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PURCHASE MONEY SECURITY INTERESTS: THE INTERACTION OF SECTION 9-301(2) OF THE UNIFORM COMMERCIAL CODE AND SECTION 547 OF THE BANKRUPTCY ACT

I. INTRODUCTION

In 1981 the North Dakota Legislature amended section 41-09-22(2) of the Century Code¹ to provide a secured party with twenty days to perfect a purchase money security interest.² Prior to this amendment the perfection period was ten days.³ The perfection period under the uniform version of section 9-301(2) of the Uniform Commercial Code is ten days.⁴ Secured creditors should approach the extension of this time period for delayed perfection with caution because the new Federal Bankruptcy Act permits only a ten day grace period for the delayed filing of security interests.⁵

This Note will examine the historical relationship between Article 9 of the Uniform Commercial Code (Code) and the Bankruptcy Act. The interaction of section 9-301(2) and the Bankruptcy Act in terms of preferential transfers will also be explored. Finally, this Note will discuss the risks that face secured creditors who rely on the new twenty day extension.

1. Act of March 11, 1981, ch. 432, § 1, 1981 N.D. Sess. Laws 1202 (codified at N.D. CENT. CODES § 41-09-22(2) (Supp. 1981)). Section 41-09-22(2) is the North Dakota counterpart to § 9-301(2) of the Uniform Commercial Code.

2. N.D. CENT. CODE § 41-09-22(2) (Supp. 1981).

3. N.D. CENT. CODE § 41-09-22(2) (1969) (amended 1981).

4. U.C.C. § 9-301(2) (1978).

5. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 STAT. 2549 (codified at 11 U.S.C. § 547(e)(2) (1979 & Supp. IV 1980)).

II. PURCHASE MONEY SECURITY INTERESTS: CREATION AND PERFECTION

A. PURCHASE MONEY SECURITY INTERESTS

Section 9-107 of the Code defines a purchase money security interest.⁶ A purchase money security interest is a special type of security interest, which the Code broadly defines as an "interest in personal property or fixtures which secures payment or performance of an obligation."⁷ Suppose, for example, that a person, Debtor (D), wishes to borrow money from a bank. The bank is willing to loan D the money, but it wants assurance that D will repay the loan. If D does not repay the loan, the bank would like something to replace the money owed to it. D may offer his car to the bank as collateral⁸ for the loan and the bank will take a security interest in D's car. If D defaults, the bank, which is now a secured creditor, can foreclose or otherwise realize on the collateral to satisfy its claim.⁹

A purchase money security interest may arise in a similar situation. Suppose D does not own a car, but wishes to buy one. The bank may be willing to make a loan to D, but again it wants collateral to secure the loan. Therefore, D will grant the bank a security interest in his new car. Because the bank loaned D the money to assist him in the purchase of the car, the bank has acquired a purchase money security interest in the car.

Two types of purchase money security interests exist. The first type is referred to as a "true" purchase money security interest.¹⁰ This type occurs when the seller of a product retains a security interest in the product. For example, if D purchases furniture from a home furnishings store on credit the store will have a "true"

6. U.C.C. § 9-107 (1978). Section 9-107 states that a security interest is:

[A] purchase money security interest to the extent that it is (a) taken or retained by the seller of the collateral to secure all or part of its price; or (b) taken by a person who by making advances or incurring an obligation gives value to enable the debtor to acquire rights in or the use of collateral if such value is in fact so used.

Id.

7. *Id.* § 1-201(37).

8. Collateral is defined by the Uniform Commercial Code (Code) as "property subject to a security interest, and includes accounts and chattel paper which have been sold." *Id.* § 9-105(c).

9. *Id.* § 9-501(1). Section 9-501(1) provides that if "a debtor is in default under a security agreement, a secured party has the rights and remedies provided in this Part. . . . He may reduce his claim to judgment, foreclose or otherwise enforce the security interest by any available judicial procedure." *Id.* See §§ 9-501 to 9-507 for the Code provisions concerning default.

10. *Id.* § 9-107(a). Section 9-107(a) defines a true purchase money security interest as a security interest that is "taken or retained by the seller of the collateral to secure all or part of its price." *Id.*

purchase money security interest in the furniture.

The second type is an "enabling" purchase money security interest.¹¹ This term describes a transaction in which a lender lends money to the debtor to enable the debtor to purchase property. For example, an enabling purchase money security interest arose when D purchased his new car with the money he borrowed from the bank. Section 9-107(b) of the Code lists the following three requirements for an enabling purchase money security interest: First, the lender must give value by making advances or incurring an obligation;¹² second, the value must have been given to enable the debtor to buy the collateral; and third, the value must have been used to buy the collateral.¹³

B. CREATION OF A SECURITY INTEREST

A security interest does not magically appear. Creditors must take certain steps to create an Article 9 security interest, which includes a purchase money security interest. Section 9-203 of the Code lists the necessary steps.¹⁴

First, the creditor must enter into an agreement with the debtor. This agreement must be in writing and be signed by the debtor.¹⁵ If the collateral is in the possession of the secured party, however, the agreement need not be in writing.¹⁶ Second, the debtor must have rights in the collateral. Third, the secured party must give value. Once these events occur, a security interest exists

11. *Id.* § 9-107(b). An enabling purchase money security interest is defined as a security interest "taken by a person who by making advances or incurring an obligation gives value to enable the debtor to acquire rights in or the use of collateral if such value is in fact so used." *Id.*

12. The value required by § 9-107(b) must be current or present value. This requirement "excludes from the purchase money category any security interest taken as security for or in satisfaction of a pre-existing claim or antecedent debt." *Id.* § 9-107, Comment 2.

13. *Id.* § 9-107(b).

14. *Id.* § 9-203. Subsection 9-203(1) states in part:

[A] security interest is not enforceable against the debtor or third parties with respect to the collateral and does not attach unless:

(a) the collateral is in the possession of the secured party pursuant to agreement, or the debtor has signed a security agreement which contains a description of the collateral . . . ;

(b) value has been given;

(c) the debtor has rights in the collateral.

Id.

15. This agreement is referred to as a security agreement. A security agreement "means an agreement which creates or provides for a security interest." *Id.* § 9-105(1)(i).

16. *Id.* § 9-203(1)(a). The requirement of a written agreement is intended to reduce the possibility of disputes concerning the terms of the security agreement and the collateral. When the secured party possesses the collateral there is less need for this written evidence. *Id.* § 9-203, Comment 3.

and "attaches" to the collateral.¹⁷

Attachment of the security interest is important to a secured creditor because without attachment, the creditor's security interest is not enforceable against the debtor or third parties.¹⁸ Suppose, for example, that when D purchased the new car he did not sign the security agreement. If D defaults on the loan, the bank cannot foreclose pursuant to the agreement because the security interest is not enforceable against D. Moreover, the bank cannot enforce the security interest against third party creditors claiming a security interest in D's car.

C. PERFECTION OF A SECURITY INTEREST

Attachment alone, however, does not protect the secured creditor from all third party claims to the collateral. The secured creditor must "perfect" his security interest.¹⁹ If the secured party merely has created an enforceable security interest without perfecting it, he may be in no better position than a general unsecured creditor. Perfection affords a secured creditor with the maximum protection against third parties.²⁰ Perfection of a security interest occurs once the interest attaches to the property and the secured party completes all the steps necessary for perfection.²¹

The most common method of perfection is filing a financing statement.²² A financing statement gives notice to third parties that a secured party may claim a security interest in the collateral described in the statement. The financing statement must be signed

17. *Id.* § 9-203(2). Subsection 9-203(2) states that "[a] security interest attaches when it becomes enforceable against the debtor with respect to the collateral. Attachment occurs as soon as all of the events specified in subsection (1) have taken place unless explicit agreement postpones the time of attaching." *Id.*

18. *Id.* § 9-203(1).

19. *Id.* § 9-303, Comment 1. Generally, a perfected security interest protects the secured creditor from "creditors and transferees of the debtor and in particular against any representative of creditors in insolvency proceedings instituted by or against the debtor." *Id.*

20. *See id.* § 9-301(1). Subsection (1) of § 9-301 states in part that "[e]xcept as otherwise provided in subsection (2), an *unperfected security interest* is subordinate to the rights of . . . a person who becomes a lien creditor before the security interest is perfected." *Id.* (emphasis added).

21. *Id.* § 9-303(1). Section 9-303(1) states:

A security interest is perfected when it has attached and when all of the applicable steps required for perfection have been taken. Such steps are specified in Sections 9-302, 9-304, 9-305, and 9-306. If such steps are taken before the security interest attaches, it is perfected at the time when it attaches.

Id.

22. *Id.* § 9-302(1). Generally, a financing statement must be filed to perfect a security interest. Section 9-302 lists those transactions exempt from the filing requirement. *See id.* § 9-302.

by the debtor²³ and include the following information: (1) the names of the parties, (2) the addresses of the parties, and (3) a description of the collateral.²⁴ The financing statement must be filed in the appropriate place to perfect the security interest.²⁵

A second method of perfection is possession of the collateral by the creditor. Possession may be used to perfect a security interest in certain kinds of collateral and must be used to perfect a security interest in other types of collateral.²⁶

Some security interests are automatically perfected under the Code upon attachment of the security interest. The most common example of automatic perfection is a purchase money security interest in consumer goods.²⁷

D. PERFECTION OF A PURCHASE MONEY SECURITY INTEREST

Under section 9-301(2) of the Code a secured creditor with a purchase money security interest has ten days after the debtor receives possession of the collateral to file a financing statement.²⁸ This ten day period is referred to as a grace period, which enables the secured creditor to cut off intervening interests of lien creditors or bulk purchasers.²⁹

If the creditor files a financing statement within ten days after the debtor receives possession of the collateral, the perfection date "relates back" to the date the security interest became

23. *Id.* § 9-402(1). Section 9-402(1) states in part:

A financing statement is sufficient if it gives the names of the debtor and the secured party, is signed by the debtor, gives an address of the secured party from which information concerning the security interest may be obtained, gives a mailing address of the debtor and contains a statement indicating the types, or describing the items, of collateral.

Id.

24. *Id.*

25. *Id.* § 9-401. The appropriate place to file will depend upon the type of collateral and which alternative of § 9-401(1) has been adopted in a jurisdiction. *Id.* § 9-401(1). North Dakota has adopted the second alternative. *See* N.D. CENT. CODE § 41-09-40 (Supp. 1981).

26. U.C.C. §§ 9-304, 9-305.

27. *Id.* § 9-302(1)(d). Examples of other interests which are automatically perfected are assignments of a beneficial interest, § 9-302(1)(c); assignments of accounts, § 9-302(1)(e); and assignments for the benefit of creditors, § 9-302(1)(g). *Id.* § 9-302(2)(c), (e), (g). Certain security interests perfect automatically for a limited time. *See id.* §§ 9-304(4)-(5), 9-306(3).

28. *Id.* § 9-301(2). Subsection (2) of § 9-301 provides:

If the secured party files with respect to a purchase money security interest before or within ten days after the debtor receives possession of the collateral, he takes priority over the rights of a transferee in bulk or of a lien creditor which arise between the time the security interest attaches and the time of filing.

Id.

