THE IMPACT OF FRAUDULENT CONVEYANCE LAW ON FUTURE ADVANCES SUPPORTED BY UPSTREAM GUARANTIES AND SECURITY INTERESTS

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INTRODUCTION

A lender, such as a bank or insurance company, often enters into a loan agreement that contemplates the making of loans, or advances, at a future date. Advances that in fact are made subsequent to the initial advance are called “future advances.”

The lender may have required, as a condition to originally entering into the loan agreement, that the borrower arrange for a third party to guarantee or secure repayment of the advances. For a corporate borrower, the third party is frequently the borrower’s subsidiary. Because the subsidiary’s guarantee or security interest is made for the benefit of a lender to the parent corporation, the guaranty or the security interest is referred to as being “upstream.”¹

Enforcement by the lender of upstream guaranties and upstream security interests may be subject to several types of attack.² For example, under certain circumstances, federal and state fraudulent conveyance laws may be used to invalidate upstream guaranties or security interests. The purpose of fraudulent conveyance laws is to invalidate transfers made or obligations incurred by companies intended to hinder, delay, or defraud creditors, or transfers made or obligations incurred by “insolvent”³ companies for which such companies receive less than the statutorily mandated equivalent value in return. The effect of fraudulent conveyance laws is to make property

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³ The terms “solvent” and “insolvent” used in this Article refer to the three financial tests set forth in § 548(a)(2) of the Bankruptcy Code, 11 U.S.C. § 548(a)(2) (1982 & Supp. III 1985), only one of which refers to balance-sheet solvency.
so transferred reachable again by the creditors and the obligation so incurred no longer an obligation of the company.4

Creditors may obtain fraudulent conveyance remedies under state law.5 Additionally, if a company becomes the subject of a federal bankruptcy case, the trustee in bankruptcy also is provided the power to challenge fraudulent conveyances.6 Under section 548 of the Bankruptcy Code, a trustee in bankruptcy may invalidate a “transfer made” or an “obligation incurred” within one year before the date the petition in bankruptcy is filed if such “transfer” is made or “obligation” is incurred at a time when the subject company is “insolvent,” and if it did not receive “reasonably equivalent value” in return for such transfer or obligation.8 Accordingly, if a subsidiary that has granted an upstream guaranty or upstream security interest was at the time “insolvent,” and a petition in bankruptcy is filed

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4 There is, however, authority that state fraudulent conveyance law does not void transfers or obligations completely, but rather voids them insofar as the creditors are concerned. See U.F.C.A. §§ 4-7, 7A U.L.A. 474-576 (1985).

5 State fraudulent conveyance law is frequently, although not always, based upon the Uniform Fraudulent Conveyance Act (“UFCA”). The UFCA, a product of the National Conference of Commissioners on Uniform State Laws, is the leading model of state fraudulent conveyance laws, and has been adopted in at least 22 states. See id. at 31 (Supp. 1987) (California, North Dakota and Oklahoma have recently repealed their UFCA provisions bringing the number of adopting states down from 25 to 22). In 1984 the Commissioners on Uniform State Laws proposed a new version of the UFCA, known as the Uniform Fraudulent Transfer Act (“UFTA”). See U.F.T.A. §§ 1-13, 7A U.L.A. 639-67 (1985 & Supp. 1987).


7 This Article assumes that the “reasonably equivalent value” test is not met. In a case where all or most of the loan proceeds are used by the parent corporation for its own benefit, e.g., Rubin v. Manufacturers Hanover Trust Co., 661 F.2d 979, 993-94 (2d Cir. 1981), the assumption would be apparent. There is, however, at least one case holding that modern financing techniques justify one member of a corporate family guaranteeing the debts of another member of the corporate family. See TeleFest, Inc. v. VU-TV, Inc., 591 F. Supp. 1368 (D.N.J. 1984). On the other hand, there are cases where subsidiaries making upstream guaranties clearly do obtain “reasonably equivalent value” under § 548, such as where a parent corporation downstreams the loan proceeds to its subsidiary as a capital contribution.

