THE UNFORTUNATE LIFE AND MERCIFUL DEATH
OF THE AVOIDANCE POWERS UNDER SECTION
103 OF THE DURBIN-DELAHUNT BILL: WHAT
WERE THEY THINKING?

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INTRODUCTION

This Article seeks to draw some lessons from the drafting, introduction, claimed justification, and eventual withdrawal of Section 103 of the Employee Abuse Prevention Act of 2002 (the “2002 Bill”).

The Bill was introduced by Senator Richard J. Durbin (D-Ill.) and Rep. William D. Delahunt (D-Mass.) on July 25, 2002. A week later the sponsors publicly announced its introduction by holding a joint press conference and issuing a joint press release. According to the sponsors, the Bill was designed to “cure abuses that deprive employees and retirees of their earnings and retirement savings when businesses collapse” and provide additional protections “from corporate practices that rob [employees and retirees] of their earnings and retirement savings.” The Bill, however, addressed much more than “abuses” and unsavory “corporate practices that rob” employees and retirees. Of particular relevance to this Symposium, section 103 of the Bill

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3 Id.


5 On April 7, 2003, we presented an outline of this Article at a symposium conference.
("Section 103") would have expanded substantially a bankruptcy trustee’s power to avoid (set aside) a debtor’s prebankruptcy transfers of property, including transfers of security interests in personal property.6

By the beginning of the American Bar Association’s 2002 Annual Meeting in early August, many of the attendees specializing in the law of secured transactions and bankruptcy had become aware of the Bill’s introduction. Many of them had not read the Bill, however, and were surprised to learn of its breadth. The sponsors explained that Section 103 was a response to the recent enactment of revised Uniform Commercial Code (“UCC”) Article 9.7 Section 103, they wrote, “restores to trustees in bankruptcy the ability to review and set aside suspect transactions which they enjoyed as lien creditors under Article 9 of the Uniform Commercial Code prior to the UCC amendments.”78 However, a closer look at the text of Section 103 revealed that it would have done far more than restore the status quo ante. It would have empowered trustees in bankruptcy to set aside a multitude of routine secured transactions that have formed part of the financial landscape for decades, even before the Bankruptcy Code was first enacted.9

During the meeting a “rump” group of practicing lawyers and academics came together to discuss their opposition to the secured-transactions-related provisions of the Bill, including Section 103. In the days following the meeting a few more participants joined the group. The group made its chief order of business the preparation of a report that would explain the problems with the Bill and generate opposition to it.10

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6 Employee Abuse Prevention Act of 2002 (Durbin-Delahunt) § 103. The Bill contained several other provisions that would have gone well beyond addressing corporate abuses. One provision would have established a new class of administrative expenses and afforded these expenses a “super” priority over secured claims. See id. § 203. Another provision would have established a new, vague, federal bankruptcy-law test for recharacterizing a prebankruptcy sale, lease, or other transfer of property as a secured loan. The new test would have replaced the generally applicable and settled state-law tests. See id. § 102. By addressing only Section 103 of the Bill in this Article, we do not intend to suggest our endorsement of the other secured-transaction-related provisions of the Bill.


8 Summary, supra note 4, see also Press Release, supra note 2 (“[Section 103] restores to bankruptcy trustees the full authority to challenge and set aside pre-bankruptcy transactions that take assets out of the company.”).

9 The Bankruptcy Code was enacted in 1978, at which time Article 9 had been in effect in every state (except Louisiana) for at least a decade. Bankruptcy Reform Act of 1978, Pub. L. No. 96-598, 92 Stat. 2549 (1978); Uniform Commercial Code Reporting Service, supra note 7.

10 Professor Mooney took the lead in organizing the group during the ABA meetings, and both of us participated in the preparation of the Report. See infra note 12.
The group’s appreciation of the need to act quickly increased substantially when, in late August, Senator Patrick J. Leahy (D-Vt.), then Chairman of the Senate Judiciary Committee, scheduled a hearing before the full Committee for Thursday, September 5, 2002, during the first week following the end of the summer recess. By the end of August, the thirteen members of the group had produced a 26-page report (“Report”). The Report offered a trenchant critique of several aspects of the Bill, including Section 103. By September 3, the day after Labor Day, the group had circulated the report electronically to thousands of lawyers and clients.

While the group was working on the Report, many interested persons engaged in an ongoing and active discussion of the Bill. Some of the discussions took place with lawyers in the office of the counsel to Senator Orin G. Hatch (R-Utah), then the ranking minority member of the Judiciary Committee, and with counsel for the Senate sponsors. Several interested organizations expressed to the sponsors their strong opposition to several of the Bill’s provisions, including Section 103. These included organizations as diverse as The Depository Trust and Clearing Corporation and The Options Clearing Corporation (writing jointly), The Bond Market Association, and the National Conference of Commissioners on Uniform State Laws (“NCCUSL”). By the end of the day on September 3, 2002, the Senate sponsors had thrown in the towel. The hearing before the full Judiciary Committee, scheduled for September 5, was cancelled.

