

Bankruptcy - Sale of Mortgaged Chattels as Wilful and Malicious Injury to Property not Dischargeable in Bankruptcy

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teet general creditors, and, in contemplation of the trustee's existing rights as a judgment creditor, the various exceptions to tax lien priority were enacted to give protection from the secret tax lien. The inescapable conclusion follows that the trustee in bankruptcy has the status of a judgment creditor as that term is used in the *Internal Revenue Code*,³⁵ and so concluded the Supreme Court in *United States v. Speers*.³⁶ Thus, to maintain secured creditor status the United States will have to file its tax lien before any petition in bankruptcy.

Two potential results seem to flow from the *Speers* decision. Foremost, there is a possibility of an increased number of involuntary bankruptcy petitions at the instance of creditors who may fare better in bankruptcy where the government's unrecorded tax lien is subordinated.³⁷ Additionally, the government's practice of forbearance in recording tax liens and taking consequent civil action for enforcement³⁸ may be reversed, which might also tend to increase the number of bankruptcies. Both possibilities are to the detriment of debtors who might otherwise be able, given time, to regain financial stability.

Robert Goldman

³⁵ INT. REV. CODE OF 1954, § 6323.

³⁷ *Id.* at 417.

³⁶ 86 Sup. Ct. 411 (1965).

³⁸ *Supra* note 21.

BANKRUPTCY—SALE OF MORTGAGED CHATTELS AS WILFUL AND MALICIOUS INJURY TO PROPERTY NOT DISCHARGEABLE IN BANKRUPTCY

On April 7, 1962, defendants executed a chattel mortgage for restaurant equipment, purchased from a dealer, to plaintiff-mortgagee bank, which plaintiff duly recorded. Subsequently, on July 30, 1963, defendants returned some of the mortgaged equipment to the original seller and received a cash refund, without notice to or approval of the chattel mortgage holder. Subsequently, the defendants filed bankruptcy, both individually and with respect to their restaurant partnership, in the United States District Court. Plaintiff first learned of defendant's disposal of the chattels when the receiver in bankruptcy was unable to deliver the chattels to the plaintiff-mortgagee pursuant to a court order. Plaintiff then instituted an action in the Circuit Court of Cook County against defendants for conversion of chattels covered by a chattel mortgage. The trial court rendered judgment for defendants on the grounds that defendant's act of disposing of the chattels did not constitute a conversion within the meaning of the Bankruptcy Act,¹ and that plaintiff's mortgage was not

¹ Bankruptcy Act § 17(a) (2), 30 STAT. 550 (1898), 11 U.S.C. § 35 (1964).

within those debts of a bankrupt which are not discharged by bankruptcy. The chattel mortgagee appealed, and the appellate court reversed, stating that the return of chattel-mortgaged property to the original seller for which money is received by the chattel-mortgagors, without securing the release or consent of the chattel mortgage holder, is tantamount to wilful conversion of property which would not be discharged under the Bankruptcy Act. *First National Bank of Lansing v. Padjen*, 61 Ill. App. 2d 310, 210 N.E.2d 332 (1965).

No other Illinois case has discussed the problem of a sale of mortgaged chattels as constituting wilful and malicious injury to property not dischargeable in bankruptcy. However, the decision in the *Padjen* case finds some support under the statutes, general case law, and public policy of Illinois.

Although the court stated that this is a case of first impression in Illinois,³ in 1934, the Illinois Court of Appeals granted certiorari to hear the case of *Davis v. Aetna Acceptance Co.*⁴ In that case, an automobile dealer sold a car secured by a chattel mortgage executed in favor of a finance company, such sale having been without the knowledge or consent of the chattel-mortgagee. The automobile dealer subsequently received a discharge in bankruptcy. The court, reversing the lower courts, upheld the discharge in bankruptcy as a defense to an action by the chattel-mortgagee for conversion of the mortgaged chattel, on the ground that the act of conversion was not willful or malicious.⁵ In the instant case, the sale of mortgaged chattels was held to constitute wilful and malicious injury to property, not dischargeable by bankruptcy.⁶ The holdings in the *Padjen* and *Davis* cases are not actually inconsistent with each other. In the *Davis* case, there was evidence to show that on many occasions, mortgaged automobiles had been sold by the defendant without the express consent of the plaintiff mortgagee, and the proceeds accounted for thereafter, this having been considered in the past to be acceptable business prac-

² *Ibid.*: "(a) A discharge in bankruptcy shall release a bankrupt from all of his provable debts, whether allowed in full or in part, except such as . . . (2) are liabilities for . . . wilful and malicious injuries to the person or property of another. . . ."

