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Section 70(d) of the Bankruptcy Act: The Need for Amendment

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COMMENT

SECTION 70(d) OF THE BANKRUPTCY ACT: THE NEED FOR AMENDMENT

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Recently there have been proposals[1] for amendment of Section 70(d) of the Bankruptcy Act.[2] The need for amendment is the topic of this Comment.

I

Bankruptcy can be initiated by the filing of either a voluntary or an involuntary petition.[3] Particularly in the latter case it is likely that the bankrupt will remain in possession of at least some of his property for a significant period of time following the petition. There is then the risk that the bankrupt may engage in post petition transactions which diminish the estate. Should this happen, a choice must be made: are those who deal with the bankrupt to be protected at the expense of his unsecured creditors? Rigorous application of the doctrine of *lis pendens* would call for abrogation of all post petition transactions initiated by the bankrupt, since the trustee's title is fixed by the date of the filing of the petition.[4] According to this theory, if the petition is well founded the bankrupt will not subsequently be entitled to sell property or receive satisfaction of obligations owed to him. But, although bankruptcy is *lis pendens*,[5] the rule has never been applied with such rigor that all post petition transactions with a bankrupt are invalid. Concessions have been made to protect third parties who engage in post petition transactions with the bankrupt.

Prior to 1938 the extent of this protection, in other than real property transactions, could only be judged by inspection of judicial decisions. It was held that the trustee's title dated from the filing of the petition because, although an adjudication subsequent to the petition

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1. Bateman, *Post-Bankruptcy Transfers: An Old Problem in Need of a New Solution*, 53 CORN. L. REV. 280 (1968); 1967 DUKE L. J. 1023. Professor Bateman's article containes a detailed review of the development of sections 21g and 70d.

2. 11 U.S.C. § 110(d) (1964) [hereinafter Bankruptcy Act § 70(d), 11 U.S.C. § 11(d) (1964) is cited as section 70(d)].

3. Bankruptcy Act §§ 3b, 4a-b, 11 U.S.C. §§ 21(b), 22(a)-(b) (1964).

4. Bankruptcy Act § 70a, 11 U.S.C. § 110(a) (1964).

5. Mueller v. Nugent, 184 U.S. 1 (1901).

was required, this adjudication related back to the filing date.[6] The operation of this doctrine of relation back was, however, limited by extending some protection to parties who dealt with the bankrupt in the period between the filing of the petition and the adjudication.[7] Undesirable uncertainty was the result so the Chandler Act of 1938 contained provisions specifically dealing with this problem.[8] The statute explicitly spelled out the type of protection that was to be afforded post petition transactions. In the case of real property, section 21(g)[9] protects subsequent purchasers until notice of the bankruptcy proceeding appears in the recording system. All other transactions are covered by the provisions of section 70(d).[10]

According to the statute the bankrupt may engage in post petition transactions which will bind the estate only in a limited number of situations: (1) the adjudication must not have occurred and (2) a receiver must not have taken possession of the property which the bankrupt seeks to convey. This is stated by the introductory clause of section 70(d), and the theory of protection is clear. It would be unwise to give the bankrupt an unlimited power of alienation, for this would

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6. Everett v. Nugent, 184 U.S. 1 (1901).
6. Everett v. Judson, 228 U.S. 474 (1913).
7. Bateman, *supra* note 1, at 284-87; Maclachlan, *Amendment of the Bankruptcy Act,* 40 HARV. L. REV. 586, 612-13 (1927).
8. Act of June 22, 1938, ch. 525 § 1(d), 52 Stat. 879, *as amended,* Bankruptcy Act § 70(a), 11 U.S.C. § 11(a) (1964).
9. 11 U.S.C. § 44(g) (1964). In the county where the bankruptcy court sits, notice is to be achieved by reference to the federal court records. In every other county, notice must be effectuated by an affirmative act of filing in the state recording system. 2 W. COLLIER, BANKRUPTCY 372 (14th ed. 1967) [hereinafter cited as COLLIER].
10. After bankruptcy and either before adjudication or before a receiver takes possession of the property of the bankrupt, whichever first occurs—

