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NOTES.

BANKRUPTCY—RIGHT OF SECURED CREDITOR TO INTEREST ON DEBT SUBSEQUENT TO THE FILING OF A PETITION.—A novel question in bankruptcy, which has been for some time working its way through the federal courts, was finally disposed of by the Supreme Court in Sexton, Trustee, v. Dreyfus, *et al.*[1] The referee certified this question to the District Court for the Southern District of New York: "Is a creditor holding security which is liquidated after the filing of the petition entitled to interest upon his claim after the filing of the petition in bankruptcy, where the proceeds of the sale of the security are inadequate to pay the face of the claim?" In other words, could the creditor subtract the amount realized on the sale from the amount of the debt plus interest up to the moment of sale and prove for the balance? This was answered in the affirmative.[2] On appeal to the Circuit Court of Appeals for the Second

[1] 31 Supreme Ct. 256 (1911).

[2] *In re* Kessler & Co., 171 Fed. 751 (1909).

Circuit, the decision of the District Court was affirmed with a dissent.[3] The Supreme Court reversed the decrees of the lower courts. In view of the fact that this probably settles for all time the particular point involved and evidently presents a very close question from the diversity of opinion manifested by the various judges who have considered the question, it is deemed worthy of a detailed study.

The section of the Bankruptcy Act of 1898[4] which mentions interest is 63 (*a*). It reads as follows: "Debts of the bankrupt may be proved and allowed against his estate which are (1) a fixed liability, as evidenced by a judgment or an instrument in writing absolutely owing at the time of the filing of the petition against him, whether then payable or not, with any interest thereon which would have been recoverable at that date or with a rebate of interest upon such as were not then payable and did not bear interest." Under the plain wording of this section in the case of an ordinary unsecured claim, no one can doubt that interest stops at the time of filing the petition. This is definitely settled in the case of Shawnee County v. Hurley.[5] At the time of filing the petition against the bankrupt, he was liable as a surety in a sum certain. A claim was filed for that amount. Subsequently the principal made a payment which considerably lessened the loss of the claimant. The question then arose, upon what basis should the bankrupt's estate be distributed? On the theory that as at law his liability would be reduced by the payment of the principal, it was argued that the claim should likewise be reduced. The court pointed out the fundamental error in this argument by showing that a claim in bankruptcy is a claim *in rem*. It represents an equitable right to such a share of the property of the bankrupt as its amount at the filing of the petition bore to the amount of all the provable claims against that property. It drew no interest after the petition was filed because it was an equitable estate and not a personal claim. On the other hand, the foundation of the claim was a right *in personam* against the bankrupt, a chose in action. It was measured by the terms of the contract and hence any payments by the principal lessened the liability of the surety. It continued to draw interest, and if ever a suit at law could be brought on it by virtue of a discharge in bankruptcy being refused, interest subsequent to the petition could be recovered. This case gives us an excellent conception of what bankruptcy proceedings are and should serve to clarify much of the confusion that exists. That it states no new and radical principles is shown in the case of *ex parte* Bennet.[6] Lord Chancellor Hardwicke there said: "Commissioners, after a man becomes a bankrupt, compute interest upon debts no lower than the date of the

[3] *In re* Kessler, 180 Fed. 979 (1910).
[4] Bankruptcy Act of 1898.
[5] 94 C. C. A. 362 (1909).
[6] 2 Atkyns, 527 (1743).

commission, because it is a dead fund and in such a shipwreck, if there is a salvage of part to each person, in this general loss it is as much as can be expected." The same thought appears in Sloan v. Lewis,[7] a decision under the old bankruptcy law of 1867.[8] Accrued interest up to the time of adjudication, but not interest to accrue thereafter, was held provable. The reason for naming the time of adjudication as the moment of time for interest to stop, and not the time of filing the petition, was because the wording of the old act was different from the present one, section 19 of the former reading: "That all debts due and payable from the bankrupt at the time of the adjudication of bankruptcy, and all debts then existing but not payable until a future day, a rebate of interest being made when no interest is payable by the terms of the contract, may be proved against the estate of the bankrupt." It will be seen that the interest allowed in the above case was not expressly provided for in the act, but the court held that it was impliedly.