³ *First National Bank of Lansing v. Padjen*, 61 Ill. App. 2d 310, 312, 210 N.E.2d 332, 334 (1965): "The question certified to this court and raised by this appeal is one of first impression in the State of Illinois. Only two other states have passed upon this question." See also, 9 AM. JUR. 2d *Bankruptcy* § 792 (1963).

⁴ 293 U.S. 328 (1934).

⁵ Although the court did not discuss the question of whether the sale of the mortgaged chattel constituted an injury to property, the fact of injury was implied, since the court referred to the sale as a conversion and since the only question discussed by the court was whether the conversion was wilful and malicious.

⁶ *Supra* note 3.

tice.⁷ The court considered this to be an innocent conversion consummated under an honest but mistaken belief of permission, engendered by a course of prior dealings, and therefore, not wilful or malicious.⁸ In the instant case, it could not be expected or contemplated by the parties that the mortgagor would sell the equipment purchased to meet the permanent needs of his business, and such a sale, not being in the ordinary course of the mortgagor's business, would be deemed wilful and malicious within the meaning of the Bankruptcy Act.

In Illinois, a chattel mortgage vests legal title of the chattel in the mortgagee.⁹ The chattel-mortgagee's interest in the mortgaged chattel is considered a protectable property interest.¹⁰ Hence, a sale of the chattel by a mortgagor, which deprives the mortgagee of property which he had a right to look to as security in the event of the mortgagor's default on a loan, could be considered an injury to the mortgagee's property interest.

These views are further exemplified by the *Uniform Commercial Code*,¹¹ which provides that a sale of collateral securing a loan by the debtor without the assent of the secured party will subject the debtor to criminal penalties.¹² Illinois statutory law predating the *Code* was in accord.¹³ Under the *Illinois Criminal Code*,¹⁴ a sale of mortgaged property by the mortgagor without approval or permission of the mortgagee constitutes a theft of property, since by definition, "a person commits theft

⁷ *Supra* note 4.

⁸ *Ibid.*

⁹ *Faubel v. Michigan Blvd. Co.*, 278 Ill. App. 159 (1934); *Greenspahn v. Ehrlich*, 277 Ill. App. 322 (1934); *Brass v. Green*, 113 Ill. App. 58 (1904). Under the Uniform Commercial Code, ILL. REV. STAT. ch. 26, § 9-202 (1965), title to collateral is immaterial: "Each provision of this article with regard to rights, obligations and remedies applies whether title to collateral is in the secured party or in the debtor."

¹⁰ In *Horwich v. Walker-Gordon Lab. Co.*, 205 Ill. 497, 506, 68 N.E. 938, 941 (1903), the court stated that "[t]he purpose of the statute requiring the written consent of the mortgagee was to prevent property in which he had an interest from being so disposed of that he would be hindered in enforcing his debt. That was intended as a protection to his property rights . . . [t]he chattel mortgage statute is for the protection of the mortgagee who is not a party to the sale and cannot protect himself." The *Padjen* case is in accord.

¹¹ ILL. REV. STAT. ch. 26, § 9-306.01 (1965).

¹² In ILL. ANN. STAT. ch. 26, § 9-306.01 (Smith-Hurd 1961), the comment states that the section "extends the criminal penalty to the security interest under this article, not merely those in the nature of a chattel mortgage. . . ."

¹³ ILL. REV. STAT. ch. 95, § 8 (1965), which makes it a misdemeanor for a mortgagor in possession of mortgaged personal property to sell, transfer, . . . or in any manner dispose of the property without the written consent of the mortgage holder. The purpose of this section is to protect the property rights of the mortgagee by preventing the disposition of the security by the mortgagor to the injury of the mortgagee. See also, *Horwich v. Walker-Gordon Lab. Co.*, *supra* note 10.

