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PAYMENT BY CHECK OF INSOLVENT PRIOR TO BANKRUPTCY

By L. L. RIESELBACH*

In the transaction of the daily business of the commercial world, the presentation of a check is the most frequent and convenient method of payment regardless of regularly constituted tender. Banks, for the accommodation of business, very frequently cash personal checks for customers and acquaintances. The law merchant and the codification of the common law establish and assist the easy negotiability of checks while attempting at the same time to safeguard the assignee or payee and the depository on which the instrument is drawn.

Where the check clears through the drawee bank and is honored, we have the customary course of affairs. There arises, however, with startling frequency the situation of the check being returned to the party receiving the same because of insufficient funds to the credit of the drawer. Where the drawer subsequently becomes bankrupt, either before or after the check has been made good but within four months of the original transaction, an interesting question arises, involving rules of law which cause the courts some difficulty because of seeming hardship inflicted by the result.

Does the holder of the n.s.f. check have a prior claim on funds in bankruptcy? Can the trustee in bankruptcy maintain an action because of a preference where the bank cashing a check has demanded and received from the drawer payment thereof after the return of the instrument for insufficient funds?

A typical instance is the recent case of Schwemer, Trustee, etc., vs. First Wisconsin National Bank. The bankrupt, pursuant to a kiting scheme had continually presented his checks drawn upon his depository to the defendant and received the amount specified in the instrument. The customary climax to so cavalier a method of obtaining a loan was reached when five checks cashed with the defendant on two successive days were returned to the defendant by the drawee bank because of insufficient funds on deposit to the credit of the drawer. The defendant bank demanded and, at the expense of the drawer's stock in trade, received repayment of the moneys advanced. Bankruptcy ensued within two weeks.

The trustee in bankruptcy commenced his action to set aside the

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It was held that all the elements of voidable preference existed and the defendant was ordered to turn over to the trustee the amount received by it upon the n.s.f. checks. The opinion apparently disregards the kiting in reaching its decision.

The far reaching effect of such a holding upon mercantile and banking transactions is apparent. It is the purpose of this note to consider the interpretation of the Bankruptcy Act and the Negotiable Instrument Law sections governing the situation.

**Elements of Preference**

In order to establish a voidable preference, the burden is upon the trustee\(^2\) to prove that there has been (1) a transfer by the bankrupt (2) while insolvent (3) to a creditor (4) upon an antecedent indebtedness thus diminishing the assets (5) within four months prior to bankruptcy (6) whereby the transferee had reasonable cause to believe that by such transfer a preference would be effected and (7) whereby the transferee receives a greater proportion upon the indebtedness than other creditors of the same class would receive\(^3\). These constituents concurring form the necessary components of the action.\(^4\)

The voidable preference is entirely a creation of statute. At common law, a debtor might deal with his property as he pleased. His was the title and his the right. His friends and relatives might be paid while others were ignored. The only curtailment of the right of alienation was the acquisition by a vigilant creditor of a lien by legal procedure. Since the owner might freely dispose of his chattels, conversely, the property might be seized on levy without restriction by other creditors. The common law was adequate where credit was the rarity and not the rule, where the creditor was his debtor's neighbor and each had the opportunity to observe the lessening volume of trade, the awkwardness of the handicraft or the other preliminary *indicia* of insolvency.

In a more complex civilization, the system handicapped the giving of credit and the statutory regulation was the necessary outgrowth of commercial demand. The trustee as a functionary of the court was delegated to supervise and compel an equal distribution in this branch of bankruptcy jurisdiction, to assure all that neither friendly nor oppressive creditors obtain a preference.

An analysis of many decisions relating to voidable preferences dis-

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\(^2\) *Pyle vs. Texas Transp. & Term. Co.* 238 U. S. 90, 59 L. ed. 1215, 35 S. Ct. 667

\(^3\) *Walker vs. Wilkinson*, 296 Fed. 850

\(^4\) Bankruptcy Act. Sec. 60b
closes that the courts regard the avoiding of the transfer as the doing of equity to all persons of the same class of creditors.\(^5\) They regard the time element and the solvency of the creditors as the two dimensions to be scrutinized most closely. While, for the most part, the word trust is assiduously avoided,\(^6\) the rationale of many cases is that when assets are diminished to the point of equalling or being less than liabilities, they constitute an equitable trust for all general creditors until the condition is either alleviated or brought to liquidation.\(^7\) Since it is the Bankruptcy Act that creates the right under discussion, it probably would be more accurate to say that the trust crystallizes at the time of bankruptcy and is retroactive for a period of four months. For the most part, the courts accept the remedy as being purely statutory and avoid the metaphysical discussion of causal theory. The conclusion is drawn from a strict compliance with the letter of the statute.

