1984

Section 547(c)(1) and Delayed Perfection of Security Interests in the Ninth Circuit: In re Vance, 721 F.2d 259 (9th Cir. 1983)

Richard F. Duncan
University of Nebraska College of Law, rduncan2@unl.edu

Follow this and additional works at: http://digitalcommons.unl.edu/lawfacpub
Part of the Legal Studies Commons

Duncan, Richard F., "Section 547(c)(1) and Delayed Perfection of Security Interests in the Ninth Circuit: In re Vance, 721 F.2d 259 (9th Cir. 1983)" (1984). College of Law, Faculty Publications. 149.
http://digitalcommons.unl.edu/lawfacpub/149

This Article is brought to you for free and open access by the Law, College of at DigitalCommons@University of Nebraska - Lincoln. It has been accepted for inclusion in College of Law, Faculty Publications by an authorized administrator of DigitalCommons@University of Nebraska - Lincoln.
Section 547(c)(1) and Delayed Perfection of Security Interests in the Ninth Circuit:

_In re Vance, 721 F.2d 259 (9th Cir. 1983)_

by

Richard F. Duncan*

Recently, in _In re Vance_, the Ninth Circuit had an opportunity to construe section 547(c)(1) of the Bankruptcy Reform Act of 1978, the so-called “substantially contemporaneous exchange exception” to the trustee’s power to avoid preferential transfers, in the context of a belatedly perfected secured transaction. The court applied the exception narrowly and mechanically, and thereby failed to recognize the legitimate contractual expectations of secured creditors who act to perfect their security interests within a commercially reasonable period of time.

_In Vance_, the secured party, Valley Bank, made a purchase money loan to the debtor on November 18, 1981, to enable him to purchase a utility trailer. At the same time, the secured party retained a security interest in the trailer and mailed the lien documents to the county assessor for recordation. However, it was not until fourteen days later, on December 2, 1981, that the bank’s security interest was perfected under Idaho law by recordation on the certificate of title covering the trailer. The debtors filed for bankruptcy on January 29, 1982, and, when Valley Bank sought relief from the automatic stay to foreclose its security interest in the trailer, the trustee counterclaimed seeking to set aside the lien as a preference under section 547(b) of the Bankruptcy Reform Act.

The bankruptcy court upheld the trustee’s counterclaim, avoided the bank’s security interest in the trailer, and refused to apply section 547(c)(1) to belatedly perfected security interests. The district court affirmed the

---

*Associate Professor of Law, University of Nebraska College of Law. This article relies heavily on an earlier article published by the author in the Nebraska Law Review. Because the author believes the Ninth Circuit in _Vance_ neglected to consider the clear language, historical development and policy goals of section 547(c)(1) he has revisited the subject. As Andre Gide once observed, “[e]verything has been said already; but as no one listens, we must always begin again.”

1721 F.2d 259 (9th Cir. 1983).


3721 F.2d at 259–60. See also _In re Vance_, 22 Bankr. 26, 27 (Bankr. D. Idaho 1982).

422 Bankr. at 28–29.
bankruptcy court's decision, and the bank appealed to the Ninth Circuit arguing that its security interest in the trailer was protected as a substantially contemporaneous exchange under section 547(c)(1). The Ninth Circuit affirmed.

I. THE COURT'S ANALYSIS

There was no question in Vance that Valley Bank's security interest was a preference under section 547(b). However, once the trustee succeeds in establishing all of the elements of a section 547(b) preference, it then becomes necessary to consider the possible application of section 547(c), which enacts a number of exceptions to the general rules of preference law in bankruptcy. Section 547(c) recognizes that certain transactions constituting preferences under section 547(b) should nevertheless be protected from the reach of the trustee to the extent necessary to effectuate overriding considerations of policy.

