be."²⁸

The long and short of that decision is that "preference" relates to the debtor's motive. If it was to favour a creditor who had exerted no pressure, there was a preference. But if the transfer could be attributed, not merely to a demand of the creditor, but also to fear of what he could do in the way of process of one sort or another, then there was no preference even though it would be impossible to describe the situation as one of duress. That is the law of England today. The revision of 1869 appears, as Lord Cairns said, "to have left the question of pressure as it stood under the old law; and, indeed, the use of the word, 'preference', implying an act of free will, would of itself make it necessary to consider whether pressure had or had not been used."²⁹

The difference between this English rule and ours of today, is illustrated by the case of a defaulting trustee who, on the eve of bankruptcy, makes restitution. That cannot be a preferential transfer in England because, in the words of Lord Esher, M. R., the bankrupt "acted solely with a view of saving himself from exposure, infamy and danger."³⁰ But under our law this would constitute a preferential transfer.³¹ A later case puts the English idea even more

²⁸Thompson v. Freeman, 1 T. R. 155, 157 (1786).

²⁹Butcher v. Stead, L. R. 7 H. L. Cas. 839, 846 (1875). Section 44 of the Bankruptcy Act of 1914, repeats the old definition, as did Section 33 of the intervening Act of 1883. See WILLIAMS, BANKRUPTCY (8th ed. 1904) 249 n., relative to Act of 1883; *ibid.* (13th ed. 1925) 309 n., relative to Act of 1914.

"I know" said Lord Halsbury, "that what A. L. Smith, L. J., has said with regard to what I might call the pressure upon a man's own mind, that he was not by his own voluntary act preferring one creditor to another, but was thinking of something else, has been contested at the Bar; but no authority in favour of that contention has been quoted, and there is an authority now not less than a century old, in fact 110 years old, in which that question was actually determined, and so far as I know it has never been disturbed since." Sharp v. Jackson, [1899] A. C. 419, 423. The reference is to Thompson v. Freeman, *supra* note 28.

³⁰*Ex parte* Stubbins, 17 Ch. D. 58 (1880); *Ex parte* Taylor, 18 Q. B. D. 295, 300 (1886); Sharp v. Jackson, *supra* note 29.

³¹Clarke v. Rogers, 228 U. S. 534, 33 Sup. Ct. 587 (1913). The contrary view expressed in the Second Circuit in *McNaboe v. Columbian Mfg. Co.*, 153 Fed. 967 (C. C. A. 2d, 1907), rested upon the idea that the robbed beneficiary of an express trust can not be put in the same class with general creditors of the embezzling trustee. The same thought found some expression in England (James, L. J., in *Ex parte* Stubbins, and Lindley and Lopes, L. J. J. in *Ex parte* Taylor, both *supra* note 30.) but Lord Halsbury emphatically says that "no such proposition can properly be maintained, and that although there are other and peculiar elements in the relation between a cestui que trust and a trustee, undoubtedly the relation of debtor and creditor can and does exist." *Sharpe v. Jackson*, *supra* note 29, at 426.

sharply. Insolvent to his own knowledge, the bankrupt asked a vendor-creditor for a renewal; the latter refused, saying, in effect, "I want a substantial payment or a return of goods, or I'll make it hot for you"; whereupon the bankrupt returned the goods. After letting in evidence of contemporaneous dealings with other creditors "to show system as against accident," Phillimore, J., held that the threats were not intended to refer to legal action against the bankrupt, but "were threats which meant that he [the creditor] would expose him to other wholesale dealers in commercial quarters in Manchester and London as a man who really was not the kind of trader anybody would deal with." Therefore, he concluded, "the dominant motive here was not the wish to prefer the creditor but to obtain some advantage for the debtor", and hence the transaction constituted a "fraudulent preference".³²

Such was the system that we inherited as applicable to our first national bankrupt act, the Act of 1800, forasmuch as that statute, like its English models of the day, said nothing at all on the subject of preferences, leaving it to the judge-made law.

