

STATUTORY LIENS UNDER SECTION 67c OF THE BANKRUPTCY ACT

FEDERAL tax liens and a proliferation of state statutory liens and priorities, enacted by legislatures to favor such local creditors as wage earners, landlords, contractors, and taxing agencies, at one time threatened to disrupt the order of payment contemplated by the Bankruptcy Act.¹ Prior to 1938, statutory lienors satisfied their claims before: junior lienors on the same property, creditors with priorities granted by Section 64a of the Bankruptcy Act, and general creditors.² And, unlike consensual liens, statutory liens could not be voided as preferential transfers.³ Moreover, holders of state statutory priorities received a seventh priority under Section 64a, entitling them to satisfy their claims before general creditors.⁴ The claims of favored creditors, particularly wage and tax lienors and the multiple state priority holders, often exhausted the bankrupt's estate before either Section 64a priorities or general creditors received any benefit.⁵ As a result, Congress took remedial action.

The 1938 Bankruptcy Act amendments withdrew recognition entirely from state statutory priorities⁶ and partially restricted the protection afforded statutory liens. Section 67b, when read with 67c, continues the immunity of statutory liens on realty from the trustee's power to void preferential transfers.⁷ But under 67c, all liens of distress for rent, whether or not statutory, on personal property, which have not been enforced by sale prior to

1. ANALYSIS OF H.R.-12889, 74th Cong., 2d Sess. 212 (1936); H.R. REP. NO. 1469, 75th Cong., 1st Sess. 16 (1937); 4 COLLIER, BANKRUPTCY 163 n.1 (14th ed., Moore, 1942).

2. *Miners' Sav. Bank of Pittston v. Joyce*, 97 F.2d 973 (3d Cir. 1938); *In re Kerby-Dennis Co.*, 95 Fed. 116 (7th Cir. 1899). See *In re Van Winkle*, 40 F. Supp. 711, 713 (W.D. Ky. 1943). Cf. *In re Edmunds*, 30 F. Supp. 934 (M.D. Pa. 1940) (lien of distress for rent).

3. 3 COLLIER, *op. cit. supra* note 1, at 799.

4. 44 STAT. 666 (1926). *In re Consolidated Iron & Steel Co.*, 76 F.2d 837 (6th Cir. 1935); *In re Lewis*, 99 Fed. 935 (D. Mass. 1900); *In re Wright*, 95 Fed. 807 (D. Mass. 1899).

5. See materials cited note 1 *supra*.

6. Except rent priorities, which were given 5th (last) place in the federal priority scheme, and restricted to "rent which is legally due and owing for the actual use and occupancy of the premises affected, and which accrued within three months before the date of bankruptcy." 52 STAT. 874 (1938), 11 U.S.C. § 104(a)(5) (1946).

7. Section 67(b) provides: "The provision of section 60 . . . notwithstanding, statutory liens . . . may be valid against the trustee, even though arising or perfected while the debtor is insolvent and within four months prior to the filing of the petition. . . ." 52 STAT. 876 (1938), as amended, 66 STAT. 427, 11 U.S.C.A. § 107(b) (Supp. 1952). The word "may" has been construed as mandatory. *Davis v. City of New York*, 119 F.2d 559 (2d Cir. 1941); *In re Valade Refrigerator Mfg. Co.*, 75 F. Supp. 443 (E.D. Mich. 1947); *In re Famous Furniture Co.*, 42 F. Supp. 777 (E.D.N.Y. 1942).

bankruptcy, must be postponed in payment to the first two priorities of 64a.⁸ All other state and federal statutory liens on personal property, which are not enforced by sale prior to bankruptcy⁹ and are not accompanied by possession,¹⁰ must also be postponed in the same manner.¹¹ When rent or wage liens are so subordinated, they are paid only to the extent permitted for the 64a rent and wage priorities.¹² Nevertheless, subordinated statutory lienors are likely to fare better than if they never had a lien; without a lien an

8. See *In re Henry*, 49 F. Supp. 957 (W.D. Pa. 1943); *In re Jay & Dee Store Co.*, 37 F. Supp. 989 (E.D. Pa. 1941), concurring opinion, 39 F. Supp. 588 (1941); *In re Lebed*, 39 F. Supp. 457 (E.D. Pa. 1941).

Landlords have sought to avoid postponement by avoiding the label of "lien of distress for rent." Compare *In re Kocialek*, 32 F. Supp. 228 (M.D. Pa. 1940), with *In re Lebed*, 39 F. Supp. 457 (E.D. Pa. 1941). See also *In re Allen*, 92 F. Supp. 717 (S.D. Tex. 1950); 4 COLLIER, BANKRUPTCY 164 n.40 (14th ed., Moore, 1942).