8 Section 548(a) of the Bankruptcy Code, 11 U.S.C. § 548(a) (1982 & Supp. III 1985), provides that:

(a) The trustee may avoid any transfer of an interest of the debtor in property, or any obligation incurred by the debtor, that was made or incurred on or within one year before the date of the filing of the petition, if the debtor voluntarily or involuntarily—

(1) made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted; or

(2)(A) received less than a reasonably equivalent value in exchange for such transfer or obligation; and

(B)(i) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;

(ii) was engaged in business or a transaction, or was about to engage in busi-
within one year, and assuming that the subsidiary has not received reasonably equivalent value in return for the upstream guaranty or security interest, the trustee in bankruptcy may have a basis for attacking the upstream guaranty or security interest as a fraudulent conveyance.

This Article will examine the problems of timing that arise under section 548 with respect to upstream guaranties or upstream security interests that support future advances. Timing is important for two reasons. First, under section 548 a trustee in bankruptcy may only invalidate "obligations incurred" or "transfers made" within one year before the date a petition in bankruptcy is filed. If an upstream guaranty or security interest is deemed to be "incurred" or "made" outside this one-year "statute of limitations," a trustee in bankruptcy may not use section 548 to challenge it. Timing is also important because only transfers made or obligations incurred when the subsidiary is insolvent or its equivalent may be fraudulent conveyances. Because solvency is determined when the transfer is made or the obligation is incurred, it is necessary to address the issue of when the "obligation" under an upstream guaranty is "incurred" and when the "transfer" of an upstream security interest is "made" under section 548.

I. TIMING ISSUES AND THE RUBIN CASE

Upstream guaranties or upstream security interests in support of future advances raise particularly difficult timing issues because at least three different events occur, although not necessarily in the following order, that might influence the timing decision:

(a) The subsidiary agrees to guarantee or grant collateral to secure repayment of future advances to be made under the parent company's loan agreement.
(b) Where collateral is granted, the lender files financing statements or otherwise perfects its security interest in the collateral.
(c) The lender advances money to the parent company, either

ness or a transaction, for which any property remaining with the debtor was an unreasonably small capital; or
(iii) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured.

This does not mean the trustee in bankruptcy has no power to attack the upstream guaranty or security interest. Under § 544(b) of the Bankruptcy Code, id. § 544(b) (1982), the trustee may exercise the state law rights of a creditor. Under most state laws, the statute of limitations is longer than one year.

See supra notes 3 & 8.
at its discretion or pursuant to an earlier commitment in the loan agreement to make the advance.

Each of the above events may be relevant in determining when an "obligation [is] incurred" under a guaranty and when a "transfer of [a security] interest" is made, within the meaning of section 548.

If the lender makes an advance to the parent company on the same day that the subsidiary executes the upstream guaranty or security interest, it is obvious that for the purposes of section 548 the obligation is incurred or the transfer of the security interest is made on that date. Accordingly, the three financial tests under section 548(a)(2) are measured, and the one-year statute of limitations commences running, on the date of the advance. But the issue is not nearly so clear where the lender enters into a loan agreement that contemplates future advances, because the future advances may be made long after the time that the upstream guaranty or security interest was executed.

This timing issue has been addressed by the Second Circuit in *Rubin v. Manufacturers Hanover Trust Co.* in *Rubin*, the court held that the date the obligation is incurred, under an upstream guaranty supporting future advances, is not limited to the date that the guaranty is executed but also may include the date that the future advance is made. Thus, an upstream guaranty supporting future advances, executed more than a year before bankruptcy, may be deemed to create new obligations of the guarantor each time a future advance is made. Some of these future advances may well be made within a year prior to the filing of the bankruptcy petition.

This has created considerable concern for commercial lenders that enter into loan agreements contemplating future advances supported by upstream guaranties or secured by upstream security interests. Under the rule in *Rubin*, a lender would have no assurance that its future advances would obtain the benefit of an upstream guaranty or security interest, to the extent that the subsidiary making such guaranty or security interest becomes bankrupt within a year of the advances.

