

# NOTES

## **“TRANSFERS BY CHECK”: THE 90-DAY RULE OF PREFERENCE RECOVERY UNDER SECTION 547(b) OF THE BANKRUPTCY CODE**

In a bankruptcy proceeding, the appointed trustee of the debtor's estate has the authority to recover any transfers of property made by the debtor within 90 days prior to the bankruptcy filing.<sup>1</sup> Thus, when a debtor makes a cash payment to a creditor less than 90 days before filing for bankruptcy, the trustee may clearly recover the transfer. It is not always clear, however, whether the payment could be recovered if made by check.<sup>2</sup> For instance, what if the check is delivered *outside* of the 90-day period but is honored by the debtor's bank *within* the 90 days? This question has divided lower courts interpreting both the Bankruptcy Act of 1898 and the Bankruptcy Reform Act of 1978.<sup>3</sup>

Due to the disagreement generated by this issue, creditors receiving payment by check face uncertainty and possible litigation if the debtor later files for bankruptcy. Such litigation could be avoided if only one rule were followed.

Several circuit courts of appeals have addressed the recoverability of check transfers under the four-month time period of the Bankruptcy Act of 1898<sup>4</sup> (the Act) and have reached different conclusions. Only the Ninth Circuit, however, has addressed the question under section 547(b) of the Bankruptcy Reform Act of 1978<sup>5</sup> (the Code), which changed the time period for recovering preferences from four months to 90 days. Thus, the question of when a transfer by check occurs for the purpose of section 547(b) is unsettled in almost every circuit.

This note will analyze whether, under section 547(b), the date a check is delivered or the date the bank honors a check should determine

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1. 11 U.S.C. § 547(b)(4)(A) (1982).

2. A significant number of transactions occur by check. In the United States, between 40 and 45 billion checks are processed annually. Telephone interview with Paul Connolly, Senior Vice President, Check Product Manager, Federal Reserve Bank of Boston (Oct. 6, 1987).

3. See *infra* notes 37-77 and accompanying text.

4. Bankruptcy Act of 1898, ch. 541, § 60(b), 30 Stat. 544, 562 (repealed 1978).

5. 11 U.S.C. § 547(b) (1982) (amended by the Bankruptcy and Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 462(b)(2), 98 Stat. 333, 378). See *infra* notes 53-57 and accompanying text.

the transfer date of the funds represented by that check for the purposes of preference recovery. First, the note considers the history and development of preference law within bankruptcy and discusses the language and legislative history of section 547 of the Code.<sup>6</sup> Next, the note sets forth the purposes of both the Code and commercial law, and with these purposes in mind surveys the various rationales used by courts in resolving this issue.<sup>7</sup> This note argues that—in light of policy considerations and pragmatic concerns, as well as in order to conform to accepted commercial practice—the date on which the check was honored should be the date by which the 90-day rule is measured.

## I. HISTORY AND DEVELOPMENT OF VOIDABLE PREFERENCES IN BANKRUPTCY LAW

Under normal circumstances, common law allows a debtor to prefer any creditor over other creditors when paying or securing a debt.<sup>8</sup> Once a debtor declares bankruptcy, however, the trustee may avoid and recover for the bankruptcy estate any transfers made by the debtor in satisfaction of a prior unsecured debt which preferred one creditor over other creditors with similar claims. The preferred creditor “is deemed to have unduly improved his position to the detriment of other creditors of the debtor’s estate.”<sup>9</sup> Such transfers, or “preferences,” contradict the goal of equal distribution among all creditors—a primary policy of bankruptcy law.<sup>10</sup>

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6. See *infra* notes 8-28 and accompanying text.

7. See *infra* notes 29-77 and accompanying text.

8. 4 COLLIER ON BANKRUPTCY ¶ 547.01, at 547-6 (L. King 15th ed. 1987) [hereinafter COLLIER]; Green, *Preference Law Under the Bankruptcy Code*, 62 MICH. BUS. J. 544, 544 (1983). See generally Countryman, *The Concept of a Voidable Preference in Bankruptcy*, 38 VAND. L. REV. 713, 714 (1985) (discussing the development of the voidable preference concept and its English antecedents).

9. Young, *Preferences Under the Bankruptcy Reform Act of 1978*, 54 AM. BANKR. L.J. 221, 222 (1980); see also Green, *supra* note 8, at 544 (preference law discourages debtor from making bad faith transfers to the detriment of certain creditors).

10. HOUSE COMM. ON THE JUDICIARY, BANKRUPTCY LAW REVISION, H.R. REP. NO. 595, 95th Cong., 1st Sess. 177-78 (1977), quoted in COLLIER, *supra* note 8, ¶ 547.01, at 547-11. The House Committee stated:

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 debtor during his slide into bankruptcy. 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 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 debtor before bankruptcy furthers the second goal of the preference section—that of equality of distribution.

H.R. REP. NO. 595, 95th Cong., 1st Sess. 177-78 (1977).