But from the first it was obvious that the English system of bankruptcy would abide with us only as it suited us. Thus the Constitution authorized Congress to enact bankrupt laws for all persons, over the protest of New York, which requested that it be confined to traders, with the result that the Congressional power that was conferred included the affairs of "insolvent debtors" indifferently with "bankruptcies", as the English used those terms.³³ Clearly, then, the English system, even when properly interpreted, was to have further changes if it should not suit.

A possibility of trouble, indeed, lay just ahead. As has been seen, the English doctrine of "pressure" on the creditor's part as excusing a preferential transfer, was purely a matter of ascertaining the debtor's "dominant motive". It had nothing to do either with duress as the courts understood that term, or with specific performance, or with the "equitable mortgage." It had been determined, before we ever started with our own system, that the bankruptcy of a purchaser or borrower would not defeat the enforcement of specific performance of any undertaking of which specific performance otherwise would be decreed.³⁴ The well known limits of this idea had already been

³²*In re Ramsey*, [1913] 2 K. B. 80, 86.

³³*Sturges v. Crowninshield*, 14 Wheat. 122 (1819); note (1888) 22 AM. L. REV. 448.

³⁴*Taylor v. Wheeler*, 2 Vern. 564 (1706); *Russell v. Russell*, 1 Bro. C. C. 269 (1783).

defined, however; it did not extend to general agreements to give security, or to sale contracts which did not describe the property.³⁵ With these boundaries respected, the doctrines of equity would be given application, quite apart from the idea of "pressure" as pardoning what otherwise would be a preferential transfer. But it is easy to see how any sort of laxity in the judicial process would lead to a confusion of the two rules.³⁶

Yet that happened, as is illustrated by a case arising under the Act of 1800. In ejection against bankruptcy assignees, plaintiffs claiming under a deed executed by the bankrupt just prior to his act of bankruptcy, the defense being that the deed was void as a preference, it appeared that the plaintiffs had endorsed the bankrupt's notes on his promise to secure them (time not stated) with "bank stock". This he did not do, but before the bankruptcy he conveyed to them the land in suit as security. The court reversed judgment for the defendants, saying:

"The court are of opinion, that to render a payment or transfer by a debtor to his creditor, fraudulent as to the other creditors, under the bankrupt law, it must be spontaneously made in consequence of a formed design to become a bankrupt. In this case the conveyance made by Brown was not voluntary, but produced by the application of the Messrs. Pleasants for a transfer of bank stock, which they were entitled to, and the refusal of Brown to comply with his engagement, or to make any provision to indemnify them, would have subjected him to an action at law, or bill in chancery for a specific execution of his contract, and in that point of view the application of the Messrs. Pleasants must be considered as importunate and pressing."³⁷

Analysis of that decision is unnecessary, in view of its conclusions that because the debtor had agreed at some future date to pledge stock, equity would compel him to mortgage land, and that the mere request for the mortgage amounted to "pressure"; but it is important to note that this idea persisted in many of our courts, not only under the Act of 1800, but as applied to state insolvency laws and the later national acts of 1841 and 1877. Thus under the Act of 1841, it was held to be no preference for the bankrupt, who had transferred a third party's note to A without endorsement, later to endorse it, because, as the court understood the English rule which it considered applicable,

³⁵See *Chase v. Peck*, 21 N. Y. 581 (1860); Stone, *The Equitable Mortgage in New York* (1920) 20 COL. L. REV. 519.

³⁶See *In re Jackson Iron Co.*, Fed. Case 7153 (E. D. Mich. 1877), for a discussion of this confusion even at that late day.

³⁷*McMeehan v. Grundy*, 3 Harr. & J. 185, 192 (Md. 1810).