(1) 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 present fair equivalent value, then to the extent of the present consideration actually paid therefor, which amount the transferee shall have a lien upon the property so transferred; (2) A person indebted to the bankrupt or holding property of the bankrupt may, if acting in good faith, pay such indebtedness or deliver such property, or any part thereof, to the bankrupt or upon his order, with the same effect as if the bankruptcy were not pending; (3) 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; (4) The provisions of paragraphs (1) and (2) of this subdivision shall not apply where a receiver or trustee appointed by a United States or State court is in possession of all or the greater portion of the non-exempt property of the bankrupt; (5) A person asserting the validity of a transfer under this subdivision shall have the burden of proof. Except as otherwise provided in this subdivision and in subdivision g of section 21 of this Act, no transfer by or in behalf of the bankrupt after the date of bankruptcy shall be valid against the trustee: *Provided, however,* That nothing in this Act shall impair the negotiability of currency of negotiable instruments.

allow him to frustrate the purpose of the bankruptcy proceedings.[11] Protection of the jurisdiction of the court is the rationale of the doctrine of *lis pendens*[12] and it is as fully appropriate to a bankruptcy proceeding as to any other proceeding involving property rights.

At the same time there may be cases in which the petition is not well founded and the bankrupt should be protected against this possibility. This is accomplished by continuing his power to pass title until such time as the adjudication firmly establishes that the proceeding is merited. The bankrupt may not, of course, convey good title, even prior to the adjudication, if a receiver is in possession of the specific item.[13]

Another, although secondary, aspect of the statute relevant to this point is the solicitude shown to bona fide purchasers. The doctrine of *lis pendens* sacrifices the interests of such purchasers in order to protect the jurisdiction of the court. But exceptions to such a rule can be expected when strengthening the hand of the bona fide purchaser will not seriously impair the effectiveness of the judicial proceeding. This helps explain the statutory rule. If the receiver does in fact have possession of a specific item, there is no possibility of bona fide purchase because the bankrupt will not be able to explain his lack of possession. But when the bankrupt still has possession and there has been no adjudication, a bona fide purchaser ought to be able to deal with a bankrupt in confidence because, first, he has no practical way of finding out about the bankruptcy proceeding and second, a legitimate argument can be made for permitting the bankrupt to remain in control of his affairs. The concurrence of these two reasons is important for neither alone is sufficient to explain section 70(d). At some point the bankrupt must lose his power to sell property or discharge obligations even when the person dealing with him is completely in good faith. This point is marked by the adjudication which fixes the outer limits of protection.[14]

If this were the extent of the coverage of section 70(d), the pattern would be clear. Real property transactions would be protected under

11. A requirement that those dealing with the bankrupt act in good faith and give present fair equivalent value will not protect the estate in all cases. The bankrupt may dissipate the proceeds of the transaction or may engage in transactions which are unwise during a period of liquidation. *Cf.* Bateman, *supra* note 1, at 306.

12. 4 AMERICAN LAW OF PROPERTY 570 (A.J. Casner ed. 1952); 3 M. MERRILL, NOTICE 60 (1952).

13. This would happen when the bankruptcy court appoints a receiver prior to adjudication under section 2(a)(3) to conserve the estate. 11 U.S.C. § 11(3) (1964). Such an appointment ordinarily will not be made where adjudication is unlikely but, when made, represents a judgment by the court that the interests of creditors no longer justify permitting the bankrupt to remain in control of his affairs. 1 COLLIER § 2.24(1).

