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COMMERCIAL LAW

OVERVIEW

During the period covered by this Survey, the Tenth Circuit Court of Appeals selected for publication several bankruptcy decisions and a few decisions in the other areas of commercial law, such as secured transactions and consumer credit. A discussion of the bankruptcy cases provides the bulk of this section. Because practitioners now have to contend with a new bankruptcy code[1] effective for actions filed on or after October 1, 1979, references will be made to provisions of the new Act whenever possible.

Perhaps the most noteworthy event for the Tenth Circuit in the area of bankruptcy law was the functional overruling of an earlier opinion, *Raley v. Nicholas (In re Nicholas)*,[2] by the United States Supreme Court in *Brown v. Felsen*.[3] *Nicholas* held that, under the principle of res judicata, a creditor would not be permitted to "go behind" the record and judgment of a state court and present extrinsic evidence to the bankruptcy judge in an attempt to show that the debt underlying the state court judgment was based upon fraud.[4] *Nicholas* was followed in *Brown v. Felsen (In re Felsen)*,[5] an unpublished Tenth Circuit opinion, and the Supreme Court granted certiorari to resolve the conflict between *Nicholas* and subsequent opinions in other circuits.[6] The Supreme Court held that the doctrine of res judicata was inapplicable and that the bankruptcy court may look beyond the state court record and judgment in making its determination of dischargeability.[7] This conclusion is warranted, according to the Court, by the 1970 amendments to the Bankruptcy Act which clearly made the adjudication of dischargeability a federal matter; the language of these amendments is inconsistent with an application of the policy of res judicata.[8] In the first opinion to be discussed herein, *Wilke v. Winters (In re Winters)*,[9] the court of appeals distinguished *Nicholas*.

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1. 11 U.S.C.A. §§ 101-1330 (West Sp. Pamph. 1979).
2. 510 F.2d 160 (10th Cir.), *cert. denied*, 421 U.S. 1012 (1975).
3. 99 S. Ct. 2205 (1979).
4. 510 F.2d at 163.
5. No. 77-2035 (10th Cir. Apr. 14, 1978) (Not for Routine Publication).
6. Four other circuits, in post-*Nicholas* decisions, had allowed the bankruptcy judge to "go behind" a state court judgment and look at extrinsic evidence in making a determination of dischargeability. *See* Bailey v. Wright, 584 F.2d 83 (5th Cir. 1978); *In re* McMillan, 579 F.2d 289 (3d Cir. 1978); Houtman v. Mann, 568 F.2d 651 (9th Cir. 1978); and Hovermale v. Pigge, 539 F.2d 369 (4th Cir. 1976).
7. Brown v. Felsen, 99 S. Ct. at 2213.
8. *Id.* at 2211-12.
9. 586 F.2d 1363 (10th Cir. 1978).

I. BANKRUPTCY

A. *Exception to Discharge*

1. Fraud

In *Wilke v. Winters (In re Winters)*,[10] the debtors appealed from a district court order directing that, upon remand, the bankruptcy judge conduct a hearing to determine the dischargeability of a debt upon which a judgment for fraud was obtained in the absence of the debtors and their counsel. The debtors' attorney had received permission to withdraw the day before trial because his clients had not been in contact with him and had, in fact, moved without providing him with a forwarding address. The bankruptcy court had originally declared this judgment void for lack of due process; the creditor appealed and the district court reversed on this issue, but held that the judgment for fraud was not dispositive as to the dischargeability of the underlying debt.[11] On appeal to the Tenth Circuit, the court of appeals affirmed. The debtors argued unsuccessfully that permitting the creditor to present evidence regarding the fraudulent nature of the actions for which judgment was awarded disregarded the holding of an earlier Tenth Circuit opinion, *Raley v. Nicholas (In re Nicholas)*.[12] The court of appeals distinguished *Nicholas*[13] as a case in which the original judgment was not for fraud, and hence, the creditor was not allowed to "go behind" the state court judgment; however, in the instant case the judgment was based upon fraud.

Addressing itself at length to the judgment declared void by the bankruptcy court, the court of appeals looked to two Colorado[14] cases: *Dalton v. People*[15] and *Thompson v. McCormick*.[16] In *Dalton*, the defendant was unaware, innocently, that his attorney had been permitted to withdraw. In *Thompson*, the defendant had discharged his attorney and was totally uninformed since notice was served on the former counsel. It appears that the court of appeals distinguished these cases from the instant one on the culpability issue: because the Winters had not kept their attorney informed as to their whereabouts, they were responsible for the judgment entered against them. The court relied upon the reasoning in *Sunshine v. Robinson*, in which a judgment was obtained after counsel was allowed to withdraw immediately

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10. *Id.*

11. The power of the bankruptcy court to determine the dischargeability of a debt is found in 11 U.S.C. § 35(c)(3) (1976) (added by Act of October 19, 1970, Pub. L. No. 91-467, § 5-7, 84 Stat. 992). There is no such provision in the revised act; it was removed as unnecessary "in view of the comprehensive grant of jurisdiction prescribed in . . . [28 U.S.C. § 1471(b)], which is adequate to cover the full jurisdiction that the bankruptcy courts have today over dischargeability and related issues under Bankruptcy Act § 17c." S. REP. NO. 989, 95th Cong., 2d Sess. 77, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5787, 5863.