"the preference, to be void, must be the voluntary act of the debtor and not arise in consequence of any previous agreement with his creditor for security."³⁸ In another case the insolvent was held not to be guilty of a preference in paying off a loan because he had obtained it "on the most solemn pledge which could bind his honor and conscience, to secure this, and all other advances, whenever and however they might demand."³⁹ And then there is the case, so often cited for the proposition of the equitable lien,⁴⁰ of *Burdick v. Jackson*.⁴¹ A few days before the filing of the bankruptcy petition the debtor executed a mortgage "in pursuance of a parol agreement between the bankrupt and the guardian of the infants more than fifteen months before." Yet the majority held that the agreement constituted an "equitable mortgage" in the sense that, as stated many years later, "where one party advances money to another upon the faith of a verbal agreement by the latter to secure its payment by a mortgage upon certain lands, but which is never executed, or which, if executed, is so defective or informal as to fail in effectuating the purpose of its execution, equity will impress upon the land intended to be mortgaged a lien" etc.⁴² The difficulty, of course, was not in the principle, but in the application of it to loose cases.

The influence of these and other decisions, stretching over a century of our judicial history,⁴³ cannot be ignored. It survived in the words "intent to prefer" which appeared, as has been said, twice in the Act of 1898 as originally passed, and remains in the section which makes the preference an act of bankruptcy. But meanwhile these words had been deprived of their original significance by a judge-made idea which had grown up alongside the rule we have just studied, finally reducing that rule to its present day proportions. The pragmatic view, that the debtor's motive or intention should be reduced to terms of his solvency or insolvency at the time when he made the transfer, was the solvent force.

The originator of this new thought was Mr. Justice Story.⁴⁴ The

³⁸*Smoot v. Morehouse*, 8 Ala. 370, 372 (1845).

³⁹*Crawford v. Taylor*, 6 Gill & J. 323, 333 (Md. 1834).

⁴⁰See, for instance, *Nat. Park Bank v. Whitmore*, 104 N. Y. 297, 10 N. E. 524 (1884); *Sleeth v. Sampson*, 237 N. Y. 69, 142 N. E. 355 (1923).

⁴¹7 Hun. 488 (N. Y. 1876).

⁴²*Sprague v. Cochran*, 144 N. Y. 104, 112, 38 N. E. 1000, 1001, 1002 (1894).

⁴³As late as 1895, three years before the passage of the national act which we now have, these with like cases were added as "American Notes" to a typical English case of "fraudulent preference," which had to do with the debtor's dominating motive. (1895) 4 ENGL. RUL. CAS. 85.

⁴⁴See *In re Jackson Iron Co.*, *supra* note 36; also *Curtis v. Leavitt*, 15 N. Y. 9 (1857), where Justice Story's decisions are quoted as applicable to the New York statute relating to corporate preferences.

national Bankrupt Act of 1841 applied both to traders (in the sense of voluntary bankrupts) and non-traders; thus combining the two features of a Bankrupt Act and an Insolvent Debtors Act. And, as later was to be done in England, we find the statute defining as well as forbidding the preferential transfer. The phrase it used was "in contemplation of bankruptcy". Then what of these phrases, "in contemplation of insolvency" as used in State laws,⁴⁵ and "in contemplation of bankruptcy" in the National Act of 1841? Did they mean the same thing? And if so, were they intended to carry into effect with us the idea of motive, as the English courts developed it, or could they be taken to mean something else?

Those questions were answered by Justice Story on the circuit. Such phrases, "in contemplation of insolvency", "in contemplation of bankruptcy", or "with a view" to either, mean the same thing; and, that being so, they lead to a certain conclusion. That meaning, and that conclusion, have, in the ultimate to do with the debtor's situation and not his motive. And then, how important are the bankrupt's motives; what of "pressure"? Of no importance, because, "in such a case, if the bankrupt makes a conveyance giving a preference to certain creditors, that is the very thing which the Bankrupt Act denounces and declares a fraud." It is, in short, a question not of the bankrupt's thoughts and motives, but of his balance sheet.⁴⁶

And what of the confusion between "pressure" and "equitable lien" of which certain state courts had been guilty? That was answered also. In holding a transaction to be preferential where the bankrupt gave security to a creditor, on the latter's demand, "and upon a verbal promise, made in general terms, when the debt was contracted, to give security on request", the Justice said:

