ARTICLE 9 SECURITY INTERESTS
AS VOIDABLE PREFERENCES

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INTRODUCTION

On November 6, 1978, the President signed into law the first major revision of the Bankruptcy Act\(^1\) since the 1938 Chandler Amendments, effective for bankruptcies filed on or after October 1, 1979.\(^2\) The culmination of eight years of study and planning,\(^3\) the Act affects virtually every area of bankruptcy law and administration.\(^4\) The focus of this Article concerns the substantial changes made in the


\(^2\) For convenience, unless otherwise indicated, I will refer to the sections as they are numbered in Title 11 of the United States Code rather than in the Statutes At Large. As is customary, the practice with regard to the 1898 and Chandler Acts will be the reverse.

\(^3\) In response to the tremendous growth of consumer bankruptcies since World War II, Congress in 1970 created the Commission on the Bankruptcy Laws of the United States with a mandate to "study, analyze, evaluate, and recommend changes" in the 1898 Act. Pub. L. No. 91-354, 84 Stat. 488 (1970). After two years of hearings and study, the Commission in July, 1973, produced a report consisting of two principal parts: Part I was a critique of the present system with recommendations for change; Part II consisted of a proposed Bankruptcy Act of 1973 to be submitted to Congress along with an elaborate section by section commentary. See 119 Cong. Rec. 33,445 (1973) (extensions of remarks accompanying the introduction of the Bankruptcy Act of 1973). As Chairman Marsh stated: "The Commission decided that the only effective way to test the validity of its general conclusions, and to reveal possible hidden difficulties or consequences that might be initially overlooked, was to attempt the arduous task of formulating those recommendations in precise statutory language." Transmittal letter, Report of the Commission on the Bankruptcy Laws of the United States, Part I, H.R. Doc. No. 93-137, 93d Cong., 1st Sess. vi (1973) [hereinafter cited as Commission Report]. In addition, the Commission authorized a number of studies, some of which appeared in law reviews. All Commission records are filed in the National Archives under accession number NN-373-186, Record Group 148. See id. Part 1, at xi-xvii n.1.

The Commission draft was in fact introduced in the 93d Congress as H.R. 10,792 and S. 2565. See 119 Cong. Rec. 33,445 (1973). It was reintroduced in 1975 as H.R. 31, 94th Cong., 1st Sess. and S. 236, 94th Cong., 1st Sess. 121 Cong. Rec. 145, 641 (1975). At the same time, a rival proposal differing primarily in its approach to the structure of the bankruptcy court system was introduced by the National Conference of Bankruptcy Judges as H.R. 32 and S. 235 ("Judges' Bill"). Extensive hearings were held for almost a year but neither bill was reported out of committee. No further action was taken until the 95th Congress, where H.R. 8200, the bill that eventually became law, was introduced. See also S. Riesenfeld, Cases and Materials on Creditors' Remedies and Debtors' Protection, 507-10 (3d ed. 1979).

For a brief account of H.R. 8200's political history including the last-minute lobbying efforts of Chief Justice Burger to keep the bill off the Senate floor, see Congress Approves New Bankruptcy System, XXXVI Cong. Q. WEEKLY REP. 2966-69.

\(^4\) For a brief rundown of the major changes the law makes in other areas, see Spivey, Bringing Bankruptcy Into Focus, 84 CASE & COM. 3 (Jan. 1979).
law of voidable preferences—formerly governed by section 60, now governed by section 547—as they pertain to security interests under the Uniform Commercial Code ("UCC"). Section 547 generally follows the earlier proposals of the Commission on the Bankruptcy Laws of the United States which in turn closely track a revision of section 60 put forth in 1970 by a committee of the National Bankruptcy Conference under the chairmanship of Professor Gilmore.

The law of preferences, introduced by Lord Mansfield in the 18th Century, has been a part of federal bankruptcy legislation for over 130 years. Its basic elements were codified in the Act of 1898.

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5 Aspects of section 547 which do not directly relate to the validity of Article 9 security interests will not be discussed. See, e.g., B.R.A. § 547(c)(2), (4), (6).

6 The proposals of the Commission on the revision of preference law are contained in Section 4-607 of its draft. See Commission Report, supra note 3, Part II, § 4-607, 166-75.

7 The Committee on Coordination of the Bankruptcy Act and the UCC was established by the National Bankruptcy Conference in 1966. Its primary task was to deal with the problem of security interests in bankruptcy. The Committee is commonly referred to by the name of its Chairman, Professor Grant Gilmore, a principal draftsman of Article 9, and that practice will be followed here as well. An early revision of section 60 was produced in 1967 and again in 1968, but controversy over the proper treatment of accounts and inventory delayed its consideration by the full conference. The Committee's final report to the Conference, a draft of a new section 60, and an accompanying commentary are reprinted as an appendix to House Judiciary Report, H.R. Rep. No. 595, 95th Cong., 2d Sess. 204-19, reprinted in 1978 U.S. ConG. Code & Ad. News 5963, 6164-79 [hereinafter cited as "House Report"). The reliance of the Commission on the earlier work of the Gilmore Committee was openly acknowledged. See Commission Report, supra note 3, Part I at xiv, 183-236. Indeed, Professor Kennedy, the Executive Director of the Commission, was a member of that same Committee.

8 See Worseley v. DeMattos, 1 Burr. 467, 97 Eng. Rep. 407 (1758). Lord Mansfield emphasized the fraudulent intent of a debtor to avoid payments to his other creditors. He did not condemn preferences when made in the ordinary course of business with no intent to defraud. Even today, the debtor's purpose or state of mind plays a major role in British law. "Where the debtor is induced or compelled by the 'importunity and pressure' of a creditor to favor that creditor, there is no preference under the English law." 3 Collier on Bankruptcy ¶ 60.04, at 769 (J. Moore 14th ed. 1977) (citing Williams on Bankruptcy at 338 (15th ed. 1937)). Since 1898, this has not been true in the United States where the so-called "objective" theory of preferences has prevailed; "objective" in the sense that the debtor's intent to prefer is irrelevant. See infra note 9. Interestingly enough, some of the arguments upholding section 9-108 of the UCC rely on ideas contained in Lord Mansfield's formulation. See Hogan, The Portland Newspaper Case and the Bankruptcy Preference Challenge, in Ia P.F. Coogan, W.E. Hogan, & D. Vact, Secured Transactions Under the Uniform Commercial Code 1207-08 (1973) [hereinafter cited as Coogan, Hogan & Vacts].

9 The first Bankruptcy Act of 1800, ch. 19, 2 Stat. 19 (repealed 1803), made no mention of preferences. However, section 2 of the Bankruptcy Act of 1841, 5 Stat. 440 (repealed 1843) provided that all payments made "in contemplation of bankruptcy, and for the purpose of giving any creditor" priority over general creditors shall be "void, and a fraud" under the Act. Note that the voidability of the transfer was conditioned on the debtor's intent to prefer, obviously influenced by the British view of preferences as a species of fraudulent conveyance. On the other hand, there was neither a time limitation of four months nor any requirement regarding the preferred creditor's state of mind. Section 35 of the Bankruptcy Act of 1867, 14 Stat. 517
Yet a variety of amendments in 1938 and 1950,\(^1\) necessitated by the
growth of new forms of personal property security interests and com-
mercial financing, had converted a relatively straightforward avoid-
ance provision into an intolerably complex and verbose body of law.

Part of the difficulty undoubtedly rested on the fact that section
60 was simply expected to do too much, handling many areas better
dealt with under fraudulent conveyance law.\(^2\) Even more basically,
while section 60 had "become the principal conduit for discussion of
the extent to which security interests were valid against or voidable by
the trustee,"\(^3\) it necessarily reflected terminology and concepts which
to a large extent were displaced by the passage of the UCC in forty-
ine states.\(^4\) The precise meaning of any given provision as it applied
to an Article 9 security interest was often, at best, a matter of con-
jecture. Thus, at a minimum there was a burning need for a revision that
would simplify the existing language and coordinate it with Article 9.

The problem, however, ran deeper. The law of voidable prefer-
ces, like most provisions in bankruptcy law, sought the implementa-
tion of two goals which, to some extent, are inconsistent: (1) equality
of treatment among creditors; and (2) debtor rehabilitation. On one
hand, the voidability of preferences prevents the enrichment of some
creditors at the expense of others on the eve of bankruptcy, thereby
facilitating the policy of equality of distribution.\(^5\) In furthermore of

\(^1\) See Bankruptcy Act of 1898, ch. 541, § 60, 30 Stat. 544.
\(^2\) Id. Section 60 was amended in 1903, 1910, and 1926 before its wholesale revision in 1938.
\(^3\) See infra text accompanying notes 66-71.
\(^4\) The 1938 Amendments to the Bankruptcy Act of 1898 are promulgated at Pub. L. No. 75-
696, 52 Stat. 840; the amended section 60 is found at 52 Stat. 889. The 1950 amendments are at
\(^5\) For a clear and forceful argument supporting this view, see Morris, Bankruptcy Law
6164.
\(^7\) As early as 1968, the UCC was adopted as law in 49 states, the District of Columbia, and
the Virgin Islands. Louisiana, the only exception, has adopted most of the UCC except for
amendments to Article 9 promulgated by the Permanent Editorial Board have been adopted by
31 jurisdictions, as of the date of this writing. See Table at Uniform Commercial Code, 1
U.L.A. 1 (pamphlet 1981). Unless otherwise indicated, all references to Article 9 are to the 1972
Official Text.
\(^8\) It must be recognized, however, that the theme of equality of distribution may be more of
a catchphrase than a reality. Some creditors are "more equal" than others. Similar to section 64
of the Bankruptcy Act of 1898, section 507 of the BRA, sets up priorities in distribution for
administrative claims, taxes, certain wage claims and the like. Since most bankruptcies do not
generate enough funds to cover even administrative expenses, the effect of recovering a prefer-
the second policy, the avoidance of prebankruptcy transfers also serves to discourage creditors from attempting to dismember the debtor during a period of great financial difficulty, thus affording the debtor the necessary breathing space to attempt to reach an agreement with his creditors and avoid the draconian remedy of bankruptcy.\textsuperscript{16}

At the same time, however, given the fact that the pro rata allocation of available assets to general creditors invariably results in giving them only a fraction of their claims, if anything at all,\textsuperscript{17} insistence on distributive equality may actually hinder, rather than foster, the debtor's rehabilitation by shutting him off from available avenues of relief, i.e., prebankruptcy extensions of credit, that would obviate the need to resort to liquidation. Moreover, a strict requirement of equality is detrimental not only to the rehabilitative prospects of the troubled debtor but to the economy in general since the risk of a negligible return in the event of bankruptcy operates as a significant constraint on the extension of credit. Thus, the preference law walked, and still walks, a narrow tightrope, attempting to strike a delicate balance between the goal of distributive equality and the need to facilitate secured credit in a modern economy.

It was widely believed that section 60 was largely unresponsive to these concerns. It was ineffective in catching the transactions deserving of condemnation,\textsuperscript{18} yet unduly harsh in invalidating transactions which the commercial world regarded as wholly legitimate and deserving of legal protection.\textsuperscript{19} Section 547 attempts to provide a new accommodation of the conflicting and diverse policies underlying this branch of the law. The extent of its success will be examined in the remainder of this Article.

\footnotesize{ence in most situations is not its pro rata distribution to general creditors, but its contribution towards priority expenses. See infra note 17. As one commentator stated, "taking from Preferred Peter to pay Priority Paul does not smack of the equality which is equity." Morris, supra note 12, at 738.


\textsuperscript{17} According to statistics compiled by the Administrative Office of the United States Courts, 210, 367 cases were filed in the bankruptcy courts from October 1, 1979 through June 30, 1980. Over 70\% (157,749) were filed under Chapter 7, the vast majority of which were voluntary consumer bankruptcies. Due to liberalized exemptions and other factors, more than 90\% of all liquidation cases provide no assets. Annual Report of the Director of the Administrative Office of the United States Courts 1980, Reports of the Proceedings of the Judicial Conference of the United States, Tables F-1 to F3BC, at 546-85.

\textsuperscript{18} As noted later, the requirement of showing that the preferred creditor had reasonable cause to know of the debtor's insolvency precluded recovery in all but the "most egregious cases." See House Report, supra note 7 at 178, reprinted in 1978 U.S. Cong. Code \& Ad. News at 6138-39.

\textsuperscript{19} Perhaps the best example was the contention that all security interests in accounts receivable or inventory acquired within four months of bankruptcy were voidable preferences notwithstanding the fact that the extension of credit and filing of the financial statement occurred well before the four month period. See infra, Part II.
I. What is a Voidable Preference and How is it Recovered?

The definition of a voidable preference was formerly contained in two subsections of section 60. Section 60(a) defined the basic term as a transfer of the property of the debtor, for or on account of an antecedent debt, made by the debtor while insolvent, within four months before the filing of a petition. Section 60(a)(2) through (8) dealt with the ostensibly simple question of when a transfer was deemed made. After defining the basic elements of a preference, section 60(b) went on to say that if the creditor, at the time of the transfer, had reasonable cause to believe the debtor was insolvent, the trustee could avoid the preference and recover the property for the benefit of the estate. The trustee had the burden of proving all of the elements of a preference—insolvency, reasonable cause to believe, time of transfer, and the like.

Section 547, following the recommendations of the Commission, sets up a two-track system. All preferential transfers made within ninety days of the filing of a petition are invalid without regard to whether the creditor-transferee had reasonable cause to believe the debtor insolvent. According to the Commission Report, trustee efforts to recover preferential payments had been largely frustrated by the section 60(b) requirement of showing reasonable cause. Indeed, in the opinion of many bankruptcy judges, a reasonable cause requirement had rendered section 60 largely ineffective and defeated its underlying policy of equality of distribution among creditors. Moreover, focusing on the creditor's knowledge of the debtor's financial condition made sense only if the primary purpose of preference law

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80 The separation between the elements of a preference and its voidability was of more than theoretical interest. Under section 3 of the 1898 Act, a preferential transfer as defined in section 60(a) constituted an act of bankruptcy which authorized the requisite number of creditors to file a petition for involuntary bankruptcy. See Bankruptcy Act of 1898, ch. 541, § 50(b), 30 Stat. 544. Since section 60(a) contained no requirement that the preferred creditor have reasonable cause to believe the debtor insolvent, certain transfers, themselves not recoverable, allowed the creditors to put the debtor into bankruptcy.

The BRA eliminates the concept of "acts of bankruptcy." Under section 303(h) of the BRA, if the debtor is not generally paying his debts as they become due or if, within 120 days prior to the filing, a custodian (defined under section 101(10) to include a receiver, trustee, or assignee for the benefit of creditors) took possession of substantially all the debtor's property, the requisite number of creditors may file the petition for involuntary bankruptcy under Chapters 7 or 11. See 11 U.S.C. § 303(b) (Supp. IV 1980) (provisions for requisite number of creditors).

81 The same was true for any of the trustee's avoidance powers under sections 67(a), 67(d), 70(c), and 70(e). See 4B COLEMAN ON BANKRUPTCY ¶ 70.94, at 1096 (J. Moore 14th ed. 1976).


83 HOUSE REPORT, supra note 7, at 178, reprinted in U.S. CONG. CODE & AD. NEWS at 6138-39; COMMISSION REPORT, supra note 3, Part I, at 315.

84 COWANS, AN AGENDA FOR BANKRUPTCY REFORMERS, 43 J. NAT'L A. REF. BANKR. 9 (1969). The author was a Bankruptcy Judge for the Northern District of California.
was to deter the race of diligence among creditors. Such a requirement bore little relationship to the more important goal of fostering distributive equality. While section 547 does provide that the debtor must in fact be insolvent even for transfers made within the ninety day period, section 547(f) creates a presumption of insolvency for the ninety days preceding the filing of a bankruptcy petition. A creditor seeking to uphold the transfer must therefore produce some evidence that would justify a finding that the debtor was solvent. Otherwise, the trustee prevails as a matter of law. Since most debtors are, as a practical matter, insolvent in the several months prior to bankruptcy, a creditor will very rarely be able to do this. At the same time, recognizing that finality in transactions is of considerable importance and that payments to creditors are generally desirable, section 547 reduced the period of avoidance from four months to ninety days.

A second category of transfers involves those made to insiders. "Insiders," as defined by section 101(25) of the BRA, include relatives, general partners, partnerships, or corporations in which the debtor is a director, officer, or person in control. Such transfers, if otherwise preferential, are voidable if made between ninety days and one year before the filing of the petition, but only if the transferee had reasonable cause to believe the debtor insolvent. The trustee has the burden of proof (with the absence of any presumption), both on the issue of insolvency and the existence of reasonable cause.

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27 House Report, supra note 7, at 179, reprinted in 1978 U.S. Cong. Code & Ad. News at 6139-40 (quoting Hearings, Part 3, at 1841). Insolvency under the BRA is basically construed as it was under prior law. Section 101(26) defines "insolvent" to mean, with reference to an entity other than a partnership, a financial condition where debts exceed property at a fair valuation. In short, the BRA continues to accept the balance sheet test, although for purposes of allowing relief on an involuntary petition, it adopts a standard essentially similar to the equity definition of "insolvency" (without using the term insolvent). 11 U.S.C. § 303(h)(1)(Supp. IV 1980). See supra note 20. Since virtually all consumer credit transactions are approved and paid on the basis of future earnings, most consumers are technically insolvent.

28 See Commission Report, supra note 3, at 170 n.10 (comments to § 4-607). The reduction of the period from four months to 90 days was designed to moderate the effect of eliminating the reasonable cause requirement and creating a presumption of insolvency.

29 11 U.S.C. § 547(b)(4)(B)(Supp. IV 1980). Interestingly, the "Judges' Bill," see supra note 3, which was generally not concerned with the avoidance powers, went considerably further. It totally eliminated the requirement of showing reasonable cause to believe insolvency, even for transactions open to attack for the one year period. H.R. 32, 94th Cong., 1st Sess. § 4-
It should be noted that even under former law, the concept of a preference was not necessarily limited to voluntary transactions. The term “transfer” was defined in section 1(30) of the 1898 Act as including “fixing a lien upon property . . . by or without judicial proceedings.” Thus, judicial liens acquired within four months of bankruptcy were vulnerable under section 60. Yet, because section 60 required the trustee to show that the creditor had reasonable cause to believe the debtor was insolvent, it was more advantageous to rely on section 67(a), a special provision which applied the four month period for the avoidance of all judicial liens regardless of the lienor’s state of mind. Since section 547 abandoned the need to prove reasonable cause for any preferential transfer within the ninety day period preceding the filing of a petition, special treatment of judicial liens was no longer necessary. The BRA thus no longer contains a provision directly corresponding to section 67(a). Judicial liens are governed exclusively by section 547, being within the definition of “transfer” contained in section 101(4) of the BRA. 30

In addition to the basic schematic changes, section 547 eliminates some anomalies that existed under the literal wording of section 60. Section 60(a)(1) stated that a preference must be a transfer, the effect of which enables the creditor to obtain a greater percentage of his debt than other creditors of the same class. In other words, before a court could void a preference, it had to compare this creditor with others in his class to determine whether, assuming the preference was allowed to stand, he would be getting more in the ultimate bankruptcy distribution 31 than others in his class. The 1898 Act nowhere

607(a)(2)(1975). Moreover, for insider transactions the ultimate burden of persuasion was imposed on the transferee to show solvency. For noninsider transactions subject to avoidance if made within 90 days, the trustee had the ultimate burden of proof but was aided by the statutory presumption of insolvency which the transferee must first rebut. Id. § 4-607(g).

The Commission’s retention of the “reasonable cause” requirement for insider transactions, carried over to the BRA, has not been without criticism. Indeed, the very considerations that motivated the abolition of the standard in the context of all other transactions—difficulties of proof, etc.—may make recovery under the insider provisions virtually impossible. At least one commentator has expressed his surprise at the anomaly of adopting a policy to prevent affiliated transfers without providing a practical means to implement it. See Note, Voidable Preferences: An Analysis of the Proposed Revisions of Section 606 of the Bankruptcy Act, 1974 Wis. L. Rev. 480, 494-95. (The author’s comments related to the Commission proposals but they are equally applicable to the BRA). The “Judges’ Bill” was thus more responsive to this particular criticism.

30 There is no provision in the BRA that deals with the invalidation of judicial liens corresponding to section 67(a). However, section 547 speaks of “transfers” and “transfers” under section 101(40) includes involuntary dispositions. The consolidation of former section 67(a)(1), (2), (3) and (5) into the preference section is due to the elimination of the reasonable cause requirement. See H.R. 32, 94th Cong., 1st Sess. § 4-607 n.18 (1975); COMMISSION REPORT, supra note 3, Part II, at 172.

31 In Palmer Clay Prod. Co. v. Brown, 297 U.S. 227, 229 (1936), the Supreme Court declared that preferential effect “is to be determined, not by what the situation would have been
spoke of classes of creditors. The courts had taken the sensible view that each priority recognized by section 64 was a class by itself, all other unsecured creditors were another class, and secured creditors to the extent of their security were yet another. 32 Thus, for example, payment of rent to a landlord, a fifth priority if not otherwise recognized by state law, was not preferential vis-a-vis other unsecured creditors not entitled to priority as long as all rent claimants were paid equally. 33

The prior Act did not condemn a priority holder for getting more than creditors in another class. Under a literal reading of the Act, however, payment to a fifth priority creditor or even to an unsecured creditor, provided that all unsecured nonpriority creditors were similarly favored, was not preferential although there might have been a superior administrative or wage claim which remained unpaid. Furthermore, section 60 required that payments be made to a creditor. That term was defined in section 1(11) of the 1898 Act to mean “anyone who owns . . . a claim provable in bankruptcy.” The concept of a “provable claim” was defined by section 63. One example of a nonprovable claim excluded from the reach of section 63 were negligence actions not pending at the time of the filing of the petition. 34 Furthermore, under section 63(d), unliquidated claims which were not capable of reasonable estimation without unduly delaying the administration of the estate—and hence not allowable under section 57(d)—were deemed not provable (or dischargeable) 35 despite otherwise meeting the terms of section 63. Thus, in both situations, the transferee of a preferential payment was not a creditor and the trustee would have no basis for recovery. 36

if the debtor’s assets had been liquidated and distributed among his creditors at the time the alleged preferential payment was made, but by the actual effect of the payment as determined when bankruptcy results.” Thus, while all the other elements of preference—insolvency, reasonable cause, antecedent debt—are determined as of the date of transfer, preferential effect is determined as of the date of the ultimate bankruptcy distribution. As a practical matter, Justice Brandeis illustrates that any payment to an unsecured creditor during insolvency has this effect.

31 See, e.g., Swarts v. Fourth Nat'l Bank, 117 F. 1 (8th Cir. 1902).
32 Actually, under Section 64(a)(5), the fifth priority was shared between rent claims (limited to the amount which accrued within three months before bankruptcy) and priorities established by federal statutes for claims other than taxes which were a fourth priority. The BRA abolishes the rent priority. See 11 U.S.C. § 507 (Supp. IV 1980).
33 See Bankruptcy Act of 1898, ch. 541, § 63, 30 Stat. 544,563.
34 Id. § 17(a).
35 A note is in order to explain the somewhat confusing structure of the Bankruptcy Act of 1898. The concept of a provable claim was central to the 1898 Act for a number of reasons. Under section 59(b), Bankruptcy Act of 1898, ch. 541, § 59(b), 30 Stat. 544, 561, only creditors with provable claims could file an involuntary petition. Under section 17(a), a discharge released the bankrupt only from his provable debts. Under section 63(a), only those debts that may be proved were allowed against the estate. Thus, those with nonprovable claims got nothing in the bankruptcy distribution although they were free to collect from the debtor later. It is important
Section 547 no longer speaks in terms of classes; it simply focuses on whether the transfer enables the creditor to receive more than he otherwise would have received in a bankruptcy liquidation,\textsuperscript{37} thus to note that a claim could be provable, and hence, dischargeable without being allowable either for failure to file a timely proof of claim under section 57(a) or for failure under section 57(g) to surrender a transfer voidable by the trustee. Under section 63(a)(8), a claim may be provable although it involved a contingent contractual liability, yet under section 57(d) such claims were not allowable if liquidation or estimation would unduly delay the administration of the estate. Section 63(d) added to the circumlocution by providing that such claims, though duly filed, were not deemed provable, and hence, nondischargeable. Apparently, Congress believed that contingent obligees should have their chance to secure payment in some forum.

