Vanderbilt Law Review

Volume 38
Issue 4 *Issue 4 - Symposium on Bankruptcy*

Article 3

5-1985

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Vern Countryman

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I. INTRODUCTION

A bankruptcy trustee is armed by statute with a number of powers to avoid prebankruptcy transfers made by the now bankrupt debtor. Probably none of these powers is of more concern to prebankruptcy transferees than the trustee's power to avoid preferential transfers. This Article examines the content of and the reasons for the concept of a preferential transfer as it has evolved over the centuries.

We inherited the notion of the preferential transfer from England; but, as elsewhere, we frequently have concluded that we

* Royall Professor of Law, Harvard Law School.

could improve on the English model. Substantial differences exist, therefore, between the English law of voidable preferences and the American approach. Taking a brief look at English antecedents will contribute to an understanding of our own concept.

II. The English Concept

As early as 1571, Parliament acted to outlaw transfers of property by a debtor with the intent and effect of hindering, delaying, or defrauding creditors.[1] The Statute of 13 Elizabeth made such a transfer a crime and punished the parties to it, except for transferees for "good consideration and bona fide."[2] Punishment consisted of imprisonment and forfeiture of one year's value of real property and "the whole value" of personalty involved in the transfer, with one half of the recovery going to the "party or parties grieved."[3] But King's Bench promptly concluded that, under this statute, a judgment creditor could treat a fraudulent conveyance as void and levy execution on the property as if the conveyance had not been made.[4]

Many states either reenacted this ancient English statute or treated it as a part of their inherited common law.[5] In half of the states, the matter is now covered by the Uniform Fraudulent Conveyance Act (UFCA).[6] The UFCA does not limit the ability to avoid fraudulent conveyances to creditors with judgment. Courts in many states not adopting the UFCA have reached the same result, because of the merger of law and equity or through the aid of a rule similar to the Federal Rule of Civil Procedure 18(b).[7]

The concept of a voidable fraudulent conveyance outside of bankruptcy, however, never embraced the concept of voidable preference. The "good consideration" that protected the bona fide transferee under the Statute of Elizabeth and the "fair considera-

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1. 13 Eliz., ch. 5 (1571).

2. *Id.*

3. *Id.*

4. Mannocke's Case, 73 Eng. Rep. 661 (K.B. 1571).

5. *See* 1 G. Glenn, Fraudulent Conveyances and Preferences § 58 (rev. ed. 1940).

6. 7A U.L.A. 161 (1918). The UFCA was promulgated in 1918 and in 1984 was revised in a new Uniform Fraudulent Transfer Act. 7A U.L.A. Supp. 67 (1985).

7. "Whenever a claim is one heretofore cognizable only after another claim has been prosecuted to a conclusion, the two claims may be joined in a single action . . . . In particular, a plaintiff may state a claim for money and a claim to have set aside a conveyance fraudulent as to him, without first having obtained a judgment establishing the claim for money." Fed. R. Civ. P. 18(b). Rule 38 also preserves the right to jury trial on all issues for which that right exists. Fed. R. Civ. P. 38.

tion" that protects him under the UFCA include antecedent debt paid or secured by the debtor's transfer.[8] There are probably two reasons for this limitation on the coverage of fraudulent conveyance doctrine. First, if the debtor's voluntary[9] transfer to a creditor leaves the debtor with sufficient assets to pay his other creditors, the creditor receiving the transfer has been "preferred" only in the sense that he is not put to the inconvenience of litigation to enforce his claim. Second, the common-law system provides a series of "grab law" remedies for the collection of claims through attachment, garnishment, execution, and similar remedies under which the race is to the swift. Furthermore, the common-law system provides those remedies without regard to the debtor's financial condition. Such a system hardly could be expected to require the creditor to return what he had received if he collected or obtained security without resort to litigation.[10] Only when the legal system provides, as an alternative to the creditors' unilateral grab-law system, a procedure for collective administration of the debtor's estate with a prescribed order of distribution to all creditors, can we expect the lawmakers to become concerned about the debtor's preadministration transfers that will frustrate the prescribed order of distribution.

Lawmakers, however, did not anticipate the preference problem. England's first bankruptcy act,[11] enacted almost thirty years before Parliament addressed the problem of fraudulent conveyances, said nothing of preferences. The act provided for bankruptcy proceedings that only creditors could initiate.[12] In these

8. *See* G. GLENN, *supra* note 5, § 289. Section 3 of the UFCA does require that the debt paid be a "fair equivalent" of, and that tbe debt secured not be "disproportionately small" as compared with, the value of the property the debtor transfers.

9. In this context, a transfer is voluntary if the law does not compel it.

10. The UFCA in § 7 allows creditors to avoid transfers tbat the debtor makes with actual intent to hinder, delay, or defraud creditors. 7A U.L.A. 242 (1918). Creditors, however, may not avoid such transfers if the debtor makes them for "fair consideration" to purchasers who have no knowledge of the fraud. *Id.* §§ 8-9. The UFCA goes beyond the common law, however. Disregarding the debtor's intent, the UFCA allows creditors to avoid transfers that the debtor makes without fair consideration and that leave the debtor either insolvent or with an unreasonably small capital for a business or transaction in which he is engaged or about to engage. *Id.* §§ 4-5. Also, a creditor may avoid the debtor's transfer without fair consideration if the debtor intends or believes he will incur debts beyond his ability to pay as they mature. *Id.* § 6. "Fair consideration" was given for the property transferred by the debtor when the transferee in good faith either gave a "fair equivalent" or when he took tbe property in good faith to secure a present advance or an antecedent debt "not disproportionately small." *Id.* at § 3.

11. 34 & 35 Hen. 7, ch. 4 (1542).

12. *Id.*

proceedings, all of the debtor's property was seized and distributed to the creditors; the debtor was imprisoned; and the unpaid balances of creditors' claims were not discharged.[13] Subsequent laws in the sixteenth and seventeenth centuries were also silent on prebankruptcy preferential transfers; although, after the Act of 1604, fraudulent conveyances were avoidable in bankruptcy.[14]

But King's Bench became concerned early with the preference problem. A decision in 1584 held that the debtor's postbankruptcy transfer of his goods to a single creditor in partial payment of that creditor's claim would not prevent the commissioners who administered the Bankruptcy Act from later passing good title to the same goods to a bona fide purchaser.[15] The court supported its decision principally by reading the act to vest exclusive power to dispose of the bankrupt estate in the commissioners.[16] But the court also emphasized that the Act directed the commissioners "to make disposition 'amongst the creditors, . . . to everyone a portion, rate and rate alike, according to the quantity of their debts' " and observed "if, after the debtor became a bankrupt, he may prefer one . . . and defeat and defraud many other poor men of their true debts . . . it would be a great defect in the law."[17]

Thereafter, Lord Mansfield took up the matter in cases concerning prebankruptcy transfers by the debtor to a creditor. Mansfield noted two types of fraudulent conveyances: those made "to defraud creditors" in violation of the Statute of Elizabeth, which did not include preferences, and those made "to defraud the public law of the land," which did include preferences in a bankruptcy context.[18] First, he held that when a debtor "on the eve of bankruptcy" transferred property to a creditor who had not demanded payment, or threatened or brought suit, the debtor's purpose was "manifestly to defeat the law" and "the equality intended by the law."[19] Consequently, the transfer was made "to defraud the . . . Statutes of Bankruptcy" and was "absolutely void."[20] Later he reached the same conclusion about a transfer of security "in contemplation of . . . bankruptcy" that a debtor gave to a creditor

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13. *Id.*
14. *See* 1 Jac., ch. 15, § 5 (1604).
15. The Case of the Bankrupts, 36 Eng. Rep. 441 (K.B. 1584).
16. *Id.* at 473.
17. *Id.*
18. *See* Alderson v. Temple, 96 Eng. Rep. 384, 385 (K.B. 1768).
19. *See id.*
20. *See id.*

whose claim was not yet due.[21] Clearly, Mansfield was concerned only with the debtor's purpose in paying or giving security.[22] In a later case, when the debtor on the day before bankruptcy paid a creditor under a mistaken apprehension that the creditor was about to resort to legal process, Mansfield found no preference.[23] He stated that a debtor generally does not make a voluntary preference if he transfers "under fear of legal process."[24] But the debtor here, "acting from mistake was under the same apprehensions of legal process as if the defendant had actually threatened suit," so that the payment "was not a voluntary act."[25] Mansfield apparently viewed as mutually exclusive the case in which the debtor paid in response to the creditor's demand on a due debt to which the debtor had no defense, and the case in which the debtor acted solely on his own initiative. In the latter case, the debtor acting "on the eve" or "in contemplation of" bankruptcy must have intended to change the distribution among creditors in bankruptcy.[26]

Mansfield's views obviously influenced Parliament when it finally acted on the preference problem in 1869. Although the "eve of bankruptcy" became any time within three months of bank-

21. Rust v. Cooper, 98 Eng. Rep. 1277, 1280 (K.B. 1777). The creditor did not demand payment or threaten suit, and the transfer was made "with no other view whatsoever but to defeat the equality of the bankruptcy laws." *Id.* at 1279-80.

22. "A general question has been started [*sic*], whether a man may or may not, on the eve of hankruptcy, give a preference to a particular creditor? I think he may and he may not. If one demands it first, or sues, him, or threatens him, without fraud, the preference is good. But where it is manifestly to defeat the law, it is bad." *Alderson*, 96 Eng. Rep. at 385. "If, in a fair course of business, a man pays a creditor who comes to be paid, notwithstanding the debtor's knowledge of his own affairs, . . . yet, being a fair transaction in the course of business, the payment is good; for the preference is . . . not the object. . . ." *Rust*, 98 Eng. Rep. at 1280.

23. *See* Thomason v. Freeman, 99 Eng. Rep. 1026, 1028 (K.B. 1786).

24. "A bankrupt when in contemplation of his bankruptcy cannot hy his voluntary act favour any one creditor; but if under fear of legal process he gives a preference, it is evidence that he does not do it voluntarily." *Id.*

25. *Id.* Mansfield knew that the legal process to which an impatient creditor might resort included a *capias* writ under which the debtor would be clapped into debtor's prison. For more detail, see Countryman, *A History of American Bankruptcy Law*, 81 COM. L.J. 226, 226-28 (1976).

26. At the time of Mansfield's decisions, only creditors could initiate bankruptcy proceedings on an involuntary petition. Their petitions had to allege the commission by the debtor of an "act of bankruptcy." Many of those acts, however, enabled the debtor, if not to avoid the petition, at least to affect its timing—failing to pay debts of $100 or more, absconding, taking sanctuary, or keeping to one's house. *See* 8 W. HOLDSWORTH, A HISTORY OF ENGLISH LAW 237-38 (2d ed. 1937). In *Alderson v. Temple*, the debtor "committed several acts of bankruptcy" three days after the transfer. 96 Eng. Rep. at 385. In *Rust v. Cooper*, the debtor stopped payments one day after the transfer. 98 Eng. Rep. at 1277-78.

ruptcy, Parliament declared that every payment or other transfer within the three month period to a creditor made or suffered by one unable to pay his debts as they became due "with a view of giving such creditor a preference over the other creditors" should "be deemed fraudulent and void against the trustee of the bankrupt."[27] As reenacted in 1883[28] and again in 1914,[29] the English concept of preference remains virtually unchanged today,[30] except for a 1947 amendment that extended the preference period from three to six months prior to bankruptcy.[31] Although the preference in the English statute still is "deemed fraudulent and void" against the bankruptcy trustee, fraud is no part of the definition. If the debtor's "dominant" intent was to prefer the creditor, then the good faith of the creditor is irrelevant. Moreover, since Mansfield's time, courts have recognized that a creditor's demand for payment will not preclude a finding that the debtor's "dominant" intent in paying a debt was to prefer the creditor paid.[32] Under the English concept, therefore, a preference, which is not voidable outside of bankruptcy, is a culpable act of the debtor with or without the preferred creditor's complicity, who can be compelled to surrender the property even though he received it in all innocence. This culpable act, like a fraudulent conveyance, is also an "act of bankruptcy" that will support a creditor's involuntary petition and will forfeit the debtor's bankruptcy discharge.[33]

III. Earlier American Concepts

Our first and short-lived federal Bankruptcy Act of 1800 followed the English model of that time. The Act was confined to "traders" or merchants, and only creditors could initiate the bankruptcy proceeding on a petition alleging that the debtor committed an "act of bankruptcy."[34] The statute gave the debtor a limited list of exempt property and a limited discharge of the unpaid balances

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27. 32 & 33 Vict., ch. 71, § 92 (1869).
28. 46 & 47 Vict., ch. 52, § 48 (1883).
29. 4 & 5 Geo. 5, ch. 59, § 44 (1914).
30. Although the 1869 Act protected a "purchaser, payee, or incumbrancer in good faith and for a valuable consideration," the 1883 and 1914 Acts made clear that the protection was confined to such a person claiming "through or under" the preferred creditor. 46 & 47 Vict., ch. 52, § 48 (1883); 4 & 5 Geo. 5, ch. 59, § 44 (1914).
31. 10 & 11 Geo. 6, ch. 47, § 116(3) (1947).
32. *See* R. Williams & M. Hunter, The Law and Practice of Bankruptcy 346-50 (19th ed. 1979).
33. *See id.* at 123-25, 131-32.
34. 2 Stat. 19-21 (1800), *repealed by* 2 Stat. 248 (1803).

of his debts.[35] Fraudulent conveyances were acts of bankruptcy and were avoidable,[36] but the act said nothing about preferential transfers.

Our second and equally short-lived Bankruptcy Act of 1841[37] went beyond the contemporary English practice. The Act not only authorized creditors' involuntary proceedings for merchants but also authorized voluntary proceedings on the debtor's own petition for both merchants and nonmerchants.[38] Both fraudulent conveyances and preferential transfers were voidable if made within two months of bankruptcy or if made at an earlier time to a transferee who had notice either of the debtor's commission of an act of bankruptcy or of his intent to become a bankrupt.[39] The Act defined the voidable preference as transfer to a creditor from a debtor "in contemplation of bankruptcy, and for the purpose" of giving the transferee a "preference or priority over the general creditors."[40] The debtor who made either a preferential or a fraudulent transfer forfeited his bankruptcy discharge.[41] But, even though the fraudulent conveyance was an act of bankruptcy, the preference was not.[42]

Our third and somewhat longer-lived Bankruptcy Act of 1867,[43] in its concern for the state of mind of the transferee, departed even further from the English concept of a preference. That Act defined the voidable preference in two steps. First, a debtor who was "insolvent, or in contemplation of insolvency" must have made a transfer within four months before bankruptcy "with a view to give a preference to any creditor."[44] Second, the creditor must have possessed "reasonable cause to believe [the debtor] insolvent" and the transfer to be in fraud "of the provisions of this act."[45] The definition also covered judicial seizures of the debtor's property under creditors' process that the debtor "procure[d]"

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35. *Id.* This "fresh start" policy had been initiated in England in 1705. 4 Anne, ch. 17 (1705).

36. 2 Stat. at 21.

37. 5 Stat. 440 (1841), *repealed by* 5 Stat. 614 (1843).

38. Voluntary proceedings did not come in England until 1844, but its law was still confined to merchants. 7 & 8 Vict., ch. 96 (1844). Parliament abolished the voluntary petition in 1869, 32 & 33 Vict., ch. 71 (1869), but restored it in 1883, 46 & 47 Vict., ch. 52 (1883).

39. 5 Stat. 440, § 2 (1841).

40. *Id.*

41. *Id.* § 4.

42. *Id.*

43. 14 Stat. 517 (1867), *repealed by* 20 Stat. 99 (1878).

44. 14 Stat. 517, § 35 (1867).

45. *Id.*

within four months of bankruptcy.[46] Any such preferential transfer or seizure, or any fraudulent conveyance, also constituted an act of bankruptcy and barred the debtor's discharge.[47]

Under the 1867 Act, the Supreme Court in *Toof v. Martin*[48] sustained a finding of voidable preference when a merchant debtor within six weeks of bankruptcy, after being presented with a creditor's bills which he could not pay, transferred real estate to the creditor in exchange for partial credit on the unpaid bills and the creditor's promise to continue supplying goods on credit.[49] Noting that the Act did not provide a definition of insolvency, the Court suggested that, for merchants, insolvency might mean the inability to pay debts as they mature;[50] and for nonmerchants, the "general and popular meaning" of insolvency was "the insufficiency of the entire property . . . to pay . . . debts."[51] The Court concluded, however, that the debtor knew that he was insolvent under both definitions at the time of the transfer.[52] And, since everyone was presumed to intend the necessary and probable consequences of his acts, the Court ruled that the prebankruptcy transfer was "conclusive evidence that a preference was intended, unless the debtor [could] show that he was at the time ignorant of his insolvency, and that his affairs were such that he could reasonably expect to pay all his debts. The burden of proof [was] on [the debtor] in such a case . . . ."[53]

The Court also found the creditor to have reasonable ground to believe the debtor insolvent.[54] Consequently, the creditor had reasonable ground to believe that the debtor made the transfer "in fraud of the provisions of the bankrupt [*sic*] act."[55] The Court reasoned that "any transfer made with a view to secure the property, or any part of it, to one, and thus prevent an equal distribution, is a transfer in fraud of the act."[56] Thus, our Court found a prefer-

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46. *Id.*

47. *Id.* §§ 29-30. Parliament included the same acts of bankruptcy in § 48 of tbe 1869 English Act. 32 & 33 Vict., ch. 71; *see also* 32 & 33 Vict., ch. 62, § 13(2) (1869).

48. 80 U.S. (13 Wall.) 40 (1871).

49. *Id.* at 41-42.

50. *Id.* at 47. This test is known as the equity test. *See* 2 COLLIER ON BANKRUPTCY ¶ 101.26 [1], [5] (L. King 15th ed. 1980).

51. *Toof*, 80 U.S. (13 Wall.) at 47.

52. *Id.* at 47-48.

53. *Id.* at 48.

54. *Id.*

55. *Id.* at 51.

56. *Id.* After *Toof*, Congress amended the 1867 Act to require that the creditor "know" that the debtor made the transfer in fraud of the provisions of the Act, even though he still

ence when Lord Mansfield would not.[57]

Our fourth bankruptcy act, the Act of 1898,[58] substantially revised by the Chandler Act of 1938,[59] remained in effect more than eighty years until the Bankruptcy Reform Act of 1978[60] repealed and replaced it. Under the 1898 Act, if the debtor either made a fraudulent conveyance or transferred any property while insolvent to one or more creditors "with intent to prefer such creditors over his other creditors," then the debtor committed an act of bankruptcy that would support a creditor's involuntary petition.[61] Although such an intentional preference was characterized as one embodying "an unworthy motive,"[62] an intentional preference, unlike a fraudulent conveyance, would not bar a discharge.[63]

In defining the bankruptcy trustee's power to avoid preferences, it apparently occurred to someone, at least with respect to some preferences, that the debtor's culpability was not important and that some definition of the preference was in order. Hence, section 60a provided:

> [A debtor] shall be deemed to have given a preference if, being insolvent,[64] he has procured or suffered a judgment to be entered against himself [sic] in favor of any person, or made a transfer of any of his property,[65] and the effect of the enforcement of such judgment or transfer [would] be to enable any one of his creditors to obtain a greater percentage of his debt than any other such creditor of the same class.[66]

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needed only reasonable cause to believe the debtor insolvent. At the same time, Congress reduced the four month period to two months in involuntary cases. 18 Stat. 180 (1874).

57. *See supra* notes 18-26 and accompanying text.

58. 30 Stat. 544 (1898).

59. 52 Stat. 840 (1938).

60. 92 Stat. 2549 (1978), 11 U.S.C. §§ 101-151326 (1982). The Reform Act became effective on October 1, 1979.

61. 30 Stat. 544, § 3(a) (1898).

62. H.R. Rep. No. 1228, 54th Cong., 1st Sess. 39 (1896).

63. 30 Stat. 544, § 14(b) (1898).

64. Section 1 defined insolvency to mean that the debtor's property was not "at a fair valuation," "sufficient in amount to pay his debts." The definition excluded property that the debtor conveyed or concealed with intent to hinder, delay, or defraud his creditors.

65. The House Committee on the Judiciary had recommended that the judgment be procured or suffered or the transfer be made with "intent (1) to defeat the operation of this act; or (2) to enable anyone of his creditors to obtain a greater percentage of his debt than any other of such creditors of the same class," H.R. Rep. No. 65, 55th Cong., 2nd Sess. 21 (1897), but the intent requirement was eliminated in Conference Committee. *See* S. Doc. No. 294, 55th Cong., 2d Sess. 21 (1898).

66. 30 Stat. 544, § 60a. The 1898 Act, like the 1978 Reform Act, identified classes of creditors in bankruptcy. By § 67d valid liens were recognized; by § 57h the collateral was valued, that amount was deducted from the creditor's claim, and a dividend was paid only on any unsecured deficiency; and by § 64 certain prepetition unsecured claims were given priority in distribution.

Section 60b further provided that if the preference occurred within four months of bankruptcy and the creditor receiving it "had reasonable cause to believe that it was intended thereby to give a preference," then the preference should be voidable by the trustee.[67]

This earliest version of old section 60 seemed to say that the debtor's intent in procuring or suffering the judgment or in making the transfer was immaterial, but that the trustee could not avoid the preference unless the creditor receiving it had reasonable cause to believe that the debtor intended to give a preference. A separate provision dealt with certain kinds of preferences: those judicial liens obtained within four months of bankruptcy by attachment, garnishment, execution, or other creditors' process. The trustee could avoid the lien under section 67c if: (1) a creditor obtained the lien while the debtor was insolvent and the lien "[would] work a preference"; (2) the creditor "had reasonable cause to believe the defendant [sic] was insolvent and in contemplation of bankruptcy"; or (3) the lien "was sought and permitted in fraud of the provision of this Act."[68]

Finally, section 57g provided that the "claims of creditors who have received preferences shall not be allowed unless such creditors surrender their preferences." The Supreme Court construed this last provision to apply to any creditor who had received a preference as defined in section 60a[69] even though the preference was not voidable under section 60b because the creditor did not have reasonable cause to believe the debtor intended to give a preference.[70] Congress promptly amended section 57g to forbid the allowance of claims of creditors who did not surrender "preferences voidable under" section 60b or fraudulent conveyances voidable under section 67e.[71]

Another amendment in 1910[72] eliminated the anomaly of section 60b's requirement that the creditor have reasonable cause to believe the debtor had an intent that section 60a did not require the debtor to have. The amendment required preferential transfer-

67. 30 Stat. 544, § 60b.

68. Section 67f compounded confusion by authorizing the avoidance of all liens "obtained through legal proceedings agaiust a person who is insolvent . . . within four months" of bankruptcy. *Cf. In re* Tune, 115 F. 906, 911 (N.D. Ala. 1902) (suggesting that, because § 67f was "the latest utterance in point of time," it "destroys" § 67c).

69. *See supra* notes 64-66 and accompanying text.

70. Pirie v. Chicago Title & Trust Co., 182 U.S. 438, 446-47 (1901).

71. 32 Stat. 797 (1903).

72. 36 Stat. 838 (1910).

ees to have reasonable cause to believe that the enforcement of the judgment or transfer "would effect a preference."[73] With this amendment, the search for debtor culpability or other inquiry into the debtor's state of mind disappeared from the American concept of a voidable preference. The debtor's state of mind remained important only when the preference was treated as an act of bankruptcy supporting an involuntary petition[74] or when section 67c authorized avoidance of judicial liens within the four month period if "sought and permitted in fraud of the provision of this Act."[75]

The 1898 Act's definition in section 60a of a preferential effect required that the preference enable the creditor to "obtain a greater percentage of his debt than any other such creditor of the same class."[76] The Supreme Court considered this definition in *Palmer Clay Products Co. v. Brown.*[77] Defendant, an unsecured, nonpriority, general creditor, sought to defeat the bankruptcy trustee's preference action to recover partial payments made to defendant. He argued that the trustee must prove that the alleged preference left the debtor with insufficient assets to pay the same portion of the claims of other creditors in defendant's class. The Court, however, explained that defendant was talking about the wrong time: defendant focused on the debtor's financial condition immediately after the transfer; he should have focused on the bankruptcy distribution to creditors of his class.[78] The Court reasoned:

> The payment on account of say 10% within the four months will necessarily result in [the creditor paid] receiving a greater percentage than other creditors [of his class], if the distribution . . . is less than 100%. For where the creditor's claim is $10,000, the payment on account $1000, and the distribution in bankruptcy 50%, the creditor to whom the payment on account is made receives $5500 [the $1000 paid plus 50% of the $9000 balance of his claim], while another creditor [of the same class] to whom the same amount was owing and no payment on account was made will receive only $5000.[79]

This will always be true, no matter what class the preferred creditor was in, as long as at least one other creditor in the class was not similarly paid and the dividend to the class was less than 100%. Because a bankruptcy case in which the dividend to un-

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73. *Id.*
74. *See supra* note 61 and accompanying text.
75. The trustee could avoid even these liens under alternative provisions in § 67f that did not implicate the debtor's state of mind. *See supra* note 68 and accompanying text.
76. 30 Stat. 544, § 60a (1898).
77. 297 U.S. 227 (1936).
78. *Id.* at 229.
79. *Id.*

secured, nonpriority, general creditors was 100% was rare indeed, this interpretation meant that the preferential effect test for voidable preferences offered little protection to this type of creditor.[80] But it worried some law professors, although the problem never seemed to arise in the cases, that, by focusing solely on the preferred creditor's class, the statutory preferential effect test would permit the debtor to prefer a junior class over a senior class.

The extensive revision in 1938 tidied up the 1898 Act, but changed little in substantive preference law. The Act still required the debtor's intent to prefer when the preference was treated as an act of bankruptcy on an involuntary petition.[81] Courts were to disallow creditor's claims until they surrendered any transfers made voidable under the Act.[82] Congress dropped preferential judgments from section 60a, which was confined to transfers that insolvent debtors made to creditors within four months of bankruptcy "for or on account of an antecedent debt" and with preferential effect.[83] Transfers covered by section 60a were voidable under section 60b if the creditor had "reasonable cause to believe the debtor insolvent" when the debtor made the transfer.[84] Finally, Congress replaced the conflicting provisions of section 67c and 67f[85] with a new section 67a(1), which empowered the trustee to avoid judicial liens that the creditor acquired within four months of bankruptcy

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80. Even after the 1903 amendment to § 57g, *see supra* note 71 and accompanying text, this interpretation also meant that the creditor who had received a voidable preference for a part of his claim and who did not surrender it would receive no dividend in the bankruptcy case. If the creditor filed a claim for the unpaid balance, the trustee could object to the allowance of the claim under § 57g and could get an order requiring a turnover of the preference. Katchen v. Landy, 382 U.S. 323, 330-31 (1966). Alternatively, the court might order the claim disallowed unless and until the creditor surrendered the preference. Bronx Brass Foundry, Inc. v. Irving Trust Co., 297 U.S. 230, 230-32 (1936). A problem remained for the creditor whose claim was fully paid by a voidable preference because the crediter had no claim to file unless he voluntarily surrendered or was compelled to surrender his preference. Although § 57n limited the time for filing claims to six months after the date first set for a creditors' meeting, a 1938 amendment added a proviso allowing a creditor to file a claim within 30 days of the trustee's recovery of a transfer, provided that the creditor surrendered the property to the trustee within 30 days after final judgment for recovery. 52 Stat. 840, § 57n (1938).

81. 52 Stat. 840, § 3a (1938).

82. *Id.* § 57g.

83. HOUSE JUDICIARY COMM., 74th Cong., 2d Sess., AN ANALYSIS OF H.R. 12889 188 (Comm. Print 1936); H.R. REP. No. 1409, 75th Cong., 1st Sess. 675 (1937). Both documents explained that the language on preferential effect remained substantially unchanged in § 60a to preserve the ruling in *Palmer Clay Prods. See supra* notes 77-80 and accompanying text.

84. 52 Stat. 840, § 60 (1938).

85. *See supra* note 68 and accompanying text.

if the lien was (a) acquired while the debtor was insolvent or (b) "sought and permitted in fraud of the provisions of this Act."[86] Congress also amended the definition of "transfer" in section 1 to include every disposition of property or an interest therein "or of fixing a lien upon property or upon an interest therein, . . . voluntarily or involuntarily, by or without judicial proceedings."[87] Because creditors usually acquired these liens for antecedent debt, nearly all such judicial liens acquired within four months of bankruptcy were also subject to section 60 if the preferred creditor had reasonable cause to believe the debtor insolvent. Furthermore, in 1952 Congress eliminated the debtor's intent to prefer as a requirement for the preference to be treated as an act of bankruptcy. The new provision required only that the debtor made a preferential transfer "as defined in" section 60a.[88]

Thus, for the last forty years under the old Act, the debtor's state of mind was of no concern in establishing voidable preferences.[89] But, for the entire history of the old Act, a trustee seeking under section 60 to avoid a preference acquired within the four month period prior to bankruptcy had to prove something about the state of mind of the transferee-creditor. For the last forty years, the trustee had to prove that the creditor had reasonable cause to believe that the debtor was insolvent. But, oddly enough, if the creditor had moved within the four month period under section 67a to obtain a judicial lien on the property of an insolvent debtor—a case that Lord Mansfield would not regard as a "fraud on the Act"[90]—the trustee's case was easier. The Act required no proof regarding the creditor's state of mind either.

86. 52 Stat. 840, § 67b(1) (1938).

87. *Id.* § 1.

88. 66 Stat. 420 (1952).

89. A possible exception existed when the trustee seeking to avoid a judicial lien was unable to establish that the debtor was insolvent when the lien was acquired. The trustee could attempt alternatively to establish under § 67a(1)(B) that the lien was "sought and permitted in fraud of the provision of this Act." *See supra* note 86 and accompanying text. In the one recorded instance of a trustee invoking this provision—as it earlier appeared in § 67c(3), *see supra* note 68 and accompanying text—the trustee succeeded in avoiding an attachment obtained while the debtor was solvent, but within four months of bankruptcy. The court did not consider the debtor's state of mind because the court read *Toof v. Martin*, *see supra* notes 48-56 and accompanying text, to hold that "any proceedings disturbing the equitable distribution of the debtor's estate" were "in fraud of the provisions of this Act" and read "permitted" to require no more than "[m]ere passivity on the part of the debtor." *In re* Pollmann, 156 F. 221, 222 (S.D.N.Y. 1907).

90. *See supra* notes 18-26 and accompanying text.

IV. The Reform Act and Later Amendments

A. *The Basic Concept*

The draftsmen of the Bankruptcy Reform Act of 1978 addressed the difference in treatment of the two kinds of preferential transfers by almost entirely eliminating any requirement that the creditor have reasonable cause to believe the debtor insolvent. The federal Commission that drafted the first version of the Reform Act identified the following three goals for the preference section of the Act: "First, it lessens the possibility of a scramble among creditors for advantage; second, it promotes equality [among classes]; and third, it eliminates the incentive to make unwise loans in order to obtain a preferential payment or security."[91] The Commission proposed a new preference section, which eliminated the requirement that the creditor have reasonable cause to believe the debtor insolvent. The section provided that the debtor was presumed to be insolvent during the period of preference vulnerability, which was reduced from four to three months as a rough trade-off for easing the trustee's evidentiary burden. To all of this there was one exception. Preferences received by creditors who were insiders of the debtor from one year to three months before bankruptcy were voidable if the debtor was insolvent[92] at the time of the transfer and if the insider-creditor had reasonable cause to believe the debtor insolvent at that time.[93] Because the Commission eliminated reasonable cause to believe the debtor insolvent as a requirement for all transfers except transfers to insider-creditors, providing a counterpart to old section 67a dealing with judicial liens was unnecessary. The same section applicable to other preferential transfers could deal with these liens.[94] Thus would disappear from American bankruptcy law the concept of a "fraud on the Act"

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91. *Report of the Commission on the Bankruptcy Laws of the United States*, H. Doc. No. 137, pt. I, 93d Cong., 1st Sess. 202 (1973) [hereinafter cited as *Commission Report*]. The Commission, with assistance from J. MacLachlan, Bankruptcy § 284 (1956), attributed the third goal to Daniel Webster, who argued for a preference provision in an early Massachusetts insolvency law. But § 60c of the former Bankruptcy Act, enacted in 1898 and unchanged thereafter, provided that a creditor who had received a voidable preference could set off in the trustee's avoidance action the amount of any unsecured credit he had extended after the voidable transfer. This result does not seem fully consistent with the third goal.

92. No presumption of insolvency was applicable during this extended period.

93. *See Commission Report*, *supra* note 91, pt. II, at 166. The Commission did not use the term "insider" but applied this provision to a creditor who was "a member of the immediate family, a partner, an affiliate, a director, an officer, or a managing agent of the debtor." *Id.*

94. *See id.*, pt. I, at 204.

embodied in old section 67a.[95]

During congressional hearings on the Commission proposals, no one stated opposition, and for that reason, the proposals received little attention. The National Bankruptcy Conference[96] fully endorsed the proposals. In a written statement submitted in the hearings, this organization defended the presumption of insolvency as a feature that "will undoubtedly lessen litigation and achieve more equality of treatment" because "[i]t is a rare bankruptcy case in which the debtor was not insolvent during the . . . three month period."[97] Also, the Conference's spokesman addressed elimination of the requirement that the creditor have reasonable cause to believe the debtor insolvent:

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95. In explanation of its proposal the Commission said:

> The requirements of establishing insolvency and reasonable cause to believe the debtor was insolvent have generated immense amounts of litigation. It can be seriously questioned whether insolvency should be an element, in light of the fact that the debtor is involved in a bankruptcy case. Such a requirement has nothing to do with equality, avoiding the grab-bag effect, or preventing unwise loans. On the other hand, it is justified on the basis of tradition and the fact that the payment is perfectly proper but for the subsequent bankruptcy. The same cannot be said about reasonable cause to believe. That requirement, more than any other, has rendered ineffective the preference section of the present Act.

Id. For an example of the obstacle the reasonable cause to believe requirement posed for the bankruptcy trustee, see the most recent case on that point decided under the old Act: Bernstein v. South Cent. Bell Tel. Co., 730 F.2d 987 (5th Cir. 1984).

As indicated *supra* note 89, the statutory formulation of "fraud on the Act" had received very little attention. In Dean v. Davis, 242 U.S. 438 (1917), however, a mortgagee took a mortgage from the debtor to secure a loan, even though the mortgagee knew that the insolvent debtor would use the loan proceeds to prefer another creditor. The Court held that the mortgage was a transfer "the intent (or obviously necessary effect) of which [was] to deprive creditors of the benefits sought to be secured by the Bankruptcy Act" and was, therefore, a transfer made with intent to hinder, delay, or defraud creditors within the meaning of old § 67e. *Id.* at 444. Congress twice thereafter tried to codify this ruling in old § 67d(3). *See* 52 Stat. 878 (1938), 66 Stat. 428 (1952). Many believed, however, that neither attempt was successful. *See* 4 COLLIER ON BANKRUTPCY ¶ 67.38 (14th ed. 1978). The Commission recommended that Congress drop the attempted codification and leave such transactions to other provisions that enabled the trustee generally to avoid transfers made with intent to hinder, delay, or defraud creditors. *See Commission Report*, *supra* note 91, pt. I, at 211-12; pt. II, at 177. Congress has followed that recommendation. *But cf. In re* Cushman Bakery, 526 F.2d 23 (1st Cir. 1975), *cert. denied*, 425 U.S. 937 (1976) (in which I failed in an attempt to obtain a modest extension of the approach taken in *Dean v. Davis* to a situation not covered by § 67d (3)).

96. The National Bankruptcy Conference is an organization of bankruptcy practitioners, bankruptey judges, and teachers of bankruptcy law. It was formed in 1932 in connection with the 1938 revision of the Bankruptcy Act and has been active since that time on virtually all amendments to bankruptcy law. I bave been a member since 1963.

97. *Bankruptcy Act Revision: Hearings Before Subcomm. on Civil and Constitutional Rights of the House Judiciary Comm. on H.R. 31 and H.R. 32*, 94th Cong. 2d Sess. 1841 (1976).

Logically and theoretically, the knowledge of the recipient of the preference has nothing to do with equality of distribution. Equality is determined by the fact that all creditors are being treated reasonably alike. So, if two creditors received a payment . . . and one had knowledge and one did not of the insolvency of the debtor, that has really no relevance to equality of treatment.

Second, this element has been a constant source of litigation. It has been used by creditors more or less as a shield. There are a great many cases where the creditor was well aware of the financial difficulties of the debtor but managed to escape the recovery of a preference because the trustee just was not able to meet the burden of proof.[98]

Congress accepted the Commission's proposals[99] in the definition of a voidable preference in new section 547(b) and in the presumption of insolvency in section 547(f), and defined the "transfer" to which section 547(b) applies to include involuntary transfers such as judicial liens.[100]

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98. *Id.* at 1855 (statement of Mr. Leon Forman). As another experienced but less diplomatic witness later put it, the requirement "put a premium on lying, because if the recipient simply said: 'I know nothing,' how could the trustee get around that denial of knowledge?" *Bankruptcy Reform Act of 1978: Hearings Before Subcomm. on Courts of the Senate Judiciary Comm. on the Bankruptcy Reform Act of 1978*, 97th Cong., 1st Sess. 244 (1981) (statement of Mr. Leonard Rosen).

99. Congress, however, changed the three month period to a more precise 90 days. The congressional draftsmen were acutely aware that all months are not of equal length, although they took no account of leap year.

100. 11 U.S.C. §§ 101(48), 547(b), 547(f) (1982). The House Committee Report offered the following explanation:

The purpose of the preference section is two-fold. First, by permitting the trustee to avoid prebankruptcy transfers that occur within a short period before bankruptcy, creditors are discouraged from racing to the courthouse to dismember the debter during his slide into bankruptey. The protection thus afforded the debtor often enables him to work his way out of a difficult financial situation through cooperation with all of his creditors. Second, and the more important, the preference provisions facilitate the prime bankruptcy policy of equality of distribution among creditors of the debtor. Any creditor that received a greater payment than others of his class is required to disgorge so that all may share equally. The operation of the preference section to deter "the race of diligence" of creditors to dismember the debter before bankruptcy furthers the second goal of the preference section—that of equality of distribution.

The current preference section contains several impediments to the proper functioning of these two policies. First, the preference section requires the bankruptcy trustee to prove the debtor's insolvency at the time the preferential transfer was made. Given the state of most debtor's books and records, such a task is nearly impossible. Given the financial condition of nearly all debtors in the three months before bankruptcy, the task is also generally not worth the effort. Rarely is a debtor solvent during the three months before bankruptcy. Thus, the preference section requires the trustce to prove a fact that nearly always exists yet never can be proved with certainty. This factor leads to far fewer preference recoveries than otherwise would be the case. Because of the difficulty of proof, creditors are not deterred from the race of diligence, and the policy of equality is defeated.

Second, the trustee must show that the creditor for whose benefit the preferential transfer was made had "reasonable cause to believe the debtor was insolvent at the time of the transfer." This provision was designed when the primary purpose of the

Under section 502(d),[101] creditors must still surrender voidable transfers before their claims will be allowed. Moreover, section 502(h)[102] and Bankruptcy Rule 3002(c)(3) still make provisions for the creditor who has no claim to file until a voidable transfer is recovered, just as under the old Act.[103] "Acts of bankruptcy" have disappeared in the Reform Act. Although the content of some former acts of bankruptcy remains, without the label, as grounds for an involuntary petition under section 303(h),[104] that section includes neither preferences nor fraudulent conveyances. Finally, a fraudulent conveyance will bar a discharge under section 727(a)(2),[105] but a preference will not.[106]

One consequence of the Reform Act changes, as the reported cases reveal, has been that, in most cases, the creditor-defendant in

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preference section was to prevent the race of diligence. Whether or not a creditor knows or believes that his debtor is sliding into bankruptcy is important if the only purpose of the preference section is to deter the race. However, a creditor's state of mind has nothing whatsoever to do with the policy of equality of distribution, and whether or not he knows of the debtor's insolvency does little to comfort other creditors similarly situated who will receive that much less from the debtor's estate as a result of the prebankruptcy transfer to the preferred creditor. To argue that the creditor's state of mind is an important element of a preference and that creditors should not be required to disgorge what they took in supposed innocence is to iguore the strong bankruptcy policy of equality among creditors. Finally, the requirement that the trustee prove the state of mind of his opponent is nearly insurmountable, and defeats many preference actions. The amount of litigation it causes is too great when the requirement itself does not further any necessary bankruptcy policy. It also defeats the policy of the preference section by limiting recoveries to only the most egregious cases.