"[W]hatever may be the case under the peculiar provisions of the bankrupt laws of England, it appears to me that it ought to be answered in the affirmative, under our Bankrupt Act of 1841. . . it is fraud upon the bankrupt act of 1841, and is therefore an act of bankruptcy within the meaning of the statute."⁴⁷

⁴⁵See the New York statute (now N. Y. CONS. LAWS, c. 59 (STOCK CORP. LAW) § 15, as quoted in *Caesar v. Bernard*, *supra* note 27; and the Maryland law as construed in *Hickley v. Merchants' Bank*, 5 Gill & J. 377 (Md. 1833).

⁴⁶*Everett v. Stone*, 3 Story 453, Fed. Case 4577 (C. C. D. Me. 1844).

⁴⁷*Arnold v. Maynard*, 2 Story 349, 358, Fed. Case 561 (C. C. D. Mass. 1842). *Accord: In re Jackson Iron Co.*, *supra* note 36; *Ex parte Ames*, 1 Low. Dec. 561, Fed. Case 323 (D. Mass. 1871); *Giddings v. Dodd*, 1 Dill. 116, Fed. Case 5405 (C. C. E. D. Mo. 1871); *Strain v. Gourdin*, 2 Woods 380, Fed. Case 13521 (C. C. D. Ga. 1874) (threat of criminal prosecution unavailing); *Douglas v. Vogeler*, 6 Fed. 53 (S. D. Ohio 1881).

Thus we have the new departure: a rule which (a) reduced the bankrupt's intention and motive to the question of his solvency, (b) eliminated the excuse that the preferred creditor had obtained the favour through "pressure", and (c) in consequence, by removing all possibility of confusing the "equitable lien" with something else, forced one who claimed specific recovery or retention as against the estate, to show that his situation was such as to entitle him to relief in equity unaided by other considerations.

In the years that passed before the coming of the present Act of 1898, a part of this doctrine became firmly established by the weight of opinion. "Pressure" on the creditor's part, as such, was eliminated as a factor. The cognate idea that the preference should be viewed as a question of the debtor's solvency, and that only, also grew to the proportions of today; the courts taking full advantage of a corresponding change in statutory definition. The Act of 1841, as we saw, defined the preference as a transfer "in contemplation of bankruptcy." The Act of 1867 used more words. Section 35 said the preference arose when a transfer was made by "any person being insolvent or in contemplation of insolvency, within four months before the filing of the petition. . . with a view to give a preference." This change was considered as significant in relieving the courts of the duty of having further to deal, even as a matter of lip service, with anything that the debtor may have "contemplated," and as allowing the judicial attention to be directed only to his financial condition. At least the way was cleared for the Supreme Court to say that whereas "everyone must be presumed to intend the necessary consequences of his act," it follows that:

"The transfer, in any case, by a debtor of a large portion of his property, while he is insolvent, to one creditor, without making provision for an equal distribution of its proceeds to all his creditors, necessarily operates as a preference to him, and must be taken as conclusive evidence that a preference was intended, unless the debtor can show that he was at the time ignorant of his insolvency, and that his affairs were such that he could reasonably expect to pay all his debts. The burden of proof is upon him in such case, and not upon the assignee or contestant in bankruptcy."⁴⁸

Indeed, to pay it in the terser language of Judge Lowell:

"If you find the knowledge of insolvency, and an expectation or fear of stopping payments, you must infer the intent, because every sane person is presumed to intend the well-known consequences of his acts."⁴⁹

⁴⁸Toof v. Martin, *supra* note 4, at 48. See also Forbes v. Howe, 102 Mass. 435 (1869). ⁴⁹*In re George*, 1 Low. Dec. 409, 411, Fed. Case 5325 (D. Mass. 1869).