The BRA eliminates the troublesome intermediate concept of provability. Under section 303(b), the entities who file an involuntary petition must have a claim that is not contingent as to liability. Under section 727(b), the debtor is discharged even from prepetition debts not allowable under section 502, although section 523 contains a number of exceptions. As noted in the text, elimination of the term "provable" in the definition of creditor has significance in the avoidance power as well.

\textsuperscript{37} 11 U.S.C. § 547(b)(5)(Supp. IV 1980). The principal beneficiary of the rule that a transfer must enable the creditor to receive more in the ultimate bankruptcy distribution than he otherwise would have received is the fully secured creditor. To the extent that the secured creditor would have received full satisfaction in bankruptcy, any payments made on account of the debt during the preference period lack preferential effect and are not recoverable. Payments to creditors who are only partially secured, i.e., either the debt exceeds the value of the collateral or the collateral is encumbered by a senior security interest, are valid only to the extent that they are applied to the reduction of the secured portion of the debt. See Barash v. Public Fin. Corp., 658 F.2d 504 (7th Cir. 1981); 11 U.S.C. § 506 (Supp. IV 1980)(a claim is secured "to the extent of the value of such creditor's interest . . . in such property.").

It should be noted that section 547 focuses not on the existence of detriment to other creditors, but on the benefit to the transferee. While preferential transfers generally will harm other creditors to the extent of the preference by diverting assets that would otherwise have been available for the satisfaction of their claims, this is not invariably the case. See infra, Part II (appreciation of existing collateral has preferential effect but detriment to creditors is less than the corresponding benefit to the transferee). Cf. 11 U.S.C. § 547(c)(5) (Supp. IV 1980) (which does contain language necessitating "prejudice to creditors holding unsecured claims," but such a requirement does not explicitly appear in section 547(b)'s basic definition).

Conversely, by focusing on preferential effect, section 547 precludes the avoidance of transfers which in a very real sense do prejudice unsecured creditors of the estate. Consider the following example: Assume that collateral with a value of $5000 is subject to a senior and junior security interest, each securing a debt of $5000. The debtor also has assets of $5000 in the form of an unsecured bank account as well as unsecured debts. If the debtor uses funds from the bank account to pay off the senior interest during the preference period, the transfer would apparently not be voidable since the senior lienholder is receiving no more than it would have received had the transfer not been made. However, had the transfer not been made, the senior interest would have been satisfied through the proceeds of its collateral, the junior lienholder would no longer possess secured status, and the unencumbered bank account would have been available to all unsecured creditors—including the junior lienholder—on a pro rata basis. As a result of the transfer, the senior lienholder retains $5000 of the bank account, the junior lienholder becomes elevated to a senior status and may assert his lien on the collateral, and general creditors are left with nothing. Thus, while the transfer of unsecured property to a fully secured creditor may not improve his position, by elevating junior liens to senior status such transfers deplete the pool of assets otherwise available for general creditors. Yet because section 547 condemns the benefit to the preferred creditor rather than the detriment to the other creditors, section 547 affords the trustee no remedy. (Note that transfer of collateral to the senior lienholder will not have a
eliminating the possibility that a payment to a lower priority is not a preference vis-a-vis a superior one. Furthermore, by redefining the term "creditor" to include "holder of a claim," and "claim" to include "unliquidated contingent obligations," without requiring that they be ultimately allowable under section 502, the BRA ensures that transfers to creditors not entitled to receive anything in distribution are still voidable.

The BRA also changes the rights of transferees of the preferred creditor. Formerly, section 60(b) of the 1898 Act provided that where a preference was voidable, the trustee could recover the property or its value from any person except "a bona fide purchaser from or lienor of the debtor's transferee for a present fair equivalent value." While present value was not defined, it presumably excluded satisfaction or securing of an antecedent debt. Thus, under former law, if a preferred creditor used the property to pay off his own creditors, the trustee could recover in full from the second creditor despite the good faith of the second transferee.40

Section 550 of the BRA, applicable to all the avoidance powers, protects any transferee (other than the initial transferee) "that takes for value, . . . in good faith, and without knowledge of the voidability

detrimental effect on other creditors since any excess that is available to the junior lienholder would have been available in bankruptcy anyway).

Under the Bankruptcy Act of 1898, transfers to one creditor which effect preferential treatment for another creditor may have been voidable under the doctrine of Dean v. Davis as codified in section 67(d), but that doctrine has been repealed by the BRA. See infra note 145.

The same example also illustrates the fact that the "preferential effect" test may invalidate transfers even where other creditors need no special protection. Assume the debtor transfers the collateral, or its proceeds, to the junior lienholder during the preference period. The transfer is clearly voidable because, had the transfer not been made, the junior lienholder would have been relegated to the status of an unsecured creditor sharing pro rata in other available assets. The preference, however, has no detrimental effect on unsecured creditors—since, in any case, these creditors would have no part in the $5000 of proceeds generated from the collateral. The only one hurt was the secured creditor. Yet, under applicable state law, even if the transfer were valid, the junior lienholder would take title subject to the senior lien anyway. See U.C.C. §§ 9-201, -312(5). Even without trustee avoidance, the senior secured party could protect his interest and there is no apparent reason why section 547 would be necessary. (Payments to the junior lienholder do deplete the estate, however, since the senior secured party may then pursue the collateral remaining in the estate).

Thus, while the "preferential effect" test was designed for creditor protection, it is both underinclusive and overinclusive, invalidating transfers which impose no harm to the interests of other creditors and validating transfers which do.

39 Id. § 101(4).
40 Presumably, the "lienor" to which section 60(b) referred was limited to a consensual lienor, i.e., one who took a security interest contemporaneously with his advance. A judicial lienor could never be a purchaser for present value.
of the transfer,” and any subsequent good faith transferee. Section 550(b)(1) specifically states that satisfaction or securing of a present or antecedent debt qualifies as “value.” Moreover, section 550’s omission of the term “fair equivalence” suggests that any consideration will protect the good faith transferee, regardless of its equivalence to the property transferred. Because this protection is limited to transferees against whom the trustee may recover under section 550(a)(2), i.e., those other than the initial transferee, the good faith of the preferred creditor remains irrelevant.

Thus, section 550 affords greater protection to secondary transferees who take in good faith. It also makes explicit the shelter principle, not specifically embodied in section 60(b), that anyone receiving property in good faith from a protected transferee has the same rights against the trustee although not taking for value—e.g., a donee. According to the Senate Judiciary Report, the good faith requirement for subsequent donees was designed to prevent the preferred creditor from reacquiring the property after a sale. If the purpose of the sale was to avoid invalidation by the trustee, the creditor has not acted in good faith. This does not mean that the preferred creditor can never be a secondary transferee in good faith. Good faith does not necessarily mean ignorance of the transfer’s initial voidability. If the preferred creditor had valid economic reasons for initially disposing of the property apart from a desire to avoid trustee invalidation, his subsequent repurchase may well qualify him as a good faith transferee of a transferee and thereby protected by the shelter principle. Undoubtedly, the burden on the creditor to make such a showing would be a heavy one.

Upon recovery by the trustee, section 60(b) gave the preferred creditor no rights at all and gave subsequent transferees that did not qualify as bona fide purchasers for a present fair equivalent value, a lien only to the extent of the consideration paid. Thus, at least a donee of the creditor, and possibly a donee of a subsequent bona fide purchaser, received nothing. The BRA now gives both the initial

42 Id. § 550(b)(2).
43 “Value” is defined in section 522(a)(2) to mean “fair market value as of the date of the filing of the petition,” but that definition is limited to the particular section in which it appears. Id. § 522(a)(2). No definition of “value” appears in section 101. Id. § 101.
45 Id.
46 11 U.S.C. § 550(d)(1) (Supp. IV 1980) provides that “[a] good faith transferee from whom the trustee may recover under subsection (a) . . . has a lien.” Since section 550(a) refers to both the preferred creditor and a secondary transferee, presumably a preferred creditor is also protected, provided that he acted in good faith.
subsequent transferees a lien on the lesser of the cost of improvements made by the transferee or the increase in value as a result of such improvements. This serves to protect donees and the initial creditor as well as subsequent purchasers to the extent they incur costs for the benefit of the property ultimately recovered by the trustee. This expanded protection is also conceptually more sound than the lien of section 60(b) since the lien of section 550 is based on benefits accruing to the recovered property rather than the consideration paid by the transferee to a third party. At the same time, however, to the extent the secondary transferee has given value, even if the consideration is nonequivalent or constitutes the satisfaction of antecedent debt, the trustee cannot reach the property at all. Accordingly, the lien on improvements is an additional, rather than a substitute, protection. The lien of section 60(b) for consideration paid no longer exists simply because there is no situation when it would ever be needed.

Focusing on the procedural problems of recovering a preference, Title II of the BRA abolishes the troublesome and confusing distinction between summary and plenary jurisdiction and thus insures that preference issues will be litigated in bankruptcy courts. Under prior law, the forum in which a section 60 action could be brought de-

47 11 U.S.C. § 550(d)(1) (Supp. IV 1980). The definition of “improvement” includes physical additions or changes to the property, repairs, payment of taxes and discharge of liens. Id. § 550(d)(2).

48 There appears to be an inconsistency between the provisions of section 548, 11 U.S.C. § 548 (Supp. IV 1980), regarding fraudulent conveyances and section 550, applicable to all the avoidance powers. As noted in the text, section 550 protects secondary transferees who take for “value.” “Value” is not limited to “fair equivalence.” Section 548(c), however, protects good faith transferees for value only to the extent of the consideration given. Section 548(c) thus appears to resurrect the limited protection of section 60(b) of the Bankruptcy Act of 1898, ch. 541, § 60(b), 30 stat. 544, which, in view of the absolute protection offered by section 550, should be unnecessary.

This author suggests, however, that section 548(c) is concerned solely with the rights of the initial transferee of the debtor who is unprotected by section 550(b). Under the operative provisions of section 548, if the debtor transfers property while insolvent within a year preceding the filing of a petition, the transfer is voidable unless the debtor “received a reasonably equivalent value” in exchange for such transfer. (Emphasis added). Section 548 merely makes clear that the initial transferee who gave value, even if less than a reasonable equivalent, has a lien to the extent of the consideration advanced. If the initial transferee, against whom the trustee could recover, transfers the property to a third party for value, section 550(b) affords the secondary transferee absolute protection. Reliance on the lien of section 548(c) is therefore unnecessary.

There is no analogue to section 548(c) in section 547. Every preference involves the extension of value by the initial transferee in the form of satisfaction or securing of antecedent debt. The presence of such value provides no basis to validate the transfer. Indeed, section 548(c) specifically declares that the lien it creates has no application to a transfer voidable under section 547. Thus, in the case of a preferential transfer, the only possible beneficiary for consideration advanced would be a secondary transferee. Since section 550(b) gives those secondary transferees who give consideration absolute protection, a section similar to section 60(b) of the Bankruptcy Act of 1898 is simply unnecessary.
pended on whether the property was in the actual or constructive possession of the debtor as of the date of the petition, and hence subject to the exclusive "summary" jurisdiction of courts of bankruptcy.49 Otherwise, plenary proceedings were necessary, and under section 60(b), state courts had concurrent jurisdiction over such proceedings. The BRA makes clear that actual or constructive possession is no longer relevant and that in all cases bankruptcy courts have jurisdiction.50

Under the BRA, proper venue for a turnover proceeding is in the bankruptcy court in which the case is pending,51 although if the trustee is seeking recovery of property worth less than $1,000, he can

49 Thus, suits by trustees to recover property of the estate held by third parties normally had to be brought in state courts or in federal courts on some independent basis of jurisdiction, e.g., diversity, except if the third party's claim was only "colorable" or a "sham" in which case it was said that the bankruptcy court had "constructive possession." See J. MACLACHLAN, HANDBOOK OF THE LAW OF BANKRUPTCY § 194, at 205-09 (1956); Treister, Bankruptcy Jurisdiction: Is it too Summary?, 39 S.C.L. Rev. 78, 80 (1966).

The issue of whether a given proceeding could be summary produced much litigation. In the case of section 60 actions, the problem was perhaps less acute, since section 60(b) provided that, even when plenary proceedings were necessary, any courts of bankruptcy had concurrent jurisdiction. See also Bankruptcy Act of 1898, ch. 541, §§ 67(e), 70(e), 30 Stat. 544, 564-66 (1898). Despite the confusing reference to "any courts of bankruptcy," a federal court entertaining a plenary suit would sit as a federal district court not subject to the Bankruptcy Rules of Procedure with cases not referable to referees. See J. MACLACHLAN, supra, § 197, at 213; Treister, supra, at 78-79. In the absence of a concurrent jurisdiction provision, the effect of classifying a suit as plenary would be more drastic; it would often mean dismissal of the case from the federal courts, forcing the trustee to start all over again.

In Katchen v. Landy, 382 U.S. 323, 330-31 (1966), the Supreme Court held that bankruptcy courts did have summary jurisdiction to order the surrender of a voidable preference if the court first passed on the issue in the context of disallowance of a claim under section 57(g). Even after Katchen, however, if the preferred creditor had been paid in full or for some other reason elected not to file a claim, plenary proceedings were necessary.

50 28 U.S.C. § 1471 (Supp. IV 1980). In Northern Pipeline Const. Co. v. Marathon Pipeline Co., 50 U.S.L.W. 4892 (U.S. June 28, 1982), the Supreme Court ruled that the broad jurisdictional grant of section 1471 was unconstitutional because it invested judicial power in judges not enjoying the protections of article III of the Constitution. The Court stayed the effect of its ruling until October 4, 1982, to enable Congress to amend the grant.

As of this writing the congressional response is uncertain. Compare H.R. 6978, 97th Cong., 2d Sess. (1982) with S. 2000, 97th Cong., 1st Sess. (1981). However, insofar as section 1471 authorizes prosecution of causes of action arising out of the bankruptcy law itself, such as section 547, no constitutional problem would appear to exist. Thus, regardless of the outcome of the amenderatory process, bankruptcy courts are likely to retain jurisdiction to order the surrender of preferences.

51 28 U.S.C. § 1473 (Supp. IV 1980). It is not clear from the BRA, however, whether state and federal courts have concurrent jurisdiction and, if they do, where is the proper venue for state actions. An action to recover a preference is presumably an action "arising under title 11" for which bankruptcy courts have original but not exclusive jurisdiction. Like section 60(b) of the 1898 Act, this apparently contemplates concurrent jurisdiction. Cf. supra note 49. At the same time, however, section 1471(e) vests the bankruptcy court with exclusive jurisdiction over the debtor's property, wherever it is located. While many preferences involve absolute payments in
bring suit only in the bankruptcy court in the district where the
defendant resides. 52 This language seems to include suits brought
against transferees of voidable transfers.

Finally, section 546(a) provides that actions under section 547
may not be commenced after the earlier of two years following the
election or appointment of a trustee 53 or the closing or dismissal of the
case, and section 505(e) provides that an action to recover the prop-
erty (as opposed to simply invalidating the transfer) must be brought
within one year after avoidance prior to the closing of the case.

II. WHEN IS A TRANSFER DEEMED MADE?

As did its predecessor, section 547(b)(2) invalidates transfers only
if made to satisfy an antecedent debt. The basic notion is that contem-
poraneous exchanges of value should not be voidable because the
estate is not depleted—whatever was taken out was put back in—and
the policy of equality among creditors is not frustrated. Consequently,
ascertaining the point at which the transfer occurred is essential in
determining whether the debt is antecedent and whether the transfer
occurred within the relevant preference period. Moreover, the time of
transfer not only governs the issue of antecedence but also all other
elements of avoidance, 54 such as insolvency and, in the case of an

which the debtor retains no property interest, this is not true for transfers such as the creation
and perfection of Article 9 security interests where the debtor still has "title" to his property. It
would indeed be surprising if the existence of concurrent jurisdiction to recover a preference
depended upon what type of transfer was made since nothing in section 547 suggests such a
 distinction. Note also that bankruptcy courts have nationwide service of process, thus rendering
the local residence or presence of the defendant creditor immaterial. See Fed. R. Bankr. P.
704(f)(1) and Proposed R. 7004.

52 28 U.S.C. § 1473(b) (Supp. IV 1980). There are also special venue provisions for actions
arising after the commencement of the case or actions brought by the trustee as statutory
successor of the debtor under section 541 or the creditors under section 544(b). Id. at § 1473 (c)53 or
(e). Neither venue provision would apply to actions brought under section 547 which involve the
assertion of an independent avoidance power which neither the debtor nor the creditors possess.

53 In a Chapter 7 liquidation, the court must appoint an interim trustee promptly after the
entry of the order for relief. 11 U.S.C. § 701(a)(Supp. IV 1980). Compare this to the discretion-
ary appointment of an interim trustee under section 303(g) during the gap between the filing of an
involuntary petition and the entry of an order, where the court may act only upon motion. At
the meeting of creditors held pursuant to section 341(a), eligible creditors may elect a permanent
trustee. Id. § 702(b). See also id. § 15701(a)(providing that in a pilot district, the United States
trustee, rather than the court, makes the interim appointment).

Although section 546(a) indicates that the two-year statute of limitations starts to run from
the appointment or election of a trustee, the reference to section 702, rather than section 701,
indicates that the statute does not run until a permanent trustee is elected. The reference in
section 546(a) to an "appointed trustee" is of necessity limited to trustees under Chapters 11 and
13 where even the permanent trustees are court appointees.

54 Except for the determination of preferential effect. See supra note 31.
insider, reasonable cause. The deceptively simple question of when a transfer takes place was the single problem most responsible for the complex structure of section 60, and, if for no other reason, we owe our gratitude to the drafters of section 547 for eliminating much of the confusion that had surrounded this particular area of preference law.

To appreciate fully some of the genuinely helpful changes section 547 has made, it is necessary to review in some depth part of the murky and confusing history of section 60 and the unresolved questions it engendered, specifically the dual perfection requirement established for transfers of personal property and the application of the twenty-one day grace period to typical security interests arising under Article 9.

A. Perfection Requirements

1. Purpose and Effect

The basic test for determining the time of transfer was the dual standard contained in section 60(a)(2). Transfers of personal property were deemed made when they were perfected to the extent that no subsequent lien upon such property by legal or equitable proceedings upon a simple contract could become superior to the rights of the transferee. Transfers of realty, on the other hand, had to be perfected against bona fide purchasers.55

The determination of when an interest was sufficiently perfected against a subsequent lien creditor or bona fide purchaser required reference to state law. In the case of personal property, the source of that law was Article 9 of the UCC and its predecessor statutes which generally provide that a security interest is ineffective against a lien creditor until such time as public notice is given of that interest either through the filing of a financing statement in the public records or

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55 The need for a double standard stems from the fact that many real estate recording statutes extend protection only to subsequent bona fide purchasers and, unlike the UCC, make no mention of the rights of lien creditors. See, e.g., California, Cal. Civ. Code § 1214 (West 1954); Indiana, Ind. Code Ann. §§ 56-118, 56-119 (Burns 1980 & Supp. 1982); and New York, N.Y. Real Prop. Law § 291 (McKinney 1968). In these jurisdictions, dating a transfer of realty from the time it became effective against a subsequent lien creditor would have successfully immunized secret transfers from being deemed preferential. Accordingly, Congress substituted the more rigorous bona fide purchaser test.

through the secured party’s taking possession of the collateral.\footnote{56} In the case of real property, all states have recording statutes that provide that conveyances or mortgages of real property are ineffective against subsequent bona fide purchasers unless those prior interests were recorded, typically in the office of the recorder of deeds for the county in which the realty is situated.\footnote{57} Consequently, under section 60, no transfer was ever deemed made until it complied with the notoriety requirements of local law. If the necessary perfection did not occur prior to the filing of a petition, the transfer was deemed to occur immediately before the filing.\footnote{58}

\footnote{56} U.C.C. § 9-301(1)(Official Text 1972). Cf. U.C.C. § 9-301(1) (Official Text 1962) (protecting only lien creditors without knowledge of the prior security interest). Under the 1972 UCC, lien creditors are protected regardless of their knowledge, although interin buyers, other than those in the ordinary course of business, must still be without knowledge of the interest to prevail. U.C.C. § 9-301(1)(c)(1972).

A brief description of Article 9’s structure may be helpful at this point. In the terminology of Article 9, the initial creation of a security interest enforceable between the debtor and the secured party is termed “attachment.” A security interest “attaches” when: (1) “value” has been given (and, for this purpose, “value” includes the securing of an antecedent debt); (2) the parties have executed a written security agreement containing a description of the collateral or, alternatively, the collateral is in the possession of the secured party pursuant to agreement; and (3) the debtor has rights in the collateral. U.C.C. § 9-203(1). As soon as the security interest attaches, it becomes enforceable against the debtor. U.C.C. § 9-203(2). However, it will be ineffective against the interests of most third parties, including subsequent lien creditors, buyers, and other secured parties, unless an additional step known as “perfection” takes place. The most common method of perfection is the filing of a document known as a “financing statement” in a designated public office. See id. §§ 9-401 (three alternatives for proper place to file), 9-402. Security interests in some types of property may not be perfected by filing. Id. § 9-304(1). The secured party may also perfect by taking possession of the collateral. Id. § 9-305. Article 9 also contains provisions for temporary perfection for up to 21 days for security interests in documents and instruments, id. § 9-304, and automatic perfection for purchase money security interests in consumer goods. Id. § 9-302(1)(d). It should be noted that some third parties may defeat even a perfected Article 9 security interest. See, e.g., id. §§ 9-307(1) (“buyer in the ordinary course of business”), 9-308 (“purchasers of chattel paper or an instrument”).

\footnote{57} See Note, Execution Sales—Rights of Bona Fide Purchasers, 24 MINN. L. REV. 80 (1940), \textit{supra} note 55.

\footnote{58} Thus, an Article 9 security interest that was unperfected as of the filing of the petition could be attacked as a preference under section 60. Since recovery under section 60 required a showing that the transferee had reasonable cause to believe the debtor insolvent, generally trustees relied on section 70(c) which expressly gave the trustee the status of a lien creditor, thereby empowering the invalidation of an unperfected security interest irrespective of the secured party’s state of mind. Section 70(c) was of limited utility. By giving the trustee the status of a lien creditor as of the date of the petition, it permitted invalidation of a security interest only if the security interest was unperfected as of the commencement of the case. Section 60, where applicable, was a more potent weapon, reaching transfers that were perfected within four months preceding the petition date. Thus, each section invalidated transfers which the other section could not catch.

This does not appear to be true under current law and, for all practical purposes, section 544(a)(1), the predecessor of which is called the “strong-arm clause,” may well be a dead letter. Under current law, the trustee retains hypothetical lien creditor status under section 544(a)(1). Yet, given the fact that for transfers made within 90 days preceding bankruptcy, a showing of
Section 60(a)(3) made clear that even if no existing creditor of the estate could have obtained a superior lien, any hypothetical creditor's power would postdate the transfer until such time as the hypothetical lien creditor could no longer obtain a superior judicial lien.\textsuperscript{59} As will

reasonable cause is no longer necessary, and given the fact that transfers unperfected as of the commencement of the case are deemed to occur immediately before the filing of the petition (hence, within the 90 day period), one can indeed wonder whether section 544(a)(1) has any useful role to play in the trustee's arsenal of weapons. This is true at least in the invalidation of consensual security transfers, except in the unusual situation where the debtor was not insolvent prior to the institution of bankruptcy proceedings and, therefore, not within section 547.