The type of preference herein described, i.e. that voidable at the instance of the trustee should not be confused with that which is an act of bankruptcy and requires the intent of the insolvent\(^8\) or with a mere preference, an innocent\(^9\) transfer on the part of the recipient and transferor or which enables the creditor to obtain a greater percentage than others of the same class\(^10\) but valid by reason of the non-existence of all or any one of the elements above described. Thus a preference may, by the intent of the transferor, be an act of bankruptcy and still be unimpeachable as a voidable transfer. The purpose of the two sections of the Bankruptcy Act applicable as to the effect of the preference is widely divergent, the one to justify an involuntary petition for bankruptcy administration; the other to nullify an unjust distribution of the insolvent's assets.

So, too, should the payment by a third party endorser to the check or sureties to a note\(^11\) be disassociated from the topic under discussion as not being a transfer of the bankrupt. Where payments are by third parties the bankrupt estate is not depleted and no voidable preference ensues\(^12\) however much the transferee may benefit or surpass the remaining creditors in proportionate recovery upon the respective obligations.

In a voidable preference actual fraudulent intent is immaterial. A transfer may be both fraudulent in fact and preferential but the so-

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\(^5\) Edison Electric Illuminary Co. vs. Tibbetts, 241 Fed. 468  
\(^6\) In re Keller, 109. 118  
\(^7\) Levenbaum vs. Hanover Trust Co., 253 Mass. 19, 148 N. E. 227  
\(^8\) Bankruptcy Act, Sec. 3a (3); Taylor vs. Carraway, 282 Fed. 876  
\(^9\) Bankruptcy Act, Sec. 60a  
\(^10\) In re Bailey, 110 Fed. 928  
\(^12\) In re Kerlin, 209 Fed. 42
called elements of preference need not be proved to permit the trustee to avoid the fraudulent conveyance and recover the property so transferred. Occasionally, the court apparently fails to distinguish between the two but the same result is achieved on other bases.

Obviously the items considered above as numbers (2), (5), and (7) are reduced to mathematical computation and for our particular problem offer little difficulty. The payment of money is considered a transfer and is included in our designation at number (1) although the use of the word transfer has been deprecated as possibly implying chattels or realty. The Bankruptcy Act refers to "property" as the subject of a transfer.

To a Creditor

Whatever confusion may have existed as to the nature of a check under the common law or law merchant is remedied to a large extent by the enactment of the Negotiable Instruments Law. In the uniform act adopted in Wisconsin a check is considered as a bill of exchange payable on demand and drawn on a banking institution. The negotiation of a check does not operate as an assignment of a fund on deposit to the credit of the drawee bank, in the absence of express stipulation.

"Under the law, a check is an instrument by which a depositor seeks to withdraw funds from a bank and as between the drawer and the payee, it is an evidence of indebtedness . . . an action may be brought thereon as upon a promissory note." Lipton vs. Columbia Trust Co., 194 App. Div. 384, 185 N.Y.S. 198.

To the effect that a check is merely a negotiable instrument the rulings of the courts in the various jurisdictions wherein the Negotiable Instrument Act represents the codification of the law merchant as well as in states under the common law have been uniform.

A minority holding limits the application of the specific negation of assignment of the specified amount as between the drawer and the bank

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13 Coder vs. Arts, 213 U. S. 223, 53 L. ed. 772, 29 S. Ct. 436
14 In re Hawkins, 243 Fed 792
15 Carson Pirie vs. Chic. Title & Trust Co., 182 U. S. 438, 45 L. ed. 1171, 21 S. Ct. 906
16 Bankruptcy Act, Sec. 1 A (25)
17 Wisc. St. 1929 Ch. 118.61
18 Wisc. St. 1929 Ch. 118.65
Kulaberg Mfg. Co. vs. Smith, 173 Minn. 504, 218 N.W. 99
National Product Bank vs. Doods, 205 Ill. App. 444
for the latter's protection from a double liability. As between drawer
and payee an equitable assignment is held to subsist.21 Although an
earlier case22 placed a similar strained construction upon the section
no other decisions have attempted to breach the line of holdings indi-
cated.