Preference law is rooted in the concept of fraud. Because a debtor could discharge his debts through bankruptcy, English courts presumed that bankrupt debtors in general were fraudulent.<sup>11</sup> Treating bankruptcy as a type of fraud continued when preferences were incorporated into American bankruptcy law. This presumption, however, was rebuttable upon a showing of no intent to defraud.<sup>12</sup> As bankruptcy law developed, the requirement that unsatisfied creditors show an intent to defraud became irrelevant,<sup>13</sup> and now virtually *any* preference is avoidable if made within a specified time period.<sup>14</sup>

Section 60 of the Act allowed a trustee to void any preferential transfers of a debtor that occurred within four months preceding the bankruptcy filing.<sup>15</sup> A creditor who received a preference within the prescribed time period was required to return the payment to the bankruptcy estate where it "be[came] available for distribution to creditors generally."<sup>16</sup> The "preferred" creditor then received only a pro rata share of the resulting bankruptcy estate.<sup>17</sup>

The Code differs in language and substance from the earlier Act. The Code was intended to promote clarity, effect coordination with the Uniform Commercial Code (UCC) and avoid nonessential litigation.<sup>18</sup> The specific language of the Code section for the avoidance of preferential transfers, however, does not vary substantially from the language of its predecessor section in the Act.<sup>19</sup> Section 547 of the Code provides that a trustee may avoid any transfer from a debtor to a creditor if the transfer was made "on or within 90 days before the date of filing of the [bankruptcy] petition" and if the creditor would receive more from the

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11. DeSimone, *Section 547(c)(2) of the Bankruptcy Code: The Ordinary Course of Business Exception Without the 45 Day Rule*, 20 AKRON L. REV. 95, 101 (1986); McCoid, *Bankruptcy, Preferences, and Efficiency: An Expression of Doubt*, 67 VA. L. REV. 249, 250 (1981). For a discussion of the development of voidable preferences in bankruptcy law, see Countryman, *supra* note 8, at 714.

12. Countryman, *supra* note 8, at 714.

13. *Id.* at 722-23; see also DeSimone, *supra* note 11, at 102-08.

14. See Breitowitz, *Article 9 Security Interests as Voidable Preferences*, 3 CARDOZO L. REV. 357, 359-60 nn.8-9 (1982); Countryman, *supra* note 8, at 725; DeSimone, *supra* note 11, at 106.

15. Bankruptcy Act of 1898, ch. 541, § 60(b), 30 Stat. 544, 562 (repealed 1978); see also Countryman, *supra* note 8, at 722.

16. Ross, *The Impact of Section 547 of the Bankruptcy Code upon Secured and Unsecured Creditors*, 69 MINN. L. REV. 39, 44-45 (1984).

17. *Id.* at 45.

18. Young, *supra* note 9, at 221 (citing REPORT OF THE COMM'N ON THE BANKRUPTCY LAWS OF THE U.S., H.R. DOC. NO. 137, 93d Cong., 1st Sess., pt. 2, at 169 (1976)).

19. See Kaye, *Preferences Under the New Bankruptcy Code*, 54 AM. BANKR. L.J. 197, 197 (1980) ("With a few notable exceptions, the basic elements of a voidable preference remain substantially the same . . ."). For further discussion of the changes made in the bankruptcy preference law in the 1978 Code, see Nimmer, *Security Interests in Bankruptcy: An Overview of Section 547 of the Code*, 17 HOUS. L. REV. 289 (1980).

transfer than he would via the bankruptcy proceedings.<sup>20</sup>

## II. THE LANGUAGE AND LEGISLATIVE HISTORY OF SECTION 547

Section 547(b)(4) states that a transfer is avoidable if made "on or within 90 days before the date of the filing of the petition."<sup>21</sup> This language gives no indication of when the 90-day preference period begins if the transfer in question is made by check. Nor does the definition of "transfer" in the Code aid in this determination.<sup>22</sup> The legislative history of the Code does not address the determinative date of a transfer by check for purposes of section 547(b).<sup>23</sup> Legislative comments have been made concerning section 547(c), which provides for exceptions to the voidability of preferential transfer. Some courts believe that these comments provide insight into the transfer question.

In the Code, section 547(c) contains the first specific statutory exceptions in preference law.<sup>24</sup> These exceptions were intended to encourage creditors to come to the aid of a businessman in financial difficulty and to protect ordinary business transactions.<sup>25</sup> Transfers made in the ordinary course of business and contemporaneous exchanges for new value are excluded from the reach of the voidability provision.<sup>26</sup>

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20. 11 U.S.C. § 547 (1982 & Supp. III 1985). Section 547(b) provides:

Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property—

- (1) to or for the benefit of a creditor;
- (2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
- (3) made while the debtor was insolvent;
- (4) made—
  - (A) on or within 90 days before the date of the filing of the petition; or
  - (B) between 90 days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and
- (5) that enables such creditor to receive more than such creditor would receive if—
  - (A) the case were a case under chapter 7 of this title;
  - (B) the transfer had not been made; and
  - (C) such creditor received payment of such debt to the extent provided by the provisions of this title.

11 U.S.C. § 547(b) (1982 & Supp. III 1985).

21. 11 U.S.C. § 547(b)(4) (Supp. III 1985).

22. "[T]ransfer' means every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property, including retention of title as a security interest and foreclosure of the debtor's equity of redemption . . ." 11 U.S.C.A. § 101(50) (West Supp. 1987).

23. For a discussion of the legislative history of the 1978 Code and a proposed step-by-step research format, see Klee, *Legislative History of the New Bankruptcy Code*, 54 AM. BANKR. L.J. 275 (1980).

24. DeSimone, *supra* note 11, at 106.

25. *Id.* at 100. See *Remes v. Acme Carton Corp.* (*In re Fasano/Harriss Pie Co.*), 43 Bankr. 871, 876 (Bankr. W.D. Mich. 1984), *aff'd*, 71 Bankr. 287 (W.D. Mich. 1987); *Tidwell v. Atlanta Gas Light Co.* (*In re Georgia Steel, Inc.*), 38 Bankr. 829, 834 (Bankr. M.D. Ga. 1984).