To remedy these two defects in the preference section, H.R. 8200 eliminatcs the reasonable cause to believe requirement for transfers made during the 90-day period preceding bankruptcy, and creates a presumption of insolvency during that period. The presumption does not shift the burden of proof on the issue of insolvency away from the trustee. Rather, it is governed by the Federal Rules of Evidence, which state that the presumption merely requires the party against whom it is directed (in this case, the transferee of the preference) to go forward to present some evidence to overcome the presumption. Once he does, the ultimate burden of proof remains with the bankruptcy trustee. [*See* FED. R. EVID. 301]. These two changes should lead to a reduction in litigation and more efficient administration. They will further the goals of the preference section and provide fairer results to all creditors of the debtor.

H.R. REP. No. 595, 95th Cong., 1st Sess. 177-79 (1977).

101. 11 U.S.C. § 502(d) (1982).

102. *Id.* § 502(h).

103. *See supra* note 80.

104. 11 U.S.C. § 303(h) (1982).

105. *Id.* § 727(a)(2).

106. In order to keep this Article within acceptable bounds, I will leave to another day certain aspects of current preference law that do not seem fundamental to the basic concept: (1) the definition of an "insider" in 11 U.S.C. § 101(25) and (2) the significance of the requirements in 11 U.S.C. § 547(b) that a voidable preference must be a transfer of an interest of the debtor in property and "to or for the benefit of a creditor."

a preference action makes no effort to rebut the section 547(f) presumption of the debtor's insolvency[107] within the ninety day prebankruptcy period, and the presumption carries the day for the trustee or other party attacking the preference[108] on the insolvency issue.[109] Also, several courts have held the defendant's evidence in-

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107. The test of solvency under § 101(29) is still whether the debtor's assets "at a fair valuation" exceed the sum of his debts. The Reform Act, however, excludes exempt property as well as that fraudulently conveyed or concealed from the calculation. *Cf. supra* note 64.

Under FED. R. EVID. 301, "a presumption imposes on the party against whom it is directed the burden of going forward with evidence to rebut or meet the presumption, but does not shift to such party the burden of proof in the sense of the risk of nonpersuasion, which remains throughout the trial upon the party on whom it was originally cast."

108. The "other party attacking the preference" might be an individual debtor attacking an involuntary preference under 11 U.S.C. §§ 522(h) and 547 to claim exemption in the transferred property when the trustee has not attacked the transfer under § 547. It might also be a debtor in possession in Chapter 11 who, under 11 U.S.C. § 1107, has all the powers of a trustee. Moreover, in some Chapter 11 cases, the court has allowed a creditor's committee to pursue preferences when the debtor in possession did not do so. *See, e.g., In re* Four Seasons Sporting Goods, Inc., 46 Bankr. 528 (Bankr. N.D. Cal. 1985); *In re* Philadelphia Light Supply Co., 39 Bankr. 51 (Bankr. E.D. Pa. 1984); *In re* Jones, 37 Bankr. 969 (Bankr. N.D. Tex. 1984); *In re* Joyanna Holitogs, Inc., 21 Bankr. 323 (Bankr. S.D.N.Y. 1982); *In re* Monsour Medical Center, 5 Bankr. 715 (Bankr. W.D. Pa. 1980); *cf. In re* Amarex, Inc., 36 Bankr. 59 (Bankr. W.D. Okla. 1984) (refusing permission to unsecured creditors to pursue preferences in a Chapter 13 case); *In re* Bridges, 31 Bankr. 27, 29 Bankr. 716 (Bankr. W.D. Ky. 1983) (court refused permission for unsecured creditors in a Chapter 11 case to pursue a preference action and, additionally, refused to order the trustee to initiate a preference action). Also, *In re* J.E. Jennings, Inc., 46 Bankr. 167 (Bankr. E.D. Pa. 1985), held that the reorganized debtor could pursue preference actions after confirmation of a Chapter 11 plan if the plan provided that the bankruptcy court retained jurisdiction for that purpose and if any recovery was to be distributed to creditors.

109. *See In re* Barash, 658 F.2d 504, 507 (7th Cir. 1981); *In re* Economy Milling Co., 37 Bankr. 914, 919 (D.S.C. 1983) (presumption not unconstitutional); *In re* Air Florida, Inc., 48 Bankr. 437, 440 (Bankr. S.D. Fla. 1985); *In re* Jaggers, 48 Bankr. 33, 36 (Bankr. W.D. Tex. 1985); *In re* Property Leasing & Management, Inc., 46 Bankr. 903, 911, 916 (Bankr. E.D. Tenn. 1985); *In re* Bob Grissett Golf Shoppes, Inc., 44 Bankr. 156, 158 (Bankr. E.D. Va. 1984); *In re* R&T Roofing Structures & Commercial Framing, Inc., 42 Bankr. 908, 910 (Bankr. D. Nev. 1984); *In re* Crump, 42 Bankr. 636, 637 (Bankr. E.D. Mo. 1984); *In re* Independent Clearing House Co., 41 Bankr. 985, 1011 (Bankr. D. Utah 1984); *In re* Harley, 41 Bankr. 276, 278-79 (Bankr. N.D. Ga. 1984); *In re* Jorges Carpet Mills, Inc., 41 Bankr. 60, 62 (Bankr. E.D. Tenn. 1984); *In re* P.M.R.C. Corp., 39 Bankr. 912, 913 (Bankr. E.D.N.Y. 1984); *In re* Kirk, 38 Bankr. 257, 259 (Bankr. D. Kan. 1984); *In re* General Office Furniture Wholesalers, Inc., 37 Bankr. 180, 183 (Bankr. E.D. Va. 1984); *In re* Bennett, 35 Bankr. 357, 359 (Bankr. N.D. Ill. 1984); *In re* Jameson's Foods, Inc., 35 Bankr. 433, 437 (Bankr. D.S.C. 1983); *In re* Cosmopolitan Aviation Corp., 34 Bankr. 592, 594 (Bankr. E.D.N.Y. 1983); *In re* Balducci Oil Co., 33 Bankr. 843, 846 (Bankr. D. Colo. 1983); *In re* Kennesaw Mint, Inc., 32 Bankr. 799, 803 (Bankr. N.D. Ga. 1983); *In re* Biddle, 31 Bankr. 449, 455 (Bankr. N.D. Iowa 1983); *In re* Ciavarella, 28 Bankr. 823, 824 (Bankr. S.D.N.Y. 1983); *In re* Vann, 26 Bankr. 148, 149 (Bankr. S.D. Ohio 1983); *In re* Brame, 26 Bankr. 309, 312 (Bankr. W.D. Ky. 1982); *In re* Formaggio Mfg., Inc., 23 Bankr. 688, 692 (Bankr. D.R.I. 1982); *In re* Maytag Sales and Serv., Inc., 23 Bankr. 384, 386 (Bankr. N.D. Ga. 1982); *In re* Thomas Farm Sys., Inc., 18

sufficient to rebut the presumption, with the same result.[110] In only eight cases have courts held the defendant's evidence sufficient to meet the presumption. In four of those cases, the courts held that the trustee carried his burden of proof on insolvency;[111] in the other four, the courts held that he did not.[112]

Bankr. 543, 544 (Bankr. E.D. Pa. 1982); *In re* Belize Airways Ltd., 18 Bankr. 485, 489-90 (Bankr. S.D. Fla. 1982); *In re* IMI, Inc., 17 Bankr. 784, 787 (Bankr. E.D. Wis. 1982) (although the trustee lost in an effort to avoid other preferential payments to an insider more than 90 days before bankruptcy when the presumption does not apply); *In re* Lucasa Int'l, Ltd., 14 Bankr. 980, 982 (Bankr. S.D.N.Y. 1981); *In re* Lucasa Int'l, Ltd., 13 Bankr. 596, 600 (Bankr. S.D.N.Y. 1981); *In re* Camp Rockhill, Inc., 12 Bankr. 829, 833 (Bankr. E.D. Pa. 1981); *In re* Amato, 10 Bankr. 120, 122 (Bankr. S.D. Fla. 1981); *In re* National Buy-Rite, Inc., 7 Bankr 407, 410 (Bankr. N.D. Ga. 1980); *In re* Duffy, 3 Bankr 263, 265 (Bankr. S.D.N.Y. 1980); *In re* Butler, 3 Bankr. 182, 186 (Bankr. E.D. Tenn. 1980); *In re* Thrifty Supermarket, Inc., 1 C.B.C.2d 823, 824 (Bankr. S.D. Fla. 1980); *cf. In re* Brooks, 44 Bankr. 963, 965 (Bankr. S.D. Ohio 1984) (creditor-defendant put in no evidence, but trustee's evidence showed solvency at the time of the transfer).

110. *See In re* Emerald Oil Co., 695 F.2d 833, 838 (5th Cir. 1983) (testimony of defendant's accountant that the trustee's accountant "may have" undervalued debtor's assets); *In re* Pippin, 46 Bankr. 281, 284 (Bankr. W.D. La. 1984) (evidence that debtor was solvent five months before bankruptcy); *In re* Group Dev. Corp., 43 Bankr. 665, 668 (Bankr. M.D. Fla. 1984) (debtor unable to pay debts as they came due); *In re* Keydata Corp., 37 Bankr. 324, 327 (Bankr. D. Mass. 1983) (evidence that debtor was "current in its bills"); *In re* Goodman Indus., Inc., 21 Bankr. 512, 521 (Bankr. D. Mass. 1982) (even though trustee lost in an effort to avoid a separate fraudulent conveyance made seven months before bankruptcy under 11 U.S.C. § 548(a)(2)(B)(i) because he failed to prove debtor's insolvency); *In re* Valles Mechanical Indus., Inc., 20 Bankr. 350, 353 (Bankr. N.D. Ga. 1982) (defendant's president unaware of debtor's insolvency); *In re* K. Pritchard Co., 17 Bankr. 508, 509 (Bankr. S.D. Ala. 1981) (defendant unaware of debtor's insolvency).

111. *See In re* A. Fassnacht & Sons, Inc., 45 Bankr. 209, 210 (Bankr. E.D. Tenn. 1984); *In re* Rocky Mountain Ethanol Sys., Inc., 21 Bankr. 707, 709-10 (Bankr. D.N.M. 1981); *In re* Utility Stationery Stores, Inc., 12 Bankr. 170, 175-79 (Bankr. N.D. Ill. 1981); *In re* Eichorn, 11 Bankr. 81, 83 (Bankr. D. Mass. 1981).

112. *See In re* Brooks, 44 Bankr. 963, 965 (Bankr. S.D. Ohio 1984); *In re* Dehman Corp., 21 Bankr. 858, 863 (Bankr. S.D. Fla. 1982); *In re* Thomas Farm Sys., Inc., 18 Bankr. 541, 542-43 (Bankr. E.D. Pa. 1982); *In re* Briarbrook Dev. Corp., 11 Bankr. 514, 519-20 (Bankr. W.D. Mo. 1981). As indicated *supra* note 64, the definition of insolvency in the old Bankruptcy Act excluded only property fraudulently concealed or transferred. *In re* Utrecht Coal Co., 63 F.2d 745, 746 (2d Cir. 1933), and *In re* Doscher, 120 F. 408, 413-14 (E.D.N.Y. 1902), however, held that, in determining whether the debtor was insolvent *at the time of an alleged preference*, the court must include property covered by the alleged preference. *In re* Big Three Transp. Co., 41 Bankr. 16, 20 (Bankr. W.D. Ark. 1983), and *In re* Beck, 25 Bankr. 947, 953 (Bankr. N.D. Ohio 1982), concluded that the same rule should apply under the new definition, *see supra* note 107, but foımd the debtor insolvent even after including the transferred property. *See also In re* Sportfame of Ohio, Inc., 40 Bankr. 42, 55 (Bankr. N.D. Ohio 1984). But in *In re* Smith, 21 Bankr. 345 (Bankr. M.D. Fla. 1982), the challenged transfer consisted of an execution levy on debtor's residence, which later was allowed to her as an exempt homestead in the bankruptcy case. The court excluded the value of the homestead in detemnining insolvency at the time of the transfer and the preferential effect of the transfer. *Id.* at 350-51. In *In re* Pereau, 37 Bankr. 902 (Bankr. M.D. Fla. 1984), the court found the debtor insolvent at the time of a preferential execution levy after excluding the

Another consequence of the 1978 Act was that the trustee or other person attacking a preference no longer had to concern himself with the creditor-defendant's state of mind, except when the challenger aimed the attack at a transfer to an insider-creditor made during the period ninety days to one year before bankruptcy.[113] But one of many amendments to the Reform Act made in July 1984 eliminated that burden even for insider-transferees. Apparently Congress did not eliminate the requirement as a deliberate policy choice, but as a matter of legislative accident. I have elsewhere characterized the 1984 amendments as establishing a record for "inept performance by Congress,"[114] and this particular amendment is a prize example.[115]

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value of the homestead exemption but including in his liability a debt secured hy a mortgage on the homestead.

113. *In re* Caro Prods., Inc., 746 F.2d 349 (6th Cir. 1984), held that the trustee constitutionally could apply the new definition of a preference to a transferee-creditor who had no reasonable cause to believe the debtor insolvent. Even though the transfer occurred before the October 1, 1979, effective date of the Reform Act, it occurred after the November 6, 1978, date of enactment. Thus, under this decision the new definition applies to all preferences occurring before the effective date but within 90 days of bankruptey.

114. Countryman, *Scramble to Define Bankruptcy Jurisdiction: The Chief Justice, the Judicial Conference, and the Legislative Process,* 22 HARV. J. LEG. 1, 40 (1985). A bill has been introduced to correct some of the more glaring errors. S. 529, 99th Cong., 1st Sess. (1985).

115. In 1981 Senator Dole's subcommittee of the Senate Judiciary Committee held hearings devoted primarily to a variety of amendments to the Reform Act proposed by the consumer credit industry. *Bankruptcy Reform Act of 1978: Hearings Before Subcomm. on Courts of the Senate Judiciary Comm. on The Bankruptcy Reform Act of 1978,* 97th Cong., 1st Sess. (Apr. 3 and 6, 1981) [hereinafter cited as *April 1981 Senate Hearings*]; *Bankruptcy Reform Act of 1978 (Future Earnings): Hearings Before Subcomm. on Courts of the Senate Judiciary Comm. on the Bankruptcy Reform Act of 1978,* 97th Cong., 1st Sess. (Oct. 29, 1981). At the hearings, creditors proposed an exception from § 547 treatment for payments on consumer debts—or at least an exception for payments not exceeding $750 within the 90 day period—unless the creditor had reasonable cause to believe the debtor insolvent. *April 1981 Senate Hearings, supra,* at 92, 92-94, 150, 158, 171-72, 181-82. Thereafter, the Senate Judiciary Committee reported out a bill that would reintroduce the reasonable cause to believe the debtor insolvent requirement for all voidable preferences. S. REP. No. 446 to accompany S. 2000, 97th Cong., 2d Sess., 23-24 (1982). Tucked away under a subtitle for "Consumer Credit Amendments," the same provision appeared in a bill that Senator Dole introduced the following year. The Committee also reported out that bill, S. REP. No. 65 to accompany S. 445, 98th Cong., 1st Sess. 60 (1983), and then it was tacked on, 129 CONG. REC. S535F7, S5363 (daily ed. Apr. 27, 1983), as an amendment to another bill, S. 1013, 98th Cong., 1st Sess. (1983), designed to deal with the problem of bankruptcy court jurisdiction raised in Northern Pipeline Co. v. Marathon Pipe Line Co., 458 U.S. 50 (1981). That bill passed the Senate in 1983. 129 CONG. REC. S5364, S5370 (daily ed. Apr. 27, 1983).

No similar provision passed the House in 1983. In 1984, however, the House passed a bill, H.R. 5174, 98th Cong., 2d Sess., that was designed to deal with the court jurisdiction problem and that contained a number of substantive provisions including an exemption from the preference section for transfers of less than $600 by individual consumer debtors.

For the final aspect of the definition of a preference now contained in section 547(b)—the requirement of a preferential effect—the Bankruptcy Commission proposed to retain from old section 60a the requirement that the preference enable the creditor to obtain a greater percentage of his debt than other creditors of the same class in order to preserve the rule of *Palmer Clay Products Co. v. Brown.*[116] But the Commission also would have added a requirement that there be "no unpaid creditor of a higher class" in order to eliminate the possibility of the debtor's preferring a junior class over a senior class.[117] The House staff rewrote this proposal to cover both matters under a somewhat different formulation in section 547(b)(5). Preferential effect occurs when the transfer enables the creditor to receive more than he would have if the transfer had not been made and if he were to get the distribution provided for

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130 CONG. REC. H1840 (daily ed. Mar. 21, 1984). When that bill reached the Senate, Senator Thurmond introduced extensive amendments, including the provision that earlier passed the Senate, reinstating the reasonable cause to believe the debtor insolvent requirement for all preferential transfers. 130 CONG. REC. S6082, S6122 (daily ed. May 21, 1984). This bill languisbed in the Senate for a month as Congress repeatedly enacted short-term extensions of the terms of sitting bankruptcy judges. The Reform Act originally scheduled their terms to expire April 1, 1984, with the last extension expiring June 27, 1984. 98 Stat. 116, 163, 214, 268 (1984). Finally, on June 19, Senator Thurmond announced that, in order to get Senator Metzenbaum's agreement to expedite debate, he was withdrawing a number of his proposed amendments, including the one reinstating the reasonable cause to believe requirement for all preferences. 130 CONG. REC. S7617 (daily ed. June 19, 1984). The bill passed the Senate on June 19, *id.* at S7625; both Houses agreed to a Conference Report, H.R. REP. No. 582, 98th Cong., 2d Sess. (1984), on June 29, 130 CONG. REC. H7500, S8900 (daily ed. June 29, 1984); and the President signed the bill on July 10. Pub. L. No. 98-353, 98 Stat. 333 (1984).

The legislative accident occurred at conference. Senator Thurmond's preference amendment would have added a new paragraph (6) to § 547(b), requiring that all preferred creditors must have reasonable cause to believe that the debtor was insolvent for the preference to be voidable. Accordingly, the amendment also would have deleted the reasonable cause requirement from paragraph (4)(B), which deals with transfers to insider-creditors between 90 days and one year before bankruptcy. 130 CONG. REC. S6122 (daily ed. May 21, 1984). The Conference Report deleted the proposed new paragraph (6) but did not remove the deletion from paragraph (4)(B). H.R. REP. No. 882, *supra*, at 73. Although Senators Dole and DeConcini attempted in October, 130 Cong. Rec. S13771 (daily ed. Oct. 5, 1984), to create some retroactive legislative history to paper over two of the many other accidents in the 1984 amendments, they either had not yet discovered this one or did not believe that they could paper it over.

The 1984 amendment to § 547(b) was enacted July 10, 1984, but applies only in cases filed 90 days thereafter. Preferences to insiders within 90 days of bankruptcy were voidable under the Reform Act even if the preferee had no reasonable cause to believe the debtor insolvent. Therefore, retroactive application of the accidental amendment to preferred insiders does not seem to present the constitutional problem that *In re Caro Prods., Inc.* contained. *See supra* note 113.

116. 297 U.S. 227 (1936); *see supra* notes 76-80 and accompanying text.

117. *See Commission Report*, *supra* note 91, pt. II, at 166, 170-71.

in a liquidation case under Chapter 7.

Although this formulation does expand the focus of inquiry from the creditor-defendant's class to embrace the preference of a junior class over a senior class,[118] it does not mean that classes of claims are now unimportant. Under section 506(a),[119] secured claims are secured only to the extent of the value of their collateral; any excess of claim over collateral is unsecured. Priorities among several unsecured claims are prescribed by section 507.[120] Unsecured, nonpriority claims are next in line, but secured or unsecured claims subordinated under section 510[121] may constitute even lower classes. These classes determine what the allegedly preferred creditor would receive in a Chapter 7 liquidation case within the meaning of section 547(b)(5).

Moreover, section 547(b)(5) requires that, in a Chapter 11 or a Chapter 13 case, the effect of the alleged preference be tested by what the defendant would have received in a purely hypothetical Chapter 7 distribution.[122] In applying this test, it behooves counsel and the court to recall certain differences found only in the Chapter 7 distribution:

(1) Under section 724(a),[123] in Chapter 7 cases only, the trustee may avoid a lien securing a claim for a "fine, penalty, or forfeiture, or for multiple, exemplary, or punitive damages," to the extent that the claim is "not compensation for actual pecuniary loss."

(2) Under section 724(b)(2),[124] in Chapter 7 cases only, a lien securing tax claims is subordinated to the first five priorities specified in section 507(a).[125]

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118. The Committee Reports noted:

> Under this language, the Court must focus on the relative distribution between classes as well as the amount that will be received by the members of the class of which the preferee is a member. The language also requires the court to focus on the allowability of the claim for which the preference was made. If the claim would have been entirely disallowed, for example, then the test of paragraph (5) will be met, because the creditor would have received nothing under the distribution provisions of the bankruptcy code.

H.R. REP. No. 595, *supra* note 100, at 372; S. REP. No. 989, 95th Cong., 2d Sess. 87 (1978).

119. 11 U.S.C. § 506(a) (1982).

120. *Id.* § 507.

121. *Id.* § 510.

122. Similarly, 11 U.S.C. §§ 1129(a)(7) and 1325(a)(4) require the court in confirming plans under Chapter 11 or Chapter 13 to test the plan by the amount certain creditors would receive in a hypothetical Chapter 7 distribution.

123. 11 U.S.C. § 724(a) (1982).

124. *Id.* § 724(b)(2).

125. A tax lien should be subordinated to the first six priorities specified in § 507(a), and doubtless would have been by 1984 amendment if the 1984 draftsmen had not forgotten that they amended § 507(a) to create a new fifth priority that relegated unsecured tax

(3) Under section 725, in Chapter 7 cases only, creditors with nonvoidable, nonsubordinated liens, if their collateral has not been abandoned under section 554,[126] if such creditors have not received relief from the automatic stay of section 362(d)[127] to foreclose, and if the trustee has not sold their collateral free of liens pursuant to section 363(f),[128] should be given access to their collateral.[129]

(4) Under section 726(a) and (b),[130] in Chapter 7 cases only, priority claims are to be paid in the order specified in section 507.[131] If, however, the trustee does not have enough funds to pay a specified class in full, he must pay the claims within the class pro rata.[132] If the trustee has more than enough funds to pay all section 507 priority claims, section 726[133] provides additional priorities in the order of distribution for Chapter 7 cases only.

Beyond these matters, most courts have had no difficulty in

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claims from sixth to seventh priority.

126. 11 U.S.C. § 554 (1982).

127. *Id.* § 362(d).

128. *Id.* § 363(f). If the trustee does sell their collateral, § 363(e) entitles secured creditors to adequate protection of their interest in the collateral that, "[m]ost often, . . . will he to have [their] interest attach to the proceeds of sale." H.R. REP. No. 595, *supra* note 100, at 345; S. REP. No. 989, *supra* note 118, at 56.

129. 11 U.S.C. § 725 (1982). Section 725 is rather inscrutable. When the provision read as it now does (except that the court was to "determine the appropriate disposition" after notice and hearing, and the trustee was to "dispose of the property in accordance with such determination"), the Committee Reports explained that § 725

> requires the court to determine the appropriate disposition of property in which the estate and an entity other than the estate have an interest. It would apply, for example, to property subject to a lien or property co-owned by the estate and another entity. The court must make the determination with respect to property that is not disposed of under another section of the bankruptcy code, such as by abandonment under section 554, by sale or distribution under 363, or by allowing foreclosure by a secured creditor by lifting the stay under section 362. The purpose of the section is to give the court appropriate authority to ensure that collateral or its proceeds is returned to the proper secured creditor, that consigned or bailed goods are returned to the consignor or bailor, and so on. Current law is curiously silent on this point, though case law has grown to fill the void. The section is in lieu of a section that would direct a certain distribution to secured creditors. It gives the court greater flexibility to meet the circumstances, and it is broader, permitting disposition of property subject to a co-ownership interest.

H.R. REP. No. 595, *supra* note 100, at 382-83; S. REP. No. 989, *supra* note 118, at 96.

130. 11 U.S.C. § 726(a) & (b) (1982).

131. *Id.* § 507.

132. For the different treatment of § 507 priority claims in Chapter 11 and Chapter 13, see *id.* §§ 1129(a)(9), 1322(a)(2). Both sections now fail to cover unsecured, nonpriority tax claims because the 1984 draftsmen forgot that they had amended § 507(a) to create a new fifth priority that relegated unsecured tax claims from sixth to seventh priority. *See supra* note 125.

133. 11 U.S.C. § 726 (1982).

reading section 547(b)(5) as incorporating the rule of *Palmer Clay Products*:[134] a preferential effect exists if the trustee can establish that a defendant unsecured, nonpriority creditor, without the allegedly preferential payment or lien, would have received less than a 100% payout in a Chapter 7 liquidation.[135] The result continues to seem sensible for the same reason it did under *Palmer Clay Products*—either because the preferential transfer covered 100% of defendant's claim or, if the transfer covered less, because the defendant would get on the unsecured balance the same dividend that other creditors in his class would get on 100% of their claims. In so reading section 547(b)(5), when the creditor receives a transfer as a partial payment or lien for his debt, most courts have seen that the inquiry is not whether, without the transfer, the creditor would have received a partial dividend equal to the amount of the transfer in a Chapter 7 distribution; rather, the inquiry is whether the creditor would have received a 100% dividend.[136]

A few courts apparently have read section 547(b)(5) to mean that the trustee establishes preferential effect by showing that the transfer gave the defendant a larger percentage of his claim than he would receive as a dividend in a Chapter 7 case.[137] This reading might be proper if the defendant were the only unsecured, nonpri-

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134. 297 U.S. 227 (1936); *see supra* notes 76-79 and accompanying text.

135. Because the test is whether the transfer enabled the creditor to receive more than he would get in a Chapter 7 distribution, it is irrelevant that the creditor's claim is nondischargeable and thus "may be paid outside the estate after bankruptcy." *In re* Kayajanian, 27 Bankr. 711, 712 (Bankr. S.D. Fla. 1983).

136. *See In re* Pippin, 46 Bankr. 281, 284 (Bankr. W.D. La. 1984); *In re* Advance Glove Mfg. Co., 42 Bankr. 489, 491-92 (Bankr. E.D. Mich. 1984); *In re* Independent Clearing House Co., 41 Bankr. 985, 1012-13 (Bankr. D. Utah 1984); *In re* Harley, 41 Bankr. 276, 279 (Bankr. N.D. Ga. 1984); *In re* Hillcrest Foods, Inc., 40 Bankr. 360, 362 (Bankr. D. Me. 1984); *In re* Zachman Homes, Inc., 40 Bankr. 171, 174 (Bankr. D. Minn. 1984); *In re* Thomas W. Garland, Inc., 39 Bankr. 412, 415 (Bankr. E.D. Mo. 1984); *In re* General Office Furniture Wholesalers, Inc., 37 Bankr. 180, 183 (Bankr. E.D. Va. 1984); *In re* Saco Local Dev. Corp., 30 Bankr. 868, 869-70 (Bankr. D. Me. 1983); *In re* Saco Local Dev. Corp., 30 Bankr. 862, 865-66 (Bankr. D. Me. 1983); *In re* Tonyan Constr. Co., 28 Bankr. 714, 723 (Bankr. N.D. Ill. 1983); *In re* Fabric Buys of Jericho, Inc., 22 Bankr. 1010, 1012 (Bankr. S.D.N.Y. 1982); *In re* Utility Stationery Stores, Inc., 12 Bankr. 170, 179 (Bankr. N.D. Ill. 1981); *In re* Thrifty Supermarket, Inc., 1 COLLIER BANKR. CAS. 2D (MB) 823 (Bankr. S.D. Fla. 1980).

137. *See In re* Big Three Transp. Inc., 41 Bankr. 16, 20 (Bankr. W.D. Ark. 1983); *In re* Sportfame of Ohio, Inc., 40 Bankr. 42, 55 (Bankr. N.D. Ohio 1984); *In re* P.M.R.C. Corp., 39 Bankr. 912, 913 (Bankr. E.D.N.Y. 1984); *In re* Balducci Oil Co., 33 Bankr. 843, 845-46 (Bankr. D. Colo. 1983); *In re* Moran Air Cargo, Inc., 30 Bankr. 406, 408-09 (Bankr. D.R.I. 1983); *In re* Gastaldo, 13 Bankr. 808, 810 (Bankr. N.D. Ohio 1981); *see also* Mann, *"Greater Percentage" Problems in the Preference Section of the New Code*, 86 COM. L.J. 49, n.3 (1981) (author erroneously characterized § 547(b)(5) as a "greater percentage" test, erroneously stated that we had no such test before, and did not mention *Palmer Clay Products*).

ority creditor in the case. But the trouble with this reading in the more typical case is not merely that it ignores *Palmer Clay Products*. It also requires the trustee to prove with greater precision what the dividend to unsecured, nonpriority creditors will be, rather than merely to prove that it will not be 100%.[138] This is not to say that the trustee need not prove anything. He must establish at least that the dividend to unsecured, nonpriority creditors will not be 100%.[139] One court held that the trustee did not satisfy section 547(b)(5) in his action to recover a partial payment to the unsecured, nonpriority creditor because the trustee introduced no evidence on the amount of the other claims, on the value of the estate, or on the amount of first priority administrative expenses incurred.[140]

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138. Mann, *supra* note 137, also envisions other difficulties because more assets may be discovered or recovered after the court decides the preference action. *Id.* at 50. Three courts have answered that argument by noting that the defendant creditor then would share pro rata with other creditors of his class in the additional dividend. *See In re* Advance Glove Mfg. Co., 42 Bankr. 489, 490 (Bankr. E.D. Mich. 1984); *In re* Brent Explorations, Inc., 31 Bankr. 745, 752 (Bankr. D. Colo. 1983); *In re* Gastaldo, 13 Bankr. 808, 810 (Bankr. N.D. Ohio 1981); *see also In re* Sportfame of Ohio, Inc., 40 Bankr. 42, 55 (Bankr. N.D. Ohio 1984).

139. Theoretically, the court also might require the trustee to show that the debtor did not make a prebankruptcy transfer of an equal percentage to all such creditors. One commentator said this possibility under *Palmer Clay Products* meant "[a]s a practical matter" that the debtor had made "a general assignment for the benefit of creditors." McLaughlin, *Sections 60, 67, and 70, Preferential and Fraudulent Transfers*, 11 J. REF. BANKR. 61, 67 (1937), although that would not be the only way of doing it. *Cf. In re* Hayes, 5 Bankr. 676, 679 (Bankr. S.D. Ohio 1980) (holding that when the insolvent debtor within 90 days of bankruptcy paid her nonexempt wages to a state statutory trustee who thereafter distributed them pro rata to the "creditors who participated in the trusteeship," the trustee had not met the requirements of § 547(b)(5) in his action to recover the distribution made to one unsecured, nonpriority creditor). Presumably the trustee could satisfy § 547(b)(5) in either instance by locating one unsecured, nonpriority creditor who did not participate in the distribution under the assignment or the trusteeship.

140. *In re* K. Pritchard Co., 17 Bankr. 508, 510 (Bankr. S.D. Ala. 1981). This court also worried about the defendant creditor's failure to file a claim in the bankruptcy case so that if the dividend to unsecured, nonpriority creditors exceeded the percentage of the partial payment to defendant, § 547(b)(5) would not have been satisfied. The defendant creditor had received payment of about one-third of its debt and may have refrained from filing to avoid surrendering payment under 11 U.S.C. § 502(d), perhaps because it did not anticipate that the dividend would be larger. As this case demonstrates, a preferred creditor does not immunize himself from § 547 attack by failing to file his claim.

In any event, the language in § 547(b)(5) requiring a calculation of what the defendant would have received in a Chapter 7 case should not require that the defendant file his claim within the time allowed by Bankruptcy Rule 3002 for Chapter 7 or 13 cases (90 days after first date set for meeting of creditors) or by Rule 3003 for Chapter 11 cases (time fixed by court, which for cause shown may grant extensions). In Chapter 11 cases, all claims that the debtor scheduled as undisputed, noncontingent, and liquidated are "deemed filed." 11 U.S.C. § 1111(a) (1982). Moreover, under Bankruptcy Rule 3002, a claim arising from the

For other unsecured creditors, whether they are entitled to priority under section 507(a)[141] and section 726(a)[142] or are subordinated under section 510, the test should be the same. If the dividend to the defendant-creditor's class in a Chapter 7 liquidation would be less than 100%, the challenged transfer has preferential effect. Only if there are no other creditors in the defendant's class is it appropriate to test for preferential effect by comparing the size of the challenged transfer with the size of the Cbapter 7 dividend without the transfer. The court seemed to recognized this principle in *In re Tenna Corp.*,[143] which concerned prepetition payment on priority tax claims of the Internal Revenue Service.[144] Finding that other tax claimants shared the IRS's then sixth priority[145] and that sixth priority claims would receive no dividend even if the payment to the IRS were recovered, the court concluded that preferential effect existed.[146] Although the Court did not indicate whether the payment to the IRS covered its entire claim or only a part of it, the result in this case should have been the same even without other tax claimants. Under section 547(b)(5) the test is no longer whether preferential effect existed within a class, but whether the payment gave the IRS more than it would have received in a Chapter 7 distribution if the payment had not been made.

Tenna originated as a Chapter 11 case, but was converted to Chapter 7 before the court decided the preference issue.[147] During the Chapter 11 case, pursuant to section 364(d),[148] the court authorized a postpetition credit extension of some four million dollars secured by a lien senior to existing liens. The Government contended that the court should construct a hypothetical Chapter 7 distribution, which would exclude the four million dollar lien and the administrative expenses of the Chapter 11 proceeding, and that

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recovery of a preference may be filed within 30 days after the judgment for recovery of the preference becomes final.

141. 11 U.S.C. § 507(a) (1982).

142. *Id.* § 726(a); *see supra* note 133 and accompanying text.

143. 43 Bankr. 140 (Bankr. N.D. Ohio 1984).

144. Under 11 U.S.C. § 108(c), any provision of the Reform Act applicable to "creditors" is applicable to "governmental units" as defined in § 101(24); therefore, § 547 is applicable to the IRS whether or not it files a claim and waives sovereign immunity. *See* 124 CONG. REC. 32,394, 33,993 (1978).

145. In 1984, Congress amended 11 U.S.C. § 507(a) to relegate tax claims to a seventh priority.

146. *Tenna*, 43 Bankr. at 142.

147. *Id.*

148. 11 U.S.C. § 364(d) (1982).

the court should consider only the administrative expenses of the Chapter 7 proceeding and prepetition claims worth approximately $270,000, entitled to priority ahead of the tax claim.[149] The court rejected this contention, however, because the case became an actual Chapter 7 case. Under section 348(d),[150] the court treated the four million dollar lien claim in the converted Chapter 7 case as a prepetition claim. Furthermore, under section 726(b),[151] the Chapter 11 administration expenses still were entitled to payment, although section 726(b) subordinated them to the Chapter 7 administration expenses on the principle that the undertaker was to be paid ahead of the doctor.[152] Hence, with an estate of only some $780,000, the administrative expenses and the four million dollar lien claim consumed the entire estate.[153]

Secured creditors present different questions, however. In a variety of contexts, the Supreme Court interpreted the preference provisions of earlier Bankruptcy Acts to require that a voidable preference must "impair"[154] or "diminish"[155] the bankrupt estate. From this interpretation, some courts concluded that payments made to a fully secured creditor were not voidable preferences.[156] The conclusion seems correct: these payments either discharged the secured debt and the lien on the debtor's property, or they

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149. *Tenna*, 43 Bankr. at 141.

150. 11 U.S.C. § 348(d) (1982).

151. *Id.* § 726(b).

152. *Tenna*, 43 Bankr. at 142.

153. *Id. In re* Thomas W. Garland, Inc., 39 Bankr. 412 (Bankr. E.D. Mo. 1984), was another preference action against the IRS but did not directly concern the Service's tax claim against the taxpayer. Within 90 days of the debtor's Chapter 11 petition, the IRS made an administrative levy on tbe bankrupt debtor to reach the debtor's obligation to the taxpayer. By two checks issued five and eight days later, the debtor paid what it owed the taxpayer to the IRS. *Id.* at 413. Under 26 U.S.C. § 6332, service of the notice of levy on the debtor imposed upon it a personal liability to the IRS; therefore, the court concluded that the IRS was a "creditor" of the debtor and that the subsequent payments to the IRS were on an "antecedent debt" witbin the meaning of § 547(b). *Id.* at 414. The court treated this "debt" as an unsecured, nonpriority deht, not as a sixth priority tax debt. Because these claims would not receive a 100% dividend in a Chapter 7 case, the Court found preferential effect. *Id.* at 415.

154. *See* Stewart v. Platt, 101 U.S. 731, 743 (1879); Clark v. Iselin, 88 U.S. (21 Wall.) 360, 378 (1874).

155. *See* Continental Trust Co. v. Chicago Title Co., 229 U.S. 435, 443 (1913); National Bank v. National Herkimer County Bank, 225 U.S. 178, 184 (1912); New York County Bank v. Massey, 192 U.S. 138, 147 (1904).

156. *See, e.g.*, Shaw v. Walter E. Heller & Co., 385 F.2d 353 (5th Cir. 1967), *cert. denied*, 380 U.S. 1003 (1968); Rheem v. Allnut, 64 F.2d 548, 549 (D.C. Cir. 1933); *see also* Bachner v. Robinson, 107 F.2d 513, 515 (2d Cir. 1939) (holding that lessor was in "a position analogous to . . . a secured creditor" and, thus, debtor's payment of rent arrears was not a preference).

reduced the amount of the debt with a corresponding increase in the value of the debtor's equity in the collateral. A more felicitous interpretation of the statute, however, would base this conclusion on the lack of preferential effect rather than on the lack of diminution of the estate. This interpretation is particularly apt under present section 547(b), in which the inquiry is whether the payment enables the creditor to receive more than the trustee would have distributed to him in a Chapter 7 case if the payment had not been made.[157] Most of the cases applying this rule under present section 547(b) have relied on section 547(b)(5) rather than on the no-diminution-of-the-estate rationale.[158]

Five of these cases[159] also addressed questions that the earlier cases did not reach: at what time, and by what measure, should the court value the creditor's collateral to determine whether he is fully secured? The logic of *Palmer Clay Products*[160] and of section

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157. In Deel Rent-A-Car, Inc. v. Levine, 721 F.2d 750 (11th Cir. 1983), a creditor acquired a judgment lien on the debtor's condominium. Within 90 days thereafter, the debtor married, which qualified him under state law to claim the condominium as an exempt homestead, and filed a voluntary bankruptcy petition. The court held that the debtor, pursuant to 11 U.S.C. § 522(h), could invoke § 547 to avoid the lien and claim his exemption. The court reasoned that "the 'diminution of estate' doctrine was not applicable in the case of a debtor bringing an action under section 522(h) to avoid a preference." *Id.* at 753. Because the lien enabled the creditor to receive more than he would in a Chapter 7 case without it, § 547(b)(5) was satisfied. The debtor also sought to avoid the lien under 11 U.S.C. § 522(f), which entitled him to avoid all judicial liens impairing exemptions. The bankruptcy court, however, held § 522(f) inapplicable because the property was not exempt when the lien was acquired. The debtor did not appeal that ruling. *Id.* at 752.

In a similar case under § 522(h), the creditor-defendant argued that "one of the conditions [of preference avoidance was] that other creditors [were] deprived." The court gave him the short answer, "[t]hat is not the way the statute reads." *In re* Pierce, 6 Bankr. 18, 19 (Bankr. N.D. Ill. 1980). Because the test is what the creditor-defendant would receive in a Chapter 7 distribution, the debtor's payment to a fully secured creditor is preferential if the security interest is in property of third parties rather than property of the debtor. *See In re* Santoro Excavating, Inc., 32 Bankr. 947, 948 (Bankr. S.D.N.Y. 1983); *see also supra* note 135.