In Vance, the only provision that might have protected Valley Bank's security was section 547(c)(1), which provides an exception from preference attack for an otherwise preferential transfer to the extent that such transfer was: (1) intended by the parties to be a contemporaneous exchange for new value, and (2) in fact a "substantially contemporaneous exchange." Following what it termed the "majority view" of cases narrowly applying section 547(c)(1) in the context of the delayed perfection problem, the Ninth Cir-

---

1 In re Vance, 36 Bankr. 69 (D. Idaho 1983). 
2 See In re Vance, 721 F.2d at 260. 
3 See In re Vance, 36 Bankr. at 70. Under 11 U.S.C. § 547(e)(2)(A), a transfer of a security interest in personal property is deemed to be made, for purposes of bankruptcy preference law, at the time it attaches under U.C.C. § 9–203, provided it is perfected not later than 10 days after attachment. However, if the secured party perfects outside this 10-day grace period, the transfer is deemed to be made at the time of perfection. 11 U.S.C. § 547(e)(2)(B). Thus, in Vance, Valley Bank's security interest was transferred at the time of perfection on December 2, 1981, within 90 days of bankruptcy and on account of the antecedent loan made on November 18, 1981. See 11 U.S.C. § 547(b). 
4 The term "new value" is defined in section 547(a)(2): 
   (2) "new value" means money or money's worth in goods, services, or new credit, or release by a transferee of property previously transferred to such transferee in a transaction that is neither void nor voidable by the debtor or the trustee under any applicable law, but does not include an obligation substituted for an existing obligation. 
5 In re Vance, 721 F.2d at 260. 
6 See, e.g., In re Murray, 27 Bankr. 445 (Bankr. M.D. Tenn. 1983), aff'd, 33 Bankr. 112 (M.D. Tenn. 1983); In re Davis, 22 Bankr. 644 (Bankr. M.D. Ga. 1982); In re Enlow, 20 Bankr. 480 (Bankr. S.D. Ind. 1982); In re Christian, 8 Bankr. 816 (Bankr. M.D. Fla. 1981). The line of cases referred to by the court in Vance is not a majority, but rather merely a plurality. There is also substantial authority for applying the substantially contemporaneous exchange exception broadly to protect security interests that are (1) created in exchange for contemporaneous new value and (2) perfected within a commercially reasonable
The court began its analysis by quoting from the legislative history of section 547(c)(1), which provides:

The first exception is for a transfer that was intended by all parties to be a contemporaneous exchange for new value, and was in fact substantially contemporaneous. Normally, a check is a credit transaction. However, for the purposes of this paragraph, a transfer involving a check is considered to be “intended to be contemporaneous,” and if the check is presented for payment in the normal course of affairs, which the Uniform Commercial Code specifies as 30 days, U.C.C. Sec. 3–503(2)(a), that will amount to a transfer that is “in fact substantially contemporaneous.”

According to the court, this legislative history indicates that Congress “was specifically concerned with transactions involving payment by check or other cash equivalent transactions” and did not intend section 547(c)(1) to be “a general exception covering a variety of transactions.” Thus, applying section 547(c)(1) to belatedly perfected purchase money security interests would inappropriately “expand the scope of the exception far beyond the contemplation of Congress.”

The court found additional support for its decision not to apply section 547(c)(1) to Valley Bank’s security from section 547(c)(3), the so-called time thereafter. See, e.g., In re Martella, 22 Bankr. 649 (Bankr. D. Colo. 1982); In re Burnette, 14 Bankr. 795 (Bankr. E.D. Tenn. 1981); In re Hall, 14 Bankr. 186 (Bankr. S.D. Fla. 1981). See also In re Lyon, 35 Bankr. 759 (Bankr. D. Kansas 1982). As this article was being prepared for publication, the Sixth Circuit joined the Ninth Circuit in refusing to apply section 547(c)(1) to the delayed perfection problem. See In re Arnett, No. 82–5098 (6th Cir. April 10, 1984) (slip opinion). Since the reasoning of the Sixth Circuit in Arnett closely parallels the reasoning of the Ninth Circuit in Vance, this article’s analysis of Vance is equally applicable to Arnett.

1121 F.2d at 260–62.
13721 F.2d at 261.
14Id.
15Section 547(c)(3) provides:
(c) The trustee may not avoid under this section a transfer—
(3) 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.

enabling loan exception, which specifically protects certain purchase money security interests from the trustee’s preference powers. Since application of section 547(c)(1) to enabling loan transactions “would make section 547(c)(3) superfluous,” the court concluded that the substantially contemporaneous exchange exception should not be applied to belatedly perfected secured transactions.