12. 510 F.2d 160 (10th Cir.), *cert. denied*, 421 U.S. 1012 (1975).

13. *Nicholas*, of course, may no longer be valid in light of Brown v. Felsen, 99 S. Ct. 2205 (1979). After *Brown*, a creditor may be allowed to allege and prove fraud regardless of the basis for the state court judgment.

14. The fraud action originated in Weld County district court and the parties stipulated that Colorado law governed. 586 F.2d at 1365.

15. 146 Colo. 15, 360 P.2d 113 (1961).

16. 138 Colo. 434, 335 P.2d 265 (1959).

prior to trial,[17] and upheld the district court's judgment against Winters.

2. Willful and Malicious Conversion

The issue presented in *Bank of Meeker v. McGinnis (In re McGinnis)*[18] was whether the sale of cattle in violation of a security agreement constituted a willful and malicious conversion—thereby rendering the underlying debt an exception to discharge in bankruptcy[19]—in view of the bank's "knowledgeable acquiesence"[20] in the bankrupt's cattle trading and the bank's "failure to take reasonable steps to protect its collateral . . . ."[21] In affirming the District Court for the Western District of Oklahoma, the court of appeals, per Judge McKay, held that the conduct of the creditor bank defeated its claims.

The security agreement between McGinnis and the bank forbade the sale of the cattle without the written consent of bank; however, the testimony before the bankruptcy court revealed the common understanding that the collateral could be sold if the proceeds were used to reduce the loan balance. In its testimony the bank denied knowledge of the bankrupt's cattle trading; but the district court found, and the court of appeals agreed, that there was sufficient evidence, such as deposits into McGinnis' account and increases in the size of his herd, for the bank to be held to that knowledge. Relying upon *Bennett v. W.T. Grant*,[22] the court of appeals concluded that the equity principles under which the bankruptcy court operates dictate that an exception to discharge is unwarranted for a creditor in the position of the Bank of Meeker.

The court summarily rejected the bank's contention that any unauthorized sale of collateral is per se a willful and malicious conversion.[23] *Davis v. Aetna Acceptance Co.*[24] articulated the standard to which the court of appeals

17. 168 Colo. 409, 451 P.2d 757 (1969). Counsel withdrew because his clients were in prison and he alleged an agreement whereby he was not to represent them at trial.

18. 586 F.2d 162 (10th Cir. 1978).

19. 11 U.S.C. § 35(a)(2) (1976). The revised Bankruptcy Act contains basically the same provision. Any debt "for willful and malicious injury by the debtor to another entity or to the property of another entity" is excepted from discharge. 11 U.S.C.A. § 523(a)(6) (West Sp. Pamph. 1979). *See* S. REP. NO. 989, 95th Cong., 2d Sess. 79, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5787, 5865.

20. 586 F.2d at 165.

21. *Id.*

22. 481 F.2d 664 (4th Cir. 1973) (per curiam). In this case, there was a conditional sales contract on some appliances, title to which remained in W.T. Grant. Bennett traded in the appliances on a mobile home, after Grant refused to repossess them. The court, after noting that the evidence showed this to be a willful and malicious conversion, stated that if the creditor had known of the conversion and failed to act, the underlying debt should be discharged in bankruptcy. Two recent cases concerning creditor conduct are *In re* Jantz, 2 BANKR. L. REP. (CCH) ¶ 67,160 (W.D. Okla. June 15, 1979) (bank could not claim a willful and malicious conversion because it had in the past permitted the use of the accounts receivable, in which it had a security interest, for the payment of ongoing obligations) and *In re* Gawne, [1977-1978 Transfer Binder] BANKR. L. REP. (CCH) ¶ 66, 535 (W.D. Wis. July 20, 1977) (a creditor who had granted to the debtor the right to sell collateral without accountability could not claim a willful and malicious conversion).

23. Creditors, of course, have argued for this rule before. *See, e.g., In re* Cote, [1977-1978 Transfer Binder] BANKR. L. REP. (CCH) ¶ 66,349 (M.D. Fla. Feb. 8, 1977).

24. 293 U.S. 328 (1934).

adhered: "[a] willful and malicious injury does not follow as of course from every act of conversion, without reference to the circumstances. . . . There may be an honest, but mistaken belief, engendered by a course of dealing, that powers have been enlarged or incapacities removed."[25]

B. *Subordination of Claims—Majority Shareholder*

In *Sinclair v. Barr (In re Mid-Town Produce Terminal)*,[26] the court of appeals was asked to decide whether, under the equitable powers of the bankruptcy court,[27] a secured claim based upon an advance made to a failing corporation and used to pay other secured creditors could be subordinated merely because the advance was made by a dominant shareholder. The bankruptcy court had disallowed the claim in its entirety; the district court reversed on the disallowance issue, but subordinated the claim and denied the security interest. The court of appeals, per Judge Logan, reversed and remanded, holding that it would be contrary to sound business and social policy not to permit a controlling shareholder to advance sums to a corporation and become a legitimate secured creditor absent, of course, evidence that the loan was really a contribution to capital or that the transaction was of such character as to invalidate the lien.