158. *See In re* Lackow Bros., Inc., 752 F.2d 1529 (11th Cir. 1985); *In re* Auto-Train Corp., 49 Bankr. 605, 609-10 (D. Colo. 1985); *In re* Property Leasing & Management, Inc., 46 Bankr. 903 (Bankr. E.D. Tenn. 1985); *In re* George Rodman, Inc., 39 Bankr. 855 (Bankr. W.D. Okla. 1984); *In re* Jameson's Foods, 35 Bankr. 433 (Bankr. D.S.C. 1983); *In re* PDQ Copy Center, 26 Bankr. 77, 79 (Bankr. S.D.N.Y. 1982); *In re* Hale, 15 Bankr. 565, 568-69 (Bankr. S.D. Ohio 1981); *In re* Conn, 9 Bankr. 431, 435 (Bankr. N.D. Ohio 1981). *But see In re* Zuni, 6 Bankr. 449, 451 (Bankr. D.N.M. 1980) (continuing to rely on the "no depletion of the estate" rationale).

159. *In re* Lackow Bros., Inc., 752 F.2d 1529 (11th Cir. 1985); *In re* Auto-Train Corp., 49 Bankr. 605 (D. Colo. 1985); *In re* George Rodman, Inc., 39 Bankr. 855 (Bankr. W.D. Okla. 1984); *In re* Jameson's Foods, 35 Bankr. 433 (Bankr. D.S.C. 1983); *In re* Zuni, 6 Bankr. 449 (Bankr. D.N.M. 1980).

160. *See supra* notes 77-80 and accompanying text.

547(b)—both of which search for the effect of the transfer on what otherwise would have been a Chapter 7 distribution—indicates that the valuation of the collateral should be made at the time of the Chapter 7 distribution.[161]

Without attempting to be more precise than is the Reform Act,[162] I would suggest that the measure of value should vary with the circumstances of the case. The distribution test always focuses on a Chapter 7 distribution, although sometimes a hypothetical one. Therefore, the court may have to hypothesize whether the secured creditor or the trustee would liquidate the property prior to the Chapter 7 distribution,[163] and the amount the liquidation then would have produced. In other cases, the court should return the collateral to the secured creditor prior to the Chapter 7 distribu-

161. Professor David Carlson posits the case of the oversecured creditor who gets paid and releases his collateral sixty days before bankruptcy but whose former collateral is totally destroyed thirty days before bankruptcy. He then argues that, since the creditor released his security interest in exchange for payment, the payment was for new value and not for antecedent debt. My colleague and collaborator, Professor Andrew Kaufman, also favors this argument and it is presented in another context in V. COUNTRYMAN, A. KAUFMAN, & Z. WISEMAN, COMMERCIAL LAW 308-09 (2d ed. 1982). But, although the language of § 547(a)(2) and (b)(2) lends technical support to such an argument, it is contrary to the policy of § 547(b) to preserve the Chapter 7 distribution policy. If the payment had not been made, the creditor would have received in a Chapter 7 distribution, not the 100% he is now holding, but what other unsecured creditors would receive in a Chapter 7 case. *See also In re* Property Leasing & Management, Inc., 46 Bankr. 903, 912 (Bankr. E.D. Tenn. 1985) (although the amount of accounts receivable collateral "fluctuated dramatically" after payments made by debtor to creditor, "the only relevant question is what the secured status of the claim would have been on the date of the petition since that alone would determine the distribution to which [the creditor] would have been entitled in a Chapter 7 liquidation."); *In re* Auto-Train Corp., 49 Bankr. 605, 610 (D. Colo. 1985) (creditor's security interest in refundable unearned insurance premiums which were constantly diminishing valued for § 547(b)(5) purposes as of bankruptcy); *In re* George Rodman, Inc., 39 Bankr. 855, 857-59 (Bankr. W.D. Okla. 1984) (finding a voidable preference when the debtor paid a creditor the full amount of his claim in exchange for release of a materialmen's lien on an oil well that later turned out to be a "dry hole"); *In re* Jameson's Foods, 35 Bankr. 433, 437 (Bankr. D.S.C. 1983) (assuming that the creditor had a security interest in identifiable proceeds in the debtor's bank account at the time it was transferred to the creditor, but finding preferential effect because, on the filing of the bankruptcy petition, the creditor under U.C.C. § 9-306(4)(b) and (c) lost its right to trace into the account and could not qualify for what U.C.C. 9-306(4)(d) gave it in exchange).To all of this Professor Kaufman would reply that it is, or should be, another bankruptcy policy that the estate not be consumed by the cost of litigation.

162. Under 11 U.S.C. § 101(25), in determining solvency or insolvency, the court considers the debtor's assets "at a fair valuation." Under 11 U.S.C. § 506(a), in fixing the amount of a secured claim, the court determines the value of collateral "in light of the purpose of the valuation and of the proposed disposition or use of such property . . . ." Under 11 U.S.C. § 522(a)(2), the value limits on exemptions mean "fair market value."

163. *See supra* notes 126-28 and accompanying text.

tion to unsecured creditors[164] for liquidation by him after the Chapter 7 distribution.

The amount tbat the court believes a secured creditor can realize on the collateral may vary, depending on the nature both of the collateral and of the secured creditor. For instance, the court may conclude that a creditor who deals in property of the kind constituting the collateral can realize more than a bank or a finance company without a recourse against a dealer. In any event, two of the cases addressing the valuation problem seem wrong. One court ignored the direction in section 547(b)(5)(B) to assume the transfer was not made. The court upheld a finance company's defense in a preference action that the value of the collateral after the debtor made the challenged payments exceeded the balance of the debt.[165] The other court held that prepetition "going concern" value of jewelry inventory and accounts, rather than postpetition liquidation value after the debtor ceased operating the business and the case had been converted from Chapter 11 to Chapter 7, was the proper valuation for establishing the finance company's defense.[166]

A payment to a secured creditor that comes from the creditor's own collateral does not effect a preference, whether he is fully or only partially secured. That has been the rule before[167] and since the Reform Act. Without this rule many prepetition foreclo-

164. *See supra* note 129.

165. *In re* Zuni, 6 Bankr. 449, 452 (Bankr. D.N.M. 1980). There are other cases similarly ignoring § 547(b)(5)(B). *See also In re* Roberson, 7 Bankr. 34, 36 (Bankr. D. Idaho 1980) (holding that because an execution sale to the creditor "extinguished" the earlier execution lien, the creditor would be an unsecured creditor who would receive less in a Chapter 7 distribution than the sale gave her). *In re* Williams, 5 Bankr. 706, 708 (Bankr. S.D. Ohio 1980), held that the creditor-defendant was not secured because it released its security interest when the debtor paid off the secured claim within 90 days of bankruptcy.

166. *In re* Lackow Bros., Inc., 752 F.2d at 1531-32. *But see infra* note 441.

167. *See* Kapela v. Newman, 649 F.2d 887, 891 (1st Cir. 1981); *In re* Holiday Airlines Corp., 647 F.2d 977, 979 (9th Cir.), *cert. denied*, 102 S. Ct. 1009 (1981); Biggins v. Southwest Bank, 490 F.2d 1309 (9th Cir. 1973); Calaway v. Admiral Credit Corp., 407 F.2d 518, 521 (4th Cir. 1969); Bogus v. American Nat'l Bank, 401 F.2d 458 (10th Cir. 1968); Walutes v. Baltimore Rigging Co., 390 F.2d 350, 351 (4th Cir. 1968); Farmers Bank v. Julian, 383 F.2d 314, 322 (8th Cir.), *cert. denied*, 383 U.S. 1021 (1967); *In re* Riedl, 339 F.2d 338, 340 (7th Cir. 1964); Azar v. Morgan, 301 F.2d 78 (5th Cir. 1962); Irving Trust Co. v. Bank of Am. Nat'l Ass'n., 68 F.2d 887, 890 (2d Cir.), *cert. denied*, 292 U.S. 628 (1934); Coppard v. Martin, 15 F.2d 743 (5th Cir. 1926); *cf.* Bertram v. Citizens Nat'l Bank, 283 F.2d 783 (6th Cir. 1960) (holding that, when the debtor sold property covered by a valid execution lien for less than the amount of the lien and paid the proceeds to the execution creditor who released the lien, no diminution of the estate occurred and the payment was not preferential even though the creditor then applied the payment to other debts secured by chattel mortgages).

sures would constitute preferential transfers.[168] Once again, the former explanation for this rule was that no diminution of the estate occurred. A more felicitous explanation is that no preferential effect exists because, if the payments had not been made before bankruptcy, the creditor would be entitled to them in a Chapter 7 liquidation. Courts have given this explanation when they apply the rule under the Reform act.[169]

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168. Whether the secured creditor or a third party purchases the property at a prebankruptcy foreclosure sale may raise a question about the fairness of the sale price. A similar question might arise when the creditor takes back the collateral and gives the debtor credit for it. A line of cases originating with Durrett v. Washington Nat'l Ins. Co., 621 F.2d 201 (5th Cir. 1980), under § 67d of the former Bankruptcy Act and carrying over to § 548 of the Reform Act, holds that when the sale price was not the fair equivalent of the value of the property and the debtor was insolvent at the time of sale, the trustee may avoid the sale as a fraudulent conveyance. The Ninth Circuit, however, does not follow these cases. *See In re* Madrid, 725 F.2d 1197 (9th Cir.), *cert. denied*, 105 S. Ct. 125 (1984).

Senator Thurmond proposed a 1984 amendment to the Reform Act to get rid of the *Durrett* doctrine. First, he would have amended the definition of "transfer" in what is now 11 U.S.C. § 101(48) by adding at the end, "and foreclosure of the debtor's equity of redemption." He also would bave amended the definition of a fraudulent conveyance in 11 U.S.C. § 548 to include "voluntary or involuntary" transfers. Both of these amendments seem redundant because the definition of transfer in § 101(48) already expressly covered "voluntary or involuntary" dispositions of an interest in property. Senator Thurmond, however, apparently designed the amendments to remove all doubt that § 548 applied to foreclosure of sales. His third amendment would have added to § 548 a provision that, when a foreclosure sale was "regularly conducted" and "noncollusive," the purchaser who bids in the full amount of the mortgage debt "gives reasonably equivalent value." 130 CONG. REC. S6081-82, S6107, S6118, S6122, S6127 (daily ed. May 21, 1984).

Thereafter, Senator Thurmond announced that he had dropped certain of his amendments, including those "relating to . . . the Durrett issue," in order to get Senator Metzenbaum's consent to expedited debate. 130 CONG. REC. S7617 (daily ed. June 19, 1984). But another legislative accident occurred. The Conference Report dropped only the third Thurmond amendment and left the other two, making it very clear that § 548 applies to foreclosure sales. H.R. REP. No. 822, 98th Cong., 2d Sess. 38, 50 (1984). Nevertheless, three months after enactment, Senators DeConcini and Dole tried, by a colloquy in the Senate, to create some retroactive legislative history indicating that the first two amendments "were not intended to have any effect one way or the other on the so called Durrett issue." 130 CONG. REC. S12771 (daily ed. Oct. 5, 1984).

Under 11 U.S.C. § 544(b), the trustee also can invoke state fraudulent conveyance law. The new Uniform Fraudulent Transfer Act, bowever, includes a provision in section 3(b) that a purchaser at a "regularly conducted, noncollusive" foreclosure sale gives "reasonably equivalent value" without regard to the amount of his bid. U.F.T.A. § 3(b), 7A U.L.A. Supp. 80 (1985). Section 5(b) of that Act does make a transfer to an insider for antecedent debt by an insolvent debtor a fraudulent conveyance if the insider had reasonable cause to believe the debtor insolvent. But, perhaps because of the proprietary interest of the Commissioners on Uniform State Laws in the UCC, § 8(e) exempts from even this provision "the enforcement of a security interest in compliance with Article 9" of the UCC

169. *See In re* Nutting, 44 Bankr. 233, 238 (Bankr. D. Vt. 1984); *In re* Cosmopolitan Aviation Corp., 34 Bankr. 592, 594-96 (Bankr. E.D.N.Y. 1983) (when execution lien on personalty by state law dated from delivery of writ to sheriff outside 90 day period, no preference occurred when sheriff levied on debtor's bank account and paid its proceeds to execu-

In contrast, if a creditor who is only partially secured received a payment from any of the debtor's property not covered by the creditor's lien, the payment has preferential effect. That result could be avoided. The creditor could apply the payment to the secured part of his claim[170] by releasing a corresponding amount of collateral. But there is no recorded instance of a partially secured creditor doing so. Instead, the creditor always takes the payment and retains all of his collateral. On those facts, the courts find that, to the extent the payment does not exceed the creditor's unsecured claim, the payment gives him more than he would receive in a Chapter 7 distribution without it.[171]

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tion creditor within 90 day period); *In re* McQueen, 27 Bankr. 717 (Bankr. D. Vt. 1983); *In re* Jefferson Mortgage Co., 25 Bankr. 963, 966-67 (Bankr. D.N.J. 1982); *In re* 550 Les Mouches Fashions, Ltd., 24 Bankr. 509, 515 (Bankr. S.D.N.Y. 1982); *In re* Ridgway, 22 Bankr. 737, 740 (Bankr. S.D. Ohio 1982) (even though creditor released security interest on receipt of payment; *cf. supra* note 165); *In re* Markim, Inc., 15 Bankr. 56, 60 (Bankr. E.D. Pa. 1981); *In re* Castillo, 7 Bankr. 135, 137 (Bankr. S.D.N.Y. 1980) (allegations that deed taken by mortgagee in lieu of foreclosure constituted a fraudulent conveyance under § 548 insufficient and complaint dismissed); *see also In re* O'Neill's Shannon Village, 750 F.2d 679 (8th Cir. 1984). *In re* Ramco Int'l, Inc., 754 F.2d 130 (3d Cir. 1985), like *Cosmopolitan Aviation Corp., supra*, holds that, where by state law an execution lien dates from delivery of the writ to the sheriff, the lien is not voidable under § 547 where the writ was delivered outside the 90 day period although the levy was made within the 90-day period.

In *In re* Jacobs, 11 Bankr. 467 (Bankr. N.D. Mo. 1981), a creditor with "a valid and perfected security interest" in debtor's tractor repossessed the tractor a few days before the debtor filed a Chapter 13 petition. The court held that the Chapter 13 debtor could recover the tractor because the repossession constituted a voidable preference. 11 Bankr. at 468. This decision has several problems. The opinion did not indicate that the debtor claimed the tractor as exempt, in which event 11 U.S.C. § 522(h) might have entitled him to invoke § 547, if the trustee did not. Otherwise, a Chapter 13 debtor, unlike a Chapter 13 trustee, is not entitled to invoke § 547 even though he is operating a business. *See* 11 U.S.C. §§ 1303, 1304 (1982); *In re* Colandrea, 12 Bankr. 568 (Bankr. D. Md. 1982). The *Jacobs* court did not inquire whether the repossession deprived the debtor of all interest in the tractor. If not, the result may have been proper, but the court should have based its decision on § 542, governing turnover of property of the estate, rather than on § 547.

170. Under 11 U.S.C. § 506(a), a partially secured creditor has two claims: a secured claim to the extent of the value of his collateral and an unsecured claim for the balance.

171. *See* Barash v. Public Fin. Corp., 658 F.2d 504, 507-09 (7th Cir. 1981); *In re* Frigitemp Corp., 34 Bankr. 1000 (S.D.N.Y. 1983), *aff'd*, 753 F.2d 230 (2d Cir. 1985); *In re* Auto-Train Corp., 49 Bankr. 605 (D. Colo. 1985); *In re* Property Leasing & Management, Inc., 46 Bankr. 903, 912 (Bankr. E.D. Tenn. 1985); *In re* Head, 26 Bankr. 375 (Bankr. M.D. Fla. 1983); *In re* Chancellor, 20 Bankr. 316, 318 (Bankr. W.D. Ky. 1982); *In re* Satterla, 15 Bankr. 166, 167-68 (Bankr. W.D. Mich. 1981); *In re* McCormick, 5 Bankr. 726, 729-30 (Bankr. N.D. Ohio 1980); *see also* Small v. Williams, 313 F.2d 39, 46 (4th Cir. 1963); Mercantile Trust Co. v. Schlafly, 299 F. 202, 205-06 (8th Cir. 1924) (decided under the old Act). The court in *Barash*, however, made the same mistake that the cases *supra* note 165 made by ignoring § 547(b)(5)(B). The court in effect instructed the bankruptcy court on remand that if creditors could establish that the value of their collateral exceeded the balance of their claims *after the challenged payments*, no preferential effect would exist. 658 F.2d at 511-12.

The old no-diminution-of-the-estate notion provided another limitation on the trustee's power to avoid preferences. A contemporaneous exchange or substitution of collateral in which no additional value was subjected to the lien was not a voidable preference. The test of the validity of the substitution was two-fold. First, the substitution of the new collateral must have been prior to,[172] simultaneous with,[173] or at least substantially contemporaneous with[174] the release of the old collateral. Second, the value of the substituted collateral could not exceed the value of the original;[175] if it did, the excess was preferential if the secured creditor needed the additional value because he was not fully secured by the original collateral.[176] Although a few cases under the Reform Act have continued to find the substitution doctrine embodied either in the no-diminution-of-the-estate notion[177] or in section 547(b)(5),[178] the doctrine now may be codified elsewhere as will be indicated later.[179]

Whether a creditor seeks to meet the preference challenge by asserting that he was fully secured at the time of the challenged

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172. *See* First Nat'l Bank v. Julian, 383 F.2d 329, 334 (8th Cir. 1967); *In re* Pusey, Maynes, Breish Co., 122 F.2d 606, 608 (3d Cir. 1941).

173. *See* Kapela v. Newman, 649 F.2d 887, 892 (1st Cir. 1981); *In re* Baumgartner, 55 F.2d 1041, 1047-48 (7th Cir. 1931); *In re* Lambert & Braceland Co., 29 F.2d 758, 759 (E.D. Pa. 1928).

174. *See In re* Holiday Airlines Corp., 647 F.2d 977, 981-82 (9th Cir.), *cert. denied*, 102 S. Ct. 1009 (1981); Walker v. Clinton State Bank, 216 F.2d 165, 168 (8th Cir. 1954); Wolfe v. Bank of Anderson, 238 F. 343, 345 (4th Cir. 1916).

175. *See* Stewart v. Platt, 101 U.S. 731, 743-44 (1879); Sawyer v. Turpin, 91 U.S. 114, 120-21 (1875); Clark v. Iselin, 88 U.S. (21 Wall.) 360, 377-78 (1874); Cook v. Tullis, 85 U.S. (18 Wall.) 332, 339-40 (1873).

176. If the original collateral fully secured the creditor, then substitution of collateral with a greater value would not cause diminution of the estate or increase over the creditor's distribution in a Chapter 7 case. The original collateral should be valued, however, at the time of that distribution. *See supra* note 161 and accompanying text.

177. *See, e.g., In re* STN Enters., Inc., 45 Bankr. 959, 962-64 (D. Vt. 1985); *In re* Cloyd, 23 Bankr. 51, 53-54 (Bankr. E.D. Tenn. 1982).

178. *In re* Bloom, 28 Bankr. 571 (Bankr. D. Or. 1983). This case joins others that ignore § 547(b)(5)(B). *See also* Barash v. Public Fin. Corp., 658 F.2d 504 (7th Cir. 1981); cases cited *supra* note 165. In *Bloom*, the debtor within 90 days of bankruptcy gave a creditor a security interest in a truck in exchange for release of an earlier execution lien on the truck and an extension of maturity on the debt. The court held that the debtor seeking to claim an exemption on the truck could not avoid the security interest. 28 Bankr. at 573. The court did not allow the debtor to use 11 U.S.C. § 522(f), which permitted such a debtor to avoid all judicial liens, because he was trying to avoid the security interest. Nor could the debtor use § 522(h), which allowed such a debtor to invoke § 547 to avoid involuntary preferences, because the giving of the security interest to avoid execution sale of the truck was voluntary. *Id.*

179. *See infra* note 293 and accompanying text.

payment, that the payment came from his own collateral, or that the challenged transfer was a valid substitution of collateral, the creditor still may be vulnerable to a two-step attack[180] by the party invoking section 547. If that party can avoid the defendant creditor's lien,[181] then the challenged transfer becomes one made to an unsecured creditor and has a preferential effect unless this creditor would receive 100% in a Chapter 7 distribution. *Benedict v. Ratner*,[182] a case known better for its first step than for its second, established the attack. In the first step, the trustee invoked old section 70e, authorizing him to invalidate transfers constituting fraudulent conveyances under state law. The trustee persuaded the Court that under New York law an assignment of accounts receivable that allowed the debtor to collect the accounts and to use the proceeds as he saw fit was invalid as a fraudulent conveyance.[183] As his second step, the trustee invoked old section 60 to recover prebankruptcy payments of some of the account proceeds to the now unsecured creditor.[184] Under section 9-205 of the Uniform Commercial Code, such an assignment of accounts is no longer a fraudulent conveyance. If, however, the party challenging a transfer to a secured creditor as a preference first can invalidate the creditor's lien on any ground, including the ground that the lien itself was a voidable preference under section 547, the challenging party then can treat the subsequent transfer under section 547 as one made to an unsecured creditor.[185]

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180. Some of my students have irreverently labeled this attack "the Countryman two-step."

181. The party must avoid the creditor's *original* lien when substitution of collateral is involved.

182. 268 U.S. 353 (1925).

183. *Id.* at 360.

184. *Id.* at 365.

185. *See, e.g., In re* Roco Corp., 701 F.2d 978, 985 (1st Cir. 1983) (security interest avoidable under 11 U.S.C. § 548 as a fraudulent conveyance); *In re* Air Florida, Inc., 48 Bankr. 437, 440 (Bankr. S.D. Fla. 1985) (security interest avoidable under 11 U.S.C. § 544(a)(1) because not perfected); *In re* Chief Freight Lines Co., 37 Bankr. 436 (Bankr. N.D. Ohio 1984) (same); *In re* Wilmington Nursery Co., 36 Bankr. 813, 815 (Bankr. E.D.N.C. 1984) (judgment lien avoidable under § 547); *In re* Brent Explorations, Inc., 31 Bankr. 745 (Bankr. D. Colo. 1983) (security interest avoidable under § 544(a)(1) because not perfected); *In re* Dunlap, 27 Bankr. 728, 732 (Bankr. M.D.N.C. 1983) (no lien acquired under state law by defective service of execution on garnishee two years before bankruptcy); *In re* Brame, 26 Bankr. 309, 312 (Bankr. W.D. Ky. 1982) (statutory materialmen's lien expired before bankruptcy by terms of creating state statute because materialman failed to file notice); *In re* B. & L. Coal Co., 20 Bankr. 864 (Bankr. W.D. Pa. 1982) (security interest became unperfected and avoidable under 11 U.S.C. § 544(a)(1) when debtor changed place of business); *In re* Mazzetti, 22 Bankr. 538, 539-40 (Bankr. E.D.Mich. 1982) (equitable mortgage avoidable under 11 U.S.C. § 544(a)(3)); *In re* Brown, 18 Bankr. 956 (Bankr. S.D. Ill. 1982) (security

Thus, we have finally come, in part by accident, to a voidable preference concept that abandons the English requirement of the debtor's culpability and our own former requirement of the creditor-defendant's culpability. Lord Mansfield's concern about transfers "in contemplation of bankruptcy" has long been replaced with a definite time period preceding bankruptcy, and no one has voiced criticism of this change. Probably all would prefer the certainty afforded by this change, although others might pick, as England has picked,[186] a different period than ninety days. All that the trustee need show[187] to avoid transfers within the ninety day period is

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interest not perfected and avoidable under 11 U.S.C. § 544(a)(1)); *In re* Express Fruit & Produce, Inc., 16 Bankr. 366 (Bankr. D. Minn. 1982) (same); *In re* Purbeck & Assoc., Ltd., 12 Bankr. 406 (Bankr. D. Conn. 1981) (same); *In re* Hawkins Mfg., Inc., 11 Bankr. 512 (Bankr. D. Colo. 1981) (no judgment lien acquired by recording of judgment more than 90 days before bankruptcy because by state law judgment lien reached only realty and debtor owned no realty in county of recording); *In re* Peninsula Roofing & Sheet Metal, Inc., 9 Bankr. 257, 262 (Bankr. W.D. Mich. 1981) (common law possessory attorney's lien avoidable under § 547); *In re* Kelley, 3 Bankr. 651, 654 (Bankr. E.D. Tenn. 1980) (security interest avoidable under § 547 because of delay in perfection); *cf. In re* Cloyd, 23 Bankr. 51 (Bankr. E.D. Tenn. 1982), which held that a security interest in livestock did not exist at the time other collateral was substituted because "[t]he cattle had either been sold, traded, or had died." *Id.* at 55. If the security interest was perfected in the cattle sold or traded (a point on which the record was silent), and the secured party did not authorize the disposition within the meaning of U.C.C. § 9-306(2), the security interest would continue in the cattle. The security interest then would be a lien on property of others and would not be recognized in the debtor's Chapter 7 distribution. *See In re* Santoro Excavating, Inc., 32 Bankr. 947, 948 (Bankr. S.D.N.Y. 1983).

186. *See supra* note 31 and accompanying text. We also at different times have picked different periods. *See supra* notes 39, 44, 67 & 83 and accompanying text.

187. 11 U.S.C. § 547(g), which was added in 1984 and provides that the trustee has the burden of establishing all elements of a voidable preference under § 547(b), merely codifies case law under former § 60a and b. *See* Pyle v. Texas Transp. Co., 238 U.S. 90, 98 (1915); Constructora Maza, Inc. v. Banco de Ponce, 616 F.2d 573, 576 (1st Cir. 1980); Wilkie v. Brooks, 515 F.2d 741, 744 (6th Cir.), *cert. denied*, 423 U.S. 996 (1975); Farmers Bank v. Julian, 383 F.2d 314, 322 (8th Cir.), *cert. denied*, 398 U.S. 1021 (1967); American Nat'l Bank v. Bone, 333 F.2d 984, 987 (8th Cir. 1964); Moran Bros. v. Yinger, 323 F.2d 699, 701 (10th Cir. 1963); Mizell v. Phillips, 240 F.2d 738, 740 (5th Cir. 1957); Barry v. Crancer, 192 F.2d 939 (8th Cir. 1951); City Nat'l Bank v. Slocum, 272 F. 11 (6th Cir.), *cert. denied*, 257 U.S. 637 (1921).

Section 547(g) also codifies case law under the Reform Act prior to the 1984 amendment. *See* Brown v. First Nat'l Bank, 748 F.2d 490, 491 (8th Cir. 1984); *In re* American Ambulance Serv., Inc., 46 Bankr. 658, 659 (Bankr. S.D. Cal. 1985); *In re* Trejo, 44 Bankr. 539, 540 (Bankr. E.D. Cal. 1984); *In re* Fred's Dollar Store, 44 Bankr. 491, 495 (Bankr. N.D. Miss. 1984); *In re* Tinnell Traffic Servs., 43 Bankr. 277, 279 (Bankr. M.D. Tenn. 1984); *In re* Big Three Transp. Co., 41 Bankr. 16, 18 (Bankr. W.D. Ark. 1983); *In re* Jameson's Foods, 35 Bankr. 433, 436 (Bankr. S.D.S.C. 1983); *In re* American Gypsum Co., 36 Bankr. 360, 361-62 (Bankr. D.N.M. 1984); *In re* Hogg, 35 Bankr. 292, 294 (Bankr. D.S.D. 1983); *In re* Damon, 34 Bankr. 626, 629 (Bankr. D. Kan. 1983); *In re* Kennesaw Mint, Inc., 32 Bankr. 799, 803 (Bankr. N.D. Ga. 1983); *In re* Deltar Constr., Inc., 30 Bankr. 90, 91 (Bankr. S.D. Fla. 1983) (trustee lost because failed to prove that value of property transferred exceeded prior liens);

that the debtor was insolvent at the time of the transfer, with the presumption of section 547(f) usually carrying the day for the trustee on this issue; that the transfer was to or for the benefit of a creditor, for or on account of antecedent debt; and that the transfer had a preferential effect as heretofore explained.

This result seems consistent with the purpose of the preference concept, although the purpose never has been explained very accurately. Even though statements in the legislative history discuss deterring creditors from scrambling for advantage,[188] it seems ridiculous to expect deterrence for two reasons. First, a preferred creditor can retain his preference if the ninety day period elapses before the bankruptcy petition is filed. Second, if the petition is filed within the ninety day period, the preferred creditor can escape all consequences of having been preferred by simply surrendering his preference, unless the creditor has a defense he is willing to litigate.[189] Given these alternatives, few creditors will be deterred from seeking or accepting a preference.

Statements in the legislative history also mention preserving the bankruptcy policy of "equality" of distribution.[190] But, with creditors classified for distribution purposes on the basis of liens and priorities,[191] no bankruptcy policy of "equality" exists. A policy of preserving classes and of preserving equality within classes does exist, however, and the preference concept is designed to preserve this policy. The function of the preference concept is to avoid prebankruptcy transfers that distort the bankruptcy policy of distribution. Transfers that do distort this policy do so without regard to the state of mind of either the debtor or the preferred creditor.

The trustee must prove the same elements when pursuing preferences to insiders in the period one year to ninety days before bankruptcy, except that he is not aided by a presumption of insolvency during that time; rather, the trustee must prove that the

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In re Murray, 27 Bankr. 445, 447 (Bankr. M.D. Tenn. 1983); *In re* Sbraga, 27 Bankr. 199, 200-01 (Bankr. M.D. Pa. 1982) (trustee lost because failed to introduce evidence on preferential effect); *In re* Jefferson Mortgage Co., 25 Bankr. 963, 966 (Bankr. D.N.J. 1982); *In re* Saco Local Dev. Corp., 25 Bankr. 876, 878 (Bankr. D. Me. 1982); *In re* Eggleston, 19 Bankr. 280, 282 (Bankr. M.D. Tenn. 1982); *In re* K. Pritchard Co., 17 Bankr. 508, 509 (Bankr. S.D. Ala. 1981); *In re* Lucasa Int'l, Ltd., 13 Bankr. 596, 598 (Bankr. S.D.N.Y. 1981); *In re* Utility Stationery Stores, Inc., 12 Bankr. 170, 175 (Bankr. N.D. Ill. 1981); *In re* Camp Rockhill, Inc., 12 Bankr. 829, 831 (Bankr. E.D. Pa. 1981); *In re* Meritt, 7 Bankr. 876, 879 (Bankr. W.D. Mo. 1980); *In re* Kelley, 3 Bankr. 651, 653 (Bankr. E.D. Tenn. 1980).

188. *See supra* notes 91 & 100 and accompanying text.

189. *See supra* notes 101 & 102 and accompanying text.

190. *See supra* notes 91, 98 & 100 and accompanying text.

191. *See supra* notes 119-121 and accompanying text.

debtor was insolvent at the time of the transfer. Removal of the requirement that the insider-creditor have reasonable cause to believe the debtor insolvent was doubtless an accident.[192] Congress very probably will make an effort to restore the requirement as soon as it again can divert its attention to the subject of bankruptcy. That the requirement should be restored is not clear, however. A transfer to an insider-creditor by an insolvent debtor, like the debtor's transfer to any other creditor, is not any more or less a distortion of the bankruptcy distribution policy depending on the transferee's state of mind. The additional burden of proof imposed on the trustee as to the transferee's state of mind, which Congress decided not to impose on him for creditors who are not insiders, also may enable many insiders to frustrate the bankruptcy distribution policy.

Before reinstating this burden of proof in the case of insider-creditors, two other questions need answers. First, is the definition of an "insider" in section 101(28)[193] too broad for preference purposes? "Insider" "includes," but is not limited to,[194] persons ranging from a corporate debtor's treasurer to an individual debtor's mother who knows nothing about his business. Those who would not be disturbed by a ruling that the treasurer must disgorge a preference received from his insolvent corporation eleven months before bankruptcy without regard to his state of mind might not favor treating the mother the same way.

Second, is the extension of the preference period from ninety days to one year for insiders too long? Although the legislative history contains no clue indicating how Congress selected this period, the length corresponds to the one year period during which prepetition fraudulent conveyances are vulnerable to the trustee's attack under section 548, as they were under section 67d of the old Act.[195] It may have been a purpose of the insider provision in section 547, as it is one of its effects, to compensate for a change in coverage of section 548. Under old section 67d, as under section 3 of the UFCA, the "fair consideration" that would save a transfer not

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192. *See supra* note 115 and accompanying text.

193. 11 U.S.C. § 101(28) (1982).

194. Under 11 U.S.C. § 102(3), " 'includes' and 'including' are not limiting." Hence, *In re* Motanino, 13 Bankr. 307, 309-10 (Bankr. D.N.J. 1981), concluded that the parents of the woman with whom the debtor had lived for the past five years, although he was married to another, were insiders for § 547 purposes.

195. 11 U.S.C. § 548 (1984). Alternatively, under 11 U.S.C. § 544(b), as under § 70e of the old Act, the trustee may invoke state fraudulent conveyance law, including the Uniform Fraudulent Conveyance Act, for which the statute of limitations may be longer.

made with actual intent to hinder, delay, or defraud creditors[196] had to be given in "good faith." Trustees invoked the "good faith" requirement for security transfers or debt payments to corporate officers and stockholders that occurred more than four months before bankruptcy, so that the transfers were not vulnerable under old section 60. And occasionally trustees were able to persuade courts that the transfers were vulnerable under old section 67d or under the UFCA because they were not taken in good faith, even though the antecedent debt secured was not disproportionately small or the antecendent debt paid was a fair equivalent.[197] Although section 548(a)(2)(A) eliminates the "good faith" requirement, the trustee under section 544(b) still may be able to invoke that requirement under UFCA section 3.[198]

B. The Perfection Requirement

Under the old Act, the best thing that could happen to a creditor who received an otherwise avoidable preference was for four months to expire without the debtor's going into bankrutpcy. Therefore, the preferred creditor had an incentive to conceal the preference.[199] Since 1898, Congress has sought to counteract this incentive by imposing bankruptcy consequences on transferees who delay complying with nonbankruptcy notoriety requirements rather than by imposing an independent bankruptcy notoriety requirement. Nevertheless, as the Supreme Court later said, prior to 1938 the courts consistently "found its efforts faulty."[200] Finally, in the Chandler Act,[201] Congress amended old section 60a to provide

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196. *See supra* note 10.

197. *See, e.g.*, Burroughs v. Fields, 546 F.2d 215, 218 (7th Cir. 1976); Bullard v. Aluminum Co. of Am., 468 F.2d 11, 13 (7th Cir. 1972); *In re* Inland Sec. Co., 382 F. Supp. 338, 347 (W.D. Mo. 1974); Duberstein v. Werner, 256 F. Supp. 515, 520 (E.D.N.Y. 1966); *see also* Gilmer v. Woodson, 332 F.2d 541, 547 (4th Cir. 1964); Cohen v. Sutherland, 257 F.2d 737, 742 (2d Cir. 1958); Studley v. Lefrak, 66 A.D.2d 208, 213, 412 N.Y.S.2d 901, 905 (N.Y. App. Div. 1979); Southern Indus. v. Jeremias, 66 A.D.2d 178, 183, 411 N.Y.S.2d 945, 949 (N.Y. App. Div. 1978).

198. *See In re* Checkmate Stereo & Elecs., Ltd., 9 Bankr. 585, 617-18 (Bankr. E.D.N.Y. 1981), *aff'd*, 21 Bankr. 402 (E.D.N.Y. 1982). In the new Uniform Fraudulent Transfer Act, "good faith" is also dropped from § 3. Under § 5(b), however, an insolvent debtor's transfer to an insider for an antecedent debt is a fraudulent conveyance as to existing creditors if the insider had reasonable cause to believe the debtor insolvent. U.F.T.A. § 5(b), 7A U.L.A. 80 (Supp. 1985). *But see supra* note 168.

199. During the 80 years under the 1898 Act, when a preference was also an act of bankruptcy that would support an involuntary petition filed within four months after the transfer, the debtor had a similar incentive.

200. Corn Exch. Nat'l Bank & Trust Co. v. Klauder, 318 U.S. 434, 438 (1943).

201. 52 Stat. 869 (1938). For more detail, see Countryman, *The Secured Transactions*

that, for the purposes of section 60a and 60b:

> [A] transfer shall be deemed to have been made at the time when it became so far perfected that no bona-fide purchaser from the debtor and no creditor could thereafter have acquired any rights . . . superior to the rights of the transferee therein, and, if such transfer is not so perfected prior to the filing of the petition . . . it shall be deemed to have been made immediately before bankruptcy.[202]

The meaning of this "perfection clause" came before the Supreme Court in *Corn Exchange National Bank v. Klauder*,[203] in which the trustee was attacking assignments of accounts receivable as preferential transfers under section 60. Because the debtor made all of the challenged assignments within four months of bankruptcy, the trustee did not need the perfection clause to toll the statutory period. But all the assignments were in fact made to secure present advances to the debtor, and the trustee asserted that, because the creditor failed to perfect the assignments, they were converted, for section 60 purposes, into assignments made immediately before bankruptcy and that the earlier advances constituted antecedent debt.[204]

The failure to perfect was not a failure to perfect against creditors of the debtor. At the time of *Klauder*, most states did not require perfection of assignments of accounts against creditors.[205] Pennsylvania, however, where the case arose, followed the so-called "English rule," under which a second assignee of the same accounts who first notified the account obligors of his assignment would prevail over an earlier assignee.[206] The only assignee in *Klauder* had not notified the account obligors.

The Supreme Court agreed with the trustee that, because the creditor-defendant failed to notify the obligors on the assigned accounts, it had not perfected against a hypothetical subsequent assignee who would be a bona fide purchaser under the perfection clause.[207] The Court agreed also that, in this situation, the perfection clause converted the assignments into assignments for antecedent debt.[208] In effect, although there is no express recognition of

Article of the Uniform Commercial Code and Section 60 of the Bankruptcy Act, 16 LAW & CONTEMP. PROBS. 76, 77-79 (1951).

202. 52 Stat. 869, § 60a (1938).

203. 318 U.S. 434 (1943).

204. *See id.* at 435, 437.

205. *See* 4 A. CORBIN, CONTRACTS §§ 902-903 (1951); 3 S. WILLISTON, CONTRACTS §§ 433-34 (3d ed. 1960).

206. *See Klauder*, 318 U.S. at 436.

207. *Id.* at 437.

208. *Id.*

that fact in the *Klauder* opinion, the Court allowed the trustee to hypothesize not merely a bona fide purchaser, but a purchaser who also had been first to notify the account obligors of his assignments.

The four month period of section 60 ran from the time of transfer; the debtor's insolvency was tested as of the time of the transfer; and the creditor's reasonable cause to believe the debtor insolvent focused on the time of the transfer. *Klauder* seemed to suggest that all these elements also would be tested at a time immediately before bankruptcy if no perfection occurred before bankruptcy and at the time of perfection if delayed perfection occurred before bankruptcy. Furthermore, under *Palmer Clay Products*,[209] preferential effect was tested as of the time of distribution, apart from any perfection requirement. Hence, in the event of a delay in perfection, or a complete failure to perfect as in *Klauder*, no element of a voidable preference was tested as of the time the transfer actually occurred.

At least *Klauder* did not require the impossible of the creditor-defendant. He could have perfected by giving prompt notice of his assignment to the account obligors.[210] Some states, however, followed the "Massachusetts," or "four horsemen," rule embodied in the Restatement of Contracts.[211] That rule allowed a second assignee to prevail over an earlier assignee if the subsequent assignee was first to obtain judgment on or payment of the account, or a novation with or a negotiable instrument from the account obligor. To subject an assignee of accounts to this rule would require the impossible of him whenever the assignee was not situated to move first because his assignment was only a security interest and the debtor was not in default. Nonetheless, one court read *Klauder* to allow the trustee to invoke this rule.[212] Another court refused to apply the rule because "the favored position acquired by the subsequent assignee . . . comes not from his status as bona fide purchaser, but from his activities following his belated assignment."[213] That rationale applies equally, however, to the hypothetical subsequent assignee in *Klauder*. The only assignees of accounts who seemed completely free from the 1938 perfection clause were those governed by the "New York rule," which had no perfection re-

209. 297 U.S. 227, 229 (1936); *see also supra* notes 77-80 and accompanying text.
210. *See Klauder*, 318 U.S. at 437.
211. RESTATEMENT (SECOND) OF CONTRACTS § 342(b) (1981).
212. *See In re* Vardaman Shoe Co., 52 F. Supp. 562, 563 (E.D. Mo. 1943).
213. *In re* Rosen, 157 F.2d 997, 1001 (3d Cir. 1946), *cert. denied*, 330 U.S. 835 (1947).

quirements against either creditors or subsequent assignees.[214]

The consequence was a 1950 amendment[215] adding a new perfection requirement as section 60a(2) and six other new paragraphs to section 60a.[216] The Reform Act consigned most of the 1950 amendments to history, but section 60a(2) is still relevant. Section 60a(2) preserved much of the language of the 1938 perfection provision, including language that a transfer was "deemed made" at perfection or immediately before bankrutpcy if not perfected before the filing of the petition. The new section bifurcated the perfection test, however. Transfers of real property had to be perfected against bona fide purchasers, and transfers of "property other than real property" had to be perfected against a "subsequent lien upon such property obtainable by legal or equitable proceedings on a simple contract."[217]

Confining the bona fide purchaser test to real property alleviated worries not only about accounts receivable but also about a variety of inventory financing devices under which a dealer-debtor could defeat even a perfected security interest by a sale to his customer.[218] But U.C.C. sections 9-102(1) and 9-302(1) now require the filing of a financing statement to perfect a sale or a security interest in accounts or a security interest in general intangibles. Also, under section 9-301(1)(b) and (d), a judicial lien creditor or a bona fide purchaser can defeat an unperfected interest in such collateral.