II. CRITICAL ANALYSIS OF THE HOLDING IN VANCE

A. IN GENERAL

Although the reasoning of the Ninth Circuit in Vance is superficially appealing, when the language and logic of section 547(c)(1) are held up against the history and policy goals of bankruptcy preference law, the inescapable conclusion is that the decision in Vance is erroneous.

For example, the court’s reliance on the legislative history of section 547(c)(1) is misplaced. This sparse and inconclusive legislative history neither states nor implies that Congress intended the substantially contemporaneous exchange provision to be a specific exception applicable only to cash or quasi-cash transactions; at most, it suggests that Congress enacted the Bankruptcy Reform Act without a clear understanding of the potential significance of section 547(c)(1). Moreover, the unambiguous and sweeping language of section 547(c)(1) rejects the court’s narrow and mechanical construction—the exception protects all “transfers,” including transfers of security interests, that are intended to be given in exchange for “new value,” including the extension of “new credit,” and that satisfy the requirement of substantial contemporaneity.

1721 F.2d at 261.
17Id. at 261–62. The court applied the traditional latin maxim “expressio unius est exclusio alterius” to bolster its conclusion that section 547(c)(3) was the exclusive exception protecting purchase money security interests. Id. at 261. The holding in Vance was thus concerned only with the inapplicability of the substantially contemporaneous exchange exception to purchase money security interests. However, the Ninth Circuit’s decision probably affects all security interests, because it is unlikely that the court would be willing to give more protection to non-purchase money security interests than it affords to the traditionally favored purchase money security interest.
18See supra notes 12–14 and accompanying text.
19The pertinent portion of the House Report is quoted in the text accompanying note 12 supra. The reference therein to payment by check as a substantially contemporaneous exchange is simply by way of example. There is no indication in the House Report that section 547(c)(1) is intended to apply only to cash or quasi-cash transactions. See House Report, supra note 12, at 373, reprinted in 1978 U.S. Code Cong. & Ad. News 5963, 6329.
20See Duncan, supra note 2, at 219.
2211 U.S.C. § 547(a)(2). The text of section 547(a)(2) is quoted in full at note 8 supra.
2311 U.S.C. § 547(c)(1).
B. HISTORICAL DEVELOPMENT OF SECTION 547(c)(1)

The historical development of the substantially contemporaneous exchange exception also suggests that a restrictive construction is inappropriate. The source of section 547(c)(1) is the United States Supreme Court and its holdings in two leading cases decided under the former bankruptcy act, Dean v. Davis and National City Bank v. Hotchkiss. In the Dean case, the Supreme Court held that the transfer of a mortgage deed of trust covering most of the debtor's property was not a preference even though it was not executed and recorded until more than a week after the loan secured thereby had been made. Since the parties had from the outset intended a secured transaction, and the transfer of the mortgage was "substantially contemporary" with the making of the loan, the Court concluded that the transfer had not been made on account of an antecedent debt. Conversely, in Hotchkiss the Court held that a preference resulted when a lender made an unsecured loan to the debtor in the morning and, after learning of the debtor's financial difficulties, demanded and received a transfer of security later the same day. Since the parties did not originally intend the loan to be secured, the subsequent transfer of security was on account of an antecedent indebtedness and therefore preferential.

As in Dean and Hotchkiss, the key inquiry under section 547(c)(1) is whether the parties at the outset intended a contemporaneous exchange. If it is determined that a contemporaneous exchange was intended, the transferee will be protected against the trustee's preference attack, provided the exchange was completed within a reasonable period of time. Thus, a potentially large number of transactions could be protected by section 547(c)(1). However, the cases are almost evenly split on the question of application of section 547(c)(1) to security interests that are not perfected.