9. If encumbered property is sold before the bankruptcy petition is filed, the lien is not affected. *In re Valade Refrigerator Mfg. Co.*, 75 F. Supp. 443 (E.D. Mich. 1947); *In re Kentucky Book Mfg. Co.*, 30 F. Supp. 400 (W.D. Ky. 1939).

10. Absence of possession resulted in postponement in the following cases: *City of Dallas v. Crippen*, 171 F.2d 526 (5th Cir. 1948); *City of New York v. Hall*, 139 F.2d 935 (2d Cir. 1944); *In re Burch*, 89 F. Supp. 249 (D. Kan. 1948); *In re Empire Granite Co.*, 42 F. Supp. 450 (M.D. Ga. 1942); *In re Auto Electric & Repair Parts Co.*, 41 F. Supp. 3 (W.D. Ky. 1941); *In re Penticoff*, 36 F. Supp. 1 (D. Minn. 1941).

Possession allowed lienor to escape postponement in the following cases: *Goggin v. Division of Labor Law Enforcement of California*, 336 U.S. 118 (1948); *United States v. Sands*, 174 F.2d 384 (2d Cir. 1949). Cf. *Gordon v. Sullivan*, 188 F.2d 980 (D.C. Cir. 1950).

11. Postponed liens are usually ranked in the same order they would have had if not postponed. The order is governed by applicable state and federal statutes. *In re Burch*, 89 F. Supp. 249 (D. Kan. 1948); *In re Auto Electric & Repair Parts Co.*, 41 F. Supp. 3 (W.D. Ky. 1941). Cf. *Adams v. O'Malley* 182 F.2d 925 (8th Cir. 1950).

Postponement protects claims for bankruptcy administration expenses, and wage claims up to \$600 per claimant. ANALYSIS OF H.R. 12889, 74th Cong., 2d Sess. 212 (1936). See *City of New York v. Hall*, 139 F.2d 935, 936 (2d Cir. 1944); *In re Jay & Dee Store Co.*, 37 F. Supp. 989, 991 (E.D. Pa. 1941).

One result of postponing a lien might be to allow an unpostponed junior lien on the same property to pre-empt payment of administration expenses and small wage claims. See *New Orleans v. Harrell*, 134 F.2d 399 (5th Cir. 1943); *In re Empire Granite Co.*, 42 F. Supp. 450 (M.D. Ga. 1942).

12. Wage claims are restricted to the amount earned within three months prior to the commencement of the bankruptcy proceeding, not to exceed \$600 per claimant. Rent claims are restricted to the amount accrued within three months before the date of bankruptcy. 52 STAT. 874 (1938), 11 U.S.C. § 104(a) (1946).

Restriction aims at protection of general creditors from exhaustion of the bankrupt's estate. ANALYSIS OF H.R. 12889, 74th Cong., 2d Sess. 201 (1936); H.R. REP. NO. 1409, 75th Cong., 1st Sess. 15-16 (1937). It was not intended that a lien be restricted for the benefit of other liens, so the Chandler Act provided for restriction "except as against other liens." This provision proved inadequate to protect general creditors. *In re Eakin Lumber Co.*, 39 F. Supp. 787 (N.D. W. Va. 1941), *aff'd sub nom.* R.F.C. v. Sun Lumber Co., 126 F.2d 731 (4th Cir. 1942); *In re Michael's Cafeteria*, 49 F. Supp. 657 (W.D. La. 1943), *modified on rehearing*, 52 F. Supp. 799 (D. La. 1943). A new amendment to 67(c)

ordinary claimant will share with general creditors after all 64a priorities are paid. And even if subordinated lienors themselves are entitled to a 64a priority, they would, with the exception of wage claimants (who possess a second priority anyway),¹³ receive a higher rank in the order of payment. By virtue of their subordinated liens, landlords, otherwise usually entitled to a fifth priority,¹⁴ take precedence over the third priority (creditors' expenses of proving the debtor's misconduct in the bankruptcy proceedings)¹⁵ and the fourth priority (tax claims).¹⁶ This elevation may enhance the claimant's chances of recovery since tax claims often take a large bite of the debtor's remaining assets.¹⁷ Tax claims, normally accorded a fourth priority in the absence of a lien, rise above the third priority too. This jump itself is likely to be inconsequential because of the typically low claims of the third priority.¹⁸ But the amount allowed on the tax claims may be increased, the fourth priority specifying that "no order shall be made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate therein" is interpreted by some courts to mean that the excess of a tax claim should not even be allowed as a general claim.¹⁹ Since 67c contains no similar proscription, the excess of a subordinated tax lien might be paid as a general claim.