29. *Id.* § 9-301, Comment 5.

enforceable.³⁰ As previously discussed,³¹ a security interest must attach to the collateral before the interest is enforceable. Attachment occurs when an agreement exists, value is given, and the debtor has rights in the collateral. In the purchase money security interest context, three dates must be viewed separately: The date the agreement is made, the date the debtor receives possession, and the date the security interest becomes enforceable. In most cases the debtor does not have rights in the collateral until he receives possession of the collateral.³² In this situation, the date of enforceability and the date of possession coincide.

Suppose a bank loans money to D on March 1 to enable D to purchase equipment. On March 2 D receives possession of the equipment. Another creditor of D, X, obtains a lien on the same equipment on March 5. On March 10 the bank perfects its security interest by filing an appropriate financing statement.

Under the general rule of section 9-301(1) (b)³³ of the Code, the bank's security interest is subordinate to the rights of X, because X became a lien creditor before the bank perfected its security interest. Section 9-301(2), however, allows the perfection date to relate back to the date the security interest became enforceable. The enforceability date is March 2, because D did not acquire rights in the collateral until this date. The perfection date is March 10, the date the bank filed the financing statement. Because the March 10 perfection date is within ten days of March 2, the date D received possession of the collateral, the perfection relates back to March 2. In this example, therefore, the bank's security

30. 4 W. COLLIER, COLLIER ON BANKRUPTCY ¶ 547.49(6), at 547-154 (15th ed. 1982).

31. See *supra* note 14 and accompanying text.

32. The Code does not specify when a debtor obtains rights in the collateral. In some situations, a security interest may be effective based on property which the debtor does not yet possess. For example, the floating lien provision of § 9-204 states that "a security agreement may provide that any or all obligations covered by the security agreement are to be secured by after-acquired collateral." U.C.C. § 9-204(1) (1978). In other cases possession by the debtor of goods owned by a third person is insufficient. See *Disch v. Raven Transfer & Storage Co.*, 17 Wash. App. 73, 561 P.2d 1097 (Ct. App. 1977) (tenant in furnished house has no power to pledge furnishings).

Professors White and Summers have noted:

[J]udges do not often mechanically apply the phrase "rights in the collateral." Nor do they mechanically determine when those rights arise. Rather, equities between competing claimants may be fought out in the name of this phrase. And the time when a court determines that the debtor acquired rights in the collateral may not only depend on such equities, but also on the nature of the competing parties and the kind of law involved.

J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE 917 (2d ed. 1980) [hereinafter cited as WHITE & SUMMERS].

33. U.C.C. § 9-301(1)(b) (1978). According to § 9-301(1)(b) "an unperfected security interest is subordinate to the rights of . . . a person who becomes a lien creditor before the security interest is perfected." *Id.*

interest has priority over the interest of X even though the rights of X arose during the time the bank was unperfected.

E. SECURITY INTERESTS AND BANKRUPTCY

A creditor who creates an enforceable security interest and who properly perfects the interest may have one additional hurdle to face: bankruptcy of the debtor. The strength of a secured creditor's position in bankruptcy is contingent upon the validity of his security interest in relation to the various powers granted to the bankruptcy trustee.³⁴ In a bankruptcy liquidation proceeding, the debtor must turn his nonexempt assets over to the trustee.³⁵ The trustee is also empowered to retrieve certain assets of the debtor, which the debtor preferentially transferred on the eve of bankruptcy.³⁶ The trustee in turn sells these assets and applies the proceeds pro rata to the claims of unsecured creditors.³⁷

Because the trustee's duty is to collect property of the bankrupt's estate,³⁸ the trustee is motivated to invalidate an Article 9 security interest. To the extent the trustee is successful, the estate is increased and therefore, the potential amount distributable to unsecured creditors is also increased.

A bankruptcy trustee succeeds both to the property rights of the debtor and the defenses available to the debtor against third parties.³⁹ In a previous example, the bank's security interest was unenforceable because D did not sign the security agreement. Because the trustee "steps into the legal shoes" of the debtor, the trustee is also able to assert the debtor's claim of unenforceability. As a result, the creditor is deprived of the collateral.

A trustee may also deprive a secured creditor of collateral in which an enforceable but unperfected security interest exists. Under the Bankruptcy Act the trustee receives all the rights under state law of a hypothetical creditor with a lien on the debtor's property.⁴⁰ The trustee's rights as a hypothetical lien creditor begin

34. WHITE & SUMMERS, *supra* note 32, at 918. Professors White and Summers state that "a secured party who perfects prior to bankruptcy is likely to have the right to snatch the collateral out of the trustee's hands, but an unperfected secured party will invariably have to eat from the general creditors' trough in bankruptcy." *Id.*

35. 11 U.S.C. § 542 (Supp. IV 1980).

36. *Id.* §§ 541-548.

37. *Id.* § 726.

38. *Id.* § 704.

39. *Id.* § 541(e).

40. *Id.* § 544(a). Section 544(a) states in part:

The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may

on the date that the bankruptcy petition is filed.⁴¹ For purposes of this discussion the relevant state law is Article 9.⁴² As an example, assume that on May 1 a bank has an enforceable, but unperfected, nonpurchase money security interest. The debtor files a petition in bankruptcy on June 22.

Under section 9-301(1) (b) of the Code, the bank's interest can be cut off by a creditor who obtains a lien on the collateral while the bank is unperfected. The Bankruptcy Act gives the trustee the same rights as this lien creditor. Therefore, the trustee may assert the rights of a hypothetical lien creditor under section 9-301(1) (b) and prevail over the bank. In this example this result is possible not only because of the Bankruptcy Act, but also because the Code, in section 9-301(3), defines a lien creditor to include a bankruptcy trustee.⁴³

One situation exists, however, in which the creditor, though unperfected at the time the bankruptcy petition is filed, may be able to achieve priority over the trustee despite the trustee's rights as a hypothetical lien creditor. Suppose that a secured creditor makes a purchase money loan to the debtor on May 1. The debtor files a bankruptcy petition on May 4 and the creditor perfects by filing on May 7. Under the ten day grace period of section 9-301(2) the creditor's perfection of the security interest will relate back to May 1. The creditor would take priority over a lien creditor whose interests intervene between the taking of a security interest and the filing of the financing statement. Because the trustee has only the rights that a lien creditor would have under state law as of the date of the bankruptcy petition, the trustee loses in this example also.

Perhaps the most significant aspect of the trustee's powers is the ability to invalidate as preferential a security interest that is fully enforceable and protected under state law. A secured creditor with an enforceable and perfected security interest must exercise

avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by —

(1) a creditor that extends credit to the debtor at the time of the commencement of the case, and that obtains, at such time and with respect to such credit, a judicial lien on all property on which a creditor on a simple contract could have obtained a judicial lien, whether or not such a creditor exists;

....

Id.

41. *Id.*

42. U.C.C. art. 9 (1978). Article 9 has been adopted by every state except Louisiana. U.C.C., 1 U.L.A. 1, 2 (Supp. 1983).

43. U.C.C. § 9-301(3) (1978). According to § 9-301(3) a lien creditor includes "a trustee in bankruptcy from the date of the filing of the petition." *Id.*

caution in this preferential transfer area. A trustee is granted the power to avoid transfers of the debtor to creditors that are "preferential".⁴⁴ Moreover, a debtor's granting of a security interest is a transfer within the meaning of the Bankruptcy Act.⁴⁵ This power is based on two policies.⁴⁶ First, the debtor should treat creditors equally.⁴⁷ This policy allows the trustee to reach transfers made within a certain time before bankruptcy. Second, because secret liens should be discouraged, a creditor should not delay perfecting a security interest in the debtor's collateral.⁴⁸ Perfection, through a filed financing statement, serves as notice that the creditor may claim an interest in the collateral. Therefore, to avoid any public record of his security interest the creditor could delay filing until notice of bankruptcy. While this tactic is still possible, the avoidance powers of the trustee make it less appealing because the trustee's powers enable him to avoid preferential transfers made within a certain time before bankruptcy.

III. THE TIMING OF PERFECTION UNDER THE BANKRUPTCY ACT OF 1938

A. A BRIEF HISTORY OF ARTICLE 9 OF THE UNIFORM COMMERCIAL CODE AND THE BANKRUPTCY ACT OF 1938

One of the primary purposes of Article 9 is to provide a unified structure for modern secured financing transactions.⁴⁹ Prior to the enactment of Article 9, the law of secured transactions was complex and unclear.⁵⁰ The results of these ambiguities were increased costs to both parties and increased uncertainty as to their rights and the rights of third parties dealing with them.⁵¹ Article 9, however, was not the panacea envisioned by its drafters. The enactment of Article 9 dated the preference provisions of the 1938 Bankruptcy Act.⁵² Inconsistencies between the Code and the Bankruptcy Act

44. 11 U.S.C. § 547 (Supp. IV 1980).

45. *Id.* § 101(40) (Supp. IV 1980). Subsection 101(40) states that a transfer "means every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property, including retention of title as a security interest." *Id.*

46. WHITE & SUMMERS, *supra* note 32, at 999.

47. WHITE & SUMMERS, *supra* note 32, at 999.

48. WHITE & SUMMERS, *supra* note 32, at 999-1000.

49. U.C.C. § 9-101, Comment (1978).

50. *Id.* The comment to section 9-101 points out that pre-Code law was baffling. For example "it was by no means clear, even to specialists, how under pre-Code law a security interest might be taken in many kinds of intangible property — such as television or motion picture rights — which have come to be an important source of commercial collateral." *Id.*

51. *Id.*

52. REPORT OF THE COMMITTEE ON COORDINATION OF THE BANKRUPTCY ACT AND THE UNIFORM

promoted the National Bankruptcy Conference to establish a committee in 1966 to coordinate the two statutes.⁵³ The report of the "Gilmore Committee"⁵⁴ urged a revision of the Bankruptcy Act.⁵⁵ One of the primary aims of the committee was to coordinate the section 60 preference provisions of the 1938 Bankruptcy Act with Article 9.⁵⁶ To meet these goals Congress enacted the Bankruptcy Reform Act, which took effect on October 1, 1979.⁵⁷

Generally the unified procedures of Article 9 have successfully allowed a creditor to obtain a security interest enforceable against both the debtor and third party claimants. Prior to 1978, however, certain provisions of the Bankruptcy Act became important to the creditor if his debtor declared bankruptcy. The preference provisions of section 60⁵⁸ had particular significance. Section 60 invalidated preferential transfers from the debtor to favored creditors before bankruptcy.

B. SECTION 60 OF THE BANKRUPTCY ACT OF 1938

The key provision of section 60 was subsection (a)(1) which defined a preferential transfer.⁵⁹ To attack a transfer as a voidable

COMMERCIAL CODE (1970), H.R. REP. NO. 595, 95th Cong., 2d Sess., *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 6164, 6167 [hereinafter cited as GILMORE REPORT]. The report more specifically stated:

In 1966 it appeared that security interests in personal property under Article 9 of the Uniform Commercial Code were in serious jeopardy in bankruptcy proceedings. At the time when the revision of § 60 [of the Bankruptcy Act] which was enacted in 1950 was being prepared, the drafting of Article 9 was in its early stages. The § 60 revision, of necessity, was written in what we may call pre-Code language If the structure of security law had remained as it was, the compromise represented by the 1950 revision of § 60 would have worked perfectly well. With the general enactment of the Code, including Article 9, the situation was radically altered. Arguably, Article 9 contained little or nothing that was revolutionary, or even novel, as a matter of substance. The Article 9 terminology, on the other hand, represented a sharp break with the past. The difficulty of making the two statutes (§ 60 and Article 9) mesh or track with each other was immediately apparent.