14. If the third party knows that the involuntary petition is well founded, there is no reason to validate his transactions with the bankrupt even prior to adjudication. This is the effect of § 70(d) (3). 11 U.S.C. § 110(d) (3) (1964).

section 21(g)[15] until notice of the bankruptcy proceedings appeared in the local recording system. This abrogation of the doctrine of *lis pendens* is justified by both history and practice. Most states have modified the *lis pendens* effect of state court proceedings by requiring that where real property is involved there must be recording in an appropriate local office.[16] Section 21(g) merely provides the same treatment for bankruptcy proceedings. While it is true that an uncooperative bankrupt may make post adjudication transfers of his property that are not in the best interests of his estate, such a concession to state recording requirements is justified by the high degree of reliance that purchasers of real property place on the record. And practically, the danger of diminishing the estate is not too great. Because real estate transactions move slowly, the trustee can usually prevent their consummation and, therefore, has relatively little need for the doctrine of *lis pendens*.

All non-real estate transactions are covered by section 70(d) and, when adjudication occurs, the protection for purchasers must cease. It should be noted that there is more danger of dissipation when liquid assets are involved; transactions in personal property and intangibles are consummated much more easily than transactions in real estate. For example, it takes little time to borrow on the cash surrender value of a life insurance policy or draw a check. It seems strange that there has been less of an inclination to apply the doctrine of *lis pendens* in non-real property transactions[17] when arguably its application there is even more necessary. As was noted by the Oklahoma Supreme Court in 1919,

> [t]he probability of defendant's entirely defeating the object of the suit by a transfer of the property pendente lite is rather greater in the case of personal than of real estate; and the necessity of some law prohibiting such transfer, to the prejudice of the prevailing party, is therefore greater in the former case than in the latter.[18]

Furthermore, except in certain isolated instances,[19] there is no dependable record to protect other than in real property transactions. Personal property is fugitive. Recording statutes of a local character are not effective ways of giving notice and the emphasis in the personal property field has been on validating the claims of those who file rather

15. Bankruptcy Act § 21(g), 11 U.S.C. § 44(g) (1964).
16. 4 AMERICAN LAW OF PROPERTY 570 (A.J. Casner ed. 1952); 3 M. MERRILL, NOTICE 97, 99 (1952).
17. 3 M. MERRILL, NOTICE 72-74 (1952).
18. Smith v. Curreather's Merc. Co., 76 Okla. 170, 184 P. 102 (1919).
19. *E.g.*, automobile title certificates.

than informing those who consult.[20] Trust in the vendor as opposed to trust in the record is a characteristic of dealings in this type of property. Because of this, it is not necessary to be overly cautious about protecting those who deal with a bankrupt and later learn to their sorrow of the previous adjudication.

This would be a neat explanation of the congressional choices embodied in section 70(d) if it were not for the language of section 70 (d)(4) stating: "[t]he provisions of paragraph (1) and (2) of this subdivision shall not apply where a receiver or trustee appointed by a United States or state court is in possesion of all or the greater portion of the nonexempt property of the bankrupt." A literal reading of this clause would suggest that there are two other events which will terminate the protection afforded by section 70(d)(1) and (2). These are possession by a court official of (1) all of the nonexempt property of the bankrupt or (2) the greater portion of the property. But this is most curious draftsmanship since termination of protection has already been dealt with in the introductory clause of section 70(d). One explanation is that section 70(d)(4) refers to events occurring prior to bankruptcy which do not *terminate* the special protection afforded by sections 70 (d)(1) and (2) but *prevent* these clauses from ever becoming operative. This situation might occur when bankruptcy supercedes another form of judicial control of the debtor's affairs. If the rationale of section 70(d) suggested above is correct, that the involuntary bankrupt should not be completely divested of his power of alienation prior to adjudication because of the danger of an ill founded petition, it would make sense to deny him this power when his affairs are for reasons other than this proceeding, already in the hands of a state or federal official. The danger of an ill founded petition is less in this case but, in any event, even if the petition is dismissed, control of his affairs will be returned to the superceded proceeding.

Although there is some support for this construction of section 70(d)(4),[21] the Court of Appeals for the Fourth Circuit in *Lake v. New York Life Ins. Co.*[22] ruled that section 70(d)(4) is operative when a federal receiver, after the filing of the petition and prior to the adjudication, takes possession of only part of the bankrupt's property. This receiver was a *bankruptcy* receiver, as already explained, who would be appointed under section 2(a)(3)[23] and would take possession of a specific piece of property under the introductory clause of section 70(d).