Section 60a(4) further defined the judicial lien obtainable by a creditor "on a simple contract," against which transfers of property other than realty had to be perfected. The lien must arise on the entry or docketing of a judgment,[219] or upon attachment, garnishment, execution, or similar process. It did not include liens that "under applicable law are given a special priority over other liens."[220] The discovery of a single state statute apparently in-

214. Countryman, *supra* note 201, at 79.

215. 64 Stat. 24 (1950).

216. For more detail, see Countryman, *supra* note 201, at 86-90.

217. 64 Stat. 24, § 60a(2) (1950).

218. By U.C.C. §§ 1-201(9) and 9-307(1), the customer, now described as a "buyer in ordinary course of business," can defeat a perfected interest in inventory if the collateral is not farm products.

219. Kentucky, Michigan, and the New England states, with two exceptions, CONN. GEN. STAT. ANN. § 49-44 (1978); VT. STAT. ANN. § 12-2901 (Supp. 1982), have no judgment lien. In most of the other states, a judgment lien reaches only real property, but in a few states it also reaches personalty. *See* ALA. CODE § 6-9-211 (1977); GA. CODE ANN. § 9-12-80 (1982); MISS. CODE ANN. § 11-7-19 (1972).

220. 64 Stat. 24, § 60a(4) (1950).

spired section 60a(4).[221] The statute authorized anyone with a damage claim arising from tortious operation of a motor vehicle to attach the vehicle and obtain a lien on it with priority over all other liens except tax liens.[222]

Most remarkably, the 1950 amendments to section 60 did not affect the "literal interpretation" of *Klauder*. The test for perfection changed for some types of collateral, but if the test was not met the result seemed the same as under *Klauder*. The creditor who took a security interest on a present advance six months before bankruptcy and waited three months to perfect would have his security interest converted into one for antecedent debt. The four month period of section 60a would be calculated from the date of perfection; the debtor's insolvency and the creditor's reasonable cause to know of the insolvency would be tested as of the date of perfection. If the creditor never had perfected before bankruptcy, he again would end with a security interest for antecedent debt, and the four month period, the debtor's insolvency, and the creditor's reasonable cause to know of the insolvency would be tested as of a time immediately before bankruptcy.[223] With preferential effect still tested at the time of distribution, no element of the trustee's case would be tested at the time of actual transfer in either instance.

Section 547(e)(1) of the Reform Act continues the bifurcated perfection test with a few modifications.[224] The test for transfers of "real property other than fixtures, but including the interest of a seller or a purchaser under a contract for the sale of real property," is perfection against a bona fide purchaser "against whom applicable law permits such transfer to be perfected." The test for transfers of "a fixture or property other than real property" is perfection against a judicial lien obtained by "a creditor on a simple contract." The Committee Reports[225] explain that the "simple contract" language "is derived from" old section 60a(4).[226] The reference to a purchaser "against whom applicable law permits such

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221. S.C. CODE ANN. § 29-15-20 (1977).

222. *Id.* Proponents of the 1950 amendment also had complained that all security transfers could not be completed "on the courthouse steps." As a result, some delay would occur between the transfer and perfection, and the "literal interpretation" of *Klauder* would convert the transfers into transfers for antecedent debt. In response to that plea, § 60a(7) gave creditors 21 days to perfect, unless state perfection law specified a shorter period.

223. *See* 2 W. COLLIER ON BANKRUPTCY ¶ 60-39[3], [4], [5] (J. Moore 14th ed. 1977).

224. *See* 11 U.S.C. § 547(e)(1) (1982).

225. H.R. REP. No. 595, *supra* note 100, at 374; S. REP. No. 989, *supra* note 118, at 89.

226. *See supra* notes 219-22 and accompanying text.

transfer to be perfected" also appears in sections 544(a)(3), 548(d)(1), 549(c).[227] The "simple contract" language appears also in section 544(a)(1). In both Houses, the floor managers of the Reform Act explained with reference to section 544(a)(3) that the language was included "so as not to require a creditor [sic] to perform the impossible in order to perfect his interest."[228] They further explained that "[b]oth the [simple contract] lien creditor test in § 544(a)(1) and the bona fide purchaser test in § 544(a)(3) should not require a transferee to perfect a transfer against any entity with respect to which the applicable law does not permit perfection."[229]

Section 547(e)(2) also provides that "a transfer is made" for the purposes of section 547 at the time it "takes effect between the transferor and the transferee" if perfected within ten days of that time, even though the perfection occurs after bankruptcy. If perfection occurs after expiration of the ten day grace period,[230] the transfer "is made" at the time of perfection, except that, if the transfer is not perfected when the debtor files the petition and the grace period has expired, the transfer "is made" immediately before the date of bankruptcy.[231] All of the provisions of section 547(e)(2) apply "except as provided in" section 547(e)(3), however, and the latter section provides that "for the purposes of" section 547, "a transfer is not made until the debtor has acquired rights in the property transferred."

But, insofar as section 547(e)(2) appeared to authorize postpetition perfection within the ten day grace period, a legislative acci-

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227. 11 U.S.C. §§ 544(a)(3), 548(d)(1), 549(c) (1979). In the Reform Act, the words in § 548(d)(1) were "against whom such transfer could have been perfected," but the 1984 amendments conformed the language to that in §§ 544(a)(3), 547(e)(1), and 549(c).

228. 124 CONG. REC. 32,400, 33,999 (1978).

229. *Id.* The floor managers also explained that Congress "intended that the simple contract test used in § 547(e)(1) [would] he applied as under section 544(a)(1) not to require perfection against a creditor on a simple contract in the event applicable law [made] such perfection impossible." *Id.* at 33,999, 34,000.

230. This 10 day period replaces the 21 day grace period of the old Act. *See supra* note 222.

231. This last provision seems nearly redundant. The trustee can defeat, under § 544(a)(1), most transfers not perfected at bankruptcy against judicial lien creditors and, under § 544(a)(3), most transfers of realty not perfected against bona fide purchasers without proving tbe elements of a voidable preference. *But see infra* note 236 and accompanying text. The same near redundancy was in the 1938 and 1950 perfection provisions of old § 60 for transfers not perfected at bankruptcy against judicial lien creditors, because old § 70c authorized the trustee to avoid the transfers for that reason alone. Until the enactment of § 544(a)(3), however, the trustee had no similar power to defeat transfers of realty not perfected at bankruptcy against bona fide purchasers.

dent may have occurred in 1978. Section 546(b)[232] subjects the trustee's avoiding powers under sections 544, 545, and 549[233] to any "generally applicable law" that grants a grace period for perfection with retroactive effect against intervening interests; moreover, section 546(b) specifically contemplates that the grace period may extend beyond the filing of a bankruptcy petition. The Committee Reports explain that " 'generally applicable law' relates to those provisions of applicable law that apply both in bankruptcy cases and outside of bankruptcy cases."[234] The Reports cite as an example U.C.C. section 9-301(2), which gives the holder of a purchase money security interest ten days from the time the debtor gets possession of the collateral to perfect the interest, with retroactive effect against intervening levying creditors and bulk transferees.[235] Also, because the filing of the petition under section 362(a)(4)[236] operates as an automatic stay of "any act to . . . perfect . . . any lien against property of the estate" an exception from that stay was written into section 362(b)(3) to the extent that the trustee's powers are subject to grace periods for perfection under section 546(b).

None of these provisions, including the exception in section 362(b)(3), however, applied to a creditor seeking to take advantage of his grace period for perfecting a transfer under section 547(e)(2). The grace period does not come by way of section 546(b) and its incorporation of "generally applicable law"; rather, it is conferred by section 547(e)(2), which is not a law applicable "both in bankruptcy cases and outside of bankruptcy cases." Under the Reform Act, the creditor apparently had to seek relief from the automatic stay before attempting a postpetition perfection within the ten day grace period of section 547(e)(2). As a result, the 1984 amendments expanded the exception from the automatic stay in section 362(b)(3) to include a perfection that is accomplished "within the period provided under" section 547(e)(2).

Nevertheless, the 1984 amendment does not solve the entire problem. Section 546(b) subjects the trustee's avoiding powers under section 544(a) only to grace periods for perfection given by "generally applicable law," not to those given by section

232. 11 U.S.C. § 546(b) (1982).

233. *Id.* §§ 544, 545, 549.

234. H.R. Rep. No. 595, *supra* note 100, at 371; S. Rep. No. 989, *supra* note 118, at 86.

235. *Id.* They also might have cited many mechanics' and materialmen's lien statutes.

236. 11 U.S.C. § 362(a)(4) (1982).

547(e)(2).[237] Although a creditor no longer needs relief from the automatic stay to take advantage of the grace period given by section 547(e)(2) for purposes of section 547, most transfers not perfected at bankruptcy against judicial lien creditors and most transfers of realty not perfected at bankruptcy against bona fide purchasers still will be voidable under section 544(a)(1) or (3).[238] Therefore, section 546(b) also should be amended to subject the trustee's avoiding powers to grace periods conferred by "generally applicable law" or by section 547(e)(2).

In addition, the reading *Klauder* gave to the old perfection provisions seems equally applicable to new section 547(e). A failure to perfect within the ten day grace period of section 547(e)(2) will toll the ninety day or one year provision of section 547(b);[239] will

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237. *See In re* Murray, 27 Bankr. 445, 448 (Bankr. M.D. Tenn. 1983); *In re* Ken Gardner Ford Sales, Inc., 10 Bankr. 632, 643 (Bankr. E.D. Tenn. 1981).

238. There may be some overlap. A purchase money secured party who takes advantage of § 546(b) and U.C.C. § 9-301(2) to make a postpetition perfection within 10 days of the time the debtor gets possession of the collateral, *if the perfection occurs* within 10 days of the time the "transfer takes effect between the transferor and the transferee," may have complied with the 10-day grace period of § 547(e)(2). But the holder of a UCC security interest that is not for purchase money has no UCC grace period to perfect. He will be in the same position as the holder of a statutory attorney's lien with no grace period in *In re* Storage Technology Corp., 45 Bankr. 83 (D.C.D. Colo. 1985). The attorney, who filed a notice to perfect his lien after the bankruptcy petition was filed, got no protection from 11 U.S.C. § 362(b)(3) or § 546(b). His filing violated the automatic stay of 11 U.S.C. § 362(a)(5) and his lien was voidable under § 545(2) as a statutory lien not perfected against a bona fide purchaser at bankruptcy. The holder of a UCC interest that is not for purchase money, who filed after bankruptcy, would be in the same position except that his security interest would be avoidable under 11 U.S.C. § 544(a)(1).

239. *See In re* Strom, 46 Bankr. 144, 148 (Bankr. E.D.N.C. 1985); *In re* Gottschalk, 46 Bankr. 49, 51 (Bankr. M.D. Fla. 1985); *In re* La Mancha Aire, Inc., 41 Bankr. 647, 648 (Bankr. S.D. Fla. 1984); *In re* Harter, 41 Bankr. 276, 278-79 (Bankr. N.D. Ga. 1984); *In re* A.E.F.S., Inc., 39 Bankr. 66 (Bankr. D. Minn. 1984); *In re* Airport-81 Nursing Care, Inc., 29 Bankr. 501, 509 (Bankr. E.D. Tenn. 1983); *In re* Hogg, 35 Bankr. 292, 297 (Bankr. D.S.D. 1983); *In re* Murrey, 27 Bankr. 445, 448 (Bankr. M.D. Tenn. 1983); *In re* Fregosi, 23 Bankr. 641, 643 (Bankr. E.D. Va. 1982); *In re* Holl, 13 Bankr. 918, 923 (Bankr. D. Hawaii 1981); *In re* Elkind, 11 Bankr. 473, 475 (Bankr. D. Colo. 1981); *In re* Eichorn, 11 Bankr. 81, 83 (Bankr. D. Mass. 1981); *In re* Amato, 10 Bankr. 120, 121 (Bankr. S.D. Fla. 1981); *In re* Meritt, 7 Bankr. 876, 878 (Bankr. W.D. Mo. 1980).

Former Bankruptcy Rule 906(a) incorporated Federal Rule of Civil Procedure 6(a), which provides that in computing

> any period of time prescribed . . . by any applicable statute, the day of the act, event, or default from which the designated period of time begins to run shall not he included. The last day of the period so computed shall be included, unless it is a Saturday, a Sunday, or a legal holiday, in which event the period runs until the end of the next day which is not a Saturday, a Sunday, or a legal holiday . . . .

New Bankruptcy Rule 9006(a), effective August 1, 1983, copies FED. R. CIV. P. 6(a). *See* Harbor Nat'l Bank v. Sid Kumins, Inc., 696 F.2d 9, 10 (1st Cir. 1982); *In re* Schneider, 44 Bankr. 961, 962 (Bankr. W.D. Wis. 1984); *In re* Wilmington Nursery Co., 36 Bankr. 813, 816 convert a security interest for a present advance into one for antecedent debt;[240] and will provide a later testing period for the debtor's insolvency.[241] Prior to the 1984 amendments, section 547(e) also provided a later testing period for the insider-creditor's reason to know of the debtor's insolvency.[242] It still provides a later testing period for determining whether the creditor-defendant was an insider.[243]

C. *The Exceptions from Preference*

Even though the trustee, with or without the aid of section 547(e), proves his entire case under section 547(b), he may recover nothing. Section 547(c) contains seven exceptions from section 547(b), and the creditor-defendant may prevent avoidance of his transfer "to the extent that" he can bring it within[244] one or

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(Bankr. E.D.N.C. 1984); *In re* Cosmopolitan Aviation Corp., 34 Bankr. 592, 594 (Bankr. E.D.N.Y. 1983) (citing cases); *In re* Enterprise Fabricators, Inc., 36 Bankr. 220, 222 (Bankr. M.D. Tenn. 1983).

240. *See, e.g., In re* Strom, 46 Bankr. at 148; *In re* La Mancha Aire, Inc., 41 Bankr. 647 (Bankr. S.D. Fla. 1984); *In re* Harley, 41 Bankr. 276, 278 (Bankr. N.D. Ga. 1984); *In re* Airport-81 Nursing Care, Inc., 29 Bankr. 501, 509 (Bankr. E.D. Tenn. 1983); *In re* Davis, 22 Bankr. 644, 646 (Bankr. M.D. Ga. 1982); *In re* Martella, 22 Bankr. 694, 651 (Bankr. D. Colo. 1982); *In re* Hall, 14 Bankr. 186, 187 (Bankr. S.D. Ala. 1981); *In re* Christian, 8 Bankr. 816, 818 (M.D. Fla. 1981); *In re* Meritt, 7 Bankr. 876, 879 (Bankr. W.D. Mo. 1980); *In re* Kelley, 3 Bankr. 651, 654 (Bankr. E.D. Tenn. 1980); *see also* Hogan, *Bankruptcy Reform and Delayed Filing Under the U.C.C.*, 35 ARK. L. REV. 35, 45 (1981).

241. *See, e.g., In re* La Mancha Aire, Inc., 41 Bankr. 647, 648 (Bankr. S.D. Fla. 1984); *In re* Eichorn, 11 Bankr. 81, 83 (Bankr. D. Mass. 1981).

242. *See In re* Camp Rockhill, Inc., 12 Bankr. 829, 834 (Bankr. E.D. Pa. 1981); *In re* Crouthamel Potato Chip, Co., 6 Bankr. 501, 507 (Bankr. E.D. Pa. 1980).

243. In *In re Camp Rockhill, Inc.*, a minority stockholder's stock was redeemed by the corporate dehtor's judgment note more than a year before bankruptcy. The stockholder recorded the note and thereby acquired a lien on the debtor's real estate more than 90 days before bankruptcy. The court held that, even though the stockholder might have been an insider before his stock was redeemed, he was not an insider at the time he acquired his judgment lien. 12 Bankr. at 834; *see also In re* Crouthamel Potato Chip Co., 6 Bankr. at 507 (holding that a transfer more than 90 days before the transferor's bankruptcy and three days before the transferee became a member of the debtor's board of directors was not a transfer to an insider); *cf. In re* Louisiana Indus. Coatings, Inc., 31 Bankr. 688 (Bankr. E.D. La. 1983) (redemption of stock of majority stockholder 11 months before corporation filed for hankruptcy was voidable preference to insider).

For a more detailed analysis of § 547(e), see Breitowitz, *Article 9's Security Interests as Voidable Preferences*, 3 CARDOZO L. REV. 357 (1982).

244. To the extent that § 547(g), added in 1984, puts the burden on the creditor-defendant to prove nonavoidability of a preference under § 547(c), it codifies prior case law. *See In re* Ken Gardner Ford Sales, Inc., 10 Bankr. 632, 646 (Bankr. E.D. Tenn. 1981), *aff'd*, 23 Bankr. 743 (E.D. Tenn. 1982); *In re* Air Vermont, Inc., 47 Bankr. 537, 539 (Bankr. D. Vt. 1985); *In re* American Ambulance Serv., Inc., 46 Bankr. 658, 660 (Bankr. S.D. Cal. 1985); *In re* Fasano/Harriss Pie Co., 43 Bankr. 871, 877 (Bankr. W.D. Mich. 1984); Tinnell Traffic

more[245] of these exceptions.[246] No picture of the current American concept of a voidable preference would be complete without an examination of these exceptions.

1. The Contemporaneous Exchange Exception

In *National City Bank v. Hotchkiss*,[247] a bank made an unsecured day loan to a stockbroker at 10:00 a.m., the stock market broke before noon, and the New York Stock Exchange suspended the broker at noon. When the bank learned of these facts, it demanded a pledge of securities from the broker, and got it between 2:00 and 3:00 p.m. the same day, although the broker advised the bank that a bankruptcy petition would be filed against it (as it was at 4:00 p.m.) and that the pledge would be a preference. In one of Justice Holmes' cryptic opinions, the Court held that the pledge was a voidable preference.[248]

Four years after *Hotchkiss*, the Court decided *Dean v. Da-*

Serv., Inc., 43 Bankr. 277, 290 (Bankr. M.D. Tenn. 1984); *In re* Blanton Smith Corp., 37 Bankr. 303, 306 (Bankr. M.D. Tenn. 1984); *In re* General Office Furniture Wholesalers, 37 Bankr. 180, 183 (Bankr. E.D. Va. 1984); *In re* Lario, 36 Bankr. 582, 583-84 (Bankr. S.D. Ohio 1983); *In re* Damon, 34 Bankr. 626, 629 (Bankr. D. Kan. 1983); *In re* Saco Local Dev. Corp., 30 Bankr. 867, 876 (Bankr. D. Me. 1983). *In re* Fetterer Eng. Assoc., Inc., 27 Bankr. 878, 882 (Bankr. E.D. Mich. 1983), holds that the debtor in possession has the burden of proof under § 547(c)(5) by confusing that section with § 547(b)(5). Fairchild v. Lebanon Prod. Credit Ass'n, 31 Bankr. 789, 794 (Bankr. S.D. Ohio 1983), reaches the same conclusion by misreading a prior decision holding that "[o]nce there is proof that a transfer is within § 547(b), the creditor has the burden of proving that he is protected by one of the exceptions." *In re* Ken Gardner Ford Sales, Inc., 10 Bankr. at 646.

245. "If a creditor can qualify under any one of the exceptions, then he is protected to that extent. If he can qualify under several, he is protected by each to the extent that he can qualify under each." H.R. Rep. No. 595, *supra* note 100, at 373; S. Rep. No. 989, *supra* note 118, at 88.

246. Old § 60a and present § 547(b)(4) apply only to transfers made "before" the filing of the petition. Hence, neither applies to postpetition transfers—a point occasionally overlooked, *e.g.*, Bank of Marin v. England, 385 U.S. 99, 103 (1966), but sometimes recognized, *see, e.g.*, *In re* Isis Foods, Inc., 37 Bankr. 334, 337 (W.D. Mo.), *appeal dismissed*, 738 F.2d 445 (8th Cir. 1984); *In re* Bridges Enters., Inc., 44 Bankr. 979, 982 (Bankr. S. D. Ohio 1984); *In re* American Gypsum Co., 36 Bankr. 360, 363 (Bankr. D.N.M. 1984). *In re* Chancellor, 20 Bankr. 316, 318 (Bankr. W.D. Ky. 1982). Postpetition transfers of property of the estate generally are avoidable under 11 U.S.C. § 549 unless the Reform Act or the court authorizes the transfers. Transfers occurring in an involuntary case after the filing of the petition, but before the order for relief, are valid under § 544(b) to the extent of "any value, including services, but not including satisfaction or securing of [prepetition] debt," despite the transferee's notice or knowledge of the case. The exceptions contained in § 547(c), however, are not applicable to § 549(b). *See In re* Bridges Enters., Inc., 44 Bankr. at 983; *In re* Isis Foods, Inc., 37 Bankr. at 337; *In re* American Gypsum Co., 36 Bankr. at 363.

247. 231 U.S. 50 (1913).

248. *Id.* at 58.

vis,[249] a case much better known for holding that a mortgage was a fraudulent conveyance when knowingly given to secure a loan that enabled a debtor to give another creditor a preferential payment.[250] But the Court also held that, since the parties intended a secured loan at the outset, the fact that the mortgage was not executed until seven days, or recorded until eight days, after the loan did not convert the mortgage into a voidable preference, because it "was given to secure . . . a substantially contemporary advance."[251]

The Commission that drafted the first version of the Reform Act proposed to define antecedent debt for preference purposes as a debt incurred more than five days before a transfer paying or securing the debt. This proposal was made for the express purpose of overruling *Hotchkiss*.[252] This author pointed out to Congress that this provision would overrule both *Hotchkiss* and *Dean v. Davis* and suggested that the two cases demonstrated that "this matter is much better left to the courts."[253] The House and Senate staff dropped the proposed definition of antecedent debt and substituted the language now in section 547(c)(1): the trustee may not avoid a transfer under section 547 to the extent that the transfer was "(A) intended by the debtor and the creditor . . . to be a contemporaneous exchange for new value given to the debtor; and (B) in fact a substantially contemporaneous exchange."[254] Apparently, the more demanding requirement of (A) came from *Hotchkiss* and the less demanding requirement of (B) from *Dean v. Davis*.

But this provision developed a troublesome legislative history. Both Committee Reports erroneously state:

> Normally, a check is a credit transaction. However, for the purposes of this paragraph, a transfer involving a check is considered to be "intended to be contemporaneous," and if the check is presented for payment in the normal course of affairs, which the Uniform Commercial Code specifies as 30 days, U.C.C. § 3-503(2)(a), that will amount to a transfer that is "in fact substantially contemporaneous."[255]

A check is "a draft drawn on a bank and payable on demand."[256] A

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249. 242 U.S. 438 (1917).
250. *See supra* note 95.
251. 242 U.S. at 443.
252. *Commission Report, supra* note 91, pt. I, at 205; pt. II, at 168.
253. *The Bankruptcy Reform Act: Hearings Before Subcomm. on Improvements in Judiciary Machinery of Senate Judiciary Comm. on S. 235 and S. 236*, 94th Cong., 1st Sess. 1041 (Nov. 12, 1975).
254. H.R. 8200, 95th Cong., 1st Sess. (1977); S. 2266, 95th Cong., 1st Sess. (1977).
255. H.R. REP. No. 595, *supra* note 100, at 373; S. REP. No. 989, *supra* note 118, at 88.
256. U.C.C. § 3-104(2)(a)(1978).

check is not a credit instrument unless it is "postdated by even one day."[257] A postdated check technically is not a check but a time draft because it is not payable until the stated date.[258] Therefore, on a check not postdated, the drawer has not obtained a legal right to delay payment. In other words, no credit has been extended. And U.C.C. section 3-503(2)(a), to which the Committee Reports referred, provides for a thirty day period for presenting a check to the drawee bank to charge the drawer with his obligation under U.C.C. section 3-413 to pay the amount if the drawee dishonors the check.[259] This thirty day period has nothing to do with whether the underlying transaction is a credit transaction.[260]

When the floor managers of the bill later attempted to clear up the confusion created by the Committee Reports, they only compounded it and extended it also to section 547(c)(2): "Contrary to language contained in the House Report, payment of a debt by means of a check is equivalent to a cash payment, unless the check is dishonored.[261] Payment is considered to be made when the check is delivered for purposes of sections 547(c)(1) and (2)."[262] As we will see, this bit of history has caused confusion. The courts, for inconsistent reasons, have held that the debtor transfers no property, *within the meaning of section 547(b)*, when he issues his own check. As under old section 60,[263] the transfer occurs when and if the drawee bank honors the check.[264] Most courts base this conclu-

257. *Id.* § 2-511 comment 6.

258. *See id.* § 3-114(2).

259. *Id.* § 3-503(2)(a).

260. *See* Engstrom v. Benzel, 191 F.2d 689 (9th Cir. 1951); Engstrom v. Wiley, 191 F.2d 684 (9th Cir. 1951).

261. Under U.C.C. § 2-511, subject to § 3-802, payment for goods by check "is conditional and is defeated as between the parties by dishonor of the check on due presentment." U.C.C. § 2-511(3)(1978). Under § 3-802, which is not confined to sale of goods, unless otherwise agreed, an obligation is discharged if a check is taken on which a bank is drawer or acceptor and for which no recourse lies against the underlying obligor. *Id.* § 3-802(1)(a). In any other case, the underlying obligation is suspended only until presentment. *Id.* § 3-802(1)(b). If the cbeck is dishonored, action may be maintained either on the check or on the underlying obligation. *Id.*

262. 124 CONG. REC. 32,400 (statement of Rep. Edwards), 34000 (statement of Sen. DeConcini) (1978).

263. *See* Nicholson v. First Inv. Co., 705 F.2d 410, 413 (11th Cir. 1983); Fitzpatrick v. Philco Fin. Co., 491 F.2d 1288, 1293 (7th Cir. 1974). *But see* Shamrock Golf Co. v. Richcraft, Inc., 680 F.2d 645, 646 (9th Cir. 1982) (the court was persuaded by the statement of the floor managers that a transfer occurs for purposes of old § 60 when the debtor delivers his check to the creditor).

264. *See In re* Insulation Materials, Inc., 47 Bankr. 832, 835 (Bankr. E.D. Tenn. 1985); *In re* Isis Foods, Inc., 37 Bankr. 334, 336 (W.D. Mo.), *appeal dismissed*, 738 F.2d 445 (8th Cir. 1984); *In re* Bridges Enters., Inc., 44 Bankr. 979, 982 (Bankr. S.D. Ohio 1984); *In re*

sion on U.C.C. section 3-409(1), which inartfully provides that "[a] check or other draft does not of itself operate as an assignment of any funds in the hands of the drawee available for its payment, and the drawee is not liable on the instrument until he accepts it."[265] By issuing its check to a creditor, the debtor does not transfer any part of the debtor's claim against its bank; rather, the debtor only gives the creditor a contingent promise under U.C.C. section 3-413(2) to pay the creditor if the drawee bank does not. If the drawee bank wrongfully fails to pay, its liability under U.C.C. section 4-402 runs only to the drawer, not to the creditor as holder of the check.[266] But some courts also have treated this situation as

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Fasano/Harriss Pie Co., 43 Bankr. 871, 873 (Bankr. W.D. Mich. 1984); *In re* Georgia Steel, Inc., 38 Bankr. 829, 834 (Bankr. M.D. Ga. 1984); *In re* Bob Grissett Golf Shoppes, Inc., 34 Bankr. 320, 322 (Bankr. E.D. Va. 1983); *In re* Video East, Inc., 33 Bankr. 61, 63 (Bankr. E.D. Pa. 1983); *In re* Brent Explorations, Inc., 31 Bankr. 745, 751 (Bankr. D. Colo. 1983); *In re* Ellison, 31 Bankr. 545, 547 (Bankr. M.D. Ga. 1983); *In re* Moran Air Cargo, Inc., 30 Bankr. 406, 408 (Bankr. D.R.I. 1983); *In re* Mailbag Int'l, Inc., 28 Bankr. 905, 907 (Bankr. D. Conn. 1983); *In re* Skinner Lumber Co., 27 Bankr. 669, 670-71 (Bankr. D.S.C. 1982); *In re* Super Market Distribs. Corp., 25 Bankr. 63, 64 (Bankr. D. Mass. 1982); *In re* Fabric Buys of Jericho, Inc., 22 Bankr. 1010, 1011 (Bankr. S.D.N.Y. 1982); *In re* Ardmore Sales Co., 22 Bankr. 911, 913 (Bankr. E.D. Pa. 1982); *In re* Sportsco, Inc., 12 Bankr. 34, 36 (Bankr. D. Ariz. 1981); *In re* Duffy, 3 Bankr. 263, 265 (Bankr. S.D.N.Y. 1980). *Contra In re* Sider Ventures & Servs. Corp., 47 Bankr. 406, 407-08 (S.D.N.Y. 1985) (court was misled by statement of floor managers); *In re* Walker Indus. Auctioneers, Inc., 45 Bankr. 452, 455 (Bankr. D. Or. 1984) (following Shamrock Golf Co. v. Richcraft, Inc., 680 F.2d 645 (9th Cir. 1982) note 263 *supra.*). In *Isis Foods* and *Bridges*, the courts' application of this rule meant that the transfers occurred postpetition and were governed by § 549 rather than § 547. 37 Bankr. at 336; 44 Bankr. at 983. *Ardmore* applied this rule to find that payment of the debtor's check constituted a transfer more than 90 days before bankruptcy. The payment constituted an accounting to the creditor, who had terminated the debtor's insurance premiums, for unearned premiums resulting from the debtor's cancellation of policies. The insurer's earlier payment to the debtor was provisional, subject to a formal audit that was completed within 90 days of bankruptcy. "[T]he final auditing affected only the rights and laibilities of [the insurer] and the debtor against each other" and had no "direct effect on the payment by the debtor to" the creditor. 22 Bankr. at 913.

265. U.C.C. § 3-409(1) (1978). "Certification of a check is acceptance." *Id.* § 3-411(1).

266. Third party checks held by the debtor as payee or indorsee are different. The debtor can transfer these checks to a creditor by voluntary delivery with any necessary indorsement. The delivery is a negotiation, and the creditor becomes a holder under U.C.C. § 3-202. In the alternative, the debtor may make a transfer that falls short of a negotiation under § 3-201. In either event, the debtor by the transfer gives the creditor rights against the third party drawer of the check. *See* McKenzie v. Irving Trust Co., 323 U.S. 365, 371 (1944) (debtor indorsed and mailed a government check to a creditor, and the Court held that the transfer occurred when the check was mailed). Cashier's checks, drawn by a bank on itself, are also different. Under U.C.C. § 3-118(a), a cashier's check is "effective as a note," and the bank's unconditional engagement as maker under § 3-413 is to pay the instrument according to its tenor. By transferring a cashier's check to a creditor, the debtor transfers rights against the bank. *See In re* Kimball, 16 Bankr. 201, 203 (Bankr. M.D. Fla. 1981) (holding that a transfer occurs for purposes of § 547(b) when the debtor delivers a cashier's check to a creditor); *cf. In re* Archie Cambell, Inc., 45 Bankr. 416 (Bankr. D.N.D.

a perfection problem under section 547(e). U.C.C. section 4-303 provides that legal process served on a bank after the bank has paid or certified a check is too late to affect the bank's duty to pay the check. Hence, these courts conclude that it is the payment or certification that "perfects" the transfer, even though there is no earlier "time the transfer takes effect between the transferor and the transferee" from which section 547(e)(2) measures the ten day period for perfection.[267]

In re Wadsworth Building Components, Inc.[268] typifies one pattern of cases emerging under section 547(c)(1). The seller delivered goods on credit in October and received in December the buyer's check for the price. When he tried to collect the check, however, it was dishonored. He then advised the buyer that no more orders would be filled until the check was made good. Upon the buyer's assurances that the check would be paid, the seller delivered more goods on credit in January. When the check was redeposited, it was paid in February, but the buyer never paid the seller for the January shipment. The buyer's bankruptcy trustee recovered the February payment as a preference. The court held that section 547(c)(1) was unavailable to the seller because the seller did not give new value in exchange for the payment, which was made to pay a past debt in order to receive further credit.[269]

1984). Certified checks are also different. By certifying (accepting) the dehtor's check, a bank makes the same unconditional engagement as does the maker of a note under U.C.C. § 3-413(1); by transferring a certified check to a creditor, the debtor again transfers rights against the bank. *See In re* Fabmet Corp., 31 Bankr. 414, 417 (Bankr. W.D.N.Y. 1983) (holding that a transfer occurs when the debtor delivers his certified check to a creditor).

267. *See, e.g., In re* Bridges Enters., Inc., 44 Bankr. 979, 982 (Bankr. S.D. Ohio 1984); *In re* Georgia Steel, Inc., 38 Bankr. 829, 834 (Bankr. M.D. Ga. 1984); *In re* Bob Grissett Golf Shoppes, Inc., 34 Bankr. 320, 322 (Bankr. E.D. Va. 1983); *In re* Fabmet Corp., 31 Bankr. 414, 417 (Bankr. W.D.N.Y. 1983); *In re* Mailbag Int'l, 28 Bankr. 905, 908 (Bankr. D. Conn. 1983); *In re* Super Market Distribs. Corp., 25 Bankr. 63, 65 (Bankr. D. Mass. 1982); *In re* Mindy's, Inc., 17 Bankr. 177, 179 (Bankr. S.D. Ohio 1982); *In re* Sportsco, Inc., 12 Bankr. 34, 36 (Bankr. D. Ariz. 1981); *see also In re* Sider Ventures & Servs. Corp., 47 Bankr. 406, 409 (S.D.N.Y. 1985).

268. 711 F.2d 122 (9th Cir. 1983); *see also In re* Fasano/Harriss Pie Co., 43 Bankr. 871 (Bankr. W.D. Mich. 1984); *In re* Naudain, Inc., 32 Bankr. 871 (Bankr. E.D. Pa. 1983); *In re* Saco Local Dev. Corp., 30 Bankr. 859 (Bankr. D. Me. 1983).

269. 711 F.2d at 124. The dissent considered the payment to be for both the past debt and the continued credit extension, although nothing indicated that the seller contractually had committed itself to extend more credit. The dissent would have held that the seller qualified under § 547(c)(1) to the extent of the goods delivered in January. *Id.* at 125 (Boochever, J., dissenting).

"New value," which must be exchanged for the debtor's transfer to qualify under § 547(c)(1), includes under § 547(a)(3), "new credit," but "new credit" is difficult to find with no commitment to extend credit. Moreover, with the entire amount of the check credited to

In re Standard Food Service, Inc.,[270] was similar, except that it concerned a cash sale rather than a credit sale. The seller took the buyer's check for the price of the goods at the time of delivery, but the check was dishonored. Again, the seller advised that no more orders would be filled until the check was made good and then accepted a cashier's check[271] for the amount of the earlier check eleven days after the goods were delivered and six days after the original check was dishonored. Apparently, this seller delivered no more goods to the buyer. The seller tried to invoke section 547(c)(1) when the trustee attempted to recover the amount of the cashier's check as a preference.[272] The court, after considering the legislative history of section 547(c)(1), said that the seller's argument that the giving of the original check constituted a transfer for new value (the goods delivered) "would be dispositive had the check cleared."[273] The court, however, invoked the language of the floor managers indicating that a check was not the equivalent of cash if it was dishonored.[274] Hence, the court concluded that "when the check bounced, the transaction became a credit transaction"; consequently, the seller's receipt of the cashier's check discharged antecedent debt and was not a contemporaneous exchange for new value.[275]

A more troublesome use of the legislative history of section 547(c)(1) was made in two other circuit decisions.[276] The courts held that section 547(c)(1) was not applicable to purchase money security interests not perfected until fourteen days, in one case, and twenty-six days in the other case, after they were acquired[277] because (1) the legislative history revealed that Congress intended the section for "check or other cash equivalent transactions" and not for purchase money security transactions, and (2) Congress specifically provided for purchase money security transactions in

past debt, finding that the debtor gave any part of his payment in exchange for "new credit" is difficult as well.

270. 723 F.2d 820 (11th Cir. 1984).

271. *See supra* note 266.

272. 723 F.2d at 821. Belatedly, the seller also tried to invoke § 547(c)(2) on appeal, but the court refused to consider the assertion because it was not raised below. *Id.* at 822.

273. *Id.* at 821.

274. *See supra* notes 261-62 and accompanying text.

275. 723 F.2d at 821.

276. *In re* Davis, 734 F.2d 604 (11th Cir. 1984); *In re* Vance, 721 F.2d 259 (9th Cir. 1983).

277. Section 547(c)(3) was not available to the creditor in either case because it had not perfected its purchase money security intorest within the 10 day period allowed by § 547(c)(3)(B). 734 F.2d at 607; 721 F.2d at 262.

section 547(c)(3)[278] and the two provisions were mutually exclusive.[279] The Sixth Circuit, in *In re Arnett*,[280] reached a similar conclusion about a nonpurchase money security interest not perfected until thirty-three days after it was acquired, reasoning that to employ section 547(c)(1) would be inconsistent with the ten day perfection period allowed by section 547(e)(2).[281] But the *Arnett* court also read the legislative history of section 547(c)(1) to indicate that Congress merely intended to codify cases that dealt with "the exchange of goods or other 'value' for a check" and not to apply to a security interest.[282] These three decisions give too much significance to a legislative history that is too muddled to support invocation of the old rule of statutory interpretation that, if the legislative history is clear enough, the court need not read the language of the statute. After all, section 547(c)(1) does not speak of "checks" but of "transfers," which section 101(48) defines clearly to include the taking or retaining of a security interest. Furthermore, both *Hotchkiss* and *Dean v. Davis*, which appear to have inspired the statutory language, dealt with security interests.[283]

At the same time, the three cases reached a correct result in not employing section 547(c)(1) to expand the ten day period for perfection allowed by section 547(e)(2). Section 547(e)(2) provides that if a transfer is not perfected within ten days after it takes effect between debtor and transferee-creditor, the transfer will "[f]or the purposes of this section" (including section 547(c)(1)) "occur" at a later time. Nothing in the statutory language or the legislative history indicates that Congress intended section 547(c)(1) to authorize departures from the precise ten day perfection period of section 547(e)(2). Therefore, courts should confine the language "in fact . . . substantially contemporaneous" in section 547(c)(1)(B) to cases in which a delay "in fact" occurs in the time when the transfer "takes effect" between debtor and transferee-creditor, which was the situation in *Dean v. Davis*.[284]

278. As indicated *infra* at text accompanying notes 333-34, the availability of § 547(c)(3) to all purchase money security interests is not clear.

279. *Davis*, 734 F.2d at 607; *Vance*, 721 F.2d at 261; *see also In re* Gottschalk, 46 Bankr. 49, 51 (Bankr. M.D. Fla. 1985) and cases cited therein.

280. 731 F.2d 358 (6th Cir. 1984).

281. *Id.* at 364; *see supra* notes 230-31 and accompanying text.

282. 731 F.2d at 361.

283. *See supra* notes 247-51 and accompanying text.