Because of this uncertainty, the draftsmen of the Uniform Fraudulent Transfer Act ("UFTA"), a recent revision of the Uniform Fraudulent Conveyance Act, have provided in section 6 that the time for determining when a guaranty obligation is incurred is the

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11 661 F.2d 979 (2d Cir. 1981).
12 Id. at 990.
date that the guaranty is executed, not the date of the future advance.\textsuperscript{15} The UFTA, if it becomes state law, would effectively answer the timing question for purposes of state-law statutes of limitations.

Section 548, however, has not been amended since the \textit{Rubin} case. Thus, even if state law is modified to adopt section 6 of the UFTA, the \textit{Rubin} case still would raise the timing uncertainty under federal bankruptcy law whenever a subsidiary guaranteeing future advances becomes bankrupt. This Article will focus on the federal rule created by \textit{Rubin}, and the uncertainty resulting therefrom.

This Article submits that the \textit{Rubin} case should be limited to its facts. The loan agreement in \textit{Rubin} that contemplated future advances was a discretionary facility.\textsuperscript{16} This Article will demonstrate that had the lender made a commitment to extend advances in the future, the proper time for determining when the obligation was incurred under the upstream guaranty (or, if the case involved a security interest, when the transfer of the security interest was made) would be the time that the lender executed the commitment to lend.

\section*{II. The Impact of Section 548 on Future Advances Supported by Upstream Guaranties}

\textit{Rubin v. Manufacturers Hanover Trust Co.} is a complicated case. What follows is a simplified version of the facts faced by the Second Circuit. \textit{P}, the parent corporation, owned 100\% of the stock of \textit{S1} and \textit{S2}, its two subsidiaries. \textit{S1} and \textit{S2} were in the business of cashing checks and selling money orders to the public. The sales staff of \textit{S1} and \textit{S2} consisted of numerous store owners. Because their check-cashing business required continuous outlays of currency, the check cashers who served as sales agents of \textit{S1} and \textit{S2} experienced a constant need for cash. The management of \textit{P} feared the temptation of these storeowners to delay remittance of money order sales proceeds and to retain such proceeds for use in their businesses. As a means of minimizing this temptation, \textit{P} arranged for the storeowners to obtain

\textsuperscript{15} The UFTA states that "an obligation is incurred: (i) if oral, when it becomes effective between the parties; or (ii) if evidenced by a writing, when the writing executed by the obligor is delivered to or for the benefit of the obligee." U.F.T.A. § 6 (5), 7A U.L.A. 659 (1985).

\textsuperscript{16} That the advances in \textit{Rubin} were discretionary is clear from two passages in the lower court's opinion. The first passage states: "Trent and Skowron would submit monthly lists requesting MHT [lender] to make loans to check cashers who were acting as sales agents for the Trent/Skowron enterprises. To the extent that the loans were approved and made by MHT, they would be covered by the guarant[y]." \textit{Rubin v. Manufacturers Hanover Trust Co.}, 4 Bankr. 447, 450 (S.D.N.Y. 1980) (footnote omitted), vacated, 661 F.2d 979 (2d Cir. 1981). The second passage states: "[O]n or about December 6, 1976, ... MHT informed Trent and Skowron that it no longer desired to extend credit to out-of-state check cashier sales agents." Id. at 452.
short-term bank financing from a lender, Manufacturers Hanover Trust Co. ("MHT"). Under the arrangement, MHT opened a credit line against which the storeowners were permitted to borrow for three-day periods. P guaranteed all these loans made by MHT. S1 and S2 in turn guaranteed P’s obligation to MHT.

The court in Rubin interpreted sections 67d(2)(a) and (b) under the Bankruptcy Act of 1898, the predecessor statute to section 548, to hold that S1 and S2 “incurred” obligations on the date when the future advances in question were made, even though these advances were made long after the upstream guaranties were executed. The court’s basis for this conclusion was that “[e]ven after the [upstream] guarantees were executed, there could be no liability under them until MHT had actually loaned money to [the storeowners].” The court added that “[u]ntil the loans were made, there existed only a framework through which [the subsidiaries making the upstream guaranties] might incur obligations, but they had not done so yet.”