26. Section 547(c) provides:

When the Code was drafted in 1978, such transfers had to be made within 45 days after the debt was incurred in order to qualify under these exceptions.<sup>27</sup> Accordingly, the date of transfer was an important component of section 547(c). The legislative history and official comment by Senator DeConcini on this section clearly delineates the determinative date of a transfer by check for these two exceptions:

[P]ayment of a debt by means of a check is equivalent to a cash payment, unless the check is dishonored. Payment is considered to be made when the check is delivered for purposes of sections 547(c)(1)

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The trustee may not avoid under this section a transfer—

- (1) to the extent that such transfer was—
  - (A) intended by the debtor and the creditor to or for whose benefit such transfer was made to be a contemporaneous exchange for new value given to the debtor; and
  - (B) in fact a substantially contemporaneous exchange;
- (2) to the extent that such transfer was—
  - (A) in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee;
  - (B) made in the ordinary course of business or financial affairs of the debtor and the transferee; and
  - (C) made according to ordinary business terms;
- (3) that creates a security interest in property acquired by the debtor—
  - (A) to the extent such security interest secures new value that was—
    - (i) given at or after the signing of a security agreement that contains a description of such property as collateral;
    - (ii) given by or on behalf of the secured party under such agreement;
    - (iii) given to enable the debtor to acquire such property; and
    - (iv) in fact used by the debtor to acquire such property; and
  - (B) that is perfected on or before 10 days after the debtor receives possession of such property;
- (4) to or for the benefit of a creditor, to the extent that, after such transfer, such creditor gave new value to or for the benefit of the debtor—
  - (A) not secured by an otherwise unavoidable security interest; and
  - (B) on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor;
- (5) that creates a perfected security interest in inventory or a receivable or the proceeds of either, except to the extent that the aggregate of all such transfers to the transferee caused a reduction, as of the date of the filing of the petition and to the prejudice of other creditors holding unsecured claims, of any amount by which the debt secured by such security interest exceeded the value of all security interests for such debt on the later of—
  - (A)(i) with respect to a transfer to which subsection (b)(4)(A) of this section applies, 90 days before the date of the filing of the petition; or
  - (ii) with respect to a transfer to which subsection (b)(4)(B) of this section applies, one year before the date of the filing of the petition; or
  - (B) the date on which new value was first given under the security agreement creating such security interest;
- (6) that is the fixing of a statutory lien that is not avoidable under section 545 of this title; or
- (7) if, in a case filed by an individual debtor whose debts are primarily consumer debts, the aggregate value of all property that constitutes or is affected by such transfer is less than \$600.

11 U.S.C. § 547(c) (1982 & Supp. III 1985).

27. Section 547(c)(2) was amended in 1984 to remove the 45-day requirement partly because 45 days proved to be too short a time period to accomplish the specific goal of the exception, which was to insulate short-term credit transactions between debtors and creditors. DeSimone, *supra* note 11, at 110-11. Professor DeSimone argues that the amendment did not solve the problems surrounding section 547(c)(2) but merely "substituted one set of problems for another." *Id.* at 133. None of the problems involved with this section relate to the timing problem addressed here.

and (2).<sup>28</sup>

If this legislative comment applied to section 547(b), that would be the end of the matter. Courts, however, are divided on its applicability to the 90-day requirement of section 547(b). In order to ascertain whether delivery or honor should determine the date of transfer, both the purposes of the Code as well as the practices of the commercial world should first be considered.

### III. THE PURPOSES OF THE CODE AND COMMERCIAL LAW

#### A. *Purposes of the Code.*

The preference section of the Code has three objectives. First, the section attempts to lessen the possibility of a "scramble among creditors" for an advantage; second, the section mandates a pro rata distribution among creditors; and third, the section eliminates the incentive to make unwise loans to a troubled creditor in order to obtain a preferential payment or security.<sup>29</sup>

#### B. *Commercial Law.*

The UCC provides that a check does not itself operate as an assignment of funds.<sup>30</sup> Furthermore, the UCC states that the obligation for which the check is given is not discharged until it is presented and accepted by the bank.<sup>31</sup> Thus, under accepted commercial practice, a transfer by check is not completed until the check is *honored* by the bank. In itself, this suggests that for the purpose of section 547(b) the date of honor should be used. Any deviation from the accepted practice in commercial law as codified by the UCC should be explicitly expressed by Congress or supported by compelling policy.<sup>32</sup>

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28. 124 CONG. REC. 34,000 (1978); see 124 CONG. REC. 32,400 (1978) (statement of Rep. Edwards), reprinted in 1978 U.S. CODE CONG. & ADMIN. NEWS 6457 ("Payment is considered to be made when the check is delivered for purposes of sections 547(c)(1) and (2)."). These statements are included in the Legislative Statements to 11 U.S.C. § 547 (1982).

29. REPORT OF THE COMM'N ON THE BANKRUPTCY LAWS OF THE U.S., H.R. DOC. NO. 137, 93d Cong., 1st Sess., pt. 1, at 202 (1976). For a discussion of the "race of diligence" among creditors, see DeSimone, *supra* note 11, at 98-99.

Professor Ross argues that, in addition, the preference section, by enhancing bankruptcy distributions to creditors as a whole, mitigates the financial loss to creditors thereby reducing the social costs of bankruptcy. Ross, *supra* note 16, at 45.