We have seen that the rule concerning interest in the case of unsecured claims has been settled from earliest times, and it has been uniformly refused after the filing of the petition. What is there that caused so much doubt in the case of a secured claim? The argument, in brief, was this: A secured creditor could first apply his security to interest, when the parties were solvent, under the ruling in Story v. Livingston.[9] In that case certain lands from which were arising rents and profits were held as security. And the creditor was allowed first of all to deduct interest due on the debt from the rents and to apply any balance toward reducing the principal of the debt. Now section 67 (*d*) of the Bankruptcy Act of 1898 provides: "Liens given or accepted in good faith and not in contemplation of or in fraud upon this act and for a present consideration, which have been recorded according to law, if record thereof was necessary in order to impart notice, shall not be affected by this act." The amendment of 1903,[10] providing for invalidating liens acquired within four months of the filing of the petition when the bankrupt was insolvent at the time, need not be considered here, as it does not enter into the question. Hence, if interest up to the time of the sale of the security is not allowed, it takes away a lien from the creditor, contrary to the provisions of the act. This argument is not without merit and probably would have prevailed in the absence of strong reasons for not so holding, the chief of which was the state of the English authorities, where the question had arisen several times and was definitely settled.

The English cases are reviewed in the opinion of Hand, J., in the District Court,[11] and he declines to follow them on the ground,

[7] 22 Wall, 150 (1874).
[8] Bankruptcy Act of 1867.
[9] 13 Peters, 359 (1839).
[10] Act. of Feb. 5, 1903, amending Bankruptcy Act of 1898.
[11] *In re* Kessler & Co., 171 Fed. 751 (1909).

that the original cases out of which the rule grew, are vague and ambiguous and a rule arising in such a way should not be followed blindly. Mr. Justice Holmes comments upon them also, and, in following them, states his reasons as follows: "Our bankruptcy system is derived from the English and these cases are not interpreting particular statutes, but are based on the fundamental principles of bankruptcy. The theory has always been that everything stops at a given date, and if we allow interest to run on after the filing of the petition, we are departing from this basic principle." In fact, under his conception the whole question arises as a result of not being able to settle matters on the spot, as the old *pied-poudre* or market courts did. If that could be done the secured creditor would sell his security immediately and prove for the deficiency, the question of interest after the petition being eliminated by not permitting any time to elapse in the settlement of the matter. And since this cannot be done, he sees no reason for allowing the interest, on the ground that all delay after a reasonable time is caused by the creditor waiting for an advance in the market, which enures to his benefit. The most recent expression of opinion in England is, *In re* London, Windsor and Greenwich Hotels Company, Quartermaine's Case.[13]

While there are no other American cases on the subject under the present bankruptcy act, there is a decision under the Act of 1867, *In re* Haake.[14] Curiously enough, it is not mentioned by any of the judges who had the question before them, and Hand, J., states that he cannot find that the question has ever been raised before under any of our bankruptcy acts. The facts were as follows: Haake had borrowed money from the Savings and Loan Society. He gave interest-bearing notes for this, secured by deeding certain premises to trustees to hold in trust for the payment of these moneys. A bill of sale intended as a mortgage of a schooner was also given. On February 14, 1871, he was adjudicated a bankrupt. The rule that only principal and interest up to the time of the adjudication could be claimed was recognized in the case of an unsecured creditor. The question was, how is this to apply to a secured creditor? Hoffman, J., said: "I have been unable to find a single decision to the effect that the sum for which the property is held as security is to be taken to be the amount of the principal with interest only up to the date of the adjudication. The entire absence of any authority on the subject justifies the presumption that the claim of the creditor to a full satisfaction of his debt according to the terms of his contract out of the secured property has been generally admitted." Mr. Justice Holmes evidently did not feel the same way about the presumption in the absence of American authority.

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[13] 31 Supreme Ct. 256 (1911).

[14] 1 Chancery, 639 (1892).

[14] 2 Sawyer, 231 (1872).