¹⁴ ILL. REV. STAT. ch. 38, § 16-1 (1965).

when he knowingly: a) obtains or exerts unauthorized control over property of the owner."¹⁵ In addition, the *Code* specifically provides that "it is no defense to a charge of theft of property that the offender has an interest therein, when the owner also has an interest to which the offender is not entitled."¹⁶ The term "property," as defined in the *Illinois Criminal Code*,¹⁷ includes commercial instruments and written instruments representing or embodying rights concerning anything of value. A chattel mortgage could be construed as either one of the defined instruments. Therefore, a mortgagee is an "owner" which the *Criminal Code* seeks to protect by making a criminal offense of certain acts committed by a mortgagor against a mortgagee, which acts include the sale of property in which the mortgagee has an interest.

The cases in other jurisdictions which have passed upon the question of wilful and malicious injury to property, as not dischargeable by bankruptcy, have considered two phases of the problem. First, the type of intent necessary to constitute the tortfeasor's acts as "wilful and malicious," and secondly, what acts constitute injury to property.

As to the type of intent necessary, the great majority of jurisdictions have ruled that the actor need not act with actual malice, hatred, or ill will, as a state of mind, nor with specific intent to injure, but need only act without legal cause, excuse, or justification, and in reckless disregard of the person, property, or legal rights of others.¹⁸

As to what acts constitute injury to property, almost all jurisdictions are in agreement that injuries to property with the contemplation of the Bankruptcy Act¹⁹ are not confined to physical damages or destruction,²⁰

¹⁵ *Ibid.*

¹⁶ ILL. REV. STAT. ch. 38, § 16-4(a) (1965).

¹⁷ ILL. REV. STAT. ch. 38, § 15-1 (1965).

¹⁸ See Note, 38 N.C.L. REV. 384 (1960), wherein it is said that the modern trend favors an interpretation not of ill will or malice, but a wrongful act done in utter disregard of the legal rights of others. See also, *Tinker v. Colwell*, 193 U.S. 474 (1904); *Peters v. U.S. ex rel. Kelly*, 177 Fed. 885 (7th Cir. 1910); *In re Stenger*, 283 Fed. 419 (E.D. Mich. 1922); *In re Drowne*, 124 F.Supp. 842 (D.R.I. 1954); *McChristal v. Clisbee*, 190 Mass. 120, 76 N.E. 511 (1906); *Wellman v. Mead*, 93 Vt. 322, 107 Atl. 396 (1919). In *Fruchter v. Martin*, 350 Mich. 12, 85 N.W.2d 125 (1957), the court held that an unlawful conversion of property might, under certain circumstances, be deemed wilful and malicious from the very act of conversion itself, and hence, a timely legal claim based upon such conversion would not necessarily be barred by the debtor's intervening discharge in bankruptcy. See also, *Atomatic, Inc. v. Berkun*, 14 Ill. App. 2d 60, 143 N.E.2d 63 (1957), wherein it was held that a conversion need not involve special malice to come within the exception of this section. In *United States v. Stinnett*, 111 F.Supp. 384 (E.D. Mich. 1953), it was held that discharge does not release bankrupt from a money obligation.

¹⁹ See *supra* note 1.

²⁰ See *Probst v. Jones*, 262 Mich. 678, 680, 247 N.W. 779, 780 (1933), wherein the court stated that "[i]njuries within the meaning of the exception are not confined to

nor need the property be tangible and physical, since injury to property rights is within the exception.²¹

Many acts of conversions of personal property and property subject to a security interest have been held to constitute wilful and malicious injury to property within the exception.²² However, every act of conversion does not necessarily constitute wilful and malicious injury to property, liability for which is not released by discharge in bankruptcy, but there may be innocent or technical conversion.²³

physical damage or destruction. Wilful and malicious conversion is an injury to property within the meaning of the present law, and liability therefor is not released by the discharged." See also, *Tudryck v. Mutch*, 320 Mich. 86, 30 N.W.2d 512 (1948); *Koch v. Segler*, 331 S.W.2d 126 (Mo. App. 1960); Annot. 78 A.L.R.2d 1220 (1960).