30. U.C.C. § 3-409(1) (1977) ("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.").

31. U.C.C. § 3-802 (1977).

32. See *Remes v. Acme Carton Corp.* (*In re Fasano/Harriss Pie Co.*), 43 Bankr. 871, 876 (Bankr. W.D. Mich. 1984) (Where congressional intent is not clearly indicated "a court should be

Those in favor of using the date of delivery as the date of transfer sometimes argue that commercial law supports using the delivery date because "in the commercial world receipt of a check, as distinguished from the date it clears the drawee bank, is customarily looked upon as the date of payment of an obligation."<sup>33</sup> In reality, this argument provides only illusory support for using the delivery date as the date of transfer. The UCC explicitly states that the obligation for which a check is given is not discharged until it is presented and accepted by the bank.<sup>34</sup> Whether or not receipt of a check is customarily looked upon as the date of payment, custom has been replaced by statute. Indeed, commercial law and pragmatic concerns of protecting the integrity of the bankruptcy process support the argument that the date of honor should constitute a transfer under section 547(b). Before turning to the policy considerations of the delivery/honor issue, it is helpful to first evaluate the various judicial approaches to resolving this issue.

#### IV. JUDICIAL APPROACHES

All of the cases raising the question of when a transfer by check occurs for purposes of avoiding preferences involve comparable factual situations. The series of events leading to litigation on this issue can be illustrated by the facts of *Eisenberg v. J L International, Ltd. (In re Sider Ventures & Services Corp.)*.<sup>35</sup> In *Sider*, the debtor delivered a check to a creditor on December 14. The check was honored by the bank on December 18. The debtor subsequently filed for bankruptcy on March 15. The 90-day period of section 547(b) began on December 15, between the date of delivery and the date on which the check was honored.<sup>36</sup> Accordingly, the trustee sued for return of the check as a preferential transfer. The creditor, however, claimed that the transfer occurred on the date of delivery and because this date fell outside the 90-day period, the transfer was not preferential. Under both the Act and the Code, courts have disagreed as to the determinative date of a transfer by check in such a situation.

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guided by policy considerations underlying the paragraph in question."), *aff'd*, 71 Bankr. 287 (W.D. Mich. 1987).

33. *Bernstein v. RJL Leasing (In re White River Corp.)*, 799 F.2d 631, 634 (10th Cir. 1986) (citing *Young Supply Co. v. McLouth Steel Corp.*, 55 Bankr. 356, 357 (Bankr. E.D. Mich. 1985)).

34. U.C.C. § 3-802 (1977).

35. 33 Bankr. 708 (Bankr. S.D.N.Y. 1983) *aff'd*, 47 Bankr. 406 (S.D.N.Y. 1985).

36. *Id.* at 709.

### A. *Decisions Under the Bankruptcy Act.*

Three circuit courts of appeals addressed the issue of when a transfer by check occurred for purposes of the four-month voidability period of section 60 of the Act—the precursor of the present 90-day requirement. In *Nicholson v. First Investment Co.*,<sup>37</sup> the United States Court of Appeals for the Eleventh Circuit found that “the date of transfer is the date when the check is honored by the paying bank.”<sup>38</sup> The court reasoned that a transfer must diminish the bankruptcy estate in order to be a preference.<sup>39</sup> Because an estate is not effectively diminished until a check is honored out of the estate’s funds, the transfer could not occur at the time of delivery.<sup>40</sup> Also, until the check is honored, another creditor could effectively collect the funds represented by the check through such means as garnishment proceedings.<sup>41</sup> It is not until the check is honored and the creditor actually receives the funds that the estate is depleted and a transfer has occurred. The United States Court of Appeals for the Seventh Circuit, in an earlier decision, came to the same conclusion.<sup>42</sup>

In contrast, the United States Court of Appeals for the Ninth Circuit held, in *Shamrock Golf Co. v. Richcraft, Inc.*,<sup>43</sup> that checks delivered to creditors outside the four-month voidability period were not voidable as preferential transfers despite the fact that they were honored by the bank within four months of the date of filing.<sup>44</sup> The court held that payment by check was equivalent to payment by cash “so long as the check was presented within a reasonable time and not dishonored.”<sup>45</sup>

### B. *Decisions Under the Bankruptcy Code.*

Rather than clarifying the issue, the Code and its accompanying legislative history have only exacerbated the problem of determining the transfer date of a check under the Code’s 90-day limitation. The added confusion is due to the potential relevance of other sections of the Code to the timing question of transfers by check under section 547(b). For instance, does Senator DeConcini’s comment to section 547(c) that a

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37. 705 F.2d 410 (11th Cir. 1983).

38. *Id.* at 413.

39. *Id.* (citing *In re Souder*, 449 F.2d 284 (5th Cir. 1971)); see also COLLIER, *supra* note 8, ¶ 547.03[2], at 547-22 to 547-25 (transfer must deplete debtor’s estate in order to be a preference).

40. 705 F.2d at 413.

41. *Id.*

42. *Fitzpatrick v. Philco Finance Corp.*, 491 F.2d 1288, 1293 (7th Cir. 1974).

43. 680 F.2d 645 (9th Cir. 1982).

44. *Id.* at 646.

45. *Id.* The court also referred to the legislative history of section 547(c) of the Code even though the case arose under the Act. *Id.* For a discussion of section 547(c) and cases interpreting it, see *infra* notes 54-57 and accompanying text.



check is to be treated as a transfer at the time of delivery apply, either directly or by implication, to section 547(b)?<sup>46</sup> Further, does section 547(e),<sup>47</sup> which relates to the perfection of transfers of real property or securities, apply to section 547(b)—and if so, with what result? In answering these questions, courts not only disagree as to whether the date of delivery or the date of honor constitutes a transfer by check, they also apply varying rationales when reaching either conclusion.