20. See the discussion of removal of collateral problems in 1 G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY 595-631 (1965).
21. 4A COLLIER § 70.68 (3) n.9; 103 U. PA. L. REV. 556, 557-58 (1955).
22. 218 F.2d 394 (4th Cir.), *cert. denied*, 349 U.S. 917 (1955).
23. Bankruptcy Act § 2(a)(3), 11 U.S.C. § 11(3) (1964).

This tortured construction of the statute could be noted in passing and dismissed were it not for the curious support it gives to a proposal to amend section 70(d). The argument proceeds along these lines: the protection of bona fide purchasers under section 70(d) is terminated by either (1) the adjudication or (2) the possession of the greater portion of the bankrupt's property by a receiver or trustee as specified in section 70(d)(4). As Professor Bateman has put it,

> [t]he principle reflected in the use of these two events in section 70(d) for terminating the protected interval is that either event is of sufficient public notoriety to constitute constructive notice of the bankruptcy to any third person who may become involved in a post-bankruptcy transaction. Essentially, this is a form of the principle of *lis pendens,* by which everyone dealing with property involved in pending litigation is deemed constructively on notice of the litigation and its outcome. The doctrine of *lis pendens*, however is usually applicable only to suits involving title to specifically identified real property and is restricted by a requirement that a notice of the suit be filed in the appropriate public land records.
>
> Even subject to these limitations *lis pendens* is usually regarded as a harsh principle, the use of which should be limited to those situations in which it has become customary and should be coupled with a requirement to give effective public notice of the suit beyond the mere records of the court. Section 70(d), however, is concerned only with personal property, including intangible property, which is often involved in rapidly moving commercial transactions. The section contains no provision for giving effective public notice of the litigation beyond the records of the court. Since a bankruptcy petition can be filed effectively in any district in the United States, and since commercial transactions today are frequently handled at high speed across great distances, it is obvious that the principle of *lis pendens* has been pushed beyond all reasonable bounds in section 70(d).[24]

He then proceeds to suggest amendments of the Bankruptcy Act to protect all those who deal with the bankrupt, even after adjudication, until either (1) a receiver takes possession of the specific property (as is now provided by the introductory clause of section 70(d) or (2) until actual notice of the proceeding is received.

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24. Bateman, *supra* note 1, at 308-09.

Professor Bateman is proceeding on the asumption that the theoretical justification for section 70(d) is unsound. He is arguing the weakness of a constructive notice theory and the justification for his argument is the possibility that a person may not be able to deal with a bankrupt prior to adjudication because of the interpretation of section 70(d)(4) which makes it applicable prior to the adjudication and which terminates the bankrupt's power to alienate porperty which is *not* in possession of the receiver. But section 70(d) would not be regarded as having anything to do with constructive notice were it not for the *Lake* decision.[25] If the operation of section 70(d)(4) were confined to pre-bankruptcy proceedings, then the bankrupt's power to alienate property would be determined only by the adjudication or by actual notice through possession by the receiver,[26] both of which are specified by the introductory clause to the section. It does not make sense to base an argument for amending the statute on such a questionable interpretation of section 70(d)(4). For other reasons, however, there may be some justification for amendments. To this question, the balance of this Comment is directed.

II

In *Bank of Marin v. England*[27] the Supreme Court of the United States held that despite the strictures of section 70(d) a bank which honored a check after the depositor had been adjudicated a bankrupt was not liable to the trustee in bankruptcy. Although the exact basis of the decision is not quite clear, the Court relied heavily on principles of law outside the statutory command. As Mr. Justice Douglas stated, "[there is an overriding consideration that equitable principles govern the exercise of bankruptcy jurisdiction."[28]

The whole course of this litigation has not gone without notice. Law reviews have published comments on the case as decided in both the court of appeals[29] and the Supreme Court.[30] The final result has been both

25. 218 F.2d 394 (4th Cir.), *cert. denied,* 349 U.S. 917 (1955).