The Wisconsin court cites as the prevailing Federal rule that "until
accepted or paid a check is revocable as is pointed out by Hand, Jus-
tice, in re Gubelman, 13 Fed. (2d) 732, 734 and does not operate as
an equitable assignment."23

Apart from the statutory regulation, the bank or person trans-
ferring funds or credit upon receipt of a check is the purchaser of the
paper24 upon the representations contained therein. He becomes the
owner and holder of the title to the instrument whether honored or
protested for non-payment.25 If payment is stopped, the instrument is
defective, or the depository has insufficient funds to the credit of the
drawer, the check operates merely as a written evidence of indebted-
ness on which an action may be brought. If such action were no avail-
able, the remedy of the payee at common law would have been indebitatus
assumpsit on money had and received. The bank can not,
except for the existence of a Banking Code as enacted in Wisconsin
or an express contract with its customer or the drawer, maintain the
theory that it is acting only as agent for collection subject to the clear-
ance at the depository. This obviously is true where cash has been
paid, and is held equally the law where the account is credi-
tor.26 To remedy this, where checks are received for deposit, it is the
custom of the banks to enter into express agreements adding to the
provisions of the Banking Code.

In bankruptcy the obligation being for a definite amount and not
contingent upon future circumstances, is considered a provable claim
either under the theory of tort or contractual relationship and is allow-
able as such.28 The absence of the intent to become a creditor can not

21 Elgin vs. Gross-Kelly, 20 N.M. 450, 150 Pac. LRA 1916A 711
22 Hove vs. Stanhope Bank, 138 Ia. 39, 115 N.W. 476
23 Union State Bank vs. Peoples State Bank, 198 Wisc. 28, 211 N.W. 931
24 Aebi vs. Bank of Evansville, 124 Wisc. 73, 68 L.R.A. 964, 199 Am. St. Rep. 925
26 Id.
28 Equitable Trust Co. vs. Rochling, etc., 275 U.S. 248, 48 S. Ct. 28, L. ed. 264
29 Clingman vs. Miller, 160 Fed. 326
avoid the practical effect of the transaction. Whether the indebtedness can be discharged in bankruptcy or not has no bearing on the relationship of the parties and can not alter the status.

Active fraud, conversion, or theft permit the following of goods into the hands of the bankrupt or his trustee upon the rationale which permits the establishment of a trust ex maleficio and the tracing thereof although the acceptance of security may be considered a waiver of trust funds. Conversely, the retaking of the identical money given or wares sold does not constitute a voidable preference.

Whether the mere presentation of a check is a warranty and the basis of rescission for fraud is not free from difficulty. It is held that the drawer undertakes by the giving of the instrument that the drawee will be found at the place described, that he has in his possession belonging to the drawer the amount specified and that he is bound to pay. With any added representation there can be little doubt but what the right to rescind exists and a trust by operation of law arises. Where the check is given for cash and returned n.s.f. the likelihood of maintaining the fund intact and thus establishing a trust, aside from the difficulty of proof, as a practical matter is very small.

Where funds are commingled with other moneys, the series of cases arising out of the amazing financial operations of Ponzi holds that claims evolving out of that genius's fraud were not prior claims in bankruptcy and that repayment after rescission and within four months of the bankruptcy were transfers constituting voidable preferences. Holding the contrary view is Fry vs. Penn Trust Co., which maintains the position that restitution after a defalcation could not be preferential. This attitude is rare. The following quotation from the prevailing line of cases is significant of the majority's attitude, having in full contemplation the tort theory.

Miller & Company (defendant) having elected to receive payment for these damages instead of endeavoring to recover the eggs themselves can not be heard to say that they were not creditors of Pendleton (bankrupt) on May 4, 1904, and were the owners of the claim against Pendleton, provable in bankruptcy, which had existed since the date of the conversion of the eggs by Pendleton. If we take the position that Miller & Company had the right to waive the tort and treat the sale as valid, we are in no better position, for that would ratify the

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29 National City Bank vs. Hotchkiss, 231 U. S. 50, 58 L. ed. 115, 34 S. Ct. 20
30 4 Remington on Bankruptcy, 1929 Supp. 192
31 Field, trustee etc. vs. Harrison, 18 Fed. (2d) 729
32 Raphael vs. People's Bank, 45 Cal. App. 115, 187 Pac. 53
33 Cunningham vs. Brown, 265 U. S., 68 L. ed. 873, 44 S. Ct. 424
34 195 Pa. 343, 46 Atl. 10
delivery of the eggs without payment and constitute Miller & Co. creditors beyond question."