When deciding the determinative date of a transfer by check, courts rely on one of four primary theories.<sup>48</sup> The first theory posits that Senator DeConcini's comment to treat the delivery of a check as a transfer under the Code's exception section—547(c)—applies to section 547(b): thus, delivery constitutes a transfer of a check for purposes of section 547(b).<sup>49</sup> The second theory applies the rule in section 547(e)(2)(A) that delivery is the equivalent of a transfer between the parties: thus, delivery of the check constitutes transfer.<sup>50</sup> The third theory posits that section 547(e)(1)(B) applies to section 547(b) such that a transfer by check occurs when another creditor can no longer secure a judicial lien on the transferred property: thus, honor constitutes a transfer.<sup>51</sup> The last the-

46. See *supra* note 28 and accompanying text.

47. Section 547(e) provides:

(1) For the purposes of this section—

(A) a transfer of real property other than fixtures, but including the interest of a seller or purchaser under a contract for the sale of real property, is perfected when a bona fide purchaser of such property from the debtor against whom applicable law permits such transfer to be perfected cannot acquire an interest that is superior to the interest of the transferee; and

(B) a transfer of a fixture or property other than real property is perfected when a creditor on a simple contract cannot acquire a judicial lien that is superior to the interest of the transferee.

(2) For the purposes of this section, except as provided in paragraph (3) of this subsection, a transfer is made—

(A) at the time such transfer takes effect between the transferor and the transferee, if such transfer is perfected at, or within 10 days after, such time;

(B) at the time such transfer is perfected, if such transfer is perfected after such 10 days; or

(C) immediately before the date of the filing of the petition, if such transfer is not perfected at the later of—

(i) the commencement of the case; and

(ii) 10 days after such transfer takes effect between the transferor and the transferee.

(3) For the purposes of this section, a transfer is not made until the debtor has acquired rights in the property transferred.

11 U.S.C. § 547(e) (1982 & Supp. III 1985).

48. Two or more compatible theories have also been applied in the same case.

49. *E.g.*, *Robert K. Morrow, Inc. v. Agri-Beef Co. (In re Kenitra, Inc.)*, 797 F.2d 790, 791 (9th Cir. 1986), *cert. denied*, 107 S. Ct. 928 (1987); *Shamrock Golf Co. v. Richcraft, Inc.*, 680 F.2d 645, 646 (9th Cir. 1982); *Franzwa v. Pro Sales, Inc. (In re Walker Indus. Auctioneers, Inc.)*, 45 Bankr. 452, 453-54 (Bankr. D. Or. 1984).

50. *E.g.*, *Eisenberg v. J L Int'l, Ltd. (In re Sider Ventures & Servs. Corp.)*, 33 Bankr. 708 (Bankr. S.D.N.Y. 1983), *aff'd*, 47 Bankr. 406 (S.D.N.Y. 1985).

51. *Bob Grissett Golf Shoppes, Inc. v. Pro Group, Inc. (In re Bob Grissett Golf Shoppes, Inc.)*, 34 Bankr. 320, 322 (Bankr. E.D. Va. 1983); *see, e.g.*, *Artesani v. Travco Plastics Co. (In re Super*

ory, followed by the majority of courts, compares the different policy concerns underlying section 547(c) and 547(b) and finds that each justifies different transfer dates. While the policy behind section 547(c)'s exceptions does require that the date of delivery controls the date of transfer, the policy behind section 547(b)'s 90-day preference period requires that the date of honor determines the date of transfer.<sup>52</sup>

1. *The First Theory: Application of the Legislative Comment to Section 547(b).* The United States Court of Appeals for the Ninth Circuit is the major judicial proponent of the theory that the date of delivery is the determinative date of a transfer by check under section 547(b). Although addressing the question under the Act and not under the Code, the Ninth Circuit, in *Shamrock Golf Co. v. Richcraft, Inc.*,<sup>53</sup> used Senator DeConcini's comment accompanying section 547(c)(1) and (2) to support its conclusion. Section 547(c) contains exceptions which allow a creditor to keep contemporaneous transfers—that is, to keep those transfers where new value is exchanged for an equivalent value in a single transaction.<sup>54</sup> The court reasoned that payment by check was the equivalent of a cash sale and thus a contemporaneous transfer.<sup>55</sup> Accordingly, because the date of the delivery of a check constitutes the date of transfer for contemporaneous transfers, the date of delivery was also the date of transfer for the statutory time period in section 547(b).<sup>56</sup> This position was directly affirmed in *Morrow v. Agri-Beef Co. (In re Kenitra)*,<sup>57</sup> a recent Ninth Circuit case arising under the Code.

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Market Distribs. Corp.), 25 Bankr. 63, 64-65 (Bankr. D. Mass. 1982); *Ardmore Sales Co. v. Thico Plan, Inc. (In re Ardmore Sales Co.)*, 22 Bankr. 911, 913 (Bankr. E.D. Pa. 1982); *Carmack v. Zell (In re Mindy's, Inc.)*, 17 Bankr. 177, 178-79 (Bankr. S.D. Ohio 1982); *Itule v. Luhr Jensen & Sons (In re Sportsco, Inc.)*, 12 Bankr. 34, 36 (Bankr. D. Ariz. 1981).