26. Or by the pre-petition appiontment of a receiver or trustee which has much the same effect as the adjudication in determining that the bankrupt should not be able to manage his property.

27. 385 U.S. 99 (1966).

28. 385 U.S. at 103. The voluntary petition was filed on Sept. 26, 1963 and England was appointed receiver on Sept. 30, 1963. (He later succeeded himself as trustee.) On October 2, 1963, he mailed notice of his appointment to the Bank of Marin which was received the following day. The checks were honored on October 2, 1963 and, in the district court the bank argued that England's failure to give notice of his appointment by telephone should constitute an estoppel. Record at 63-64. The Brief for the Petitioner in the Supreme Court urged equitable grounds for relief but did not make a vigorous estoppel argument. Brief at 24-25.

29. Bank of Marin v. England, 352 F.2d 186 (9th Cir. 1965), *rev'd,* 385 U.S. 99 (1966).

praised and damned. Perhaps the most exasperation is expressed in the latest revision of *Collier on Bankruptcy*:

> [c]ited by both the Court of Appeals and the Supreme Court is *Pepper v. Litton*, which without regard to its particular facts can and is used every time a particular contention may be contrary to a provision in the Act or may not find support in any provision in the Act. In effect, it is commonly used in this fashion: 'Since the court of bankruptcy is a court of equity, *Pepper v. Litton*, it should reach this result because it is the equitable one.' Now counsel and courts will be prone to include an additional citation for the same proposition in the same circumstances: '*Bank of Marin v. England* and *Pepper v. Litton*.'[31]

There is no doubt that the Supreme Court faced a difficult decision in *Bank of Marin*. The bank in honoring the checks was merely performing its contractual duty owed to its customer, an obligation which it had assumed prior to bankruptcy. Not only had the account been opened prior to bankruptcy but the checks had been issued prior to bankruptcy. The facts would have presented no difficulty except for the well established rule that a check, by itself, is not an assignment of funds on deposit.[32] Since the Court accepted this rule, it could not hold that the transfer ante-dated the trustee's acquisition of title.[33]

The approach adopted by the Supreme Court is controversial because the rationale for its opinion is not clear. The opinion is unequivocal only in its demonstration that the Court did not like the result which it felt would follow from a literal reading of the statute. In addition, if the Supreme Court takes seriously its suggestion that "equitable considerations" are significant in a case like this, there is the possibility that there may be substantial erosion of the protection afforded the bankrupt estate by the principle of *lis pendens*. There have already been suggestions that the statute should be amended, either to correct the decision or at least to remove the uncertainty which has followed in its wake. Such suggestions are premature.

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30. 16 AM. U.L. REV. 409 (1967); 16 CATH. U.L. REV. 323 (1967); 1967 DUKE L.J. 1023; 52 IOWA L. REV. 997 (1967); 65 MICH. L. REV. 195 (1966); 31 MO. L. REV. 565 (1966); 41 N.Y.U.L. REV. 430 (1966); 45 N. CAR. L. REV. 1025 (1967); 42 NOTRE DAME LAWYER 818 (1967); 18 SYRA. L. REV. 853 (1967); 42 TUL. L. REV. 210 (1967); 15 U. KAN. L. REV. 100 (1966); 28 U. PITT L. REV. 579 (1967); 20 VAND. L. REV. 1152 (1967); 52 VA. L. REV. 528 (1966); 18 W. RES. L. REV. 1369 (1967).

31. COLLIER § 70.68.

32. 385 U.S. 99, 103 (1966) (dissenting opinion of Mr. Justice Harlan).

33. The petitioner did not argue that the transfer of funds occurred before bankruptcy.

It is far from clear that *Bank of Marin* was anything other than a poorly articulated rejection of a state property concept; if, under state law, the transaction had been consummated when the check was drawn rather than when it was presented for payment there would have been no argument about the validity of the bank's action. State rules of substantive law need not, and indeed have not, been accepted by bankruptcy courts when they frustrate a clearly expressed bankruptcy policy.[34] Normally, the rejection of state rule is negative, that is when it limits the rights of the trustee in an unacceptable manner. But the reverse can also be true.