Since the intent to become a creditor is immaterial it follows that one from whom money is stolen is in no better position than he who has relied upon a check and vice versa; and, where funds can not be traced and identified, no trust by implication of law arises.

"The fallacy of defendant's contention that, because its money was in effect stolen the repayment of a like amount could not effect a preference, requires no exposition. No effort was made to trace the bank's money into the jewelry sold to raise the sum repaid to the bank. See Cunningham vs. Brown, 265 U.S. 1, 44 S. Ct. 424, 68 L. ed 873."

The relationship is held to be that of debtor and creditor. Where, however, money was obtained upon spurious bills of lading and the merchandise later shipped, the transaction was upheld but had not, however, been attacked as a preference. The general rule is that the acceptance of other property than the converted goods waives the tort and any right that might have accrued under the theory of a trust ex maleficio.

**UPON ANTECEDENT INDEBTEDNESS**

It is apparent that upon the relation of debtor and creditor arising as a matter of law the time of payment becomes material. If the exchange of consideration for consideration is simultaneous or payment for consideration instantaneous the transaction is terminated and, if the consideration is adequate, no claim of voidable preference can be maintained by the trustee. A lapse of time however small has the effect of making the transfer of security preferential.

The test generally applied is whether or not the assets of the bankrupt which would otherwise be available for distribution to the general creditors have been diminished by the transaction. While the giving of security of any nature upon a pre-existing indebtedness within the statutory period considered without reference to the adequacy of the past consideration is without doubt included in the prohibition, the

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35 Clingman vs. Miller, 160 Fee. 326, 20 A. B.R. 360
36 Walser, Trustee etc. vs. International Union Bank, 21 Fed. (2d) 294
37 Lovell vs. Newman & Son, 192 Fed. 753
38 Burgoine vs. McKillip, 182 Fed. 452
39 Stedman vs. Bank of Monroe, 117 Fed. 237
40 Harding vs. Fed. Nat. Bank, 31 Fed. (2d) 914
41 Sawyer vs. Turpin, 91 U. S. 114, 23 L. ed. 235
42 National City Bank vs. Hoitchiss, 231 U. S. 50, 34 S. Ct. 20, 58 L. ed. 115
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exchange of securities, values being equal\textsuperscript{44} does not constitute a voidable transfer\textsuperscript{45} even though made after the service of an involuntary petition in bankruptcy.\textsuperscript{46} Knowledge that the proceeds of a sale for an adequate present consideration are to be applied toward a transfer clearly preferential and so intended has been held to avoid the general rule of diminution of the estate as the criterion\textsuperscript{47} upon the theory that there exists in the transaction an active intent to work a fraud in fact not alone upon creditors but upon the Bankruptcy Act itself and to establish by ciriosity what could not have been accomplished directly.\textsuperscript{48} But such cases turn upon fraud in fact rather than voidable preference.

In loose business terminology the transfer of wares for a check is considered a cash transaction. The drawer of the instrument acquires for his general estate certain chattels or realty and apparently relinquishes and transfers all claim to a specified fund of equal value. This is palpably the contemplation of the parties when cash is transferred upon receipt of a check. Under the Negotiable Instrument Law, however, it is obvious that whether the apparent intent miscarries or not the status of debtor and creditor subsists as between parties until the obligation evidenced by the check is met. As a matter of law, the term, a cash transaction, is an unfortunate misnomer.