Id. at 6167.

53. *Id.* at 6164.

54. The committee is commonly referred to as the "Gilmore Committee" because its chairman was Professor Grant Gilmore.

55. See generally GILMORE REPORT, *supra* note 52, at 6164-70.

56. GILMORE REPORT, *supra* note 52, at 6166. The Committee report states that "[s]o far as human wit and intelligence can insure the outcome, the proposed revisions of § 60 and Article 9, if they succeed in winning enactment, should be able to coexist comfortably." *Id.*

57. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, title IV, § 2 Stat. 2682 (codified at 11 U.S.C. §§ 101-151326) (Supp. IV 1980).

58. 11 U.S.C. § 96 (1976) (current version at 11 U.S.C. § 547 (Supp. IV 1980)). See also 11 U.S.C. § 110(c) (1976) (current version at 11 U.S.C. §§ 541(e), 544(a) (Supp. IV 1980)). Section 110(c) gave the trustee the status of an "ideal lien creditor" as of the date of bankruptcy. This status enabled the trustee to defeat an unperfected security interest because under section 9-301(b) a lien creditor defeats a party with an unperfected interest. WHITE & SUMMERS, *supra* note 32, at 994 n.10.

59. 11 U.S.C. § 96(a)(1) (1976) (current version at 11 U.S.C. § 547 (Supp. IV 1980)). Section 60(a)(1) defined a preference as:

preference, the trustee was required to prove the following elements: (1) a transfer of the debtor's property to a creditor, (2) for an antecedent debt, (3) while the debtor was insolvent, (4) within four months before the filing of the bankruptcy petition, and (5) at a time when the creditor knew or had reason to know that the debtor was insolvent.⁶⁰ The issues become whether the transfer occurred within four months of bankruptcy, whether the transfer was for an antecedent debt, and whether the debtor was insolvent when the transfer took place.⁶¹ To resolve these issues it was necessary to determine when the transfer occurred. The disharmony between Article 9 and the Bankruptcy Act produced problems in this area.

The Bankruptcy Act established a test for determining when the transfer was deemed to have occurred.⁶² If under applicable state law, a party was given twenty-one days or less after the transfer to record or deliver, and the party did so within the grace period, the transfer was deemed to have occurred at the time of the actual transfer. If the applicable state law specified either no grace period or a period greater than twenty-one days, but a party acted within twenty-one days, the transfer was deemed to have occurred at the time of the actual transfer. This timing provision was referred to as Paragraph I.⁶³ If the party recorded after twenty-one days, the transfer was deemed to have occurred at the time the party recorded his security interests.⁶⁴

[A] transfer, as defined in this title, of any of the property of a debtor to or for the benefit of a creditor for or on account of an antecedent debt, made or suffered by such debtor while insolvent and within four months before the filing by or against him of the petition initiating a proceeding under this title, the effect of which transfer will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class.

Id.

60. *Id.*

61. Mann & Phillips, *The Timing of Perfection of Security Interests Under the Uniform Commercial Code and the Bankruptcy Reform Act*, 15 AKRON L. REV. 369, 372 (1981).

62. 11 U.S.C. § 96(a)(7)(I), (II). Paragraph I provided:

Where (A) the applicable law specifies a stated period of time of not more than twenty-one days after the transfer within which recording, delivery, or some other act is required, and compliance therewith is had within such stated period of time; or where (B) the applicable law specifies no such stated period of time or where such stated period of time is more than twenty-one days, and compliance therewith is had within twenty-one days after the transfer, the transfer shall be deemed to be made or suffered at the time of transfer.

Id.

Paragraph II provided that "[w]here compliance with the law applicable to the transfer is not had in accordance with the provisions of subparagraph I . . . the transfer shall be deemed to be made or suffered at the time of compliance therewith." *Id.*

63. Mann & Phillips, *supra* note 61, at 372.

64. 11 U.S.C. § 96(a)(7)(II) (1976) (current version at 11 U.S.C. § 547 (Supp. IV 1980)).

The following example illustrates the operation of Paragraph I. On March 1 D grants the bank a security interest in equipment that D presently owns to secure a loan. On March 23 the bank perfects the security interest. On April 25 D files a petition in bankruptcy.

Because the bank acted more than twenty-one days after the original transfer, the Bankruptcy Act would deem the March 23 perfection date to be the date of transfer. Therefore, under Paragraph I the transfer from the debtor to the creditor occurred on March 23.

By applying Paragraph I the trustee may possibly avoid the transaction. Because the debt arose on March 1 and the transfer occurred on March 23, the transfer of the security interest on March 23 was for a previously existing debt. In the language of the Bankruptcy Act, this was a transfer "for or on account of an antecedent debt."⁶⁵ If the trustee is able to establish the other elements of a preferential transfer, this transaction is voidable.

To apply the twenty-one day timing provision, Paragraph I required a reference to state law. The language of Paragraph I, however, presented no serious problem when applied to customary filing-type statutes under pre-Code law.⁶⁶ Typically these statutes provided a grace period within which the filing party was to act.⁶⁷ If the state statute provided a grace period of twenty-one days or less, the state statute controlled.⁶⁸ If the state statute provided either a grace period of more than twenty-one days or none at all, the Bankruptcy Act provided a twenty-one day grace period.⁶⁹ Therefore, if the secured party perfected within the applicable grace period, the time of the transfer for bankruptcy purposes was the time of the actual transfer.

Although no serious problems existed under pre-Code law, the same was not true under Code law. A severe problem developed when the applicable state law was the Uniform Commercial Code. Article 9 of the Code provides no grace period for perfecting a security interest.⁷⁰ The language of Paragraph I, however, suggests that the drafters assumed a statutory grace period.⁷¹ Therefore, an

65. *Id.* § 96(a)(1).

66. 2 G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 45.8, at 1326 (1965).

67. *Id.* Professor Gilmore notes that sometimes the grace period was a specified number of days, but other times it was merely a "reasonable time." *Id.* Under the "reasonable time" formula, the grace period was left to judicial decision. *Id.*

68. Mann & Phillips, *supra* note 61, at 373.

69. Mann & Phillips, *supra* note 61, at 373.

70. The exception to the no grace period rule is a purchase money security interest. U.C.C. § 9-301(2) (1978). See *supra* notes 28-33 and accompanying text for a discussion of section 9-301(2).

71. GILMORE REPORT, *supra* note 52, at 6170.

issue arose whether a secured party under Article 9 had a twenty-one day grace period for perfecting the security interest. Commentators generally concluded that the twenty-one day grace period was appropriate.⁷² The application of this grace period, however, allowed a lien creditor, but not the bankruptcy trustee, to defeat the non-purchase money secured party. Professor Lawrence King described the situation as follows:

Assume a loan is made and a security agreement is entered into on January 2, but that the financing statement which is required for full perfection is not filed until January 20. The debtor files a petition in bankruptcy on May 15. If there had been a creditor who obtained a judgment lien on the collateral between January 2 and January 20, by application of Section 9-301 [(1) (b)] the judgment creditor would clearly prevail over the secured creditor. The result is not so certain under the Bankruptcy Act. Most authorities take the position that the trustee cannot set aside the security interest when the financing statement has been filed within twenty-one days after the security interest was granted. Under section 60(a) (7) (I) (B), therefore, the transfer must be deemed made for a contemporaneous consideration on January 2, more than four months before the filing of the petition in bankruptcy.⁷³

A potential solution to this problem was to interpret section 9-301(1) of the Code as giving a specified period of zero days, no grace period, in which to perfect a security interest.⁷⁴ Professor King further illustrated:

If . . . the grace period is inapplicable, the transfer must be deemed made on January 20. Two crucial elements of a voidable preference could therefore be proven: (1) the date of filing, May 15, is within four

72. G. GILMORE, *supra* note 66, at 1327. See also 1A P. COOGAN, W. HOGAN, & D. VAGTS, SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE, § 9.03(5)(c), 995 (1963) [hereinafter cited as COOGAN, HOGAN, & VAGTS].

73. King, *Voidable Preferences and the Uniform Commercial Code*, 52 CORNELL L. Q. 925, 929 (1967).

74. G. GILMORE, *supra* note 66, at 1327-28. Professor Gilmore concluded:

If the underlying policy of § 60(a)(7) is thought to be the adoption of any state filing requirement which is shorter than the 21-day maximum, it would be entirely possible to conclude that any filing delay after the security interest had attached would make

months of the transfer; and (2) since no consideration passed on January 20, the transfer was for an antecedent debt. (The other elements comprise fact questions not material to the present discussion.) It seems clear that the result in bankruptcy proceedings would differ from that under the Code only if the twenty-one day grace period is applicable. To the extent that the results do differ, the Bankruptcy Act fails to make the trustee a hypothetical judicial lien creditor under applicable state law.⁷⁵

Either solution posed problems. If the twenty-one day grace period was found applicable, the Bankruptcy Act violated the Article 9 policy of encouraging advance or immediate filing of non-purchase money security interest.⁷⁶ In addition, the result reached in a bankruptcy proceeding would differ from that reached in a non-bankruptcy proceeding. If section 9-301 of the Code was viewed as giving a specified period of zero days, the Code violated the bankruptcy provision policy of allowing the secured party a reasonable amount of time to perfect the transfer.⁷⁷

C. SECTION 60 AND PURCHASE MONEY SECURITY INTERESTS

A greater problem arose when the timing provision of Paragraph I was applied to purchase money security interests. Purchase money security interests are granted a ten day grace period by the Code.⁷⁸ If the purchase money secured creditor files within ten days after the debtor receives possession of the collateral, the date of filing "relates back" to the date the security interest attached. The delayed filing operates to cut off the rights of any intervening lien creditors or bulk purchasers.⁷⁹ The grace period reflects the intent of the Code drafters to favor purchase money security interests.⁸⁰

Because section 9-301(2) provides a stated period of ten days

the transaction a transfer for an antecedent debt under § 60(a)(7). The language of § 60(a)(7) is that the filing must be made within whatever "stated period," less than 21 days, may be "specified" in the "applicable law." Article 9 could be taken as a statute which specifies a stated period of zero days.

Id.

75. King, *supra* note 73, at 929.

76. King, *supra* note 73, at 929.

77. King, *supra* note 73, at 928.

78. U.C.C. § 9-301(2) (1978).

79. *Id.*

80. WHITE & SUMMERS, *supra* note 32, at 1043. Generally, the three reasons for the priority given to purchase money security interests are as follows: (1) purchase money lenders enjoyed priority

for a secured party to act, the creditor would have a ten day grace period under Paragraph I.⁸¹ If the non-purchase money secured party received the twenty-one day grace period under Paragraph I, the purchase money secured party received a shorter grace period.⁸² Obviously this result did not advance the Code policy of preferring purchase money security interests. Moreover, the result reached in a bankruptcy proceeding differed from that reached outside bankruptcy. Section 9-301(2), through the relation-back provision, allowed a purchase money secured party to defeat a lien creditor or bulk purchaser outside bankruptcy. In bankruptcy, however, the purchase money secured party would receive a shorter grace period than would a nonpurchase money secured party.