The trustee in *Bank of Marin* was seeking to exploit the advantage accuring from the California rule that payment by check did not give the payee enforceable rights in the drawer's account. In his view, it was not significant that the transaction originated prior to bankruptcy at a time when the bankrupt could not be regarded as trying to defeat the jurisdiction of the court. Instead his argument involved a mechanical combination of federal statute and state law to reach a result not clearly justified by the history and purpose of section 70(d).

Where the Bankruptcy Act calls for a reference to state law, as it does in section 70(d), the reference must be made in a discriminating manner. Due regard for the role of state law in the resolution of controversies arising in the course of bankruptcy administration requires something other than wooden acceptance of state substantive rules which are not clearly inimical to the trustee's position. Undue deference to state law, regardless of the bankruptcy consequences, is just as undesirable as an outright denial of any role for state law in resolving these controversies. The Supreme Court has shown its awareness of the need for controlling exploitation of all the advantages which theoretically might accure to the trustee from a combination of state and federal law. In 1961,[35] it rejected a construction of section 70(c)[36] which would have permitted the trustee to create a hypothetical situation in which a state recording statute would have invalidated a chattel mortgage, even though the lien was indefeasible under state law by the time bankruptcy occurred. While the Bankruptcy Act might be read to permit such result, Mr. Justice Douglas stated: "that is too great a wrench for us to give the bankruptcy system, absent a plain indication from Congress which is lacking here."[37]

34. Local Loan Co. v. Hunt, 292 U.S. 234 (1934); cf. Chicago Board of Trade v. Johnson, 264 U.S. 1 (1924); Barutha v. Prentice, 189 F.2d 29 (7th Cir.), cert. denied, 342 U.S. 841 (1951). But cf. Hertzberg v. Associates Discount Corp., 272 F.2d 6 (6th Cir. 1959), cert. denied, 362 U.S. 950 (1960).

35. Lewis v. Manufacturer's Nat'l Bank, 364 U.S. 603 (1961).

36. Bankruptcy Act § 70(c), 11 U.S.C. § 110(c) (1964).

37. Lewis v. Manufacturers Nat'l Bank, 364 U.S. 603, 610 (1961).

The problem was essentially the same in *Bank of Marin* for the trustee was seeking to exploit the advantage to which he was arguably entitled because of the capricious interaction of state and federal law. Instead of speaking of equitable considerations it would have been perfectly proper for the court to have held that the transfer was complete for the purposes of section 70(d) although it was still inchoate for some non-bankruptcy purposes under state law.[38]

If this interpretation of the *Bank of Marin* case is correct there is nothing in the decision which suggests that immediate amendment of the Bankruptcy Act is necessary. It is of course possible that the obscure opinion of Justice Douglas suggests much more. The Court might take its equitable responsibility seriously and emasculate section 70(d) by protecting bona fide purchasers in transactions which originate after the adjudication. Or it might hold that the doctrine of *lis pendens* involves an unconstitutional deprivation of property without due process of law.[39] But it would be unwise to amend the Bankruptcy Act to take care of problems suggested by some readings of Justice Douglas' opinion until it is apparent that such problems really exist. The facts are so peculiar that a wait and see attitude is justified.

III

Proposals for amendment of section 70(d) need not be directed at correcting or ratifying the decision in *Bank of Marin*. General disaffection with the doctrine of *lis pendens* may generate proposals for reform and at least two types of amendments are possible:

(1) elimination of the *lis pendens* effect of bankruptcy in all cases where the person dealing with the bankrupt has no actual notice of the proceeding, or

(2) retention of the present statutory scheme for involuntary proceedings but adoption of a new procedure for voluntary bankruptcy.