Section 544(a)(1) may also play a role in the invalidation of unperfected statutory liens which are excepted from section 547, but, in view of section 545, which already requires that such liens be perfected against bona fide purchasers, it appears to be unnecessary. Finally, section 544(a)(1) invalidates security interests in the rare case where bankruptcy intervenes prior to the expiration of the 10 day grace period of section 547(e) and where the secured party attempts to perfect his interest after the petition. Because of the trustee's lien creditor status, such postpetition action will be unavailing, effectively limiting postpetition validation to purchase money security interests under section 9-301(2) of the UCC. See infra text accompanying notes 101-05.

\textsuperscript{59} Section 60(a)(3) was important principally under pre-UCC statutes and, to a lesser extent, in states adopting the 1962 version of Article 9. Many pre-UCC statutes permitted lien creditors to invalidate unperfected security interests only if those creditors extended credit in the gap between the creation of those interests and their perfection, on the theory that only those creditors were harmed by misleading appearances. Indeed, some of those statutes protected the "gap creditor" even if the creditor's lien was not obtained until after perfection. See 1 G. Gilmore, Security Interests in Personal Property § 16.3, at 486 (1965). In those jurisdictions, if all creditors had extended credit prior to the creation of a security interest, even if they would later obtain a lien in the interim, those creditors would be subject to the prior security interest. Section 60(a)(3) made clear that, for purposes of section 60, a transfer was not deemed made until the possibility of any type of lien creditor obtaining superior rights was eliminated, even if at some earlier point in time the ability of actual creditors to do so was already foreclosed.

Under the 1962 version of Article 9, section 9-301 provided that a lien creditor could prevail over an unperfected security interest only if he obtained his lien without knowledge of the earlier interest though he need not have extended credit in the gap. Consequently, if all creditors in fact have knowledge, in the absence of section 60(a)(3), the postdating of the transfer pursuant to section 60(a)(2) would not occur, since as of the date of attachment no actual creditor could have obtained a superior lien on the property. The 1972 version of Article 9 eliminated the requirement that the lien creditor be without knowledge. Accordingly, section 60(a)(3) and its successor have little, if any, importance today since actual creditors will always be able to defeat an unperfected interest.

The ability of a trustee to hypothesize a gap extension of credit for purposes of postdating a transfer under section 60 of the 1898 Act should be contrasted with his inability to do so under section 70(c). Although the trustee could assert the status of a lien creditor as of the date of petition, whether or not such a creditor existed, he was deemed to have extended credit only as of that date and could not invoke state statutes which extended protection to creditors who lent money in the gap between attachment and perfection, although they obtained their liens subsequent to perfection. See Lewis v. Manufacturers Nat'l Bank, 364 U.S. 603 (1961). For the purposes of section 60, however, the trustee could indeed have posited the existence of such a creditor and, under such a state statute, even perfection would not foreclose the rights of a gap creditor to obtain a superior lien. The transfer would be deemed made immediately before bankruptcy and hence within the preference period.

Section 544(a)(1) explicitly codifies the Lewis holding. The trustee may not hypothesize the rights of a creditor who extended credit prior to the petition date to invalidate a transfer
be shown below, section 547(e) basically retains this dual standard with the addition of a ten day grace period. While section 60(a)(7) on its face seemed to allow a twenty-one day grace period of relation back, the applicability of the subsection to the standard Article 9 security interest was far from self-evident.

The delaying effect of these perfection provisions served two distinct functions. On one hand, they were necessary to implement effectively the basic policy of section 60. Under section 3(a)(2) of the 1898 Act, a preferential transfer as defined in section 60(a) was an act of bankruptcy allowing the creditors to file a petition for involuntary bankruptcy within four months of its occurrence. If section 60(a) contained no perfection requirement, creditors could obtain preferential treatment without compliance with recording or notoriety statutes, allow the four months to run, and then perfect. By the time other creditors discovered that a preference had taken place, they would be unable to do anything about it. By delaying the time of transfer to the point of compliance with recording statutes, the 1898 Act insured that creditors could vindicate their right to file a petition for involuntary bankruptcy, thereby permitting the debtor's trustee to invalidate the transfer. Thus, the perfection clauses avoided the evil of a secret preference and furthered the basic goal of distributive equality between creditors.

At the same time, the result of section 60(a)(2) was the conversion of contemporaneous exchanges which were not truly preferential into transfers for antecedent debt. Assume, for example, that a creditor pursuant to a written security agreement lent the debtor $1,000, perfected before bankruptcy. Such a qualification appears unnecessary, however, since section 9-301 of the UCC affords no special protection to a gap extension of credit not accompanied by the acquisition of a lien. Moreover, in the unlikely event that some jurisdictions would repeal section 9-301 and grant preferential treatment to the gap extender of credit, who later obtains a lien after perfection, the inability of the trustee to hypothesize that preferred status under section 544(a)(1) would not preclude his doing so under section 547, thereby delaying the transfer to the eve of bankruptcy and making it voidable as a preference. In view of the fact that section 547 would not require the showing that the transferee has reasonable cause to believe the debtor insolvent, recovery under section 547 would be no more difficult than recovery under section 544(a)(1).

Thus, codification of the Lewis holding, in the present state of law, is simply surplusage and would not prevent avoidance of the transfers it was intended to validate.

See infra text accompanying notes 64-79.

There was not a perfect correspondence between section 3 and section 60. No section 60(b) requirement of reasonable cause existed in the former since it referred only to section 60(a). Thus, creditors could put a debtor into bankruptcy and still be unable to recover the property that was transferred away. Nevertheless, if in fact a voidable preference had been made, the combination of sections 3(a) and 60(a) always allowed creditors to vindicate their rights by filing which would not be the case if the time of transfer would not be determined by perfection.

Under the BRA, which abolishes the concept of "acts of bankruptcy," the making of a preferential transfer does not by itself furnish the basis for an involuntary petition though it may
receiving simultaneously with the advance a security interest in all of the debtor's personal property. Assume further that the creditor did not file a financing statement for two months. Within four months from the date of filing, the debtor went into bankruptcy. Since, under section 9-301 of the UCC, the security interest was vulnerable to the claims of a lien creditor until the filing, the transfer was artificially postdated to the time of its perfection, with the result that not only was the transfer deemed to have occurred within the preference period, but it also became a transfer on account of an antecedent debt that was incurred two months previously. This is equally true under section 547, although the period of voidability has been shortened to ninety days.

Why should an unperfected or tardily perfected contemporaneous exchange of value, which gives back to the estate exactly what is taken out, be condemned as a preference? Unlike the secret preference, upholding such transfers hardly frustrates the goal of distributive equality. Indeed, were the transfer promptly recorded, it would not be preferential at all and creditors would have no means of attacking it even if bankruptcy immediately followed.

Apparently, the extension of perfection requirements to contemporaneous exchanges, perhaps not originally intended but by now firmly established, was based on a general hostility toward secret liens and a fear that the existence and recognition of such liens perpetrate a fraud upon creditors. Since bankruptcy legislation did not and does not expressly void secret liens, one way in which this hostility found its expression was through an artificial categorization of these transfers as preferences.

result in the debtor's inability to pay debts as they mature which is such a ground. See 11 U.S.C. § 303 (Supp. IV 1980).

The invalidation of transfers where the debtor retained ostensible ownership thereby giving the impression that the assets were unencumbered has a venerable history dating from Twyne's Case, 76 Eng. Rep. 809 (Star Chamber 1601), though secret liens, as such, are not expressly characterized as fraudulent conveyances either under the Uniform Fraudulent Conveyance Act ("UFCA") or its federal analogue, section 548. Both sections 544(a)(1) and 544(b) are possible weapons in such a situation if by state law a levying creditor could prevail.

The doctrine is recognized, though not codified in U.C.C. § 2-402(2)(1972), which provides:

A creditor of the seller may treat a sale . . . as void if as against him a retention of possession by the seller is fraudulent under any rule of law of the state where the goods are situated, except that retention of possession in good faith and current course of trade by a merchant-seller for a commercially reasonable time after a sale . . . is not fraudulent.

In the specific context of security interests, hostility toward secret liens was the impetus behind cases such as Benedict v. Ratner, 268 U.S. 353 (1925), which invalidated security interests in inventory because of the debtor's "unfettered dominion or control over the collateral." See U.C.C. § 9-205 (Official Comment 1972).
Without in any way denying the potential for fraud that lurks in a secret transaction, one can surely wonder whether the law of preferences section is the appropriate vehicle to deal with it. The problem of secret liens essentially involves the doctrine of ostensible ownership, a species of common law fraudulent conveyance, and as such more logically belongs in section 548 and its predecessor, section 67(d) of the 1898 Act, rather than in a section the principal focus of which is distributive equality among creditors. In other words, the vice of fraud should be fraud—a secret mortgage or security interest should be invalid because of its potential to mislead innocent third parties, not because the contemporaneous exchange is statutorily deemed to have occurred at a later point in time, thereby permitting its invalidation under a section having nothing to do with fraudulent conduct.\textsuperscript{63} Moreover, there is little reason to invalidate such transfers only because their perfection occurred within a specified period prior to bankruptcy. A lien that was originally secret but perfected six months before bankruptcy may have been just as fraudulent and misleading to other creditors as one perfected during the preference period.

Yet, rightly or wrongly, the encrusted burden of history has been too great to slough off. Since at least 1910, section 60 has been used to convert contemporaneous exchanges, whose only vice was their secrecy, into preferences, and section 547 continues this venerable tradition. It is essential, however, to recognize that the policy considerations underlying the invalidation of these two types of transfers are totally distinct; the fact that a particular transfer may not be a secret lien does not necessarily mean that the transfer does not frustrate the central goal of distributive equality. Combining these two policies in

\textsuperscript{63} It should also be noted that utilization of state perfection requirements, as a means of striking down secret liens, is an inherently clumsy weapon. First of all, secret liens are protected to the extent recognized by state law, which introduces the element of nonuniformity in bankruptcy law with varying degrees of protection for creditors. (Of course, with the passage of the UCC, the possibilities for this nonuniformity have been effectively eliminated.) Second, requiring perfection against lien creditors, rather than directly proscribing secret liens, permits the invalidation of transfers that are neither secret nor preferential but which have merely failed to comply with some element of local law. The best example is the Supreme Court’s decision in Corn Exch. Nat’l Bank & Trust Co. v. Klauder, 318 U.S. 434 (1943). Klauder arose under the pre-1950 Act which required perfection against bona fide purchasers. The Supreme Court struck down as preferential an assignment of accounts receivable made more than four months before bankruptcy on the grounds that, under Pennsylvania law, a second assignee could prevail due to the failure of the first to give notice to the account debtor. See infra, Part II. While the Court was undoubtedly right that the transfer was unperfected against a subsequent bona fide purchaser (i.e., a second assignee), the lien was not secret. The assignment was noted in the books of the debtor, easily ascertainable by any creditors, and in fact was arranged by a creditors’ committee. Thus, by invalidating secret liens through the indirection of state perfection requirements, rather than directly striking them down as fraudulent, Congress permitted the invalidation of interests which implicated neither policy of section 60.
one section, at the very least, generates confusion and may lead to erroneous results as well.\textsuperscript{44}

2. The Elimination of the Dual Perfection Standard for Transfers of Personal Property

A far more serious difficulty in the 1898 Act was the fact that, while section 60(a)(2) seemed to date transfers of personal property from the time they became perfected against lien creditors, section 60(a)(6) set up a second and more stringent test. Section 60(a)(6) stated that if (1) a transfer was for security and (2) applicable law required a writing, delivery of possession, or recording as a condition to its full validity against third persons other than buyers in the ordinary course of trade, and (3) such transfer resulted only in an equitable lien, such transfer was not deemed made, notwithstanding its state law priority over a subsequent lien creditor. Thus, section 60(a)(6) apparently postdated a transfer to the time it was perfected against third parties other than buyers in the ordinary course of trade even if at an earlier point it was sufficiently protected against a lien creditor under the applicable state law. When to apply section 60(a)(2) or section 60(a)(6) was far from clear. Yet, the insertion of these two conflicting tests represented a congressional attempt to deal with what Professor MacLachlan has called an essentially insoluble problem.\textsuperscript{45} Some history is in order.

Congress was concerned with the use of secret liens and concealed preferences as far back as 1903 and its solution, rightly or wrongly, was to postdate secret transfers and convert them into preferences.\textsuperscript{46} For a variety of reasons, this failed. In a series of cases, the

\textsuperscript{44} Thus, the courts upholding floating liens on inventory that was acquired within the preference period commonly spoke of the fact that creditors were put on notice, the lien was not secret, and that the policy of section 60 was merely the avoidance of secret liens. But this ignored the fact that while the perfection requirements of section 60(a)(2) were perhaps aimed at the evil of secrecy, the primary policy of section 60 was to insure distributive equality among creditors. If the debtor acquires new collateral in the preference period which becomes subject to the secured party’s lien on after-acquired property, that policy is being frustrated. A true preference is not cured by its being in the open. See Morris, supra note 12; Countryman, Code Security Interests in Bankruptcy, 75 COM. L. 269, 279 n.75 (1970).

\textsuperscript{45} J. MacLachlan, supra note 49, at 305.

\textsuperscript{46} As enacted in 1898, section 60 did not contain a perfection clause delaying transfers. However, preferences were acts of bankruptcy under section 3(a), and an involuntary petition could be filed within four months of the commission of an act of bankruptcy. Section 3(b) did contain a perfection clause which had the effect of tolling the four month period until the preferred party complied with notoriety requirements. However, since section 60 apparently dated the transfer from the time it was initially made, this allowed for the making of secret preferences which later could not be recovered. A 1903 amendment correlated section 3(b) to section 60 by adding a sentence to the end of section 60(a): “Where the preference consists in a
Supreme Court held that transfers effected before the four month period were not vulnerable under section 60 even though they were secret. The 1938 Chandler Act attempted to overrule those cases by adopting a bona fide purchaser test for both realty and personality, since most states did impose notoriety requirements for security interests to be effective against bona fide purchasers. Yet in its attempt to void secret liens by forcing compliance with recording statutes, the 1938 Act endangered legitimate nonpreferential security transfers. Virtually all security interests in inventory were subordinate to the rights of a buyer in the ordinary course of business, so in effect all inventory financing would be postdated to the time of petition.

transfer, such period of four months shall not expire until four months after the date of registering the transfer, if by law such recording or registering is required.” Note that the language implies that there first must be a preferential transfer, i.e., a transfer, inter alia, for antecedent debt before the four month period would be tolled. If the exchange was in fact contemporaneous, delays in recording would not make a difference. Indeed, the House Report, supra note 7, clearly indicates that the evil it was seeking to eliminate was the unrecorded preferential mortgage executed subsequent to the extension of credit. Furthermore, all the other elements—insolvency, reasonable cause, etc.—were to be measured as of the date of the actual transfer, not its perfection. A 1910 amendment specified that all elements of the preference were to be measured as of the date recording was required, including whether the debt was antecedent to the transfer. For a detailed discussion of the pre-1938 treatment of secret transfers, see 3 Collier on Bankruptcy, supra note 8, ¶ 60.37, at 916-40.

67 The main problem was the failure of section 60 to specify against whom perfection is required. In the case of Carey v. Donahue, 240 U.S. 430 (1916), the infamous “pocket lien” case which was a prime motivation for the 1938 revision, the Court upheld the validity of a real estate mortgage that was not recorded until the preference period on the grounds that recording was not required against creditors since realty recording statutes generally protect only purchasers. In Martin v. Commercial Nat'l Bank, 245 U.S. 513 (1918), the Court went even further. It held that if a recording statute only protected levying creditors and no creditor had actually levied, the proviso did not apply, despite the fact that creditors could have levied. See also Sexton v. Kessler & Co., 225 U.S. 90 (1912); Thompson v. Fairbanks, 196 U.S. 516 (1905).


69 This was the case under section 9(2) of the Uniform Trust Receipts Act and continues to be the law under section 9-307(1) of the UCC with the sole proviso that the buyer must be in good faith. See U.C.C. §§ 9-307(1) comment 2, 1-201(9) (1972). Even where older chattel mortgage statutes contained no express provision, the courts generally protected the purchaser on a variety of theories. See 2 C. Gilmore, Security Interests in Personal Property §§ 86.1-8, at 677-97.

70 A similar problem arose with regard to the assignment of accounts receivable made more than four months before bankruptcy. In many retail businesses, such assignments were routinely made without notification to the account debtor who would continue to make payments to the assignor. Under the so-called “English rule” pertaining to priority between assignees, a second assignee who was the first to notify the account debtor would prevail over the first assignee. Accordingly, under a bona fide purchaser standard, such an assignment would be preferential. See Corn Exch. Nat'l Bank & Trust Co. v. Klauder, 318 U.S. 434 (1943).

By 1950, however, most states had passed accounts receivable statutes which permitted an assignee to perfect his interest against subsequent assignees without necessitating notice to the account debtor. See Countryman, The Secured Transactions Article of the Commercial Code and Section 60 of the Bankruptcy Act, 16 Law & Contemp. Probs. 76 (1951). See also infra, Part II. Thus, the principal need for congressional revision in 1950 was for the validation of inventory financing.
To protect inventory financing, Congress in 1950 adopted a levying creditor test for personalty while retaining the bona fide purchaser test for transfers of realty since many real estate recording statutes protected only purchasers. The problem then became the resurrection of the "equitable lien" that the 1938 Act was designed to eliminate. While the term "equitable lien" is not clearly defined, the basic doctrine involved an agreement between two parties to presently charge specific property as security for a debt while failing to take some step required for the creation of that interest, e.g., possession in the case of a pledge. When that element was supplied at a later date, under equitable principles the lien was said to relate back to the time of the initial agreement, thereby cutting off the rights of intervening interests. Prior to 1938, applying the relation back concept, courts upheld pledges of property where possession was delivered within the four month period if such possession was taken pursuant to an earlier agreement which was either prior to the preference period or for a new value at the time.\(^{71}\) Because rights arising under an equitable pledge were generally cut off by bona fide purchasers, the 1938 amendments effectively eliminated the use of equitable liens as a means of circumventing section 60. Yet, section 60(a)(2) after 1950 seemed to bring it back again since such liens were superior to intervening levying creditors. In effect, the old bona fide purchaser test invalidated too much and the lien creditor test too little.

Section 60(a)(6) was designed to uphold inventory financing without allowing the equitable lien. It did this by requiring perfection against third parties, including buyers, not in the ordinary course of business. Hence, in the case of the equitable pledge, the transfer would be postdated to the time actual possession was delivered without relation back since, prior to the delivery of possession, such buyers would cut off the rights of the equitable pledgee. The inability of a secured party to perfect a security interest in inventory as against a buyer in the ordinary course of business, however, would not convert the security interest into a preference since perfection against these types of purchasers was not required by section 60(a)(6).

But when was the intermediate level of perfection in section 60(a)(6) required? Professor MacLachlan\(^{72}\) took the position that the higher standard of perfection was always required whenever state law recognized different tests for prevailing over lien creditors and other third party interests (except for buyers in the ordinary course of trade). At the other extreme were cases like Porter v. Searle,\(^{73}\) imply-

\(^{71}\) See supra note 67.

\(^{72}\) MacLachlan, Preferences Redefined, 63 Harv. L. Rev. 1390, 1394 (1950).

\(^{73}\) 228 F.2d 748 (10th Cir. 1955). See infra note 78.
ing that section 60(a)(6) had little utility even for the classic situation it was designed to cover. The confusion was compounded in trying to apply the provision to Article 9 security interests; the concept of an equitable lien, a term difficult to define under any circumstances, is nowhere used by the UCC and was apparently rejected by its drafters.  

Fortunately, by and large, whether section 60(a)(2) or section 60(a)(6) applied made little difference under the UCC. A perfected Article 9 security interest is generally valid both against levying creditors and against buyers not in the ordinary course of business; therefore, if the interest were perfected more than four months before a petition was filed, under either test, the transfer would not be preferential. Conversely, because section 9-305 rejects the notion of the equitable pledge, perfection within the preference period would convert the transfer into a preference even under a single lien creditor test.

However, there were situations under the UCC where the application of section 60(a)(2) or section 60(a)(6) would produce differing results and knowing which provision applied thus became vital. One key problem area was the purchase money security interest in consumer goods. Under section 9-302(1)(d), such interests may be perfected without filing a financing statement or taking possession of the collateral. Consequently, from the time the interest attaches, it would prevail over a subsequent lien creditor, thereby meeting the section 60(a)(2) standard. On the other hand, section 9-307(2) substantially limits the utility of such automatic perfection by providing:

In the case of consumer goods, a buyer takes free of a security interest even though perfected if he buys without knowledge of the security interest, for value and for his own personal, family or household purposes unless prior to the purchase the secured party has filed a financing statement covering such goods.

This provision is designed to protect the second consumer buyer who buys from the first. Under the UCC's own definition, such a buyer cannot qualify as a buyer in the ordinary course of business since he is not buying from someone in the business of selling goods of that kind. Moreover, under section 9-307(1), a buyer in the ordinary course of business takes free of an Article 9 security interest even if a financing statement had been filed. It is apparent that section 9-

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74 Section 9-305 of the UCC rejects the notion of the equitable pledge by stating: "A security interest is perfected by possession from the time possession is taken without relation back . . . ." See U.C.C. § 9-305 comment 3 (Official Text 1972).

75 Id. § 1-201(9).
307(2)'s filing requirement is to attain priority over a buyer not in the ordinary course of business. Accordingly, the so-called automatic perfection of section 9-302(1)(d) for purchase money security interests in consumer goods is effective against a subsequent lien creditor but is not effective against a consumer buyer not in the ordinary course of business until a permissive filing is made. Presumably, a buyer not "in the ordinary course of business" under Article 9 would be not "in the ordinary course of trade" within the meaning of section 60(a)(6).

Would a purchase money security interest in consumer goods for which no filing was made or for which a permissive filing was made within the preference period have been voidable as a preference by application of the section 60(a)(6) standard or would the transfer have been antedated to the time of its attachment under the section 60(a)(2) standard? Two of the elements necessary to trigger section 60(a)(6) were clearly present: (1) the transfer was for security; and (2) applicable law required a recording as a condition to its full validity against third persons other than buyers in the ordinary course of trade. Yet the third element required that the transfer result in an "equitable lien." What meaning would that third element have under a statutory scheme that rejects the concept? Could the purchase money security interest in consumer goods itself be characterized as an equitable lien subject to section 60(a)(6)?

While no reported decision under the 1898 Act has expressly invalidated such an interest, Professor Countryman has cogently argued that such security interests were indeed vulnerable. He took the position that, although the UCC had abolished the equitable pledge, the unfiled purchase money security interest is virtually indistinguishable, having the same vice of secrecy. This conclusion would certainly follow under the MacLachlan analysis that the higher standard of perfection was always required whenever state law recognized two tests for perfection against lien creditors or purchasers, regardless of whether the unperfected interest was denounced an equitable lien.

The status of an unfiled purchase money security interest in consumer goods—a relatively common transaction—remained an open question under the 1898 Bankruptcy Act. The scope and application of section 60(a)(6) had never been definitively resolved, and the problem chosen for illustration is indicative of some of the doubts that

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76 Id. § 9-307 comment 3.
77 Countryman, supra note 64, at 279.
section 60(a)(6) engendered.\textsuperscript{78} Other potential problem areas—now largely of historical interest—are discussed in the footnote.\textsuperscript{79}

\textsuperscript{78} Since the passage of the BRA, the exact meaning of section 60(a)(6) has mercifully become moot. Nevertheless, at the risk of beating a dead horse, I venture several comments regarding its scope which may facilitate comparison with current law.