The court’s holding in Rubin perhaps is understandable insofar as it applies to MHT’s credit line, in which future advances were discretionary. MHT alone determined, at the time each advance was requested by a storeowner, whether or not to advance the funds. Each time that MHT decided to advance funds to a storeowner, MHT could reassess the credit risk, including whether or not the advance would ultimately be repaid by the storeowner, and whether and when the upstream guaranties supporting the advance would be drawn upon. MHT also could reassess at such time whether S1 and S2, the subsidiaries making the upstream guaranties, then satisfied the three financial tests of section 548(a)(2). If S1 and S2 did not then satisfy these financial tests, MHT could refuse to make the requested advance, since it is discretionary.

If, on the other hand, a lender is legally obligated to make future advances, that lender could not refuse to make a requested advance, even if the advance were supported by an upstream guaranty of a sub-

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17 The holding in Rubin, decided under the old Bankruptcy Act, nonetheless should remain applicable under the Bankruptcy Code because the relevant statutory language—"obligation incurred" and "transfer of an interest"—is almost identical in both statutes (compare 11 U.S.C. § 548(a) (1982 & Supp. III 1985) with 11 U.S.C.A. app. § 107(d)(2)(a) (1979) (repealed 1978)) and because the Bankruptcy Code has been interpreted by reference to case law decided under the Bankruptcy Act to the extent that the Bankruptcy Code incorporates similar language and concepts. See, e.g., Barr v. Weber (In re Carousel Candy Co.), 38 Bankr. 927, 936 (Bankr. E.D.N.Y. 1984) (noting that Judge Kearse’s observations about § 67(d) in Rubin had not lost their pertinence even though § 548 had replaced § 67(d)).

18 Rubin, 661 F.2d at 990.

19 Id.

20 Id.
A clear understanding of when to measure the three financial tests under section 548(a)(2) and when the statute of limitations starts running is therefore desirable to encourage normal commercial lending transactions. A lender that has uncertainty regarding the enforceability of upstream guaranties and security interests supporting its future advances may well be discouraged from extending a commitment for a loan facility contemplating future advances.

In addition to policy considerations, an analogy may be drawn from limitations of actions in tort law to support the view that the one-year statute of limitations under section 548 should begin running at the time that the guaranty of a committed loan facility is executed. The statute of limitations for a tortious act generally begins to run when the tortious act is committed. For discretionary future advances, a separate tortious act may be committed each time the lender makes a future advance, because each advance creates a debt that is supported by the upstream guaranty of the subsidiary, which in turn may impose a loss upon the subsidiary’s creditors. On the other hand, where future advances are to be made pursuant to a committed loan agreement, the lender no longer has discretion whether or not to make any requested advance; the last act of the lender within its control occurs when the loan commitment is executed. Thus, for a committed loan agreement, the “tortious act” would occur at the time that the upstream guaranty is executed.

The foregoing analysis should not be qualified by the fact that injury to creditors of the subsidiary that has made the upstream guaranty may occur at a future date (e.g., when the upstream guaranty is enforced). Ordinarily, the statute of limitations for a tortious act begins to run from the time the tortious act is committed, even though

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21 A prudent lender could make it a contractual condition precedent to each future advance that the subsidiary making the upstream guaranty satisfy the three financial tests of § 548(a)(2), see supra note 8 (setting out the three financial tests), at the time of each advance. But if the lender relies solely on the borrower’s representation and warranty to that effect made at the time of each advance, the upstream guaranty still might be subject to challenge as a fraudulent conveyance if the representation and warranty subsequently turns out to be untrue. On the other hand, for the lender to require due diligence as to the subsidiary’s compliance with these financial tests at the time of each future advance could be commercially impractical.