The following example illustrates this problem. On May 1 D grants the bank a security interest in equipment. D has possession of the equipment on May 1 and the security interest also attaches on this date. On May 25 D files a petition in bankruptcy. Assuming the bank has a purchase money security interest, it must perfect its security interest no later than May 11. If perfection occurs later than May 11 the trustee in bankruptcy may avoid the transaction as a preferential transfer.

If, however, the bank has a nonpurchase money security interest, the bank may wait until May 22 to perfect the interest. This inconsistent result was possible because in bankruptcy the purchase money secured party would receive only a ten day grace period while a nonpurchase money secured party would receive the Paragraph I twenty-one day grace period.

Two solutions were posed, which attempted to eliminate the disparity. The first solution was to interpret Paragraph I as also applying the twenty-one day grace period to purchase money security interests.⁸³ This approach, however, took certain liberties

under pre-Code law; (2) it should not be necessary for a seller to examine the filings to sustain his priority over goods he himself owns; and (3) purchase money provisions enable the debtor to receive greater credit and bargaining power. *Id.*

81. G. GILMORE, *supra* note 66, at 1328-29. Another interpretative issue is at what moment does the grace period begin. Paragraph I merely stated that the grace period exists for "twenty-one days after the transfer." 11 U.S.C. § 96(a)(7)(I) (emphasis added). Section 9-301(2) states that the grace period exists for "ten days after the debtor receives possession of the collateral." U.C.C. § 9-301(2) (emphasis added). For further discussion of when the grace period begins, see *infra* note 84.

82. G. GILMORE, *supra* note 66, at 1328. Professor Gilmore noted that "[t]his is an obviously anomalous result since the purchase-money party, who is singled out for favored treatment under Article 9, gets the axe under § 60(a)(7) 11 days sooner than his non-purchase-money competitor." *Id.*

83. COOGAN, HOGAN, & VAGTS, *supra* note 72, § 9.03(5)(c), at 995. Professor Gilmore also commented on this suggestion:

The anomaly can be avoided by saying that, despite the "stated period" of § 9-301(2), the holder of a purchase-money interest, like the holder of any other interest, should

with the interpretation of section 9-301(2) of the Code and the Bankruptcy Act. Section 9-301(2) clearly provides a ten day grace period and Paragraph I obviously considered such a grace period.⁸⁴

The second alternative was to interpret section 9-301(1) as providing a stated period of zero days for non-purchase money security interests.⁸⁵ Under this approach, purchase money security interests would still have the ten day grace period and would still receive favored treatment. Nonpurchase money security interests, however, would have no grace period. Yet, interpretative problems still existed because section 9-301(1) mentions nothing about a grace period of zero days.⁸⁶ Furthermore, Paragraph I contemplated situations in which state statutes were silent about grace periods by providing the twenty-one day period. The

have the full 21 days. This suggestion has, indeed, been made, and by an eminently respectable source, but there is some difficulty in squaring it with the (at this point) quite precise language of § 60(a)(7). Or we can console ourselves with the thought that anomalies are only to be expected when inconsistent statutory formulas must somehow be made to work in double harness.

G. GILMORE, *supra* note 66, at 1328.

84. G. GILMORE, *supra* note 66, at 1328-29. Another difficulty is when the grace period begins. Under section 9-301(2) the period dates from the time the debtor receives possession of the collateral and not from the time of transfer, which is the date under the Bankruptcy Act. Compare 11 U.S.C. § 96(a)(7)(I) with U.C.C. § 9-301(2). Commenting on the situation, Professor Gilmore offered the following possibilities:

If "transfer" is translated into Article 9 terminology, the § 60(a)(7) period runs from the date the security interest attaches. . . . In many purchase-money transactions, attachment of the security interest and delivery of the collateral to the debtor will be simultaneous. In such cases the § 60(a)(7) period and the § 9-301(2) period run from the same point in time and there is no difficulty. If, however, there is a delay after attachment and before delivery, we are all at once back in the familiar land of anomaly. Are we to say that, for the purpose of § 60(a)(7), the purchase-money party must file within 10 days from attachment ("transfer") even though his § 9-301(2) grace period has not yet run? Or are we to say that, at least in such a case, § 9-301 does not "specify" a "stated period" running from the date of transfer so that the purchase-money party who delays delivery gets 21 days while the party who makes an immediate delivery gets only 10 days? Perhaps the suggestion that all purchase-money filing should have the benefit of the 21-day period can be reinforced by the observation that § 9-301(2), read literally, does not specify a stated period running from the date of transfer and therefore should not be held to cut back the full period in any case.

G. GILMORE, *supra* note 66, at 1328-29.

85. Mann & Phillips, *supra* note 61, at 376.

86. King, *supra* note 73, at 932-33. Professor King indicated that the situation was not insolvable:

[T]he problem is capable of a logical solution. The Bankruptcy Act defers to state law for a determination of when a security interest is perfected, and the policy of the Bankruptcy Act is to give the trustee in bankruptcy the same rights as judicial lien creditors. Under state law there is *no* period of grace for perfecting non-purchase-money security interests and there is a *ten-day* grace period for perfecting purchase-money security interests. For purposes of Section 60 of the Bankruptcy Act, the same conclusions should be reached in a bankruptcy proceeding. Such an interpretation does not derogate from the concept of federal supremacy over state, since the Bankruptcy Act clearly *refers* to state law for application of the transfer test.

Id. (emphasis in original).

problem, as noted by Professor Gilmore, was "not capable of a logical solution: the courts may as well decide the case by rolling the dice."⁸⁷ The only satisfactory answer was to change either the Bankruptcy Act or Article 9 of the Code.⁸⁸

IV. THE BANKRUPTCY REFORM ACT OF 1978

A. SECTION 547 PREFERENTIAL TRANSFERS

The above problems were addressed by the Bankruptcy Reform Act. Section 547, the successor of section 60, contains substantial modifications.⁸⁹ Many of the modifications were in response to the problems created by the interaction of Article 9 of the Code and the Bankruptcy Act.⁹⁰

Section 547 defines preferential transfers and lists seven elements the bankruptcy trustee must prove to establish a preferential transfer.⁹¹ First, a transfer is required. The Bankruptcy Act defines transfer to include the granting of a

87. G. GILMORE, *supra* note 66, at 1329.

88. GILMORE REPORT, *supra* note 52, at 6170. The Gilmore Committee urged a revision of the Bankruptcy Act as follows:

Present § 60, as even its dearest friends will concede, is, as a matter of language, intolerably and unnecessarily complex. Furthermore, as has already been pointed out, present § 60 was, necessarily, written in pre-Code terminology, which leads to difficult, indeed logically insoluble, problems of statutory construction in applying the § 60 rules to Article 9 security interests. For example present § 60(a)(7) deals with the problem of late filing of security interests subject to a filing perfection requirement. The Article 9 filing system is quite different from the filing systems set up under the pre-Code security statutes. For one thing, there is no grace period for filing under Article 9, except for purchase money security interests which get a 10-day grace period. Present § 60(a)(7) clearly assumes that all filing statutes have grace periods for all required filings. Consequently no one really knows what § 60(a)(7) means when it is applied to Article 9 filings and, indeed, the commentators who have discussed the point have proposed divergent and contradictory solutions.

Id.

89. Mann & Phillips, *supra* note 61, at 378.

90. S. REP. NO. 989, 95th Cong., 2d Sess. 87, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5787, 5873. The Committee notes state that "[t]his section [§ 547] is a substantial modification of present law. It modernizes the preference provisions and brings them more into conformity with commercial practice and the Uniform Commercial Code." *Id.* at 5873.

91. 11 U.S.C. § 547(b) (Supp. IV 1980). Section 547(b) defines a preferential transfer as follows:

[A preferential transfer is] any transfer of property of the debtor —

(1) to or for the benefit of a creditor;

(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;

(3) made while the debtor was insolvent;

(4) made —

(A) on or within 90 days before the date of the filing of the petition; or

(B) between 90 days and one year before the date of the filing of the petition, if such creditor, at the time of such transfer —

(i) was an insider; and

security interest.⁹² Second, a transfer of the debtor's property must occur. Third, the transfer must be to or for the benefit of a creditor. Fourth, the transfer must be for a previously existing debt. Fifth, the transfer must occur while the debtor is insolvent. A statutory presumption aids the trustee in proving this element. Under section 547(f) the debtor is presumed to have been insolvent for ninety days prior to bankruptcy.⁹³ The sixth element places a time limit on the trustee's ability to reach transfers. Only transfers made within ninety days or one year are vulnerable.⁹⁴ If the transfer was made to an insider,⁹⁵ the trustee may avoid the transfer if it was made during the period that begins one year before the filing of the petition and ends ninety days before the filing.⁹⁶ If the transfer was made to any other creditor the period is ninety days before bankruptcy.⁹⁷ There is no requirement that the antecedent debt arise during these periods, only that the "transfer" occur within the period.⁹⁸ Seventh, the transfer must enable the creditor to receive more than he would have under a liquidation proceeding.⁹⁹ If the trustee establishes these elements, he may avoid the transfer.

(ii) had reasonable cause to believe the debtor was insolvent at the time of such transfer; and

- (5) that enables such creditor to receive more than such creditor would receive if —
 (A) the case were a case under chapter 7 of this title;
 (B) the transfer had not been made; and
 (C) such creditor received payment of such debt to the extent provided by the provisions of this title.

Id.

92. *Id.* § 101(40).

93. *Id.* § 547(f). Section 547(f) states that "the debtor is presumed to have been insolvent on and during the 90 days immediately preceding the date of the filing of the petition." *Id.*

94. *Id.* § 547(b)(4).

95. *Id.* § 101(25). The term insider is defined by § 101(25) of the Bankruptcy Act. *Id.* Generally, an insider is "one who has a sufficiently close relationship with the debtor that his conduct is made subject to closer scrutiny than those dealing at arms length with the debtor." S. REP. NO. 989, *supra* note 90, at 25, U.S. CODE CONG. & AD. NEWS at 5810. The insider must also have had reasonable cause to believe that the debtor was insolvent at the time of the transfer. 11 U.S.C. § 547(b)(4)(B)(ii) (Supp. IV 1980).

96. 11 U.S.C. § 547(b)(4)(B).

97. *Id.* § 547(b)(4)(A).

