LEGISLATION

EFFECT OF TENANT'S BANKRUPTCY ON PENNSYLVANIA LANDLORD'S CLAIM FOR RENT—Where the Pennsylvania landlord, claiming rent in arrears upon the bankruptcy of his tenant,[1] seeks the aid of the federal courts under the *Bankruptcy Act*,[2] a determination of the rights involved will depend primarily, of course, upon the law as stated in the Act, but also upon the existing state laws to the extent that the *Bankruptcy Act* does not completely control.[3]

The landlord, upon the bankruptcy of his tenant, is, of course, anxious that his claim be paid in full out of the bankrupt's estate. If he can prove that his claim amounts to a lien under Section 67 (d) of the *Bankruptcy Act*,[4] the probability of accomplishing this purpose is greatest. Claims proved under this section must be discharged in full, if possible, out of the proceeds of the sale of the property subject to the lien, the only priority being the cost necessarily incident to the preservation of the particular estate, its conversion into money, and payment thereof to the lienor.[5] The section reads:

> "Liens given or accepted in good faith and not in contemplation of or in fraud upon the provisions of this title, and for a present consideration, which have been recorded according to law, if record thereof was necessary in order to impart notice, shall, to the extent of such present consideration only, not be affected by anything herein."

Failure to prove his claim under the above section will not necessarily, however, leave the landlord among the rank and file of general creditors. Section 64 (b) (5) of the Act[6] provides:

> "debts to have priority . . . and to be paid in full out of bankrupt estates . . . shall be . . . (5) debts owing to any person who by the laws of the states or the United States is entitled to priority."

Under this section the landlord is entitled to priority over claims not specified in the same section as being higher in right.[7] Those so specified include taxes, the costs of preserving the estate, creditors' filing fees, administration expenses, and wages earned within the three months preceding the bankruptcy.

Whether the landlord can prove that he has a lien, under Section 67 (d), or that he is entitled to priority over general creditors, under Section 64 (b) (5), depends entirely upon the laws of the respective states,—that is, in any given instance the relationship which the landlord's claim will bear to others will depend upon the law of the jurisdiction in which the leased premises are situated. Section 67 (d) has been so construed by virtue of its words "according to law"[8] and Section 64 (b) (5) expressly so provides.[9]

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[1] No attempt will be made to deal with the status of claims in bankruptcy for rent accruing after the filing of the petition. A recent article dealing with this question is that by W. S. Schwabacker and S. C. Weinstein, *Rent Claims in Bankruptcy* (1933) 33 COL. L. REV. 213. See also *infra* note 22.

[2] 30 STAT. 544, 11 U. S. C. A. § 1 (1927).

[3] Among such state laws are included those relating to the title to property, exemptions, and the order of priority of debts. See 1 REMINGTON, BANKRUPTCY (1923) §§ 5-7.

[4] 36 STAT. 842, 11 U. S. C. A. § 107 (d) (1927).

[5] *In re* Rauch *et al.*, 226 Fed. 982 (E. D. Va. 1915).

[6] 30 STAT. 563, 11 U. S. C. A. § 104 (b) (5) (1926).

[7] *In re* Consumers' Coffee Co., 151 Fed. 933, 20 A. B. R. 835 (E. D. Pa. 1907).

[8] Holt v. Crucible Steel Co., 224 U. S. 262, 32 Sup. Ct. 414, 27 A. B. R. 856 (1912).

[9] The words used are "debts owing to any person who *by the laws of the states* . . ."