22 Fraudulent conveyances are, after all, in the nature of torts. A lender that draws on the upstream guaranty of an insolvent subsidiary takes property that otherwise would generally be available to creditors of the insolvent subsidiary. Such an act seems analogous to a tort.

23 See Restatement (Second) of Torts § 899 comments c & e (1977). See also Albertson v. T.J. Stevenson & Co., 749 F.2d 223, 228-29 (5th Cir. 1984) (ordinarily, the invasion of the person’s legally protected interest occurs when the tortious act is committed).
little, if any, actual damage occurs immediately upon commission of
the act. The statute of limitations may bar recovery for subsequent
damages, even if such damages are not ascertainable at the time the
tort is committed.

There is an exception to the foregoing rule where the tort in­
volves continuing or repeated injury. The statute of limitations then
does not begin to run until the date of the last injury, or when the
tortious acts cease. Successive actions for damages caused by a tort,
however, can be maintained only where the tortfeasor is continually
at fault; he cannot be charged as a continuing wrongdoer unless he
has the right and is under the duty to terminate the cause of injury.

In the case of a committed loan agreement supported by an upstream
guaranty, once the lender signs the loan agreement and the subsidiary
executes the upstream guaranty, neither has a right or duty to termi­
nate its respective obligation. The one-year statute of limitations
under section 548 therefore should begin running at the time the com­
mitted loan agreement and the upstream guaranty have been executed
by the lender and the subsidiary, respectively.

Accordingly, had the loan facility in Rubin been committed
rather than discretionary, the court should have decided that the stat­
uate of limitations under section 548, applicable to the upstream guar­
anty of the future advance, would have already run.

III. THE IMPACT OF SECTION 548 ON FUTURE ADVANCES
SECURED BY UPSTREAM SECURITY INTERESTS: SHOULD
THE RUBIN DECISION BE APPLICABLE?

The foregoing discussion concerned Rubin and the application of
section 548 to upstream guaranties of future advances. As already
mentioned, the same types of issues also could arise for upstream se­
curity interests securing future advances. For example, when a
lender offers to make advances to the borrower, the lender may require one or more subsidiaries of the borrower to grant a security interest in its assets to secure repayment of the advances. It should be noted that security interests, in general, may properly secure future advances, whether or not made pursuant to a commitment.\textsuperscript{28}

In analyzing the upstream guaranties in \textit{Rubin} under the predecessor statute to section 548, the court focused on when the "obligations" are "incurred" under those guaranties. The granting of an upstream security interest does not, however, constitute an "obligation incurred" within the meaning of section 548. Rather, section 548 applies to upstream security interests by virtue of the statutory phrase "transfer of an interest"\textsuperscript{29} in property. The granting by a subsidiary of an upstream security interest would constitute such a "transfer of an interest" under section 548.\textsuperscript{30} It is therefore necessary to determine under section 548 when the "transfer of an interest" is deemed to be made with respect to an upstream security interest that secures future advances.

Section 548(d) governs when a security interest is deemed transferred. Section 548(d) states that the "transfer" of a security interest occurs when the security interest is "so perfected that a bona fide purchaser from the [subsidiary making the upstream security interest] against whom applicable law permits such transfer to be perfected cannot acquire an interest in the property transferred that is superior to the interest in such property of the transferee [lender]."\textsuperscript{31} Thus, one must inquire as to when the upstream security interest has been "perfected" under applicable nonbankruptcy law governing matters of perfection.