G. Sinclair, his wife, and their son, R. Sinclair, owned all the stock of Mid-Town Produce in February 1975 when G. Sinclair deposited $20,000 into his son's personal account. R. Sinclair, in turn, paid the money to Mid-Town so that the company's secured creditors could receive partial repayment. A security agreement was executed, giving G. Sinclair a security interest in Mid-Town's accounts receivable; this agreement was signed by R. Sinclair as president, even though he did not become president until June 1975, at which time all the stock was transferred to him. G. Sinclair signed the agreement in August 1975 and it was filed several days later. In December 1975, Mid-Town's bankruptcy proceedings began.[28]

The threshold question, as the court of appeals saw it, was whether the advance was a loan or a contribution to capital.[29] Since facts relevant to this inquiry were not available to the court on appeal, the case was remanded for this determination.[30] However, the court went on to discuss, in terms of subordination, the consequences if the advance were found to be debt rather

25. *Id.* at 332.

26. 599 F.2d 389 (10th Cir. 1979).

27. The courts have evolved the principles of equitable subordination by bankruptcy judges. *See* Sampsell v. Imperial Paper & Color Corp., 313 U.S. 215 (1941); Pepper v. Litton, 308 U.S. 295 (1939). It was the intent of the framers of the revised Bankruptcy Act to codify this case law. *See generally* 3 COLLIER ON BANKRUPTCY ¶ 510.04 (15th ed. 1979). The revised act reads in relevant part: "[T]he court may—(1) under principles of equitable subordination, subordinate for purposes of distribution all or part of an allowed claim to all or part of another claim or all or part of an allowed interest to all or part of another allowed interest. . . ." 11 U.S.C.A. § 510(c) (West Sp. Pamph. 1979).

28. 599 F.2d at 391.

29. 599 F.2d at 393.

30. The court said that two factors, *inter alia*, should be considered: the interest rate on the loan and the repayment schedule. 599 F.2d at 393-94. The facts as presented by the Tenth Circuit do not indicate whether undercapitalization is a problem. However, in the opinion, two cases relied upon by the district court are distinguished from the instant case because they dealt

than contribution to capital. In its discussion,[31] the court appeared to ignore the secured nature of the claim[32] and focused upon the powers of the bankruptcy court in utilizing the equitable subordination doctrine to postpone payment of some creditors' claims. The court should have made clear in its opinion that, in bankruptcy proceedings, security interests are invalidated, if at all, if they were created in violation of the pertinent bankruptcy provisions[33] and not because of the exercise of the equitable subordination powers of the bankruptcy court.[34]

C. *Chapter X—Notice to Creditors*

In March of 1974, Gulf South Corporation and its subsidiaries, one of which was Gulf South Advisors, Ltd. (GSA), filed a petition seeking reorganization under Chapter X of the Bankruptcy Act.[35] May 31, 1974 was set as the date after which creditors' claims would be barred if filed. The Kays, who were owners of Gulf South Mortgage Investors (GSMI), of which GSA was advisor, were not scheduled as creditors of GSA and hence were not notified. Publication did appear in the *Wall Street Journal* and other newspapers. In February of 1975, the Kays filed a plenary action alleging l0b-5 violations by GSA and seeking damages. The lawsuit was stayed. Two months later, the trustee, via his attorney, told the Kays to apply for permission to file a late claim. More than one year later the Kays filed this application, which was turned down in November 1976 by the reorganization court. At this time, the reorganization plan had not yet been filed.

On appeal from this rejection, the Kays argued, first, that they should have been notified because they were GSMI owners and, second, that they were entitled to receive actual notice of the reorganization and its developments once the trustee knew of their claim.

In *Kay v. Hogan (In re Gulfco Investment Corp.)*,[36] the court of appeals, per Judge Doyle, rejected these arguments and said that notice to "all owners of all the affiliated entities when the existence of their claims is unknown"[37] is

with gross undercapitalization, Braddy v. Randolph, 352 F.2d 80 (4th Cir. 1965) and *In re* Sterling House, Inc., 356 F. Supp. 1113 (W.D. Va. 1973).

31. 599 F.2d at 393-94.

32. All of the opinions cited by the *Sinclair* court deal with the unsecured claims of majority shareholders. *E.g.*, Frasher v. Robinson, 458 F.2d 492 (10th Cir.), *cert. denied*, 409 U.S. 1009 (1972); Spach v. Bryant, 309 F.2d 886 (5th Cir. 1962); and Forbush v. Bartley, 78 F.2d 805 (5th Cir. 1935).

33. A security interest will be invalidated if there is a violation of the Bankruptcy Act preference provision, 11 U.S.C. § 96 (1976), or the fraudulent transfer provision, 11 U.S.C. § 107(f)(1) (1976).

34. This opinion appears to be a portent of the possible resolution of similar cases arising under the equitable subordination provisions of the new Bankruptcy Act. Secured creditors may become subject, due to creditor misconduct, to an application of the doctrine of equitable subordination.

The new Act provides that the court may "order that any lien securing such a subordinated claim be transferred to the estate." 11 U.S.C. § 510(c)(2) (West Sp. Pamph. 1979).

35. 11 U.S.C. §§ 501-676 (1976). In the revised Bankruptcy Act, the formerly separate reorganization chapters are consolidated into one. 11 U.S.C.A. §§ 1101-1174 (West Sp. Pamph. 1979).