---

242 U.S. 438 (1917).
221 U.S. 50 (1913).
242 U.S. at 442-43.
223 U.S. at 55-58.
2See In re Saco Local Dev. Corp., 25 Bankr. 876, 879 (Bankr. D. Me. 1982); In re Fabris Buys of Jericho, Inc., 22 Bankr. 1013, 1016 (Bankr. S.D.N.Y. 1982); In re Rosman, 20 Bankr. 569, 572-73 (Bankr. N.D. Ohio 1982). Although interesting questions of proof of the intent element may arise in certain situations, see, e.g., In re T.I. Swartz Clothiers, Inc., 15 Bankr. 590 (Bankr. E.D. Va. 1981), the intent of the parties to exchange contemporaneous value should be easy to prove in the typical delayed perfection case. There, the secured party will usually have documentation, delivered at the closing of the loan, such as a note, a loan agreement, and a security agreement, evidencing the parties' intent to enter into a secured transaction. See In re Lyon, 35 Bankr. 759, 762 (Bankr. D. Kansas 1982).
2The Bankruptcy Reform Act contains no guidance as to the meaning of "substantially contemporaneous exchange." The better-reasoned bankruptcy cases apply a case-by-case approach and consider all of the factors bearing on the commercial reasonableness of the delay. See, e.g., In re Arnett, 13 Bankr. 267, 269 (Bankr. E.D. Tenn. 1981), aff'd, 17 Bankr. 912 (E.D. Tenn. 1982), rev'd, No. 82-5098 (6th Cir. April 10, 1984) (slip opinion) (delay of 33 days held substantially contemporaneous where, after considering all of the surrounding facts, the trial court concluded that the transferee had "satisfactorily explained the delay").
within the ten-day grace period established by section 547(e). The author of this article believes that the better-reasoned cases are those that, unlike Vance and its camp followers, adopt a purposive approach to the delayed perfection problem and apply section 547(c)(1) broadly to security interests, whenever perfected, that meet its requirements.

C. Policy Analysis

In Vance, the Ninth Circuit made no attempt to consider the purposes and goals of section 547 of the Bankruptcy Reform Act. This oversight, perhaps more than any other flaw in the court’s reasoning, casts doubt on its decision to narrowly apply the substantially contemporaneous exchange exception.

Bankruptcy preference law is one of the major battlegrounds in the war between secured and unsecured creditors. One of the primary goals of bankruptcy law is to minimize the social costs of bankruptcy by spreading the risk of the debtor’s financial collapse among all of his or her creditors. To the extent that security interests are recognized and enforced in bankruptcy, these costs are borne disproportionately by unsecured creditors. However, bankruptcy law is not intended to interfere with the legitimate contractual expectations of creditors who bargain for security against the risk of the borrower’s insolvency. Bankruptcy is the litmus test of security, and to deny protection to secured creditors in bankruptcy would have a potentially disastrous effect on the cost and availability of both consumer and commercial credit. Bankruptcy preference law, and in particular gray areas such as section 547(c)(1), should be construed purposively and with due regard being given to the interests of both secured and unsecured creditors.

Under what circumstances are the purposes of preference law undercut by recognition of security interests in bankruptcy? Let’s look at three cases.

Case 1

First, consider the classic example of preferential security, a security interest given during the preference period to secure a preexisting, unsecured obligation. This transfer offends preference policy because it is the equivalent of a cash payment made on the eve of bankruptcy to a general creditor—assets of the debtor that ought to be included in the bankruptcy distribution to all creditors have been encumbered for the benefit of a

30See cases cited at note 10 supra; Duncan, supra note 2, at 212-215.
31See Jackson & Kronman, Voidable Preferences and Protection of the Expectation Interest, 60 Minn. L. Rev. 971, 989 (1976).
32See id.
33See id. at 988-89.
favored creditor who had no legitimate expectation of preferential treatment.

Case 2

In contrast, when a creditor extends new credit on a secured basis to the debtor and immediately perfects its lien, no preference results;³⁴ although the debtor's assets are being tied up for the benefit of a particular creditor, the secured party legitimately expects, and receives, protection in bankruptcy for two reasons: (1) it never intended to extend unsecured credit to the debtor—the security was negotiated in connection with the making of the loan and was an integral factor in the secured lender's calculation of the risk and cost of the credit; and (2) the transaction did not deplete the debtor's estate available for distribution to other creditors, because the debtor received equivalent value, i.e., the proceeds of the loan, contemporaneously with the transfer of the security.