98. S. REP. NO. 989, *supra* note 90, at 87, U.S. CODE CONG. & AD. NEWS at 5873.

99. 11 U.S.C. § 547(b)(5) (Supp. IV 1980). The trustee must prove that the transfer enabled the creditor to receive more than he would have if the case were a liquidation case, if the transfer had not been made and if the creditor received payment to the extent provided by the provisions of the Code. S. REP. NO. 989, *supra* note 90, at 87, U.S. CODE CONG. & AD. NEWS at 5873. Under § 60(a)(1) the trustee was required to prove that the transfer enabled the creditor to "obtain a greater percentage of his debt than some other creditor of the same class." 11 U.S.C. § 96(a)(1) (1976) (repealed 1978). Thus, all creditors of the same class had to receive an equal percentage of their claims or the transfer would be preferential. WHITE & SUMMERS, *supra* note 32, at 1004 n.43. Under § 60(a)(1) the transfer could possibly escape the trustee's avoidance powers if all creditors within a class received equal percentages or if the creditor was the only member of his class, even though the paid creditor was in a class of lower priority than another class of unpaid creditors. Young, *Code Preferences*, 54 AM. BANKR. L. J. 221, 224 (1980). The Bankruptcy Reform Act now requires the court to focus on the relative distribution between different classes as well as the amount received by members of the same class. S. REP. NO. 989, *supra* note 90, at 87, U.S. CODE CONG. & AD. NEWS at 5873. The new Act also requires a consideration of the allowability of the creditor's claim. Under old § 60(a)(1) if a creditor's claim was disallowed, a transfer to this creditor would probably not have been preferential because

Under section 547 the time a transfer occurs is important. This date is necessary for determining the presence of an antecedent debt,¹⁰⁰ insolvency,¹⁰¹ and the ninety day or one year vulnerability period.¹⁰² Although section 60 provided a twenty-one day grace period, section 547(e)(2) changes the grace period to ten days.¹⁰³ The grace period in the new Bankruptcy Act applies to all transfers, without regard to any grace period provided by state law.¹⁰⁴ Thus, section 547 resolves one of the problems created by the interaction of Article 9 with section 60: whether the secured party had a grace period within which to perfect his security interest.

B. THE TIMING OF TRANSFERS UNDER SECTION 547

Section 547(e) (2) provides three timing provisions.¹⁰⁵ First, if a transfer is perfected within ten days of attachment of the security interest, the date of attachment is the date of transfer.¹⁰⁶ This

"the holder of a disallowed claim belongs to no actual class in the bankruptcy proceedings" and therefore this creditor did not receive a greater percentage than others of the same class. Young, *supra*, at 224-25. Section 547(b)(5) of the new Act would declare a disallowed claim a voidable preference. A creditor with a disallowed claim would have received nothing under the distributive provisions of the Bankruptcy Act and therefore the transfer enabled the creditor to receive more than he would have in a chapter 7 liquidation. S. REP. No. 989, *supra* note 90, at 87, U.S. CODE CONG. & AD. NEWS at 5873.

100. 11 U.S.C. § 547(b)(2) (Supp. IV 1980).

101. *Id.* § 547(b)(3).

102. *Id.* § 547(b)(4)(A), (B).

103. *Id.* § 547(e)(2).

104. Hogan, *Bankruptcy Reform and Delayed Filing Under the U.C.C.*, 35 ARK. L. REV. 35, 46-47 (1981). Reference to state law is still necessary to determine what acts constitute perfection. See 4 W. COLLIER, COLLIER ON BANKRUPTCY ¶ 547.46(1), at 547-136 (15th ed. 1982).

105. 11 U.S.C. § 547(e)(2) (Supp. IV 1980). Subsection 547(e)(2) states that a transfer is made:

- (A) at the time such transfer takes effect between the transferor and the transferee, if such transfer is perfected at, or within 10 days after, such time;
- (B) at the time such transfer is perfected, if such transfer is perfected after such 10 days; or
- (C) immediately before the date of the filing of the petition, if such transfer is not perfected at the later of—
 - (i) the commencement of the case; and
 - (ii) 10 days after such transfer takes effect between the transferor and the transferee.

Id.

106. Section 547(e)(2) uses the phrase "at the time such transfer takes effect between the transferor and the transferee." 11 U.S.C. § 547(e)(2)(A). This phrase is commonly interpreted to mean the date the security interest became enforceable and attached to the collateral. GILMORE REPORT, *supra* note 52, at 6173. The Gilmore Report further explained the phrase:

A final word should be said about the phrase "became effective between the parties" which is used in the Draft in lieu of the Article 9 term "attached." It is believed that the reference to the time when a transfer becomes effective between the parties (but not, necessarily, against third parties) is one that will be generally understood by lawyers, no matter what kind of transfer is involved. The use of the technical Article 9 term "attached" might have caused difficulty with respect to

section operates similarly to the "relation-back" provision of the Code. Second, if perfection occurs more than ten days after attachment, the date of perfection is the date of transfer.¹⁰⁷ Third, if no perfection has occurred on the date of bankruptcy, the transfer is deemed to occur immediately before bankruptcy.¹⁰⁸

The Bankruptcy Act and the Code are still greatly interrelated because state law determines what acts constitute perfection. Article 9 of the Code provides the relevant rules in forty-nine states.¹⁰⁹ The Bankruptcy Act, however, provides the definition of perfection. Suppose a creditor wishes to perfect his security interest. To determine what actions are necessary the creditor must examine Article 9. The creditor generally will need to file a financing statement.¹¹⁰ If the creditor wishes to determine whether the interest is perfected in bankruptcy, however, he must look to the Bankruptcy Act.

Under the Bankruptcy Act a transfer of personal property or fixtures is perfected when it is effective against a creditor with a judicial lien.¹¹¹ For transfers of security interests in personal property, filing is usually necessary.¹¹² For example, D grants the bank a security interest in equipment to secure a loan. Unless the bank files a financing statement, the bank's security interest is unperfected. If X obtains a judicial lien on D's equipment, X will have an interest superior to the bank's interest. Under the Bankruptcy Act, the bank's interest is not perfected because it is not effective against X, a judicial lien creditor.¹¹³ Therefore, the trustee may avoid the transaction.

The following example illustrates the operation of the ten day period of section 547(e) (2). Assume on July 1 D grants the bank a security interest in equipment that D owns to secure a loan. On July 9 the bank perfects its security interest by appropriately filing a financing statement. D files a petition in bankruptcy on July 30,

transfers other than Article 9 security interests. Indeed "becomes effective between the parties" is what "attached" means in the Article 9 context — a point which is spelled out in the proposed revision of Article 9 which is currently under study by the Article 9 Review Committee.

Id.

107. 11 U.S.C. § 547(e)(2)(B).

108. *Id.* § 547(e)(2)(C).

109. U.C.C., 1 U.L.A. 1, 2 (Supp. 1983). Louisiana is the only state which has not adopted Article 9. *Id.*

110. See U.C.C. § 9-302, § 9-302, Comment 1 (1978).

111. 11 U.S.C. § 547(e)(1)(B) (Supp. IV 1980). Section 547(e)(1)(B) states that a "transfer of a fixture or property other than real property is perfected when a creditor on a simple contract cannot acquire a judicial lien that is superior to the interest of the transferee." *Id.*

112. U.C.C. § 9-302 (1) (1978).

113. 11 U.S.C. § 547(e)(1)(B) (Supp. IV 1980).

within ninety days of the transfer.

Under section 547(e)(2), the transfer is deemed to occur on July 1 because perfection occurred on July 9, within ten days of the date on which the security interest became enforceable.¹¹⁴ Therefore, the trustee may not avoid the bank's security interest. No antecedent debt exists because the debt arose on July 1 and the transfer is deemed to occur on the same day. If, however, the creditor did not perfect its security interest until July 12, the time of transfer is July 12 because this date is more than ten days after the July 1 enforceability date.¹¹⁵ In this case the trustee would establish the antecedent debt requirement because the debt arose prior to the July 12 time of transfer.

Section 547 also appears to protect the creditor if perfection occurs after the bankruptcy petition is filed but within the ten day grace period because the time of transfer remains the time of attachment.¹¹⁶ Suppose D grants the bank a security interest on May 1. On May 5 the debtor files a petition in bankruptcy. The bank perfects the security interest on May 10. At first glance this may appear to be a preferential transfer, but section 547 provides otherwise. Because the transfer was perfected within ten days of the date of attachment, the perfection relates back to the date of attachment. The trustee cannot establish the antecedent debt element because, for purposes of section 547, the debt and the transfer arose simultaneously.

C. PURCHASE MONEY SECURITY INTERESTS AND SECTION 547 OF THE BANKRUPTCY ACT

Section 547 eliminates the second problem created by the interaction between section 60 and Article 9: the tendency to favor nonpurchase money security interests over purchase money security interests.¹¹⁷ Under section 547(e)(2) state law grace periods

114. *Id.* § 547(e)(2)(A).

115. *Id.* § 547(e)(2)(B).

116. W. COLLIER, *supra* note 104, ¶ 547.45, at 547-135. One commentator concludes:

If the ten-day period for perfection has not yet expired when the petition is filed, it can still be utilized to relate back to the actual time of transfer. In other words, if the petition is filed a week after a transfer was made, three days are still left to perfect it and the automatic stay should not apply to depart from the intent of the statute in this regard.

Id. See also Hogan, *supra* note 104, at 48 ("Section 547(e)(2)(C) clearly authorizes a filing after bankruptcy and within the 10 day zone for transactions on the eve of bankruptcy.").

117. For a discussion of the interaction between § 60 and purchase money security interests, see *supra* notes 79-88 and accompanying text.

are irrelevant.¹¹⁸ Section 547(e)(2) treats these two security interests equally by not employing state law to establish the time of the transfer. The ten day grace period under section 547(e)(2) is applied to all transfers.¹¹⁹ Because this equal treatment violates the Code's policy of favoring purchase money security interests, the drafters of section 547 provided an exemption for certain transfers under section 547(c)(3).¹²⁰ This section protects the creditor's security interest when value is given to the debtor after the signing of the security agreement. The transaction, however, must meet several requirements. The value must be given to enable the debtor to acquire the collateral and the debtor must in fact use the value to acquire this collateral. Additionally, the creditor must perfect the security interest within ten days of attachment.¹²¹

This provision closely parallels section 9-107 of Article 9. In most situations section 547(c)(3) will protect purchase money security interests from a preference attack.¹²² Generally, the secured party will file within ten days and meet the requirements of section 547(c)(3). Because of the parallel protection under section 9-107 of the Code, section 547(c)(3) seems to add little to the protection offered by section 547(e)(2).¹²³ In certain situations, however, section 547(c)(3) will not protect the purchase money lender. Section 547(e)(3) states that a transfer cannot occur until the debtor acquires rights in the collateral.¹²⁴ Section 547(e)(2), therefore, would not protect a purchase money lender if the debtor

118. Mann & Phillips, *supra* note 61, at 381.

119. Mann & Phillips, *supra* note 61, at 380.

120. 11 U.S.C. § 547(c)(3) (Supp. IV 1980). Section 547(c)(3) states:

[A] trustee may not avoid . . . a transfer . . . of a security interest in property acquired by the debtor —

(A) to the extent such security interest secures new value that was —

(i) given at or after the signing of a security agreement that contains a description of such property as collateral;

(ii) given by or on behalf of the secured party under such agreement;

(iii) given to enable the debtor to acquire such property; and

(iv) in fact used by the debtor to acquire such property; and

(B) that is perfected before 10 days after such security interest attaches.

Id.

121. *Id.* § 547(c)(3)(B). The phrase "perfected *before* 10 days" of section 547(c)(3)(B) has been interpreted literally by at least one commentator. Professor Hogan has noted that "if the security interest attaches on January 2, 10 days after that date will be January 12: but perfection must occur on *January 11* to qualify the perfection as *before* January 12." Hogan, *supra* note 104, at 47 (emphasis added).