Professor MacLachlan’s analysis seems contrary to both the language and structure of section 60. Most obviously, his approach simply ignored the term “equitable lien.” Second, if one interprets section 60(a)(6) to always require the higher of two standards of perfection, there would have been no reason to retain section 60(a)(2) in the 1898 Act. Section 60(a)(6) required perfection against third persons other than a buyer in the ordinary course of trade. “Third persons” could equally include lien creditors and buyers not in the ordinary course of trade and, by its own terms, section 60(a)(6) embodied any standard that section 60(a)(2) could possibly impose. The presence of the lien creditor standard in section 60(a)(2) indicated that there were situations where the higher standard of perfection was unnecessary.

Porter v. Searle, 228 F.2d 748 (10th Cir. 1955), a case often criticized for virtually reading section 60(a)(6) out of the law, provides a useful starting point. In that case, the Tenth Circuit held that an agreement to execute a chattel mortgage gave rise to an equitable lien good against judgment creditors and that the refusal of the debtor to execute the chattel mortgage made the means of legal perfection unavailable. It then applied section 60(a)(2) (the lien creditor test) rather than section 60(a)(6) (the test using purchasers not in the ordinary course of trade), holding that the date of transfer was the time of perfection against lien creditors. Hence, the transfer was deemed to have occurred as of the date of the agreement. While the court’s conclusion that the mere refusal of the debtor to execute the chattel mortgage took the lien out of section 60(a)(6) is highly questionable, the court’s reliance on the first sentence of the paragraph is instructive: “The recognition of equitable liens where available means of perfecting legal liens have not been employed is hereby declared to be contrary to the policy of this section.” \textit{Id.} at 752. In other words, while section 60(a)(2) adopted a lien creditor test, section 60(a)(6) declared that such test sufficed only if the legal steps necessary to attain the section 60(a)(2) perfection had already been taken; namely compliance with statutory requirements. However, if those steps had not been taken, the transferee would prevail over a lien creditor solely because, when the step is later taken, the transfer would relate back and be fictionally deemed to have been taken previously; then the higher standard in section 60(a)(6) must be met. Thus, section 60(a)(6) never intended to postdate every secret lien; only those secret liens that attain their section 60(a)(2) perfection because of “legal” steps taken later. If, for example, a state statute has no recording requirements for priority against lien creditors, then section 60(a)(2), not section 60(a)(6), would apply. If there is no recording requirement, then, by definition, available means of perfecting legal liens have been employed. There was no suggestion in section 60(a)(6) that the specific means of recording or possessing must be utilized if there were other legal means recognized by local statute, including automatic perfection. Accordingly, I would maintain that a purchase money security interest in consumer goods, because the UCC required no additional step to achieve priority, did not, in fact, qualify as an equitable lien. Under this analysis, the only circumstances in Article 9 that may be so characterized are the grace periods of section 9-301(2) for purchase money security interests and section 9-304(4), permitting a 21 day period of temporary perfection for negotiable instruments and documents. Here, the UCC has ultimately required public notice through filing or possession but then permits that notice to relate back to an earlier time, so that prior creditors claiming an interest in the collateral are defeated. Even in these cases, section 60(a)(6) would not have had the effect of invalidating such transfers because of the 21 day grace period of section 60(a)(7). \textit{See infra} note 79.

\textsuperscript{79} Section 9-301(1)(b) and (c), state that an unperfected security interest is subordinate not only to gap liens, but to buyers not in ordinary course of business who take possession of the collateral without knowledge. Thus, an unperfected Article 9 security interest would fail to meet both the section 60(a)(2) test and the section 60(a)(6) test and, if perfection occurred within four months of the petition, could have constituted a preference. The issue of whether to use the section 60(a)(2) or 60(a)(6) test could have risen only under circumstances where an Article 9 interest is
The BRA resolves the issue quite simply. Section 547 eliminates entirely the troublesome concept of equitable liens. Transfers of personal property are subject only to the lien creditor test. Since an unfiled purchase money security interest in consumer goods is effective against a lien creditor from the time it attaches, it is now clear that such interests, if arising prior to the preference period, are not vulnerable as preferences, although such liens may indeed suffer the vice of secrecy.

3. The Problem of Fixtures

In its adaptation of the section 60(a)(2) test, section 547(e) does make one change which may be of some significance. It specifically validly protected against lien creditors but not against buyers not in the ordinary course of trade. There are potentially three such situations. First, there is a purchase money security interest in consumer goods, treated in the text. But there are at least two other cases as well.

Chattel paper and instruments. U.C.C. § 9-308 allows a purchaser of chattel paper or instruments who takes possession to prevail over one who perfected by permissive filing. Section 9-308 does specify that the purchase must be in the ordinary course of the buyer’s business. This, however, is not the same as the UCC’s concept of “buyer in ordinary course of business” used in section 9-307(1) which, under section 1-201(9), requires that the seller be in the business of selling goods of that kind. It is certainly arguable that when section 60(a)(6) of the 1898 Act speaks of “buyer in the ordinary course of trade,” it refers to a concept similar to that in section 9-307(1). Consequently, a section 9-308 purchaser of chattel paper or instruments in the ordinary course of his business may still be a buyer not in the ordinary course of trade under the section 60(a)(6) test. Thus, security interests in chattel paper perfected by permissive filing were conceivably subject to a preference challenge for failing the section 60(a)(6) test, even though they passed the section 60(a)(2) test. One could argue that because there has been full compliance with a recording statute, the resulting interest could hardly be characterized as an “equitable lien” by any definition. On the other hand, section 60(a)(6) was not limited to situations where recording was the missing step to obtain perfection against buyers not in the ordinary course of trade; it also spoke of delivery of possession. Since possession of chattel paper would prevent a purchaser under section 9-308 from obtaining priority, the requisite legal step had therefore not been taken. But see supra note 78 (priority over lien creditors does not depend on any notion of relation back and interest can therefore not be characterized as an “equitable lien”).

Grace periods as to lien creditors but not as to buyers in the ordinary course of trade. Under section 9-301(2), an unperfected purchase money security interest may prevail over a gap lien creditor if the secured party files within 10 days after the debtor receives possession of the collateral. Under section 9-301(1)(c), however, a buyer not in ordinary course of business would cut off the secured party’s rights. Arguably, under the lien creditor test of section 60(a)(2), the transfer could be dated as of the time of attachment, although the priority attained at that time is contingent on a later act of perfection. Under section 60(a)(6), the transfer would have to be postdated to the time of filing. Yet, under section 60(a)(7), the time of the transfer relates back to attachment if perfection occurs within 21 days after attachment See infra text accompanying notes 92-99. Therefore, under either test, the transaction would ordinarily be safe. The same holds true for the section 9-304(4) which permits temporary perfection in instruments and negotiable documents for 21 days from the time of attachment. Although a section 9-308 buyer of chattel paper or instruments may prevail during those 21 days, if perfection by possession occurred within the 21 day period, the date of the transfer related back to the time of attachment, thanks to section 60(a)(7). If perfection is delayed beyond the 21 day period, then the temporarily perfected interest in instruments and negotiable documents lapses, even as to lien creditors. Thus, even if the 21 day automatic perfection for instruments and the 10 day grace
provides that a security interest in fixtures need meet only the lien creditor test, not the bona fide purchaser test for transfers of realty, a point not made clear under former law.

Section 9-313 of the UCC governs the creation and perfection of security interests in fixtures. A “fixture” is not defined in the UCC but generally denotes personal property that is affixed to reality to the extent that it can be regarded as part of the real estate for purposes of mortgages, conveyances, and the like. Under the 1962 version of Article 9, one could perfect a security interest in goods which become fixtures only through the filing of a financing statement in the real estate records. Since a real estate filing was necessary to prevail both against a subsequent lien creditor and a subsequent bona fide purchaser, the choice of test to be applied to a fixture was relatively unimportant. However, the 1972 version of section 9-313 introduced the concept of a “fixture filing.” A filing was necessary in the real estate records only for purposes of obtaining priority over subsequent real estate interests such as purchasers and mortgagees. However, to prevail over judicial lien creditors, it was sufficient if perfection complied with “any method permitted by this Article” including a standard Article 9 filing under section 9-401. Accordingly, which perfection test under section 60 applied to fixtures was of crucial importance. If fixtures were subject to the bona fide purchaser test of real estate, an

period for purchase money security interests are considered equitable liens, section 60(a)(7) ordinarily precludes their voidability as preferences.

80 See U.C.C. § 9-401 (Official Text 1962). Under all three alternatives of section 9-401, where the collateral is “goods which at the time the security interest attaches are or are to become fixtures . . . .” the financing statement must be filed in the “office where a mortgage on the real estate [concerned] would be filed or recorded.” Id.

81 U.C.C. § 9-313(4) (Official Text 1962). A security interest which attaches but which is unperfected (whether the interest attached prior to affixation of the fixture to the real estate or subsequent to such affixation) is subordinate to “the rights of a subsequent purchaser for value of any interest in the real estate” or “a creditor with a lien on the real estate subsequently obtained by judicial proceedings. . . .” Id.

82 “[A] ‘fixture filing’ is the filing, in the office where a mortgage on the real estate would be filed or recorded, of a financing statement covering goods which are to become fixtures and conforming to the requirements of subsection (5) of section 9-402.” U.C.C. § 9-313(1)(b) (Official Text 1972). Accordingly, a UCC filing which does not comply with the special provisions of section 9-402(5) will be referred to as a “nonfixture filing.”

83 “A perfected security interest in fixtures has priority over the conflicting interest of an encumbrancer or owner of the real estate where . . . (b) the security interest is perfected by a fixture filing before the interest of the encumbrancer or owner is of record . . . .” Id. § 9-313(4) (emphasis added). Special exceptions exist for purchase money security interests under section 9-313(4) which may prevail over a prior mortgage or conveyance if perfected by a fixture filing within 10 days after the goods become fixtures.

84 Id. § 9-313(4)(d) & comment 4(c).

85 If the fixtures were readily removable factory or office machines, or readily removable replacements of domestic appliances, even a nonfixture filing would be sufficient perfection against purchasers and mortgagees, but only if the financing statement were filed prior to
Article 9 security interest in fixtures, perfected well before the preference period but through a nonfixture filing, could potentially become a voidable preference, effectively eliminating the option recognized by the UCC for alternative methods of perfection. To insure that timely perfection would insulate a fixture transfer from a preference challenge, Congress specified in section 547 that fixtures were to be subject to the lien creditor test.

However, an apparently unintentional omission may have left the job undone. It will be recalled that an unperfected security interest may either be invalidated under section 547, by deeming the transfer to have been made immediately before bankruptcy within the preference period, or under section 544(a)(1), permitting the trustee to assert the status of a lien creditor. Similarly, an unrecorded conveyance of real property may be attacked either under section 547, by deeming the transfer to have been made immediately before bankruptcy due to the failure to perfect against a bona fide purchaser, or under section 544(a)(3) by the trustee directly asserting the status of a hypothetical bona fide purchaser of real property as of the petition date. The clarification that fixture transfers are to be subject to the same standard as personal property appears only in section 547(e); there is no mention of fixtures in section 544(a). Accordingly, a trustee could conceivably invalidate a perfected Article 9 security interest in a fixture under section 544(a)(3) unless that interest was perfected by an optional fixture filing. Yet such a construction would hardly be consistent with the fact that, in section 547(e)(1)(B), Congress deliberately went to the trouble of insuring that security interests in fixtures could not be voidable as preferences even if unperfected against bona fide purchasers, a meaningless gesture if in fact all such interests were voidable under a different section of the BRA. Technical amendments have been proposed to conform section 544(a)(3) to section 547(e); as of this writing, those amendments have been approved by the Senate but await passage by the House.86

Perhaps a more serious problem arises from the fact that the classification of fixtures as personal property for purposes of dating the transfer under section 547 does raise the possibility of permitting unrecorded fixture transfers to escape invalidation. It is true that section 9-313(4)(d) of the UCC requires at least a nonfixture filing to prevail over a subsequent lien creditor, and to that extent a wholly

affixation of the collateral to the real estate. Id. § 9-313(4)(c). In that situation, it would of course be unnecessary to determine whether fixtures were classified as realty or personalty for purposes of section 60. However, this determination was crucial for fixtures not covered by the section 9-313(4)(c) exception, i.e., where the collateral becomes affixed before the security interest is perfected.

unperfected security interest in a fixture would be vulnerable even under a lien creditor standard. However, section 9-313 specifically states that security interests in fixtures may be created under real property law not subject to the rules or priorities established by Article 9.87 Thus, if instead of attempting to create an Article 9 security interest in fixtures, the secured party executes a real estate mortgage which includes, as most do, subsequent fixtures and accessions to the realty, the rights of subsequent third party interests, such as lien creditors and purchasers, would not be governed by section 9-313 at all, but by the general real estate law. As was discussed previously,88 many real estate recording statutes do not protect lien creditors and are limited to the protection of subsequent bona fide purchasers and mortgagees. Indeed, this dichotomy of treatment was precisely the reason why section 547 (and its predecessor, section 60) incorporated the bona fide purchaser standard for transfers of realty. Yet, as section 547 currently stands, in a jurisdiction where lien creditors cannot invoke the protection of recording statutes, an unrecorded real estate mortgage covering land and fixtures would not be deemed preferential with regard to the fixtures even though the mortgage was entirely secret. Given the fact that the clear policy of section 547 (and section 60) is the postdating of transfers to the point in time at which they become matters of public record, this result is untenable.89

Accordingly, it is proposed that section 547(e) be amended to provide that fixtures will be treated as personal property only to the extent that the transfer is effected pursuant to local law governing transfers of personal property and that fixtures will be treated as real property to the extent that the transfer is effected pursuant to real property law. This would insure that an Article 9 security interest perfected more than ninety days before bankruptcy (by a noninsider) would be effectively immune against a preference attack, even though notice was not filed in the real estate records. At the same time section 547(e)(1) would not extend protection to an unrecorded real estate mortgage covering fixtures in a jurisdiction where lien creditors are generally not protected. The same conforming amendment should appear in section 544(a)(3).

87 "This Article does not prevent creation of an encumbrance upon fixtures pursuant to real estate law." U.C.C. § 9-313(3) (1972).
88 See supra note 55.
89 Of course, to the extent that section 544(a)(3) is read to include "fixtures," the problem is eliminated. But such a reading endangers the nonfixture filing as well. Avoidance of nonfixture filings under section 544(a)(3) will be precluded by the technical conforming amendments now under consideration. See supra note 86.
4. Time of Transfer

A final change in section 547's definition of "transfer" is the fact that section 547, unlike section 60(a)(2), no longer defines "transfer" exclusively in terms of becoming "so far perfected that no subsequent lien upon such property obtainable by legal or equitable proceedings on a simple contract could become superior to the rights of the transferee." Section 547(e)(1) still defines "perfection" as the attainment of priority over lien creditors. However, section 547(e)(2) now provides that a transfer is deemed made at the time the transfer takes effect between the parties if perfected at that time or within ten days thereafter, or at the time such transfer is perfected if the transfer is perfected more than ten days after its taking effect. Section 547(e)(3) goes on to provide that a transfer is not deemed made until the debtor acquires rights in the property transferred.

Thus, unlike the 1898 Act, which could be construed to define transfer solely in terms of establishing an undisputable priority over subsequent judicial liens, section 547 requires at a minimum that: (1) the debtor have rights in the property; and (2) the transfer be effective between the parties. Since the time when a transfer takes effect between the immediate parties is determined by reference to state law, a transfer of a security interest in personal property could not be deemed made until it "attached" under section 9-203 of the UCC, which requires, inter alia, that the debtor have rights in the collateral, a requirement reinforced by section 547(e)(3)'s explicit directive. The mere fact that the filing of a financing statement, even prior to the debtor's acquisition of the collateral, may protect the secured party's future security interest from the competing claims of lien creditors will not suffice to date the transfer from the filing.

The significance of this additional element lies in its application to floating liens and after-acquired property clauses to be discussed further.

B. Grace Periods

1. The History and the General Operation of Section 547(e)(2)

Both the current and former law dated transfers from the time of perfection. Section 60(a)(7), however, contained a modification of this basic principle and allowed, under certain circumstances, a transfer to be deemed made at an earlier date despite the fact that the transfer was not perfected against levying creditors or bona fide pur-

90 DuBay v. Williams, 417 F.2d 1277 (9th Cir. 1969). See infra, Part II.
91 See id.
chasers at that time. The purpose of section 60(a)(7) was to prevent small gaps between the transfer and the perfection from converting contemporaneous exchanges into preferences. It provided that perfection within twenty-one days after the transfer took effect antedated the transfer to the time of its taking effect if such delayed perfection was permitted by state law. If state law required perfection within a shorter period of time, relation back was only permitted for perfection within that shorter time period. Like section 60(a)(6), the provision was drafted with reference to state laws quite different from the UCC. Its application to Article 9 security interests was therefore quite confusing and unclear.

At the time of the passage of the 1950 amendments to section 60, many states had grace period statutes by which an earlier interest could prevail over an intervening one by a subsequent filing within a certain period of time. The principal issue under section 60(a)(7) was whether it provided a grace period only when state law provided a grace period or whether it provided a grace period when, under state law, security interests could be perfected only with prospective effect. In other words, did perfection within twenty-one days antedate the transfer to the time of its taking effect between the immediate parties only where, under state law, such perfection would in fact relate back and supersede prior lien creditors and, in the case of realty, bona fide purchasers or was the effect of perfection under state law immaterial as long as such delayed perfection was in fact permitted.

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92 The grace period of section 60(a)(7) was limited to transfers effected for new consideration, i.e., contemporaneous exchanges of value, and did not apply to transfers which at the time of their attachment were already on account of antecedent debt although prior to the start of the preference period. Thus, if six months before bankruptcy, creditor lends debtor $1000 and 1.5 months later executes a security agreement and obtains an interest in the debtor's property which is perfected during the preference period but within 21 days of the attachment, section 60(a)(7) did not operate to antedate the transfer to the time of its attachment, thereby invalidating the transfer as one that took place prior to the start of the four month period. Rather the transfer was deemed made only when perfected. Section 547(c), while shortening the grace period to 10 days, contains no such limitation. See infra text accompanying notes 100-05.

93 Section 5 of the Uniform Conditional Sales Act, for example, provided that reservation of title in the seller was void as to subsequent purchasers and levying creditors unless a filing was made within 10 days after the making of the conditional sale. In many situations, grace periods were established by the courts. See 1 Gilmore, supra note 59, §§ 16.2-3, at 48.

94 Under the first reading, section 60(a)(7) was better understood as a refinement of, rather than an exception to, section 60(a)(2), by simply incorporating state law notions of relation back for periods up to 21 days and not permitting relation back if necessary perfection occurs after that period (even if, under state law, such delayed perfection does have relation back effect). Thus, section 60(a)(7) antedated a transfer to the time of its taking effect only because, as of that time, the transfer already met the basic standard of section 60(a)(2), assuming the later perfection step was complied with subsequently. (The purpose of section 60(a)(7) would then have been to ensure that the necessity of taking that later step would not have the effect of delaying the transfer). Under the second reading, section 60(a)(7) was clearly an exception to section 60(a)(2), in that section 60(a)(7) allowed transfers to relate back to the time of their taking effect, if
The UCC, with some exceptions, is essentially not a grace statute. Under section 9-301, a person who becomes a lien creditor before the security interest is perfected prevails over the secured party (subject only to the purchase money exception in section 9-301(2)). On the other hand, the UCC does not expressly provide a time within which a filing must be made and permits financing statements to be filed more than twenty-one days after attachment, without forfeiture of the security interest. Was a standard UCC nonpurchase money security interest entitled to the twenty-one day grace period of section 60(a)(7)?

Most commentators assumed that it was, reasoning that the policy of not penalizing relatively small gaps in perfection mandated that no distinction be drawn between grace and nongrace statutes. Yet this in turn raised the anomalous possibility that in the one area where the UCC does permit a subsequent filing to defeat an earlier lien creditor—the purchase money security interest in nonconsumer goods—the grace period under section 60(a)(7) would be reduced. Section 9-301(2) provides that a purchase money security interest that is perfected within ten days of the debtor’s receiving possession of the collateral prevails over a creditor who obtains a judicial lien in the gap between attachment and perfection. Since section 60(a)(7) allowed a twenty-one day grace period only if state law did not specify a shorter period of time and since section 9-301(2) does specify a period which is potentially shorter, arguably a purchase money security interest that was perfected eleven days after the debtor received possession of the collateral could have been vulnerable as a preference, and yet a nonpurchase money security interest, for which state law provided no grace period at all, was protected under section 60(a)(7).

perfected within 21 days, even though such transfers clearly did not meet the section 60(a)(2) standard of perfection against lien creditors.

85 See 1A COOCAN, HOGAN & VACCHI, supra note 8, § 9.03(5)(c), at 995. Contra 2 GILMORE, supra note 69, § 14.8, at 1328 (section 60(a)(7) permitted perfection up to 21 days only if, under state law, such delayed perfection had a relation back effect).

86 See supra note 56 (for definitions of basic Article 9 terminology). Section 9-301(2) is necessary only for purchase money security interests in property other than consumer goods. For purchase money security interests in consumer goods, no grace period for perfection is necessary since perfection and priority over a lien creditor occur automatically upon attachment, though filing may be necessary to prevail over subsequent buyers. See U.C.C. §§ 9-302(1)(b), 307(2) (Official Text 1972); see also infra text accompanying notes 105-10.

87 The 21 day grace period in section 60(a)(7) starts running with the “transfer.” The 10 day grace period of U.C.C. § 9-301(2), however, does not start until the debtor obtains possession of the collateral. Therefore, in cases where the debtor obtains rights in the collateral but no immediate possession—e.g., the goods are being shipped to the debtor—the 10 day grace period in section 9-301(2) can be longer than the 21 day grace period in section 60(a)(7). See infra text accompanying note 105.
for the entire twenty-one day period. This conclusion was not the only possible construction of section 60(a)(7) but the fact that the plain language of the statute did suggest that purchase money security interests, by virtue of their favorable status under state law, could be more vulnerable to a preference challenge than their less favored nonpurchase money counterparts, indicated the necessity of a revision that would identify with some specificity those interests which were entitled to grace periods and those that were not.

Section 547 does indeed make clear that all Article 9 security interests, even those which were vulnerable to a lien creditor until perfection, have a grace period which will permit the transfer to be antedated to the time of its taking effect, although the period was shortened from twenty-one to ten days. Section 547(e)(2) provides that a transfer is made either: (a) at the time when such transfer takes effect between the transferor and transferee, if the transfer is perfected at or within ten days after such time; or (b) at the time of perfection (which in the case of personal property means the obtaining of priority over lien creditors) if perfected more than ten days after the transfer took effect between the parties. Depending on the proper construction of section 60(a)(7), permitting a ten day grace period for any security interest may be either an expansion or contraction of prior law but, in any case, is certainly a clarification. Note that section 547(e) does not have a "new value" trigger as did section 60(a)(7). It permits perfection within ten days to relate back to the time of attachment even where the security agreement was executed to secure antecedent debt.

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98 This was the position taken by the editors of Collier. See 3 COLIER ON BANKRUPTCY, supra note 8, ¶ 60.51.

99 At least two alternative constructions of section 60(a)(7) were advanced, either of which eliminated that anomalous disadvantage which purchase money security interests apparently suffered by virtue of their favored status under state law. Professor Gilmore took the position that section 60(a)(7) was limited to grace period statutes.