Consider as a single transaction there appears to be no diminution of the assets of the drawer of the checks. His instrument is given for value received. He adds to his general assets the money or merchandise and orders an equal value to be transferred to the payee of the instrument. Under the scrutiny of courts applying the Negotiable Instruments Act, the giving and receiving are, however, isolated as separate transactions both where the instrument is known or believed to have been valueless at the time of acceptance,\textsuperscript{49} or taken in perfect good faith at the time of the sale of merchandise\textsuperscript{50} and the acceptance of any security in lieu of the n.s.f. check held to establish a waiver of a right to rescind and thus constitute a voidable preference.\textsuperscript{51}

If the sale is thus dissected as to the time element, the drawer's estate is first enriched in toto by the accretion of the merchandise or cash, although there arises simultaneously the obligation as a general creditor, and subsequently depleted to an equal amount by the presen-

\textsuperscript{44}In re Manning, 123 Fed. 180
\textsuperscript{45}In re Perpall-Hammerslough, 256 Fed. 758
\textsuperscript{46}Matter of Perpall, 271 Fed. 466
\textsuperscript{47}Dean vs. Davis, 242 U. S. 438, 61 L. ed. 419. 37S. Ct. 130
\textsuperscript{48}Bank of Newport vs. Herkimer Co. Bk., 225 U.S. 178, 56 L. ed. 1042, 32 S. Ct. 633
\textsuperscript{49}Goetz vs. Zef, 181 Wisc. 628, 195 N. W. 874
\textsuperscript{50}Security etc., Bank vs. Staats et al., 230 Fed. 514
\textsuperscript{51}Id. and Field Trustee vs. Harrison et al., 18 Fed. (2d) 729
tation and honoring of the bill of exchange so conveniently called a check. When the check is honored, obviously the drawer's indebtedness is diminished to an equal extent. The preference therein, it will be observed, is not the giving of the instrument but the payment of it out of the bankrupt's estate. Had bankruptcy intervened prior to the cashing of the check, the financial status remaining as of that time, a larger percentage would inure to each creditor upon distribution.

Justice Holmes indicates the line of cleavage both as to the time element so as to make the transfers upon an antecedent obligation, and as to the diminution of the estate in National City Bank vs. Hotchkiss, considered a leading case on the subject.

"The consent to become a general creditor for an hour, that was imported, even if not intended to have that effect, by the liberty allowed to the firm, broke the continuity and established the loan as part of the assets. No doubt many general creditors have increased a bankrupt's estate by their advances, but they have lost the right to take them back." National City Bank vs. Hotchkiss, supra.

Upon strict logic, where the added element of "reasonable cause to believe" the drawer insolvent existed, payment of any check tendered to the vendor would be tantamount to a preference voidable by the potential trustee in bankruptcy although knowledge of insolvency can not possibly vitiate a sale for cash. Consequently the courts have earnestly sought facts in each case to minimize the drastic effect of the rule. Where the rule delineated has been partly abrogated because of the recognition by the court of the inherent danger to the easy negotiability of checks and seeking to avoid the palpably startling result the precedent has been characterized as "dangerous doctrine" because of the inroads upon the strict applicability of the Bankruptcy Act.

The intent that title should not pass until payment was made swayed the court in Re Perpell where stock certificates were delivered earlier in the business day than the check for the payment therefor was received . . . "that a few hours transpired and they could not be said to be literally contemporaneously made, was because of the business and the practices in the custom of this business." In Goetz vs. Zeif, however, the court, under circumstances apparently similar, scrutinized the transaction in the light of the cases cited, followed the

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52 In re Harrison Bros. 197 Fed. 320
53 231 U. S. 50, 34 S. Ct. 20, 58 L. ed. 115
54 Illinois Parlor Grame Co. vs. Goldman, 257 Fed. 300
55 4 Remington on Bankruptcy, 459 n
56 271 Fed. 466
57 181 Wisc. 628, 195 N.W. 874
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prevailing rule, and reached conclusion opposite from the stockbroker case.

Payment by check is specifically held not to be inconsistent with a cash transaction in *Hough vs. Atchison etc. Ry. Co.*, but the facts show a reliance upon the release of lien for freight charges fraudulently obtained. The case is clearly not in line with cases above cited holding fraud immaterial, although distinguishable on facts. The right of stoppage in *transitum* granted a vendor by the Sales Act is not affected by the bankruptcy so long as there has been no delivery to the bankrupt or his agent.

REASONABLE CAUSE TO BELIEVE

The necessity of proof by the trustee that the creditor had, at the time of the transfer, reasonable cause to believe a preference would be effected by it limits the jeopardy of check transactions.

Reason to believe is derived from such facts or circumstances as would cause the customary prudent man to investigate and the creditor is presumed to possess knowledge of all facts which such an investigation would disclose. Like all questions of reasonable cause, it resolves into a question of fact based on the relationship subsisting at and prior to the time of the transaction between the parties.