One other point was decided in our principal case. Interest and dividends accrued upon some of the securities after the filing of the petition. Was this sum to go toward reducing the principal debt and thus cut down the amount of the claim? It was held that this could be set-off against the accrued interest subsequent to the petition. Again, the English cases furnished authority, and in accordance with their rule, Mr. Justice Holmes expounded our law. *Ex parte* Ramsbottom.[15] He also suggested this very practical reason for it: "There is no more reason for allowing the bankrupt estate to profit by the delay beyond the day of settlement than there is for letting the creditors do so. Therefore, to apply these subsequent dividends to subsequent interest, seems just."

The decision of the United States Supreme Court is undoubtedly in accordance with the theory of the bankruptcy law. But under the language of our act in regard to liens, an opposite conclusion would have been supportable, and the only American case hitherto decided has taken that view of it.

E. S. M.

PARTIAL RESTRAINTS ON ALIENATION.—One of the fundamental principles in the law of real property is that an estate in fee cannot be created subject to a provision that it shall not be transferred by the owner. Alienability, in other words, is one of the essential incidents of a fee simple estate. There is some doubt as to what is the underlying reason for this prohibition, but it has been said that if no other reason could be found, public policy would be a sufficient one.[1] On the other hand, it is also generally recognized that estates can be transferred with a qualified restraint on the transferee's power of alienation. The only doubt is as to the extent of the qualification allowed by the law. Cases where the owner's power of alienation has been partially restricted group themselves into three classes:

1. Where alienation is limited to certain persons or classes of persons.

2. Where alienation is prohibited for a certain time.

3. Where alienation is restricted to a certain method, *i. e.*, by will. As the same underlying principles apply to all cases on partial restraints, a thorough investigation of the subject would require a consideration of the cases in all of the above classes. Such an extended discussion is here impossible, and our inquiry is restricted to the state of the law on the first of these three classes, that is, where the creator, usually a testator, fixes the persons, to whom the land may or may not be aliened. It is worth noting that the decisions themselves draw the lines sharply between the above classes.[2]

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[15] 2 Mont. & A. 79 (1835).

[1] De Peyster v. Michael, 6 N. Y. 467 (1850); Mandelbaum v. McDowell, 29 Mich. 78 (1874); Gray, Restraints on Alienation, p. 11.

The first case flatly deciding the question under consideration was Doe v. Pearson.[3] This was a devise to two of the testator's daughters on the condition that, if either one had no lawful issue, that one should not have the power to dispose of her share except to her sisters or their children. This restraint was held valid. In Attwater v. Attwater,[4] there was a devise of land with the condition that, if it be sold at all, it must be sold to one of five named brothers of testator. This was held to be a void restraint on the power of alienation. In *in re* Macleay,[5] there was a devise of land to the testator's brother on the condition "that he never sell it out of the family." The condition was held to be valid in an elaborate opinion by Sir George Jessel, M. R. He reconciles the two prior cases on the ground that in the former alienation was restricted to an unascertained class, while in the latter it was restricted to ascertained and named persons. He then says: "The test is whether the condition takes away the whole power of alienation substantially; it is a question of substance, not of mere form"; and applying this test to Doe v. Pearson and Attwater v. Attwater, he concludes those cases were both rightly decided. Some doubt has been thrown on this opinion by a later case,[6] but Doe v. Pearson and *in re* Macleay must be taken to be the present law of England.[7] The law in Canada seems to follow these decisions.[8]

In this country there have been numerous cases touching this question directly or by way of *dicta*. A number of cases, mostly by way of *dicta*, however, support the English view,[9] but the tendency of authority seems to be opposed to it and in favor of holding such a restraint on alienation void.[10] No case, however, gives the subject the treatment, which, as a close question, it deserves.

Such was the state of the law, when the question was squarely presented for the consideration of the Supreme Court of Rhode Island in the recent case of Manierre v. Welling.[11] Here there was a devise of land to children and grandchildren of the testatrix on the condition that the interest devised should cease "if any of the children or grandchildren shall voluntarily or involuntarily alienate or

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[3] Mandelbaum v. McDowell, *supra; Re* Martin & Dagneau, 11 Ont. Law Rep. 344 (1906).

[3] 6 East, 173 (1805).

[4] 18 Beav. 330 (1853).

[5] L. R. 20 Eq. Cases, 186 (1875).

[6] *In re* Rosher, L. R. 26 Ch. Div. 80 (1884).

[7] But see Jarman on Wills, 6th ed., p. 1490.