36. 593 F.2d 933 (10th Cir. 1979).

37. 593 F.2d at 935.

not necessary and that since the Kays were aware of the reorganization proceedings, they were obligated to pursue their claim. The court then distinguished three of the opinions relied upon by the frustrated creditors, *City of New York v. New York, N.H. & H.R. Co.*,[38] *In re Intaco Puerto Rico, Inc.*,[39] and "*Harbor Tank Storage Co.*[40] as cases in which the trustee failed to provide notice after he became aware of a creditor's "unsatisfied meritorious claims."[41] In the instant case, the trustee told the Kays that they should file a request for permission to file a late claim; this was the Kays' notice, which they failed to heed. The court was reluctant, on equitable grounds, to allow an extension to persons who had already delayed for two years without a sound reason.[42]

D. *Chapter XII—Opposition to Arrangement*

In *Gardens of Cortez v. John Hancock Mutual Life Insurance Co.* (*In re Gardens of Cortez*),[43] the court of appeals held that a bankruptcy judge may dismiss a petition for a real property arrangement under Chapter XII of the Bankruptcy Act[44]—without giving the debtor an opportunity to present an alternative plan—if the debtor had already submitted one plan that was unanimously rejected, and by the time of the hearing, the debtor had settled his claims with the unsecured creditors, thereby leaving only one class of creditors consisting of two secured parties, one of whom held 90% of the secured indebtedness and who was unalterably opposed to any plan.

Relying upon two Ninth Circuit cases[45] that held that dismissal is proper if there are no classes assenting to a proposed plan and the likelihood of acceptance is remote, the court thought inapplicable the earlier Tenth Circuit opinion, *Rader v. Boyd*,[46] offered in support by the debtor. *Rader* held that there was nothing in the law to prevent a debtor from tendering an alternative Chapter XII plan and that the court "in the wise exercise of its

38. 344 U.S. 293 (1953). In this railroad reorganization case, which held that notice by publication was inadequate since property liens would be destroyed, the Court said that "even creditors who have knowledge of a reorganization have a right to assume that the statutory 'reasonable notice' will be given to them before their claims are forever barred." *Id.* at 297.

39. 494 F.2d 94 (1st Cir. 1974). The creditor here had actual knowledge of the existence of a Chapter X proceeding; however, the court said that "the fact that the creditor may, as here, be generally aware of the pending reorganization, does not of itself impose upon him an affirmative burden to intervene . . . and present his claim. The trustee cannot avoid his statutory responsibility under Chapter X, to formally provide the required notice, simply because of a creditor's possible familiarity with general aspects of the proceeding." *Id.* at 99.

40. 385 F.2d 111 (3d Cir. 1967). The attorneys of the creditors here communicated with the trustee at various times during a Chapter X proceeding. The court said "a creditor has every right to assume that he will be sent all the notices to which he is entitled under the Act." *Id.* at 115.

41. 593 F.2d at 935.

42. *Id.*

43. 585 F.2d 975 (10th Cir. 1978).

44. 11 U.S.C. §§ 801-926 (1976).

45. Owners of "SW 8" Real Estate v. McQuaid, 513 F.2d 558 (9th Cir. 1975) and Taylor v. Wood, 458 F.2d 15 (9th Cir. 1972). *See also* Kunze v. Prudential Ins. Co., 106 F.2d 917 (5th Cir. 1939).

46. 267 F.2d 911 (10th Cir. 1959). *Rader* was remanded because the bankruptcy judge did not follow the proper procedure in his adjudication.

discretion"[47] may allow the debtor to propose as many plans as the judge deems appropriate. In *Gardens*, however, the major secured creditor indicated he would veto any plan; therefore, the profferring of another proposal would be useless.

The second issue presented to the court of appeals concerned the applicability of the "cram down" provision of the Bankruptcy Act.[48] The court followed the line of cases that stand for the proposition that "cram down" is inapplicable when the secured creditors are unanimously opposed.[49]

E. *Jurisdiction*

United States v. Wilshire Apartments, Inc.[50] is being discussed in this section because the court of appeals, inexplicably, used bankruptcy law principles regarding summary jurisdiction to decide the case.

In July 1970, the Federal National Mortgage Association (FNMA) recorded its mortgage on the Wilshire property. Six years later, in January 1976, Medical Center State Bank lent Wilshire money secured in part by certificates of deposit. The United States, to which Wilshire's mortgage had been assigned by the FNMA, effected the appointment of a receiver for Wilshire in December 1976. At this time, the bank held $5370.75 in certificates which, under the terms of its loan agreement, it applied to the loan; it then submitted the balance, in the amount of $267.83, to the receiver. The United States contended that the certificates should be turned over because they were an asset of Wilshire at the time of the appointment of the receiver; the bank, of course, argued that they were not an asset and cited *Bowles v. City National Bank & Trust Co.*,[51] a recent Oklahoma case.

After several orders and responses, the district court for the District of Oklahoma entered its order directing the bank to turn over to the receiver the remaining certificates because they were an asset of Wilshire in December 1976. The bank complied and appealed.

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47. *Id.* at 914.