²¹ *Barbachano v. Allen*, 192 F.2d 836 (9th Cir. 1951). See *In Re Minsky*, 46 F.Supp. 104 (S.D.N.Y. 1942), wherein a bankrupt induced a third party to breach a contract that the third party had made with plaintiff, and it was held not to be dischargeable by bankruptcy. The court considered a contract right to be property, and interference with such contract relations an injury to that property. See also, *McIntyre v. Kavanaugh*, 242 U.S. 138 (1916), wherein the Court held that to deprive another of his property by deliberately disposing of it without semblance of authority was certainly an injury thereto within the common acceptance of the words.

²² See *re Binsky*, 6 F.Supp. 789 (S.D.N.Y. 1934), wherein acts of conversion were held not dischargeable by bankruptcy. Cases supporting this same thesis include: *In re Healer*, 243 Fed. 770 (N.D.N.Y. 1917), wherein conversion of money deposited to secure performance by another was held to be a wilful and malicious injury; *Baker v. Bryant Fertilizer Co.*, 271 Fed. 473 (4th Cir. 1921), wherein a merchant who misappropriated proceeds of the goods sold contrary to the sales agreement was not discharged by bankruptcy; *Covington v. Rosenbusch*, 148 Ga. 459, 97 S.E. 78 (1918); *Massachusetts Bonding and Insurance Co. v. Lineberry*, 320 Mass. 510, 70 N.E.2d 308 (1946); *Barbery v. Cohen*, 183 App. Div. 424, 170 N.Y.S. 762 (1918); *Bank of Williamsville v. Amherst Motor Sales*, 234 App. Div. 261, 254 N.Y.S. 825 (1932); *Savage v. Wilkerson*, 176 Okla. 593, 56 P.2d 877 (1936); *Smith v. Ladrie*, 98 Vt. 429, 129 Atl. 302 (1925). The rationale behind the majority view that a conversion, although not amounting to physical destruction, constitutes injury to property, is explained in *McIntyre v. Kavanaugh*, *supra* note 21 at 141, wherein the Court stated "[t]he argument is that an examination of our several Bankruptcy Acts and consideration of purpose and history of the 1903 amendment will show Congress never intended the words in question to include conversion. We can find no sufficient reason for such a narrow construction. And instead of subserving the fundamental purposes of the statute, it would rather tend to bring about unfortunate if not irrational results. Why, for example, should a bankrupt who had stolen a watch escape payment of damages, but remain obligated for one maliciously broken."

²³ See *Davis v. Aetna Acceptance Co.*, *supra* note 4; *Crawford v. Burke*, 195 U.S. 176 (1904); *Tudryck v. Mutch*, *supra* note 20. See also, *Rees v. Jensen*, 170 F.2d 348 (9th Cir. 1948); *In re Hammond*, 22 F.Supp. 192 (S.D.N.Y. 1938), *rev'd on other grounds*, 98 F.2d 703 (2d Cir. 1938), wherein the court stated that wilful and malicious injury does not follow as a matter of course from every act of conversion; *Hunter v. Commercial Securities Co.*, 237 Miss. 41, 113 So. 2d 127 (1959); *Fechter v. Postel*, 114 App. Div. 776, 100 N.Y.S. 207 (1906); *Ulver v. Doran*, 167 App. Div. 259, 152 N.Y.S. 655 (1915); *Rone Jewelry Co. v. Conley*, 204 Tenn. 275, 319 S.W.2d 245 (1958); *Taitch v. Lavoy*, 57 Wash. 2d 857, 360 P.2d 588 (1961).

The minority view, which appears to be comprised of primarily the early New York cases, is well stated in the case of *In re Ennis and Stoppani*,²⁴ wherein brokers, by fraud, induced a customer to authorize them to purchase stocks for him and to deposit margins therefor. Subsequently, they converted such stocks and became bankrupt. The court, in holding for the bankrupt brokers, stated, "injury to person and property means causing damage to the subject matter of the rights, not depriving the owner of them."²⁵

While the instant case finds collateral support in the general case law of other jurisdictions, only two states have passed upon the specific question of whether the sale of property subject to a chattel mortgage constitutes wilful and malicious injury to property.