Turning, therefore, to the laws of Pennsylvania, it is found that any right of the landlord to a priority or lien is dependent upon the ancient common law remedy of distress.[10] This remedy, in medieval England, entitled the feudal lord to take any goods of the tenant found on the leased premises and hold them as a gage, or pledge, to induce the tenant to pay what he owed.[11] In 1690, the remedy was broadened by statute [12] so that the landlord, upon complying with certain conditions,[13] could sell the goods in order to satisfy the debt. Again, in 1709, a further enactment [14] provided that no goods on leased lands should be taken in execution unless the party at whose suit the execution was sued paid to the landlord, before removing the goods, the arrears of rent up to but not exceeding the amount of one year's rent due at the time of the execution. The purpose of this statute was to mitigate the hardship to the landlord of the operation of the common law rule that goods in the custody of the law were not distrainable.[15]

Partly because the right to distrain is so nearly extrajudicial in its nature, giving the landlord a right amounting to that of self-help, it has not been universally accepted by the states of the United States.[16] Pennsylvania, however, did adopt it, and in 1772 a statute very similar to the English Act of 1690 was passed,[17] and in 1836 one similar to the English Act of 1709.[18] Both of these statutes are in force today.[19]

Approaching at this point the factual situations, it is found that if the landlord has distrained prior to the institution of the bankruptcy proceedings, he is held to have established a valid lien upon the goods distrained for the full amount of the rent in arrears.[20] Furthermore, if, prior to the bankruptcy, an execution is levied upon the tenant's goods on the leased premises, the landlord, under the Act of 1836,[21] is regarded as having a lien on the goods to the extent of one year's rent in arrears.[22] Both of these liens are recognized in bankruptcy proceedings in the federal courts,[23] and this is true even though

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[10] ENEVER, DISTRESS (1931) 67; GILBERT, DISTRESSES (4th ed. 1823) 4.

[11] ENEVER, *op. cit. supra* note 10, at 7; 2 TIFFANY, LANDLORD AND TENANT (1910) § 325.

[12] 2 W. & M. c. 5, § 2 (1690).

[13] A short period of time, five days, was given the tenant or owner of the goods in which to replevy with sufficient security, failing which the distrainor desiring to sell the goods was to cause them to be appraised by two sworn appraisers. The goods then could be sold.

[14] 8 ANNE, c. 14, § 1 (1709).

[15] ENEVER, *op. cit. supra* note 10, at *226*. For a Pennsylvania case dealing with the operation of this rule see Pierce v. Scott, 4 W. & S. 344 (Pa. 1842); also *infra* note 55.

[16] For a summary of the status of the right in the various states see 2 TIFFANY, *op. cit. supra* note 11, at 1987.

[17] PA. STAT. ANN. (Purdon, 1930) tit. 68, § 291.

[18] PA. STAT. ANN. (Purdon, 1930) tit. 68, § 321.

[19] PA. STAT. ANN. (Purdon, 1930) tit. 68, §§ 291 and 321.

[20] *In re* Hoover, 113 Fed. 136, 7 A. B. R. 330 (W. D. Pa. 1902).

[21] *Supra* notes 18 and 19.

[22] Shalet v. Klauder, 34 F. (2d) 594, 7 A. B. R. (N. S.) 501 (C. C. A. 3d, 1929); *In re* Mt. Winans Lbr. Co., 228 Fed. 831 (D. Md. 1915). (The Maryland statute is also based on the Statute of 8 ANNE, c. 14, § 1). Furthermore, and the question is somewhat similar to that mentioned *supra* note 3, the courts of Pennsylvania have given the Act of 1836 the construction that a covenant for rent payable in advance, or a stipulation in a lease that on breach of a covenant the whole rent for the balance of the term shall at once become due is within the terms of the statute "money due for rent at the time of taking such goods" and also is within the class of "debts owing to any person," which, under Section 64 (b) (5) of the Bankruptcy Act, priority is enforced when awarded by state law. Such covenants not being against public policy, are sustained to the extent of giving the landlord priority for one year's rent: Collins' Appeal, 35 Pa. 83 (1860); Platt Barber Co. v. Johnston, 168 Pa. 47, 31 Atl. 935 (1895); *In re* Keith-Gara Co., 203 Fed. 585 (E. D. Pa. 1913).