52. *E.g.*, *Remes v. Acme Carton Corp. (In re Fasano/Harriss Pie Co.)*, 43 Bankr. 871, 873-76 (Bankr. W.D. Mich. 1984), *aff'd*, 71 Bankr. 287 (W.D. Mich. 1987); *Video East, Inc. v. Acadia Video Co. (In re Video East, Inc.)*, 33 Bankr. 61, 63 (Bankr. E.D. Pa. 1983); *Brent Explorations, Inc. v. Karst Enters. (In re Brent Explorations, Inc.)*, 31 Bankr. 745, 751-52 (Bankr. D. Colo. 1983); *Harris v. Harbin Lumber Co. (In re Ellison)*, 31 Bankr. 545, 547 (Bankr. M.D. Ga. 1983); *Quinn v. TTI Distrib. Corp. (In re Moran Air Cargo, Inc.)*, 30 Bankr. 406, 408 (Bankr. D.R.I. 1983); *Gander Mountain, Inc. v. Beatrice Foods Co. (In re Gander Mountain, Inc.)*, 29 Bankr. 269, 270 (Bankr. E.D. Wis. 1983); *Campbell v. Kimberly Clark Corp. (In re Skinner Lumber Co.)*, 27 Bankr. 669, 671 (Bankr. D.S.C. 1982); *Rovzar v. Biddeford & Saco Bus Garage, Inc. (In re Saco Local Dev. Corp.)*, 25 Bankr. 876, 879 n.5 (Bankr. D. Me. 1982); *In re Duffy*, 3 Bankr. 263, 266 (Bankr. S.D.N.Y. 1980).

53. 680 F.2d 645 (9th Cir. 1982).

54. 11 U.S.C. § 547(c) (1) (1982). A contemporaneous transfer is essentially a "wash transaction"—one in which an amount of property is transferred in return for equivalent new property. Such a transaction does not deplete the debtor's estate since what transfers out is replaced. Thus the remaining creditors are not prejudiced by such a payment.

55. 680 F.2d at 646.

56. *Id.*

57. 797 F.2d 790, 791 (9th Cir. 1986), *cert. denied*, 107 S. Ct. 928 (1987).

2. *The Second and Third Theories: Application of Section 547(e).*

Federal courts have applied various subsections of section 547(e) that deal with the issue of when a transfer is "perfected" to transfers by check for the purpose of determining the date of transfer for section 547(b).<sup>58</sup> These applications are neither uniform nor consistent. Indeed, different courts have reached opposite holdings by using different subsections of section 547(e) in their analysis.

Although section 547(e) generally pertains to the perfection of interest in real property or securities,<sup>59</sup> some courts have applied this section to checks as well. In *Eisenberg v. J L International, Ltd. (In re Sider Ventures & Services Corp.)*,<sup>60</sup> the court applied section 547(e)(2)(A) to a situation involving section 547(b). Section 547(e)(2)(A) provides that the time of transfer is when it "takes effect between the transferor and the transferee if [it] is perfected at, or within ten days after [this] time."<sup>61</sup> Using this section's language, the court in *Sider* held that the date of the delivery of a check was controlling as the date of transfer under 547(b) because it is at this point that it "takes effect" between the debtor and the creditor.<sup>62</sup>

A contrary result was reached in *Artesani v. Travco Plastics Co. (In re Super Market Distributors)*.<sup>63</sup> Instead of applying section 547(e)(2)(A) to the question, the court applied section 547(e)(1)(B), which provides that a transfer is perfected "when a creditor on a simple contract cannot acquire a judicial lien that is superior to the interest of the transferee."<sup>64</sup> In accordance with this subsection, the court held that the date of the transfer by check was the date it was honored by the bank because after that time a judicial lien could no longer be attached to the funds.<sup>65</sup>

Several courts have refused to apply section 547(e).<sup>66</sup> These courts

58. See *supra* note 48.

59. See *supra* note 47.

60. 33 Bankr. 708 (Bankr. S.D.N.Y. 1983), *aff'd*, 47 Bankr. 406 (S.D.N.Y. 1985).

61. 11 U.S.C. § 547(e)(2)(A) (1982).

62. 33 Bankr. at 711. The court noted that the check had, in fact, been honored by the payee bank within 10 days after delivery, implying that actual perfection occurred when it was honored.

63. 25 Bankr. 63 (Bankr. D. Mass. 1982).

64. 11 U.S.C. § 547(e)(1)(B) (1982).

65. 25 Bankr. at 64-65.

66. *E.g.*, *Ray v. Security Mut. Fin. Corp. (In re Arnett)*, 731 F.2d 358, 362 (6th Cir. 1984) ("Congress has given security interests specialized treatment both in sections 547(c)(3) and 547(e)(2). . . . Congress [intended] to differentiate [between the transfer of checks and security interests] under the Bankruptcy Reform Act."); *O'Neill v. Nestle Libbys P.R., Inc.*, 729 F.2d 35, 38 (1st Cir. 1984) (Section 547(e) "deals with the perfection of security interests in the debtor's property."); *Chaitman v. Chicago Boiler Co. (In re Almarc Mfg., Inc.)*, 52 Bankr. 582, 584 (Bankr. N.D. Ill. 1985) ("The legislative history of [section 547(e)] . . . restricts [its] application to matters involving secured transactions."); *Remes v. Acme Carton Corp. (In re Fasano/Harriss Pie Co.)*, 43 Bankr. 871, 875 (Bankr. W.D. Mich. 1984) (Section 547(e) was not intended "to apply beyond the realm of

reason that Congress intended section 547(e) to apply only to secured transactions. Because a check does not create a security interest in the funds involved, application of this section to checks is misplaced.