284. *See In re* Lyon, 35 Bankr. 759, 763 (Bankr. D. Kan. 1982) (holding that, when the creditor made a loan to the debtor that the parties intended to secure by a real property mortgage executed 21 days later and recorded 5 days after execution, § 547(c)(1), which

Section 547(c)(1) also may perform another function. The debtor and the transferee-creditor must intend the "new value" as a contemporaneous exchange for the debtor's transfer, and a substantially contemporaneous exchange must occur in fact. Included in the definition in section 547(a)(2) of the "new value" is a "release by a transferee of property previously transferred to such transferee in a transaction that is neither void nor voidable by the debtor or the trustee under any applicable law."[285] If one bears in mind that section 547(c)(1) is a defense for a transferee-creditor only "to the extent that" the section covers him, the definition of "new value" appears to be an attempt to codify the substitution of collateral doctrine. Courts originally developed the doctrine under the preferential effect requirement of old section 60,[286] limited by the *Benedict v. Ratner* two-step approach, which permitted the trustee to avoid the substitution as a preference if he could avoid the original lien on any ground.[287]

The history of section 547(c) contains some support for the above hypothesis. From 1967 to 1970 a committee of the National Bankruptcy Conference, chaired by the late Professor Grant Gilmore, studied the treatment of security interests in bankruptcy and drafted proposals for a variety of amendments to old section 60.[288] One proposal, which the committee described as "merely a

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codifies *Dean* v. *Davis*, applied; and § 547(e)(2) was also satisfied). *But see In re* Strom, 46 Bankr. 144, 148 (Bankr. E.D.N.C. 1985)(holding that when a deed of trust was "in fact" executed by the debtor when new value was given, but recorded eight months thereafter and within 90 days of bankruptcy, § 547(e)(2) converted the deed of trust into a transfer for antecedent debt). This is not to say that § 547(c)(1) should not apply to payments as well as to the taking of security interest. *But cf. In re* George Rodman, Inc., 39 Bankr. 855, 857 (Bankr. W.D. Okla. 1984) (creditor took payment of its claim in exchange for "immediate release" of a statutory materialmen's lien on an oil well that later turned out to be a "dry hole," and court held that it made a contemporaneous exchange for the payment within the meaning of § 547(c)(1), but that the "valid but valueless" materialmen's lien that it released did not constitute "new value." And in *In re* Air Vermont, Inc., 45 Bankr. 817, 820 (D.C. D. Vt. 1984), the security interest attached on January 6 when the secured party gave value by a binding commitment to extend credit on that date. The secured party made its advance on January 12 and the security interest was perfected on January 17. The court recognized that the transfer did not occur under § 547(e)(2) until January 17, but used § 547(c)(1) to extend the 10 day period of § 547(e)(2).

For a different view of § 547(c)(1), see Duncan, *Section 547(c)(1) and Delayed Perfection of Security Interests in the Ninth Circuit*, 58 AM. BANKR. L.J. 269 (1984); Duncan, *Delayed Perfection of Security Interests in Personal Property and the Substantially Contemporaneous Exchange Exception to Preference Attack*, 62 NEB. L. REV. 202 (1983).

285. The 1984 amendment to § 547(a)(2) adds "including proceeds of such property."

286. *See supra* notes 172-79 and accompanying text.

287. *See supra* notes 180-85 and accompanying text.

288. The 1970 report of the Gilmore Committee is printed in an appendix to H.R. REP.

statutory restatement of the 'substitution of collateral' idea,"[289] would have provided:

> If a transferee has released or returned to the debtor property previously transferred to him in a transaction which was not voidable . . ., then a transfer in substitution for the property released or returned is not voidable except to the extent that the value of the substituted property exceeds the value of the property released or returned. The release or return and the substitution need not take place simultaneously provided that the release or return is made in contemplation of the substitution and the substitution is made within a reasonable time after the release or return.[290]

Although the Bankruptcy Commission adopted many of the Gilmore committee's proposals, the Commission did not adopt this proposal,[291] nor did the House and Senate draftsmen.[292] But the draftsmen did include, in the definition of "new value" in section 547(a)(2), the Gilmore committee's language about release of prior transfers. In addition, the language with which they drafted section 547(c)(1) bears a strong resemblance to the language of the Gilmore committee.

Even though some cases under the Reform Act recognize the doctrine of substitution of collateral, courts have continued to base the doctrine on the preferential effect requirement of section 547(b)(5).[293] In one respect, the basis of that doctrine makes a difference. Under section 547(g), if the proper basis is section 547(b)(5), the trustee has the burden of proof; but if the proper basis is section 547(c)(1), the transferee-creditor has the burden.

2. The "Current Expenses" Exception—And How It Grew

Formerly, establishing the debtor's intent to prefer was essential before a preferential transfer would be considered an act of bankruptcy.[294] During that time, a number of cases held that creditors who filed involuntary petitions did not establish the debtor's intent to prefer in payments usually, but not invariably, for current expenses made within four months of bankruptcy. Usually, the payments were described as "necessary" to the continuance of the business or made in the "ordinary course of business."[295] And,

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No. 595, *supra* note 100, at 204-19. I was a member of tbe committee.

289. *Id.* at 215.

290. *Id.* at 212.

291. *Commission Report, supra* note 91, pt. II, at 166-68.

292. H.R. 8200, 95th Cong., 1st Sess. (1978); S. 2266, 95th Cong., 1st Sess. (1977).

293. *See supra* notes 177-78 and accompanying text.

294. *See supra* note 88 and accompanying text.

295. *See* Goodlander-Robinson Lumber Co. v. Atwood, 152 F. 978, 979 (4th Cir. 1907) (supplier of inventory); Martin v. Hulen & Co., 149 F. 982, 983 (8th Cir. 1906) (same); Rich-

with no help from, or regard for, the language of the statute, a smattering of cases held that such payments were also exempt from avoidance under old section 60.[296] Based on these cases, the leading bankruptcy treatise advised that "payments on account of current expenses . . . are generally not within the category of preferential transfers."[297]

In an apparent attempt both to confine the earlier rulings under section 60 and to provide them with some statutory base, the Bankruptcy Commission proposed to exclude from its definition of antecedent debt "(A) a debt for personal services, (B) a debt for utilities incurred within three months of the petition, [and] (D) a debt for inventory paid for within three months of the delivery of the goods in the ordinary course of the debtor's business."[298] The National Bankruptcy Conference, treating these as exclusions of "utilities and trade debt," proposed to limit the excluded debt for personal services to "non-executive type employees," to limit the excluded debt for inventory to that paid for within thirty days of delivery, and to limit the exclusions for inventory and utilities to that supplied and paid for in the ordinary course of business of both parties.[299]

The House and Senate draftsmen instead supplied section 547(c)(2) as enacted in 1978: the trustee could not avoid a transfer under section 547 to the extent that it was in payment of a debt incurred in the ordinary course of business or financial affairs of the debtor and the creditor; if the payment was also made in the ordinary course of business or financial affairs of both and was ac-

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mond Standard Steel Spike & Iron Co. v. Allen, 148 F. 657, 662 (4th Cir. 1906) (president's salary); *In re* Union Feather & Wool Mfg. Co., 112 F. 774, 777 (7th Cir. 1902) (current payroll); *In re* E.T. Russell Co., 291 F. 809, 813-14 (D. Mass 1923) (insurance premiums, teamster's services, stationery and painting expenses, finance company installment loan, and president's salary); *In re* Columbia Real Estate Co., 205 F. 980, 982 (D.N.J. 1913) (unspecified debts); *In re* Hallin, 199 F. 806, 808 (W.D. Mich. 1912) (unspecified debts); *In re* Perlhefter, 177 F. 299, 304 (S.D.N.Y. 1910) (advertising expense); *In re* Tirre, 95 F. 425, 426 (S.D.N.Y. 1899) (back rent and taxes).

296. *See* Marshall v. Florida Nat'l Bank, 112 F.2d 380, 382 (5th Cir. 1940) (warehouse charges); Talty v. Ross, 14 F.2d 240, 241 (D. Mass. 1926) (current payroll); Brush v. Seymore, 30 F. Supp. 202, 204 (D.N.H. 1939) (current payroll); *In re* Mersick, Inc., 1 Bankr. 599, 601-02 (Bankr. D. Conn. 1979) (current rent); Dunn v. E.L. Gayvert & Co., 263 A.D. 785, 31 N.Y.S.2d 370 (1941), *aff'd*, 288 N.Y. 669, 43 N.E.2d 72 (1942) (utilities).

297. 3 W. COLLIER ON BANKRUPTCY ¶ 60.23 (14th ed. 1977); *see also* Kaye, *Preferences Under the New Bankruptcy Code*, 54 AM. BANKR. L.J. 197, 201-02 (1980).

298. *Commission Report*, *supra* note 91, pt. II, at 168.

299. *Bankruptcy Act Revision: Hearings Before Subcomm. on Civil and Constitutional Rights of the House Judiciary Comm. on H.R. 31 and H.R. 32*, 94th Cong., 2d Sess. 1849 (Mar. 19, 1976).

cording to ordinary business terms; and if the payment was made not later than forty-five days after the debt was incurred.[300] The Committee Reports explained that for "a consumer, the paragraph uses the phrase 'financial affairs' to include such nonbusiness activities as payments of monthly utility bills," and that the "purpose of this exception is to leave undisturbed normal financial relations, because it does not detract from the general policy of the preference section to discourage unusual action by either the debtor or his creditors during the debtor's slide into bankruptcy."[301] Clearly, Congress intended to limit the exception to the payment of current expenses. If there was an intent to limit the exception also to "trade debt," the draftsmen must have despaired of attempting to define that frequently used but intensely undefined term,[302] and invoked the forty-five day limitation in recognition that most of the trade debt at which they were aiming was short term. Nevertheless, the draftsmen must have realized that their formulation also would apply to short-term credit of any kind.

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300. H.R. 8200 and S. 2266, *supra* note 254.

301. H.R. REP. No. 595, *supra* note 100, at 373; S. REP. No. 989, *supra* note 118, at 88. One of the draftsmen later elaborated on this modest explanation:

> The second exception to the preference section insulates ordinary trade credit transactions that are kept current. . . . Forty-five days was selected as a normal trade credit cycle. For example, a normal trade credit transaction might be as follows: supplier ships goods during month 1 and sends his bill to the debtor at the end of the month or the very early of the part of the following montb. Normally, that bill would become due, or will be payable in the debtor's ordinary course of business, by the 10th of month 2. If it is paid by the 15th, there will be no question that the entire transaction—incurring of the credit and the payment—took place within 45 days.
>
> Congress has not defined when a debt is incurred. In the preceding example, of course, there is no question. However, if the supplier's bill was paid toward the end of month 2, the supplier/creditor might argue that the debt was not incurred until the invoice was sent, thus bringing the payment within the 45-day period. Congress's intent seems to be contrary. For the purposes of this exception, the debt is incurred when it becomes a legally binding obligation on the debtor. Thus, when goods are shipped, the debtor becomes liable for the payment, and the debt is incurred. This is supported by Congress's selection of the 45-day period: Congress treated as non-preferential an ordinary-course payment of trade credit in the first 15 days of the month following the month in which the goods were shipped or services performed. Payments later than the 15th are often late payments and an indication of financial trouble.

Levin, *An Introduction to the Trustee's Avoiding Powers*, 53 AM. BANKR. L.J. 173, 186-87 (1979). The generalization that the debtor is liable to pay when the goods are shipped may cover most sales of goods, but not all. Any lawyer worth his or her salt can draw a contract under which the buyer is not only liable to pay, but the payment is due, before the seller ships the goods. *But cf. In re* Gold Coast Seed Co., 781 F.2d 1118 (9th Cir. 1985).

302. With apologies to Mr. Justice Erle, who remarked more than a century ago that "the words 'equitable lien' are intensely undefined." Brunsdon v. Allard, 121 Eng. Rep. 8, 11 (Q.B. 1859).

Most of the litigation under section 547(c)(2) has been concerned with when a debt is incurred and when a payment is made because of the forty-five day limit between the two dates. The cases concerning the date the debt is incurred may be relevant to whether a transfer is for an antecedent debt under section 547(b)(2).[303] If the payment is by check, the cases concerning the payment date may be relevant to when a transfer is made under section 547(b), (c)(1), or (c)(4). These cases, however, are no longer relevant under section 547(c)(2) and will not be considered here because a 1984 amendment to that section eliminated the forty-five day limit.[304]

The 1984 amendment has long roots. One of the first groups to seek any amendment to section 547 were issuers of commercial paper backed by an irrevocable letter of credit from a bank, a bank's irrevocable commitment to lend the issuer money to meet maturities, or an indemnity bond from an insurance company. Their concern was with the market for this paper in the light of the horrible possibility that the issuer might pay at maturity but then go into bankruptcy within ninety days. Unless the holder of the paper could find an applicable exception in section 547(c), the trustee frequently would be able to recover the payment, even though the holder had no reason to believe the issuer insolvent at the time of

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303. Section 547(a)(4) provides that a debt for taxes is incurred on the last day when the tax is payable without penalty, including any extension. The floor managers explained this provision to Congress solely in terms of its effect on the determination of when a tax debt is incurred for purposes of § 547(c)(2). 124 CONG. REC. 32,417, 34,017 (1978). Since the 1984 amendment to § 547(c)(2), the provision no longer has any office to perform under § 547(c)(2). If a tax debt is paid on the last day payable without penalty, however, the payment should not be for antecedent debt within the meaning of § 547(b)(2). *See* H.R. REP. No. 595, *supra* note 100, at 373. This provision also seems applicable to estimated tax payments, which the House Report explains will not be preferential "because no tax is due when the payments are made. Therefore, the tax on account of which the payment is made is not an antecedent debt." *Id.* This explanation overlooks the regrettable reality that a time does come (the time when most of us pay them) when estimated tax payments are due.

304. Nevertheless, the attorney confronting the statement of the bill's floor managers that payment is considered made when a check is delivered "for purposes of sections 547(c)(1) and (2)," *see supra* note 262 and accompanying text, should not miss *In re* Advance Glove Mfg. Co., 25 Bankr. 521, 527 (Bankr. E.D. Mich. 1982) (concluding that the reference to § 547(c)(2) "appears to be clearly inadvertant, gratuitous, and unintentional" and holding that when payment is by check no transfer occurs under § 547(c)(2) until the check is paid), *indorsed by In re* Staveco Elec. Constr. Co., 48 B.R. 247, 250 (Bankr. D.N.J. 1985), and *In re* Naudain, 32 Bankr. 871, 874 (Bankr. E.D. Pa. 1983); *see also In re* Advance Glove Mfg. Co., Bankr. L. Rep. (CCH) ¶ 70,505 (6th Cir. 1985); O'Neill v. Nestle Libbys P.R., Inc., 729 F.2d 35 (1st Cir. 1984); *In re* Emerald Oil Co., 695 F.2d 833 (5th Cir. 1983); *In re* Property Leasing & Management, Inc., 46 Bankr. 903, 912-14 (Bankr. E.D. Tenn. 1985); *In re* Quality Holstein Leasing, Inc., 46 Bankr. 70 (Bankr. N.D. Tex. 1985).

payment. The only possibly available exception was section 547(c)(2), but frequently the exception would not apply because the commercial paper involved had more than a forty-five day maturity. And the holder then would have no recourse against the bank or insurance company that backed the paper because their undertaking would have terminated when the issuer paid.

Senator DeConcini in 1980 proposed, as a solution to their problem, adding another exception for this specially backed paper with a maturity date not exceeding nine months.[305] During hearings on this proposal,[306] and in subsequent hearings during which the proposal was revived,[307] its proponents never indicated, and were never asked, whether they had considered seeking from the banks, insurance companies, or others an undertaking to pay if the bankruptcy trustee recovered the issuer's payment from the holder. During the subsequent hearings, other groups objecting to the forty-five day limit in section 547(c)(2) joined the specially backed commercial paper group.[308] These groups also suggested that the forty-five day period, or some shorter period, should run from the due date rather than the day the debt was incurred.[309]

The fruit of these proposals was a bill introduced by Senator Dole that would have provided an exception, as a new section 547(c)(7), for payments made on specially backed commercial paper regardless of its maturity date and would have deleted the forty-five day limit from section 547(c)(2).[310] Somewhere between the introduction of this bill and its adoption by the Senate, however, an untoward thing happened to new section 547(c)(7). After its revision, it did not except from section 547 a payment to the holder of specially backed commercial paper by the issuer of the

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305. S. 3023, 96th Cong., 2d Sess. (1980).

306. *Preference Section of the Bankruptcy Code: Hearings Before Subcomm. on Judicial Machinery of the Senate Judiciary Comm. on S. 3023*, 96th Cong., 2d Sess. (Aug. 18, 1980).

307. *April 1981 Senate Hearings*, *supra* note 115, at 229-74.

308. One group was suppliers of sporting goods who sold to dealers at the beginning of the season on credit that extended to the end of the sporting season. *Id.* at 251-55. A spokesman for the National Association of Credit Management also testified that in many industries "in the real world" the "normal trade credit cycle" was more than 45 days. *Id.* at 255-61.

309. *Id.* at 249, 255, 261.

310. S.445, 98th Cong., 1st Sess., §§ 211(b), 359(b) (1983). The first provision was contained in a subtitle of the bill for "Technical Amendments" and the second in a subtitle for "Consumer Credit Amendments" with the one sentence explanation that the 45-day limitation in § 547(c)(2) "places undue burdens upon creditors who receive payments under business contracts providing for billing cycles greater than 45 days." S. Rep. No. 55, 98th Cong., 1st Sess. 60 (1983).

paper; instead, it excepted a payment by the bank that had issued the letter of credit or loan commitment or by the insurance company that had issued the indemnity bond![311] More than a year later, Senator Thurmond tacked to the 1984 amendatory act both of these provisions as they had earlier passed the Senate.[312] The exceptions for specially backed commercial paper now appeared as section 547(c)(8). Later, however, in order to obtain Senator Metzenbaum's consent to expedited consideration of the 1984 amendments, Thurmond withdrew his proposed section 547(c)(8).[313]

In explaining the Conference Report before its adoption in the Senate, Senator Dole blanketed the amendment of section 547(c)(2) in with "a host of technical matters."[314] Senators Dole and DeConcini explained only that the elimination of the forty-five day period would "relieve buyers of commercial paper with maturities in excess of 45 days of the concern that repayments of such paper at maturity might be considered as preferential transfers."[315] But the elimination does much more than that. Elimination of the forty-five day period creates a gaping hole in the preference policy by protecting every creditor who receives a payment otherwise avoidable under section 547(b) who can persuade the court that the debt was incurred and the payment was made "in the ordinary course of business or financial affairs" of debtor and creditor and that the payment was made "according to ordinary business terms."

The quoted statutory words of limitation do not come into the bankruptcy law with a heavy gloss from use in other areas. The "ordinary course of financial affairs" and "ordinary business terms," both undefined, are new to our jurisprudence. "[O]rdinary course of business" also is undefined. The concept of a "buyer in ordinary course of business" is defined in U.C.C. section 1-201(9) and used in U.C.C. sections 9-307(1) and 2-403(3) for the buyer of goods from a seller in the business of selling such goods. The UCC definition is not helpful, however, in determining when a debtor obtains credit and later pays, or when the creditor extends credit and later receives payment in the ordinary course of business.[316]

311. 129 CONG. REC. S5378 (daily ed. Apr. 27, 1983).

312. 130 CONG. REC. S6081-82, S6107, S6122, S6127 (daily ed. May 27, 1984), S7265 (daily ed. June 19, 1984).

313. *Id.* at S7617 (daily ed. June 19, 1984).

314. *Id.* at S8890 (daily ed. June 29, 1984).

315. *Id.* at S8897.

316. The bulk purchaser who buys "not in ordinary course" of the seller's business

Although the above concepts have now been in the Reform Act since 1978, case law reveals little about what they may come to mean. Most of the litigation under section 547(c)(2) has been concerned with the times when the debt was incurred and when the payment was made under the part of section 547(c)(2) that Congress eliminated in 1984. Nevertheless, among the few cases dealing with other matters under section 547(c)(2), courts have held that certain payments were not made in the ordinary course of business of either debtor or creditor.[317] Other courts have held that

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under U.C.C. § 6-102(1) is even less translatable.

317. Debtor and creditor both engaged in buying and selling seed, and they agreed that creditor would take a shipment of seed from debtor in payment of an overdue debt. *In re* Gold Coast Seed Co., 24 Bankr. 595, 597 (Bankr. 9th Cir. 1982). *But cf. In re* American Gypsum Co., 36 Bankr. 360, 363 (Bankr. D.N.M. 1984) (assuming that a transfer of some of the debtor's wallboard inventory to pay a trucking company's hill is covered by § 547(c)(2)). After debtor's check to supplier was dishonored, the parties agreed that debtor would deposit casb or debtor's customers' checks with a third party. Supplier delivered inventory to debtor only to the extent of deposits, and seller was paid by the depository. *In re* D.A.C. Meats, Inc., 8 Bankr. 230, 231 (S.D.N.Y. 1981). Debtor made regular monthly payments of $28 on an installment debt for 20 months, two payments totalling more than $350 in the next two months, none for the next three months, and then within a few days of bankruptcy full payment of the $340 balance ahead of time. *In re* Williams, 5 Bankr. 706, 707 (Bankr. S.D. Ohio 1980). As indicated *supra* note 165, the court erroneously ignored that the creditor was at least partially secured. In another case, after debtor's customer paid in advance for silver that debtor was unable to deliver, debtor repaid customer in cash and by the negotiation of other customers' checks. Customer contended that the cash and checks constituted "silver's worth" delivered in fulfillment of its order. *In re* Kennesaw Mint, Inc., 32 Bankr. 799, 805 (Bankr. N.D. Ga. 1983). Creditor advised debtor that creditor had been approached by another creditor about joining in an involuntary petition and asked debtor for financial statements and anything else debtor could do to show its good faith. Debtor switched from payments by its corporate checks to payments by cashier's checks. *In re* Craig Oil Co., 31 Bankr. 402, 406 (Bankr. M.D. Ga. 1983). After debtor closed its business operations, it returned goods purchased on credit to an unpaid supplier. *In re* Martin County Custom Pools, Inc., 37 Bankr. 52, 53 (Bankr. S.D. Fla. 1984); *cf. In re* Amex Trading Co., 32 Bankr. 793, 799 (Bankr. W.D. Tenn. 1984) (reaching different result because of evidence of trade custom). After debtor had closed its business and was attempting to liquidate it, but before bankruptcy, debtor turned over a customer's check to its attorney. The attorney was authorized to, and did, use the money collected from the check to pay for past due and current legal fees. *In re* Peninsula Roofing & Sheet Metal, Inc., 9 Bankr. 257, 261 (Bankr. W.D. Mich. 1981). After insolvent debtor redeemed its majority shareholder's stock in exchange for property, cash, and an unsecured promissory note, debtor made payments on the note. The court said that ordinary course of business was confined to "the ordinary and necessary running expenses of the debtor's business, of types and amounts that the debtor had theretofor made a practice of paying." *In re* Louisiana Indus. Coatings, Inc., 31 Bankr. 688, 695 (Bankr. E.D. La. 1983). The court derived its definition from three of the old cases which held that lack of intent to prefer meant that preferential payments could not be treated as acts of bankruptcy. *See In re* Union Feather & Wool Mfg. Co., 112, F. 774 (7th Cir. 1902); *In re* Columbia Real Estate Co., 205 F. 980 (D.N.J. 1913); *In re* Perlhefter, 177 F. 299 (S.D.N.Y. 1910). After debtor for years had made monthly payments to a supplier that were only one or two days late by checks that always cleared, one payment was

neither the incurring of the debt nor the payment of it were in the ordinary course of business.[318] Two courts have determined that payments by the debtor were not according to ordinary business terms.[319] Finally, only two courts have held that debts incurred or payments made were in the ordinary course of business of the debtor and the creditor, according to ordinary business terms.[320]

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nine days late because debtor's check was dishonored; other payments were two to twelve days late; some payments "split" the monthly bill into two payments; and some payments were made after supplier had put future deliveries on a C.O.D. basis. *In re* Ewald Bros., Inc., 37 Bank. 52, 56-60 (Bankr. D. Minn. 1984). Finally, one court held, without explanation, that an individual debtor's purchase of a used car from an automobile dealer was not in the ordinary course of debtor's business or financial affairs. *In re* Martella, 22 Bankr. 649, 652 (Bankr. D. Colo. 1982).

318. A farmer delivered grain to the warehouse of debtor milling company with an option in debtor to purchase or return it within a specified time. Debtor thereafter exercised the option and made payment. Farmer failed to prove "that he, or other farmers, had entered into like option contracts with the debtor in the past. *In re* Economy Milling Co., 37 Bankr. 914, 922 (D.S.C. 1983). After corporate debtor engaged in construction business got into financial difficulties, its sole stockholder made "sporadic advances" to meet daily payroll overdrafts. Debtor repaid stockholder when it received payments on its construction projects. *In re* Fulghum Const. Co., 45 Bankr. 112, 115-16 (Bankr. M.D. Tenn. 1984). Debtor obtained payment from 10 to 15 customers by submitting false invoices. Six days later, debtor had a change of heart toward one customer, admitted that the invoices were false, and repaid him. *In re* Tinnell Traffic Servs. Inc., 41 Bankr. 1018, 1020 (Bankr. M.D. Tenn. 1984). A corporate debtor borrowed money from its president's wife to pay its taxes and avoid an IRS levy on its assets and later repaid her. *In re* Arctic Air Conditioning, Inc., 35 Bankr. 107, 108 (Bankr. E.D. Tenn. 1983). Five months after the debtor's business had been closed by fire damage, it retained a law firm on a contingent fee basis to pursue its claim against the lessor of the business premises and one month later the firm effected a settlement and collected its fee. The relationship between a law firm and the debtor was held not to be a "normal credit transaction such as the sale of goods for a business supplier on account" and, moreover, the firm was not retained until the debtor's business had closed. Kallen v. Litas, 47 Bankr. 977, 984 (Bankr. N.D. Ill. 1985).

319. Debtor between March and May bought goods on open account and then in September, three weeks before bankruptcy, paid his account in full. The payment was not according to ordinary business terms. *In re* Gulf States Marine, Inc., 1 COLLIER BANKR. CAS. 2d (MB) 650, 653 (Bankr. W.D. La. 1980). Payments made by debtor operating a modern "Ponzi" scheme, under which funds obtained from later investors were used to pay "interest" to earlier investors, were not made in ordinary course of debtor's business or according to ordinary business terms. Instead, the court held that the payments were "unusual, extraordinary, and unrelated to any business enterprise whose protection was intended by the drafters of § 547(c)(2)." *In re* Independent Clearing House Co., 41 Bankr. 985, 1014-15 (Bankr. D. Utah 1984).

320. The IRS levied on debtor's obligation to a delinquent taxpayer. The court held that debtor's obligation to the IRS and its payment of the obligation were in the ordinary course of business of both the IRS and debtor and that the payment was according to ordinary business terms. *In re* Thomas W. Garland, Inc., 39 Bankr. 412, 415-17 (Bankr. E.D. Mo. 1984). If the court extended its ruling to a debtor who paid in response to service of a writ of garnishment on behalf of a private creditor of one to whom the debtor was obligated, the court would be approaching Lord Mansified's concept of ordinary course of business. *See supra* notes 18-26 and accompanying text. The court, however, may have been influ-

Even if other patterns that are not "ordinary" for incurring and paying debt develop in case law, and even if these patterns include prepayment of debt and payment of debt long overdue, section 547(c)(2) in its present form (which I am unable to characterize as another "legislative accident") seems doubly indefensible. The exception creates a huge gap in the policy underlying section 547. First, that a debt was "ordinarily" incurred and paid has no more relevance to whether the debt repayment distorts the bankruptcy distribution scheme than does the purpose of the debtor in making the payment, and of the creditor in receiving it. Second, the present section 547(c)(2) immunizes the ordinary "payment," whether in cash or property, but does not immunize ordinary transfers by way of security.[321] No rational explanation for this distinction is conceivable, except that the drive to amend section 547(c)(2) presented those hostile to the preference policy with an opportunity to exempt payments from preference treatment but with no similar opportunity to exempt security transfers.

The only apparent justification for section 547(c)(2) as enacted in 1978 (I have not yet heard, but would like to hear, a plausible justification for it in its present form) is the following: If a debtor selectively can meet debts currently coming due in order to continue functioning outside of bankruptcy, creditors should be encouraged to accept these payments, even though preferential. Consequently, creditors may continue doing business with the debtor because they will not be penalized if the debtor's attempt to function outside of bankruptcy fails. This justification is not compelling because it is contrary to the entire concept of preference. If this justification provides the basis for an exception, then the exception should not be confined to "trade debts," however that term might be defined. A banker's demand or thirty day note may pose as great an obstacle to keeping the debtor's business or financial

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enced because the levy was for taxes—"the life-blood of government." 39 Bankr. at 416.

Debtor, engaged in the distribution of cedar products, incurred debt to suppliers on open account in ordinary course of business of debtor and supplier. Supplier then assigned the account to a bank to secure an extension of credit. The court held that § 547(c)(2) protected payments made to the bank by debtor because the bank as assignee stood "in the shoes of" supplier assignor. *In re* Bagwell, 29 Bankr. 457, 461 (Bankr. D. Or. 1983); *In re* Bagwell, 29 Bankr. 461, 465 (Bankr. D. Or. 1983). The court did not inquire whether the assignments were perfected.

321. At least one court, however, has tested transfers by way of security for compliance with § 547(c)(2), but found that the provision was unsatisfied in other respects. *In re* Martella, 22 Bankr. 649, 652 (Bankr. D. Colo. 1982). Another court found that a transfer by way of security satisfied § 547(c)(2). *In re* Hart Ski Mfg. Co., 7 Bankr. 465, 469 (Bankr. D. Minn. 1980).

affairs in operation as the claim of an inventory supplier or a utility. The real rub, however, is that a banker's longer term note, or other long-term installment obligations, or a retailer's long overdue accounts may present the same obstacle. The 1984 amendments now permit payment of these long-term obligations, even though the 1978 version of section 547(c)(2) did not protect them.[322]

In view of the feeble inspiration for this exception,[323] and because the exception is completely at war with the concept of a preference and has no rational confining limits, the best future for present section 547(c)(2) is repeal.

3. The Enabling Loan Exception

U.C.C. section 9-107 defines two types of purchase money security interests. A purchase money security interest arises (a) when the seller of the collateral takes or retains a security interest to secure all of the sale price; or (b) when one who, by making advances or incurring an obligation, gives value to enable the debtor to acquire rights in or the use of the collateral and the value is in fact so used.[324]

The Gilmore committee of the National Bankruptcy Conference[325] urged an exception to the preference concept, not for a security interest retained by the seller under section 9-107(a), but for

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322. *See In re* Barash, 658 F.2d 504 (7th Cir. 1981) (monthly installment obligation); *In re* McCormick, 5 Bankr. 726, 730-32 (Bankr. N.D. Ohio 1980)(same); *In re* Burner, 3 Bankr. 617 (Bankr. E.D. Tenn. 1980)(same). Because courts considered that the debtor incurred installment obligations when the credit was extended rather than when monthly installments became due, any payment beyond the first installment was unprotected under the 45 day limit. *See also In re* Pippin, 46 Bankr. 281, 283-84 (Bankr. W.D. La. 1984) and cases cited therein. *But see In re* Iowa Premium Serv. Co., 695 F.2d 1109 (5th Cir. 1982); *In re* Graves, 45 Bankr. 858 (E.D. Cal. 1985). Payments on a charge account also were unprotected by § 547(c)(2) when the debtor made the latest charges more than 45 days before payment, *see In re* Gulf States Marine, Inc., 1 COLLIER BANKR. CAS. 2D. (MB) 650, 652 (Bankr. W.D. La. 1980); or when the debtor made charges within 45 days, but a state statute required payment to be applied first to the oldest charges, *see In re* Williams, 5 Bankr. 706, 708 (Bankr. S.D. Ohio 1980). Under the 1978 version of § 547(c)(2), in the absence of a similar state statute, courts applied the usual rule that the debtor may direct how the payments shall be applied; if the debtor does not direct payment, the creditor may decide. *See In re* American Gypsum Co., 36 Bankr. 360 (Bankr. D.N.M. 1984); *In re* Balducci Oil Co., 33 Bankr. 843, 847 (Bankr. D. Colo. 1983); *In re* Gander Mountain, Inc., 29 Bankr. 260 (Bankr. E.D. Miss. 1983). Courts experienced more difficulty with utility bills when service was provided continuously, but the meters were read monthly. *See In re* Georgia Steel, Inc., 38 Bankr. 829 (Bankr. M.D. Ga. 1984); *In re* Keydata Corp., 37 Bankr. 324 (Bankr. D. Mass. 1983); *In re* Thomas W. Garland, Inc., 19 Bankr. 920 (Bankr. E.D. Mo. 1982).

323. *See supra* notes 295-97 and accompanying text.

324. U.C.C. § 9-107 (1978).

325. *See supra* note 288 and accompanying text.

a security interest taken by the "enabling lender" under section 9-107(b). The committee explained that its proposal would protect from preference attack "what are usually called 'enabling loans' where the acquisition of the property by the debtor is, chronologically, later in time than the advance of the enabling loan, so that the transfer of the security interest in the property acquired is, technically, for antecedent debt."[326] The seller who retains a security interest in property sold to the debtor does not face this problem. He must be concerned about preference law only if he delays perfection of his interest beyond the time allowed under that law.

The Bankruptcy Commission quoted the above explanation from the Gilmore committee report and proposed an exception labeled "Enabling Loans." If a security interest is perfected within ten days after the debtor first "acquires rights in the property," the exception applies to the extent "that [the collateral] secures new value previously given to enable the debtor to acquire the property."[327] The National Bankruptcy Conference, not surprisingly, supported this proposal. The Conference spokesman explained that the proposal was

> designed to coordinate with, and in a sense is made necessary by, section 9-203 of the [U.C.C.], which provides tbat a security interest is not created and does not attach until the debtor has rigbts in the collateral;[328] therefore, where the creditor lends money to a debtor to acquire the collateral, the security interest may be deemed to be given for antecedent debt.[329]

The House and Senate staff accepted the proposal but rewrote the exception in section 547(c)(3) as enacted in 1978.[330] The exception applied to a transfer under section 547(c)(3)(A) when a security interest "in property acquired by the debtor" secured new value "(i) given after the signing of a security agreement that contains a description" of the collateral, "(ii) given by or on behalf of the secured party, . . . (iii) given to enable the debtor to acquire such property, and (iv) in fact so used by the debtor." Under section 547(c)(3)(B), the exception applied if the security interest was perfected within ten days after "such security interest attaches." The Committee Reports explain in a single sentence that this ex-

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326. H.R. REP. No. 595, *supra* note 100, at 214.

327. *Commission Report*, *supra* note 91, pt. I, at 208; pt. II, at 167.

328. Section 547(e)(3) is in accord with U.C.C. § 9-203. *See* text following *supra* note 231.

329. *Bankruptcy Act Revision: Hearings before Subcomm. on Civil and Constitutional Rights of House Judiciary Comm. on H.R. 31 and H.R. 32*, 94th Cong., 2nd Sess. 1482 (Mar. 19, 1976).

330. H.R. 8200 and S. 2266, *supra* note 254.

ception is "for enabling loans in connection with which the debtor acquires the property that the loan enabled him to purchase after the loan is actually made."[331] This formulation exceeds earlier proposals by requiring, as does U.C.C. section 9-107(b), that the debtor in fact use the loan to acquire the collateral.[332] In addition, the proposal exceeds section 9-107(b) by requiring that the security interest contain a description of the collateral—a requirement that may cause difficulties for secured parties who take security interests in collateral in which the debtor does not have rights and which may not be in existence.

Nevertheless, a loan must be given at or after the signing of the security agreement to enable the debtor to acquire collateral, and the debtor in fact must use the loan to acquire collateral. Under section 547(e)(3), the excepted transfer is not made until the debtor has acquired rights in the property transferred. This provision and the scattered but fairly clear legislative history indicate that Congress did not intend section 547(c)(3) to apply to a seller who retains a purchase money interest in the goods sold; rather, Congress intended the exception to apply to the purchase money secured party whose transaction in fact involves antecedent debt: the enabling lender.[333] Nevertheless, some courts have concluded, without express discussion of the matter, that section 547(c)(3) may be available to a seller who has retained a security interest.[334] Those cases, however, caused no damage because the

331. H.R. REP. No. 595, *supra* note 100, at 373; S. REP. No. 989, *supra* note 118, at 88.

332. U.C.C. § 9-107 applies only to personal property collateral. Section 547(c)(3), cast in terms of "property," is not confined to personalty although the reported cases that have arisen under it so far are.

333. One could design an enabling loan to take effect after the debtor acquired the collateral, so that no antecedent debt in fact would exist. One also could design a seller's security interest not to attach until some time after the goods were sold to the dehtor, so that an antecedent deht problem in fact would exist. These designs, however, would not be typical transactions, and neither of them seemed to inspire § 547(c)(3). In *In re* Damon, 34 Bankr. 627, (Bankr. D. Kan. 1983), the lender made an unsecured enahling loan and took a security interest after the debtor acquired the collateral. The court held that § 547(c)(3) was inapplicable because the loan preceded the security agreement. *Id.* at 630.

334. *See, e.g., In re* Davis, 734 F.2d 604 (11th Cir. 1984); *In re* Murray, 27 Bankr. 445, 448 (Bankr. M.D. Tenn. 1983); *In re* Martella, 22 Bankr. 649, 651 (Bankr. D. Colo. 1982); *In re* Enlow, 20 Bankr. 480, 483 (Bankr. S.D. Ind. 1982); *In re* Lucas, 28 Bankr. 366 (Bankr. S.D. Ohio 1982). In *Davis, Murray, Martella,* and *Enlow,* the seller had assigned the security interest to a finance company that was the defendant in the preference action. In *Davis* and *Murray,* the dealer was a Ford dealer and the finance company was Ford's captive Ford Motor Credit Corporation (FMCC). Although the definition of "new value" in § 547(a)(2) includes "new credit," the case did not indicate whether FMCC made a contractual commitment after the security agreement was executed and before the debtor acquired the collateral that would qualify as "new value" under § 547(c)(3). FMCC claimed solely as assignee

security interest was not perfected within ten days and failed to qualify under section 547(c)(3)(B) as a result.

The separate ten day perfection provision in section 547(c)(3)(B) is both perplexing and a possible trap for the unwary. First, as enacted in 1978, the ten day period of section 547(c)(3)(B) ran from the time the "security interest attaches." Presumably this ten day period referred to the same time period as section 547(e)(2), which, "[f]or the purposes of this section," prescribed a ten day perfection period from the time the "transfer takes effect between the transferor and the transferee," unless there is some difference between the quoted terms. This interpretation would not render section 547(c)(3)(B) redundant because the failure to perfect within ten days would disqualify the secured party for section 547(c)(3), but only would postpone when the transfer occurs under section 547(e)(2). There is some support for this interpretation. Under U.C.C. section 9-203(1), a security interest is not enforceable against the debtor and does not attach until the debtor signs a written security agreement (or the secured party has possession of the collateral under an oral agreement), the secured party has given value, and the debtor has rights in the collateral. The Gilmore committee's enabling loan provision required only that "within a reasonable time" after the loan "the debtor acquire[d] the property and [made] a perfected transfer of it."[335] The Gilmore committee's equivalent of section 547(e)(2) also measured the time for perfection from the time when the transfer "became effective between the parties."[336] The committee explained that it had not used the U.C.C. term "attached" because confusion might have resulted for transfers other than Article 9 security interests. But the committee added that "becomes effective between the par-

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of the dealer's retained purchase money interest. *Davis*, 734 F.2d at 604; *Murray*, 27 Bankr. at 448.

In *Martella*, the debtor was a General Motors dealer, and the finance company was General Motors captive General Motors Acceptance Corporation (GMAC). Although the court concluded GMAC could not invoke § 547(c)(3) because its interest was not perfected withn the 10 day period of § 547(c)(3)(B), it disagreed witb those courts holding that § 547(c)(1) and § 547(c)(3) were mutually exclusive. *See supra* notes 276-78 and accompanying text. In concluding that GMAC qualified for § 547(c)(1), although the time of the assignment of the dealer's retained interest to GMAC did not appear, the court decided that the transfer to GMAC and the giving of new value were substantially contemporaneous because the dealer "was acting as GMAC's agent." 22 Bankr. at 652. In *Enlow*, the seller assigned its retained security interest to an apparently unrelated finance company 12 days after the sale. 20 Bankr. at 483.