Case 3

Now consider the problem of delayed perfection of a security interest given by the debtor to secure a contemporaneous extension of credit. Is this scenario more like Case 1 or Case 2 above? Clearly, the answer is the latter—there is no difference in economic effect between Case 2 and Case 3, because in each case contemporaneous exchanges of equivalent value have been made. Yet, it is just as clear that section 547(e) treats Case 3 as a transfer on account of an antecedent debt, if the security interest is not perfected within the ten-day grace period following attachment.³⁵ What is being accomplished by this employment of section 547(e), and how does section 547(c)(1) figure in the design?

The ten-day rule for perfection of security interests established by section 547(e) is an attempt by Congress to employ preference law to avoid a class of transfers, so-called "secret liens," that are not true preferences.³⁶ Bankruptcy condemns true preferences because of their economic consequences—the goal of preference law is to prevent a general, unsecured creditor from improving its position, at the expense of other, similarly situated creditors, by a bankruptcy-eve transfer of property of the debtor.³⁷ An exchange of concurrent value between debtor and creditor, such as a transfer of collateral to secure a loan being made at the same time, does not

³⁶"The purpose [of section 547(e)(2)(B)] is to protect other creditors who may rely on the public record by punishing the negligent creditor who fails to record his security interest within ten days." In re Hall, 14 Bankr. 186, 187 (Bankr. S.D. Fla. 1981).
offend this policy, because the secured party does not thereby improve its preexisting position at the expense of other creditors. However, unperfected transfers of security are condemned because of the danger that other creditors dealing with the debtor will be misled by the unencumbered facade of the debtor's assets.

The existence of an antecedent debt, which is at the core of preference policy, is, therefore, completely irrelevant to the Bankruptcy Reform Act's hostility toward secret liens. Since the primary function of section 547(e) is to date transfers for purposes of the antecedent debt requirement, it is an inappropriate tool for dealing with the secret lien problem in bankruptcy. Moreover, it is clear that in at least some cases belatedly perfected security interests that offend neither preference nor secret lien policy are treated as preferential under sections 547(b) and 547(e)(2)(B). It is the thesis of this article that purposive construction of section 547(c)(1) may aid in the resolution of this breakdown in bankruptcy policy.

III. A PROPOSED SOLUTION

As discussed above, the case law has produced competing interpretations of the relationship between section 547(c)(1) and the delayed perfection problem. Each of those views is the result of a reasonable attempt to construe a hopelessly inconclusive enactment. However, only one of those views, that broadly applying the substantially contemporaneous exchange exception to belatedly perfected security interests, is true to both the spirit, as well as the letter, of the relevant provisions of the Bankruptcy Reform Act.

In Vance, the Ninth Circuit supported its refusal to apply the substantially contemporaneous exchange exception to the delayed perfection problem with debatable conclusions concerning the intent of Congress. It took the position that the legislative history of section 547(c)(1) and the enactment of a ten-day grace period for perfection of purchase money security in-

---

See id. at 294.
See id. at 737, 757-59. Using preference law as a device for invalidation of secret liens presents problems both of overkill and underkill. Thus, overkill occurs when rigid application of the 10-day rule allows the trustee to employ his or her preference powers to avoid security interests that offend neither preference nor secret lien policy. Underkill can result when one or more of the elements of a preference is absent in a case involving a secret lien. Suppose, for example, that a security interest is created on January 1, 1983, perfected on January 1, 1984, and bankruptcy is filed on April 5, 1984. Although this security interest remained a secret lien for a period of one year, it is not avoidable under section 547(b) unless the transferee is an insider, because the transfer did not occur during the 90-day, prepetition preference period. 11 U.S.C. § 547(b)(4)(A), (e)(1)(B), (e)(2)(B).
terests in section 547(c)(3) demonstrate that Congress intended the substantially contemporaneous exchange exception to protect only cash or quasi-cash transactions.\(^4\) Other courts point to the ten-day grace period for perfection of security interests established by section 547(e)(2)(A) as a further indication of such Congressional intent.\(^5\) This reasoning, although not unreasonable, is both incomplete and ultimately unpersuasive.