48. This provision reads, in relevant part:

An arrangement—

> (11) shall provide for any class of creditors which is affected by and does not accept the arrangement by the two-thirds majority in amount required under this chapter, adequate protection for the realization by them of the value of their debts against the property dealt with by the arrangement and affected by such debts, either, as provided in the arrangement or in the order confirming the arrangement. . . .

11 U.S.C. § 861 (11) (1976).

49. *E.g.*, Meyer v. Rowen, 195 F.2d 263 (10th Cir. 1952); *In re* Herweg, 119 F.2d 941 (7th Cir. 1941); *In re* Spicewood Assocs., 445 F. Supp. 564 (N.D. Ill. 1977); *In re* Georgetown Apts., 3 BANKR. CT. DEC. 512 (M.D. Fla. July 12, 1977). Other cases hold that if any of the secured creditors object, there can be no plan. Preas v. Kirkpatrick & Burns, 115 F.2d 802 (6th Cir. 1940); *In re* Bekare Realty Assocs., 3 BANKR. CT. DEC. 646 (E.D. Pa. Aug. 23, 1977). *Cf., In re* Hobson Pike Assocs., Ltd., 3 BANKR. CT. DEC. 1205 (N.D. Ga. Sept. 20, 1977) and Massachusetts Mut. Life Ins. Co. v. Marietta Cobb Apts. Co. (*In re* Marietta Cobb Apts. Co.), 3 BANKR. CT. DEC. 720 (S.D.N.Y. Sept. 9, 1977) (both holding that "cram-down" can be used against the sole creditor if there is adequate protection.) *See generally* Gilbert & Massari, *Chapter XII "Cram-Down"—Bad Medicine or Just Desserts?*, 52 AM. BANKR. L.J. 99 (1978).

50. 590 F.2d 876 (10th Cir. 1979).

51. 537 P.2d 1219 (Okla. Ct. App. 1975). The payee had used two $200,000 notes as security for a loan and had endorsed them over to City Bank. The court held that, here, the payee's receiver was not entitled to the two notes until the loan was paid off.

The court of appeals reversed and remanded for a plenary hearing on the bank's claim. In its analysis, the court depended upon cases defining the summary jurisdiction powers of the bankruptcy courts.[52] The court concluded that the district erred in ordering the bank to surrender the certificates in a summary proceeding, in light of possession by a third party with a colorable claim adverse to the receiver.

The court also rejected the contention of the United States that the turn-over directive was a non-appealable order.[53] The economic assets of Wilshire were very limited, and if the receiver were allowed to keep the certificates and pay other obligations with the funds, the bank might suffer "irreparable loss and injury."[54] Therefore, the court reasoned, the order materially affected the bank's rights and was appealable.[55]

The concurring opinion of Judge McKay pointed out that bankruptcy jurisdiction principles, while persuasive, are not controlling in the instant case.[56] While noting that, here, the applicable rule is the same for receivership and bankruptcy proceedings,[57] the concurring opinion also looked to a receivership case, *Cusack v. Prudential Insurance Co.*[58] *Cusack* held that a receiver could not utilize a summary proceeding to gain possession of property held by third persons claiming adversely.[59]

F. *Secured Transactions in Bankruptcy Context*

1. Filing Requirements

In *Lentz v. Bank of Independence (In re Kerr)*,[60] the court of appeals was asked to decide whether, in light of 1975 amendments to the Kansas UCC provisions,[61] the earlier holding in *Commerce Bank v. Chambers (In re Littlejohn)*[62] should be abandoned. In *Commerce Bank*, the court of appeals held

52. Phelps v. United States, 421 U.S. 330 (1975); Cline v. Kaplan, 323 U.S. 97 (1944); Messenger v. Frontier Plumbing & Heating (*In re* Fox Metal Indus., Inc.), 453 F.2d 1128 (10th Cir. 1972). These cases stand for the proposition that if a third party is in possession and claims adversely to the receiver or trustee in bankruptcy, then the third party has the right to have his claim adjudicated in a plenary action. *See also* Western Bd. of Adjusters v. Clements (*In re* Desert Paint & Supply Co.), 479 F.2d 45 (9th Cir. 1973); First Nat'l Bank v. Bailes (*In re* Amer. Southern Pub. Co.), 426 F.2d 160 (5th Cir.), *cert. denied*, 400 U.S. 903 (1970); Hollywood Nat'l Bank v. Bumb, 409 F.2d 23 (9th Cir. 1969). The question of summary versus plenary jurisdiction is academic now because the revised Act provides that the bankruptcy court has "exclusive jurisdiction of all of the property, wherever located, of the debtor . . . ." 28 U.S.C.A. § 1471(e) (West Sp. Pamph. 1979).

53. 590 F.2d at 881-82.

54. *Id.* at 882.

55. *See, e.g., In re* Brissette, 561 F.2d 779 (9th Cir. 1977) (interlocutory orders arising in bankruptcy proceedings are appealable if they do not arise in controversies in bankruptcy proceedings); Young Properties Corp. v. United Equity Corp., 534 F.2d 847 (9th Cir.), *cert. denied*, 429 U.S. 830 (1976); Sherr v. Sierra Trading Corp., 492 F.2d 971 (10th Cir. 1974) (in a bankruptcy proceeding, an interlocutory order that determines some right or duty is appealable).

56. 590 F.2d at 883.