[8] O'Sullivan v. Phelan, 17 Ont. 730 (1889); *Re* Porter, 13 Ont. Law. Rep. 399 (1907).

[9] Cowell v. Springs Co., 100 U. S. 55 (1879); Felt *v.* Richards, 64 N. J. Eq. 16 (1902); Gray v. Blanchard, 8 Pick. 284 (1829).

[10] Schermerhorn v. Negus, 1 Denio, 448 (1845); Anderson v. Cary, 36 Ohio St. 506 (1881). In Pa. such a restriction is held void for uncertainty; McCullough's Heirs v. Gillmore, 11 Pa. 370 (1840).

[11] 78 Atl. Rep. 509 (R. I., Jan., 1911).

devise any portion of said land set apart to her or him other than to some descendants of mine * * * without the consent of all my descendants." Parkhurst, C. J., prefaced his discussion with the remark that this was a case of first impression in Rhode Island, and which, in view of the hopeless confusion in the decided cases, was therefore worthy of the most careful treatment. After an exhaustive and critical survey of practically all the cases and rules on the subject, he comes to the conclusion that such a restraint on alienation is void. Applying Jessel's test, he holds that the power of alienation is substantially, and in fact wholly, taken away by forbidding the owner to alienate to any one except her descendants without the consent of all the rest of the descendants; that this leaves only a "possibility" of alienation, which cannot logically be called a "power" of alienation; and that the power is really in the "descendants" to determine whether there be any alienation or not. He admits that Doe v. Pearson is the same case, but holds in opposition to Jessel, that it was incorrectly decided.

This clearly illustrates the great weakness of Jessel's rule, which is the uncertainty of result in its application. On exactly the same state of facts two judges of high authority come to opposite conclusions as to whether the owner has been "substantially" deprived of the power of alienation. The difficulty is to determine what facts must be considered as evidence of a substantial deprivation. "What am I to say is the principle? Is it that there must be a condition, that, if you alienate, you must alienate to a member of your own family, or that you must look to the number of the individuals to whom the alienation is permitted, or where there are a number of individuals, to whom alienation is permitted, am I to inquire whether they are agreeable or likely to be willing to purchase the property to which the condition is attached? * * * It seems that the adoption of any such rule would produce the greatest uncertainty and confusion."[12]

This weakness being recognized, another rule has been submitted, which is supported by an eminent authority on the subject, Professor Gray. It seems to be universally conceded that a restraint in a devise that the devisee may aliene to any one in the world except a certain person or class is valid. The line is drawn between this case and our principal case, the rule being stated as follows: "A condition is good if it allows of alienation to all the world with the exception of selected individuals or classes; but it is bad if it allows of alienation only to selected individuals or classes."[13] The line drawn here would seem to be a somewhat artificial and arbitrary one, and a testator might circumvent the rule, perhaps, by shrewdly framing the words of the devise. However, it has a decided advantage over Jessel's test in being certain in its application.

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[12] Pearson, J., *in re* Rosher, *supra*.

[13] Williams on Settlements, pp. 134, 135; Gray, Restraints on Alienation, p. 30.

Under this rule it would be possible to inform a testator whether the condition he wished to fasten on future alienation was valid or not, while under Jessel's rule, unless the proposed restriction was exactly that of a decided case, the testator could not be assured of its validity. This rule, it is clear, narrows the field of permissible restraints on alienation further than does Jessel's. It is also apparent that it would not fit the English view of the situation, but that is not necessarily a fatal objection. One reason urged in favor of this stricter rule is that in America, unlike England, conditions such as these are not subject to the Rule against Perpetuities. So these restraints should be scrutinized much more severely here than in England, as otherwise the alienation of property could be tied up indefinitely.[14] It has been also urged that the only rational way to treat these restrictions is to abolish them altogether. The trend of authority and opinion, as seen from the above brief review, is distinctly in that direction, due in all probability to the constantly increasing traffic in lands and the consequent unwillingness of the courts to check these sales by saddling them with burdensome restrictions. In view of these facts it would seem to be a safe prediction that in the near future it will be impossible for the transferor to prevent his transferee from alienating or devising a fee simple estate to whomsoever he pleases.

A. S. S., Jr.

[14] Gray, Restraints on Alienation, p. 30.