As discussed above, the legislative history of section 547(c)(1) is sparse and inconclusive; at most, it suggests that Congress did not have a clear understanding of the potential significance of the substantially contemporaneous exchange exception.\(^6\) Moreover, the argument that applying section 547(c)(1) to the delayed perfection problem would "make superfluous" the grace period of section 547(e)(2)(A) also misses the mark. Since by definition section 547(c) applies only after the trustee has established a section 547(b) preference,\(^7\) application of section 547(c)(1) will always be in connection with a transfer that has already been determined to have been made on account of an antecedent debt under the timing rules of section 547(e).\(^8\) Section 547(c)(1) is intended to be inconsistent with section 547(e); its proper role is to protect recipients of substantially contemporaneous exchanges against the sometimes arbitrary lines drawn by the artificial timing rules of section 547(e).

Neither is there a fatal inconsistency between sections 547(c)(1) and 547(c)(3).\(^9\) Obviously, there is a substantial overlap between section 547(c)(3), which protects certain purchase money security interests that are perfected "before 10 days after" attachment,\(^10\) and a liberal construction of section 547(c)(1), which would protect all security interests created in exchange for new value and perfected within a commercially reasonable time thereafter. However, the legislative history of section 547(c) makes it clear beyond doubt that the several subsections of section 547(c) are intended to be cumulative.\(^11\) Moreover, there is ample room for the coexistence of both

\(^{-721}\) F.2d at 261-62.
\(^{-2}\) For example, Bankruptcy Judge Young mentioned this point in the lower court action in Vance. In re Vance, 22 Bankr. 26, 28 (Bankr. D. Idaho 1982).
\(^{-3}\) See supra notes 18-23 and accompanying text.
\(^{-4}\) See text accompanying note 7 supra; Duncan, supra note 2, at note 15 and accompanying text.
\(^{-5}\) 11 U.S.C. § 547(b)(2), (c)(1), (e). In fact, the sole function of section 547(c)(1) is to protect intended contemporaneous exchanges that, for one reason or another, are postponed (and, therefore, treated as having been made on account of an antecedent debt) under the timing rules of section 547(e).
\(^{-6}\) See supra notes 15-17 and accompanying text.
\(^{-8}\) Subsection (c) contains exceptions to the trustee's avoiding power. If a creditor can qualify under any one of the exceptions, then he is protected to that extent. If he can qualify under several, he is protected by each to the extent he can qualify under each. House Report, supra note 12, at 373, reprinted in 1978 U.S. CODE CONG. & AD. NEWS, 5963, 6329. See In re Martella, 22 Bankr. 649, 651-52 (Bankr. D. Colo. 1982); 4 COLLIER ON BANKRUPTCY ¶ 547.37[1] (15th ed. 1983). In Vance, the Ninth Circuit simply dismissed this unambiguous legislative history as "not persuasive." 721 F.2d at 262.
the substantially contemporaneous exchange and the enabling loan exceptions in the scheme of preference law in bankruptcy. The primary purpose of section 547(c)(3) is to protect from preference attack purchase money security interests when attachment is postponed by delays in the debtor’s acquisition of rights in the collateral. Thus, section 547(c)(3) provides absolute protection to purchase money security interests perfected within its ten-day grace period without regard to whether the transaction constitutes “in fact a substantially contemporaneous exchange.” Consider the following example.

On January 1, 1984, SP lends D $100,000 for the purpose of enabling D to purchase an item of business equipment from X. At the closing of the enabling loan, SP and D enter into an adequate security agreement covering the business equipment, and SP promptly files a financing statement in the proper public office. However, D and X are unable to conclude their negotiations for the purchase of the equipment until March 10, 1984, when D applies the proceeds of the loan to purchase a specific item of equipment. Under section 547(e), the transfer of the security interest occurs on March 10, 1984, when D first obtained rights in the collateral and SP’s security interest simultaneously attached and became perfected. The transfer of the security interest is therefore on account of an antecedent debt (the January 1, 1984 enabling loan), and apparently preferential under section 547(b).