57. *Id.*

58. 192 Okla. 218, 134 P.2d 984 (1943).

59. 192 Okla. at 221, 134 P.2d at 987. *See also* 2 R. CLARK, A TREATISE ON THE LAW AND PRACTICE OF RECEIVERS § 632 (3d ed. 1959).

60. 598 F.2d 1206 (10th Cir. 1979).

61. Ch. 32, 1975 Kan. Sess. Laws § 2 (amending KAN. STAT. ANN. § 84-9-302(3)(c) (1965).

62. 519 F.2d 356 (10th Cir. 1975).

that a lender's lien upon an automobile was perfected when the lender effected a notation of the lien on either the bill of sale or the former owner's title. The court in *Commerce Bank* balanced the rather complicated transfer of title process[63] against the lender's concern for having a perfected security interest and decided that the bank had done all it could to protect its interest. "We cannot hold that the burden of assembling all these items is to be placed upon the lienholder bank."[64]

In *Lentz*, which presented essentially the same factual situation as *Commerce Bank*, the bank did not fare as well as the lender. The purchasers in *Lentz* did not apply for a Kansas title at all after buying their automobile in August 1976. In November 1976, when they were adjudicated bankrupt, the bankruptcy court and the district court held that, under *Commerce Bank*, the bank's security interest had been perfected via the lien notation on the former owner's title. The Tenth Circuit reversed in light of a new statutory perfecting procedure available to banks which lend money for automobile purchases.

The 1975 amendments—which became effective after *Commerce Bank* was decided[65]—provide an alternate, simple, and inexpensive method whereby a lender could protect his lien in the interim between the purchase of an automobile and the issuance of a new certificate of title: "the mailing or delivery by a dealer or secured party to the appropriate state agency of a notice of security interest as prescribed by K.S.A. 8-135 . . . .[66]

Assuming that a statute that placed the status of a lender's lien in the hands of the debtor was contrary to the philosophy of the UCC, the court of appeals in *Lentz* reasoned that the Kansas legislature sought to remedy this situation by amending its code to allow lenders the initiative in the perfection of their liens. The *Lentz* court construed the 1975 amendments as *requiring*[67] the lender to use this alternative if it wants its liens perfected in the interim between purchase and title application.

Commerce Bank presented many problems when it was decided,[68] many of which were taken care of by the 1975 amendments and *Lentz*. The *Lentz* case is a warning for all Kansas lenders that failure to remit this notice of security agreement could mean an unperfected lien and an unsecured claim in bankruptcy court.

2. Retention of Collateral

The creditor had sold a retail store to the bankrupts and maintained a

63. Documents that need to be presented are: "application for an original certificate of title, a title fee, bill of sale showing the bank's lien, application for registration of the car, registration fee, proof of payment of personal property taxes, and evidence of tax assessment of the automobile." 598 F.2d at 1207-08.

64. 519 F.2d at 358.

65. Chapter 32 of the 1975 Kansas session laws was effective Jan. 1, 1976. *Commerce Bank* was decided June 25, 1975.

66. KAN. STAT. ANN. § 84-9-302(3)(c) (Supp. 1978).

67. 598 F.2d at 1209.

68. *See generally* Comment, In re Littlejohn: *Equitable Departure From State Certificate of Title Act Filing Requirements*, 1975 UTAH L. REV. 726.

security interest in the store assets. The bankrupts agreed to keep the inventory at the level of the time of sale; it was also agreed that if the inventory level declined, the creditor had the right to repossess. Less than two years later, the bankrupts returned the store keys to With, the creditor, saying that they were giving up trying to make the business successful; they refused to listen to With's offer of help. With closed the store and reopened one week later. The difference between the value of the inventory at time of sale and upon repossession was approximately $12,000, the amount which which With claimed should be excepted from discharge[69] in bankruptcy proceedings because of willful and malicious conversion.

The bankruptcy referee found that the decrease in inventory level and accounts receivable was so excessive as to be characterized as prima facie "willful and malicious;"[70] that a substantial inventory decrease had occurred within the three months prior to the repossession; and that the bankrupts had wasted the assets and used the proceeds for themselves.[71] The referee declared the debt non-dischargeable; the District Court for the District of New Mexico agreed and the Tenth Circuit affirmed in *With v. Amador*.[72]

The court of appeals held that With "had a security interest in . . . the inventory, the level of which the [bankrupts] had agreed to maintain at $23,209.23. When the inventory was sold down to below that level, [With's] security interest in the inventory was converted to that extent."[73] Because this conversion could be characterized as willful and malicious, the converted amount is a debt not dischargeable in bankruptcy.

The court rejected the bankrupts' contention that With had elected to repossess and retain the collateral in full satisfaction of their obligation. The court said that § 50A-9-505(2)[74] of the New Mexico statutes was not applicable here because 1) the debtors had practically forced With to repossess by foisting the keys upon him; 2) the total collateral repossessed was worth approximately one half of the amount still owed to With, so selling it would be fruitless; and 3) it would be inequitable.[75]

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69. The pertinent language in the Bankruptcy Act is: "A discharge in bankruptcy shall release a bankrupt from all of his provable debts, whether allowable in full or in part, except such as . . . are liabilities . . . for willful and malicious conversion of the property of another . . . ." 11 U.S.C. § 35(a)(2) (1976).