The result, with the consequent disregard of all old ideas, is thus expressed in another case, also arising under the Act of 1867. After speaking of the language employed in English cases, the court observed:

"It is hardly necessary to say that this language is wholly inapplicable to our bankrupt system. The current of authorities is uniform, that if the knowledge of both parties of a present or an approaching insolvency be shown the intent to prefer is presumed from the fact of preference, and the element of pressure on the part of the creditor plays no part in the transaction. As a matter of fact, preferences are rarely given except under pressure, and the debtor is presumed to act voluntarily if he yields to unlawful solicitations."⁵⁰

So strong, then, was this current that when the Act of 1898 came, nothing that it said as to "intent to prefer" really made any difference. The key note was sounded as before, that a man is to be taken as intending the consequences of his acts; he cannot be treated as though he had not examined his own books and inventories. The result of the transaction, therefore, and not the state of mind of the transferor, was made the test even before the 1910 amendment; and the amendment was merely meant for better emphasis.⁵¹

This evolution involves, incidentally, the development of the saving clause that now, with us, protects the transferee who has no "reasonable cause to believe" that a preference will result. The rule that originated in Lord Mansfield's time did not require a showing as to whether the person receiving a preference had or had not grounds for thinking that his debtor was facing an act of bankruptcy. And if the old view, persisting, as we have seen, to this day in England, is taken in its true spirit, there is no need of a saving clause. The transaction in the usual course of business is protected expressly,⁵² as is the transfer that is made under "pressure". As to what remains, why should not the preferred creditor do his part in putting back the estate to where it would have been if the bankrupt had performed the duty which he owed the creditors equally? That, the writer infers, accounts for the omission of any "saving clause" from the present English Act of 1914 or its predecessor of 1883, although there

⁵⁰*In re Jackson Co.*, *supra* note 36 followed in *Douglas v. Vogeler*, *supra* note 47. To same effect, *In re Binninger*, 7 Blatchf. 262, Fed. Case 1420 (C. C. S. D. N. Y. 1870).

⁵¹*Hewitt v. Boston Straw Board Co.*, 214 Mass. 260, 101 N. E. 424 (1913). The court cites *Forbes v. Howe*, *supra* note 48; *In re George*, *supra* note 49; and *Toof v. Martin*, *supra* note 4, for this, although the case arose after the 1910 amendment. See also *Rogers v. Am. Halibut Co.*, 216 Mass. 227, 103 N. E. 689 (1913).

⁵²See *WILLIAMS, op. cit. supra* note 17, at 318; 4 & 5 GEO. V, c. 59, § 45 (1914).

was such a provision in the Act of 1869.⁵³ But it is interesting to observe how with us the saving clause appeared and operated in connection with our discarding of the English rule in favour of the idea that the preference should be viewed from the standpoint of the debtor's balance sheet. The national Act of 1841 had such a clause, and, as we have seen, the Story decisions that changed the fundamental rule were announced in cases arising under that Statute.⁵⁴ It is noteworthy in this connection, also, that the New York statute relating to preferential transfers by an insolvent corporation, a statute which dates far back so far as the law of preferences is concerned,⁵⁵ was amended last year so as expressly to save "any rights or interests which may be acquired thereunder by any person without notice or reasonable cause to believe that such conveyance. . . would effect a preference."⁵⁶ This amendment, it is believed, is traceable to frequent judicial remarks, although flat decisions there were none, to the effect that the statute avoided a preferential transfer regardless of the transferee's situation.⁵⁷

And so we are brought to the last of our tasks of synthesis. Today, as before, the preference is connected, logically, with the bankrupt's discharge. The shift of legal view which we have examined is by no means devoid of moral significance. The trust zone which the early rule established was based upon the bankrupt's duty, a duty correlative with his right to a discharge. The idea of the preference as "a fraud upon the bankrupt laws", therefore, was signaled by its being enumerated among the acts of bankruptcy upon the re-writing

⁵³WILLIAMS, *op. cit.* *supra* note 17, at 315, 316.