335. H.R. REP. No. 595, *supra* note 100, at 210.

336. *Id.*

ties" had the same meaning as "attached" in the Article 9 context.[337]

Second, any purchase money secured party governed by the U.C.C. has, under section 9-301(2), a ten day grace period to perfect. He may invoke that period, if it has not expired, even after bankruptcy against a trustee who seeks to use his avoiding power under section 544(a).[338] But the ten day period of section 9-301(2) runs from the time "the debtor receives possession of the collateral." Hence, suppose an enabling lender in New York advances money to a New York debtor pursuant to a signed security agreement to enable the debtor to acquire collateral from a California supplier, and the debtor so uses the loan. If the lender, in reliance on section 9-301(2), waits until the debtor receives the collateral in New York and perfects within ten days thereafter, he may find that the debtor acquired rights in the collateral when it was shipped in California,[339] or even earlier.[340] Therefore, the security interest attached and became enforceable against the debtor more than ten days before perfection under U.C.C. section 9-203 and within the meaning of both section 547(c)(3)(B) and (e)(2).[341]

Several courts have held that an enabling lender failed to qualify for section 547(c)(3) because he did not perfect within the ten day period.[342] In none of these cases, however, does reliance on U.C.C. section 9-301(2) appear to have misled the secured party. Nonetheless, section 547(c)(3)(B) was amended in 1984 to make its ten day perfection period run from the time the debtor acquires possession of the collateral. No change was made in section 547(e)(2), under which the ten day period runs from the time the transfer "takes effect" between the debtor and the secured party. Courts probably will hold that, even though section 547(e)(2) liter-

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337. *Id.* at 213.

338. *See supra* notes 232-38 and accompanying text.

339. "Unless otherwise explicitly agreed title passes to the buyer at the time and place at which the seller completes his performance with reference to the physical delivery of the goods. . . ." U.C.C. § 2-401(2) (1978).

340. "The buyer obtains a special property and insurable interest in goods by identification of existing goods to which the contract relates. . . ." *Id.* § 2-501(1).

341. Under Tennessee's version of § 9-301(2), the purchase money secured party is given 20 days from the time the debtor acquires possession of the collateral to perfect. TENN. CODE ANN. 47-9-301 (1980). *In re* Murray, 27 Bankr. 445 (Bankr. M.D. Tenn. 1983), recognized that § 546(b) did not apply to § 547, so that Tennessee's § 9-301(2) could not extend the grace periods of either § 547(c)(3)(B) or § 547(e)(2). 27 Bankr. at 451.

342. *See In re* Vance, 721 F.2d 259, 260 (9th Cir. 1983); *In re* Ken Gardner Ford Sales, Inc., 23 Bankr. 743, 747 (E.D. Tenn. 1982); *In re* Brimhall, 13 Bankr. 942, 948 (Bankr. D. Idaho 1981); *In re* Christian, 8 Bankr. 816, 819 (Bankr. M.D. Fla. 1981).

ally applies throughout section 547, the 1984 amendment carves an exception to section 547(e)(2) and prescribes a special rule for section 547(c)(3). Also, the enabling lender who runs afoul of section 547(b) because of this failure to perfect within ten days of the time the transfer "takes effect" between the debtor and the secured party still may qualify for the section 547(c)(3) exemption if he perfects within ten days of the time the debtor acquires possession of the collateral as section 547(c)(3)(B) now requires.

4. The Subsequent Advance Exception

Old section 60c provided, from its enactment in 1898,[343] that if a creditor had been preferred "and afterward in good faith gives the debtor further credit without security of any kind for property which becomes a part of the debtor's estate, the amount of such new credit remaining unpaid" at bankruptcy "may be set off against the amount" of the preference that the trustee recovers. The Gilmore committee recommended a provision that would carry the concept of old section 60c into the Reform Act. If a transferee who did not give new value when the transfer occurred "thereafter delivers goods to the debtor or makes further advances to him, or otherwise gives new value, then, to the extent of the new value so given, the transfer is not voidable."[344] The provision directed that the trustee deduct any security given for the new value.[345] The committee reasoned that the "net result" of these transactions was "no depletion" of the estate.[346] The Bankruptcy Commission simplified the Gilmore committee's recommendation to read: "[A] transfer is not voidable to the extent of new value given at the time of the transfer or at any time thereafter." The Commission retained the direction that the trustee deduct the value of any security taken from the new value. The Commission

343. 30 Stat. 562 (1898).

344. H.R. REP. No. 595, *supra* note 100, at 210.

345. *Id.*

346. The Committee explained that:

> [t]he core meaning of the entire preference concept is that the transfers which should be avoided are those whicb, if allowed to stand, would leave the estate available for distribution among creditors permanently depleted. If, in a series of transactions between the (bankrupt) transferor and a transferee, the "net result" is zero (i.e. no depletion), it seems unfair to penalize a transferee by holding each separate "transfer" preferential without crediting him for the subsequent unsecured new value contribution he bas made to the estate.

Id. at 214. For a somewhat different proposal, see Taylor, *Section 60c of the Bankruptcy Act: Inadequate Protection for the Running Account Creditor*, 24 VAND. L. REV. 919 (1971).

explained that it was eliminating the old section 60c requirements that the creditor act in good faith in connection with the suhsequent credit extension, that the suhsequent credit extension remain unpaid at bankruptcy, and that no security be taken for the subsequent credit extension.[347]

The House and Senate staff cast the subsequent advance proposal in section 547(c)(4) in its present form. The transfer is exempted from section 547 if, "after such transfer, such creditor gave new value to or for the benefit of the dehtor . . . (a) not secured by an otherwise unavoidable security interest; and (b) on account of which value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor."[348] The requirements of old section 60c that the new credit be given in good faith and the express requirement that the new credit remain unpaid at bankruptcy were deleted. Furthermore, in place of the requirement of old section 60c that the credit be given "without security of any kind,"[349] section 547(c)(4) requires only that an otherwise nonvoidable transfer not secure or be made on account of the credit extension. The House and Senate reports do not explain clearly any of these changes; rather, they state only:

> The fourth exception codifies the net result rule in § 60c of current law. If the creditor and debtor have more than one exchange during the 90-day period, the exchanges are netted out according to the formula in paragraph (4). Any new value that the creditor advances must be unsecured in order for it to qualify under this exception.[350]

The Gilmore committee report also explains that its proposal is based on old section 60c and on "the case law, mostly of fairly ancient vintage, which discusses what is usually referred to as the 'net result' rule."[351] The Commission report, however, which quotes the above language from the Gilmore committee report in a note to its proposed preference section,[352] also says in a passage that appears earlier in the report hut was later written:

> The Commission's recommendation does not, however, go as far as the "net result rule" established by some early cases. A true "net result" rule would total all payments and all advances and offset the one against the

347. *Commission Report, supra* note 91, pt. I, at 210; pt. II, at 167, 171-72. The Commission's only elaboration was to quote from the Gilmore Committee's report.

348. H.R. 8200 and S. 2266, *supra* note 254.

349. The § 60c requirement could have disqualified even a credit extension secured by a transfer that the trustee later avoided. This argument apparently never was made.

350. H.R. REP. No. 595, *supra* note 100, at 374; S. REP. No. 989, *supra* note 118, at 88.

351. H.R. REP. No. 595, *supra* note 100, at 214.

352. *Commission Report, supra* note 91, pt. II, at 171.

other. This is not allowed under the Commission's recommendation, since the advances to be offset must be subsequent to the preference [as they must be also under section 547(c)(4)].[353]

In fact, no "net result" rule has existed since 1903, and the rule never was applicable to old section 60c. The rule developed when old section 57g required creditors to surrender "technical" preferences, which were not voidable because the creditor had no reasonable cause to believe the debtor insolvent, before their claims would be allowed.[354] To mitigate the rigors of section 57g, lower courts developed, and the Supreme Court approved, a "net result" rule under which all "technical," nonvoidable preferences received by a creditor and all unsecured credit extended by that creditor during the then four month preference period were viewed as a single transaction.[355] Only to the extent that the "net result" showed a gain by the creditor would the creditor be required to surrender it before his claim would be allowed. Courts, however, applied that rule only under section 57g and only to creditors who had received nonvoidable preferences; the rule did not apply to creditors who received preferences that the trustee could avoid under old section 60. Those creditors might have been able to set off subsequent unsecured credit extensions under section 60c, but they could not invoke the "net result" rule. When Congress amended section 57g in 1903 to confine its operation to voidable preferences, there was no longer any occasion to apply the "net result" rule. Every court that has considered the effect of the amendment of section 57g on the "net result" rule has reached this conclusion.[356]

Fortunately, the misleading legislative history of section

353. *Id.*, pt. I, at 210-11.

354. *See supra* notes 69-71 and accompanying text.

355. *See* Joseph Wild & Co. v. Provident Trust Co., 214 U.S. 292 (1909); Yaple v. Dahl-Millikan Grocery Co., 193 U.S. 526 (1904); Jaquith v. Alden, 189 U.S. 78 (1903).

356. *See In re* Frigitemp Corp., 753 F.2d 230 (2d Cir. 1985); Cooper Petroleum Co. v. Hart, 379 F.2d 777 (5th Cir. 1967); Campanella v. Liebowitz, 103 F.2d 252 (3d Cir. 1939); *In re* Ira Haupt & Co., 304 F. Supp. 917, 945 (S.D.N.Y. 1969). Some cases under the old Act did not consider the effect of the amendment of § 57(g). These courts, however, assumed that the rule continued to apply, and they held that the rule was unavailable to a creditor with reason to know the debtor insolvent. *See, e.g.*, Talty v. Ross, 14 F.2d 240 (D. Mass. 1926); *In re* Farmers' Store & Supply Co., 214 F. 505 (N.D.W. Va. 1914); Chisholm v. First Nat'l Bank, 269 Ill. 110, 109 N.E. 657 (1915). Courts also applied the rule in favor of a creditor who did not need it because he had no reason to believe the debtor insolvent. *See, e.g.*, *In re* Fred Stern Co., 54 F.2d 478 (2d Cir. 1931); Dunlap v. Seattle Nat'l Bank, 93 Wash. 568, 161 P. 364 (1916). Finally, some courts misapplied the rule on behalf of a creditor who had reasonable cause to believe the debtor insolvent. *See, e.g.*, Farmers Bank v. Julian, 383 F.2d 314 (8th Cir.), *cert. denied*, 389 U.S. 1021 (1967).

547(c)(4) has caused less damage than the similarly misleading history of section 547(c)(1) and (2). Most courts have agreed with the Sixth Circuit's decision in *In re Fulghum Construction Corp.*[357] that, in light of the clear requirement that the new value be given "after" the voidable preference, section 547(c)(4) "has transformed the judicially created net result rule into . . . a subsequent advance rule."[358]

In determining the time of transfer under section 547(c)(4), courts have received no assistance from legislative history, except when they take the history of section 547(c)(1) and (2) to mean that payment by check is a transfer at different times under different provisions in section 547. Nevertheless, the courts consistently have held that, for the purposes of section 547(c)(4), a transfer occurs when the debtor's check is delivered to the creditor, at least when the drawee later honors the check. Thus, the creditor who is encouraged by receipt of the check to extend new unsecured credit without waiting for the check to clear may invoke section 547(c)(4) to apply the credit against the trustee's recovery of an earlier preference.[359]

The creditor, however, must give the new value *after* the preferential transfer. For example, in *In re Wadsworth Building Components, Inc.*,[360] the debtor gave his check in December for goods sold on credit and delivered in October. The check was dishonored

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357. 706 F.2d 171 (6th Cir.), *cert. denied*, 104 S. Ct. 342, 343 (1983).

358. *Id.* at 174; *see, e.g., In re* Wadsworth Bldg. Components, Inc., 711 F.2d 122, 123-24 (9th Cir. 1983); *In re* Gold Coast Seed Co., 30 Bankr. 551, 553 (9th Cir. 1983); Leathers v. Prime Leather Finishes Co., 40 Bankr. 248, 250-51 (D. Me. 1984); *In re* Isis Foods, Inc., 39 Bankr. 645, 649-50 (W.D. Mo. 1984); *In re* Columbia Packing Co., 44 Bankr. 613, 615 (Bankr. D. Mass. 1984); *In re* Keydata Corp., 37 Bankr. 324, 328 (Bankr. D. Mass. 1983); *In re* Saco Local Dev. Corp., 30 Bankr. 859, 862 (Bankr. D. Me. 1983); *In re* Rustia, 20 Bankr. 131, 135-36 (Bankr. S.D.N.Y. 1982); *In re* Thomas W. Garland, Inc., 19 Bankr. 920, 922-26 (Bankr. E.D. Mo. 1982); *In re* Bishop, 17 Bankr. 180, 183-84 (Bankr. N.D. Ga. 1982); *see also In re* Fabric Buys, Inc., 22 Bankr. 1013, 1017 (Bankr. S.D.N.Y. 1982).

359. *See In re* Gold Coast Seed Co., 30 Bankr. 551, 553 (9th Cir. 1983); *In re* Sider Ventures & Servs. Corp., 33 Bankr. 708 (Bankr. S.D.N.Y. 1983), *aff'd on other grounds*, 47 Bankr. 406 (S.D.N.Y. 1985); *In re* Fasano/Harriss Pie Co., 43 Bankr. 871, 874-76 (Bankr. W.D. Mich. 1984); *In re* Georgia Steel, Inc., 38 Bankr. 829, 837 (Bankr. M.D. Ga. 1984); *In re* Blanton Smith Corp., 37 Bankr. 303, 307-09 (Bankr. M.D. Tenn. 1984) (to satisfy perfection requirements of § 547(e)(2), the check must be honored within 10 days after delivery); *In re* Chemical Separations Corp., 36 Bankr. 141, 143 (Bankr. E.D. Tenn. 1984); *In re* Philadelphia Light Supply Co., 33 Bankr. 734 (Bankr. E.D. Pa. 1983) (even though check was dishonored over a month after receipt by creditor because of an error by drawee bank, which paid creditor by wire transfer four days later); *In re* Saco Local Dev. Corp., 30 Bankr. 868, 878 (Bankr. D. Me. 1983); *In re* Thomas W. Garland, Inc., 19 Bankr. 920, 928 (Bankr. E.D. Mo. 1982).

360. 711 F.2d 122 (9th Cir. 1983).

but was redeposited and paid in February, after the seller had delivered more goods on credit in January. The court treated the transaction as a perfection problem under section 547(e)(2);[361] the transfer, therefore, did not occur until February, and the January shipment came too early to invoke section 547(c)(4).[362] The dissent argued that the seller had qualified under section 547(c)(1) to the extent of the value of the goods delivered in January.[363] The dissenting opinion, in addition to raising difficulties under section 547(c)(1),[364] seems inconsistent with the timing requirements of section 547(c)(4).

Although old section 60c was limited to subsequent "credit . . . for property that becomes part of the debtor's estate,"[365] any consideration fitting the definition of "new value" in section 547(a)(2),[366] given after the preferential transfer, will qualify under section 547(c)(4). But here the old notion of "diminution of the estate" has emerged, perhaps with some justification, with an assist from one of the draftsmen who wrote that section 547(c)(4) "insulates from preference attack a transfer to a creditor to the extent that the creditor thereafter replenishes the estate."[367] Thus, the exception may include more than goods sold on unsecured credit[368] or money lent. For instance, it also may include the value

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361. *See supra* note 267 and accompanying text; *In re* Blanton Smith Corp., 37 Bankr. 303, 309-10 (Bankr. M.D. Tenn. 1984).

362. *Wadsworth*, 711 F.2d at 123-24.

363. *Id.* at 124-25.

364. *See supra* note 269.

365. In Kaufman v. Tredway, 195 U.S. 271 (1904), the Court held that § 60c did not require that the money or property remain in the "dehtor's estate" at hankruptcy in order to become part of the bankrupt estate. *Id.* at 274-75. The Court also held that the language of § 60c requiring that the subsequent credit be extended in "good faith" (omitted in § 547(c)(4)) required only that the creditor "let the debtor have the money or property for some honest purpose" and that the creditor not "intentionally defeat the Bankruptcy Act" by aiding the debtor to conceal the transfer from the bankruptcy trustee. *Id. In re* Ira Haupt & Co., 424 F.2d 722, 724(2d Cir. 1970), held that "property" under § 60c included lawyers' and accountants' services. Bernstein v. Home Life Ins. Co., 25 Bankr. 321, 324 (S.D.N.Y. 1982), held that "property" covered health insurance for the debtors' employees by reading *Haupt* to mean that "property" under § 60c "may include services which do not result in a traceable balance that increases the assets of the debtor."

366. Section 547(a)(2) defines "new value" as:

> Money or money's worth in goods, services, or new credit, or release by a transferee of property previously transferred to such transferee in a transaction that is neither void nor voidahle by the debtor or the trustee under any applicable law, including the proceeds of such property, but does not include an obligation substituted for an existing obligation.

11 U.S.C. § 547(a)(2)(1982).

367. Levin, *supra* note 301, at 187.

368. *See In re* Isis Foods, Inc., 39 Bankr. 645 (Bankr. W.D. Mo. 1984); Butz v. Cham-

of insurance coverage provided after the payment of delinquent premiums,[369] the value of leased equipment when the lessor permitted the debtor-lessee to continue using the equipment to produce inventory after default in rental payments,[370] and may include the value of electricity supplied by a utility to the debtor after preferential payments.[371]

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paign Landmark, Inc., 33 Bankr. 926, 929 (Bankr. S.D. Ohio 1983); *In re* D.A.C. Meats, Inc., 8 Bankr. 230, 233 (Bankr. S.D.N.Y. 1981) (even though a third party guaranteed the suhsequent unsecured credit extension).

369. *In re* Dick Henley, Inc., 45 Bankr. 693, 699 (Bankr. M.D. La. 1985).

370. *See In re* Quality Plastics, Inc., 41 Bankr. 241, 243 (Bankr. W.D. Mich. 1984). The court concluded that the debtor was not legally bound to pay the total rent specified in the lease from the time the lease was signed; rather, he had to pay only when the equipment was used. Therefore, the obligation to pay for postdefault use was not merely substituted for an existing obligation within the meaning of § 547(a)(2). *See supra* note 366; *see also In re* Iowa Premium Serv. Co., 695 F.2d 1109, 1111 (8th Cir. 1982); *In re* Clothes, Inc., 35 Bankr. 489 (D.N.D. 1983), *on remand*, 45 Bankr. 419 (Bankr. D.N.D. 1984); *In re* Mindy's, Inc., 17 Bankr. 177, 179 (Bankr. S.D. Ohio 1982). The *Quality Plastics* court also distinguished *In re* Duffey, 3 Bankr. 263 (Bankr. S.D.N.Y. 1980). The *Duffey* court, without revealing to what use the debtor put a rented automobile, held that the lessor gave no new value by forbearing to repossess the auto after the debtor defaulted on rental, because the forbearance did "not enhance the value of the debtor's estate. The debtor's continued right to drive the rented vehicle is not an asset of benefit to his creditors that could reasonably offset the dimunition of his estate upon payment" of the preference. *Id.* at 266. *In re* Lario, 36 Bankr. 582 (Bankr. S.D. Ohio 1983), held that a lessor of real estate did not give new value under § 547(c)(4) by forbearing to terminate the lease for defaults beginning in June or by consenting to an assignment of the lease for a price, which produced enough to pay the lessor and other creditors in November before bankruptcy. By forbearing to terminate, the lessor was "merely exercising a pre-existing right, not giving 'new value.' " *Id.* at 584. In exchange, the debtor's obligation to pay rent was replaced by an obligation to pay an antecedent debt that was merely an obligation substituted for an existing obligation, excluded from "new value" by § 547(a)(2), *supra* note 366. *Id.*

371. *See In re* Keydata Corp., 37 Bankr. 324, 328-29 (Bankr. D. Mass. 1983); *In re* Thomas W. Garland, Inc., 19 Bankr. 920, 928-29 (Bankr. E.D. Mo. 1982). Prior preferential payments occurred becuase the debtors delivered their checks to the utilities (treated as the time of transfer) approximately a month after the meter was read at monthly intervals (treated as the time the debt was inccured). An analogous case was *In re* Georgia Steel, Inc., 38 Bankr. 829 (Bankr. M.D. Ga. 1984), which regarded the supplying of gas to the debtor after the payment of earlier bills as the giving of new value. Because the debtor's payments were made between meter readings, however, the court held that the utility had not met its burden of showing how much gas had been supplied aftor the payment. *Id.* at 837-41. This same problem seems to be present in *Keydata* and *Garland*, but the courts in both cases placed a value on postpayment service supplied.

Although postpayment services also may be considered new value, one court refused to find any value in the services of a technical expert on leather finishing who was compensated by the debtor's supplier of leather where there was no evidence on the value of the services. Leathers v. Prime Leather Finishes Co., 40 Bankr. 248 (D. Me. 1984). Furthermore, the debtor had not contracted for the services; rather, he only contracted to pay the price of the goods supplied. Therefore, the court held that the services were nothing more "than an incentive gratuity offered to facilitate the sale of [the supplier's] products." *Id.* at 252; *see also In re* Saco Local Dev. Corp., 30 Bankr. 859, 862 (Bankr. D. Me. 1983).

Section 547(c)(4) does not expressly require, unlike old section 60c, that the new unsecured credit[372] remain unpaid at bankruptcy. Most courts nonetheless agree with *In re Bishop*[373] that when the debtor has paid for the new credit, the requirement is preserved by section 547(c)(4)(B), which directs that the debtor make no other unavoidable transfer on account of the new value.[374] This reading apparently also would mean that if a preferential payment was followed by new unsecured credit for which the debtor later paid, and if that payment itself was a voidable preference (or was otherwise avoidable), then the amount of the new credit should be a defense to the recovery of the earlier preference. But not all courts agree with this reading. One court held that unsecured credit that had been repaid before bankruptcy could be invoked, because the "only two exceptions" are those specified in section 547(c)(4)(A) and (B), without considering whether (B) fit the case.[375] Another held that unsecured credit that had been paid

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Although new value is given for actual charges made on the debtor's credit card following preferential payments, no additional new value is given merely because the preferential payments restore an unused portion of the debtor's credit limit on the card. "New credit is extended only when the debtor actually uses the credit line by making purchases or receiving cash advances, since the value of the item purchased or the cash obtained augments the estate for the purposes of distribution to creditors." *In re* Rustia, 20 Bankr. 131, 136 (Bankr. S.D.N.Y. 1982). In another case, new value was given by shipment on unsecured credit of belt buckles custom made for the debtor, which the debtor returned after the bankruptcy petition was filed. *In re* Gander Mountain, Inc., 24 Bankr. 827 (Bankr. E.D. Wis. 1982). The creditor had to melt down the buckles and recast them in order to resell them. The parties had stipulated the value of the buckles for which the creditor was entitled to credit under § 547(c)(4). Nevertheless, the court held that the amount could not be increased by the cost to the creditor of reprocessing the buckles, because § 547(c)(4) required that, after receiving a preference, the creditor "replace[s] part of that diminution [of the estate]" resulting from the preference. *Id.* at 829.

372. *In re* H & S Transp. Co., 45 Bankr. 233, 237 (Bankr. M.D. Tenn. 1984), treated as new value supplied on unsecured credit goods and services that were supplied on credit secured by a statutory maritime lien on a ship. At some undisclosed time, the ship had been sold, and the entire proceeds of sale went to satisfy a senior ship mortgage.

373. 17 Bankr. 180, 183 (Bankr. N.D. Ga. 1982).

374. *See In re* H & S Transp. Co., 45 Bankr. 233, 237 (Bankr. M.D. Tenn. 1984); *In re* Fulghum Constr. Corp., 45 Bankr. 112, 119 (M.D. Tenn. 1984); *In re* Columbia Packing Co., 44 Bankr. 613 (Bankr. D. Mass. 1984); *In re* Quality Plastics, Inc., 41 Bankr. 241, 242 (Bankr. W.D. Mich. 1984); *In re* Keydata Corp., 37 Bankr. 324, 328 (Bankr. D. Mass. 1983); Butz v. Champaign Landmark, Inc., 37 Bankr. 926, 929 (Bankr. S.D. Ohio 1983); *In re* Saco Local Dev. Corp., 30 Bankr. 859, 861 (Bankr. D. Me. 1983). *In re* Strom, 46 Bankr. 144, 149 (Bankr. E.D.N.C. 1985), held that the creditor could invoke a new advance made after the recording of a mortgage that covered future advances because the mortgage was voidable as a preference. The result seems correct, but for a different reason: to the extent of the new advance, the mortgage was not for antecedent debt.

375. *In re* Isis Foods, Inc., 39 Bankr. 645, 653 (Bankr. W.D. Mo. 1984); *see also In re* H & S Transp. Co., 45 Bankr. at 237-39 (allowing the creditor to invoke credit secured by a

might be invoked because, apparently, it regarded a contrary rule to be based on the discontinued "net result" rule.[376] This reading apparently would not preclude recovery under section 547 of later payments made by the debtor on unsecured credit that the creditor extended after an earlier preference.[377]

The prevailing interpretation seems to be the correct one. If the debtor has made payments for goods or services that the creditor supplied on unsecured credit after an earlier preference, and if these subsequent payments are themselves voidable as preferences (or on any other ground), then under section 547(c)(4)(B) the creditor should be able to invoke those unsecured credit extensions as a defense to the recovery of the earlier voidable preference.[378] On the other hand, the debtor's subsequent payments might not be voidable on any other ground and not voidable under section 547, because the goods and services were given C.O.D. rather than on credit,[379] or because the creditor has a defense under section 547(c)(1), (2), or (3). In this situation, the creditor may keep his payments but has no section 547(c)(4) defense to the trustee's action to recover the earlier preference. In either event, the creditor gets credit only once for goods and services later supplied.[380]

But courts that refuse to allow section 547(c)(4) to be invoked for subsequent unsecured credit later paid by the debtor, those that do allow it, and those that have not ruled on the point lose sight of the question when confronted with the following pattern: a preferential payment, followed by an extension of unsecured credit, which in turn is followed by the debtor's additional payments to the creditor. These courts have not inquired whether the later payments were applied to the intervening credit extension, or whether any unpaid balance remained after the earlier preference

statutory maritime lien because § 547(c)(4)(A) is confined to a "security interest." The court did not consider whether the statutory lien involved a "transfer" within the meaning of § 547(c)(4)(B)).

376. *In re* Amex Trading Co., 37 Bankr. 793, 796 (Bankr. W.D. Tenn. 1984).

377. *Id.* at 798.

378. Similarly, if his later credit extensions had been secured but his security interest was voidable, the creditor could invoke those later credit extentions under § 547(c)(4)(A). *See In re* Strom, 46 Bankr. 144 (Bankr. E.D.N.C. 1985).

379. If the creditor gave the goods and services C.O.D., the debtor's payments would not be for antecedent debt under § 547(b)(2).

380. When the creditor is able to invoke the later credit extensions as a defense only under § 547(c)(4), he will get full credit for the extensions only if they do not exceed the amount of the earlier preferences for which they are a defense. Nevertheless, as indicated *infra* text accompanying notes 384-89, any excess of his claim for unsecured credit over the earlier preferences should remain as an unsecured claim in the bankruptcy case.

to which the later payments could have been applied. Instead, they have allowed the intervening credit extensions to be invoked under section 547(c)(4).[381]

My Boston neighbor, bankruptcy Judge Lavien, recently ruled on a question of first impression under section 547(c)(4) in *In re Columbia Packing Co.*[382] Suppose a creditor receives an $8000 payment on a $10,000 antecedent debt that would be a voidable preference, except for section 547(c)(4). Without section 547(c)(4), the creditor would be required by section 502(d)[383] to surrender the $8000 before any part of his claim would be allowed. But if he did surrender the $8000, or if the trustee obtained a judgment compelling him to do so, the creditor would have an allowable claim for $10,000 under section 502(h)[384] and Bankruptcy Rule 3002(c)(3). However, after the receipt of the preference, the creditor extended an additional $5000 in unsecured credit for which he was not paid. Under section 547(c)(4), he then had to surrender only $3000 before his claim would be allowed. But in what amount should the claim be allowed? Counsel for the debtor-in-possession apparently argued that, because the creditor was allowed by section 547(c)(4) to retain $5000 of the $8000 preference, he should have only a $5000 claim on surrender of the $3000 balance of the preference. If that was the argument of counsel for the debtor-in-possession, it ignored the fact that the $5000 subsequent advance was also the basis for a claim. Therefore, the creditor's total claim would be $15,000 unless the $5000 subsequent advance were disallowed because the creditor used it to retain $5000 of his $8000 preference.

That is apparently the way Judge Lavien understood debtor's counsel's argument, since he rejected it because "the creditor would be penalized an additional $5000 on his proof of claim, all for shipping an additional $5000 in goods."[385] Judge Lavien first pointed out that section 547(c)(4), unlike old section 60c, did not expressly use the words "set off;" instead, under section 547(c)(4), "there is simply *no preference* to the extent of" $5000.[386] Second,

381. *See, e.g., In re* Quality Plastics, Inc., 41 Bankr. 241, 242-43 (Bankr. W.D. Mich. 1984); *In re* Isis Foods, Inc., 39 Bankr. 645, 652-53 (Bankr. W.D. Mo. 1984); *In re* Amex Trading Corp., 37 Bankr. 793, 807 (Bankr. W.D. Tenn. 1984); *In re* Saco Local Dev. Corp., 30 Bankr. 871, 872 (Bankr. D. Me. 1983); *In re* Hersman, 20 Bankr. 569, 575 (Bankr. N.D. Ohio 1982); *In re* Thomas W. Garland, Inc., 19 Bankr. 920, 929 (Bankr. E.D. Mo. 1982).

382. 44 Bankr. 613 (D. Mass. 1984).

383. 11 U.S.C. § 502(d)(1982); *see supra* note 101 and accompanying text.

384. 11 U.S.C. § 502(h) (1982); *see supra* note 102 and accompanying text.

385. *Columbia Packing*, 44 Bankr. at 615.

386. *Id.* at 614 (emphasis in original). This point hardly seems dispositive.

he concluded that the creditor on surrender of the $3000 preference had an allowable claim of $10,000—the total credit extended of $15,000 minus the $5000 payment retained under section 547(c)(4).[387] Finally, he concluded that the "claims of creditors are not to be diminished by more than any payment [the creditors] are allowed to retain and for which they have not already given credit."[388] That conclusion must be correct.[389] The creditor's total claim, including that part on which he received a voidable preference, must be reduced by the amount of the preference that section 547(c)(4) allowed him to retain. Otherwise, he could assert a claim for credit that had been paid.

5. The No-Improvement-in-Position Exception

The Gilmore committee's chief concern was reconciling the after-acquired property clause, legitimated and made effective by section 9-204 of the U.C.C., and the preference concept of bankruptcy law. Suppose a creditor makes an advance to the debtor, takes and perfects a security interest in the debtor's presently owned and after-acquired inventory or receivables more than ninety days (or four months under the old Bankruptcy Act) before bankruptcy, and makes no further advances to the debtor. Section 9-203 of the U.C.C. (section 9-204 in the 1962 version) also provides that a security interest cannot attach until, among other requirements, the debtor acquires rights in the collateral.[390] The 1962 version of the U.C.C.—in a provision omitted in the 1972 version—also provided in section 9-204 that the debtor had no rights in an account until the account came into existence.[391] And section 9-303 in both the 1962 and the 1972 versions of the U.C.C. provides that a security interest is perfected when it has attached and

387. At least, I believe that is what he concluded; his opinion is a bit confusing. After discussing the creditor who received an $8000 preference on a $10,000 antecedent debt and then extended $5000 in new credit, Judge Lavien said that when "$3,000 is returned, the original $10,000 is still unpaid and represents the creditor's claim." *Id.* at 615. But then he hypothesized another case in which the subsequent credit was $12,000, bringing the total credit extension to $22,000. Because the entire $8000 preference then might be retained under § 547(c)(4), Judge Lavien said that "the creditor's claim would be the original $10,000 and the $4,000 of the new shipment or $14,000." *Id.*

388. *Id.*

389. Anticipating the problem discussed *supra* note 378, Judge Lavien added that if, subsequent to the last new credit extension, the debtor paid the creditor an additional $4000, the creditor would have to relinquish the payment as a preference because no new credit extension followed it. *Id.* at 615.

390. *See supra* note 328 and accompanying text.

391. U.C.C. § 9-204 (1962) (amended 1972).

the required perfection steps have been taken; moreover, if the perfection steps are taken before the interest attaches, the security interest is perfected when it attaches. If the debtor enters bankruptcy and the secured party claims a security interest in inventory that the debtor acquired, or in accounts that arose, within ninety days of bankruptcy, then isn't the secured party claiming under a transfer that occurred within ninety days of bankruptcy to secure antecedent debt?

The substitution of collateral doctrine[392] offers little comfort. Inventory generally declines over a period of time as the debtor makes sales and then increases abruptly as the debtor replenishes inventory. To conclude that most of the increase would be substantially contemporaneous with the decrease is difficult. Conversely, accounts receivable generally increase as the debtor makes sales during a billing period and then decrease abruptly shortly after the end of the billing period. Again, to conclude that the increase was substantially contemporaneous with the decrease is difficult.

The U.C.C. draftsmen anticipated the timing problem and sought to deal with it in section 9-108. Section 9-108 concerns, as did my hypothetical, a secured party who at the outset makes an advance that is to be secured in whole or in part by after-acquired property. In that situation, section 9-108 provides that the secured party's security interest in the after-acquired collateral "shall be deemed" taken for new value and not as security for antecedent debt if the debtor acquires rights in the after-acquired collateral "either in the ordinary course of his business or under a contract of purchase made pursuant to the security agreement within a reasonable time after the new value is given."[393] In a comment to section 9-108, the draftsmen discuss this remarkable provision but never mention the supremacy clause of the Constitution; instead, the draftsmen carefully and misleadingly explain that "when a transfer is for antecedent debt is largely left by the Bankruptcy Act to state law."[394] A more accurate statement would be that, although state law usually determines when a debt is incurred and when a transfer is made, once state law fixes the time of their occurrence, bankruptcy law determines whether the debt is antece-

392. *See supra* notes 172-79 & 285-93 and accompanying text.

393. U.C.C. § 9-108 (1972). The last clause was apparently an attempt to take care of the enabling lender, who is now better taken care of by § 547(c)(3). *See supra* notes 325-42 and accompanying text.

394. U.C.C. § 9-108 comment 1 (1972).

dent to the transfer.[395] State law, the U.C.C., quite clearly would provide in my hypothetical case that the security interest would not attach until the debtor acquired rights in inventory or in the receivables. The only contribution of section 9-108 would be the argument that inventory or receivables acquired within the ordinary course of the debtor's business should "be deemed" taken for new value, rather than "deemed" given for antecedent debt—the purpose that the secured party intended.

While the Gilmore committee was grappling with the after-acquired collateral problem, two circuit courts of appeals ruled on cases concerning accounts receivable. In *DuBay v. Williams*,[396] the Ninth Circuit concluded under the 1962 version of the U.C.C. that the bankruptcy trustee could not recover after-acquired accounts receivable arising within the then four month preference period because the transfer occurred more than four months before bankruptcy and, thus, by the same token was not for antecedent debt. Although the U.C.C. clearly provided that the security interest could not attach to the accounts until they came into existence within four months of bankruptcy, the U.C.C. did not determine the time of transfer. "Congress itself defined" the time of transfer, "leaving only some details to be brushed in by state law."[397] The court reached this conclusion with express disavowal of any reliance on U.C.C. section 9-108.[398] Instead, the court, by turning upside down the perfection provision of old section 60,[399] which was aimed only at cases in which perfection was delayed, applied the provision to a case in which there was no delay in perfection and the perfection provision had no office to perform. The court read section 60 to say that the transfer was "deemed" made when it was perfected against levying creditors. Because by state law no levying creditor could have defeated the secured party's security interest from the time a financing statement was filed more than four months before bankruptcy, the transfer was made when the statement was filed.[400] If the Ninth Circuit had peered more deeply into state law, it would have found that levying creditors could not reach accounts receivable by garnishing account obligors until the

395. *See* Countryman, *Code Security Interests in Bankruptcy*, 75 COM. L.J. 269, 275 (1970), *reprinted in* 4 U.C.C. L.J. 35, 49 (1971).

396. 417 F.2d 1277 (9th Cir. 1969).

397. *Id.* at 1287.

398. *Id.* at 1289 n.15.

399. *Id.* at 1287-88; *see supra* text accompanying notes 213-23.

400. *Id.* at 1288-89.

accounts came into existence within the four month period. This result would occur not because a financing statement was filed, but for the same reason that the security interest would not attach: the accounts had not come into existence, and no account obligors were available.

The *DuBay* court said its holding was perfectly consistent with two identified policies of old section 60. One policy was to discourage secret liens that "concealed from general creditors the precarious financial condition of the debtor."[401] In *DuBay* the secured party's "floating lien on accounts receivable was easily ascertainable by any creditor who cared to look at the financing statement."[402] The other policy was "to prevent an insistent creditor from harvesting more than his fair share of the insolvent's assets."[403] "[N]o last minute favoritism characterizing true preferences"[404] occurred, however, because the secured party had contracted for favoritism in advance.

In the other case concerning accounts receivable, *Grain Merchants v. Union Bank*,[405] the Seventh Circuit also decided the case under the 1962 version of the U.C.C., also expressly disclaimed any reliance on U.C.C. section 9-108,[406] and reached the same conclusion as *DuBay*. The Seventh Circuit embraced what I have called the *DuBay* court's "Abracadabra, or The Transfer Occurred Before It Occurred" theory.[407]

In addition, *Grain Merchants* advanced two alternative theories. One theory was the "Entity" or "Mississippi River" theory. An ancient metaphysician, Heraclitus, once said, "You can't step twice in the same river," and I believe we can understand what he meant. But a more recent metaphysician, Professor Raymond Henson, argued, "You can step twice into the Mississippi River, and that is good enough."[408] In other words, don't think small; think

401. *Id.* at 1288.

402. *Id.* at 1289. Under U.C.C. § 9-402(3), however, the financing statement need not disclose that after-acquired property is claimed as collateral. Other creditors, or potential creditors, who pursue the inquiry authorized by U.C.C. § 9-208 will not necessarily discover that after-acquired collateral is covered.

403. *Id.* at 1288.

404. *Id.* at 1289.

405. 408 F.2d 209 (7th Cir.), *cert. denied*, 396 U.S. 827 (1969). In this case, the secured party made additional advances within the four month period, but the trustee sought to reach only accounts that came into existence after the last advance.

406. *Id.* at 218.

407. *See* Countryman, *supra* note 395, at 277.

408. Henson, *"Proceeds" Under the Uniform Commercial Code*, 65 COLUM. L. REV. 232, 233 (1965).

big. Don't think about individual accounts or about individual items of inventory; think about only an "entity" called "accounts" or "inventory" without regard to its composition at any given time. If a person can expand his thoughts to that extent, he can persuade himself that the only transfer occurs when the original security agreement was made and perfected. The Seventh Circuit was able to expand its thoughts to that extent. The second alternative theory in *Grain Merchants* was a "Relaxed Substitution" theory. For some reason, which the court did not explain, the fact that U.C.C. section 9-205 had amended state fraudulent conveyance law so that a security interest was no longer fraudulent merely because it permitted the debtor to sell inventory or collect accounts without accounting to the secured party for the proceeds,[409] meant that it was "no longer appropriate to apply strict timing or value rules"[410] of the doctrine of substitution of collateral[411]—a doctrine based entirely on the preference section of the Bankruptcy Act.

DuBay and *Grain Merchants* established that, subject to any prior valid liens on the accounts concerned, the secured party defendants in those cases could take all the accounts they could find at bankruptcy to the extent needed to pay their claims. Some commentators argued that the secured party should be confined to the lowest value of accounts during the preference period because at that low point the substitution of new accounts failed to match the depletion of old accounts.