70. With v. Amador (*In re* Amador), 596 F.2d 428, 430 (10th Cir. 1979).

71. *Id.*

72. 596 F.2d 428 (10th Cir. 1979).

73. *Id.* at 431.

74. N.M. STAT. ANN. § 50A-9-505(2) provides:

> [A] secured party in possession may, after default, propose to retain the collateral in satisfaction of the obligation. Written notice of such proposal shall be sent to the debtor . . . . If the debtor or other person entitled to receive notification objects . . . the secured party must dispose of the collateral . . . . In the absence of such written objection the secured party may retain the collateral in satisfaction of the debtor's obligation.

The identical provision is now found at N.M. STAT. ANN. § 55-9-505(2) (Michie 1978).

75. Generally, § 9-505(2) of the UCC does not operate to deny creditors their rights. *See* Nelson v. Armstrong, 99 Idaho 422, 582 P.2d 1100 (1978) (creditor must manifest an intent to retain the collateral); Harris v. Bower, 266 Md. 579, 295 A.2d 870 (1972) (because creditor did not propose to retain the collateral and it would not be in his best interests to do so, the debt was not extinguished); Jones v. Morgan, 58 Mich. App. 455, 228 N.W.2d 419 (1975) (§ 9-505(2)

II. UNIFORM COMMERCIAL CODE

A. *Article Nine—Conversion by Auction Company*

An interesting Article Nine case is *Security National Bank v. Belleville Livestock Commission.*[76] The bank held security agreements with a cattle feeder on almost a thousand head of cattle and the proceeds therefrom. The agreement provided that the cattle could not be sold without the written consent of the bank. There was deposition testimony indicating that the bank knew Larkin, the cattle feeder, was buying and selling cattle at auction but failed to remonstrate with him and also knew that the bank permitted the sales as long as the proceeds were applied to the loan balance.[77] The bank brought an action in conversion[78] against three livestock auction companies and was granted summary judgment in the District Court for the District of Kansas. On appeal to the Tenth Circuit, the court held that the bank did not impliedly waive its security interest via its course of conduct and failure to remonstrate with the debtor. The court also held that the bank may have waived its security interest through an express authorization to sell the cattle, and thus, the auction companies—as agents of the debtor—could not be guilty of conversion. Because there was a genuine issue as to whether the bank consented to the sales, the court set aside the summary judgment and remanded.

The court of appeals chose to rely upon *North Central Kansas Production Credit Association v. Washington Sales Co.*,[79] in which the Kansas Supreme Court said that an implied waiver of a security interest cannot be shown, without more, from a creditor's failure to remonstrate with a debtor for violating the security agreement and the creditor's acceptance of the proceeds of unauthorized sales.

The auction companies based their argument on *Clovis National Bank v. Thomas*,[80] an earlier New Mexico opinion, that held a course of dealing by a bank effected the waiver of both the consent requirement and its security interest in the cattle.[81]

Understandably, the court rejected *Clovis*[82] in favor of the recent Kan-

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was "drafted for the benefit of the secured party . . . . A debtor who has been damaged by improper retention of collateral finds his remedy in U.C.C. § 9-507(1) . . . ." *Id.* at 461, 228 N.W.2d at 423). *Contra*, Moran v. Holman, 514 P.2d 817 (Alaska 1973) (retention for a long period of time of depreciating collateral, such as a motor vehicle, and personal use of it allows the debtor to claim that the debt is extinguished) and Northern Financial Corp. v. Chatwood Coffee Shop, Inc., 4 U.C.C. REP. SERV. 674 (N.Y. Sup. Ct. 1967) (a debtor is not barred from claiming that the creditor retained the collateral in full satisfaction of the debt even though the creditor did not give notice that he was doing so). *See generally* Annot., *Construction and Operation of UCC § 9-505(2) Authorizing Secured Party in Possession of Collateral to Retain It in Satisfaction of Obligation*, 55 A.L.R.3d 651 (1974).

76. No. 76-2113, 76-2114, 76-2115 (10th Cir., filed May 4, 1979).

77. *Id.* at 18-20.

78. *See generally* Annot., *Personal Liability of Auctioneer to Owner or Mortgagee for Conversion*, 96 A.L.R.2d 208 (1964).

79. 223 Kan. 689, 577 P.2d 35 (1979).

80. 77 N.M. 554, 425 P.2d 726 (1967).

81. *See also* Planters Prod. Credit Ass'n v. Bowles, 256 Ark. 1063, 511 S.W.2d 645 (1974) and Lisbon Bank & Trust Co. v. Murray, 206 N.W.2d 96 (Iowa 1973).

82. *Clovis* created a legal disturbance and § 50A-9-306(2) of the New Mexico code was

sas law found in *Washington Sales*. In *Washington Sales*, a finding of express consent was based upon testimony by the president of the lending association that he told the debtor that cattle sales were permissible as long as the proceeds were applied to the loan balance. In *Security National*, the court concluded that there was a material issue as to whether the bank expressly consented to the sales; the bank representative testified that Larkin had sold cattle previously on many occasions with the bank's consent.