⁵⁴As to the Act of 1898, see *supra* note 2. Section 3 of the Act of 1841 saved transfers if made to "a bona fide creditor, or purchaser for a valuable consideration, without notice." This statute also contained a clause saving transactions in the usual course of business. Section 35 of the Act of 1867 invalidated a preference only if the recipient should have reasonable cause to believe that the debtor was insolvent, and that the transfer was made "in fraud of the provisions of this Act." In 1874 an amendment required actual knowledge that "the transfer is made in fraud of the provisions of this Act." 18 STAT. 178 (1874). It is of interest that Mullin, P. J. in *Burdick v. Jackson*, *supra* note 41, at 491, concurred solely on the ground "[t]hat the defendants were not at the time of receiving the mortgage aware of the insolvency of the mortgagor, and that the mortgage, as to them, was in fraud of the bankrupt law."

⁵⁵N. Y. CONS. LAWS, c. 59 (STOCK CORP. LAW) § 15. For its history see *Caesar v. Bernard*, *supra* note 27.

⁵⁶N. Y. CONS. LAWS, c. 59 (STOCK CORP. LAWS) § 15.

⁵⁷*Davis v. Seneca Falls Co.*, 17 F. (2d) 546 (C. C. A. 2d, 1927), and cases there cited. See also Grossman, *The Long Arm of the Trustee: Recoveries under Section 15, Stock Corporation Law* (1925) 2 A. B. REV. 77; *Perry v. Van Norden Trust Co.*, 192 N. Y. 189, 84 N. E. 804 (1908).

of the statutes. And similarly, the bankrupt was to be refused a discharge if it should appear that he had been guilty of giving a preference. But the new idea, that the debtor was no longer to be judged by his intentions, but by the result of his acts regardless of all else, has led, not only to a refusal of Congress to include the preferential transfer among the grounds for refusing a discharge, but to a judicial distinction between the preference and the fraudulent conveyance. The latter is instinct with immorality, but the former is not, as our courts now see it. To quote the Supreme Court:

"A preference, if it have the effect prescribed in Section 60, enabling one creditor to obtain a greater portion of the estate than others, is not necessarily fraudulent; preferences are set aside when made within four months, with a view to obtaining an equal distribution of the estate, and in such cases it is only essential to show a transfer by an insolvent debtor to one who, himself, or by his agent knew of the intention to create a preference. In construing the bankruptcy act this distinction must be kept constantly in mind."⁵⁸

But old values cannot be so easily confiscated; old habits sometimes relate to things that are stubborn against change. And that is illustrated by the struggles that continue even today with regard to two situations, common of occurrence and not to be silenced by new dogma.

The first situation is related to the earlier cases, already considered, that confused the true "equity" of a creditor as fastened upon a specific item of the bankrupt estate, with the creditor's "pressure" which keeps a transfer from being a preference. That is no longer the law, as we have seen; but has the change in law really touched bottom? If so, how are we to account for the lines of cleavage that are to be found in decisions of today with respect to the "equitable lien"? The problem is thus put in the words of a late comment:

"That a lien valid between the parties before the four months periods may be perfected against the trustee by recording or taking possession within the four months is not now disputed. The doubtful question is: what facts prior to the four months are operative to create a lien which may be so perfected?"⁵⁹

He who attempts an answer that will reconcile the decisions of today will only reach the vague border that encloses what is called an "equitable lien", or even an "equitable pledge". But an effort to survey this line by using the ideas that animate an equity court in

⁵⁸Coder v. Arts, 213 U. S. 223, 241, 29 Sup. Ct. 436, 443 (1910); followed in Van Iderstine v. Nat. Discount Co., 227 U. S. 575, 33 Sup. Ct. 343 (1913).