Section 9-303(1) of the Uniform Commercial Code ("UCC") governs perfection of a security interest.\textsuperscript{32} It states that a security interest...
interest is perfected once it has "attached" and various routine steps required for perfection have been taken.\textsuperscript{33}

Assuming that the routine steps for perfection, which may include the filing of UCC financing statements or, in appropriate cases, physical possession of the collateral by the lender, will have been taken and completed at the time the lender originally signs the loan agreement, a second question must be answered: when has the security interest "attached"? Whether a security interest has "attached" is governed by UCC section 9-203.\textsuperscript{34} Attachment occurs when (a) there is an agreement to grant the security interest (which, for purposes of this Article, is assumed to be in place); (b) the subsidiary granting the upstream security interest has rights in the collateral (which, again, will be assumed); and (c) "value has been given."\textsuperscript{35}

In the case of a discretionary loan facility, where the lender has not promised to make advances, it is difficult to argue that any value has been given until the advances are actually made. Even after the initial advance has been made in a continuing discretionary loan facility, such that the lender has given some value, there is authority to the effect that value has not been given for an upstream security interest to the extent it secures subsequent, future advances.\textsuperscript{36} Accordingly, for an upstream security interest securing a discretionary future advance, it would appear that value is not given, and attachment does not occur, until the advance actually is made. This result is in accord with the decision in \textit{Rubin} insofar as it applies to discretionary future advances supported by upstream guaranties.

On the other hand, where the future advance is made pursuant to a committed loan agreement, the result should be different. The loan commitment, by itself, should constitute the giving of "value" within the meaning of UCC section 9-203. The term "value" is defined in UCC section 1-201(44) in several alternative ways. Under 1-201(44), a person gives "value" for rights if he acquires them "in return for a binding commitment to extend credit . . . whether or not drawn upon," or "generally, in return for any consideration sufficient to sup-

\textsuperscript{33} Id. These routine steps include the filing of UCC financing statements for most types of collateral governed by the UCC, see id. § 9-302, and physical possession of the collateral for certain other types of collateral, see id. § 9-305. See also id. §§ 9-103, 9-304 & 9-306 (related rules governing the perfection of security interests).

\textsuperscript{34} Id. § 9-203.

\textsuperscript{35} Id. §§ 9-203(1)(a)-(c).

\textsuperscript{36} See discussion in Dick Warner Cargo Handling Corp. v. Aetna Business Credit, Inc., 746 F.2d 126, 131-33 (2d Cir. 1984). See also Carlson & Shupack, Judicial Lien Priorities Under Article 9 of the Uniform Commercial Code: Part I, 5 Cardozo L. Rev. 287, 347 (1984) ("Attachment and perfection with regard to a discretionary future advance, however, can be no earlier than the date on which the advance is made, at least under the 1972 UCC.").
port a simple contract." There is no requirement under the UCC that the entity whose assets are pledged must be the party who receives the value or consideration. It may be concluded, therefore, that for an upstream security interest securing future advances made pursuant to a commitment, value is given by the lender, and accordingly the one-year statute of limitations begins running, at the time the loan agreement containing the commitment is executed, rather than the time that the future advance is made.

37 U.C.C. § 1-201(44) (1986) provides:

Except as otherwise provided with respect to negotiable instruments and bank collections (sections 3-303, 4-208 and 4-209) a person gives "value" for rights if he acquires them

(a) in return for a binding commitment to extend credit or for the extension of immediately available credit whether or not drawn upon and whether or not a chargeback is provided for in the event of difficulties in collection; or
(b) as security for or in total or partial satisfaction of a pre-existing claim; or
(c) by accepting delivery pursuant to a pre-existing contract for purchase; or
(d) generally, in return for any consideration sufficient to support a simple contract.

38 It is clear that in determining whether "value has been given" under UCC § 9-203(1)(b), the focus should be on what is given by the lender, and not necessarily on what is received by the subsidiary that grants the upstream security interest. (If the focus were on what the subsidiary receives, there would be a question in many cases whether value is given because the subsidiary often does not receive any direct benefit from the advances made to its parent corporation.) First, the use of the term "given" in § 9-203(1)(b), as a matter of statutory interpretation, focuses on the giver of value (the lender) as opposed to the party receiving the value. The definition of "value" in UCC § 1-201(44) likewise focuses on the giving of value. Second, the term "value" includes "any consideration sufficient to support a simple contract." It is black letter law that there would be sufficient contract consideration for the subsidiary to grant the upstream security interest supporting advances made to its corporate parent, even if the subsidiary fails to receive any benefit from such advances, because the lender, in making its loan commitment or making the advances, suffers a legal detriment. See, e.g., J. Calamari & J. Perillo, The Law of Contracts § 4-1, at 134 n.12 (2d ed. 1977) ("[I]t is well settled that the detriment [loan commitment or advances] may . . . run to a person other than the promisor [subsidiary]."). See also Restatement (Second) of Contracts § 79 comment b, illustration 1 (1981) ("A contracts to sell property to B. As a favor to B, who is C's friend, and in consideration of A's performance of the contract, C guarantees that B will pay the agreed price. A's performance is consideration for C's promise."). Accord Putnam Realty Inc. v. Terminal Moving & Storage Co. (In re Terminal Moving & Storage Co.), 631 F.2d 547, 551 (8th Cir. 1980).