[23] See *supra* notes 21 and 22.

they were perfected within the four months next preceding the institution of the bankruptcy proceedings.[24] But where the landlord has failed to distrain, and there has been no execution levied, the landlord's right to a preferred position is not readily apparent.

Upon institution of bankruptcy proceedings, the bankrupt tenant's goods pass into the custody of the law, as represented by the trustee,[25] and the landlord's right to distrain is cut off by operation of the common law rule that goods in the custody of the law are not distrainable.[26] Therefore, in order to assert his claim to a preference under the Act of 1836,[27] the landlord must proceed upon the theory that bankruptcy proceedings are equivalent to an execution. The law as it developed with regard to the soundness of this theory is of considerable interest.

The question whether bankruptcy proceedings could be regarded as an execution arose in 1874 in the case of *Longstreth v. Pennock.*[28] In that case the Supreme Court of the United States held that bankruptcy proceedings came "within the equity of the statute," adding that the question was one "belonging to the local law of Pennsylvania". The latter phrase is particularly significant in that the Supreme Court of Pennsylvania had, earlier in the same year, decided that the statute did not operate in favor of the landlord in sales by receivers appointed on a bill in equity.[29] This situation was so closely akin to that before the Supreme Court of the United States that it should have been determinative of the question,[30] but apparently the local case was not brought to the attention of the Supreme Court.[31] The Supreme Court of Pennsylvania, however, again considered the same question in 1916,[32] and, after pointing out that the statute was in derogation of the common law and should be strictly construed, once more held that the statute did not help the landlord. In a subsequent bankruptcy case, *Rosenblum v. Uber,*[33] the trustee and referee felt bound by the local law and refused to follow the result reached by the Supreme Court of the United States. This holding was affirmed without further opinion by the district court,[34] but was reversed by the circuit court of appeals,[35] not merely upon the earlier theory that the case was within the equity of the statute, but also because the court felt that a bankruptcy proceeding was in essence an execution. Whether this last decision was correct,[36] however, became a matter of purely academic interest, inasmuch as the legislature of Pennsylvania in 1919 enacted a companion statute to that of 1836 specifically covering the bankruptcy situation.[37] It reads in part:

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[24] Under the Bankruptcy Act, Section 67 (f), preferences acquired by legal proceedings within four months of the institution of the bankruptcy are declared invalid. The courts, however, have held that a distress levy is not a legal proceeding within the intendment of the Act. In the Matter of Rowe & Bros., Inc., 18 F. (2d) 958, 9 A. B. R. (N. S.) 140 (W. D. Pa., 1927); *In re* Abbruzzo, 276 Fed. 405 (W. D. Pa., 1921); City of Richmond v. Bird, 249 U. S. 175, 39 Sup. Ct. 186 (1918).

[25] 36 STAT. 840, 11 U. S. C. A. § 75 (2) (1927).

[26] See *supra* note 16.

[27] See *supra* notes 18 and 19.

[28] 87 U. S. 575 (1874).

[29] Singerly v. Fox, 75 Pa. 112 (1874).

[30] The construction adopted by the state supreme court should control in such a situation. City of Richmond v. Bird, *supra* note 24.

[31] The state decision, handed down in January, might not have been published by the fall of the same year.

[32] Grayson v. Aiman, 252 Pa. 461, 97 Atl. 695 (1916).

[33] Entitled in the District Court, Matter of Stern, 256 Fed. 584, 41 A. B. R. 712 (W. D. Pa. 1918).

[34] See *supra* note 33.

[35] 256 Fed. 584 (W. D. Pa. 1919).

[36] The reasoning of the upper court was little more than dogmatic and does not seem to have been as logical as that of the referee.

[37] PA. STAT. ANN. (Purdon, 1930) tit. 39, § 96.