Furthermore, section 547(c)(1) may not apply, because the March 10, 1984 transfer of security probably does not qualify as a substantially contemporaneous exchange for the January 1, 1984 loan. However, section 547(c)(3) should protect this purchase money security interest, because it appears to qualify as an enabling loan transaction and SP’s security interest was perfected before expiration of the 10-day grace period following attachment.

Additionally, the Ninth Circuit’s holding that the existence of section 547(c)(3) precludes application of section 547(c)(1) to purchase money security interests effectively overturns much of the rule of Dean v. Davis.

Suppose, for example, that on January 1, 1984, SP lends D $100,000 for the purpose of enabling D to purchase an item of business equipment from X. D

49See A. Cohen, Bankruptcy, Secured Transactions and Other Debtor-Creditor Matters ¶ 22-206.43[1], at 499–502 (1981). Conversely, a flexible construction of the substantially contemporaneous exchange exception would serve primarily to insulate secured parties against preference attack for commercially reasonable delays in filing, recordation or other perfection requirements.


immediately uses the proceeds of the loan to purchase the equipment. However, although the parties at all times intended the loan to be secured by the equipment, a security agreement is not entered into until January 3, 1984. The security interest is then immediately perfected by filing. What are the trustee’s rights under section 547, when D files for bankruptcy on February 1, 1984? Under section 547(e)(2)(A), the transfer of the security interest occurs on January 3, 1984, when the security interest attached and became effective between the parties. It is therefore on account of an antecedent debt (the January 1, 1984 loan), and apparently a preference under section 547(b). Moreover, section 547(c)(3), the enabling loan exception, does not protect this purchase money security interest, because the purchase money loan was made before the security agreement was entered into between the parties. Section 547(c)(1) and the rule in Dean v. Davis ought to protect this transaction, because (1) the parties from the outset intended a secured transaction, and (2) the making of the loan and the transfer of the security were in fact substantially contemporaneous. And yet, under the confused logic of the Ninth Circuit in Vance, section 547(c)(1) (and, therefore, Dean v. Davis) does not apply in these circumstances.

As noted above, a limited role for the substantially contemporaneous exchange exception is also denied by the unambiguous and sweeping language of section 547(c)(1). Moreover, both equity and commercial reality demand application of the exception to the delayed perfection problem. For example, the ten-day grace periods of sections 547(c)(3) and 547(e)(2)(A) appear to be particularly burdensome when applied to security interests in motor vehicles, trailers, mobile homes, boats and other collateral covered by certificate of title legislation. Typically, these security interests are perfected by notation of the lien on the certificate of title covering the collateral, and not by the filing of an article 9 financing statement. A disproportionate number of the cases decided under the substantially contemporaneous exchange exception involve collateral covered by certificates of title. These cases demonstrate the need for a flexible approach to the delayed perfection problem, because, in at least some cases, moderate delays in perfection can occur in the ordinary course of business.

---

"The hypothetical presented in the text is identical in all material respects with the facts of Dean v. Davis. See supra note 26 and accompanying text.


Id. at § 547(c)(3)(A)(i).

See supra notes 21-23 and accompanying text.


Sec. e.g., In re Burnett, 14 Bankr. 795, 803 (E.D. Tenn. 1981) (secured party perfected its purchase money security interest 20 days after the sale, when it applied for a certificate of title; the court
The legitimate contractual expectations of secured creditors who act to protect their interests within a commercially reasonable time should not be disregarded in bankruptcy unless some overriding purpose is served thereby. No such purpose is furthered by an inflexible approach to the delayed perfection problem. Security interests created in exchange for contemporaneous value and perfected within a commercially reasonable time offend neither preference nor secret lien policy in bankruptcy. Such security interests do not deplete the debtor’s estate for the benefit of a particular creditor; neither do they create an unreasonable risk of misleading other creditors dealing with the debtor. It follows that they should be recognized and enforced in bankruptcy.

In order to achieve this goal, section 547(c)(1) should be construed to protect security interests transferred during the preference period to the extent that such security interests are (1) created in exchange for contemporaneous new value, and (2) perfected within a commercially reasonable time thereafter.