In 1952, Congress again critically considered state statutory liens and restricted them further.²⁰ Former 67c became 67c(1) and subdivision (2) was added, which provides that:

"[S]tatutory liens created or recognized by the laws of any State for debts owing to any person, including any State or any subdivision

now permits the trustee to "take over" the excess of restricted liens as well as the entire amount of liens voided by 67(c)(2) (see text at p. 1134 *infra*) for the benefit of the estate. This clearly makes restrictions serve the interests of the general creditors. 66 STAT. 427, 11 U.S.C.A. § 107(c) (Supp. 1952).

13. 52 STAT. 874 (1938), 11 U.S.C. § 104(a)(2) (1946); *In re Empire Granite Co.*, 42 F. Supp. 450 (M.D. Ga. 1942); *In re Auto Electric and Repair Parts Co.*, 41 F. Supp. 3 (W.D. Ky. 1941); *In re Penticoff*, 36 F. Supp. 1 (D. Minn. 1941).

14. The fifth priority includes landlords' claims for rent only if they are entitled to priority under state law. 52 STAT. 874 (1938), 11 U.S.C. § 104(a)(5) (1946).

15. 52 STAT. 874 (1938), as amended, 63 STAT. 108 (1949), 11 U.S.C.A. § 104(a)(3) (Supp. 1952).

16. 52 STAT. 874 (1938), 11 U.S.C. § 104(a)(4) (1946).

17. See 4 COLLIER, BANKRUPTCY 163 (14th ed., Moore, 1942).

18. *Ibid.*

19. See cases and discussion in MOORE & COUNTRYMAN, DEBTORS' AND CREDITORS' RIGHTS 1073 n.4 (1951).

20. 66 STAT. 427, 11 U.S.C.A. § 107(c) (Supp. 1952). This time Congress was apparently aiming at state liens which attach to a debtor's property generally, termed "floating liens." Such liens, it was felt, are indistinguishable from priorities; the favored creditor asserts the full amount of his claim against all the property in the estate at the time of bankruptcy and is paid before general creditors. H.R. REP. NO. 2320, 82d Cong., 2d Sess. 13 (1952).

thereof, on personal property not accompanied by possession of, or by levy upon or by sequestration or distraint of, such property, shall not be valid against the trustee. . . ."²¹

Liens on personalty not enforced by sale prior to bankruptcy remain within the sweep of 67c. Nor does the 1952 amendment alter the status of non-statutory liens of distress for rent and federal statutory liens: the former will be subordinated if not already enforced by sale, the latter if not enforced by sale prior to bankruptcy *and* not accompanied by possession. But 67c(1), in view of the new subdivision (2), will subordinate state statutory liens not enforced by sale prior to bankruptcy and not accompanied by possession *only* if they are accompanied by levy, sequestration, or distraint.²² Subdivision (2) invalidates state statutory liens not enforced by sale prior to bankruptcy and not accompanied by possession *or* by levy, sequestration, or distraint. Thus the significance of the 1952 amendment should be readily apparent to the state statutory lienor: he retains some benefits from his lien if he falls under (1), but is relegated to the status of a general creditor if he comes within (2).

Even with the restrictive effect of the 1952 amendment, Section 67c remains an imperfect implementation of Congress' desire to preserve the Bankruptcy Act's order of payment. Section 67c still applies only to statutory liens on personalty; yet statutory liens on realty may constitute a greater threat to the Act's payment scheme since they probably consume a larger share of the bankrupt's estate.²³ Moreover, holders of statutory liens on personalty may continue to disrupt the hierarchy of payment. Statutory lienors can escape 67c completely by foreclosing their liens prior to bankruptcy, or, with the exception of landlords with a lien of distress for rent, by obtaining possession of the encumbered property; and while the federal government as tax lienor qualifies for 67c(1) without taking any steps to protect its lien, state statutory lienors can come under 67c(1) by acquiring a levy, sequestration, or distraint.

21. 66 STAT. 427, 11 U.S.C. § 107(c)(2) (Supp. 1952).

22. *State statutory liens of distress for rent*: From an independent reading of the two subdivisions, 67(c)(1) would apply to *all* state statutory liens of distress for rent. Yet 67(c)(2) covers some of the same ground, since it applies to state statutory liens of distress for rent not accompanied by possession, levy, sequestration, or distraint. A harmonious interpretation of the subdivisions requires 67(c)(1) to be read as applicable, not to all state statutory liens of distress for rent, but only to those accompanied by either possession, levy, sequestration, or distraint: all others fall under 67(c)(2).