122. WHITE & SUMMERS, *supra* note 32, at 1006-07.

123. WHITE & SUMMERS, *supra* note 32, at 1006-07. Professors White and Summers note that "[b]ecause of the ten day grace period in subsection (e), it will seldom be necessary for even a purchase money lender to invoke this exception. Normally he will protect himself by filing within ten days of the time the security agreement is signed." *Id.*

124. 11 U.S.C. § 547(e)(3) (Supp. IV 1980). According to § 547(e)(3) "a transfer is not made until the debtor has acquired rights in the property transferred." *Id.*

acquires rights in the collateral after completion of the security agreement because the transfer would be for an antecedent debt. Professors White and Summers illustrated the problems as follows:

Assume for example that a bank agrees to lend a million dollars to debtor for the debtor's purchase of some expensive equipment. The parties sign the security agreement and the loan is made on day one but the collateral is not actually purchased until day 30 and the filing is not made until day 31. But for the purchase money exception, that transaction could be attacked as a voidable preference notwithstanding the ten day grace period. Since no transfer can occur until the debtor acquires rights in the collateral and since the debtor acquired such rights only on the 30th day, the transfer would be for the antecedent debt that had arisen on day one. Subsection 547(c)(3) will save that transaction; the ten day relation back rule would not save it.¹²⁵

In sum, the revision of section 60 of the Bankruptcy Act has resolved one of the interpretative difficulties created by the section 60 interaction with Article 9. Security interests perfected within ten days of attachment will not be attacked as preferential. Furthermore, section 547 extends the ten day protection to all transactions, including purchase and nonpurchase money security interests. Although this violates the Code's policy of encouraging advance filing,¹²⁶ some clarity has nevertheless been achieved. This "clarity is often more valuable than case-by-case justice, and in bringing some certainty to this area section 547's drafters have performed a signal service for commercial lawyers."¹²⁷

V. EXTENSION OF THE TIME PERIOD FOR PERFECTION

A. THE EFFECT OF THE NORTH DAKOTA AMENDMENT

In 1981 the North Dakota Legislature amended subsection 2

125. WHITE & SUMMERS, *supra* note 32, at 1007. Professor Hogan noted:

[T]he careful secured party may simply contract to make the transfer take effect at the time of delivery and thus get the full 10 days recognized in Bankruptcy. The Bankruptcy Act should simply measure the ten day period in purchase money cases from the time of delivery of the goods.

HOGAN, *supra* note 104, at 46.

126. Mann & Phillips, *supra* note 61, at 382.

127. Mann & Phillips, *supra* note 61, at 382.

of section 41-09-22 of the North Dakota Century Code.¹²⁸ The amendment extended the ten day grace period for perfecting a purchase money security interest to twenty days.¹²⁹ This extension creates a potential conflict with section 547 of the Bankruptcy Act.

As discussed above, the time of transfer is important in determining whether a transfer is preferential.¹³⁰ Assume on May 1 a seller retains a purchase money security interest in equipment sold to a buyer. The parties sign a security agreement and the debtor receives possession of the equipment also on May 1. On May 15 a financing statement covering the equipment is filed in the appropriate office. On June 1 the buyer files a petition in bankruptcy, within ninety days of the transfer. In this example the security interest attaches and becomes enforceable under state law on May 1.¹³¹ The security interest is perfected on May 15 when the financing statement is filed.¹³² The granting of the security interest, however, is a transfer within the meaning of the Bankruptcy Act.¹³³ Therefore, the critical bankruptcy question is when did the transfer occur. In this hypothetical the transfer takes effect on May 1, the date the security interest attaches and becomes enforceable. However, because perfection occurred more than ten days after the transfer took effect, May 15, the "relation-back" rule of section 547(e)(2)(A) does not apply. Rather, section 547(e)(2)(B) applies. Under section 547(e)(2)(B) the transfer is deemed to occur on May 15, the date when perfection took place. In this example the date of perfection is deemed the date of transfer. Therefore, the transfer is for or on account of an antecedent debt. Assuming the other elements of a preferential transfer are present,¹³⁴ the trustee may avoid the purchase money security interest, even though the seller filed the financing statement within the twenty day grace period of section 41-09-22(2) of the North Dakota Century Code. The

128. Act of March 11, 1981, ch. 432, § 1, 1981 N.D. Sess. Laws 1202 (codified at N.D. CENT. CODE § 41-09-22(2) (Supp. 1981)).

129. See N.D. CENT. CODE § 41-09-22(2) (Supp. 1981). Section 41-09-22(2) provides as follows:

If the secured party files with respect to a purchase money security interest before or within *twenty days* after the debtor receives possession of the collateral, he takes priority over the rights of a transferee in bulk or of a lien creditor which arise between the time the security interest attaches and the time of filing.

Id. (emphasis added).

130. 11 U.S.C. § 547(e)(2). See *supra* notes 89-104 and accompanying text.

131. U.C.C. § 9-203(1), (2) (1978). See N.D. CENT. CODE § 41-09-16(2) (Supp. 1981).

132. U.C.C. §§ 9-302(1), 9-303(1).

133. See 11 U.S.C. § 101(40) (Supp. IV 1980).

134. For a discussion of the elements of a preferential transfer, see *supra* notes 89-104 and accompanying text.

exemption of section 547(c)(3) would not protect the security interest because perfection did not occur within ten days after the security interest attached.¹³⁵

A second hypothetical further illustrates the difficulty. Assume on August 1 the seller retains a purchase money security interest in equipment sold to the buyer and the parties sign a security agreement. The buyer receives possession of the equipment on September 1. On September 15 the seller appropriately files a financing statement. On October 1 the buyer files a bankruptcy petition, within ninety days of the transfer. Under the North Dakota amendment to section 41-09-22(2) perfection occurred within the twenty day grace period.¹³⁶ Therefore, under the "relation-back" rule the transfer would have occurred on September 1, the date the buyer took possession. Under section 547(e)(2)(B), however, the transfer occurred on September 15 because perfection occurred more than ten days after the transfer took effect on August 1. The trustee may avoid the transfer of the security interest because it is on account of an antecedent debt.¹³⁷

As the two hypotheticals illustrate, section 41-09-22(2) presents two traps for the purchase money lender. The security interest can be avoided as a preferential transfer under section 547 in either of the following situations: (1) when attachment and the buyer's receipt of possession occur simultaneously but perfection occurs more than ten days after the debtor receives possession of the collateral (the first hypothetical); or (2) when attachment of the security interest occurs before the buyer takes possession of the collateral and perfection is delayed more than ten days after attachment (the second hypothetical).

B. THE NORTH DAKOTA AMENDMENT AND SECTION 544

The most commonly used avoidance powers of the trustee are those contained in section 544 of the Bankruptcy Act.¹³⁸ Section 544(a) gives the trustee all the rights under state law of a hypothetical creditor with a lien on property of the debtor.¹³⁹

135. For a discussion of the operation of § 547(c)(3), see *supra* notes 120-25 and accompanying text.

136. See N.D. CENT. CODE § 41-09-22(2). The seller's security interest was perfected on September 15, the date the financing statement was filed. Because this filing occurred within 20 days of the date the debtor received possession of the collateral, September 1, the seller perfected within the grace period of § 41-09-22(2).

137. See 11 U.S.C. § 547(b)(2) (Supp. IV 1980).

138. See WHITE & SUMMERS, *supra* note 32, at 996. Professors White and Summers have noted that "[b]y far the most common and simple clash is between the bankruptcy trustee and the Article 9 claimant who either fails to perfect at all or lets his perfection lapse." *Id.*

139. See 11 U.S.C. § 544 (Supp. IV 1980). Section 544(a) is commonly referred to as the "strong

Assuming the relevant state law is Article 9, the relevant provision is section 9-301(1)(b), which gives priority to a creditor who obtains a lien on property of the debtor during the time a security interest in the same property is unperfected.¹⁴⁰ Accordingly, under the terms of section 544(a) the bankruptcy trustee may assert the rights of a hypothetical creditor under section 9-301(1)(b).¹⁴¹ Consequently, the trustee will prevail over most Article 9 claimants whose interests are not perfected at the date the petition is filed.

The trustee's powers under section 544 are limited, however, by section 546(b) of the Bankruptcy Act.¹⁴² Under section 546(b), if an interest holder at the date of bankruptcy still has the opportunity to perfect his interest against an intervening creditor under applicable state law, the interest holder may perfect against the trustee.¹⁴³ This section allows a secured party who is unperfected at the date of bankruptcy to perfect his security interest if the state grace period for filing has not yet expired. Section 9-301(2) is a "generally applicable law" under section 546(b).¹⁴⁴ In this case the North Dakota amendment to section 9-301(2), section 41-09-22(2), does not appear to create a problem. The purchase money lender may perfect within the twenty day period and withstand the trustee's attack under section 544(a).¹⁴⁵

As discussed above, a purchase money lender may be

arm clause." S. REP. No. 989, *supra* Note 90, at 85, U.S. CODE CONG. & AD. NEWS at 5871. Section 544(a) provides as follows:

The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by —

(1) a creditor that extends credit to the debtor at the time of the commencement of the case, and that obtains, at such time and with respect to such credit, a judicial lien on all property on which a creditor on a simple contract could have obtained a judicial lien, whether or not such a creditor exists;

....

11 U.S.C. § 544(a).

140. U.C.C. § 9-301(1)(b) (1978). Section 9-301(1)(b) states that "an unperfected security interest is subordinate to the rights of . . . a person who becomes a lien creditor before the security interest is perfected." *Id.* See N.D. CENT. CODE § 41-09-22(1)(b) (1981).

141. WHITE & SUMMERS, *supra* note 32, at 997-98.

142. 11 U.S.C. § 546(b) (Supp. IV 1980). The relevant portion of § 546(b) states that "[t]he rights and powers of the trustee under section 544, 545, or 549 of this title are subject to any *generally applicable law* that permits perfection of an interest in property to be effective against an entity that acquires rights in such property before the date of such perfection." *Id.* (emphasis added).

143. *Id.*

144. S. REP. No. 989, *supra* note 90, at 86, U.S. CODE CONG. & AD. NEWS at 5872. The phrase "generally applicable law" refers to laws that apply both in bankruptcy and outside of bankruptcy. *Id.* The legislative history of § 546(b) specifically mentions § 9-301(2) of the U.C.C. as an example of generally applicable law. *Id.*

145. The legislative history of § 544(a) contains a specific approval of the Code purchase money rule in this context. The report, however, refers specifically to the uniform 10 day period. The House

unperfected at the time the petition is filed and yet defeat the trustee's powers under the preference provisions of section 547.¹⁴⁶ This result also is possible under section 544(a). Normally the filing of a petition in bankruptcy acts as a stay of various actions against the debtor.¹⁴⁷ To the extent the trustee is subject to section 546(b), however, the filing of a petition does not operate as a stay of an act of perfection.¹⁴⁸ Assume a secured creditor makes a purchase money loan to the debtor on July 1. On July 3 the debtor files the bankruptcy petition. The creditor perfects the security interest on July 7. Under section 9-301(2) the creditor's security interest would relate back to July 1 and take priority over a lien creditor whose interests intervene between the taking of the security interest and the filing of the financing statement. Because 544(a) gives the trustee the rights a lien creditor would have under state law, the trustee may not successfully attack the security interest. The North Dakota amendment to section 9-301(2) does not appear to change the result under section 544(a).