"In all cases where a tenant or tenants become insolvent . . . or bankruptcy or other insolvency proceedings are instituted either by or against the tenant or tenants, covering goods and chattels upon demised premises and which are liable to distress by the landlord for rent, the landlord shall be first entitled to receive out of the proceeds of the sale of such goods and chattels by the legal representatives of the tenant any sum or sums of money due the landlord for rent of such demised premises at the time of the institution of the . . . proceedings, not exceeding one year's rent. . . . "

This statute is of course a complete answer to the referee's contention in *Rosenblum v. Uber,* and clearly entitles the landlord's claim to priority at least.[38]

The further question remains whether under this statute the landlord can successfully establish a claim to a lien on the bankrupt's goods found on the leased premises. This did not arise directly until 1931. It is doubtful if prior to that time the actual significance of the question had been even realized. The language used in several decisions[39] indicates a total obliviousness to the situation. It is only recently that there has been any question whether the landlord's claim actually constitutes a lien. The importance of the point was first recognized in cases where the bankrupt's estate was insufficient to pay in full those creditors whose claims were entitled to priority under Section 64 (b) (5).[40]

On January 16, 1931, the Federal District Court for the Middle District of Pennsylvania held, in the case of *In re Hoopert,*[41] that the landlord's claim for rent was payable in full from the proceeds of the bankrupt's personalty located on the leased premises in preference to administration expenses, which under Section 64 (b) should take priority over the landlord's claim. The same court, when the question again arose in July, 1931, reached an exactly opposite result,[42] but without reference to the earlier decision. It is interesting to note that the earlier opinion did not at any point indicate that the court realized that it was actually according to the landlord the rights of a lienor, whereas the latter opinion dealt directly with the question whether, under the Pennsylvania law, the landlord who has not distrained has a lien within the meaning of Section 67 (d). The latter opinion, therefore, at once commends itself because of the clearer perception of the problem involved.[43] In order to reach any conclusion on the merits of the problem, however, the matter should be considered further.

It has been argued that Section 67 (d), because of its very phraseology, could apply to only voluntary liens.[44] The great weight of authority, however,

[38] For bankruptcy interpretations of the Statute of 8 ANNE in other jurisdictions see: *In re* Wall, 60 F. (2d) 573, 21 A. B. R. (N. S.) 434 (E. D. Miss. 1932); *In re* Bishop, 153 Fed. 304, 18 A. B. R. 635 (D. S. C. 1907); *In re* Bennett, 153 Fed. 673 (C. C. A. 6th, 1907); *In re* Mitchell, 116 Fed. 87, 8 A. B. R. 324 (D. Del. 1902); *In re* Chaudron & Peyton, 180 Fed. 841, 24 A. B. R. 811 (D. Md. 1911).

[39] Shalet v. Klauder, *supra* note 22, at 595,—"the landlord had not distrained on the goods when the levy of the sheriff was made. After that it was too late to distrain, but the landlord was not left without a remedy. He could have given notice to the sheriff of his claim for rent for one year, and his right to distrain would thereby have become a lien." In effect the holding in *In re* Morris, 159 Fed. 591, 19 A. B. R. 781 (M. D. Pa. 1908) grants a lien. And see *In re* Hoopert, *infra* note 41.

[40] See *supra* text following note 8.

[41] 58 F. (2d) 349 (M. D. Pa. 1931).

[42] *In re* Philbin, 53 F. (2d) 218 (M. D. Pa. 1931).

[43] The decision in *In re* Hoopert, by Judge Johnson, merely cites a number of earlier cases which involved the right to priority and others in which there had been actual distress levies.

[44] Because only such liens can be said to be "given or accepted in good faith" for a present consideration.

is to the effect that it applies also to statutory liens.[45] At common law a lien involved the bare right to possession of the goods subject thereto.[46] By statute this right has been generally enlarged to include the power of sale.[47] Unfortunately, the word lien covers so broad a field that there is no hard and fast definition to which to turn. As a recent writer has expressed it:[48]

> "the word lien has not succeeded in attaining any fixed application as a technical term of English law. Its use is capricious and uncertain."