State statutory non-rent liens: While both subdivisions apply to non-rent state statutory liens only when the lienor has no possession, 67(c)(2) does not come into play unless the lienor also lacks levy, sequestration, or distraint. On a literal reading of the statute, 67(c)(1) would seem to apply to liens that fall under 67(c)(2), since such liens would not be accompanied by possession. To avoid this, the subdivision must be read so that liens not accompanied by possession fall under 67(c)(1) only when levy, sequestration, or distraint is present: in their absence, such liens are within the exclusive jurisdiction of 67(c)(2).

23. See 4 COLLIER, BANKRUPTCY 166 (14th ed., Moore, 1942).

But 67c(2) may have been enacted to encourage statutory lienors to give public notice of the existence of their liens, in order to prevent extension of credit on encumbered property by unsuspecting creditors.²⁴ This goal, however, is incompatible with the section's primary objective. To the extent creditors receive public notice through possession, levy, sequestration, or distraint, the Act's hierarchy of payment will be upset: maximum attainment of the notoriety aim will cause maximum interference with the Act's payment scheme. Aside from this incompatibility of aims, the section's ability to promote notoriety of liens is probably limited. Since the section is restricted to liens on personalty, 67c(2) does not encourage public notice of realty liens. In fact, 67b may allow perfection of realty liens after bankruptcy if the state statutory period for perfection has not elapsed.²⁵ Moreover, even as to statutory liens on personalty, 67c ignores public notice by recordation. Some states allow or require perfection in this way.²⁵ And recordation, especially in states where it is the required method of perfection, might provide more effective notice than possession, levy, sequestration, or distraint.

The increasing antipathy toward statutory liens on personalty, evidenced by the 1938 and 1952 amendments to the Act, may signal a trend toward complete withdrawal of protection for such liens in bankruptcy proceedings. Such a goal seems eminently desirable. The Act now offers 64a priorities to groups that are generally thought to merit special consideration: wage earners, landlords, state and federal taxing authorities. Congress could enact additional priorities if other creditors were thought deserving of special treat-

24. It is not clear that the Chandler Act provision was intended to promote notice. The National Bankruptcy Conference Report, ANALYSIS OF H.R. 12889, 74th Cong., 2d Sess. 212 (1936), does not indicate this purpose, nor does the Committee Report on the Chandler Act, H.R. REP. NO. 1409, 75th Cong., 1st Sess. (1937). But several courts have suggested "notice" as an aim of the section. See *Goggin v. Division of Labor Law Enforcement of California*, 336 U.S. 118, 127-9 (1949); *City of New York v. Hall*, 139 F.2d 935, 936 (2d Cir. 1944). The 1952 House of Representatives Committee Report hints that notice was intended; and to explain why liens on realty were not made subject to 67(c), it states: "A lien upon real estate is commonly dealt with adequately by recording acts. . . ." H.R. REP. NO. 2320, 82d Cong., 2d Sess. 13 (1952). Since the primary function of recording is notice, this implies that notice was a goal of 67(c).

It is possible that notice was not an objective of the Chandler Act, and that the notion was voiced in the cases by judges who, in other situations, were accustomed to viewing possession as a means of giving notice.

25. *E.g.*, *In re Taylorcraft Aviation Corp.*, 168 F.2d 803 (6th Cir. 1948).

26. Most wage liens require recording within a specified time to prevent expiration of the lien. See *R.F.C. v. Sun Lumber Co.*, 126 F.2d 731, 739 (4th Cir. 1942); *In re Pennsylvania Central Brewing Co.*, 114 F.2d 1010, 1012-3 (3d Cir. 1940), *cert. denied sub nom. Stern v. Pennsylvania Brewing Co.*, 312 U.S. 685 (1941); *In re Empire Granite Co.*, 42 F. Supp. 450, 454 (M.D. Ga. 1942). "Perfection" or "fixing" of liens often means recording. See ILL. ANN. STAT. c. 82, §§ 41-2, 52 (Smith-Hurd, 1935); *id.* §§ 78, 97 (Supp. 1952); 5 OHIO GEN. CODE ANN. §§ 8324, 8332, 8340, 8378 (Page, 1933); 16 TEX. CIV. STAT. ANN. tit. 90, arts. 5453, 5476, 5486 (Vernon, 1925).

ment. However, even limited recognition of statutory liens abdicates to the states the responsibility for defining the range of needy creditor groups. As a result, uniformity among the states is lost, and some creditors may benefit to the detriment of others who, in Congress' mind, are equally deserving. And these considerations apply to statutory liens on realty as well as personalty. Judicious use of the power to enact 64a priorities may be a simple and effective substitute for the patchwork that is now 67b and 67c.

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