Discovery of fraud makes investigation imperative and repayment thereafter is a voidable preference. Where discoverable insolvency exists at the time of such payment.

"That the debtor did commit the crime of forgery to enable him to secure loans of money would indicate to the ordinary intelligent mind that his financial condition was desperate." *Watchmaker vs. Barnes.*

Circumstances warranting the inference of knowledge are varied. An assignment of accounts to secure an existing indebtedness is in itself sufficient to put the bank on inquiry and, therefore, there was reasonable cause to believe that such assignment would effect a preference. The taking up of accommodation paper before due and the substitution of accounts is held sufficient to charge creditor with

58 34 Fed. (2d) 238
59 In re *Darlington*, 163 Fed. 389
60 Bankruptcy Act Sec. 60b
61 *Coder vs. McPherson*, 152 Fed. 951
63 *Walser, Trustee, etc., vs. International Union Bank*, 21 Fed. (2d) 294
64 *Goetz vs Zeif*, 181 Wis. 628, 195 N.W. 874
65 259 Fed. 783
66 *Eyges vs. Boylston National Bank*, 294 Fed. 286
knowledge. Frequent visits of the debtor affording the creditor an opportunity to inquire into and determine the debtor’s condition are held to be circumstances from which the inference of knowledge is drawn from the availability of facts to determine the financial standing of the bankrupt.

Failure to pay some notes while taking up others in itself has been held to impute knowledge of insolvency to the creditor. Payment in merchandise or out of the usual course of business is sufficient basis to cause inquiry. Knowledge of banking transactions of the debtor such as over-drafts forced payments thereon, or the permitting of checks to go to protest has been held to be ample to establish reasonable cause to believe a preference would be established.

The question of fact in its ultimate analysis is not whether the defendant knew the bankrupt to have been insolvent or even believed him so. If the creditor had in his possession information which would incite the ordinary man to inquiry and which upon investigation would have shown the true facts of the creditors financial condition, he is chargeable with knowledge.

On the other hand, inability to meet debts is not of itself sufficient reason to believe. Nor is the expressed belief the man is “crooked” for a person may be dishonest and still amply solvent. The creditor’s being in arrears in payment is not sufficient foundation for the belief where security is taken for the arrearage, for the bankruptcy definition of insolvent varies from that of the state courts and is that the assets at a fair valuation do not equal the liabilities. Thus difficulties due to a market depression or deflation of value as is the current situation is not sufficient without other proof. These facts may constitute reason for inquiry but there is no presumption of insolvency based upon them.

67 Matter of Star Spring Bed Co., 265 Fed. 133
68 Benjamin vs. Buell, 268 Fed. 792
69 Cohen vs. Tremont Trust Co., 256 Fed. 399
70 In re Andrews, 135 Fed. 599
71 Field vs. Harrison, 18 Fed. (2d) 759; In re Brayton
72 Walser, Trustee vs. International Union Bank, 21 Fed (2d) 294;
73 Roys vs. First Nat. Bk. of Monroe, 183 Wisc. 10, 197 N.W. 237
74 Buchanan St. Bank vs. De Groot, 39 Fed. (2d) 397
75 In re Eggert, 102 Fed., 735
76 Walsh vs. Lowell Trust Co., 245 Mass. 455x, 139 N.E. 789
77 O’Grady vs. Chautauqua Builders Supply Co., 33 Fed. (2) 956
79 Manly vs. Southern Supply Co., 14 Fed. (2d) 273
80 In re Pettengill & Co., 135 Fed. 218, Bankruptcy Act Sec. 1a (15)
81 Closson vs. Newberry’s Hdw. Co., 283 Fed. 33
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It should be noted the facts must be such as would give a reasonable man the inference that a preference would and not merely might result from the transfer. The difficulties of proof in drawing the distinction gives the court or jury considerable latitude in the finding of fact.

If the creditor had not come to the realization that his debtor was in a precarious financial condition at any prior time, the fact that he did not actually investigate will afford no excuse where the creditor's information was sufficient to put the ordinary man upon inquiry. A person cannot by intentionally closing his eyes to the situation or being stupid obtain an advantage over the intelligent vigilant creditors.

The knowledge of an agent is by the Bankruptcy Act considered the knowledge of the principal and the same degree of care is necessary.