The Gilmore committee recommended an exception from section 60 that was a compromise between these two positions. The committee proposed that, for accounts and inventory, which typically fluctuate in value, the secured party should not be penalized for nor be allowed to improve his position as a consequence of these fluctuations. If the inventory or accounts "arose in the ordinary course of the debtor's business" and became collateral covered by a security agreement, a perfected transfer of the collateral within four months of bankruptcy would not have been avoidable "except to the extent" that the transferee had "improved his position"[412] because a "deficiency" between the amount of the debt and the value of the collateral four months before bankruptcy was reduced or eliminated at the time of the petition.[413] The test was

409. *See supra* notes 183-84 and accompanying text.
410. *Grain Merchants*, 408 F.2d at 209.
411. *See supra* notes 172-79 and accompanying text.
412. H.R. REP. No. 595, *supra* note 100, at 211.
413. This circumlocution was in recognition that the secured party's position might be

strictly a two-point comparison between the secured creditor's unsecured deficiency four months before bankruptcy and his position at the time of bankruptcy, with no inquiry into variations within the four month period.[414] This proposed rule would have applied whether or not the debtor was insolvent "at any date prior to the . . . filing [of] the petition" and whether or not the creditor "had reasonable cause to believe . . . the debtor was insolvent" at the time of any transfer.[415]

Professor Homer Kripke,[416] who was not a member of the Gilmore committee but who was invited to sit in on its deliberations, still was not satisfied with the exception. He was concerned about four situations in which the collateral improved in value within the four month period: (1) farm crops[417] whose value enhanced upon harvest; (2) work in process[418] transformed into more valuable finished goods; (3) off-season merchandise that reached its seasonal peak in value; and (4) inventory converted into more valuable cash and receivables.[419] Professor Kripke thought that the secured party should "keep the benefit of the improvements in the cases mentioned so long as it was not at the expense of other parties interested in the estate."[420] He recommended amendments to the Gilmore committee proposal to require that, in these four instances, a deficiency should not be "deemed" reduced or eliminated if the secured party paid to the estate the amount by which "portions of the estate not subject to the security interest" were depleted in connection with the improvements in value, and if the secured party paid the amounts of any allowed claims against the estate that arose in conection with the improvements.[421]

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affected either by further extensions of credit or by an increase in the value of collateral. The proposal was designed to allow the secured party the benefit of the former but not of the latter.

414. H.R. Rep. No. 595, *supra* note 100, at 211.

415. *Id.*

416. Professor Kripke, with the late Professor Robert Braucher, codrafted what became tbe 1972 revision of Article 9 of the U.C.C. and they both were invited to participate in the deliberations of the Gilmore committee.

417. The Gilmore committee defined "inventory" to include farm products such as crops or livestock. *See* H.R. Rep. No. 595, *supra* note 100, at 211.

418. Work in process also was included in the committee's definition of "inventory." *See id.*

419. Memorandum of Professor Kripke to all members of the Gilmore committee, September 17, 1970, at 2-4 [hereinafter cited as *Kripke Memorandum*]. A part of this memorandum is reproduced in *Commission Report, supra* note 91, pt. I, at 210. I have a complete copy.

420. *Kripke Memorandum, supra* note 419, at 2-4.

421. *Id.*

The National Bankruptcy Conference did not endorse the Kripke amendments. As I recall, many of us did not regard the entire exception as very important because we felt that, in the typical case, the secured party's unsecured deficiency increased rather than decreased during the preference period; moreover, Professor Kripke had been unable to find a single case involving any of his four situations.[422] I recall also that some of us did not believe that any "transfer" within the meaning of section 60 occurred when an inventory of Christmas tree ornaments increased in value from four months before bankruptcy to the filing of the petition in early December.[423]

Nevertheless, the Bankruptcy Commission did attempt "partially to meet Professor Kripke's criticism." The Commission proposed that if receivables or inventory "arose and became collateral covered by a security agreement within 90 days of bankruptcy," the perfected security interest in the collateral was not voidable "except to the extent that the transferee had improved his position at the expense of the estate" between the earlier of either ninety days before bankruptcy, or the time when new value was first given under the security agreement, and the time of bankruptcy. The trustee had the burden to prove "no improvement in position by an increase in value of security at the expense of estate and the extent thereof."[424] Gone were the Gilmore committee's perhaps not very significant requirement that the inventory and receivables be acquired in the ordinary course of the debtor's business and the committee's distinction between an increase in the value of collateral and an increase in unsecured deficiency. Since the Commission had also recommended creation of a presumption of insolvency for the period ninety days before bankruptcy and elimination of reasonable cause to believe the debtor insolvent for all but insiders in the period one year to ninety days before bankruptcy, the Commission's proposed exception contained no special provisions concerning insolvency or reasonable cause to believe. The proposed exception, however, would not reach insider-creditors in the period one

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422. Professor Kripke argued by analogy, *id.* at 2, from Meinhard Greeff & Co. v. Edens, 189 F.2d 792 (4th Cir. 1951). In this old Chapter X case, the trustee after bankruptcy processed yarn into finished goods and sold the goods. The court held that a creditor with a perfected security interest in the yarn was entitled to the proceeds of sale less the cost to the trustee of finishing the goods. *Id.* at 797.

423. The Minutes of the October 29-31, 1970, annual meeting of the National Bankruptcy Conference, at 7-8, indicate only that the Kripke proposal was not adopted. They do not report or summarize the dehates.

424. *Commission Report, supra* note 91, pt. I, at 208; pt. II, at 167, 172.

year to ninety days before bankruptcy.

The House and Senate committee staffs made some slight changes in the Commission's proposal and cast it in the form in which section 547(c)(5) was enacted.[425] They had in section 547(f) created a presumption of insolvency for the period of ninety days before bankruptcy and had eliminated reasonable cause to believe the debtor insolvent for all but insiders within the period ninety days to one year before bankruptcy. The section 547(c)(5) exception applies to a perfected security interest[426] in inventory or receivables or the proceeds of either arising within ninety days—or one year for insiders[427]—of bankruptcy, except to the extent that the security interest causes a reduction in unsecured deficiency "to the prejudice of other creditors holding unsecured claims"[428] between the later of either ninety days—or one year in the case of an insider—before bankruptcy, or the date on which new value was first given under the security agreement, and the date of bankruptcy. Section 547(a) provides definitions in the form in which they were enacted under which "inventory" is not confined to the U.C.C. notion of "goods" but covers all personal property and includes "farm products such as crops or livestock, held for sale or lease." And "receivables" means "[a] right to payment, whether or not . . . earned by performance," which would cover "accounts," "chattel paper," "instruments," and most "general intangibles" under U.C.C. sections 9-105 and 9-106.[429]

The Committee Reports explain that section 547(c)(5) "codifies the improvement of position test, and thereby overrules such cases as *DuBay v. Williams*[430] and *Grain Merchants of Indiana v. Union Bank* (citations omitted)[431] . . .," although the reports also add that section 547(e)(3),[432] "more than any other in [section

425. H.R. 8200 and S. 2266, *supra* note 254.

426. The 1984 amendments make no change in § 547(c)(5) except that, instead of excepting from § 547 "a transfer of a perfected security interest," the amendments except "a transfer that creates a perfected security interest." 98 Stat. 378 to be codified at 11 U.S.C. § 547(e)(5).

427. Under the 1984 amendment to § 547(b)(4)(B), insiders no longer need to have reasonable cause to believe the debtor insolvent. *See supra* note 115.

428. 11 U.S.C. § 547(c)(5)(1982). Apparently, the secured party has a defense when the only prejudice is to junior secured claims whose collateral is overencumbered so that unsecured creditors would have received nothing from the collateral in any event.

429. "Receivables" under § 547(a)(3) also includes a "contract right" under the 1962 version of U.C.C. § 9-106.

430. *See supra* notes 396-404 and accompanying text.

431. *See supra* notes 405-11 and accompanying text.

432. *See supra* text following note 231.

547], overrules" those cases.[433] The reports further note that the test of section 547(c)(5)

> is a two point test, and requires determination of the secured creditor's position 90 days before the petition and on the date of the petition. If new value was first given after 90 days before the case, the date on which it was first given substitutes for the 90-day point.[434]

So far, section 547(c)(5) has proved to be of as little importance as many supposed it would be.[435] As the Gilmore committee pointed out, "[u]nless there is a deficiency . . . on the first date, there can be no preference" under section 547(c)(5)[436] from the acquisition of more collateral through an after-acquired property clause. But if the secured party receives payments from the debtor during the ninety day period, the secured party also may have to establish that he was fully secured at bankruptcy in order to protect the payments from preference attack.[437] A creditor whose after-acquired property clause picks up inventory or receivables obtained within the ninety day period cannot invoke this exception if his interest in the after-acquired collateral is not perfected because he failed to perfect the basic security interest.[438] Because the exception is confined to "a perfected security interest," section 547(c)(5) is not available to a creditor who garnishes the debtor's wages[439] (which are "receivables" under section 547(a)(3)) within

433. H.R. REP. No. 595, *supra* note 100, at 374; S. REP. No. 989, *supra* note 118, at 88-89.

434. *Id.*

435. *See supra* note 422 and accompanying text; *see also* Ross, *The Impact of Section 547 of the Bankruptcy Code Upon Secured and Unsecured Creditors*, 69 MINN. L. REV. 39 (1984). Section 547(c)(1) receives at least as much attention as it deserves in Breitowitz, *Article 9 Security interest as Voidable Preferences: Part II*, 4 CARDOZO L. REV. 1 (1982).

436. H.R. REP. No. 595, *supra* note 100, at 216.

437. This rule was misapplied in *In re* Lackow Bros., Inc., 19 Bankr. 601, 604-05 (Bankr. S.D. Fla. 1982), *aff'd*, 752 F.2d 1529 (11th Cir. 1985). Because the payments came from the creditor's own collateral, it should have made no difference that the creditor was not fully secured at bankruptcy. If, however, the payments had come from other property of the debtor, they would have been preferential to the extent that the creditor was unsecured at bankruptcy. *See supra* notes 167-71 and accompanying text.

438. *See In re* Ken Gardner Ford Sales, Inc., 23 Bankr. 743, 747 (E.D. Tenn. 1982). In a similar case, *In re* Phillips, 24 Bankr. 712 (Bankr. E.D. Cal. 1982), the court held that taking possession of the debtor's inventory by a state court receiver four days before bankruptcy would not perfect a security interest in the inventory created more than two years earlier. *Id.* at 714. Alternatively, even if the interest were perfected, the delay in perfection converted the security interest into one for antecedent debt. *Id.* And section 547(c)(5) was not available because it was "directed to floating liens that have been perfected outside" the 90 day period. *Id.* at 715. *But cf. In re* American Ambulance Serv., Inc., 46 Bankr. 658 (Bankr. S.D. Cal. 1985).

439. *See supra* note 429 and accompanying text.

the ninety day period.[440] But section 547(c)(5) is concerned with a reduction in deficiency "as of the date of the filing of the petition." Hence, a decision, earlier criticized for using "going concern" value for inventory and accounts of a debtor whose business had ceased and who had been converted from Chapter 11 to Chapter 7 to find no preferential effect under section 547(b)(5), may be on firmer ground in using that value to find no decrease in deficiency under section 547(c)(5).[441]

The most interesting case yet to arise under section 547(c)(5) is *Fairchild v. Lebanon Production Credit Association*,[442] which concerned a security interest given by a farmer-debtor and apparently perfected more than ninety days before bankruptcy, covering "all hogs" and "all offspring." The debtor in possession contended that attachment of the security interest to piglets born within ninety days of bankruptcy constituted a voidable preference. Although the definition of "inventory" in section 547(a)(1) includes "farm products such as . . . livestock, held for sale," the court held that section 547(c)(5) was not applicable because no "transfer" had occurred.[443]

> [A]llowing for gestation, [the creditor's] rights in the entire herd[444] attached

440. *In re* Larson, 21 Bankr. 264, 266 (Bankr. D. Utah 1982). An analogous case was *In re* Jefferson Mortgage Co., 25 Bankr. 963 (Bankr. D.N.J. 1982), in which a bank took and perfected a security interest in a tax refund and proceeds more than 90 days before bankruptcy. The debtor transferred tbe tax refund check to tbe bank four days before bankruptcy. The court held that the bank could not invoke § 547(c)(5) because the tax refund was a "general intangible" under U.C.C. § 9-106 (a tax refund is also a "receivable" under § 547(a)(3)). *Id.* at 967-68. The bank, however, did not need the § 547(c)(5) exception to escape § 547(b) because it's security interest was not voidable and the transfer of the refund to it was not preferential. *Id. But cf. In re* Fitterer Eng'g Assocs., 27 Bankr. 878, 881-82 (Bankr. E.D. Mich. 1983) (holding tbat an attorney's common-law cbarging lien on continuing royalties from settlement of patent infringement litigation was protected by § 547(c)(5) and was not subject to § 552(a) insofar as the lien applied to postpetition royalties, because § 552(a) is confined to security intcrests); *see also In re* Lackow Bros., Inc., 19 Bankr. 601 (Bankr. S.D. Fla. 1982), *aff'd*, 752 F.2d 1529 (11th Cir. 1985).

441. *In re* Lackow Bros. Inc., 752 F.2d 1529 (11th Cir. 1985). *But see supra* note 166.

442. 31 Bankr. 789 (Bankr. S.D. Ohio 1983).

443. *Id.* at 794 (emphasis in original).

444. The Compact Edition of the Oxford English Dictionary (1971) defines a "herd" as "a company of domestic animals of one kind." But, although I lived in my early years on a California ranch where one of my duties was to feed to a company of pigs all peaches and melons too ripe to ship, never before have I heard of a "herd" of pigs or hogs. Neither, I learned through the good offices of my colleague and collaborator, Zipporah Wiseman, had Professor Sarah Redfield, former Deputy Commissioner of the Maine Department of Agriculture, nor I. SPARKS, DICTIONARY OF COLLECTIVE NOUNS AND GROUP TERMS (1978). Sparks suggests, as did Professor Redfield, a "drift" of hogs. Sparks also suggests a "drove," a "flock," and a "sounder." But the learned Articles Editor of this review advises me that "herd of pigs" is in common usage in Texas, where he grew up. He also advised me to

> prior to the preferential period and any increase in the herd's value was 'merely' an increase in the value of the collateral in which [the creditor's] interest had previously attached . . . . [Section] 547(c) is only applicable as an *exception* to . . . § 547(b). In this case, there was no transfer during the preference period, and . . . § 547(b) is thus not dispositive.[445]

The debtor in possession's futile preference attack, however, apparently was based solely on the increase in number of the pig population during the ninety day period. He did not raise the classic "fat pig" case, with which bankruptcy lawyers have long amused themselves, by asserting that unmortgaged feed had been fed (transferred?)[446] to, had fattened, and had increased the value of the entire pig population.[447] If the court had found a "fat pig" transfer, it would then have had to inquire whether the value of collateral had increased, and thereby had reduced the unsecured deficiency "to the prejudice of other creditors holding unsecured claims" within the meaning of section 547(c)(5).

Because section 547(c)(5) is confined to inventory and receivables, as defined in section 547(a), and their proceeds, there has been some speculation whether courts disposed to follow *DuBay*[448] and *Grain Merchants*[449] for other types of collateral are still free to do so.[450] The answer, I believe, is that section 547(c)(5) is merely a special dispensation for inventory, receivables, and their proceeds from other provisions in section 547 by which the draftsmen intended to overrule those decisions. The provision in section 547(e)(3) that, "for the purposes of" section 547, a transfer "is not made until the debtor has acquired rights in the property trans-

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consult the King James version of the Bihle, Mark 5:11: "Now there was there nigh unto the mountains a great herd of swine feeding." The Oxford English Dictionary lists "swineherd" as a term no longer in colloquial use but meaning, when used, either "a man who tends swine" or "a boar, he being the head or master of the herd." A friend of the Articles Editor from Alabama suggests a "passle" of pigs, but O.E.D. does not recognize the existence of such a word. This matter needs more research.

445. In the 1962 version of the U.C.C., § 9-204(2)(a) provided that the debtor "has no rights . . . in the young of livestock until they are conceived." That provision was dropped in the 1972 revision of Article 9.

446. Under 11 U.S.C § 101(48), "transfer" means "every mode, direct or indirect, . . . of disposing of or parting with property or with an interest in property. . . ."

447. *See* Hogan, *Games Lawyers Play with the Bankruptcy Preference Challenge to Accounts and Inventory Financing*, 53 CORNELL L. REV. 553, 558-59 (1968). Because my other colleague and collaborator, Andrew Kaufman, is as good at identifying nondistinguishable cases as at distingnishing others, the "fat pig" becomes a "fat steer" in COUNTRYMAN, KAUFMAN, & WISEMAN, *supra* note 161 at 273.

448. *See supra* notes 396-404 and accompanying text.

449. *See supra* notes 405-11 and accompanying text.

450. At least such speculation goes on in some law school classrooms. *See* COUNTRYMAN, KAUFMAN, & WISEMAN, *supra* note 161, at 288-89.

ferred," certainly should dispose of the "Abracadabra" or "The Transfer Occurred Before It Occurred" theory invoked in both cases and should dispose of the Seventh Circuit's "Entity" or "Mississippi River" theory as well. And the Seventh Circuit's "Relaxed Substitution" theory should not survive section 547(c)(1) if that provision is recognized, as I believe it should be,[451] as a codification of the substitution theory.[452] In any event, the "Relaxed Substitution" theory should self-destruct on its own stated but unexplained assumption that a change in state fraudulent conveyance law somehow changes federal preference law.

6. The Statutory Lien Exception

The old Bankruptcy Act after 1952 and 1966 amendments, in section 67c provided for either the subordination or the invalidation of certain statutory liens as defined in section 1(29a).[453] The Act also provided in section 67b that, notwithstanding section 60, "statutory liens in favor of employees, contractors, mechanics, or any other class of persons, and statutory liens for taxes and debts owing to the United States" or any state or local subdivision "may be valid against the trustee, even though arising or perfected while the debtor is insolvent and within four months" of bankruptcy.[454]

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451. *See supra* notes 285-93 and accompanying text.

452. A substitution problem similar to that of the pig or steer fattened by unmortgaged feed exists for one type of after-acquired collateral—proceeds—whether the original collateral is inventory, receivables, or something else. When the conversion to proceeds occurs within the preference period before bankruptcy, the substitution of proceeds for the original collateral is simultaneous, but the value of the proceeds may exceed the value of the original collateral. Moreover, the increase in value, although it is "proceeds" within the meaning of U.C.C. § 9-306(1) as "whatever is received on disposition of the original collateral," also may be the product of unmortgaged raw materials, capital, labor, rent, and managerial skills. If the original collateral were inventory, receivables, or the proceeds of either, some "prejudice" may occur to unsecured creditors within the meaning of § 547(c)(5). If the original collateral were something else, the substitution theory would not save the increase in value. *See* Countryman, *supra* note 395, at 272-74.

453. "Statutory lien" shall mean a lien arising solely by force of statute upon specified circumstances or conditions, but shall not include any lien provided by or dependent upon an agreement to give security, whether or not such a lien is also provided by or is also dependent upon statute and whether or not the agreement or lien is more fully effective by statute. 80 Stat. 268 § 1(29a) (1966). This definition was inspired by an effort to prevent "a recurrence of the misapplication" that occurred when one court held that a chattel mortgage was a statutory lien, apparently because a state statute provided for its perfection, *In re* Quaker City Uniform Co., Bankr. L. Rep. (CCH) ¶ 58,278, although that opinion was later withdrawn and the decision placed on another ground. 238 F.2d 155 (3d Cir. 1956), *cert. denied*, 352 U.S. 1030 (1957). *See* H.R. Rep. No. 686, 89th Cong., 1st Sess. 5 (1965); S. Rep. No. 277, 89th Cong., 1st Sess. 6 (1965).

454. 80 Stat. 268 § 67b (1966). Before the statutory definition was supplied in 1966,

The Gilmore committee did not concern itself with statutory liens, but the Bankruptcy Commission proposed to invalidate most statutory and common-law liens in bankruptcy because recognition of them "substantially frustrates the goals of equality and uniformity, and has generated a substantial amount of litigation and made the Act considerably more complex."[455] For the few liens that would survive, the Commission proposed an exception in the preference section for "a statutory or common-law lien not invalid" under the Commission's other proposal, or "a transfer in satisfaction of such a lien."[456] The Commission's proposal would have invalidated the federal tax lien[457] in bankruptcy, and the Commission also proposed to reduce the priority given to tax claims.[458] The Treasury Department, in response to the Commission's inquiries, had professed to be unable to determine the effect of the Commission's proposals on the federal fisc. Nevertheless, the Commission concluded that, because the Treasury projected annual collections under the existing system of $5.6 million on liens and $31.6 million on priorities, the effect would be "insignificant for the federal government."[459]

The Treasury Department and the Tax Division of the Department of Justice opposed the Commission's proposals, explaining that the IRS was a "nonconsensual creditor" similar to one hit by the debtor's truck (some may feel the analogy was reversed), which had no option but to become a creditor. By now the IRS had

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the court in *In re* Tele-Tone Radio Corp., 133 F. Supp. 739, (D.N.J. 1955), invoked some of the language of § 67b to conclude that a factor's lien was not a statutory lien subject to subordination under § 67c even though a state statute authorized the parties to create such a lien by written agreement. "The familiar doctrine of *ejusdem generis* here applies, i.e., that such 'other classes of persons' must be similar to the classes specifically named. But financiers are not similar to the classes named, i.e., employees, contractors, mechanics, or landlords [landlords were delated in 1966]. . . .[F]inanciers are merely ordinary creditors." *Id.* at 747.

455. *Commission Report, supra* note 91, pt. I at 212; pt. II at 164-66.

456. *Id.* pt. I at 166, 170.

457. I.R.C. §§ 6321-6323 (1982).

458. *Commission Report, supra* note 91, pt. II at 110.

459. *Id.* pt. I at 216, 233-35.

In 1973, the year of the Commission's report, total federal gross revenue collection was $237.8 billion. 1973 COMM'R OF INTERNAL REVENUE ANN. REP. at v. A Brookings Institution study of bankruptcy liquidation cases closed in 1964 had estimated that the tax priority had produced $5.8 million for the IRS, slightly more than 0.005% of the total gross revenue of $112.3 billion for 1964. At the same time, the tax priority amounted to 11% of all funds distributed in liquidation cases in 1964 and to almost one-third of the amount paid to unsecured creditors in those cases. D. STANLEY & M. GIRTH, BANKRUPTCY: PROBLEM, PROCESS, REFORM 131 (1971) (I was a consultant on this study).

revised the projections for collections under the existing priority system to $11.5 million for cases commenced in 1974, $15.5 million for 1975, and $17 million for 1976. But on the proposed elimination of the statutory lien they now had no projections and asserted only that the proposal could "be expected to reduce recovery of unpaid taxes from the assets of a bankruptcy estate." Their only other contribution to intelligence was that, while gross revenues were $293.8 billion in 1975, after refunds net revenues were about $250 billion. But when a subordinate conceded that the total collections under the existing priorities were "infinitesimal," the Commissioner of Internal Revenue objected to that term, even though he conceded that the total was "small, in relation to what we collect."[460]

Nonetheless, the congressional staff rewrote, as section 545[461] in the form of enactment, a provision that authorized avoidance of some statutory liens defined in section 101(45)[462] but that did not on its face appear to invalidate the federal tax lien.[463] The staff also drafted an exception to section 547 in section 547(c)(6) for a transfer "that is the fixing of a statutory lien that is not avoidable under section 545" or a transfer "in satisfaction of such a lien."[464] The draftsmanship was not superb, because it provided that if the trustee could invalidate a statutory lien under section 545, he also might attack the lien as a preference under section 547 and thus impose a double-kill. Nevertheless, the purpose of section 547(c)(6) was fairly clear. Having stated in section 545 the grounds on which statutory liens would be avoidable, the draftsmen did not intend the liens to be subject to a second scrutiny under section 547. The Committee reports explain that section 547(c)(6) "excepts statutory liens validated under § 545 from preference attack."[465]

Section 547(c)(6), therefore, exempts from section 547 a hospi-

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460. *Bankruptcy Act Revision: Hearings Before Subcomm. on Civil and Constitutional Rights of the House Judiciary Comm. on H.R. 31 and H.R. 32,* 94th Cong., 2d Sess. 1944-45, 1951-52, 1953, 1990, 1995-96 (Apr. 2, 1976); *The Bankruptcy Reform Act: Hearings Before Subcomm. on Improvements in Judicial Machinery of the Senate Judiciary Comm. on S. 235 and S. 236,* 94th Cong., 1st Sess. 782-83, 790, 795-97 (Nov. 6, 1975).

461. The 1984 amendments to § 545 made no changes relevant here.

462. The definition in § 101(45) is heavily indebted to the former definition, *supra* note 453, but is more explicit in excluding judicial liens defined in § 101(30) and security interests defined in § 101(42) and § 101(43).

463. As indicated *infra* notes 512-20 and accompanying text, the federal tax lien nonetheless may be in some jeopardy under § 545.

464. H.R. 8200 and S. 2266, *supra* note 254. In H.R. 8200, this provision was § 547(c)(7), but § 547(c)(6), which conerned setoffs, was deleted prior to enactment.

465. H.R. REP. No. 595, *supra* note 100, at 374; S. REP. No., *supra* note 118, at 88.

tal's statutory lien, valid under section 545 on damages received by a patient who had been injured in an accident.[466] Courts have reached the same result for a statutory attorney's lien[467] and a statutory lien on a condominium unit for the debtor-owner's share of common expenses.[468] In another case, a state statute required that state tax refunds be paid to a county to which the taxpayer-debtor was obligated because his spouse or ex-spouse, in order to qualify for aid to families with dependent children, had assigned her rights under a child support order to the county.[469] The court held that the statute created a statutory lien valid under section 545 and exempt from section 547 under section 547(c)(6).[470] Another case concerned a state tax lien created by statute under which the lien was not effective until a restraint warrant was docketed with a court clerk in the manner that judgments were docketed.[471] The court held that when the warrant was docketed before bankruptcy the lien was not a judicial lien but a statutory lien exempted by section 547(c)(6) because it was "a lien arising solely by force of statute on specified circumstances or conditions" within the meaning of section 101(45).[472]

In all but two of these section 547(c)(6) cases,[473] the trustee or debtor was seeking to recover payments made to the creditor within ninety days of bankruptcy in full or partial discharge of the lien. As section 547(c)(6) was originally enacted in both houses, it covered not only statutory liens valid under section 545 but also transfers "in satisfaction of such a lien."[474] In the compromise between the House and Senate without a conference committee, the

466. *See In re* Howard, 43 Bankr. 135, 139 (Bankr. D. Md. 1983).

467. *See In re* Territo, 35 Bankr. 353, 345 (Bankr. E.D.N.Y. 1983).

468. *See In re* Stern, 44 Bankr. 15, 19-20 (Bankr. D. Mass. 1984).

469. *See In re* Small, 18 Bankr. 318 (Bankr. D. Minn. 1982).

470. *Id.* at 319. An analogous case was *In re* Biddle, 31 Bankr. 449 (Bankr. N.D. Iowa 1983), which conerned a similar provision in I.R.C. § 6402 (1982) that authorizes the IRS to divert federal tax refunds to states to which the taxpayer's uncollected child support obligations had been assigned. The court held that § 6402 created a statutory lien that was effective more than 90 days before bankruptcy, and therefore was not avoidable under § 547. 31 Bankr. at 457. If the lien was a statutory lien not avoidable under § 545, however, the lien would be exempt from § 547 under § 547(c)(6), even though it arose within 90 days of bankruptcy. *Id.* at 457 n.13.

471. *In re* E.W. Shields, Co., 34 Bankr. 44 (Bankr. D. Or. 1983).

472. *Id.* at 46; *see also Stern*, 44 Bankr. at 18 (concluding that the lien on condominium units was statutory rather than judicial, although enforced by, and with a priority established by, a judicial action).

473. *In re* Howard, 43 Bankr. 135; *In re* Stern, 44 Bankr. 15.

474. H.R. 8200 and S. 2266, *supra* note 254.

quoted language was dropped without explanation.[475] Section 545 prescribes only the circumstances under which the trustee can avoid the "fixing of a statutory lien," and its predecessor, old section 67c, prescribed the circumstances under which the trustee could avoid "statutory liens." Old section 67c(5), however, provided that section 67c did "not apply to liens enforced by sale before the filing of the petition." The Committee reports explain that the trustee may avoid under section 545 "a transfer of a lien under this section even if the lien has been enforced by sale before the commencement of the case. To that extent, Bankruptcy Act section 67c(5) is not followed . . . ."[476] I have never been sure that the draftsmen of section 545 successfully embodied in it the opposite of old section 67c(5) simply by omitting the language of section 67c(5). But, even if they have, and the trustee can avoid a statutory lien under section 545 when the lien has been enforced by sale before bankruptcy, does it follow that, if section 545 does not apply, the exemption in section 547(c)(6) from section 547 for "the fixing of a statutory lien" extends also to payments received in enforcement of the lien?[477]

In the cases discussed above in which the creditor had received payments in discharge of the lien, the difference between the "fixing" of a statutory lien under section 547(c)(6) and payments in discharge of the lien that the trustee or debtor was trying to recover was ignored. On the facts, however, the cases reached the correct result on the payments even if section 547(c)(6) does not extend to the payments. In every case the statutory lien was not avoidable under section 545.[478] The payments received came from property covered by the lien, so that there was no preferential effect under section 547(b)(5) and no exception under section 547(c) was necessary.[479] The result should be the same if the value of the property covered by the valid lien was sufficient to secure

475. *See* 124 CONG. REC. 23,400, 34,000 (1978).

476. H.R. REP. No. 595, *supra* note 100, at 371; S. REP. No. 989, *supra* note 118, at 85.

477. Even if § 547(c)(6) does not apply, a payment in exchange for release of a valid statutory lien may qualify as a contemporaneous exchange under § 547(c)(1). *See In re* George Rodman, Inc., 39 Bankr. 855 (W.D. Okla. 1984).

478. If a statutory lien is not perfected at bankruptcy against a bona fide purchaser, it could be avoided under § 545(2), unless the law creating the lien also gives a grace period for perfection, good against intervening interests, which has not expired at bankruptcy. The liener could still perfect before the grace period expired pursuant to § 546(b). *See In re* Storage Technology Corp., 45 Bankr. 363 (Bankr. D. Colo. 1983), and *supra* text accompanying notes 232-36.

479. *See supra* notes 167-69 and accompanying text.

the creditor's full claim, regardless of the source of payment.[480] But, under the *Benedict v. Ratner* two-step,[481] the result should be different if the statutory lien, although immunized from section 547 by section 547(c)(6) because not voidable under section 545, was voidable on some other ground.[482] The result also should be different when a valid statutory lien only partially secures the creditor's claim, and the creditor receives payment from property of the debtor not covered by the lien.[483]

I have isolated for separate treatment the ubiquitous federal tax lien, although much of the discussion applies also to state tax liens. Under section 6321 of the Internal Revenue Code (IRC),[484] if any person "liable to pay any tax neglects or refuses to pay the same after demand," the amount of the tax plus interest, penalties, and costs "shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person."[485] This lien "arises" at the time of assessment[486] and continues until the amount assessed "is satisfied or becomes unenforceable by reason of lapse of time."[487] But under IRC section 6323,[488] the tax lien is not valid against a purchaser, a holder of a security interest, a mechanics' lienor, or a judgment-

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480. *See supra* notes 154-58 and accompanying text.

481. *See supra* notes 180-185 and accompanying text.

482. A statutory lien, although valid under § 545, is not immunized from the trustee's avoiding powers under § 544 or § 548.

483. *See supra* notes 170-71 and accompanying text.

484. I.R.C. § 6321 (1982).

485. The lien reaches after-acquired property of the taxpayer, *see* Glass City Bank v. United States, 326 U.S. 265, 268 (1945), and property generally exempt from creditors' process by state or federal law, *see* United States v. Bess, 357 U.S. 51, 57 (1958); however, if the lien is enforced by IRS administrative levy, a niggardly list of exemptions from that levy in I.R.C. § 6334 (1982) may apply.

486. I.R.C. § 6322 (1982). When the taxpayer files a return acknowledging tax liability, the tax is "assessed" when the acknowledge liability is recorded on a list at the District Director's Office. *Id.* § 6203. A deficiency assessment is made when a taxpayer's return has been audited and he has agreed to an adjustment. If the taxpayer does not agree with the deficiency determination, the deficiency assessment is made after the taxpayer has exhausted his administrative remedies and either has disregarded a notice advising him that the assessment will be made unless he files a petition with the Tax Court within 90 days, or has lost in the Tax Court and the decision of that court has become final. *See id.* §§ 6211-6215. The IRS, however, may avoid delays in making the deficiency assessment by a jeopardy assessment made at any time the IRS believes the assessment or collection will be jeopardized by delay. *Id.* § 6861.

487. *Id.* § 6322. The basic statute of limitations on collection of taxes is six years after assessment under I.R.C. § 6502, but a variety of circumstances may extend the time. *See* W. PLUMB, FEDERAL TAX LIENS 49 (3d ed. 1972), which should be consulted by anyone with a federal tax lien problem.

488. I.R.C. § 6323 (1982).

lien creditor unless filed. From the date of bankruptcy, the bankruptcy trustee has under section 544(a)[489] the hypothetical status of a creditor with a judicial lien (which includes under section 101(30) a judgment lien) on all the debtor's property that is subject to a judicial lien and the hypothetical status of a bona fide purchaser of the debtor's real property. Therefore, the trustee can avoid under section 544(a) federal tax liens unfiled at bankruptcy.[490]

The federal tax lien first was considered under new section 547 in a Chapter 7 case[491] in which the lien was filed before bankruptcy and the government had received no payments on the tax claim. The court concluded without difficulty that section 724(b) required that the lien in Chapter 7 cases be subordinated to the first five priorities for unsecured claims.[492] The cases are more complicated, however, when the IRS within ninety days of bankruptcy has received a payment on its claim. In another Chapter 7 case,[493] the IRS had not filed its lien for delinquent taxes, but the taxpayer-debtor made a partial payment on the delinquent taxes within ninety days of filing a petition by liquidating all of its business assets. The court ruled that the unfiled lien was not valid against a bona fide purchaser, a judgment lien creditor, or the bankruptcy trustee.[494] The court did not indicate, however, whether it relied on section 544(a) or on section 545(2), which enabled the trustee to avoid a statutory lien that was not perfected against a bona fide

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489. 11 U.S.C. § 544(a)(1982).

490. The trustee's avoidance power is subject to the possibility of a very large exception. As indicated in note 219 *supra*, but apparently unknown to the draftsmen of I.R.C. § 6323, no judgment lien exists in Kentucky, Michigan, or, with two exceptions in the New England states. Where the judgment lien does exist, with three exceptions it extends only to realty and not to personal property. By Treas. Reg. § 301-6323(h)-1 (1976), the IRS has attempted to define "judgment lien creditor" to mean a lien by levy, when a levy is necessary before a lien on personal property becomes effective against third parties. The bankruptcy trustee also has the hypothetical status of a creditor who obtains a lien by levy. *See* 11 U.S.C. §§ 101(30), 544(a)(1)(1982).

491. *In re* Riverfront Food & Beverage Corp., 29 Bankr. 846 (Bankr. E.D. Mo. 1983).

492. *Id.* at 851-52; *see supra* notes 124-25 and accompanying text. In *In re* Debmar Corp., 21 Bankr. 858 (Bankr. S.D. Fla. 1982), the IRS had filed its lien more than 90 days before bankruptcy and, within the 90 day period, levied on obligors of the taxpayer debtor. The court found that considering the application of § 724(b) was unnecessary because no one showed either that any claims were present within the first five priorities or that the state was insolvent. *Id.* at 862; *see also In re* Community Hosp., 15 Bankr. 785, 788 (Bankr. S.D.N.Y. 1981).

493. *In re* K & L Interiors, Inc., 34 Bankr. 118 (Bankr. D. Or. 1982).

494. *Id.* at 119.

purchaser when the petition was filed.[495] Although the court observed that payment "extinguishe[d] the assessment lien to the extent of such payment," it failed to note that no assets remained to which the lien could attach, except for the unlikely possibility that the bankrupt corporation would acquire some assets in the future.[496] The court also rejected the IRS's argument that the payment "fixed" the lien within the meaning of section 547(c)(6) and concluded that filing was required to "fix" the lien.[497] Because no valid lien existed, the payment was "nothing more than a payment to an unsecured creditor within 90 days before bankruptcy on an antecedent debt" and was recoverable under section 547(b).[498]

So far, so good. But the trustee, against the possibility that the court might agree with the IRS that the debtor's payment had "fixed" the tax lien within the meaning of section 547(c)(6), argued that the trustee should nonetheless be entitled to recover enough of the payment to cover claims with the first five priorities for which section 724(b) provided that tax claims secured by a lien on "property in which the state ha[d] an interest" would be subordinated.[499] The court did not need to consider this problem because it had held that the trustee could avoid the lien. But, assuming the lien had been valid but reduced by the amount of the payment, and because no other property remained in the estate, the court concluded: "Payment on a tax lien is payment to a secured creditor and is not recoverable by the trustee as a preference, nor is it recoverable for distribution purposes under Section 724(b) as the estate no longer had any interest in it as required by such section."[500]

In the court's conclusion lies much confusion about section 724(b). Because the test of preferential effect under section 547(b)(5) is whether the creditor gets more than he would have in a Chapter 7 distribution if the payment had not been made, it is

495. The 1984 amendments to § 545(2), substituting "the time of the commencement of the case" for "the date of the filing of the petition," made no substantial change. 98 Stat. 333, 377 (1984). Under §§ 301-03, a case is commenced by filing a petition.

496. *K & L Interiors*, 34 Bankr. at 118.

497. *Id.* at 119.

498. *Id.* Perhaps the full amount of the payment was not recoverable. Under § 507(a), as it then read, the IRS tax claim, even though unsecured, was entitled to a sixth priority with other tax claims. If the unsecured claims with the first five priorities (the amount of many of which had not yet been determined) did not consume the total amount of the payment to the IRS, the IRS would retain its pro rata share of the balance with other sixth priority tax claims.

499. *Id.* at 119.

500. *Id.* at 119.

no longer completely true that "[p]ayment on a tax lien is payment to a secured creditor and is not recoverable by the trustee as a preference" even if the creditor is fully secured—the IRS was not—or even if the payment is from the secured creditor's collateral—the payment was. Without the payment to the IRS, even if its lien were valid, the proceeds of the sale of the debtor's business in a Chapter 7 case, by virtue of section 724(b), would have been applied first to unsecured claims within the first five priorities.[501] Moreover, the court assumed that if the lien was valid, it had been extinguished as to the proceeds from the sale of assets by the payment of those proceeds to the IRS. Consequently, the lien no longer remained on property in which the estate had an interest as required by section 724(b). This court, like other courts,[502] made the mistake of ignoring the direction in section 547(b)(5) that courts test for preferential effect by calculating what the Chapter 7 distribution would be if the payment had not been made. Because the court disposed of the trustee's argument under section 724(b) by assuming that if the lien were valid the payment would not have preferential effect, it did not address whether, if a payment that had preferential effect, it, as well as the "fixing" of the lien, was excepted from section 547 by section 547(c)(6).

In a later case[503] before the same judge and again under Chapter 7, the IRS had filed its lien more than ninety days before bankruptcy. Within the ninety day period, the IRS levied on and sold all of the debtor's assets and collected all of its collectible accounts receivable in order to satisfy the liens. If the payments had not been made, then the amount of claims entitled to the first five priorities would have prevented the IRS from receiving anything in a distribution pursuant to section 724(b). The court recognized that the filed tax lien would have been exempted from section 547 by section 547(b)(6) but followed its earlier example of ignoring section 547(b)(5)'s direction that the court decide the preference question as if the payment to the IRS had not been made. Again, the court concluded that, because application of the proceeds of the sale and collection by the IRS had extinguished the lien and left the debtor without any interest in those proceeds, section

501. *See supra* notes 124-25 and accompanying text. The court's statement is also wrong if applied to a lien securing a fine, penalty, or forfeiture, or for multiple, exemplary, or punitive damages, to the extent that the claim is not compensation for actual pecuniary loss. Under § 724(a), these liens are avoidable in Chapter 7 cases. 11 U.S.C. § 724(a)(1982).

502. *See supra* notes 165, 171 and accompanying text.

503. *In re* Rogers Refrigeration, Inc., 33 Bankr. 59 (Bankr. D. Or. 1983).

724(b) was inapplicable.[504] Again, the court did not address whether, if the payment were preferential, section 547(c)(6) would exempt the payment as well as the fixing of the lien.

Much of the confusion engendered by these two cases was dissipated in *In re R&T Roofing Structures & Commercial Framing, Inc.*,[505] another Chapter 7 case. The IRS had filed its lien more than ninety days before bankruptcy, but within the ninety day period had levied upon cash, which was the only asset of the debtor's estate, and applied the cash in partial payment of the tax-lien claim. Once again, claims within the first five priorities exceeded the amount of cash that the IRS seized. Although the court viewed section 547(c)(6) as exempting the filed tax lien from section 547, it concluded from the legislative history of the deletion of transfers "in satisfaction of such a lien" from section 547(c)(6)[506] that section 547(c)(6) would not also exempt the IRS levy.[507] If the levy had not been made, section 724(b) would have subordinated the tax lien, although valid, to priority claims exceeding the amount of the cash that the IRS seized. The seizure, therefore, gave the IRS "far more than [it] could have otherwise hoped to receive under a Chapter 7 liquidation," and thus had a preferential effect under section 547(b)(5).[508]

The result in *R&T Roofing* is consistent with the preference policy to avoid transfers within the ninety day period that distort the Chapter 7 distribution scheme.[509] If the IRS had received no payment, either by levy or by the debtor's payment without levy, within the ninety day period, its lien would have been subordinated to the first five priorities by section 724(b), even though exempt from section 547 by virtue of section 547(c)(6). The Chapter 7 distribution is the test of preferential effect under section

504. *Id.* at 60-61.