39 This distinction between commitments to lend and discretionary future advances is consistent with the 1972 version of the UCC. For example, § 9-301(4) of the UCC provides that a lien creditor takes subject to a security interest that secures future advances made "pursuant to a commitment entered into without knowledge of the lien." U.C.C. § 9-301(4) (1986). UCC § 9-307(3) sets forth a similar rule with respect to the rights of certain buyers of goods. Id. § 9-307(3). See Dick Warner Cargo Handling Corp., 746 F.2d at 133. See also U.C.C. § 9-312(7) (1986) (detailing priority of perfected security interests).
IV. PRACTICAL CONSIDERATIONS REGARDING COMMITMENTS
AND DISCRETIONARY FUTURE ADVANCES

The foregoing discussion raises the issue of what constitutes a “commitment” to lend. Although a complete discussion of this issue is beyond the scope of this Article, the inclusion in the loan agreement of conditions precedent to the obligation of the lender to make advances should not, by itself, make the advances discretionary. Rather, the analysis should be whether, at the time the loan agreement is executed, the lender has sole and unfettered discretion in determining whether or not to make requested future advances. If the lender does not have such discretion, the future advance would be made pursuant to a commitment.40 This is consistent with section 9-105(1)(k) of the UCC which states that “[a]n advance is made pursuant to commitment [if] the secured party has bound himself to make it, whether or not a subsequent event of default or other event not within his control has relieved or may relieve him from his obligation[.]”41

Nevertheless, lenders and borrowers may wish to enter into discretionary loan facilities involving future advances supported by upstream guaranties and security interests. How should they do it to preserve the lender’s benefit of the bargain? At a minimum, they should obtain, as a condition to making each future advance, the same representations and warranties as to the subsidiary’s financial condition and compliance with the three financial tests set forth in section 548(a)(2)(B) as was obtained at the time the loan facility was originally extended. Compliance by the subsidiary at the time of the future advance with all three financial tests of section 548(a)(2)(B) would be a defense (absent fraudulent intent) to a challenge under section 548 that the upstream guaranty or security interest would be voidable, as regards such advance. There is, however, a risk that these representations and warranties are made incorrectly. A lender could gain additional comfort by performing the same level of due diligence regarding these financial tests as was made originally. Whether that is practicable would have to be examined on a case by case basis.

40 An issue that the court in *Rubin* did not focus on, but the answer to which appears evident from the court’s reasoning, is whether a discretionary future advance starts the statute of limitations running not only for an upstream guaranty or security interest supporting that advance but also for the same upstream guaranty or security interest supporting prior advances. The statute of limitations, even for a discretionary future advance, should only begin running anew as to upstream guaranties and security interests insofar as they support that particular future advance.

CONCLUSION

Logic and policy compel the result that the *Rubin* case should be limited to its facts. An upstream guaranty or security interest supporting a discretionary future advance is, respectively, an “obligation incurred” or a “transfer made” within the meaning of section 548 only once that advance is actually made. On the other hand, if the future advance is to be made pursuant to a committed loan agreement, then the “obligation [would be] incurred” or “transfer [would be] made” when the loan agreement has been executed and the upstream guaranty has been made, or the upstream security interest has been perfected.