100 Compliance with the grace period will avail the secured party in such a case, only if the security interest attached prior to the preference period. See supra note 94. Since a typical Article 9 security interest had no grace period at all to prevail over a prior lien creditor, it was not covered by section 60(a)(7), and any delay in perfection would render such a transfer a preference. Since purchase money security interests did have a 10 day grace period under state law, perfection within that time period protected the transfer under section 60(a)(7). Neither interest was covered by the 21 day grace period of section 60(a)(7) since in both cases state law specified a shorter period. See 2 GILMORE, supra note 69, § 45.8, at 1328. This interpretation tolerates no gaps for the typical Article 9 interest.

Another interpretation would grant the standard Article 9 security interest the benefit of the entire 21 day grace period of section 60(a)(7) but, at the same time, would not limit the purchase money security interest to the 10 ten limit of section 9-301(2). To the same extent that the UCC does not specify a time of filing for nonpurchase money security interests, i.e., a time after which filing will no longer be even prospectively effective against future levyng creditors of the debtor, neither does it supply such a time for purchase money security interests. The fact that Article 9 does specify a 10 day period to defeat a prior lien creditor is of no significance if section 60(a)(7)
Moreover, unlike section 60 which simply provided that a failure to perfect before bankruptcy postdated the transfer to the time immediately before the petition, section 547 explicitly recognizes that the ten day grace period may encompass postbankruptcy perfection as well. Section 547(e)(2)(C) provides that a transfer will be deemed made as of the commencement of the case only if it is unperfected as of the later of the commencement of the case or ten days from the transfer taking effect, the clear implication being that if bankruptcy came first, the secured party still has ten days in which to perfect, thereby backdating the transfer to the time it took effect between the parties.\footnote{101}

In most cases, postbankruptcy perfection will be ineffective in sustaining the validity of a prebankruptcy transfer. If the transfer was in fact unperfected as of the date of bankruptcy, it would generally be vulnerable to attack under section 544(a)(1), which gives the trustee hypothetical lien creditor status as of the commencement of the case, notwithstanding compliance with the ten day grace period of section 547. Compliance with the ten day grace period does not mean that the interest was deemed perfected against a lien creditor in the interim—an issue left to state law—only that the transfer was deemed made although it was not yet perfected. Accordingly, such a transfer would still have been subordinated to the rights of a lien creditor under section 9-301 and, therefore, if bankruptcy intervenes, to the trustee’s derivative rights under section 544(a)(1).

Postbankruptcy perfection will be effective, however, if under state law such subsequent action would have a relation back effect defeating the rights of a prior lien creditor. Under section 9-301(2), this is the case for the purchase money security interest in nonconsumer goods which, if perfected within ten days of the debtor’s receiving possession of the collateral, will prevail over the rights of a prior lien creditor. Section 546(b) specifically states that the trustee’s lien creditor status under section 544(a)(1) may be defeated by such postpetition perfection if, under applicable state law, a lien creditor could be so defeated. Moreover, such postpetition perfection is excepted from the operation of the automatic stay in section 362(b)(3).\footnote{102} While section 546(b) does not expressly state that postpetition perfec-

\footnote{101} Of course, such a transfer will still have occurred within the preference period but may nonetheless be nonpreferential by virtue of its being in exchange for a contemporaneous extension of value.

tion may defeat avoidance under section 547, section 547 by its own terms permits postpetition perfection within ten days to antedate the transfer to the time of its taking effect. A purchase money security interest perfected pursuant to section 9-301(2) will therefore rarely be voidable, even if bankruptcy intervenes prior to perfection.\footnote{Compliance with section 9-301(2) will not, however, guarantee validity of the purchase money security interest. As will be discussed at infra text accompanying notes 106-11, there may be some situations where a transfer, although complying with section 9-301(2), may nonetheless be voidable under section 547 if the debtor acquires rights in the collateral prior to the time he receives possession, depending on the proper construction of section 547(e). Moreover, even if the secured party does perfect within 10 days of the transfer’s taking effect, the statutory backdating of section 547(e) will not validate the transfer if it attached subsequent to the incurrence of the debt, which will typically be the case for an enabling loan. See supra note 79. While enabling loans perfected within 10 days are generally covered by section 547(c)(3), there are certain instances of purchase money interests under Article 9 that do not meet the standards of the section 547(e)(3) statutory exception and would be covered by neither section 547(e) or section 547(c)(3). See infra text accompanying notes. But at least in purchase money security interests retained by a seller of goods, commonly the security interest “takes effect” contemporaneously with the extension of value, i.e., transfer of ownership to the debtor, thereby precluding its voidability as a preference if perfected within 10 days of its taking effect(a)(1).}

In short, although for purposes of section 547(e)(2)(C), timely postpetition perfection will always antedate the transfer to the time of its taking effect, it is only the purchase money security interest that will thereby be validated. Section 546(b) immunizes the transfer from attack under section 544(a)(1) and section 547(e) immunizes the transfer from attack under section 547. A nonpurchase money security interest that was unperfected as of the date of bankruptcy and not protected by section 546 would always be voidable under section 544(a)(1) irrespective of the time the transfer is deemed to occur under section 547.\footnote{Section 546(b) does have some effect on preference cases. Section 362(b)(3), by referring to section 546(b), makes clear that postpetition perfection of purchase money security interests is not automatically stayed. Other postpetition perfection is automatically stayed, thereby rendering section 547(e)(2)(C)(ii)’s approval of postpetition perfection moot for nonpurchase money security interests. Even without the express proscription of section 362, however, postpetition of nonpurchase money interests would be unavailing because of section 544.}

In any case, whether a purchase money security interest could be perfected postpetition was an open question under both section 60 and section 70(c) of the 1898 Act. Section 547(e), together with section 546(b) and section 362(b)(3), answers that question in the affirmative.\footnote{It is not entirely clear, however, why section 547(e)(2)(C) is necessary to achieve this result. Even if the 10 day grace period would not encompass postbankruptcy perfection, the only effect would be to deem the time of transfer to be immediately before the petition. Yet, while that may indeed convert a contemporaneous exchange of value into a transfer on account of an antecedent debt, the transfer would not, by that fact alone, become voidable. Section 547(c)(3) generally protects purchase money security interests that are perfected within 10 days of the interest taking effect even if at the time the interest took effect the transfer was already preferential, e.g., an enabling loan where the property was purchased subsequent to the advance. The section...}
2. Grace Periods for Purchase Money Security Interests in Nonconsumer Goods

Section 547(e)(2), however, is not without problems of its own. Specifically, given the fact that section 547(e)(2) grants a ten day grace period even for security interests and transfers that are unperfected in the interim (at least where the perfection occurs prior to bankruptcy)—an issue left open by section 60(a)(7)—the question remains whether it would impose the same ten day limitation on security interests that have a longer grace period for retroactive perfection under state law, or would the transfer be automatically antedated to the time it took effect by virtue of the relation back permitted under state law without regard to the ten day limitation in section 547? In other words, under a state statute providing for relation back, at what point in time is a transfer of personal property deemed perfected against a lien creditor—at the time the requisite perfection step is taken or from the time the interest is actually superior by virtue of that later perfection step? An example involving purchase money security interests under Article 9 will clarify this point.

This Article has made repeated reference to section 9-301(2), which provides that a purchase money security interest (taken either

547(c)(3) exception does not depend on artificially backdating the transfer. It simply requires that perfection occur within a certain time. If perfection is timely, the transfer is protected without regard to when it is deemed to occur. Thus, the definitional backdating of section 547(e)(2) is entirely unnecessary. As long as postpetition action is permitted to be taken under section 546(b), when such perfection occurs, the section 547(c)(3) exception will automatically be triggered without resort to section 547(e)(2). Conversely, in the nonpurchase money context, when section 547(c)(3) is unavailable, section 547(e)(2) is equally unavailable.

In response, an argument could be made that while both sections 547(e)(2)(C) and 547(c)(3) are concerned with, and limited to, purchase money security interests, the subsections are addressing different types of those interests. The protection provided by section 547(e)(2)—i.e., compliance with a 10 day grace period—is completely sufficient to protect security interests retained by the seller who is selling goods on credit. The seller's security interest generally arises contemporaneously with the seller's extension of value, and thus, by deeming the transfer made as of the time it took effect, the transfer is effectively insulated from a preference challenge. Section 547(e)(2)(C) merely makes clear that the necessary perfection can occur postpetition as well. Backdating the transfer, however, would afford little protection to the enabling loan, i.e., a loan made by a third person to finance the acquisition of a particular item, since even if the security interest is perfected within 10 days of its taking effect, the transfer often does not take effect until some time after the extension of value. Thus, the special exception of section 547(c)(3) was necessary. However, section 547(c)(3) is limited only to the situation for which it was needed. It does not cover purchase money security interests retained by the seller and accordingly the definitional mechanisms contained in section 547(e)(2) regarding the time of transfer are still necessary. Congress could have drafted a single purchase money exception under section 547(e)(3) embracing both the enabling loan and the seller's retained interest but, as the law stands, Congress elected not to do so.

This analysis is not conclusive. The requirement in section 547(c)(3) that new value be given "to enable the debtor to acquire such property" can conceivably be construed to include a seller extending credit, and if that is the case, section 547(e)(2)(C) is indeed redundant. (Section 547(c)(3), however, is not redundant, since it certainly includes the enabling loan). See infra text accompanying notes 191-92.
by the seller or an enabling lender) perfected within ten days of the debtor's receiving possession of the collateral will prevail over a prior lien creditor. If the holder of the purchase money security interest does not perfect in a timely manner, the general rule of section 9-301(1) applies, granting priority to the lien creditor whose rights arise between attachment and perfection of the purchase money security interest. Thus, the status of the purchase money secured party vis-à-vis a lien creditor cannot be determined until the time of perfection, although once perfection occurs, its effect may relate back to the time of attachment. The question then becomes: For purposes of section 547(e), is the transfer perfected as of the date it takes effect between the parties (and hence perhaps not preferential either because it occurred prior to the preference period or because it was contemporaneous with the value extended to the debtor) or as of the date the necessary perfection step is actually taken?

It must be pointed out that in situations where the secured party is reasonably diligent this inquiry will be irrelevant. Even if the time of perfection within the meaning of section 547(e) occurs only when the requisite perfection step is taken, as long as that step is taken within ten days of the transfer taking effect, the transfer will be antedated to the time of attachment by the grace period in section 547(e)(2). Moreover, even if the transfer took effect within the preference period and was not contemporaneous with the advance (e.g., an enabling loan where the debtor acquired the property some time later), section 547(e)(3) still exempts the purchase money security interest from avoidance if perfection occurs within ten days of attachment. It is entirely possible, however, for perfection of a purchase money security interest to occur beyond the grace period permitted by section 547 but within the time set down by section 9-301(2) to prevail over lien creditors. The ten day period in section 547(e)(2), as well as in section 547(c)(3)(B), run from the time that the transfer takes effect between the parties as determined by state law (i.e., attachment); the ten day period in section 9-301(2) run from the debtor's obtaining possession of the collateral. The two events will not necessarily occur on the same day. Under section 9-203, an Article 9 security interest is effective between the parties only upon the debtor's acquiring rights in the collateral. However, due to shipping delays and the like, the debtor may acquire rights in the collateral well in advance of his receiving possession.\textsuperscript{108} The ten day period of section 9-301(2) would then extend beyond the expiration of the grace period under section 547. It thus becomes essential to determine whether compliance with

section 9-301(2) alone affords protection to the transfer at least where the transfer is contemporaneous with the extension of value as in the case with an interest retained by the seller or occurred prior to the start of the preference period. This can be illustrated by the following example:

On January 1, seller ships goods to debtor and retains an unperfected purchase money security interest. Debtor acquires title immediately under the agreement but does not receive possession until February 1. Seller files the necessary financing statement on February 6. Within ninety days the debtor goes into bankruptcy. Assume the debtor was insolvent on February 6. Does the seller have a valid purchase money security interest? 107

The central issue is at what point in time a purchase money security interest is deemed perfected against a lien creditor within the meaning of section 547(e)(1)(B)—at the time the necessary perfection step is taken (the February 6 filing) or the time after which, by virtue of that later step, an intervening lien creditor could be defeated (i.e., as of January 1, when the debtor first obtained rights in the collateral)? If the transfer is deemed perfected as of the date of attachment, the transfer arises contemporaneously with the seller’s extension of value and is not preferential, notwithstanding the fact that the financing statement was filed more than ten days after the transfer took effect. If, on the other hand, the transfer is deemed perfected only when the financing statement is filed, the transfer is on account of an antecedent debt and is potentially voidable. If the latter proposition is true, neither the general ten day grace period of section 547(e)(2) nor the specific purchase money exception in section 547(c)(3)(B) causes a relation back since both exceptions require perfection within ten days of the transfer taking effect. 108

While there is some recent judicial authority to the contrary, 109 a close reading of section 547(e)(2) appears to suggest that purchase

107 For purposes of the example, it must be assumed that the buyer was not insolvent at the time of the receipt of the goods, or that no written demand for reclamation was made within 10 days of the debtor’s receipt of the goods. If the debtor was insolvent at the time of receipt and written demand was made, section 546(c) recognizes the seller’s right of reclamation in bankruptcy, to the extent recognized by state law. See id.; U.C.C. § 2-702(1972). If the seller does have a statutory right of reclamation not subject to section 547, any payment to the creditor not in excess of the value of the goods cannot be a preference. The example assumes section 546(c) is inapplicable.

108 In any case, section 547(c)(3) may be limited to the enabling loan and has no application to security interests retained by a seller on credit. See supra note 105.

109 See John v. First Tenn. Bank (In re Burnette), 14 Bankr. 795 (E.D. Tenn. 1981). That case arose under the Tennessee version of section 9-301(2) which provided a 20 day grace period for purchase money security interests. The security interest in that case was perfected before the
money security interests are not deemed perfected until a financing statement is filed, notwithstanding the fact that a prior lien creditor would be defeated under state law. Consequently, compliance with section 9-301(2) would not guarantee validation of the transfer against a bankruptcy trustee unless the act of perfection occurred within the ten day grace period of section 547.

The mere fact that section 547(e) chose a grace period different, and often shorter, than the one in section 9-301(2) carries no implication that reliance on section 9-301(2) is foreclosed; section 547(e) may have been principally intended to establish a uniform grace period for all security interests, even nonpurchase money transfers are beyond the scope of section 9-301(2). However, such an inference may be drawn from section 547(e)(2)(C)(ii), which expressly contemplates that the ten day grace period may extend beyond the filing of the petition, and that such compliance is necessary to insure that the transfer will not be deemed made immediately before the commencement of the case. If one takes the position that purchase money security interests complying with section 9-301(2)—i.e., a filing ten days after the debtor gets possession of the collateral—are deemed perfected against lien creditors within the meaning of section 547(e)(1)(B) as soon as they arise, there would be no situation where postpetition compliance with section 547(e)(2)(C) would ever be necessary. As noted earlier,¹¹⁰ by virtue of section 546(b), postpetition perfection can save a prepetition transfer from the trustee’s strong arm power in section 544(a) only if such perfection has a relation back effect under state law, allowing the transfer to defeat an intervening lien creditor. The nonpurchase money security interest that was unperfected as of the commencement of the case would thus be voidable even if a postpetition UCC filing was made within ten days of the transfer taking effect. Accordingly, unlike the general grace period of section 547, the provisions of section 547(e)(2)(C)(ii) regarding the effectiveness of postbankruptcy perfection within ten days of the transfer taking effect can apply only to the purchase money security interest that complies with section 9-301(2), for only such an interest could be validated by postpetition compliance in spite of section 544(a). Yet that is the very situation where such compliance should be unnecessary, since the purchase money security interest would supposedly be deemed perfected from the time of attachment under section

¹¹⁰ See supra text accompanying note 105.
547(e)(1)(B), without regard to section 547(e)(2)(C). Thus, providing any postbankruptcy perfection period for such interests would be surplusage. Even if section 547(e)(2)(C) simply stated that a transfer unperfected as of the commencement of the case would be deemed to occur as of the commencement of the case, the purchase money security interest for which no financing statement was filed until after bankruptcy, but which otherwise complied with section 9-301(2), would still be protected.

More important, by providing a grace period that terminates sooner than the one created by section 9-301(2) and by providing that a failure to perfect by either the expiration of such period or the commencement of the case, whichever is later, will postdate the transfer to the commencement of the case, Congress clearly indicated two things: (1) that a purchase money security interest is not “perfected” within the meaning of section 547(e) until the filing of a financing statement; and (2) a filing which complies with section 9-301(2) but which was not made within the period specified in section 547(e)(2)(B) or (C) would not guarantee validation of the transfer against the bankruptcy trustee.

One could make the argument that in providing for postpetition perfection of purchase money security interests (which are the only interests for which such action is effective), Congress was merely acting out of an abundance of caution to insure the validation of purchase money security interests for which no filing was made prior to bankruptcy but without necessarily implying that such interests are unperfected in the interim. Accordingly, the “surplusage” of a postpetition grace period would not be evidence that purchase money security interests complying with section 9-301(2) are not deemed perfected as of the date of their attachment. Yet while this argument explains why Congress believed it necessary to provide some form of postbankruptcy perfection, it offers no explanation why the period given for such perfection is different, and shorter, than the one allowed under section 9-301(2). While Congress is certainly free to adopt any or no grace period at all in connection with other Article 9 security interests, it makes no sense to adopt a shorter period for purchase money security interests if compliance with such period is unnecessary. Thus, if such interests were deemed perfected from the date of attachment, at the very least section 547(e)(2)(C) should have been amended to allow postpetition filing of a financing statement for purchase money security interests up to ten days after the debtor receives possession of the collateral.\textsuperscript{111}

\textsuperscript{111} This would not necessitate amending the basic grace period of section 547(e) applicable to all Article 9 security interests since that grace period would simply not govern security interests within the scope of section 9-301(2).
Of course, what has been said heretofore is relevant only to establish the time at which a purchase money security interest has been transferred under section 547(e)—i.e., only when the UCC filing is made. A separate question is whether the purchase money security interest is voidable. These transactions are never voidable as preferences if they meet the rigorous requirements of section 547(c)(3). In that section, a separate ten day grace period is given to purchase money security interests. But, as with section 547(e)(2), the ten days begin to run from attachment, not the debtor’s obtaining possession of the collateral, as in section 9-301(2). Therefore, compliance with section 9-301 does not guarantee validation of the purchase money security interest under section 547(c)(3). Nor does it guarantee a relation back to attachment under section 547(e)(1)(B) or 547(e)(2).

3. The Twenty-One Day Grace Period Under Section 9-304

There are other grace periods arising under the UCC which appear not to be subject to the limitations of section 547. Consider the twenty-one day grace period for the perfection of security interests in instruments and negotiable documents of title. Section 9-304(4) provides: “A security interest in instruments (other than certified securities) or negotiable documents is perfected without filing or the taking of possession for a period of twenty-one days from the time it attaches to the extent that it arises for new value given under a written security agreement.” Assume that a security interest in a negotiable document of title attached on January 1, pursuant to new value given under a written security agreement. On January 20, the secured party took possession of the document, thereby perfecting a security interest in the goods under section 9-304(2). Assume further that the debtor was insolvent at the time and was placed into bankruptcy within ninety days of the secured party’s taking possession. Is the security interest voidable as a preference?

The answer, of course, depends on when the transfer was deemed to occur. While no judicial authority appears to have addressed this question, I would suggest that the transfer would be deemed made as soon as it took effect between the parties on January 1 and hence, the transfer would not be a voidable preference, both because it occurred prior to the preference period and because of its being in exchange for contemporaneous value released to the debtor. This is true although the delivery of possession took place more than ten days after the transfer took effect but within twenty-one days of the attachment.

Although the twenty-one day grace period of section 9-304 bears a superficial resemblance to the ten day grace period for purchase
money security interests, a clear distinction can be drawn between the grace period in section 9-301(2) and the temporary perfection of section 9-304(4), with only the former subject to the ten day limitation of section 547(e). Section 9-301(2) is not an automatic perfection statute; it does not state that the security interest is perfected for ten days, but then lapses if no filing has been made. Rather, it provides that if there is a timely filing, the secured party can defeat a prior lien creditor. If a creditor levies within ten days of the debtor’s receiving possession of the collateral but the secured party does not file a financing statement for eleven days, the lien creditor would prevail. Thus, perfected status under section 9-301(2) is conditional on later action. Because the validity of a purchase money security interest against the competing rights of a lien creditor can be determined only upon the filing of a financing statement within the time period of section 9-301(2)—although once a filing is made, its effect relates back to the time of attachment—the interest is deemed unperfected until filing and, hence, vulnerable to a preference challenge unless there is compliance with the separate grace period of section 547(e).

This is to be contrasted with the twenty-one day grace period of section 9-304(4). There, the security interest is deemed perfected against a lien creditor for twenty-one days regardless of whether or not any supplementary action is taken. If a lien creditor would levy on the nineteenth day, he would lose irrespective of what the secured party did or failed to do by the twenty-first. The lapse in perfection is wholly prospective. Accordingly, the transfer would be deemed to occur under section 547(e)(2)(A) “at the time such transfer takes effect” because “such transfer is perfected at . . . such time.” Since taking possession within the twenty-one day period merely continues the preexisting perfected status of the security interest, the ten day grace period of section 547(e) should have no relevance. In short, a transfer which is already fully perfected prior to the preference period

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112 Under section 9-303(2), when there is no gap in perfection, the security interest is deemed continuously perfected.

113 Perhaps the best example illustrating this point would be the filing of a continuation statement before the expiration of five years from the original filing. See U.C.C. § 9-403 (Official Text 1972). No one would contend that such action would thereby transform a contemporaneous security interest into a preference since it merely prevents a perfected interest from lapsing. Indeed, in one respect, the case is stronger under section 9-304(4) where the lapse is wholly prospective than under section 9-403(2) where failure to file a continuation statement permits all prior lien creditors and purchasers, even those who acquired their interests before lapse, to prevail over the Article 9 claimant. Thus, section 9-403 is more closely analogous to section 9-301(2). See supra text accompanying note 109; infra text accompanying notes 132-35.
should not be deemed preferential merely because a later action is necessary to continue that perfected status.

4. Multistate Transactions

(a) The 1972 UCC

Section 9-103 of the UCC deals with the perfection of security interests in the context of a multiple-state transaction. It provides two basic rules regarding the proper state within which to perfect. For most types of tangible personal property, a financing statement must be filed in the state in which the collateral is located.\textsuperscript{114} For accounts and other types of intangible property, the filing is made where the debtor is located.\textsuperscript{115} If the collateral is moved into another state or the debtor changes location, the security interest remains perfected in the new state for up to four months after removal or change without supplementary action.\textsuperscript{116} However, the perfection lapses at the end of such period unless the interest is reperfected by action in the new jurisdiction.

Since section 9-103 permits perfection well beyond the grace period of section 547(e), compliance with section 9-103 may raise potential preference problems. Assume for example that a creditor perfected an Article 9 security interest in ordinary goods on January 1. A month later, the goods are moved into another state. After two months, the creditor files a financing statement in the second state.

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\textsuperscript{114} Under section 9-103(1)(b), for documents, instruments, and ordinary goods—i.e., all goods other than those covered by a certificate of title, mobile goods, and minerals—perfection is governed by the law of the jurisdiction "where the collateral is when the last event occurs on which is based the assertion that the security interest is perfected or unperfected."

It is important to note that the last event will not necessarily be the filing of a financing statement. Under section 9-203, a security interest cannot be perfected until it has attached. Under section 9-203, a security interest cannot attach until three conditions are met. See supra note 56. If, for example, a financing statement was filed in one state prior to the making of an advance, at a time when the collateral was located in that state, but by the time the advance was made the collateral had been moved, a new filing would be required and the secured party would not have the benefit of the four month grace period which applies only if the interest had already been perfected in the first state within meaning of the "last event" test.