In 1962, a Louisiana appellate court heard the case of *Excel Finance Company, Inc. v. Tannerhill*,²⁶ involving the sale of inventory subject to a chattel mortgage. The defendant-mortgagor was engaged in the furniture business, and to secure a note held by the plaintiff-finance company, he mortgaged some of the furniture on the premises, which he subsequently sold without permission of the mortgagee. The court held that the wrongful sale of mortgaged property was a conversion of property to the injury of the holder of the note and mortgage, and was a wilful and malicious injury to the property within the statute which declared what debts were not affected by a discharge in bankruptcy.²⁷

Vermont passed upon this same question in the case of *Mason v. Sault*,²⁸ wherein the court, in the mortgagee's suit for conversion, held that the act of the mortgagor of a mare, the mortgagor having mere permissive possession, in selling her at public sale and appropriating the proceeds to his own use, could be found to be a wilful and malicious injury to the mortgagee's personal property within the meaning of the section excepting such a liability from operation of a discharge in bankruptcy.²⁹

The case of *Probst v. Jones*³⁰ is also in point, but is concerned with mortgaged land rather than chattels. The mortgagor sold land subject to an unrecorded mortgage without the knowledge or consent of the mortgagee. The court held that the destruction of the mortgagee's security by such sale was an injury to property within the exception of the statute, and the mortgagor was not released from liability by a subsequent discharge in bankruptcy.³¹

The majority view, as set out above, is to the effect that a conversion,

²⁴ 171 Fed. 755 (S.D.N.Y. 1909).

²⁸ 93 Vt. 412, 108 Atl. 267 (1919).

²⁵ *Id.* at 757. See also, *supra* note 23.

²⁹ *Ibid.*

²⁶ 140 So. 2d 202 (La. App. 1962).

³⁰ 262 Mich. 678, 247 N.W. 779 (1933).

²⁷ *Ibid.*

³¹ *Ibid.*

such as found in the instant case, is a wilful and malicious injury to property and is not discharged by bankruptcy. Illinois statutory and case law, as well as the *Uniform Commercial Code*, are substantially in accord with this view. However, even in jurisdictions holding to the majority view, there is no unanimity in the basis for their holding. Some of these courts put greater emphasis on the actor's intent, state of mind, and his reason for the conversion, while other courts give only passing attention to the tortfeasor's intent or wilfulness, but place their emphasis on the act of conversion itself looking primarily to the injury to property or property rights.

The instant case may be distinguished from earlier Illinois decisions on wilful and malicious injury to property as constituting a bar to a discharge in bankruptcy, in that these earlier decisions stressed the actor's intent, emphasizing the wilfulness and maliciousness of the act. The *Padjen* decision paid little note to how wilful or malicious the conversion was, but emphasized the injury to the mortgagee's property right in the secured chattel on account of the mortgagor's conversion of such chattel. Perhaps the court was influenced largely by Illinois statutory law, and the *Uniform Commercial Code*, which recognizes that a mortgagee has a protectable property right in mortgaged property, and which contains various provisions designed to protect the holder of a security interest against conversion of the secured property by a mortgagor.

Joel Lipscher

CONSTITUTIONAL LAW—CONSCIENTIOUS OBJECTOR— EFFECT OF FAILURE TO BELIEVE IN SUPREME BEING

Irving Stolberg was denied conscientious objector status by his local draft board. Acting upon the recommendation of the Department of Justice, the appeal board sustained his 1-A classification. Stolberg refused to submit to induction and was convicted of violating the Universal Military Training and Service Act.¹ He appealed from said decision, and the court of appeals reversed, granting him the conscientious objection exemption despite the fact that he did not believe "the Supreme Being constituted a force outside of man."² *United States v. Stolberg*, 346 F.2d 363 (7th Cir. 1965).

¹ Universal Military Training and Service Act, § 6(j), Stat. (1948), 50 U.S.C. § 456(j) (1964).

² *United States v. Stolberg*, 346 F.2d 363, 364 (7th Cir. 1965).