Under this test, the timing rules of section 547(e) will continue to play an important role in the delayed perfection scenario. Security interests perfected within the ten-day grace period will, in general, be entitled to absolute protection against the trustee, because their transfer will relate back to the date of attachment for purposes of the antecedent debt, preference period, and insolvency requirements of section 547(b). Moreover, section 547(e) will still serve to help the trustee satisfy his or her burden of establishing a section 547(b) preference when perfection is delayed beyond expiration of the grace period. Thus, security interests perfected more than ten days after attachment will continue to date from perfection for purposes of the antecedent debt, preference period, and insolvency requirements.

However, once the trustee has established a section 547(b) preference, the proposed construction of section 547(c)(1) will permit the secured creditor to defend its belatedly perfected security against the trustee’s preference attack by demonstrating that the delay was within the bounds of commercial reasonableness (and thus, “in fact substantially contemporaneous”). If the transferee is unable to make the necessary showing of substantial contemporaneity, its belatedly perfected security will be set aside. Thus, the policy of protecting unsecured creditors against secret liens

noted that “as a practical matter it may take a diligent secured party twenty days to perfect”); In re Arnett, 13 Bankr. 267 (Bankr. E.D. Tenn. 1981), aff’d, 17 Bankr. 912 (E.D. Tenn. 1982), rev’d, No. 82-5098 (6th Cir. April 10, 1984) (slip opinion) (delay of 33 days was caused by the holder of a prior security interest who, after being paid off by the secured party, waited nearly a month before releasing its lien and returning the certificate of title covering the collateral).


62 U.S.C. § 547(b)(2)-(4), (e)(2)(B), (f). See supra note 7; Duncan, supra note 2, at 205-09.
is achieved, without interfering with the legitimate contractual expectations of secured creditors, by limiting the trustee's power to invalidate belatedly perfected security interests to those cases in which delays in perfection unreasonably increase the likelihood that unsecured creditors will be misled.

Defining substantial contemporaneity in terms of commercial standards softens the rigidity of the ten-day rule by excusing longer delays that are nevertheless reasonable under the circumstances of the particular case. All factors bearing on the reasonableness of the delay should be considered by the courts when making this determination. Typically, these factors will include: (1) the length and cause of the delay; (2) the likelihood that other creditors might have been misled by the delay; and (3) whether the secured party has acted in good faith and with diligence in attempting to comply with the perfection requirements of applicable state law.63 However, in striving for maximum flexibility, the bankruptcy courts should not lose sight of the ordinary meaning of the phrase "substantially contemporaneous"—lengthy delays in perfection should be tolerated, if at all, only in extreme cases in which the secured party is able to demonstrate that the delay was caused by circumstances beyond its control.

IV. CONCLUSION

The Bankruptcy Reform Act's treatment of belatedly perfected security interests in personal property is enigmatic, because it attempts to employ preference law to avoid a class of transfers, so-called "secret liens," that are not true preferences. When a security interest is granted in exchange for contemporaneous value, preference policy in bankruptcy is not offended, because the transaction does not cause a depletion of the debtor's estate for the benefit of a particular creditor. However, the effect of the timing rules of section 547(e) of the Bankruptcy Reform Act is to treat most security interests perfected during the preference period and more than ten days after attachment as section 547(b) preferential transfers.

Recently, in the Vance case, the Ninth Circuit had an opportunity to apply section 547(c)(1), the substantially contemporaneous exchange exception, to the delayed perfection problem. Following a line of cases that apply the exception narrowly and mechanically, the court adopted an inflexible construction of section 547(c)(1) and refused to apply it to security interests that are not perfected within the ten-day grace period established by section 547(e). This decision should not be followed by courts in other jurisdictions.

because its reasoning is flawed and neglects to take into account the purposes and goals of bankruptcy preference law and the broad language and historical development of the substantially contemporaneous exchange exception.

The better-reasoned cases apply section 547(c)(1) broadly and protect security interests that are (1) created in exchange for contemporaneous new value, and (2) perfected within a commercially reasonable time thereafter. This flexible approach to the delayed perfection problem ought to be followed, because it recognizes and protects the legitimate contractual expectations of secured creditors who act to perfect their security interests within a reasonable period of time, without sacrificing the interests of unsecured creditors who might have been misled by unreasonable delays in perfection.