\textsuperscript{115} Section 9-103(3) which covers accounts, general intangibles, and mobile goods other than those covered by a certificate of title provides that perfection is governed by the jurisdiction in which the debtor is located. "A debtor shall be deemed located at his place of business if he has one, at his chief executive office if he has more than one place of business, otherwise at his residence." U.C.C. § 9-103(3)(d) (1972). Nonpossessory security interests in chattel paper are governed by the same rules. \textit{id.} § 9-103(4).

Section 9-103(3) does not contain a "last event" test as does section 9-103(1). Accordingly, it is not clear at what point in time the debtor's location is to be determined.

\textsuperscript{116} \textit{id.} §§ 9-103(1)(d), (3)(e).
The debtor files for bankruptcy within ninety days of that second filing. Will the transfer be deemed made as of the time of the refiling and hence within the preference period or as of the time it was originally perfected in the first state?

Vis-a-vis lien creditors, the lapse in perfection, due to a failure to reperfect before the expiration of four months, is wholly prospective. The security interest is deemed to have been unperfected as of the date of removal only as against a person who became a purchaser after removal.117 “Purchaser” includes buyers and other secured parties but does not include a lien creditor who acquires his interest without a voluntary act of the debtor.118 Accordingly, only a creditor who acquires a judicial lien after the lapse could defeat the previously perfected Article 9 interest. A lien creditor who levies within the four month period would lose to the secured party because the out-of-state security interest does not become unperfected as of the date of removal against third parties who are not “purchasers,” although it does become prospectively unperfected even against such nonpurchaser interests if the secured party does not reperfect within the four months.

In light of the limited effect of such lapse, two situations appear to be clear. First, where bankruptcy intervenes after the goods were removed but before the expiration of the four month period, the interest clearly could not be voidable as a preference. From the time of its initial perfection in the first state, the security interest was immune from subsequent judicial liens. Any creditor who would have levied between the time of the initial perfection of the security interest and the filing of the petition would have been subordinate to the holder of the security interest, irrespective of whether the latter reperfected before the expiration of four months. Since no lien creditor after January 1 could have obtained rights superior to the secured party, the security interest is valid under both section 544(a)(1) and section 547.

Conversely, if the secured party allowed his interest to lapse and then reperfected within the preference period with bankruptcy occurring within ninety days, the interest would be clearly voidable notwithstanding its earlier perfection. Upon the expiration of the four

117 Id. §§ 9-103(1)(d)(i), (3)(e).
118 Section 1-201(32) provides that “purchase includes taking by sale . . . lien . . . or any other voluntary transaction creating an interest in property.” (Emphasis added). It does not include a judicial lien. See also id. § 9-103 comment 7; cf. id. § 9-403(2) (failure to file a continuation statement permits prior purchasers and lien creditors to prevail).
month period, a postlapse lien creditor could have defeated the security interest. Accordingly, the transfer would be deemed made not as of January 1 but only upon its reperfection within the preference period. If the secured party failed to reperfect before bankruptcy, the transfer would be deemed made immediately before the petition and would be voidable under both section 544(a)(1) and section 547.\footnote{Section 547(e)(2)(C) provides that a transfer is deemed made as of the commencement of the case only if it is unperfected as of the later of the commencement of the case or 10 days after the transfer took effect between the parties. If bankruptcy intervenes after the expiration of the four month grace period of section 9-103, the period for postpetition perfection has obviously lapsed even if the goods were removed immediately after attachment, which is typically not the case. In any event, postpetition perfection is unavailable under section 544(a)(1) unless such action has a relation back effect under section 546(b). \textit{See supra} text accompanying notes 102-05. Reperfection after lapse has no such effect. \textit{See U.C.C.} §§ 9-103 comment 7, 9-303(2) comment 2.}

The question arises, however, where the secured party does reperfect within the four month period after removal to another state, and bankruptcy occurs within ninety days after the reperfection. Had the secured party not taken action within the preference period, there were or could have been prebankruptcy lien creditors that could have defeated his interest. Since the security interest could have been defeated by some lien creditors if supplementary action had not been taken, arguably only upon such reperfection can the transfer be deemed made, making it preferential under section 547.

While no definitive answer can be given at this point, it is important to note that on balance the four month grace period of section 9-103 is essentially identical to the twenty-one day grace period of section 9-304 and are both distinguishable from the ten day grace period of section 9-301(2). For the four months after removal, the security interest is deemed perfected against lien creditors whether or not subsequent action is taken. Even if such action is not taken, the postremoval prelapse lien creditor not qualifying as a "purchaser" still loses out. Because the security interest was already fully perfected against all lien creditors for a specified period of time and reperfection merely extends that preexisting perfection, necessary reperfection, like the filing of a continuation statement, may not constitute the making of a new transfer. As noted earlier in connection with section 9-304,\footnote{\textit{See supra} text accompanying notes 112-13.} this is to be distinguished from section 9-301(2) where the purchase money security interest is vulnerable to subsequent lien creditors unless perfection follows within ten days. Where even interim perfection is dependent on subsequent action, a strong argument can be made that the interest cannot be regarded as perfected until that action is taken, although when taken, it can defeat a prior lien creditor.\footnote{\textit{See id.}}
argument is less compelling where subsequent action is necessary only to prevent prospective lapse and no lapse has actually occurred. The fact that Congress intended the former to be deemed preferential (at least where there is no compliance with section 547(c)(3) or section 547(e)(2)(B) and (C) proves nothing regarding the latter.

(b) The 1962 UCC

The problems posed by the 1962 version of section 9-103 are more complex though fortunately less pressing. The 1962 version of section 9-103 contained the same four month grace period but merely provided that, as of the end of the four months, the security interest became unperfected. What effect did lapse have on preexisting interests such as lien creditors or purchasers who acquired their interests after removal of the collateral to another state but prior to lapse? The Official Comments to section 9-103 indicated that if the secured party failed to reperfected within the four month period, the prelapse interests that were originally subordinated to the secured party now acquired senior status. The previously existing priorities were reversed not only as to postremoval purchasers (as is true in the 1972 version of section 9-103), but as to lien creditors as well. Courts and commentators were in disagreement whether the effect of lapse was wholly prospective, with prelapse priorities remaining intact, or whether lapse made the security interest unperfected as of the date of removal. The 1972 official text represented a legislative compromise, taking the former position with respect to lien creditors and the latter with respect to lien buyers and other secured parties.

In any event, to the extent that the effect of the lapse was wholly prospective under the 1962 UCC, the conclusions that emerge are identical to those under the 1972 UCC. As soon as the security interest was initially perfected, it was automatically superior to all preremoval lien creditors and, for four months, to postremoval creditors as well. Because reperfected is necessary only to prevent prospective lapse, but not to insure priority over prelapse creditors, reperfected within the preference period arguably does not effect a new transfer.

122 The majority of states have adopted the 1972 Official Text. See supra note 14.
123 U.C.C. § 9-103 comment 7 (Official Text 1962).
124 Note that the lapse was not entirely retroactive. Creditors who acquired their liens prior to removal of the collateral were still subordinated to the lapsed security interest.
Similarly, if bankruptcy intervenes before the expiration of four months, the security interest would be valid, whether reperfected or not.\textsuperscript{126}

However, if, as the Comments suggest, the effect of lapse under the 1962 version of section 9-103 was retroactive both as to lien creditors and purchasers, the status of the security interest during the four months following removal closely resembles that of the purchase money security interest during the ten day grace period of section 9-301(2). Once the collateral is moved into another jurisdiction (or, in the case of accounts, once the debtor changes his location), the secured party will prevail over a postremoval lien creditor only if the secured party reperfected before the end of the four month period. The function of reperfection would no longer simply be the extension of a preexisting priority over lien creditors for a longer period of time, but would be the very act that determines previous postremoval priorities. Until such reperfection is taken, it could not be said with certainty that a security interest in collateral that was removed from state to state had priority over subsequent lien creditors. Like section 9-301(2), the grace period of section 9-103 was conditional, rather than temporary, and as such, the transfer could not be deemed made until the necessary conditions for perfection had occurred.

If one accepts the argument here advanced that priority over lien creditors conditional on a later act is not deemed perfected within the meaning of section 547(e) until that later act is taken—a position not universally accepted\textsuperscript{127}—then section 547 appears to dictate the following results: (1) where reperfection occurs within the preference period, the security interest is voidable even if there was no period of lapse;\textsuperscript{128} (2) if the security interest is not reperfected before bankruptcy, the security interest is voidable even if bankruptcy intervened before the expiration of four months. Although postpetition reperfection before lapse would prevent invalidation under section 544(a)(1)

\textsuperscript{126} There would clearly be no need to reperfected to insure priority over postlapse creditors. Since bankruptcy intervened prior to lapse, the secured party has priority over the trustee irrespective of any action taken later. Thus, while section 546(b) does permit postbankruptcy perfection, if necessary to prevail over a prior interest, utilization of section 546(b) to reperfected before lapse appears to be superfluous.

\textsuperscript{127} See supra note 109.

\textsuperscript{128} This is clearly true if bankruptcy then occurs more than four months after removal where, without reperfection, the security interest would have been unperfected before bankruptcy. Even if bankruptcy occurs prior to the expiration of the four month period, the interest would still be voidable since, in the absence of perfection, postremoval lien creditors could defeat the security interest because of the retroactive nature of the lapse. In both situations, if the security interest is reperfected within 10 days of its initially taking effect, e.g., where the goods were taken into another state immediately or shortly after the security interest arose in the original
by virtue of section 546(b), the transfer, if deemed unperfected as of the petition date by virtue of its conditional, contingent status vis-a-vis postremoval lien creditors, would still be voidable under section 547. As noted earlier, section 547 is not subject to the postpetition relation back of section 546; postpetition action can validate an otherwise unperfected prepetition transfer under section 547 only if such action is taken within ten days of the transfer taking effect. Unless the goods were removed to another state within ten days after attachment, and bankruptcy intervened within the same period, compliance with section 547(e)(2)(C) as a means of saving the transfer would be impossible.

It must be emphasized that these results do not inexorably follow from section 547. The validity of the above analysis rests on two underlying assumptions, one general and one specific, both of which are open to question: first, that conditional perfection does not meet the perfection standards of section 547 until the necessary condition is met, and second, specifically in the section 9-103 context, to the extent lapse is retroactive, the status of the security interest, pending perfection prior to the expiration of the four month grace period, is merely one of conditional perfection. Neither is necessarily the case.

Regarding the first premise, there is authority that even conditional perfection is sufficient under section 547(e).130 Yet there is strong evidence, both from the language of the statute and its legislative history, that a truly conditional interest such as a purchase money security interest under section 9-301(2) is deemed an unperfected interest and can be saved only by compliance with the grace periods created by section 547.131 This alone, however, is not determinative of the second issue—whether section 9-103 of the 1962 UCC, even under a reading which provides that lapse has a retroactive effect, is a conditional perfection statute. A strong counterargument can be made that it is not. Consider the filing of a continuation statement. Under section 9-403, a financing statement is effective for a period of five years from the date of filing. Upon the expiration of the five year period, the effectiveness of the statement lapses unless a continuation statement was filed prior to the lapse.132 Upon lapse, the security interest becomes unperfected, and it is deemed to be unperfected as

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129 See supra text accompanying notes 102-03.
130 See supra note 109.
131 See supra text accompanying notes 106-07.
132 U.C.C. § 9-403(2),(3). Continuation statements must be filed within six months prior to the expiration of the five year period.
against a purchaser or lien creditor before lapse.\textsuperscript{133} Thus, in the context of a continuation statement, the effect of lapse is wholly retroactive.

One could argue then that every perfected Article 9 security interest securing a debt payable over a period longer than five years or contemplating future advances over such a period of time is only conditionally perfected against lien creditors, since the priority of the security interest over a subsequent judicial lien would be lost by a failure to take the necessary continuing action. This leads to the untenable and indeed preposterous result that an Article 9 security interest duly perfected years before bankruptcy on property the debtor owned years before bankruptcy, securing an advance made years before bankruptcy, may nonetheless be stricken down as a preference by reason of the filing of a continuation statement during the preference period. Surely there can be no discernible congressional policy in routinely invalidating security interests that are over five years old. Yet in what way is the status of such an interest any different than the purchase money security interest, which because of its conditional status, is indeed deemed unperfected until filing?

The answer appears to be that the second assumption made above is simply erroneous—the fact that perfection of a security interest lapses, with even retroactive effect, does not necessarily mean that its perfected status in the interim is contingent or conditional. In the case of a long term security agreement, if a priority conflict arose at any time within the five year period, that dispute would be resolved without reference to what occurs or fails to occur at a later date. For example, if, in the fourth year, a lien creditor asserts a conflicting claim against collateral subject to a perfected Article 9 security interest, the lien creditor will lose,\textsuperscript{134} although if the same lien creditor did not assert his claim until after the expiration of five years and the secured party failed to file a continuation statement, the priorities would be reversed.\textsuperscript{135} In short, section 9-403 does not compel a "wait-and-see" attitude on the part of courts precluding the recognition of

\textsuperscript{133} The last sentence of section 9-403(5) provides: "If the security interest becomes unperfected upon lapse, it is deemed to have been unperfected as against a person who became a purchaser or lien creditor before lapse." This language did not appear in the 1962 official text. See id. § 9-403 (Reasons for 1972 Change).

\textsuperscript{134} Id. § 9-301(1)(b).

\textsuperscript{135} Certainly, a court deciding the issue in the fourth year would have to afford priority to the secured party notwithstanding the possibility of a retroactive lapse. Moreover, it is possible that even if the issue is not decided by the court until after the expiration of the five year period, if the dispute formally came to the attention of the court during the prelapce period either through the initiation of litigation or the commencement of the bankruptcy proceedings with the trustee asserting lien creditor status, prelapce priorities would remain frozen. See infra note 137.
perfected security interests until such time as a continuation statement is filed. The resolution of priority disputes in the interim period prior to lapse does not hinge on what happens later. The filing of a continuation statement can therefore not be properly regarded as a necessary condition to the attainment of perfected status although the failure to file such a statement effects a retroactive forfeiture.

The same is true under the 1962 version of section 9-103. Even if the effect of lapse is retroactive, as the Comments assume,\textsuperscript{136} thereby allowing an interim lien creditor to prevail, it is still true that to the extent that the conflict arises (or is decided) within that four month interim period subsequent to removal, the secured party would prevail by virtue of the earlier filing.\textsuperscript{137} Lapse effects a reordering of priorities only vis-a-vis the lien creditor who acquires his lien after four months, or the lien creditor who acquires his lien after removal and prior to lapse but asserts no superior rights in the collateral until after lapse. Since the secured party does have an unconditionally perfected security interest within the four months following removal, reperfection in the second state does not effect a new transfer, but merely continues the existing status of the interest.

Both situations are fundamentally distinct from that of the purchase money security interest under section 9-301(2). The language of section 9-103(2) is expressly conditional. A purchase money security interest prevails over a judicial lien only if that interest is perfected within ten days after the debtor receives possession of the collateral. If a creditor obtains a judicial lien on the ninth day, a court could not then say that the secured party was entitled to priority. Section 9-301(2) directs the court to defer its decision until the expiration of the ten day grace period, only after which can the relative priorities be determined. Accordingly, only the purchase money security interest would be deemed unperfected within the meaning of section 547(e)(2) until a financing statement was filed and hence, vulnerable to a preference challenge if perfected beyond the grace periods permitted by section 547(c)(3) and section 547(e)(2).

C. Summary

Section 547, like its predecessor, defines “transfer” by reference to the point in time at which the transfer attains priority over subse-

\textsuperscript{136} See supra text accompanying note 123.

\textsuperscript{137} See J. White & R. Summers, Handbook of the Law Under the Uniform Commercial Code § 23-18, at 973-75 (2d ed. 1980) (even under the 1962 version of the UCC, if the lien creditor asserts claim in a judicial forum before the expiration of four months, the priorities freeze with the lien creditor remaining in subordinate position). The same is true if bankruptcy intervenes before the four months are up. Id.
quent lien creditors. It eliminates the confusing additional standard of section 60(a)(6). It provides a uniform ten day grace period which is not limited, as section 60(a)(7) may have been, to transfers for which grace periods are recognized under state law. Moreover, the application of section 547(e) does not require the transfer to have been originally created for "new value."

Ostensibly, the time at which a transfer is perfected against a lien creditor appears to be solely an issue of state law. Yet implicit in the standard is a subtle question of federal law as well, namely, what degree of perfection under state law does federal law require? While it is relatively simple to ascertain the priorities between the secured party and the lien creditor under state law, the degree of state law perfection required by federal law raises formidable difficulties.

Of course, in most situations, priority over lien creditors is determined by the occurrence of a single event, i.e., the filing of a financing statement or the occurrence of the last step of the four steps necessary for perfection. Thus, at a given point in time, a transfer is either completely perfected or totally unperfected, and there can be no question about what standard of lien creditor perfection is required under federal law. However, there are situations where an interest may currently have priority over lien creditors only if some later action is taken. When are such interests considered perfected under section 547? While compliance with the ten day grace period of section 547(e) may render the inquiry moot since regardless of when the transfer is deemed perfected, the transfer is deemed made upon its taking effect, where the necessary perfection step was taken beyond that point or not at all before bankruptcy, serious problems of preference law arise. As noted, these problems pose issues of federal, not state, law.

This portion of the Article has considered several situations under state law where this difficulty arises. The tentative conclusions are as follows:

(1) Purchase money security interests under section 9-301(2) are not deemed perfected until a financing statement is filed, notwithstanding their priority over a lien creditor from the time of attachment.

(2) Security interests in documents and instruments temporarily perfected for up to twenty-one days under section 9-304 are

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138 Namely, the three steps of attachment and then the additional step for perfection are required, since a security interest cannot be perfected until it attaches. See U.C.C. § 9-203 (1972); supra note 56.
deemed perfected from the date of their temporary perfection although actual possession took place within the preference period.139

(3) Security interests in collateral that is moved from jurisdiction to jurisdiction are deemed perfected from the date of their perfection in the initial jurisdiction although the necessary reperfection occurred within the preference period. This is clearly true under the 1972 Official Text. The issue is less clear under the 1962 version of section 9-103, but one can reach the same conclusion.140

(4) Security interests in accounts, general intangibles and mobile goods, where the debtor changed location, are deemed perfected from the date of their perfection in the jurisdiction where the debtor was originally located, even if the necessary reperfection occurred within the preference period. Again, this result clearly follows from the 1972 UCC and may be true under the 1962 version as well.141

(5) A security interest is deemed perfected from the time an initial financing statement is filed (assuming the conditions of attachment have already been met) even if a necessary continuation statement is filed within the preference period to prevent lapse.

III. WHEN IS A DEBT ANTECEDENT?

Before a transfer could be voidable under section 60, the trustee had to show that it was made on an account of an antecedent debt and not for a contemporaneous extension of new value. Yet, the same problem that gave rise to section 60(a)(7)—delays in recording that converted contemporaneous transactions into transfers on account of antecedent debt—applied here with even greater force. Did the exchange of values have to be simultaneous or was some delay tolerated? Section 60 gave no guidance; the law was largely judge-made though the resolution of the issue was apparently one of federal law.142 If read literally, the statute condemned payments of telephone bills, service charges, utilities, possibly even payment by check143—all transactions

139 This is true only if the necessary perfection occurs before the expiration of the 21 day period, allowing no gap for a lien creditor to prevail.

140 This is true only if the reperfection occurs within four months after the collateral was brought into the jurisdiction.

141 See supra text accompanying notes 114-38. Here too, the necessary reperfection must take place within four months after the debtor changed location.

142 But see U.C.C. § 9-108 comment (1972). (“The determination of when a transfer is for antecedent debt is largely left by the Bankruptcy Act to state law.”).

143 "Unless otherwise agreed, where an instrument (defined in section 3-103 to include a check) is taken for an underlying obligation (and the check is not certified) the obligation is suspended pro tanto until the instrument is due. . . . If the instrument is dishonored action may be maintained on either the instrument or the obligation." Id. § 3-802(1)(b). Since a check is only
not commonly regarded as payments for previous extensions of credit. In *National City Bank v. Hotchkiss*, a bank made an unsecured loan to a customer at 10 a.m. Upon learning of his financial difficulties, the bank demanded security between 2 p.m. and 3 p.m. of the same day. The Supreme Court held that, because the debt was incurred several hours prior to the transfer, it was antecedent within the meaning of section 60 and the security interest was voidable. Yet in *Dean v. Davis*, the Supreme Court seemed to adopt a substantial contemporaneity test validating a transfer even though there was a delay of several days between the debt and the transfer. There was also a series of cases involving continuous sales of goods on open account holding that payments made within four months of bankruptcy were not preferential to the extent that these payments did not exceed the value of the goods shipped, even though the goods may have been received prior to the four month period. These cases have been criticized.

A conditional payment and not a discharge, arguably no payment is made until the drawee bank honors the check with the later period determining the time of the transfer. *Compare* Latrobe v. J.H. Cross Co., 29 F.2d 210 (E.D. Pa. 1928) (time of transfer is acceptance of the check by the payee) *with* Goodfellow v. Webber Lumber Supply Co., 257 Mass. 503, 154 N.E. 187 (1926) (time of presentment and payment). Some of the cases delaying the transfer dealt with postdated checks or situations where, at the time of the transfer, the debtor had no funds in his account. See generally 3 Collier on Bankruptcy, supra note 8, ¶ 60.14.

* 231 U.S. 50 (1913).

* 242 U.S. 438 (1917). *Dean v. Davis* is better known for its holding that a security interest or transfer made to obtain funds for the purpose of preferring some creditors over others may be voidable as a fraudulent conveyance if the transferee knew the debtor intended to do so. This gave the trustee in bankruptcy the option of pursuing the preferred creditor or voiding the security interest taken by the supplier of the funds. This rule was codified in section 67(d)(3) of the 1898 Act. Unlike other species of fraudulent conveyances under section 67, the avoidance was limited, like section 60 itself, to transfers made within four months prior to the petition. Section 67(d) failed to clarify what the transferee’s state of mind had to be. The Commission bill eliminated this rule, and it no longer appears in the law. If in fact such transfers are fraudulent under state law, the trustee may still utilize his section 544(a)(1) status of a hypothetical lien creditor, or assert the rights of any actual unsecured creditors under section 544(b). See U.C.C. § 4-607 (1972).

* E.g., Joseph Wild & Co. v. Provident Life and Trust Co., 214 U.S. 292 (1909); Yapple v. Dahl Millikan Grocery Co., 193 U.S. 526 (1904); Jaqueith v. Alden, 189 U.S. 78 (1903). At least one court has concluded that the “net result” rule is still good law without regard to the creditor’s state of mind and irrespective of whether the extension of credit occurred after the transfer as section 547(c)(4) seemed to require. See *In re Fulghum Const. Co.*, 14 Bankr. 293 (M.D. Tenn. 1981). But see infra notes 147-48.

* See *In re Fred Stern & Co.*, 54 F.2d 478 (2d Cir. 1931) (following the “net result” rule) where Learned Hand wrote in concurrence: “I am not sure that I understand on what principle those cases [i.e., Jaqueith, Yapple, Joseph Wild] rest, but I cannot distinguish them on the facts.” *Id.* at 481. In a later case, Judge Hand simply stated that, “[t]he doctrine is somewhat anomalous at best and can be defended in principle only by the fiction of treating all items of the account as one. . . .” *Willcox v. Goess*, 92 F.2d 8, 12 (2d Cir. 1937), cert. denied, 303 U.S. 647 (1938).

The “net result” rule was somewhat distinct from the concept embodied in section 60(c). Section 60(c) provided that a preferred creditor, who later in good faith extended unsecured
Moreover, some of the cases appeared to have been decided on the ground that the trade creditor had no reason to know the debtor was insolvent.\textsuperscript{148} Since current law no longer requires that the transferee have reasonable cause to believe the debtor insolvent, at least for transfers made within ninety days before bankruptcy, that rationale would no longer be applicable.