The court in *Remes v. Acme Carton Corp. (In re Fasano/Harriss Pie Co.)*<sup>67</sup> advanced this argument, following both the First<sup>68</sup> and Sixth<sup>69</sup> Circuits in rejecting the application of section 547(e) to the controversy. The court concluded that Congress intended section 547(e) to apply only to secured transactions.<sup>70</sup> This conclusion is based on the legislative history of section 547(e), which states that the section "is designed to reach the different results under the 1962 version of Article 9 of the U.C.C. [dealing with secured transactions] and under the 1972 version . . ." <sup>71</sup> Because checks are not security instruments under Article 9 of the UCC, and section 547(e) deals only with secured instruments, this section does not apply to checks in determining when they constitute a transfer under the other subsections of section 547.<sup>72</sup>

3. *The Fourth Theory: Policy Considerations Mandate the Date of Honor as the Date of Transfer.* The majority of bankruptcy courts—outside of the Ninth Circuit—that have decided the issue under section 547(b) have held that the date the bank honors the check is the date that determines whether the transfer is preferential.<sup>73</sup> These courts reject theories that look to outside sources such as the legislative comment to section 547(c) or the language of section 547(e); rather these courts analyze the underlying policy bases for the different subsections of section 547, as well as the traditional commercial practice of negotiable instruments.

In *Remes v. Acme Carton Corp. (In re Fasano/Harriss Pie Co.)*,<sup>74</sup> for example, one of several checks issued by the now-bankrupt debtor was delivered before the 90-day preference period but honored within the 90 days. The court held that the date of honor determined the date of trans-

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secured transactions."), *aff'd*, 71 Bankr. 287 (W.D. Mich. 1987); *Franzwa v. Pro Sales, Inc., (In re Walker Indus. Auctioneers, Inc.)*, 45 Bankr. 452, 454 (Bankr. D. Or. 1984) (Section 547(e) "does not govern transactions that are not . . . transfer[s] of a security interest in property.").

67. 43 Bankr. 871 (Bankr. W.D. Mich. 1984), *aff'd*, 71 Bankr. 287 (W.D. Mich. 1987).

68. *O'Neill v. Nestle Libbys P.R., Inc.*, 729 F.2d at 38.

69. *In re Arnett*, 731 F.2d at 364.

70. 43 Bankr. at 875. See also cases cited *supra* note 66.

71. 43 Bankr. at 875 (quoting S. REP. NO. 595, 95th Cong., 2d Sess. 89 (1978)).

72. *Id.* See *O'Neill v. Nestle Libbys P.R., Inc.*, 729 F.2d 35, 38 (1st Cir. 1984); *Chaitman v. Chicago Boiler Co. (In re Almarc Mfg., Inc.)*, 52 Bankr. 582, 584 (Bankr. N.D. Ill. 1985); *Franzwa v. Pro Sales, Inc. (In re Walker Indus. Auctioneers, Inc.)*, 45 Bankr. 452, 454 (Bankr. D. Or. 1984).

73. A number of courts have merely followed the lead of other bankruptcy courts without performing their own analysis. *E.g.*, *In re Moran Air Cargo, Inc.*, 30 Bankr. 406 (Bankr. D.R.I. 1983); *In re Skinner Lumber Co.*, 27 Bankr. 669 (Bankr. D.S.C. 1982); *In re Fabric Buys of Jericho, Inc.*, 22 Bankr. 1010 (Bankr. S.D.N.Y. 1982).

74. 43 Bankr. 871 (Bankr. W.D. Mich. 1984), *aff'd*, 71 Bankr. 287 (W.D. Mich. 1987).

fer and allowed the check to be avoided and returned to the estate.<sup>75</sup> The court based its holding on an analysis of congressional purpose<sup>76</sup> and distinguished the use of the date of delivery for section 547(c) by the different policy considerations of that section.<sup>77</sup>

### C. *Policy Concerns.*

The policies underlying sections 547(b) and 547(c) do justify different determinations as to the date of transfer. Subsections 547(c)(1) and (2) benefit the *debtor*; they are "designed to encourage creditors to deal with a failing business and to protect ordinary business transactions" in order to prevent the debtor's slide into bankruptcy.<sup>78</sup> Treating the check as cash and accordingly the delivery date as the date of transfer, as required by Senator DeConcini's comment, best implements this policy.<sup>79</sup> The exceptions of 547(c) allow a creditor to keep transfers that occur in a contemporaneous transfer or a transfer in the ordinary course of business. Because such transactions involve a simultaneous exchange of equivalent value, it follows that the payment should be treated as a cash transaction whether the payment is made by cash or by check. Thus, under section 547(c), "Congress intended to create an *exception* to the general rule that a check is not a transfer until it is honored by the drawee bank."<sup>80</sup>

Section 547(b) is far more concerned with the welfare of *creditors*. It addresses the depletion of the debtor's estate<sup>81</sup> in order to avoid transactions to favored creditors.<sup>82</sup> To be avoidable, a preferential transfer must occur in a credit transaction; transfers must be in payment of an already existing debt and such transfer must deplete the bankruptcy estate.<sup>83</sup> No policy is promoted by treating a transfer as cash for purposes of avoiding transfers to favored creditors. Unlike section 547(c), no justification exists for deviating from accepted commercial practice or for deviating

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75. *Id.* at 874.