Professor Bateman[41] has suggested that those dealing with a

38. Engstrom v. Wiley, 191 F.2d 684 (9th Cir. 1951) held that the payment of an obligation by check did not convert a cash sale into a preferential transfer under a state preference statute although the check was not cashed until some time later. It has been assumed that the same result would obtain under the federal statute. 3 COLLIER § 60.14; J. MACLACHLAN, BANKRUPTCY 292 (1956).

39. The Ninth Circuit expressly rejected this possibility. Bank of Marin v. England, 352 F.2d 188, 191-92 (9th Cir. 1965). As Mr. Justice Harlan notes in his dissent, 385 U.S. at 103 (1966), the majority avoided resting its decision on constitutional grounds. Opinion is divided as to whether there is a constitutional infirmity in the doctrine of *lis pendens*. Compare 52 IOWA L. REV. 997, 1001-02 (1967) with 1967 DUKE L.J. 1023, 1030-31 and 65 MICH. L. REV. 195, 197 n.14 (1966). *See also* Bateman, *supra* note 1, at 310.

40. A proposal limited to vlountary proceedings can be found in 1967 DUKE L.J. 1023.

41. Bateman, *supra* note 1, at 310-12.

bankrupt be protected, even after the adjudication, until such time as (1) the receiver or trustee takes possession of the property in question or (2) the third party has actual notice of the pending proceedings. This actual notice would be achieved by one of two methods. Those persons indebted to or holding property of the bankrupt would presumably be listed in the schedules and could be notified directly.[42] Potential purchasers of property of the bankrupt could not be identified but would need to be warned by publication both at the situs of the bankruptcy proceeding and in all localities where property of the bankrupt is located.

This proposal definitely favors the interests of third parties over those of the bankrupt's general creditors and, for some time, there has been a trend in property law to strengthen the hand of the bona fide purchaser. The motto "all the world loves a bona fide purchaser", while a labored aphorism reflects the temper of our times. Perhaps section 70(d) will be amended to give further recognition to this fact. Nevertheless, it is worthwhile to ask whether the bona fide purchaser's case is so strong that the interests of the estate should be sacrificed. If the protection could be accomplished with a minimum of risk and expense to the estate it might be worthwhile amending the statute. But it is far from certain that the risk and expense would be minimal.

It is not possible to estimate accurately what risks would be involved if the bankrupt retained a relatively unlimited power to sell property and satisfy obligations subsequent to adjudication. The spector of dissipation has been raised[43] but there is no way of measuring the potential damage to the estate. Thus, a justification of *lis pendens* rests upon assumptions that can not be supported by evidence. Any defense of the doctrine must fall back on the perceived recognition of its usefulness as evidenced by long retention in the legal system.

It is possible to be more specific about the expense and difficulty of arranging for actual notice. The existence of tangible property of the bankrupt in the possession of third persons or obligations owed to the bankrupt should be revealed in the schedules attached to the voluntary petition because in such a proceeding the bankrupt will generally be cooperative. The risk of alienation in derogation of the proceeding is minimal and the opportunity to give notice is present so that the risk to the estate is fairly limited. The mechanics of such notification are, however, not simple. Even in a voluntary proceeding the trustee does not take office immediately. He is designated at the first meeting of credi-

42. No mention is made of the consequences of a failure to schedule assets.

43. 1967 DUKE L.J. 1023, 1035; 70 HARV. L. REV. 548, 549 (1957); 65 MICH. L. REV. 195, 202 (1966).

tors[44] which may be held no less than ten days after the adjudication.[45] If notice is to be given by the trustee, there will be an appreciable period following adjudication in which the estate may be depleted. If this notice is to be given at an earlier time, provision must be made for the designation of a person to give it. One possibility is to secure the appointment of a receiver under section 2(a)(3)[46] for the specific purpose of notifying those holding property of the bankrupt.