The Commission was concerned that many short term transactions not generally regarded as payment for an extension of credit were potentially vulnerable as preferences, particularly in view of their abandonment of the reasonable cause standard as a condition for recovery. In their draft legislation, they attacked the problem by redefining the term "antecedent debt" to mean a debt "incurred more than five days before a transfer."\textsuperscript{149} This, combined with the ten day grace period for perfection, would have meant that a transfer could be

\textsuperscript{148} E.g., Campanella v. Liebowitz, 103 F.2d 252 (3d Cir. 1939). Campanella is a quite ingenious opinion which attempted to show that the "net result" rule had no application to the 1938 Chandler Act. It noted that the Yaple case was not dealing with a suit by the trustee to recover a preference under section 60, but rather with a denial of a claim on the balance, pursuant to section 57(g), which provided that claims were not allowed until preferences were surrendered. Id. at 254; see supra note 47. Under the Bankruptcy Act, prior to a 1903 amendment, section 57(g) did not require that the preference be voidable under section 60(b). Thus, for example, if a creditor was preferred at a time when he did not have reasonable cause to believe the debtor insolvent, although the trustee could not directly seek affirmative recovery under section 60, he could deny any allowance of a claim until prior payments were surrendered. In that context, i.e., for the protection of the good faith creditor, courts developed the "net result" rule to prevent the unjust application of section 57(g). It was never designed to protect preferences that would otherwise be voidable under section 60(b). After section 57(g) was amended in 1903 and was limited to voidable preferences, the "net result" rule lost its justification and, the court concluded, should no longer be applied.

As noted earlier, some courts disagree and have applied the "net result" rule without regard to a creditor's state of mind, and indeed, under a statute where state of mind is immaterial. See supra note 147. Suffice it to say that while all of the Supreme Court cases were in fact dealing with section 57(g) questions, there is no suggestion in any of the relatively brief opinions that the doctrine could not be used to protect transfers under section 60(b) as well. Admittedly, however, the court in Jaquith made the point that the preferred creditor had no reasonable cause to believe insolvency. See id.

\textsuperscript{149} Commission Report, supra note 3, Part II, § 4-607(g), at 174.
perfected against a lien creditor up to fifteen days after value was received and still not be deemed a preference. Perfection within ten days antedated the transfer to the time it took effect between the parties, and if that time was within five days of the incurring of the debt the transfer would not have been on account of an antecedent debt. The Commission Report declared its intention to overrule the *Hotchkiss* case. The Commission bill also excluded from its definition debts for personal services and utilities, and payments for inventory made within three months of the delivery of goods. In all those cases the Commission believed that the exchange of value was sufficiently contemporaneous that no preference should be found.

Section 547, as finally enacted, is considerably narrower. Antecedent debt is given no statutory definition and presumably any delay in payment would fit the meaning of the term. Section 547(c) does, however, contain an exception which somewhat mitigates the rigors of a literal definition of antecedence, when applied to UCC security interests.

Section 547(c)(1) provides that if the transfer was intended by the parties to be a contemporaneous exchange for new value and the exchange was substantially contemporaneous, the transfer is not voidable. While “substantially contemporaneous” is not defined, the Senate Report suggests that at least in some circumstances, e.g., payment by check, there may be a delay of up to thirty days. Although section 547(c)(1) appears to relax the requirement of strict simultaneity of exchange in accordance with the standard adopted in *Dean v. Davis*, it also requires that the parties intend to make a contemporaneous exchange.

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150 *Id.* at 175.

151 *Id.*

152 Pursuant to the Commission’s suggestion regarding payments for inventory, utility, and telephone bills, Congress also adopted a provision protecting payments for debts incurred in the ordinary course of business made not later than 45 days after the debt was incurred. See 1978 U.S.C.A. § 547(c)(2). Because the exception shields absolute payments rather than transfers by means of security, its consideration is beyond the scope of this Article, although it too significantly modifies the notion of strict antecedence.

153 See *Senate Report, supra* note 44, at 88, reprinted in U.S. Cong. Code & Ad. News at 5874. The report states that although technically a check may be a credit transaction since it only suspends the obligation and does not discharge it, it is generally regarded by the parties as a contemporaneous exchange for value given. However, intent is not enough; the exchange must in fact be substantially contemporaneous in time. If the check is presented for payment in the normal course of business which, under U.C.C. § 3-503, is 30 days after the later of the date or issue, the second requirement is met. Presentment need not be made to the payor bank within that time; initiation of bank collection would suffice. While the Committee Report does not address the issue, presumably postdated checks or checks on which there are insufficient funds at the time of issue would continue to be governed by the case law that has found such transactions to be on account of antecedent debt. *See supra* note 143.

154 *See supra* text accompanying note 145.
neous exchange. Thus, as in *Hotchkiss*, if a creditor extended unsecured credit without intending at the time to take a security interest but several hours later, due to discovery of the debtor’s financial condition, demands and takes security, although the transfer is substantially contemporaneous, the transfer would fail because it was not initially intended to be so.\(^{155}\) Indeed, the distinction between *Davis* and *Hotchkiss* may lie precisely in the fact that the creditor in the former case initially intended to get security while the bank in the latter case did not.

It should also be noted that, in determining whether a transfer is “substantially contemporaneous,” one must look to the time of transfer as defined in section 547(e) and not simply at the time the transfer took effect between the parties. If a creditor extended new value pursuant to a written security agreement granting a security interest in all of the debtor’s currently owned personal property but neglected to file a financing statement for two months, the transfer would not be “substantially contemporaneous” because the transfer is deemed made not when it took effect between the parties but only upon its perfection against lien creditors.\(^{156}\) The same result would follow even if the creditor filed a financing statement immediately upon the extension of credit but the statement was filed in the wrong place or contained the wrong information and the error was not corrected for two months. Although the creditor and the debtor may have intended to effect a contemporaneous exchange and the transfer took effect between the parties simultaneously with the extension of new value, the transfer as defined in section 547(e) did not and it is the latter definition that controls.

The final point concerns the requisite intent of the parties. The word “substantially” appears only as a modifier for the time the transfer must take place. The term is not used with regard to the intent of the parties. This suggests that the parties must intend the transfer to be simultaneous with the extension of new value, although the actual transfer may take place at some time in the near future. Thus, as noted above, because normal business practice regards pay-

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\(^{155}\) Thus, unlike the *Commission Report*, the legislative history makes no mention of overruling the specific holding in *Hotchkiss*.

\(^{156}\) Although section 547(c)(1)(B) speaks of a “substantially contemporaneous exchange” rather than a substantially contemporaneous transfer, the subsection requires “such transfer”—as defined in section 547(e)—to be part of that exchange. Accordingly, if the transfer was deemed made at a time when it could no longer be considered “substantially contemporaneous,” the transfer is not protected by section 547(c)(1) although, when it took effect, it was “substantially contemporaneous.”
ment by check as a cash rather than credit transaction, although the check may not actually clear for thirty days, the transfer was nevertheless intended by the parties to be fully simultaneous with the extension of new value.

However, in the context of a security interest, the necessary intent is somewhat unclear. Assume that A lends money to B pursuant to a written security agreement and immediately acquires an Article 9 security interest in B's personal property within ninety days prior to B's bankruptcy. If A files a financing statement within ten days, under section 547(e), the transfer is deemed made as soon as it took effect between the parties. The transfer is contemporaneous with the extension of new value—and not merely "substantially contemporaneous"—without reliance on section 547(c)(1). If, however, the interest is perfected eleven days after it took effect, under section 547(e) the transfer is deemed made as of the time of its perfection. Strictly speaking, the transfer is no longer a contemporaneous exchange but is on account of an antecedent debt. If the security interest is valid, it can be so only because of section 547(c)(1). I will assume for purposes of discussion that a transfer which occurs eleven days after new value is given is at least "substantially contemporaneous." The sole issue then becomes whether the parties intended to effect a contemporaneous exchange. The fact that they may have intended to effect a "substantially contemporaneous" exchange is insufficient. Must the parties intend to effect a contemporaneous transfer as the term is defined in section 547(e)(2)? To put it another way, must the secured party specifically intend either to perfect his interest at the time new value is extended or within ten days thereafter, or is their mutual intent to create a contemporaneous transfer enforceable between themselves sufficient, as long as perfection is merely "substantially" contemporaneous?

157 The legislative history does suggest that transfers up to 30 days after the extension of new value are "substantially contemporaneous," see supra note 153, but the extent to which this is true in contexts other than payment by check is unclear.

158 One could argue that any intentional delay in perfection indicates that the parties did not intend the transfer to be contemporaneous. If the transfer was actually perfected within 10 days of its taking effect, the transfer would then be contemporaneous with the extension of new value and valid without regard to their intent. If, however, the parties merely intended to perfect within 10 days, but actually perfected within 11 days, the transfer may be "substantially contemporaneous" but the parties may not have intended to effect a contemporaneous exchange. Under this view, section 547(c)(1) would apply only where the secured party intended to perfect simultaneously with the extension of value.

This appears to be too narrow a reading of the section 547(c)(1) exception. Neither state law nor the BBA defines "transfer" exclusively in terms of perfection, at least if perfection takes place within 10 days of attachment. There is no reason to import such a narrow definition into section 547(c)(1)'s requirement of contemporaneous intent.
There is no clear-cut answer to this question, although the language of the statute that the parties must intend the transfer to be contemporaneous strongly supports the first interpretation. Accordingly, an Article 9 security interest that took effect immediately upon the giving of new value will never be protected by section 547(c)(1) if perfection was intentionally delayed more than ten days.

Even according to this reading, however, if the secured party intended to perfect his interest contemporaneously with the extension of new value or within ten days thereafter, but due to a defective filing the interest was perfected eleven days later, the transfer would nevertheless be valid. The parties intended the transfer to occur contemporaneously with the extension of value, believing it to have been deemed made as of the date it took effect between the parties pursuant to section 547(e) and it was in fact at least “substantially contemporaneous,” thereby meeting the two prongs of section 547(c)(1).

IV. The Purchase Money Exception: Section 547(c)(3) and U.C.C. Section 9-108

A basic theme running throughout Article 9 is that a purchase money financier should be afforded a certain favored status as “founder of the feast.” Indeed, Article 9 attempts to give sellers of goods superior reclamation rights in insolvency proceedings, even in the absence of a perfected security interest. A purchase money security interest is defined in section 9-107 to include either an interest in collateral retained by the seller to secure all or part of its purchase price, or an interest taken by a third party who gives value to enable the debtor to acquire the collateral, if such value is in fact so used. The latter is often termed an enabling loan.

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Prior law, under one or another theory, usually constrained to protect purchase money interests over after-acquired property interests (to the extent to which the after-acquired property interest was recognized at all). ... While this Article broadly validates the after-acquired property interest, it also recognizes as sound the preference which prior law gave to the purchase money interest.

160 See U.C.C. § 2-702(2) (1962); see also supra note 107. Presumably tongue in cheek, Professor Countryman suggests an alternative rationale. “[T]he arduous course of drafting the longest of all the Articles of the Code” caused the draftsmen to develop “a special empathy with those who must live within its confines.” Countryman, Buyers and Sellers of Goods in Bankruptcy, 1 N.M.L. Rev. 435, 435 (1971).

161 The definition is of major importance because the UCC in several places treats purchase money interests more favorably than other Article 9 security interests. Under section 9-302(1)(d), a purchase money security interest in consumer goods—defined in section 9-109 as goods “used or bought for use primarily for personal, family, or household purposes”—may be perfected without the filing of a financing statement. The effect of this automatic perfection, however, is qualified by section 9-307(2) which protects a buyer, without knowledge of the security interest,
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Purchase money security interests were potentially vulnerable under section 60. While interests retained by the seller involved contemporaneous exchanges of value, which were protected in bankruptcy if perfection was timely, enabling loans posed a significant problem. Since the debtor did not acquire the property until after the money had been advanced, the creditor's interest always attached when the debt was already antecedent. Even if a financing statement on the security interest were immediately filed, the transfer would still be a preference. This, of course, was not a difficulty unique to the purchase money lender, but was present whenever advances were made under an agreement containing an after-acquired property clause. Indeed, the problem more commonly arose in the context of security interests on accounts receivable and inventory where the components of the collateral constantly changed. Suffice it to say,

who buys for his own personal use unless an optional filing had been made prior to the purchase. An automatically perfected purchase money security interest in consumer goods will, however, be superior to a subsequent lien creditor under section 9-301. As mentioned previously, there was some discussion whether such unfiled interests were vulnerable to a preference attack under section 60(a)(6) which imposed a bona fide purchaser test for equitable liens on personal property, supra note 78, but under the BRA which adopts only a lien creditor test, it is clear that the interest is valid and would survive in bankruptcy.

A second advantage is that despite the general rule of section 9-301(1)(b) that an unperfected security interest is subordinate to the rights of a gap lien creditor, section 9-301(2) provides that the holder of a purchase money interest, who perfects within 10 days of the debtor's receiving possession of the collateral, may prevail over a creditor who acquired a lien between the attachment and perfection of the security interest. Note that compliance with the grace period will avail the secured party only if his interest attached prior to the creation of the judicial lien. If, for example, a creditor levied prior to the signing of the requisite security agreement, the normal rule of section 9-301(1) would apply even if the secured party perfected within 10 days.

The third advantage is very similar—that enjoyed over competing Article 9 security interests. Under the general rule of priority under section 9-312(5), the first to file a financing statement will prevail even if that interest was perfected subsequently. Section 9-312(4) is an exception to that rule and provides that a purchase money security interest in collateral other than inventory may prevail over an earlier filed nonpurchase money security interest by perfecting within 10 days of the debtor's receiving possession of the collateral. Unlike the one in section 9-301(2), this grace period applies even if the purchase money security interest had not attached prior to the filing of the other Article 9 interest. Section 9-312(3) affords a more limited protection for purchase money security interests in inventory. The security interest must be perfected as soon as the debtor receives possession of collateral—i.e., no 10 day grace period; the purchase money lender must give written notice to the holder of the earlier filed competing interest; the priority is limited to inventory or identifiable cash proceeds—if the inventory is converted into accounts, the earlier filing will prevail regardless of whether that filing covered the accounts directly as after-acquired property or only the inventory of which the accounts are noncash proceeds. See U.C.C. § 9-312 comments 3, 8 (1972).

Under the Bankruptcy Act, it was unclear within what period of time perfection would be timely. While section 60(a)(7) provided a general grace period of 21 days, some commentators asserted that the effect of section 9-301(2) was a shortening of the grace period from 21 to 10 days. See supra text accompanying notes 96-99. Under section 547(e) of the BRA, perfection within 10 days of the transfer taking effect will always antedate the transfer to the time of its taking effect.
however, that at least some of the theories used by the courts to uphold security interests in after-acquired inventory and receivables would not have protected the enabling loan.\(^{163}\) If the debtor acquired the collateral during the preference period, while insolvent and subsequent to the creation of the debt, the creditor has clearly been preferred and the resulting security interest should be voidable. The drafters of the UCC sought to change this result through the adoption of section 9-108.

Section 9-108 attempts to deal with the general problem of security interests in after-acquired property being deemed preferential transfers. Its approach is not to manipulate the time of transfer so as to make it simultaneous with the enabling loan, but to artificially push forward the time when new value was given, thus making the later transfer not on account of antecedent debt. Section 9-108 provides that when a secured party gives "new value" to be secured in whole or in part by after acquired property, the security interest in the collateral is statutorily deemed to be taken for new value and not on account of antecedent debt, if either one of two conditions are met: (1) the debtor acquires his rights in such collateral in the ordinary course of business;\(^{164}\) or (2) the debtor acquires his rights in the collateral under a contract of purchase made pursuant to the security agreement within a reasonable time after new value was given.

Without discussing the oft-debated issue regarding the validity of section 9-108,\(^{165}\) the typical enabling loan appears to be covered by the

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\(^{163}\) There were essentially three theories which the courts developed to uphold the so-called "floating lien." Both the entity and substitution theories presupposed the existence of some collateral prior to the start of the preference period (or at the time of the advance, if later) and could not protect the enabling loan where the sole security is a particular piece of after-acquired property. Under the "sufficient perfection" theory, however, a transfer could be deemed made even prior to the debtor's obtaining rights in the collateral. Consequently, as long as the enabling lender did file a financing statement prior to the preference period, he would have been protected. See infra, Part II.

\(^{164}\) The first prong of section 9-108 is discussed in connection with section 547(c)(5). See infra, Part II.

\(^{165}\) Most commentators have regarded section 9-108 as a boldfaced attempt to amend the federal bankruptcy law. See, e.g., Countryman, supra note 64; Gordon, The Security Interest in Inventory Under Article 9 of the Uniform Commercial Code and the Preference Problem, 62 Colum. L. Rev. 49 (1962), reprinted in Coogan, Hogan & Vagts, supra note 8 at 1183. By Article 9's own definition, a transfer cannot occur until the debtor acquires rights in the collateral. See U.C.C. § 9-203(1)(c) (1972). Whether at that particular time the transfer is on account of antecedent debt is solely a matter of federal law, if not common sense. State law does have a role in defining the time of transfer—state law defines when a transfer takes effect between the parties and when the interest is perfected against lien creditors—but the bankruptcy law envisions no apparent role for state law in the characterization of debts as contemporaneous or antecedent. Had Article 9 sought to protect security interests in after-acquired property through a redefinition of the concept of attachment, it may well have succeeded. As written, however, section 9-108 is a tacit admission that transfer occurs only upon the debtor's acquisition of collateral and thus contains the seeds of its own destruction.
second prong of this section, since the agreement of the enabling lender will invariably specify that the funds advanced will be used to purchase specific collateral. It is important to note, however, that the second prong of section 9-108 is not limited to the enabling lender. Under section 9-107(b), a security interest qualifies as a purchase money security interest only if the funds advanced were actually used to purchase the collateral. A mere recital in the agreement that the funds will be so used is insufficient. No tracing requirement exists under section 9-108 which refers only to specification in the agreement. Nevertheless, the drafters of the UCC believed that if the purchase took place, or at least the contract of purchase was executed, within a reasonable time after value was extended and the security agreement specified that the value would be used for that purchase, such use can be (conclusively) presumed. Yet there is no indication that, for any of the other purchase money advantages enjoyed under section 9-301(2), section 9-302(1)(d), section 9-312(3), or section 9-312(4), this presumption would be employed. Conversely, if the acquisition (or execution of the contract of purchase) did not take place within a reasonable time after value was extended, the secured party would be unprotected by section 9-108, even if he could show that the funds were used to acquire the collateral and that he did qualify as a purchase money lender under section 9-107(b). In short, while the second prong of section 9-108 may have been designed to protect the holder of a purchase money security interest in the event of bankruptcy, its utilization of a statutory presumption, in lieu of

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166 Actually, section 9-108 is not too clear about what the agreement must specify. In providing that the collateral must be acquired "under a contract of purchase made pursuant to the security agreement," section 9-108 does not necessarily require the agreement to recite that the funds will be used to purchase the collateral, but merely that the specific purchase will be made. As such, the second prong of section 9-108 may not have been designed to protect the enabling loan—since neither tracing nor specification is necessary—but rather to protect security interests in acquisitions that were contemplated by the parties at the time of their agreement, whether to be purchased by the advance or not. But cf. infra note 168.

167 The phrase "within a reasonable time" may refer to either to when the purchase must be made or to when the contract of purchase must be executed. Syntactically, the latter interpretation appears more correct since otherwise the phrase should have been inserted earlier. Instead of stating "if the debtor acquires his rights in such collateral . . . under a contract of purchase made pursuant to the security agreement within a reasonable time after new value is given," U.C.C. § 9-108 (Official Text 1972) (emphasis added), it would have read, "if the debtor acquires his rights in such collateral . . . within a reasonable time after new value was extended under a contract of purchase made pursuant to the security agreement."

168 See 2 Gilmore, supra note 59 section 45.6, at 1314-15 (section 9-108 design to protect purchase money financing without requiring specific tracing and, consequently, parties must at least intend that value will be used to acquire collateral). The statement in the text reflects the Gilmore analysis. But cf. supra note 166; infra note 170.

169 See supra notes 166, 168.
tracing, affords protection to interests which do not meet the purchase money standards of section 9-107(b), and denies protection to some interests which do. The trigger to section 9-108 is the giving of “new value.” Section 9-108 thus excludes from its scope security agreements entered into subsequent to the extension of credit. Even in the absence of an explicit “new value” requirement, such agreements could not give rise to purchase money interests under section 9-107(b) since, if the advance preceded the agreement, the advance could not have been made for the purpose of enabling the acquisition of collateral as section 9-107(b) requires. The imposition of such a requirement in section 9-108 is nevertheless necessary because of the imperfect correspondence between the sections. While section 9-108 does provide that the agreement specify that the debtor is to use the funds for the acquisition of collateral, it does not provide that the advance

170 The fact that section 9-108 forecloses the option of tracing in lieu of specification may in itself suggest that it was not designed to protect the purchase money loan. See supra note 166. However, an analogy may be drawn from section 9-306(4)(d) which provides that, in the event of insolvency, a secured party may assert a security interest in commingled cash proceeds, not to exceed the amount of all cash proceeds received by the debtor within 10 days prior to the insolvency proceeding. Compare Gibson Products of Ariz. v. Itule (In re Gibson), 543 F.2d 652 (9th Cir. 1976), cert. denied, 430 U.S. 946 (1977) with Fitzpatrick v. Philco Fin. Corp., 491 F.2d 1288 (7th Cir. 1974). The purpose of the provision was to eliminate the need to determine the extent of the creditor’s interest in the account by some form of tracing. Nevertheless, section 9-306(d) has been held to be exclusive; even if a creditor can successfully trace funds into the commingled account and demonstrate that his interest in the account exceeds the proceeds that were received in the preceding 10 days, he is limited to the lower figure. See J. White & R. Summers, supra note 137, § 24-6, at 1013.

What does severely undercut the Gilmore analysis is the fact that, of all the purchase money provisions in Article 9, section 9-108 is the only one in which such a presumption is employed in lieu of tracing and that alone should indicate that section 9-108 is not an attempt to protect the enabling loan based on a fictitious presumption, but has an entirely different focus. See supra note 166. Whatever its focus or purpose, however, it is clear that the second prong does protect the enabling loan, though not necessarily because of its purchase money status.

171 “New value” is left without statutory definition. Examples given include making an advance, incurring an obligation, or releasing a perfected security interest. See U.C.C. 9-108 comment 2 (Official Text 1972).

172 Section 9-108 does not explicitly state when “new value” must be given, unlike section 547(c)(3) of the BRA. The term does exclude “antecedent debt,” however, and since every antecedent debt was created by some earlier new value, the existence of new value at some point surely could not suffice. Thus, section 9-108 implicitly requires that the agreement be executed for “new value” or, in other words, that the advance not precede the agreement.

173 Section 9-107(b) provides that the lender must give value to enable the debtor to acquire rights in the collateral. This condition could never be satisfied if the incurring of the debt precedes the agreement, even if the original funds have not yet been dissipated and can in fact be used for the purchase of collateral. Thus, although section 9-107(b) refers only to “value” and, under section 1-201(44), “value” included “antecedent debt,” the section implicitly requires the giving of “new value” to meet its definition. See U.C.C. § 9-108 comment 2 (Official Text 1972). (The specific language “by making advances or incurring an obligation” excludes from the purchase money category any security interest taken as security for an antecedent debt).