505. 42 Bankr. 908, 915 (Bankr. D. Nev. 1984).

506. *See supra* notes 474-77 and accompanying text.

507. *R & T Roofing*, 42 Bankr. at 915.

508. *Id.* The court did observe, however, that its conclusion "might be different if the trustee and his counsel were merely attempting to retrieve the property for the sole purpose of creating a fund for their own [first priority] fees." *Id.* at 915-16. Fourth priority claimants, however, were seeking contributions to employee benefit plans in excess of the amount seized by the IRS. *Id.* at 916.

509. Another case consistent with the preference policy was *In re* Thomas W. Garland, Inc., 39 Bankr. 412 (Bankr. E.D. Mo. 1984). The IRS levied on a debtor, not because he was the taxpayer whom the IRS was pursuing, but because he was obligated to that taxpayer. The court held that any IRS statutory tax lien would not be on property of the debtor but on property of the taxpayer; therefore, neither § 545 nor § 547(c)(6) was applicable. *Id.* at 415.

547(b)(5), which courts are to administer as if the payment had not been made. Although *R&T Roofing* was a Chapter 7 case, the test of preferential effect under section 547(b)(5) still would be what the IRS would have received without the payment in a Chapter 7 case even if the preference action arose in a Chapter 11 or 13 case.

Nevertheless, section 547(c)(6) can be of value to the IRS. Under section 547(a)(2), the taxpayer's debt for taxes is incurred on the last day on which the debt is payable without penalty. Typically, the tax lien is filed much later than that date. Also, the lien usually is filed much more than ten days after the date of assessment; consequently, under section 547(e)(2) the transfer occurs for purposes of section 547 when it is filed. Nearly all tax liens filed within ninety days of bankruptcy therefore would be in jeopardy under section 547 were it not for section 547(c)(6)'s exception from section 547. For this great boon to the IRS, the price is subordination to the first five[510] priorities under section 547(a).

But to survive bankruptcy any statutory lien must not be avoidable under section 545. This requirement may pose a special hurdle for the federal tax lien and for state tax liens modeled after the federal lien. As already indicated, when sections 544(a)(3), 547(e)(1), 548(d)(1), and 549(c) employ a bona fide purchaser test of transfers, the test is a "bona fide purchaser against whom applicable law permits such transfer to be perfected," and the purpose of the quoted qualifying language is to avoid requiring the impossible of the transferee.[511] Section 545(2), however, authorizes the trustee to avoid a statutory lien not perfected at bankruptcy against a bona fide purchaser,[512] and the qualifying language is omitted.

Moreover, applicable law does not permit the tax lien to be perfected against certain types of purchasers and holders of security interests.[513] Under IRC section 6323(b), the tax lien, even though filed, is not valid against bona fide purchasers of certain kinds of property, such as securities, motor vehicles if the purchaser takes possession, or any tangible personal property if the

510. A tax lien may become subordinated to the first six priorities of § 547(a). *See supra* note 125.

511. *See supra* notes 224-29 and accompanying text.

512. This is true unless the law creating the lien gives the lienor a greater period of perfection that has not expired at bankruptcy. *See supra* note 478.

513. A holder of a security interest is also a "purchaser" under § 545 because § 101(35) defines "purchaser" as a "transferee of a voluntary transfer." 11 U.S.C. § 101(35)(1982).

purchaser is a retail purchaser in the ordinary course of the taxpayer's business.[514] Under section 6323(c), the filed tax lien is also invalid against certain types of security interests in certain types of property (e.g., inventory, accounts receivable, negotiable instruments) acquired under an after-acquired property clause without actual notice of the tax lien within forty-five days of tax lien filing on account of advances made within that period.[515] Finally, under section 6323(d), the filed tax lien is invalid for any kind of property owned by the taxpayer at the time of tax lien filing against a security interest in that property, acquired under an after-acquired property clause without actual notice or knowledge of the tax lien on account of advances made within forty-five days of tax lien filing.[516]

Other evidence shows that the draftsmen of section 545 intended to require the impossible of the federal tax lien. Section 522(c)(2)(B) provided that the debtor's exempt property remained subject to liens that were not avoided and to "a tax lien, notice of which [was] properly filed, and avoided under section 545(2)."[517] Apparently the impossible was to be required of the federal tax lien only for the benefit of other creditors and not for the benefit of debtors. But section 522(c)(2)(B) clearly recognized that a properly filed tax lien might be avoided under section 545(2). That effect remains even though a 1984 amendment to section 522(c)(2)(B) deleted the language "and avoided under § 545(2)." Moreover, the floor managers of the Reform Act explained that "a Federal tax lien is invalid under section 545(2) with respect to property specified in sections 6323(b) and (c) of the Internal Revenue Code . . . ."[518] Although the floor managers did not mention

514. I.R.C. § 6323(b)(1982).

515. *Id.* § 6323(c).

516. *Id.* § 6323(d).

517. 11 U.S.C. § 522(c)(2)(B) (1982).

518. The House and Senate managers also explained that § 545(b), as it appeared in the Senate bill, was "deleted as unnecessary." *Id.* That provision said:

> If a statutory lien for taxes has been perfected in the manner prescribed by law for perfection against bona fide purchasers in general, such lien shall be considered perfected against the trustee with respect to all the debtor's property . . . te which such perfection may be ineffective in particular property or against particular purchasers or classes of purchasers.

124 CONG. REC. 32,400, 34,000 (1982). The Senate Report explained that under IRC § 6323(b) "certain purchasers who acquire an interest in certain specific kinds of personal property will take free of an existing filed tax lien," and that the purpose of § 6323(b) was "to encourage free movement of these assets in general commerce." S. REP. No. 989, *supra* note 118, at 86. This reason, however, did not apply to a bankruptcy trustee "who is not in the same position as an ordinary bona fide purchaser as to such property." *Id.* at 85-86.

section 6323(d), if (b) and (c) apply, then (d) should apply as well.

There is one case recognizing that the debtor-in-possession under section 545(2) may invoke IRC section 6323(b) but holding that section 6323(b) does not apply to a filed tax lien on the debtor's accounts receivable and bank accounts.[519] Apparently the debtor-in-possession did not attempt to invoke section 6323(c), which expressly covers accounts receivable, or section 6323(d), which applies to any kind of property. Another case[520] allowed the debtor-in-possession to invoke a state statute similar to section 6323(b), but which the court interpreted to invalidate a filed state tax lien against bona fide purchasers of all personal property, in order to invalidate the filed state tax lien under section 545(2).

7. The Consumer's Small Preference Exception

The 1984 amendments added section 547(c)(7), excepting from section 547 a transfer by "an individual debtor whose debts are primarily consumer debts"[521] if "the aggregate of all property that constitutes and is affected by such transfer is less than $600."[522] The Bankruptcy Commission had proposed a similar exception for all transfers of less than $1000, not made to insiders, and not confined to consumer debtors or individuals. The Commission explained, in support of its proposal, that the exception of "relatively small" preferences would not "seriously impinge" on the preference policy; that the "expense of recovery [of small preferences] is often disproportionate to the benefit to creditors;" and that the exception "is also intended to soften the impact of the Commission's recommendation to abandon the resonable cause to believe requirement and to impose a presumption of insolvency."[523] The National Bankruptcy Conference recommended that the maximum exempt transfer be reduced to $500. The Conference pointed out that, for larger amounts, "the trustee will have the responsibility of determining when litigation . . . is too burdensome" and that the "threat of litigation alone may be sufficient to recover many pref-

519. *See In re* Debmar Corp., 21 Bankr. 858, 861-62 (Bankr. S.D. Fla. 1982).

520. *See In re* Tropicana Graphics, Inc., 24 Bankr. 381-84 (Bankr. C.D. Cal. 1982).

521. "Consumer debt" is defined in § 101(7) as a "debt incurred by an individual primarily for a personal, family, or household purpose."

522. 11 U.S.C. § 547(c)(7) (1982). Under § 104, the Judicial Conference of the United States was to transmit to the Congress and to the President before May 1, 1985, and every six years thereafter, "a recommendation for the uniform percentage adjustment of each dollar amount in this title" and in the bankruptcy filing and additional fees in 28 U.S.C. § 1930 (1982).

523. *Commission Report, supra* note 91, pt. I, at 206; pt. II, at 166.

erences in excess of" \$500.[524] The National Conference of Bankruptcy Judges and the Justice Department recommended elimination of this exception, leaving the entire matter to the discretion of the trustee as before.[525]

The congressional draftsmen did not incorporate any "small preference" exception, and none appeared in the Reform Act of 1978. The new section 547(c)(7), with a \$750 limit, originated as one of many amendments to the Reform Act sponsored by the consumer credit industry.[526] That industry justified the exception on the ground that the forty-five day limit of section 547(c)(2) did not protect them in the receipt of installment payments on long-term debt, on current bills not paid within forty-five days, or on charge accounts in which the payments were applied to the oldest charges.[527] With the 1984 elimination of the forty-five day limit in section 547(c)(2),[528] the consumer credit industry now has it both ways. For all consumer payments of less than \$600, the industry does not have to worry about the "ordinary course of business" limitations in section 547(c)(2). Moreover, because section 547(c)(7), unlike section 547(c)(2),[529] is not confined to "payments" but applies to any transfer, consumer creditors now have a \$600 exception from section 547 for all consumer-credit security interests.

It still seems to me that the small preference exception is unjustifiable. Official statistics for the year ended June 30, 1983, the latest available, indicate that bankruptcy case filings hit a record high of more than 374,700.[530] Of these filings, approximately

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524. *Bankruptcy Act Revision: Hearings Before Subcomm. on Civil and Constitutional Rights of the House Judiciary Comm. on H.R. 31 and H.R. 32*, 94th Cong., 2d Sess. 1841 (Mar. 19, 1976).

525. *Id.* at 2122. I also opposed the entire idea of such an exception because it was too mechanical. When, year in and year out,

> nothing is available for distribution to creditors in more than 85% of the straight bankruptcy cases and in about three-fourths of the cases nothing is available for administration expenses either, [the matter] should be left to the judgment of the trustee as to whether the issue is worth litigating. Moreover, if this exception were deleted, there would be many instances where the trustee can recover preferences of less than \$500—or a compromised portion thereof—without litigating.

The Bankruptcy Reform Act: Hearings Before Subcomm. on Improvements in Judicial Machinery of the Senate Judiciary Comm. on S. 235 and S. 236, 94th Cong., 1st Sess. 1041 (Nov. 18, 1975).

526. *See supra* note 115.

527. *April 1981 Senate Hearings*, *supra* note 115, at 68 n.31, 93, 150, 158.

528. *See supra* notes 312-20 and accompanying text.

529. *See supra* note 321 and accompanying text.

530. This figure counts as a single case actions commenced by spouses' filing a joint

251,300 were liquidation cases under Chapter 7, and 207,500 of these cases were "nonbusiness" or consumer filings.[531] In the years prior to 1979, when the information was published, "no asset" liquidation cases, in which no funds were available for administrative expenses or creditors after exemptions, were consistently from seventy-one to seventy-seven percent of the total Chapter 7 cases. And "nominal asset" cases, in which no assets were left for creditors after exemptions and administrative expenses, accounted for another twelve to fifteen percent.[532] Most of the cases in both categories were probably consumer cases, although the information was not broken down separately for consumer cases by assets or the lack of assets. In the "no asset" cases, the trustee, whose fee is included in the first priority administrative expenses,[533] is paid only the twenty dollars (increased to forty-five dollars in 1984) that section 330(b) gives him from the sixty dollar filing fee. And in the "nominal asset" cases, the trustee is not necessarily paid the amount that the court concludes he has earned.[534]

In these circumstances, it seems to me indefensible to give each preferred creditor of a consumer a $600 immunity from section 547, even if we accept the consumer credit industry's debatable assumptions that, before the 1984 amendment, total recoveries of preferences in consumer cases were consumed entirely by first priority administrative expenses, including the trustee's fee, so that there was "no corresponding benefit to the debtor or to any creditor."[535] Bankruptcy judges operate within a system that, except for the judges' salaries and expenses, must pay its own costs from its own gate receipts. Quite understandably, after a judge has saddled a trustee with some cases in which the trustee receives no or little compensation, the judge will try to make it up to him in cases in which assets are available for his fee.[536] Thus, the creditors

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petition under 11 U.S.C. § 302.

531. 1983 ANN. REP. OF THE DIR. OF THE ADMIN. OFFICE OF THE UNITED STATES COURTS 418, 420.

532. *See* V. COUNTRYMAN, CASES AND MATERIALS ON DEBTOR AND CREDITOR 264 (2d ed. 1974).

533. *See* 11 U.S.C. §§ 503(b)(2), 507(a)(1982).

534. *See id.* §§ 326, 330(b).

535. *April 1981 Senate Hearings, supra* note 115, at 69, 93. This assertion also overlooks the fact that exemptions are ahead of administrative expenses and that under § 522(g) and § 522(h), the debtor is authorized to take exemptions from involuntary preferences voidable under § 547.

536. Section 15701, applicable in pilot districts in which a United States trustee is serving, provides for the United States trustee's appointment of trustees for liquidation cases from a panel of private trustees for Chapter 7 cases establishes by the United States

of consumers get their $600 immunity at the expense of creditors in other cases.

V. Conclusion

As previously indicated, it seems to me that the basic concept of a preference, as defined in section 547(b), is in satisfactory form with one exception.[537] Many will believe that Congress should undo the accident by which reasonable cause to believe the debtor insolvent is no longer required to avoid a preference made to an insider within a period of one year to ninety days before bankruptcy.[538] I agree that something should be done about that accident, but I am not sure that the solution should be to restore reasonable cause to believe the debtor insolvent even for insider preferences. The reasonable-cause-to-believe requirement may enable many insiders to frustrate the bankruptcy distribution policy by taking preferential transfers from insolvent debtors. At the least, a study of that requirement's restoration should be combined with further study of the breadth of the definition of an insider and of the appropriateness of a longer preference vulnerability period for insider creditors than for other creditors, without a requirement that the insider creditor have reasonable cause to believe the debtor insolvent.[539] It also seems to me that the perfection requirements of section 547(e), which operate very much as they have since the 1943 decision of the Supreme Court in *Klauder*,[540] are in satisfactory form;[541] and I detect no significant groundswell for change in that respect.

The large area of disarray and disagreement has occurred in the exceptions from section 547 contained in section 547(c). In part, I suppose it was predictable that the very idea of a substantial list of exceptions to the preference policy was bound to produce efforts for legislative change. Many preference defendants against whom the trustee could void transfers under section 547(b), indeed many who concede the preference under section

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trustee. It also provides that, if no one on the panel is willing to serve, the United States trustee shall serve in the case. No similar provision exists for recalcitrant nominees in § 701, which provides for the appointment of trustees in nonpilot districts by the bankruptcy court. But the court, and not the United States trustee, allows the trustee's compensation.

537. *See supra* notes 186-98 and accompanying text.

538. *See supra* notes 113-15 and accompanying text.

539. *See supra* notes 193-98 and accompanying text.

540. *See supra* notes 203-08 and accompanying text.

541. *See supra* notes 199-243 and accompanying text.

547(b), were bound to seek an exception that would fit them in section 547(c). Many of those who failed to fit the specifications of any of the exceptions were likely to go further and seek congressional amendments that would either tailor an existing exception to their needs or provide an additional exception suitable for their purposes.

In the exception expansion process, the 1984 amendment deleting the forty-five day limit in what I have called the "current expense" exception of section 547(c)(2) has torn the bankruptcy preference policy asunder in a completely indefensible way. Because this exception was originally ill-conceived and, as amended in 1984, indefensibly at war with the bankruptcy preference policy, my solution for this exception would be to repeal it.[542] Repeal is also the solution for the new exception of section 547(c)(7) for consumer preferences of less than $600. Although section 547(c)(7) does less damage to the bankruptcy preference policy than present section 547(c)(2), it is nonetheless at war with preference policy.[543] And, in the process of those repeals, perhaps Congress could leave some clues in the legislative history that a check is neither the equivalent of cash nor a credit instrument, and that the U.C.C.'s thirty day period for presentment of a check applies only to charging the drawer in the event of dishonor and has no other significance.[544]

The remaining exceptions, for contemporaneous exchanges under section 547(c)(1),[545] for enabling loans under section 547(c)(3),[546] for subsequent advances under section 547(c)(4),[547] and for statutory liens under section 547(c)(6),[548] and even for the compromise on after acquired property clauses under section 547(c)(5), seem to me to be either consistent with the preference policy or, in the instance of section 547(c)(5),[549] to represent a tolerable compromise with the preference policy which does little damage to it. Perhaps the ten day perfection period of section 547(c)(3)(B) should be conformed to the ten day perfection period of section 547(e)(2)(A).[550] But, otherwise, experience with these ex-

542. *See supra* notes 294-323 and accompanying text.
543. *See supra* notes 521-36 and accompanying text.
544. *See supra* notes 255-62 and accompanying text.
545. *See supra* notes 247-93 and accompanying text.
546. *See supra* notes 324-42 and accompanying text.
547. *See supra* notes 343-89 and accompanying text.
548. *See supra* notes 453-520 and accompanying text.
549. *See supra* notes 390-452 and accompanying text.
550. *See supra* text following note 342.

ceptions indicates that it would be premature to encourage Congress to tinker further with section 547(c) at this point, even if we could assume a more responsible congressional approach than we got from the accident-prone 98th Congress in the 1984 amendments.

I realize that all do not share my views. In particular, much disagreement will come from four young turks in the law teaching profession.[551] Because three of them are participating in this symposium and the fourth has friends here, I will address the bases for our differences.

By way of preface, let me say that I can sympathize with their position. All of them began teaching after the Bankruptcy Commission had submitted its report and three of them after Congress had begun hearings on that report. The fourth entered teaching two years after enactment of the Reform Act. None of them, as far as I know, was asked for his advice on the content of that Act. I was once in a similar position. I began as an associate professor in 1948 two years before Congress, in reaction to alarums about the *Klauder* decision,[552] expanded old section 60a from a single paragraph to a second paragraph defining, and six more horrendous paragraphs expanding on, the perfection requirement.[553] No one sought my advice on those amendments either. Nevertheless, I was brash enough in 1949 to submit to Congress a modest suggestion that the entire problem then perceived could be solved by the addition of eight words to then section 60a to require perfection only against those "against whom the transfer could have been perfected."[554] Perhaps because of my youth, perhaps because I then was teaching at Yale, or conceivably because my suggestion was unsound, no one paid any attention to it. I placed most of the blame for the 1950 amendments on Professor James A. MacLachlan of Harvard Law School[555] and, still in my brash years,

551. Some disagreement also may come from Professor John McCoid, who is too near my age to be classified as a young turk. A few years ago he set out "tentatively [to] suggest that, at least in the absence of fraud, the most efficient response to preferential transfers may be to abolish preference law." But he concluded that, for lack of empirical evidence on the "efficiency" of preference law either in deterring or recapturing preferences, a further "reappraisal" was necessary. McCoid, *Bankruptcy, Preferences, and Efficiency: An Expression of Doubt*, 67 VA. L. REV. 249, 250, 273 (1981).

552. *See supra* notes 203-14 and accompanying text.

553. *See supra* notes 215-23 and accompanying text.

554. Countryman, *supra* note 201, at 85 n.56. My suggested language later appeared in new § 548(d)(1), but was replaced in 1984. *See supra* note 227.

555. This is the same Professor McLaughlin of *supra* note 139, and Professor MacLachlan of *supra* note 91. In 1948 he changed the spelling of his name, "correcting an

in 1951 wrote a rather undiplomatic, if not impolite, article about his efforts.[556] At that time I never had met Professor MacLachlan. I never met him afterward, either—he would not speak to me. But I want to assure my four young turks in advance that, because they are neither undiplomatic nor impolite, my reaction to their criticism will not resemble Professor MacLachlan's reaction to mine.

First, I will address the views of the young turk who did not participate in this symposium and who apparently has moved on to other areas of the law: Professor Anthony Kronman. Professor Kronman followed my 1949 example by not waiting to be asked for his suggestions, but his suggestions were much more ambitious than mine. In 1975, a few months after his graduation from Yale Law School, and while Congress was still conducting hearings on the Reform Act, he published an article that he had written in an earlier draft as a student of Professor Grant Gilmore. His subject was the treatment of security interests in after-acquired property under the preference section, and his focus was on the Bankruptcy Commission's version of what had primarily concerned the Gilmore committee and what became section 547(c)(5).[557] Professor Kronman had three criticisms of the Commission's proposal that he surely would regard as equally applicable to section 547(c)(5) in its present form.[558]

First, Professor Kronman urged that the trustee should not be able to recover all the secured creditor's improvements in position by an increase in the value of the collateral at the expense of the estate.[559] Some improvements in position, such as the seasonal fluctuations in an inventory of Christmas ornaments or the increase in value of raw materials processed into finished goods, are attributable to events occurring in the normal course of the debtor's business. The debtor and the secured party anticipate these improvements, and the secured party relies on them in extending credit on the terms he did. On the other hand, the secured party should lose improvements caused by "his own fraudulent or

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error made in Scotland about 1835." J. HANNA & J. MACLACHLAN, CASES AND MATERIALS ON CREDITORS' RIGHTS, at viii n.1 (cons. 4th ed. 1951).

556. *See* Countryman, *supra* note 201.

557. Kronman, *The Treatment of Security Interests in After-Acquired Property Under the Proposed Bankruptcy Act*, 124 U. PA. L. REV. 110 (1975).

558. He also was critical, not of the Commission's proposal that "antecedent debt" be statutorily defined, but of the way in which is was defined. *See id.* at 138-41. That part of the Commission's proposal was not enacted.

559. In § 547(c)(5), the concept is now all reduction in deficiency to the prejudice of unsecured creditors.

manipulative conduct," as when a party secured by receivables influences the conduct of a "fire sale" of inventory in order to "pump receivables," or improvements caused by an unanticipated "windfall" resulting from a flurry of sales by the debtor that the secured party did not inspire.[560] Professor Kronman's solution for this problem was to rewrite the exception so that an increase in the value of the collateral under its two-point test merely created a presumption that the secured party had improved his position at the expense of the estate.[561]

But that left the courts pretty much at large, so Professor Kronman proposed an additional refinement—a presumption for when the presumption of improvement in position should apply and a rule for when it should not. It should apply when the increase in value resulted from fluctuating market values or the conversion of other property into receivables in the ordinary course of the debtor's business. In contrast, no presumption would apply, and the increase would not be at the expense of the estate, if the increase resulted from the manufacture or assembly of raw materials, work in process, or component parts into a product.[562] For all increases in value that fell outside of these specified instances, the courts were to find the solution by determining whether the increase was "at the expense of the estate."[563]

Finally, Professor Kronman argued that, by being confined to inventory and receivables, the proposed exception raised doubts for all other types of collateral. Because security interests in after-acquired property such as equipment did not fit readily into any other exception, the interests would be vulnerable to attack as preferences, "which [would] reverse the treatment of such increases under the present version of section 60."[564] (There is one very good reason why Professor Kronman cites no evidence of such present treatment. There was none.) Professor Kronman's final recommendation was that the improvement-in-position exception be extended to all property.[565]

In all of this, Professor Kronman offered little to justify his proposals other than the occasional assertion that "it seems reasonable to assume" that the secured party had bargained for the

560. Kronman, *supra* note 557, at 144.
561. *See id.* at 148.
562. *See id.* at 157-58.
563. *Id.* at 158.
564. *Id.* at 161.
565. *See id.* at 162.

increases in value that Professor Kronman would except from preference attack[566] and to invoke[567] Professor Kripke's assertion[568] that "[i]n the long run (not necessarily in any particular case), the unsecured trade creditor is henefited by secured credit" because secured credit keeps the debtor in business and enables him to pay his unsecured creditors, "although in a particular case [unsecured creditors] may be distressed because the dividend in bankruptcy is small." That assertion overlooks both Keynes' dictum that in the long run we are all dead and the fact that bankruptcy preference law applies only in the "particular case."

While the Commission's proposals were still pending before Congress, Professor Thomas Jackson joined with Professor Kronman to supply a more elaborate justification for the Kronman proposals.[569] Even though the justification was elaborate, it adhered to a precise blueprint. Preference law, like bankruptcy law generally, must reconcile two basic aims, "neither of which is strong enough to warrant the exclusion of the other in defining the concept of a voidable preference."[570] One basic aim is "to protect the contractual arrangements fashioned by the bankrupt and his various creditors," including the "expectation interest" inherent in all contracts.[571] The second and competing aim is "to minimize . . . social costs associated with bankruptcy by spreading its impact among all classes of creditors."[572] Although strict pursuit of the first aim would impact most heavily on unsecured creditors, proper regard for the second aim requires some power in the trustee "to avoid the contractual rights of . . . secured creditors," including their expectation interest, "in certain limited cases."[573]

The allocation of four risks determines the expectation interest of the secured creditor. Two are the risk of gain and of loss from events "in the ordinary course of the debtor's business"—risks that can be calculated on the basis of "objective" factors.[574] The other two are "windfall" gains or losses, whether fore-

566. *See id.* at 155, 157 n.150.

567. *Id.* at 143.

568. Krause, Kripke and Seligson, *The Code and The Bankruptcy Act: Three Views on Preferences and After-Acquired Property*, 42 N.Y.U. L. Rev. 278, 287 (1967).

569. *See* Jackson and Kronman, *Voidable Preferences and Protection of the Expectation Interest*, 60 Minn. L. Rev. 971 (1976).

570. *Id.* at 986.

571. *Id.* at 987-88.

572. *Id.* at 989.

573. *Id.*

574. *Id.* at 993.

seen or unforeseen, that cannot be calculated on the basis of "objective" factors.[575] "It seems plausible to conclude" that the secured party expects to receive both types of gains and to suffer both types of losses; therefore, Jackson and Kronman concluded that the debtor and the secured party have "contracted on the basis" of these expectations and that to deprive the secured party of his "windfall" gain "would interfere with his bargained-for expectation interest."[576] Now it is simply a matter of arithmetic to find the best preference provision. *DuBay v. Williams*[577] was taken as establishing that the solution under old section 60 was to give the secured creditor both the "ordinary course" and the "windfall" gains, which furthered the first basic aim of bankruptcy law to the exclusion of the second. The Commission's proposal would deprive the secured creditor of both gains, which would further the second basic aim to the exclusion of the first. But the Kronman proposal would preserve the secured creditor's "ordinary course" gains and deprive him of the "windfall" gains, which would balance the two basic aims and "represent[] a genuine compromise," unlike the Commission's proposal.[578]

As I struggled through this extensive process of manufacturing contractual "expectation interests" for many parties not given to these rarefied expectations, and as I recalled that section 547(c)(5) has proved to be the least important exception in section 547(c),[579] I recalled also that I was experiencing a reaction similar to one I once provoked in my onetime colleague and longtime friend, Professor Gilmore. I once labored mightily to prove that U.C.C. section 2-502, giving a buyer of goods who had paid in advance a right to recover the goods from an insolvent seller, and section 2-702, giving an unpaid seller of goods on credit a right to reclaim them from an insolvent buyer, should not be applied in bankruptcy

575. *Id.* at 995-96.

576. *Id.* at 1000.

577. *See supra* notes 396-404 and accompanying text.

578. Jackson and Kronman, *supra* note 569, at 1005. I can testify from my attendance at meetings of the Gilmore committee, where the Commission's solution originated, that the Commission's proposal did represent a compromise between two vigorously debated proposals but not two of the three that Jackson and Kronman posit. *DuBay* had its defenders on the Gilmore committee, but so did the view that the secured party should be confined to the lowest level of his collateral within the preference period. Jackson and Kronman do acknowledge another view but the only one they were able to imagine was one that would compensate the secured party for windfall losses and deprive him of windfall gains. That view was disregarded as being no better than the Commission's proposal. *See id.* at 1006-08.

579. *See supra* notes 435-40 and accompanying text.

cases.[580] Shortly thereafter, I received a brief note from Professor Gilmore. I have not preserved the note, but I am certain that I remember it exactly. Those who knew him will recognize it as pure Gilmore: "I was surprised to learn that you were so exercised about § 2-502," he wrote. "It was drafted merely to placate Karl Llewellyn and was meant to be meaningless."

More recently, Professor Jackson revisited the subject of preferences, announced that he has changed the view he shared with Professor Kronman, and came up with a new analysis.[581] Bankruptcy rules, including rules about preferences, should be viewed as based on a new "creditors' bargain" theory for the cases in which not enough assets are present to pay off all creditors—"an attempt to implement the type of collective and compulsory system that rational creditors would privately agree to if they could bargain together before the fact."[582] Professor Jackson reasons: "From the perspective of the creditors' bargain theory, bankruptcy exists at its core to maximize the value of assets in the face of individualized pressures to ignore the collective weal for individual gain."[583] Of course, creditors do not bargain on such matters "before the fact," and there is in fact no creditors' bargain. Nevertheless, Professor Jackson can intuit what that bargain would be and tell us how preference law can "bind them to their presumptive [i.e., fictitious] ex ante agreement and . . . foil the attempts of each creditor to welsh on the agreement for individual gain."[584]

Professor Jackson intuits that all creditors would "presumptively agree" that preference law should reach both (1) "last minute grabs" through payments or the taking of a security interest for antecedent debt, and (2) "secret liens" when perfection is delayed. Both policies, embodied in their fictitious agreement, are "designed to deter opt-out behavior that interferes with the goals of bankruptcy."[585] But the creditors' fictitious agreement appar-

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580. Countryman, *Buyers and Sellers of Goods in Bankruptcy*, 1 N.M. L. Rev. 435 (1971). A new provision in the Reform Act § 546(c)) was designed to accommodate, at least in part, § 2-702. The 1984 amendments add a new § 546(d) to do the same thing specifically for grain farmers and fishermen.

581. *See* Jackson, *Avoiding Powers in Bankruptcy*, 36 Stan. L. Rev. 725, 757 n.93 (1984).

582. *Id.* at 728. Professor Jackson had launched his "creditors' bargain" theory earlier in other bankrupcy contexts. *See* Jackson, *Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain*, 91 Yale L.J. 857 (1982).

583. Jackson, *supra* note 581, at 729.

584. *Id.* at 758-59.

585. *Id.* at 762-64.

ently extends only to last minute purposeful behavior. "[O]ptimal" preference law would reach only to actions of a creditor who " 'tries to change his position after the extension of credit in order to improve his lot in an anticipated bankruptcy' " or of a debtor who, " 'at the behest of such creditor, so tries to change the position of such creditor.' "[586]

In other words, the purpose of preference law in Professor Jackson's view is not to preserve the bankruptcy distribution policy but to punish culpable creditors who reveal their culpability within a very limited period prior to bankruptcy. They are to be punished for behavior occurring within the ninety day preference period only. The creditor who has contracted in advance for preferential treatment during that period by a properly perfected security agreement containing an after-acquired property clause, and who makes no other "grabs" during that period, would be immunized from preference law. For his foresight in making an "advance grab," he gets this immunity although what his after-acquired property clause "grabs" during the preference period defeats the bankruptcy distribution policy just as much as does the "last minute grab" of another creditor who levies under a writ of execution within the preference period. As I hope I have made clear,[587] I do not believe that it should be the purpose of preference law to punish "bad" and absolve "good" creditors, but to preserve the bankruptcy distribution policy.

Professor Jackson concedes that "bright-line" rules may be preferable to his "better fitting, but fuzzier, standard" on grounds of administrative cost. His more "accurat[e]," albeit "fuzz[y]," standard nonetheless provides a "useful focus . . . to examine what sorts of transfers should be reached by the preference section."[588] Which brings us back to section 547(c)(5), for which Professor Jackson believes that the proper way to view its two-point test is "as a presumptive rule" which the creditor could rebut by showing that "the improvements did not result from a last-minute grab," but resulted from the debtor acquiring rights in after-acquired property in ordinary course of business,[589] just as Professor

586. *Id.* at 765.

587. *See supra* notes 188-91 and accompanying text.

588. Jackson, *supra* note 581, at 765-66.

589. *Id.* at 774-75. Professor Jackson would be willing to allow tbe trustee to rebut the creditor's rebuttal by showing "that deliberate preferential behavior occurred during the 90 day period preceding bankruptcy even when that behavior does not produce an improvement of position." *Id.* at 775. The creditor being nourished by his after-acquired property

Kronman had suggested earlier. Despite the fact that Congress ignored that suggestion in 1978 and in 1984 added section 547(g) to put the full burden of proof on the secured creditor under section 547(c)(5), it is not clear whether Professor Jackson is proposing the Kronman presumption as an amendment to, or as an interpretation of, section 547(c)(5). But at this point Professor Jackson, who began by intuiting a fictitious agreement for all creditors, seems to have narrowed his constituency to intuit a separate fictitious agreement for secured creditors only, since he suggests no reason why unsecured creditors would agree to recognize the sanctity of the "advance grab" of an after-acquired property clause.

Then there is Professor Ted Eisenberg, who in his original publication on bankruptcy law started with a modest proposition: "The new bankruptcy act is a failure."[590] I don't believe he has established that expansive claim yet,[591] although I agree with much of what he has to say in this symposium on the section 1111(b) election.[592] But, in the course of attempting to establish his claim, he also has addressed the section 547(c)(5) problem. After advancing the proposition that bankruptcy law should depart from state law only when some good reason exists for doing so, he focuses on section 547(c)(5) as "perhaps the most important . . . departure from state law" and one that was not made with good reason.[593] Amazingly, he characterizes as "the states' result," and the result reached by "all states,"[594] in the situation covered by section 547(c)(5), the result reached under old section 60 by the federal courts in *DuBay*[595] and *Grain Merchants*.[596] The common ground of those decisions, however, was their conclusion that state law, which indicated that no transfer occurred until an account came into existence within the preference period, was not applicable but was superseded by the perfection provision of old section 60, which the two courts read to mean that the transfer occurred when the

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clause must remain quiescent.

590. Eisenberg, *Bankruptcy Law in Perspective*, 28 UCLA L. REV. 953 (1981).

591. *See* Harris, *A Reply to Theodore Eisenberg's Bankruptcy Law in Perspective*, 30 UCLA L. REV. 327 (1982); *see also* Eisenberg, *Bankruptcy Law in Perspective: A Rejoinder*, 30 UCLA L. REV. 617 (1983); Eisenberg, *Some Costs of Bankruptcy Reform*, 9 CORNELL L.F., No. 3, p. 2 (1983).

592. *See* Eisenberg, *Secured Creditors Election in Reorganization: A Preliminary Assessment*, 38 VAND. L. REV. 931 (1985).

593. Eisenerg, *supra* note 590, at 956-59.

594. *Id.* at 963.

595. *See supra* notes 396-404 and accompanying text.

596. *See supra* notes 405-11 and accompanying text.

financing statement was filed outside the preference period.

Moreover, Professor Eisenberg states that no "larger economic view" justifies section 547(c)(5)'s departure from "state law." He does not agree with Jackson and Kronman that bankruptcy should take some account of allocating losses between secured and unsecured creditors. There is no impact on "the economy as a whole" if secured creditors are favored over unsecured creditors. If the "state result" theory were followed, any resulting increase in the cost of unsecured credit would be roughly balanced by a decrease in the cost of secured credit (excluding "transaction costs," of course).[597]

Professor Eisenberg also identifies, as another of the "questionable departures from state law,"[598] the provisions in section 547(e)(2) that a transfer not perfected within ten days after taking effect between the parties will be treated as a transfer occurring on the date of perfection. In many instances, section 547(e)(2) would enable the trustee to recover assets for the benefit of unsecured creditors whereas, under the state law of U.C.C. sections 9-201 and 9-301, an unperfected security interest is perfectly valid against unsecured creditors. Professor Eisenberg can find no justification for the bankruptcy rule, although he does not expressly consider whether proper bankruptcy policy might penalize the concealment of security interests. Hence he does not consider whether, if such a policy is justified, there is justification also for avoiding a duplication of notoriety requirements by invoking, for the protection of unsecured creditors in bankruptcy, existing state notoriety requirements, even though the states do not impose those requirements for the protection of unsecured creditors.

I have not found any pertinent published works by Professor Douglas Baird on preferences,[599] but am willing to take the risk of assuming that his views on preferences, like many of his other views on bankruptcy, are not substantially dissimilar from Professor Jackson's.[600]

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597. Eisenberg, *supra* note 590, at 965-66.

598. *Id.* at 970-71.

599. Baird, *Standby Letters of Credit in Bankruptcy*, 49 U. CHI. L. REV. 130 (1982), concerns a narrow point of preference law that I have not dealt with in this Article. *See supra* note 106.

600. *See* D. BAIRD & T. JACKSON, CASES, PROBLEMS, AND MATERIALS ON BANKRUPTCY (1985); D. BAIRD & T. JACKSON, SECURITY INTERESTS IN PERSONAL PROPERTY 501-617 (1984); Baird & Jackson, *Fraudulent Conveyance Law and Its Proper Domain*, 38 VAND. L. REV. 829 (1985); Baird & Jackson, Kovacs *and Toxic Wastes in Bankruptcy*, 36 STAN. L. REV. 1199 (1984); Baird & Jackson, *Corporate Reorganization and the Treatment of Diverse*

I am not prepared to say that Professors Kronman, Jackson, Eisenberg, and Baird are 100% wrong in their views on preferences. I will leave that assertion to Professor Alan Schwartz when and if he gets around to it.[601] And I will admit that their approach leaves them free from the burden of scrutinizing the vast judicial output that reveals how the current preference law is being administered—a subject in which they evince little interest.

But I do not find their approach helpful. They assume that every creditor—apparently including asbestos victims and other tort claimants ("nonconsensual creditors" like the IRS), the most unsophisticated customer or supplier of goods and services, and the lowliest employee—will have full information and competent legal advice in dealing with the debtor. They assume further that every creditor will make the same assumptions they do and bring to bear their same highly skilled free market economic analysis—which also assumes that everyone acts solely on the basis of pure and fully informed greed—in fixing his price and other terms. I confess to sharing the reaction of Professor Richard Markovitz after he had listened to another preacher of the true gospel. He suggested that the answer to the question, "How many Chicago economists does it take to change a light bulb?" was: "None. If it needed changing, the market would have changed it already."[602]

With all their assumptions, it is not even presumptuous for some of the young turks to proceed to invent fictitious "agreements" among all creditors concerned with what the law of preference should be.[603] But, since their assumptions are wrong to such a large extent, the authority some of them assume to concoct fictitious agreements is left without foundation, as are their proposals for a preference law to implement such "agreements." For this reason, I do not find their approach helpful either in drafting a preference law or in interpreting it.[604]

Ownership Interests, 51 U. CHI. L. REV. 97 (1984).

601. *See* Schwartz, *The Continuing Puzzle of Secured Debt*, 37 VAND. L. REV. 1051 (1984), Schwartz, *Security Interests and Bankruptcy Priorities: A Review of Current Theories*, 10 J. LEGAL STUD. 1 (1981).

602. Markovits, *The Limits to Simplifying Antitrust: A Reply to Professor Easterbrook*, 63 TEX. L. REV. 41, 86 (1984).

603. Professor Jackson recognizes that the "fresh start" policy of the Reform Act, particularly as embodied in provisions in 11 U.S.C. § 522 empowering the debtor to avoid involuntary preferences for the purpose of claiming his exemptions, may indicate that the debtor also has an interest in the preference policy. But he assumes the debtor's interest away and creates no fictitious agreements to which the debtor is a party. *See* Jackson, *supra* note 581, at 727 n.8, 767.

604. While Professor Kripke and I have, and frequently enjoy, our differences, *see*

supra text accompanying notes 422-23 and text following note 568, I respect both his intelligence and his experience. It is therefore comforting to me to note that he finds the sort of analysis employed by the young turks no more helpful, in other contexts, than I find it in the context of preference law. See Kripke, *Law and Economics: Measuring the Economic Efficiency of Commercial Law in A Vacuum of Fact*, 133 U. PA. L. REV. 929 (1985).