The Supreme Court of Pennsylvania, in the case of *Singerly v. Fox*,[49] in speaking of the 1836 statute, said:

> "The Act of Assembly requires the sheriff to pay out of the proceeds of his levy and sale of the tenant's goods to the landlord a sum not exceeding one year's rent, but this is by virtue of the directions of the act in that special case, and not because of any lien. This act is no doubt based upon the idea that it would be inequitable to take from the landlord that which he regarded as the security for his rent, and which he might at any time seize by virtue of his warrant."

Furthermore, there are decisions by lower Pennsylvania courts dealing with the manner in which the landlord can enforce his rights under the statute. These decisions do not give the landlord a right to proceed against the goods, but hold that his action must be brought against the sheriff if he fails to pay the landlord's claim out of the proceeds of the sale.[50] In short, the sheriff can sell the chattels free and clear of any claim on them by the landlord.[51] These cases are not reconcilable with the existence of a lien.[52]

The argument that there is a lien finds its basis, for the most part, in a statement that

> "Whenever the law gives a creditor a right to have a debt satisfied from the proceeds of property or before the property can be otherwise disposed of, it gives a lien on such property to secure the payment of this debt." [53]

This statement, however, is loosely phrased and may easily be misconstrued. As already pointed out, the early failure to appreciate the problem involved, resulting as it did in a misuse of terms, is also responsible for some of the difficulty. On the whole, it seems patent that the only conclusion possible is that the statute, as construed by the Pennsylvania courts, does not create a lien in favor of the landlord. The decision in the *Hoopert* case is regrettable. It could have resulted only from a failure to appreciate the fundamental problems involved.

In conclusion, it should be emphasized that the right to distrain is not altogether an instrumentality to enable the landlord to close down upon his unfortunate tenant. It serves, on the other hand, as the credit basis on which many

[45] City of Richmond v. Bird, *supra* note 24; *In re* San Joaquin Packing Co., 295 Fed. 311, 4 A. B. R. (N. S.) 37 (C. C. A. 9th, 1924). *Contra: In re* Cramond, 145 Fed. 966, 17 A. B. R. 22 (N. D. N. Y. 1906).

[46] 1 JONES, LIENS (3d ed. 1914) c. 1.

[47] *Ibid.* c. 3.

[48] SALMOND, JURISPRUDENCE (6th ed. 1920) 402, n. 3.

[49] *Supra* note 29.

[50] West, Adm. v. Sink, 2 Yeates 274 (Pa. 1798); Allen v. Lewis, 1 Ashm. 184 (Pa. 1827); Fisher v. Allen, 2 Phila. 115 (1856).

[51] Schuyler v. Phila. Coach Co., 29 W. N. C. 343 (Pa. 1891).

[52] For a lien to exist the landlord's claim should be a charge against the goods or the proceeds.

[53] Chase, C. J., *In re* Wynne, Chase 227 (C. C. D. Va. 1867).

persons are enabled to secure a lease. The right would not have survived so long if it did not serve a useful purpose. It seems only proper, therefore, that where the landlord loses his right to distrain he be granted special consideration to compensate him for this loss. Such special consideration is given him in the bankruptcy situation under the Pennsylvania law,[54] although it cannot be said that his claim amounts to a lien.

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[54] It is of interest to note here an analogous situation in which the landlord is held to lose his right to distrain:

On the death of a tenant the lease continues to exist as an asset of the estate, Wartanian's Est., 305 Pa. 333, 157 Atl. 688 (1931), but because of the decedents' estates statute, PA. STAT. ANN. (Purdon, 1930) tit. 20, § 501, which fixes the order of payment of decedent's debts, it was held in Gandy v. Dickson, 166 Pa. 422, 31 Atl. 127 (1895) that the landlord loses his right to distrain on the goods of the deceased tenant. The reason given was that if distraint were allowed the order of payment fixed by the statute would be disturbed. Inasmuch, however, as the statute entitles the landlord to priority for "rents not exceeding one year", here too the landlord is given special consideration.