III. Other Decisions Briefly Noted

A. *Truth-In-Lending*

In *Gallegos v. Stokes*,[83] the Tenth Circuit held that the purchase of a truck by a poorly educated widow who wanted to begin selling fresh produce and who was able to buy the truck only by trading in her car and some jewelry was a consumer credit transaction for purposes of the Truth-In-Lending[84] disclosure provisions.[85] The court also held that a creditor who did not have a review procedure or any other mechanism whereby calculation errors could be caught could not avail himself of the "bona fide error" defense[86] to a Truth-In-Lending violation.[87]

B. *Miller Act*

United States ex rel Olmstead Electric, Inc. v. Neosho Construction Co.[88] was a Miller Act[89] case in which the Tenth Circuit held that a supplier's claim was

amended in 1968 by the addition of this sentence: "A security interest in farm products and the proceeds thereof shall not be considered waived by the secured party by any course of dealing between the parties or by any trade usage." 1968 N.M. Laws ch. 12, § 2. *Clovis* has not always been followed; *see, e.g.*, Colorado Bank & Trust Co. v. Western Slope Inv., Inc., 36 Colo. App. 149, 539 P.2d 501 (1975) (non-enforcement of provision requiring written consent to sell does not effect a waiver of that provision) and Southwest Washington Prod. Credit Ass'n v. Seattle-First Nat'l Bank, 92 Wash. 2d 30, 593 P.2d 167 (1979) (Non-enforced written consent provision; however, the court reasoned that the bank's consent to sales was conditioned upon receipt of the proceeds. "The UCC does not prevent a second party from attaching such a condition or limitation to its consent to sales of collateral by a debtor. A sale by the debtor in violation of those conditions is an unauthorized sale and the security interest, under § 9-306(2), continues in the collateral." 593 P.2d at 169 (citations omitted)). *Clovis* has also been criticized for its holding that the common law of waiver supplements the Code. *See, e.g.*, Swift & Co. v. Jamestown Nat'l Bank, 426 F.2d 1099 (8th Cir. 1970) ("Section 9-306(2) serves as a codification of the common law of waiver." 426 F.2d at 1103-04.) and United States v. Greenwich Mill & Elevator Co., 291 F. Supp. 609 (N.D. Ohio 1968) (*Clovis* goes too far in its "continuance of the doctrine of waiver." 291 F. Supp. at 614.)

83. 593 F.2d 372 (10th Cir. 1979).
84. 15 U.S.C. §§ 1601-1644 (1976).
85. 593 F.2d at 375.
86. A creditor who proves that "the violation was not intentional and resulted from a bona fide error notwithstanding the maintenance of procedures reasonably adapted to avoid any such error" is not liable under the Truth-In-Lending disclosure provisions. 15 U.S.C. § 1640(c) (1976).
87. The court relied upon Mirabal v. General Motors Acceptance Corp., 537 F.2d 871 (7th Cir. 1976). *See also* Detillo v. J.R. Moore Farm Supply Co., 449 F. Supp. 559 (W.D. Pa. 1978).
88. 599 F.2d 930 (10th Cir. 1979).
89. 40 U.S.C. §§ 270a-270d (1976). The Miller Act provides financial protection to persons who supply labor or materials to either the prime contractor or the subcontractor in the performance of a government contract by requiring the posting of a payment bond by the government contractor.

barred because notice to the general contractor was provided more than ninety days after the supplier's last unpaid shipment to the subcontractor.[90] One month before he gave notice, the supplier had delivered to the general contractor electrical supplies that had been ordered by the subcontractor. The general contractor paid the supplier for the equipment, and thus, this purchase was not to be included in any claims the supplier might have. Because there were no other unpaid shipments within the ninety days prior to the supplier's notice, the supplier's claim was defeated for untimeliness.

The dissenting opinion of Judge Logan pointed out that there were only two ways by which the supplier could have protected his claim: 1) refuse payment from the general contractor so that a recent charge would be outstanding or 2) give notice, routinely, whenever accounts are almost ninety days old.[91]

C. *Uniform Bill of Lading*

The court, in *Atchison, Topeka & Santa Fe Railway v. Littleton Leasing & Investment Co.*,[92] held that letters[93] to the carrier from the shipper in response to "past-due" notices from the carrier's credit department for unpaid freight charges did not constitute compliance with the written notice of claim requirement of the uniform bill of lading which formed the parties' contract. The dissent of Judge McKay indicates that he would characterize the letters as in compliance because they did give notice of damage incurred, notwithstanding that they were directed to the wrong department within the carrier's large organization.[94]

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90. The applicable notice provision is:

> [A]ny person having direct contractual relationship with a subcontractor but no contractual relationship express or implied with the contractor furnishing said payment bond shall have a right of action upon the said payment bond upon giving written notice to said contractor within ninety days from the date on which such person did or performed the last of the labor or furnished or supplied the last of the material for which such claim is made. . . .

40 U.S.C. § 270b(a) (1976).

91. 599 F.2d at 934.

92. 582 F.2d 1237 (10th Cir. 1978).

93. One of the letters to the railway company's credit manager stated that several damage claims were pending and another said that the shipper was awaiting credit memoranda before making payment. The carrier's credit department's response to the first letter was that the freight charges were separate from any damage claims that the shipper may have had; the carrier's response to the second letter was that, according to their freight claim department, no claims by the shipper were pending.

94. 582 F.2d at 1241-42.