The mechanics of notice are more complicated when the bankruptcy is involuntary. The bankrupt's hostility will increase the risk of transfers in derogation of the proceedings and information as to the identity of property held by third persons and obligations owed to the bankrupt will not be as readily available as in a voluntary proceeding. The bankrupt's obligation to furnish a schedule of assets is deferred under section 7(a)(8)[47] until five days after the adjudication and may be extended upon a showing of cause. The only way to secure information prior to that time would be to ask for a section 21(a)[48] examination which may be had at any time prior to the adjudication[49] and which will reveal assets, including bank accounts, that can be tied up by the giving of notice. But if actual notice is to be the method by which the bankrupt's power of alienation is to be terminated, it should be based on information which can be gathered with a minimum of expense and delay and it is likely that in the normal involuntary proceedings the filing of the schedule under section 7(a)(8) will be the first readily available source of information upon which to base an actual notice rule.

The second part of Professor Bateman's suggestion is that, as to those who may become innocent transferees for value, a system of notice by publication be adopted. Such potential transferees can not be identified from the schedules or from any source of information, but he suggests that substitution of publication at the situs of the property and the situs of the proceeding will create substantially more notoriety than the adjudication does today. But it is necessary to question whether or not the gains from increased notoriety are worth the additional burden to the estate. It is not clear for instance what types of transferees would find notice by publication valuable. Banks and insurance companies listed in the schedules would not be interested as they would already be receiving actual notice. The other types of transferees—individual, unsophisticated buyers—are not likely to check bankruptcy notices before purchasing.

44. Bankruptcy Act § 44a, 11 U.S.C. § 72(a) (1964).
45. Bankruptcy Act § 55a, 11 U.S.C. § 91(a) (1964).
46. Bankruptcy Act § 2(a)(3), 11 U.S.C. § 11(3) (1964).
47. 11 U.S.C. § 25(a)(8) (1964).
48. 11 U.S.C. § 44(a) (1964).
49. 2 COLLIER § 21.08.

Furthermore the mechanics of publication are cumbersome. Publication at the site of the proceeding would not be likely to come to the attention of prospective purchasers in other jurisdictions. Publication at the site of the property might become very complicated when the estate was distributed over wide areas and would, in any event, be of little practical value since the property could easily be moved and sold in a different locality if the bankrupt were so inclined. The gains to potential transferees really do not seem worth the risk of depleting the estate.[50]

Another possibility which Professor Bateman does not suggest is to confine the amendment of the Bankruptcy Act to providing special treatment for voluntary proceedings. The chances of dissipation through post-petition debtor activity are less than in involuntary proceedings and information is contained in the bankruptcy schedules and may be readily utilized in giving notice to third parties. If the danger to third parties is so great that amendments to section 70(d) must be considered this is the logical place to start.

For instance, some protection for third parties could be achieved without undue risk to the estate by inserting a new paragraph in section 70(d) between current paragraphs (4) and (5):

> [i]n a voluntary proceeding the provisions of paragraph (2) of this subdivision shall apply after the adjudication to assets duly scheduled until the person indebted to the bankrupt or holding property of the bankrupt receives actual notice of the proceeding.

At the same time the phrase "appointed prior to the commencement of proceedings under this act" should be inserted immediately following the reference to "State court" in current paragraph (4) to correct the tortured statutory construction adopted in *Lake v. New York Life Ins. Co.*[51] This provision would protect those third parties who could be given actual notice while placing on them the risk of omission of assets from the schedules. There is no restriction on the persons who may give notice to these third parties nor is responsibility for the giving of notice imposed on the court, as opposed to the trustee.

The amendment is not, however, offered with the strong conviction that it is necessary. The doctrine of *lis pendens* certainly is effective; whether it can be condemned as harsh or unfair is not as clear. These adjectives express a desire to strengthen the position of third parties. Should such sentiments carry the day, the proposed amendment may

50. Professor Bateman's proposal appears to be a return to the constructive notice theory which he originally criticized.

51. 218 F.2d 394 (4th Cir.), *cert. denied*, 349 U.S. 917 (1955).

reasonably reconcile the interests of such purchasers with those of the bankrupt's general creditors.

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