Although the recent North Dakota amendment does not seem to create difficulties under section 544, the problems under section 547 cannot be ignored.¹⁴⁹ A great potential exists for confusion about the interaction between section 41-09-22(2), as amended, and section 547. According to the session laws, the bill to amend

report states:

[M]any State laws, under the Uniform Commercial Code, permit perfection of a purchase-money security interest to relate back to defeat an earlier perfected non-purchase-money security interest if the former was perfected within ten days. U.C.C. section 9-301(2). Such perfection would then be able to defeat a hypothetical judicial lien creditor on the date of the filing of the petition. The purpose of the subsection is to protect, in spite of the surprise intervention of bankruptcy petition, those whom State law protects by allowing them to perfect their liens or interests as of an effective date that is earlier than the date of perfection.

H. R. REP. NO. 595, 95th Cong., 1st Sess. 371, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5963, 6327.

146. *See supra* note 116 and accompanying text.

147. 11 U.S.C. § 362(a) (Supp. IV 1980).

148. *Id.* § 362(b)(3). Section 362(b)(3) provides:

(b) The filing of a petition under section 301, 302, or 303 of this title does not operate as a stay —

....
(3) under subsection (a) of this section, of any act to perfect an interest in property to the extent that the trustee's rights and powers are subject to perfection under section 546(b) of this title.

Id. Although the secured party filing after bankruptcy pursuant to § 546(b) is specifically excepted under § 362(b)(3), no corresponding exception exists in the Bankruptcy Act for § 547(e)(2)(C). Hogan, *supra* note 104, at 43 n.23.

149. WHITE & SUMMERS, *supra* note 32, at 999. Professors White and Summers state that while "the trustee will find as many opportunities for the use of section 547 as he will for section 544, section 547 is at least as important to a lawyer." *Id.*

section 41-09-22(2) was introduced by the Committee on Industry, Business, and Labor at the request of the Secretary of State.¹⁵⁰ The Secretary of State explained that the bill "merely changes from 10 days to 20 days, the reason being they (creditors) cannot get the filing done in time between the creditor and the debtor. As an example . . . the creditor may be in North Dakota and the debtor is in Chicago. It will give them more time to get the paper work back and forth."¹⁵¹ This appears to have been the extent of the discussion about the bill.

C. THE EXTENSION OF THE TIME PERIOD IN OTHER STATES

North Dakota, however, is not alone in extending the grace period for purchase money security interests. Other states that have amended section 9-301(2) include the following: Alabama,¹⁵² Georgia,¹⁵³ Illinois,¹⁵⁴ Iowa,¹⁵⁵ Maine,¹⁵⁶ Montana,¹⁵⁷ North Carolina,¹⁵⁸ South Carolina,¹⁵⁹ Tennessee,¹⁶⁰ Texas,¹⁶¹ and Wisconsin.¹⁶² The general rationale is that more time is needed for filing because of delays caused by transit in the mails.¹⁶³

A recent case discussed the effect of the Tennessee filing time extension. In *Jahn v. First Tennessee Bank of Chattanooga (In re Burnette)*¹⁶⁴ the court held that a security interest perfected within the ninety day preference period and within the twenty day perfection period was not preferential.¹⁶⁵

On November 14, 1980, the debtor, Burnette, purchased a truck from a dealer on credit and received possession of the truck.¹⁶⁶ The dealer assigned its security interest to the defendant bank. Twenty days after the sale, December 4, 1980, the bank filed

150. Act of March 11, 1981, ch. 432, § 1, 1981 N.D. Sess. Laws 1202.

151. *Hearing on S.B. No. 2115 Before the Committee on Industry, Business, & Labor*, 47th Leg. Sess. (1981) (statement of Ben Meier, Secretary of State).

152. ALA. CODE § 7-9-301(2) (Supp. 1981) (20 days).

153. GA. CODE § 109A-9-301(2) (Supp. 1981) (15 days).

154. ILL. ANN. STAT. ch. 26, § 9-301(2) (Smith-Hurd Supp. 1982-83) (20 days).

155. IOWA CODE ANN. § 554.9301(2) (West Supp. 1982-83) (20 days).

156. ME. REV. STAT. ANN. tit. 11, § 9-301(2) (Supp. 1982-83) (20 days).

157. MONT. CODE ANN. § 30-9-301(2) (1981) (20 days).

158. N.C. GEN. STAT. § 25-9-301(2) (Supp. 1981) (20 days).

159. S. C. CODE ANN. § 36-9-301(2) (Supp. 1982) (20 days).

160. TENN. CODE ANN. § 47-9-301(2) (1979 & Supp. 1982) (20 days).

161. TEX. BUS. & COMM. CODE ANN. § 9-301(b) (Supp. 1981) (20 days).

162. WIS. STAT. ANN. § 409.301(2) (West Supp. 1981-82) (20 days).

163. COOGAN, HOGAN & VAGTS, *supra* note 72, § 9C.06(e), at 410 (Supp. 1982).

164. 14 Bankr. 795 (E.D. Tenn. 1981).

165. *Jahn v. First Tennessee Bank of Chattanooga (In re Burnette)*, 14 Bankr. 795, 802 (E.D. Tenn. 1981).

166. *Id.* at 796.

an application for a certificate of title noting its lien.¹⁶⁷ The debtor filed a petition in bankruptcy on February 11, 1981, and the bankruptcy trustee brought suit to avoid the bank's security interest in the truck.¹⁶⁸ The trustee argued that a preferential transfer had occurred because perfection took place twenty days after the security interest was transferred.¹⁶⁹ The bank, on the other hand, argued that under Tennessee law its security interest was "continuously perfected" from the time of the sale.¹⁷⁰ The issue was whether the transfer was for or on account of an antecedent debt.¹⁷¹

To determine whether antecedency existed, the court had to resolve the conflict between the twenty day grace period of section 47-9-301(2) of the Tennessee Code¹⁷² and the ten day grace period of section 547 of the Bankruptcy Act. The court dismissed the trustee's argument that the state grace period was irrelevant because the federal preference statute was controlling.¹⁷³ The court found that a reference to state law is required under the preference statute to determine when a transfer is perfected.¹⁷⁴

The court examined the legislative history of section 547 and admitted that "Congress intended for ten days to be a uniform grace period."¹⁷⁵ The court noted that section 60, the forerunner of section 547, made state grace periods expressly relevant. These state grace periods, however, created problems.¹⁷⁶ Therefore, the court reasoned that Congress desired to eliminate the problems by

167. *Id.* The court found that the bank's security interest was perfected when this application was filed. *Id.*

168. *Id.*

169. *Id.*

170. *Id.* According to the bank, no preferential transfer existed. Because perfection occurred within the twenty day grace period of the Tennessee Code, the bank argued that its security interest was perfected from the time of attachment. The bank claimed that its security interest was perfected under both state law and the definition of perfection in the Bankruptcy Act. *Id.* at 802.

171. *Id.* at 796. The court found that the other elements of a preferential transfer were satisfied. *Id.*

172. TENN. CODE ANN. § 47-9-301(2) (1979 & Supp. 1982). Section 47-9-301(2) provides in part:

If the secured party files with respect to a purchase money security interest before or within *twenty (20) days* after the collateral comes into the possession of the debtor, he takes priority over the rights of . . . a lien creditor which arise between the time the security interest attaches and the time of filing.

Id. (emphasis added). Compare N.D. CENT. CODE § 41-09-22(2) (Supp. 1981), which also provides a 20 day grace period.

173. 14 Bankr. at 801. The court concluded, however, that "Congress did not intend for state grace periods to be relevant under the preference statute." *Id.*

174. *Id.*

175. *Id.* The court recognized this intent several times throughout the opinion: "The idea was that the preference statute should establish a uniform grace period." *Id.* at 798-99. Again, the court noted that "Congress set the grace period at ten days, apparently so that the preference statute would treat secured creditors the same as state law." *Id.* at 800.

176. For a discussion of the problems created by state grace periods, see *supra* notes 66-77 and accompanying text.

subordinating state grace periods to section 547.¹⁷⁷ The court found that when Congress intended for grace periods to limit the trustee's powers, Congress expressly provided for these limits. As an example of this congressional intent, the court discussed the limits sections 546(b) and 362(b)(3) place on the trustee's powers under section 544(a).¹⁷⁸ The court concluded:

It is evident that Congress did not intend for state grace periods to be relevant under the preference statute. There was to be a uniform rule throughout the nation. In any jurisdiction, a transferee was to have only ten days to perfect a transfer and thereby avoid the antecedent debt problem. Ten days was picked apparently because it corresponded to state law, but Congress did not specifically refer to grace periods under state law.¹⁷⁹

Thus, the court recognized that Congress intended the ten days to be a uniform rule, but nevertheless stated that the definition of perfection was to be interpreted in a manner most appropriate to its wording.¹⁸⁰ According to the Gilmore Committee definition, perfection cannot occur until "(1) any act required of perfection (e.g. filing) has been accomplished and (2) 'an interest in property' has been transferred."¹⁸¹ The court stated that this definition should mean that Article 9 security interests "are perfected at the moment when the last event required for perfection under Article 9 occurs."¹⁸²

The court found, however, that this definition of perfection could be interpreted in two ways, depending on the tense of the definition.¹⁸³ Under the first interpretation the court examined the statement "[a] security interest 'is perfected' when a creditor 'cannot' acquire a superior judicial lien."¹⁸⁴ When perfection is used in this tense, the court found that it must look at the facts at any moment in time. The court posed the following hypothetical:

Suppose that a bank has a purchase money security interest that it has not filed to perfect, but the twenty day

177. 14 Bankr. at 801. The court found that Congress could have followed the example set by § 60 if Congress had wished state grace periods to be relevant under § 547. *Id.* at 800.

178. *Id.* at 800. For a discussion of the limits on the trustee's powers, see *supra* notes 116-25 and accompanying text.

179. *Id.* at 801.

180. *Id.* at 801.

181. *Id.* (quoting H.R. REP. NO. 595, 95th Cong., 1st Sess. 209, 218-19 (1977)).

182. 14 Bankr. at 802.

183. *Id.* at 801-02.