It should be noted that the time at which the indicia giving rise to the suspicions of insolvency must exist is not at the giving of the check, but the payment thereof. As a matter of reason the return of a check because of insufficient funds in the depository should be due warning that the financial situation of the drawer is precarious and from that moment the payee is charged with knowledge of all the facts he might have ascertained by a actual investigation Payment thereafter constitutes a preference voidable in bankruptcy by the trustee.

The vendor is somewhat protected by such right to rescission as he may have upon the dishonor of the check. If the payee retains his right of rescission, asserts it properly, and subsequently resells for cash to the insolvent, he apparently is transgressing no rule of preference. If this course is followed, all steps should be taken without ambiguity so no waiver of the rescission, or estoppel in pais can be invoked to defeat his purpose. Inability by reason of the dissipation to seize the opportunity afforded by the fraud to rescind, of the res or the waiver of the right to rescind by the acceptance of security make payment a transfer upon preexisting indebtedness and voidable by the trustee.

The vendor of merchandise thus has a very apparent advantage over the bank that accommodatingly cashes a check. By the creation of a trust ex maleficio he is, under ordinary circumstances, assured of

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82 Sumner vs. Park, 270 Fed. 675
83 Matter of Campion et al, 256 Fed. 902, 43 A.B.R. 625; McDonald & Sons, 178 Fed. 487
Rogers vs. Page, 140 Fed 596, 72C.C.A. 164
84 Collet vs. Bronx National Bank, 205 Fed. 370
85 Walser, Trustee vs. International Bank, 21 Fed (2d) 294
86 Schwemer etc. vs. First Wisconsin National Bank, U.S. Dist Ct. Eastern Dist. of Wisconsin (1930)
87 Security Bank vs. Staats Co., 233 Fed. 514
at least a pro tanto recoupment by rescission as to the merchandise remaining in the vendee's possession.

The original English Bankruptcy Act. 34 Henry VIII, considered bankruptcies as criminal and permitted the seizure of the bankrupt's assets to be distributed by the proper official. The state of 13 Elizabeth, too, provided for the "repression" of bankrupts. But only the fraudulent conveyances of the bankrupts were attacked. Prior to the possession of the Lord Chancellor under the statutes each creditor was at liberty of fend for himself. Alertness and lack of forbearance carried the same reward. The modern bankruptcy acts encompass a far wider field.

The ancient maxim that the law favors the diligent in the discussion of the courts has yielded to the modern theory that equality is equity. The mere scent of financial disaster might bring the avid creditors to the debtor's door and, in the rush, those who are tolerant in the effort to re-establish a tottering business would be the ones to suffer. This is necessarily vicious and repugnant to the modern theory.

"It is a case the circumstances of which call strongly for the principle that equality is equity and this is the spirit of the bankruptcy law. Those who were successful in the race of diligence violated not only its spirit but its letter, and secured an unlawful preference."88

The circumstances under which the tradesman or bank in accepting a check believes himself to be a party to a cash transaction do not protect him from this reasoning unless he rescinds not only pro forma but in fact. Where rescission is impossible, however outraged he may be by the fraud, he receives no advantage over other general creditors.

CONCLUSION

Despite the hardship apparently occasioned by several individual instances, it is apparent that the rationale of the decisions is one which under the ordinary run of circumstances cannot be avoided by the courts. They are forced to hold by an almost inexorable line of precedents that the person who gives cash or credit for a check becomes the purchaser thereof and the status of debtor and creditor arises at that moment. The relations of the parties being established, the courts are forced to apply, where bankruptcy has ensued, the operations of the Bankruptcy Act. This leaves as the only alternative the loss of the merchandise or cash except for the dividend in bankruptcy. The recovery of the specific merchandise or money by implication of law upon a

88 Cunningham, Trustee etc. vs. Brown et al, 265 U.S. 1, 68 L. ed. 873, 44 S. Ct. 424
trust arises *ex maleficio*. Where a check is returned for insufficient funds, there are probably ample *indicia* upon which the purchaser of the instrument should be compelled to investigate the financial circumstances of the drawer of the check. Where this is done, or ought to be done, and the facts warrant reasonable inference of insolvency, there can be no escape from the results which the courts have reached.

"It is a fine thing that in America the profession of law is open to everyone, however humble his origin. But we have been too prone to keep the office down to the level of the man instead of raising the man to the level that the office demands. This is a common error of democracy."

—Everett Fraser.