174 At least according to the Gilmore analysis, cf. supra notes 166, 168, 170.
must initially have been made for that purpose. Accordingly, in the absence of "new value," if money was initially advanced on unsecured credit and a later security agreement provided that funds previously advanced should now be used for the purchase of collateral, the security interest would have been protected (at least to the extent that the original funds were not already dissipated).\textsuperscript{175} It is only the imposition of a "new value" trigger that precludes this result although such a requirement would be unnecessary to effect a similar exclusion from section 9-107(b) and other UCC sections extending special protection to purchase money interests.

The "new value" rule may also have the effect of invalidating transfers that meet the UCC's definition of a purchase money security interest. By requiring that "new value" be given at or after the signing of the security agreement, section 9-108 would not protect security interests in collateral acquired by the debtor during the preference period where value was initially extended, with the intention of enabling the debtor to acquire collateral but, through delay, the agreement was not embodied in writing until later. Such an agreement arguably could create a purchase money interest under section 9-107 which contains no "new value" requirement\textsuperscript{176} (as long as the funds could be traced into the collateral) but could not qualify under section 9-108.

The "new value" proviso does not merely exclude security agreements for which no new consideration was received, but also those for which a previously unsecured debt was released or extended. Suppose A owes B $1,000 payable May 1. A has already spent the original $1,000. B extends the term of the debt and specifies in a security agreement that A is to buy specific collateral. Although in a sense some consideration has moved from B to A, i.e., the extension of time and substitution of one obligation for another by release of the old debt, such release does not constitute "new value." Consequently, any security interest in property acquired within the preference period would be voidable.

\textsuperscript{175} If the original funds were dissipated, it would be impossible for the agreement to specify that the funds should be used for the purchase of collateral. Consequently, the agreement could not meet the standards of section 9-108 even if there had not been a "new value" trigger. But the foregoing is true only under the Gilmore analysis, see supra note 168.

\textsuperscript{176} But cf. U.C.C. § 9-107 comment 2 (Official Text 1972) (security interests taken to secure antecedent debt can never have purchase money status). While this is generally true, I would argue that in the rare case where an enabling loan was made but no security agreement was executed until after the advance, the resulting security interest should have purchase money status provided the funds were used to acquire collateral. Even that case would fail under section 9-108.
Again, in most cases, such a transfer could not constitute a purchase money security interest under section 9-107 even in the absence of a "new value" rule since, in the release or extension of an unsecured obligation, there is never any identifiable fund that is used to purchase an item of collateral, making it impossible to trace monies into the collateral.\(^{177}\) Moreover, to the extent that the second prong of section 9-108 rests on a presumption that funds will be used to purchase collateral\(^{178}\) (though specific proof of tracing is not required), section 9-108 itself would presuppose an identifiable fund available for the acquisition of collateral, thereby excluding the release of an unsecured debt without regard to the requirement of "new value." It would therefore appear that the principal utility of the section 9-108 "new value" test, insofar as it excludes the release or extension of an unsecured obligation where the original funds have already been dissipated, is to preclude the section's application to property acquired in the ordinary course of business—the first prong of section 9-108.

An additional point regarding the scope of "new value" under section 9-108 is the fact that the release of a perfected security interest qualifies. This is significant because it enables every unsecured creditor to create a security interest protected by section 9-108 through a two-step process. Assume a creditor makes an unsecured advance. Later, he takes and perfects a security interest in existing collateral. The security interest in that collateral is clearly unprotected under section 9-108 since the agreement was executed to secure antecedent debt, not new value. Consequently, if bankruptcy occurs within ninety days of the creation and perfection of that interest, the transfer is clearly voidable. Assume, however, that, at the time of the transfer of the original collateral, there was a risk of imminent bankruptcy and the debtor was solvent. The secured party merely wanted to insure that subsequent acquisitions of collateral, which may indeed take place during the preference period, will be protected from invalidation. All the secured party has to do is execute a new security agreement covering after-acquired property and at the same time release his interest in the existing collateral. Because "new value" has now been given, section 9-108 would protect subsequent acquisitions meet-

\(^{177}\) There may be cases situations where a debtor who was previously liable on an unsecured obligation has segregated money in a bank account or the like for payment which the creditor now releases in exchange for an Article 9 security interest directly to the debtor to apply the released funds to the acquisition of collateral. Such a release could indeed qualify as the creation of a purchase money interest under section 9-107 and would fall under section 9-108 only by virtue of its "new value" requirement. But cf. id. § 9-107 comment 2 (a security interest taken to secure antecedent debt can never have purchase money status).

\(^{178}\) See supra note 168 (Gilmore analysis). It is, however, equally possible that section 9-108 does not rest on such a presumption. See supra notes 166, 170.
ing either one of its two prongs. In short, although the first agreement was executed to secure antecedent debt, by releasing the security interest pursuant to a new agreement, which preceded or was contemporaneous with that release, the secured party may enjoy the protections of section 9-108 without having to make a new advance.\textsuperscript{179} Moreover, if the original security agreement itself contained an after-acquired property clause which permitted the debtor to liquidate collateral without applying proceeds to the satisfaction of the debt,\textsuperscript{180} it is arguable that a supplementary agreement would be unnecessary; even if the original debt was antecedent to the agreement, since the agreement itself provided for a release of collateral and preceded that release, the security interest it purports to create on after-acquired property could be deemed to secure the debt created by the release, rather than the debt created by the initial extension of credit.\textsuperscript{181} This

\textsuperscript{179} Generally, a secured party will not do this unless he is assured that the new collateral will be forthcoming. This is commonly the case if the acquisition will be made in the ordinary course of the debtor's business (the first prong of section 9-108), but may occur in the purchase money context as well. It must be noted, however, that given the fact that section 9-108 will protect security interests in subsequent acquisitions only to the extent of the collateral that was released, there may be little incentive for the release and execution of a new agreement.  

\textsuperscript{180} See infra, Part II. The so-called floating lien on inventory or receivables is the most common example.  

\textsuperscript{181} It must be noted, however, that while an agreement providing for the liquidation and substitution of collateral through the use of an after-acquired property clause may meet the "new value" test even if the agreement was executed subsequent to the original advance, section 9-108 will not protect security interests in new acquisitions unless they were acquired "under a contract of sale made pursuant to the security agreement." The security agreement must require that a specific purchase be made. A general after-acquired property clause does not meet the standard.  

Such general language would nevertheless suffice where the agreement creates a floating lien on inventory and receivables required by the debtor in the ordinary course of business, since the first prong of section 9-108 does not require any specific language in the agreement. Thus, one can safely create a floating lien to secure an antecedent debt and still be guaranteed the protections of section 9-108 for collateral acquired during the preference period, provided only that the secured party did have a perfected security interest in some collateral prior to the start of the preference period. See infra, Part II. The secured party, however, would be limited to the total amount of collateral that was released prior to the start of the preference period rather than the total amount of the debt, since only the amount released constitutes "new value."  

Note that section 9-108 requires the secured party to have an indefeasible interest in some collateral prior to the preference period only if the release is used as the basis for "new value," i.e., the debt is antecedent to the agreement. If the agreement preceded or was contemporaneous with the advance, security interests in subsequent acquisitions meeting either of the prongs of section 9-108 are protected to the full extent of the advance, although no collateral was acquired until after the start of the preference period. Thus, section 9-108 is to be distinguished from theories like the entity and substitution theories which, in all cases, required that the secured party who extended credit prior to the preference period have a perfected security interest in "some" collateral prior to the preference period.  

Even where the "new value" is the release of a perfected security interest which requires the secured party to have an interest in collateral that would survive bankruptcy, section 9-108 would not necessitate that the release occur contemporaneously with new acquisitions as would
analysis, however, may create difficult valuation problems, limiting the protection of section 9-108 to the value of the released collateral, rather than the entire amount of the debt since, vis-a-vis the original debt, the agreement cannot be deemed to be for "new value."

One commentator has asserted that this ability to convert unsecured loans into protected transactions raises the specter of bootstrapping. Nothing in section 9-108 requires that new value be given and the security agreement entered into prior to the preference period. Thus, if a creditor makes an advance pursuant to a security agreement covering after-acquired property two months before bankruptcy, even though he is undercollateralized or even unsecured at the time, section 9-108 itself would nevertheless uphold the validity of a security interest in a subsequent acquisition (although that would be a case where section 9-108 itself may be held to conflict with the bankruptcy law). Consider, however, the following case: Creditor extends money on unsecured credit two months before bankruptcy. A week later, he executes a security agreement covering the debtor's property and files the necessary financing statement. Clearly, the interest is voidable as a preference. But what if, taking advantage of the two-step plan outlined above, the creditor would release the perfected security interest under a new security agreement? Technically, new value has been given and, under the literal wording of section 9-108, any security interest in after-acquired collateral should be valid. This would mean that every perfected security interest voidable under section 547(b) due to a delay in perfection could be saved by a release and a new agreement, if the acquisition met either one of the prongs of section 9-108. It is highly unlikely that this would be the result. Even under section 9-108, release of a perfected security interest should constitute new value only if the interest that was released would itself have survived bankruptcy, either because its creation was contemporaneous with the loan, was prior to the preference period, or

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traditional substitution. See infra, Part II. As long as the agreement secures "new value," whether in the form of an advance or a release, security interests in subsequent acquisitions are protected even though they arise on account of antecedent debt. The notion of simultaneity of exchange is totally unnecessary under section 9-108 in any case.


183 Indeed, as will be demonstrated, section 9-108 is more protective of the interests of secured creditors than even the DuBay theory. See infra, Part II. While the latter would uphold security interests in after-acquired property although no collateral was owned until after the start of the preference period, as does section 9-108, only section 9-108 would permit both the execution of the agreement and filing of the financing statement to occur in that period.

184 See supra note 185.

185 Indeed, in some cases, e.g., floating lien on inventory or receivables, perhaps a new agreement would be unnecessary. See supra note 181; infra, Part II.
was itself valid under section 9-108 because the execution of the security agreement under which it was created preceded, or was contemporaneous with, the advance.\textsuperscript{186} Release of a voidable interest would not qualify.

Insofar as section 9-108 sought to protect purchase money security interests from invalidation as preferences, its policy has been largely carried over into the BRA. Section 547(c)(3), modeled after the earlier proposals of the Commission\textsuperscript{187} and the Gilmore Committee,\textsuperscript{188} avoids the artificial terminology of section 9-108 and simply creates a special exception for the enabling loan. It upholds a security interest on property acquired by the debtor during the preference period to the extent that: (1) the security interest secures new value that was given at or after the signing of a security agreement that contains a description of such property as collateral; (2) that new value was given to enable the debtor to acquire such property; and (3) that the new value was in fact used for that purpose. Finally, the security interest must be perfected within ten days after it “attaches.” Since “attachment” requires value, agreement, and the debtor’s having rights in the collateral,\textsuperscript{189} and since, under section 547(c)(3), the creditor must have already given value pursuant to an agreement to enable the acquisition, the reference to attachment is apparently synonymous with the debtor’s acquiring rights in the collateral, and the ten day grace period would commence to run from that point.\textsuperscript{190}

Before analyzing the points of similarity and departure between section 9-108 and section 547(c)(3), two observations should be made. First, although section 547(c)(3) is arguably broad enough to include purchase money interests retained by the seller,\textsuperscript{191} its exclusive utility

\textsuperscript{186} Of course, where the agreement was contemporaneous with the advance, there would be no need to rely on the release of the security interest as the requisite “new value” since the advance itself would so qualify, unless the original security agreement did not cover particular collateral and a new agreement must now be executed.


\textsuperscript{188} As quoted in the House Report, supra note 7, at 214, reprinted in U.S. Cong. Code & Ad. News at 6174-75, the Gilmore draft did not require perfection within a specific period after the acquisition of the collateral but only “within a reasonable time.” Cf. infra text accompanying note 200.

\textsuperscript{189} While the term “attachment” used in section 547(c)(3)(B) is not defined in the BRA, presumably the legislative intent was the incorporation of the elements found in U.C.C. § 9-203.

\textsuperscript{190} Although, under Article 9, the events of attachment and perfection may occur in any order, any exception in section 547 presupposes a debt antecedent to a transfer (since otherwise no preference could ever exist and no statutory exception would be necessary). Since “new value” requires the agreement to precede, or be contemporaneous with, the advance and section 547(c)(3) contemplates an advance preceding the transfer, the final event of attachment will always be the debtor’s acquisition of collateral.

\textsuperscript{191} See supra note 105. The point is not entirely certain since it is unclear whether the receipt of the collateral itself can be characterized as “new value” which enables the debtor to acquire the collateral.
is for the enabling loan. A purchase money security interest retained by a seller will always attach contemporaneously with the extension of value since "value" and the "debtor's acquiring rights in the collateral" are one and the same.\textsuperscript{102} If the interest is then perfected within ten days of its attachment, under section 547(e), the transfer is deemed made as of the time of its attachment and is not a transfer on account of antecedent debt, but is rather a transfer in exchange for contemporaneously received consideration. Even without reliance on section 547(c)(3), such transfers would be protected under the basic rule of section 547(e). Conversely, to the extent that the interest was perfected more than ten days after it took effect so that under section 547(e) the transfer would be deemed made only as of the time of its perfection, section 547(c)(3)—which also requires perfection within ten days of attachment—would be equally unavailing. In the enabling loan context, however, it is quite possible that the debtor will acquire rights in the collateral a considerable time after value was advanced. Consequently, even if the interest is perfected within ten days of its taking effect and under section 547(e) the transfer is deemed made as of the time it took effect, it would still be a transfer on account of an antecedent debt and would have been voidable in the absence of section 547(c)(3).

Second, while the ten day grace period for perfection in section 547(c)(3) is identical to the general grace period in section 547(e), it is to be sharply distinguished from the period established by sections 9-301(2) and 9-312(4). It will be recalled that, under Article 9, a purchase money security interest that is perfected within ten days of the debtor's receiving possession of the collateral will prevail over an intervening lien creditor, and in the case of collateral other than inventory, over an earlier filed Article 9 security interest.\textsuperscript{103} A debtor may acquire rights in collateral, however, prior to his receiving possession of it. Compliance with section 9-301(2) does not guarantee protection under section 547(c)(3).\textsuperscript{104}

\textsuperscript{102} While it may be possible in rare cases for attachment to occur subsequent to the debtor's acquisition of collateral where, e.g., the parties failed to execute a security agreement until after the sale and perfection within 10 days of attachment would not remove the stigma of antecedence, that atypical situation could hardly be a justification for section 547(c)(3), since the resulting security interest would still be unprotected because of section 547(c)(3)'s "new value" requirement.

\textsuperscript{103} See supra note 161.

\textsuperscript{104} With regard to security interests retained by the seller where attachment is contemporaneous with the extension of value, compliance with section 9-301(2) may indeed have the effect of validating the transfer depending on the proper construction of the lien creditor test of section 547(e). See supra text accompanying notes 105-11. However, for enabling loans where attachment is not contemporaneous and reliance on section 547(c)(3) is accordingly necessary, the longer grace period of Article 9 would be unavailable.
Section 547(c)(3) does depart in some respects from the enabling loan prong of section 9-108. First of all, it makes clear that the funds must in fact be used to acquire the property. The fact that the acquisition took place within a reasonable time after new value was given would not suffice; on the other hand, neither is "reasonable time" a prerequisite. As long as the interest is perfected within ten days of the debtor's obtaining rights in the collateral, the interest is valid regardless of how much time elapsed between the advance and the attachment. Moreover, section 547(c)(3) does not require that the security agreement specify that the funds will be used to purchase the collateral, i.e., there need not be a specific recital that the loan is enabling.\footnote{This assumes that section 9-108 requires a recital in the agreement that the debtor will use the funds for the acquisition of the collateral, the position of Professor Gilmore. See supra notes 166, 168. As noted earlier, it is entirely possible that section 9-108 requires nothing more than a recital that the debtor will acquire a specific item of collateral. Under this reading, the requisite level of specification under section 9-108 and section 547(c)(3) is identical. But cf. infra note 196. It should be noted that, for purposes of section 9-107 and the purchase money priorities of Article 9, it appears that no specification is necessary. As long as the security agreement covers the collateral to be acquired, which it may do by a broad general after-acquired property clause, and the creditor can show the purpose for which the funds were advanced and the actual use of those funds, a purchase money security interest has been created. Nor does section 9-203 change this result. While section 9-203(1)(a) does require that the security agreement be in writing (unless the secured party takes possession of the collateral) and that it contain a description of the collateral, there is no intimation that the agreement must specify that it purports to create a purchase money security interest. Of course, as an evidentiary matter, a creditor relying on section 547(o)(3), or the purchase money priorities under Article 9, should always state in the agreement the purpose for which the monies were advanced but, in theory, this step is unnecessary (except perhaps for section 9-108). The language of section 547(c)(3)(A)(i) is substantially similar to section 9-203 in that it merely requires that the security agreement contain a "description of such property as collateral." On its face, this suggests that the same broad general description that suffices to create an Article 9 security interest, i.e., a typical after-acquired property clause, would suffice for purposes of section 547(c)(3) as well. Yet if section 547(c)(3)(A)(i) was intended to require nothing more than the existence of an agreement enforceable under state law, the reference to description is superfluous since none of the exceptions to section 547 purport to validate transfers that fail to meet the minimum standards of section 9-203. It is probable that section 547(c)(3) requires specificity beyond that imposed by section 9-203, and that, in lieu of a general after-acquired property clause, the agreement must make reference to the acquisition of a specific item of collateral.} If a creditor can prove that the advance was made with the intent to enable the acquisition of certain collateral and in fact the funds were so used, the agreement need only contain a description of the property to be acquired.

While a security agreement containing a general after-acquired property clause may fail to qualify under either provision, if the description was geared towards a specific piece of collateral the agreement would pass muster under section 547(c)(3) though not necessarily under section 9-108.\footnote{This assumes that section 9-108 requires a recital in the agreement that the debtor will use the funds for the acquisition of the collateral, the position of Professor Gilmore. See supra notes 166, 168. As noted earlier, it is entirely possible that section 9-108 requires nothing more than a recital that the debtor will acquire a specific item of collateral. Under this reading, the requisite level of specification under section 9-108 and section 547(c)(3) is identical. But cf. infra note 196. It should be noted that, for purposes of section 9-107 and the purchase money priorities of Article 9, it appears that no specification is necessary. As long as the security agreement covers the collateral to be acquired, which it may do by a broad general after-acquired property clause, and the creditor can show the purpose for which the funds were advanced and the actual use of those funds, a purchase money security interest has been created. Nor does section 9-203 change this result. While section 9-203(1)(a) does require that the security agreement be in writing (unless the secured party takes possession of the collateral) and that it contain a description of the collateral, there is no intimation that the agreement must specify that it purports to create a purchase money security interest. Of course, as an evidentiary matter, a creditor relying on section 547(o)(3), or the purchase money priorities under Article 9, should always state in the agreement the purpose for which the monies were advanced but, in theory, this step is unnecessary (except perhaps for section 9-108). The language of section 547(c)(3)(A)(i) is substantially similar to section 9-203 in that it merely requires that the security agreement contain a "description of such property as collateral." On its face, this suggests that the same broad general description that suffices to create an Article 9 security interest, i.e., a typical after-acquired property clause, would suffice for purposes of section 547(c)(3) as well. Yet if section 547(c)(3)(A)(i) was intended to require nothing more than the existence of an agreement enforceable under state law, the reference to description is superfluous since none of the exceptions to section 547 purport to validate transfers that fail to meet the minimum standards of section 9-203. It is probable that section 547(c)(3) requires specificity beyond that imposed by section 9-203, and that, in lieu of a general after-acquired property clause, the agreement must make reference to the acquisition of a specific item of collateral.}
The additional requirements of section 9-108—specification in the agreement and acquisition within a reasonable time—were intended to be evidentiary substitutes for the specific tracing required under section 9-107(b). Since section 547(c)(3) requires a showing that funds advanced were actually used in the purchase of collateral, the additional burden of showing specification in the agreement and acquisition within a reasonable time have no justification and are abandoned.

Section 547(c)(3) also clarifies a number of points that were ambiguous under section 9-108. It makes clear that new value must be given contemporaneously with, or subsequent to, the execution of the security agreement; section 9-108 never explicitly stated when “new value” had to be given. Second, by emphasizing that the security interest is valid only to the extent that it secures new value, section 547(c)(3) makes clear that the mere giving of new value pursuant to an agreement which secures both that value and antecedent debt will not protect a security interest in a subsequent acquisition for that antecedent debt. No such qualifying language appears in section 9-108. Finally, by defining “new value” to include the release of a security interest only if that interest is not voidable by the trustee in bankruptcy proceedings, section 547(c)(3) precludes the bootstrap arguments possible under a literal reading of section 9-108.

A final observation concerns the respective perfection requirements of the two provisions. Section 9-108 provides that new value given under a security agreement protects acquisitions under contracts of purchase made pursuant to that agreement within a reasonable time. It does not specifically address the issue of when such interest must be perfected. Indeed, one could contend that as long as an Article 9 filing was made at some point before bankruptcy so as not to be vulnerable under section 544(a)(1), the security interest could not be attacked as a preference. This author will argue in Part II of this article that this is an incorrect and overly expansive view of the

Section 547(c)(3) accordingly can be viewed as necessitating an intermediate level of specification. Section 9-108 required (under the Gilmore analysis) that the agreement specify that funds were to be used in the acquisition of collateral (though without proof of tracing). At the other extreme, section 9-107 merely required that the agreement cover the collateral. Section 547(c)(3) requires that the agreement specifically describe the collateral to be acquired but no reference need be made to the use of the funds advanced.

197 See supra note 168.
198 But see supra note 172.
199 Skilton, supra note 182, at 966, noted this problem under section 9-108, although I doubt that his fears were ever justified.
200 Assuming, of course, that section 9-108 itself is valid. See supra note 165.
limited protection section 9-108 was designed to afford.\textsuperscript{201} All section 9-108 does is to deem that new value is given at the time the debtor acquires the collateral rather than at the time the advance is actually made. If a creditor delays perfection beyond that point, the security interest in the property may still be considered a transfer on account of an antecedent debt. Thus, even where section 9-108 applies, to obtain its protection a creditor must comply with an Article 9 filing either prior to the debtor’s acquisition of the collateral or within whatever grace period bankruptcy law allows for the transfer to be deemed made as of the date of the acquisition. Under the 1898 Act, the financing statement would have to be filed within twenty-one days of the debtor’s acquisition of collateral for the transfer to be deemed made as of that date.\textsuperscript{202} Under section 547(e), that period has now been shortened to ten days. This reduction would, of its own force, shorten the perfection period for section 9-108 as well, since section 9-108 does nothing more than postdate the giving of value to the time of the debtor’s acquisition without providing that the transfer will necessarily be deemed made at that point, an issue which even under the UCC is to be determined exclusively by the federal bankruptcy law. In effect, then, the perfection requirements of section 547(e) are no more onerous than those that would be necessitated by section 9-108 itself.

Indeed, the foregoing observation is true for section 547(c)(3) as a whole; except for the imposition of a tracing requirement and a relaxation of the need to specify in the security agreement that the funds will be used to purchase the collateral, section 547(c)(3) is essentially a federal codification of the second prong of section 9-108 treating enabling loans exactly as they would have been treated under the UCC. The BRA, however, does depart radically from section 9-108’s treatment of nonpurchase money interests. This will be covered in Part II.\textsuperscript{203}

\textsuperscript{201} See infra, Part II.
\textsuperscript{202} But cf. supra note 99 (some commentators have asserted that the effect of section 9-301(2) was a shortening of the grace period to 10 days).
\textsuperscript{203} It should be noted that the same issue regarding the validity of section 9-108 under the Bankruptcy Act of 1898 may continue to exist under the BRA, and section 9-108 could arguably be available for security interests which do not qualify under section 547(c)(3). However, the only respect in which section 9-108 is more lenient is in this abandonment of tracing.

[Part II Appears at 4 Cardozo L. Rev. 1 (Fall 1982)]