⁵⁹Note (1925) 34 YALE L. J. 891, 892.

compelling performance of an agreement wherein the terms must be as clear as the subject is specific, will end only with a field note indicating doubt. In truth, as the authority last above cited proceeds to state, there are two judicial policies; one generalistic in accordance with the idea of bankruptcy as already outlined; the other particularistic, emphasizing the hardship of the creditor who has succeeded in getting his own although within the twilight period, with especial tenderness in the case of an enabling loan, as illustrated by the trust receipt.⁶⁰ It may well be that in the latter case the courts are influenced by economic considerations. But in others, where there is no "enabling loan", what has really influenced the courts is the fact that the creditor has obtained his preference by pressure,—and then are we not back in Lord Mansfield's time, or where the English courts stand today?

Equally difficult is the situation thus put in a modern case: "The creditor knows the debtor to be insolvent for the moment in the sense of the statute, yet he honestly supposes that some of his assets, worthless for the moment, will, if he be allowed to continue, realize enough to pay his debts in full. May he safely take security under such circumstances?"⁶¹ For the reasons already stated, early decisions would have answered that question in the affirmative; but the modern inclination should be against such a transaction. Thus the Massachusetts court held under the Act of 1867 that the test was insolvency and that only, distinguishing an earlier decision on the ground that such a transaction could be supported under the Act of 1841, because it did not occur "in contemplation of bankruptcy", whereas the Act of 1867 "avoids a sale made with a view to give a preference if the debtor at the time be in fact insolvent, although he may not contemplate bankruptcy".⁶² But the problem was not downed; it reappeared under the Act of 1867 and state insolvency laws,⁶³ and has been considered as prominent enough under our present Act to warrant editorial notice. The problem posed for us, according to this editorial, is whether we are to view the situation as it presented itself to the parties at the time of the transaction? To

⁶⁰*Supra* note 58. As a typical case, of the "strong equity" of the man who has advanced the money that paid for the very goods which are transferred to him as security when the buyer's condition becomes bad, see *McDonald v. Daskam*, 108 Fed. 593 (D. Ore. 1900), 116 Fed. 276 (C. C. A. 7th, 1902).

⁶¹*Kennard v. Behrer*, 270 Fed. 661 (S. D. N. Y. 1920).

⁶²*Forbes v. Howe*, *supra* note 48, distinguishing *Jones v. Howland*, 8 Metc. 377 (Mass. 1844).

⁶³See *Grant v. Monmouth Bank*, 97 U. S. 80 (1877); *Mundo v. Shepard*, 166 Mass. 323, 44 N. E. 244 (1896).

say no, is simply "to return to the rule adopted in the Statute of 1867." That rule, it is said forbids a creditor to "indulge in guessing the future of a debtor whom he knows to be insolvent, and if his guess is approved gain an advantage over other creditors."⁶⁴

That, however, hardly seems to be the complete way of putting it. Credit may, in given circumstances, be a commodity of value; and a creditor who is "uncertain enough of his claim to be unwilling any longer to leave it at risk," as Judge Learned Hand puts it⁶⁵ is simply doing what, from one point of view, any man may be taken as doing when he lends at the outset on collateral rather than on naked note. The debtor who gives security in exchange for time in those circumstances is not conscious of giving a preference; the creditor thinks of himself as having changed a bill into a loan rather than as having done an unfair thing. So with the equitable lien and its vagaries, to which reference was made a moment ago, only this time it is the courts who do the thinking, so to speak. When they stretch the idea they do it because they cannot see a preference in the transaction, in the sense in which "preference" was used in an older day.

Once the idea had moral significance; now it has been reduced to the debtor's inventory, in the light of a fair valuation. But inventories cannot express everything; and hence the preferential transfer is not and probably will never be a thing of logical symmetry.

⁶⁴Note (1921) 34 HARV. L. REV. 547, discussing *Kennard v. Behrer*, *supra* note 60. See also *In re Carlile*, 199 Fed. 612 (D. N. C. 1912); *In re Gaylord*, 225 Fed. 234 (N. D. N. Y. 1915); HOLBROOK & AIGLER, *op. cit. supra* note 15, at 298 n.

⁶⁵*Kennard v. Behrer*, *supra* note 61, at 664.