76. The court also noted that a majority of courts used the date of honor. *Id.* at 873-74.

77. *Id.* at 876 n.2.

78. *Id.* at 876; *see also* Tidwell v. Atlanta Gas Light Co. (*In re* Georgia Steel, Inc.), 38 Bankr. 829, 834 (Bankr. M.D. Ga. 1984) ("Such a delay is clearly not in the interest of a distressed business . . .").

79. Bernstein v. RJL Leasing (*In re* White River Corp.), 799 F.2d 631, 634 (10th Cir. 1986) ("The delivery date view encourages trade creditors to continue dealing with troubled businesses by insulating normal business transactions from the trustee's avoiding power."); *Fasano/Harris*, 43 Bankr. at 876 (date of delivery best implements the policy of sections 547(c)(1), (2) and (4)).

80. *Georgia Steel*, 38 Bankr. at 834 (emphasis added).

81. *Id.*

82. *Fasano/Harris*, 43 Bankr. at 876 n.2.

83. 11 U.S.C. § 547(b) (1982).

from the general rule that a check is not a transfer until it is honored.<sup>84</sup> Nor has Congress explicitly expressed any intention of creating an exception or deviation for section 547(b). Thus, the date of honoring a check should remain the date that the transfer took place.<sup>85</sup>

The *Fasano/Harriss* court also relied on basic commercial law principles to support its reasoning. The court noted that "a check simply presents an order to the drawee bank to make payment and does not vest in the payee any title to or interest in the funds of the drawee bank until the check is honored."<sup>86</sup> Therefore, because a creditor does not receive an interest in funds until a check is honored, a transfer does not occur until that time.<sup>87</sup>

#### V. PRAGMATIC JUSTIFICATIONS FOR USING THE DATE OF ACCEPTANCE

Pragmatic concerns also justify using the date of honor over the date of delivery for purposes of section 547(b). The strongest argument against using the date of honor is that the date of delivery would provide an element of certainty for creditors receiving payment by check. This argument, however, is not compelling.

First, as recently noted by the Ninth Circuit, an opportunity for manipulation arises if the delivery of a check is considered the transfer of funds.<sup>88</sup> Under such circumstances, the debtor, as opposed to the bank, determines the precise date of transfer. It is also the debtor who chooses the date of filing; by determining both, a debtor effectively can "prefer" one creditor over another. Therefore, though creating "certainty" for an individual creditor, using the date of delivery permits manipulation and creates uncertainty for all others involved in the bankruptcy process.

In addition, several practical arguments mitigate against the concern for providing creditors with certainty. First, a transferee receives the funds represented by a check on the day the check is honored. Using this date to determine the date of transfer follows logically. Until the bank honors a check, a creditor has no control over the funds represented by the check and in fact, has no guarantee of receiving payment. For instance, other creditors may prevent collection on a check through garnishment of the bank account, the debtor may stop payment on a check, or there may be insufficient funds to cover the payment of a

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84. See *supra* note 77 and accompanying text.

85. *Fasano/Harriss*, 43 Bankr. at 873-74; *Georgia Steel*, 38 Bankr. at 834.

86. 43 Bankr. at 873-74.

87. *Id.* See also notes 30-32 and accompanying text.

88. *Kupetz v. Elaine Monroe Assoc. (In re Wolf & Vine)*, 825 F.2d 197, 202 (9th Cir. 1987).

check.<sup>89</sup> Because the creditor remains vulnerable to these actions until the check is honored by the bank, a creditor has not truly received a transfer of the funds when the check is delivered and should not be treated as having received them under section 547(b).

Similarly, as noted in *In re Georgia Steel, Inc.*,<sup>90</sup> the date of honor should determine the date of transfer because that is when the debtor's estate is depleted. The funds represented by a check remain part of the debtor's property until the check is honored by the bank which debits the debtor's account. Until the check is honored and the debtor's account is debited, no actual transfer of funds has occurred. Instead, only an exchange of a negotiable instrument—the check—has occurred between the parties.<sup>91</sup>

If a particular creditor desires to protect himself from having his payment recalled, the creditor may require payment by cashier's check or certified check. These instruments are obligations of the bank and effectively diminish the estate of the debtor when certified.<sup>92</sup> Because the check is immediately honored and has *already* diminished the debtor's estate, the date of delivery would be the effective equivalent of the date of transfer.

## VI. CONCLUSION

The preference section of the Code has spawned disagreement over when a transfer by check occurs for its various provisions. Courts examining this issue have come to a variety of conclusions and use differing rationales even when arriving at the same conclusion. Neither the specific wording of the section nor its legislative history presents an obvious solution to the question. Nonetheless, the policy considerations underlying the section, as well as basic commercial law and pragmatic concerns, have led a majority of bankruptcy courts to hold that the date of honor is the date of transfer for purposes of section 547(b). The reasoning of these courts is compelling. In the future, courts should analyze this issue by weighing the relevant policy considerations. They should reject the Ninth Circuit's application of the legislative comment to section 547(c) and rule that the determinative date of a transfer for section 547(b) is the date on which the check is honored by the bank.

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89. 43 Bankr. at 874.

90. 38 Bankr. at 829, 833-34 (Bankr. M.D. Ga. 1984).

91. *Id.* at 833.

92. *Meister v. State National Bank of Connecticut (In re Mailbag Int'l, Inc.)*, 28 Bankr. 905 (Bankr. D. Conn. 1983) (certified check transferred at time of delivery).