184. *Id.* at 801.

grace period has not expired. During the grace period and before the bank files, a creditor can possibly acquire a superior judicial lien. That depends on whether the bank actually does file within the grace period. If the bank does, then its security interest will have priority because its perfection will relate back to when the security interest attached, before the creditor acquired the judicial lien. But from the creditor's perspective, it could not know what was going to happen when it acquired its judicial lien.¹⁸⁵

The court found this interpretation of "perfection" to be consistent with congressional intent because perfection cannot occur until the last event required for perfection occurs.¹⁸⁶ The court stated, however, that this approach strained the wording of the definition because a court is required "to consider the facts from an earlier perspective, rather than as they turned out."¹⁸⁷

Because this interpretation was strained, the court chose a second approach. The court found that the best approach was to view the definition of perfection as referring to a period of time rather than a moment in time. The court stated "the definition means a security interest is perfected during any period of time when a creditor cannot acquire a superior judicial lien. The period of time can begin before the last step necessary for perfection occurs."¹⁸⁸

The court found this approach more reasonable because it was "less troublesome," even though the first interpretation agreed with the congressional intent.¹⁸⁹ Because the court chose the second interpretation of "perfection," the court held that the bank was "continuously perfected" during both the twenty day and the ten day grace period of the preference statute.¹⁹⁰ As a result the bank's security interest was "perfected from the time it attached, both under state law and under the definition of perfection in the preference statute. There was no transfer on account of an antecedent debt."¹⁹¹

Several observations should be made about the court's conclusion that the transfer was not for an antecedent debt. The

185. *Id.*

186. *Id.*

187. *Id.*

188. *Id.* The court noted that the words "perfection" and "perfected" have a dual meaning. *Id.* n.7. The court stated that "[t]hey describe the act of perfecting a security interest or its state of being perfected." *Id.*

189. *Id.* at 801.

190. *Id.* at 802.

191. *Id.* The court also held that the transfer was substantially contemporaneous within the

court is correct in stating that the bank's security interest was perfected on December 4, the day the bank filed an application for a certificate of title with its lien noted. Because this filing occurred during the twenty day period, between November 14 and December 4, no "creditor . . . [could] acquire a judicial lien . . . superior to the interest of the transferee," the bank.¹⁹² Under the Tennessee Code the bank was continuously perfected. The importance, however, of sections 547(e)(1) and (2) for purposes of antecedency is two-fold: section 547(e)(1) defines perfection and section 547(e)(2) specifically provides rules for determining when a transfer occurs. Because perfection is referred to in section 547(e)(2) only to fix the date of transfer, the single question left to state law is what acts constitute perfection.¹⁹³

The bank argued that it was perfected during both the twenty day period and the ten day period.¹⁹⁴ This argument presents no conflict with section 547. It does not, however, resolve the issue of antecedency, because the date of the transfer is necessary to determine antecedency. The general rule is that a transfer is made at the time it is perfected.¹⁹⁵ The exception to this general rule is that if a transfer is perfected within ten days of attachment of the security interest, the date of attachment is the date of transfer.¹⁹⁶ Section 547(e)(2) does not state that if a transfer is continuously perfected during the ten days after the transfer, then perfection is deemed to occur at the time of the transfer.

The court's reasoning appears to be that because the bank was perfected from the time the security interest attached on November

meaning of 11 U.S.C. § 547(c)(1) and therefore, the transfer was not preferential. *Id.* at 802-03. The court recognized that § 547(c)(1) was not meant to apply to credit situations. *Id.* at 802. The court found, however, that the exception was broad enough to encompass the case before it because the 20 day grace period provided "a good indication of what should be expected of secured parties." *Id.* at 803. *But see* Exchange Bank of Polk County v. Christian (*In re Christian*), 8 Bankr. 816, 819 (M.D. Fla. 1981) ("[T]he first exception to the Trustee's voiding power . . . dealing with contemporaneous transactions is not applicable to situations involving security interests.").

192. 11 U.S.C. § 547(e)(1)(B) (Supp. IV 1980).

193. W. COLLIER, *supra* note 104, ¶ 547.46, at 547-136.1. This perfection concept is emphasized in the following discussion of which law governs in bankruptcy:

The idea of supremacy of state law is confined to the field just discussed, *i.e.*, what constitutes perfection of a transfer. The question of *whether* the transfer is preferential and avoidable by the trustee is governed by section 547. Thus a state rule that a creditor may be preferred and if able to obtain the property before its seizure under process, can hold it for his debt, must yield to the provisions of section 547. What constitutes the general frame work of section 547 is a federal question, whether presented in a state or federal court, upon which the United States Supreme Court is the final arbiter.

Id. (emphasis added) (footnotes omitted).

194. 14 Bankr. at 797.

195. *See* 11 U.S.C. § 547(e)(2) (Supp. IV 1980). For a discussion of the timing provisions of section 547, see *supra* notes 103-08 and accompanying text.

196. 11 U.S.C. § 547(e)(2).

14, under section 547(e)(2) the transfer was not on account of an antecedent debt. The court does not clearly address the issue of when the transfer occurred. Under section 547(e)(2)(B) the transfer did not occur on November 14, but rather on December 4, the date of perfection.¹⁹⁷ The debt arose on November 14 and therefore, the transfer on December 4 was "for or on account of an antecedent debt owed by the debtor before such transfer was made."¹⁹⁸

The determination of when a transfer is perfected and what acts constitute perfection under section 547(e) depend on state law.¹⁹⁹ The relevance of state law, however, is limited to this area.²⁰⁰ The Bankruptcy Act governs what acts constitute a transfer, when a transfer occurs, whether a transfer is preferential, and whether the trustee may avoid the transfer.²⁰¹ The result reached in *Jahn* is contrary to this principle. The holding ignores the congressional intent of preempting state grace periods in preference cases.²⁰² The effect of the decision is to subject the Bankruptcy Act to the variances of state law.

Conversely, the Code itself recognizes the preeminence of federal law. Section 9-104(a) states that "[t]his Article does not apply . . . to a security interest subject to any statute of the United States, to the extent that such statute governs the rights of parties to and third parties affected by transactions in particular types of property."²⁰³ The Bankruptcy Act is clearly a statute of the United

197. *Id.* § 547(e)(2)(B). According to § 547(e)(2)(B) a transfer perfected after 10 days of the date of attachment is deemed to occur on the date of perfection. *Id.*

198. *Id.* § 547(b)(2).

199. See *supra* note 106 and accompanying text.

200. See *Furedy v. Appleman (In re Vodeco Volume Development Co., Inc.)*, 567 F.2d 967 (10th Cir. 1977). In *Appleman* the court concluded that "although the procedure to be followed in perfecting a security interest in the property of a bankrupt is determined in accordance with state law, the time at which 'perfection' becomes effective against the trustee in bankruptcy is determined by federal law." 567 F.2d at 970. (emphasis in original). See also *E. F. Corp. v. Smith*, 496 F.2d 826, 830 (10th Cir. 1974) (time of transfer is determined by federal law, but state law determines the perfection); *Selby v. Ford Motor Co.*, 405 F. Supp. 164, 170 (E.D. Mich. 1975) (when a transfer is perfected depends upon State law); *Ford Motor Credit Co. v. Ken Gardner Ford Sales, Inc. (In re Ken Gardner Ford Sales, Inc.)*, 10 Bankr. 632, 643 (E.D. Tenn. 1982) (perfection relates back only as allowed by the preference statute); *Palmer v. Morford (Matter of Canup Mechanical, Inc.)*, 1 Bankr. 703, 704 (M.D. Fla. 1979) (perfection of an interest in bankrupt property is determined by state law; time of the transfer is determined by federal law).

201. *W. COLLIER, supra* note 104, ¶547.46, at 547-136.1. *Collier* illustrates the supremacy of the federal Bankruptcy Act in the following example:

In State B, assume that recording is required, but that this may be done within thirty days, or within a "reasonable time," or that no time limit is fixed. Here, if the security interest is recorded within ten days after it was given, it will not be treated as a transfer for an antecedent debt, but if recording is delayed beyond that time (even though effected within the thirty days allowed by state law), its preferential character will be judged as of the recording date, and the debt will be antecedent.

Id. at 547-136.3-4.

202. Although the court expressly recognizes the intent of Congress, the court makes no attempt to reconcile its holding with this intent. The court merely states that its approach "is less troublesome than the interpretation that agrees with Congress's [sic] intent." *Jahn*, 14 Bankr. at 802.

203. U.C.C. § 9-104(a) (1978). The comment to § 9-104 expands upon the concept of federal

States which governs the rights of such parties.

VI. CONCLUSION

Unfortunately the *Jahn* case is the only reported case dealing with the conflict between the ten day period of section 547(e)(2)(A) and the twenty day period of section 9-301(2), as amended. Therefore, it is difficult to speculate what other courts will decide when presented with the issue. Considering the intent of Congress in enacting section 547 and the problems with the twenty day provision, the courts should follow the principle of federal supremacy. While the new Bankruptcy Act has not solved all the problems of interaction with the Uniform Commercial Code, a certain consistency has been achieved.²⁰⁴

Because of the uncertainty which now exists, secured creditors should perfect security interests within ten days and ignore the twenty day amendments. As noted by Professor Krahmer, since "the gift of prescience is not common among secured creditors, a debtor's future bankruptcy should always be considered a potential risk, and filing within ten instead of twenty days is a virtually cost free means of avoiding a substantial part of that risk."²⁰⁵ In the meantime other state legislatures should not extend the filing period beyond the uniform ten day period. Those states that have done so already should consider returning to the uniform ten day period to avoid wasteful and costly litigation.²⁰⁶

PAMELA A. DUGGER

supremacy. Comment 1 states that "[w]here a federal statute regulates the incidents of security interests in particular types of property, those security interests are of course governed by the federal statute and excluded from this Article." *Id.*, Comment 1.

204. For discussions of some problem areas that still exist, see Hogan, *supra* note 104; Mann & Phillips, *Section 546(c) of the Bankruptcy Reform Act: An Imperfect Resolution of the Conflict Between the Reclaiming Seller and the Bankruptcy Trustee*, 54 AM. BANKR. L.J. 239 (1980); Mann & Phillips, *The Reclaiming Seller Under the Bankruptcy Reform Act: Resolution or Renewal of an Old Conflict?*, 33 VAND. L. REV. 1 (1980); Nimmer, *Security Interests in Bankruptcy: An Overview of Section 547 of the Code*, 17 HOUS. L. REV. 289 (1980).

205. Krahmer, *Commercial Transactions*, 34 S.W. L.J. 199, 222 (1980). See also Walker, *Creation, Perfection, & Enforcement of Security Interests Under the "Tennessee" Commercial Code*, 48 TENN. L. REV. 819, 926 (1981) ("A creditor would be well advised to perfect a security interest within ten days of the transfer regardless of state law.").

206. In February 1983 Representative Glenn Pomeroy introduced a bill to amend § 41-09-22(2) of the North Dakota Century Code. H.B. 1609, 48th Leg., Sess. (1983). The purpose of the bill was to change the 20 day grace period back to 10 days. *Id.* During discussion of the bill Representative Pomeroy noted the potential problems the current 20 day period presents. *Hearing on H.B. No. 1609 Before the Committee on Industry, Business & Labor*, 48th Leg. Sess. (1983). Tom Kelsh of the North Dakota Bankers Association stated that the 20 day period creates a trap for the unwary. *Id.* In response to the question of whether any bankers had complained about the 20 day period, Mr. Kelsh responded no. *Id.* A motion to do not pass the bill was made by Representative Elmer Retzer. This motion was carried by a vote of 12 yes and 4 no. On February 9, 1983, House Bill 1609 was voted on by the House of Representatives. N.D. H. JOUR., Feb. 9, 1983, at 875. The final vote was 52 yeas, 51 nays, 3 absent and not voting. *Id.* The bill was declared lost for lack of a constitutional majority. *Id.* at 876. Therefore, the grace period for filing purchase money security interests in North Dakota is still 20 days.