From that time on, it was clear that the Bill as it then existed was doomed. Revised versions of some of the Bill’s provisions subsequently surfaced, but the final nail in the Bill’s coffin was a joint

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13 Letter from The Depository Trust and Clearing Corporation and The Options Clearing Corporation to The Honorable Richard Durbin (Aug. 30, 2002) (on file with authors).


16 Notice of Full Committee Hearing Postponement (Sept. 3, 2002), available at http://www.senate.gov/~judiciary/hearing.cfm?id=395. This development was personally disappointing to one of us (Mooney), who was scheduled to testify as a witness for the minority at the September 5 hearing.
letter voicing the strong objections of the Secretary of the Treasury and the Chairs of the Securities and Exchange Commission, the Commodity Futures Trading Commission, and the Board of Governors of the Federal Reserve System. They wrote, in part:

[T]he proposed legislation risks creating substantial uncertainty regarding the enforceability of a wide range of secured transactions and financial instruments that play a crucial role in the U.S. capital markets or otherwise facilitate risk management. As a result financial markets would be less efficient—borrowers would face higher costs of credit and investors would receive lower returns as intermediaries were forced to charge larger fees to compensate for the greater risk and uncertainty.

Accordingly, we ask that you eliminate those provisions in the Employee Abuse Prevention Act that threaten the operation of the U.S. financial markets.

Part I of this article examines the sponsors’ claim that Section 103 addresses abusive corporate practices by restoring to trustees in bankruptcy the avoidance powers they enjoyed before UCC Article 9 was revised. We conclude that the claim does not ring true. The changes wrought by Revised Article 9 do not deprive lien creditors (or bankruptcy trustees) of the power to set aside abusive or even suspect transactions. Nor are the effects of Section 103 limited to restoring the pre-2001 regime with respect to a distinct class of secured transactions, abusive or otherwise. The proposed avoidance powers in the Bill go far beyond negating the recent revisions to Article 9. By rendering many routine secured transactions ineffective in bankruptcy, the proposed

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18 Letter from Paul H. O’Neill et al., supra note 17, at 2. The Report, which had been made available to these organizations, reached similar conclusions:

These two sets of provisions [sections 103 and 203] would significantly impair in bankruptcy many nonpossessory and possessory security interests in personal property. These changes would effectively repeal, immediately and retroactively, much of Uniform Commercial Code (“UCC”) Article 9, thus relegating secured transactions law in the United States to the genre of legal regimes that exist in many developing countries, with the corresponding impediments to financing and capital formation. This repeal would come not long after all 50 states, the District of Columbia, and the U.S. Virgin Islands adopted changes to UCC Article 9 intended to modernize the statute to facilitate the capital formation that is so crucial to the health of our national economy. Indeed, the sponsors indicate that the expanded avoidance powers in the Bill are specifically intended to override certain of these changes to UCC Article 9. The proposed avoidance powers in the Bill go far beyond negating the recent changes made to UCC Article 9. They would render UCC Article 9 largely without effect to support extensions of secured credit because many secured transactions would not be effective in bankruptcy.

REPORT, supra note 12, at 5 (footnote omitted).
avoidance powers would render Article 9 largely without effect to support extensions of secured credit.

Part II examines the startling contrast between the narrow, stated purpose of Section 103 and the section’s potentially devastating effects. We assume first that, for whatever reason, Section 103 imperfectly reflects the sponsors’ limited objective and consider whether there is any principled support for that objective or for the broader objective of protecting employees and retirees. We conclude that none exists. Then we assume that the text of Section 103 reflects other, unstated principles and consider whether those principles reflect sound bankruptcy policy. Here again, we conclude that they do not. Part III draws some lessons from the legislative process surrounding Section 103, and is followed with a brief conclusion.

1. The Mismatch Between Section 103 and the Sponsors’ Explanation of It

Section 103(a) of the Bill would have expanded two of the bankruptcy trustee’s powers to avoid prebankruptcy transfers, including the transfer (creation) of security interests in personal property: the “strong-arm” power in Bankruptcy Code § 544(a) and the power to avoid preferences in Bankruptcy Code § 547. We discuss these in turn.

A. The Trustee’s “Strong-arm” Avoidance Power—Bankruptcy Code Section 544(a)

Bankruptcy Code § 544(a) arms the trustee with the rights and powers of a hypothetical judicial lien creditor. Because the rights of a judicial lien creditor are senior to an unperfected security interest in personal property under UCC Article 9, § 544(a) generally empowers a trustee in bankruptcy to avoid security interests that are unperfected when the debtor enters bankruptcy.23

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20 Id. § 547.
21 See id. § 544(a)(1). Section 544(a) also arms a trustee with the rights and powers of a hypothetical creditor who obtains an execution that is returned unsatisfied, see id. § 544(a)(2), and a hypothetical bona fide purchaser of real property, other than fixtures. See id. § 544(a)(3). We discuss the latter provision infra Part II.C.2.
22 U.C.C. § 9-317(a)(2).
23 There are some exceptions. See, e.g., U.C.C. § 9-317(e) (purchase-money security interest perfected within twenty days following delivery of collateral to debtor takes priority over an intervening (i.e., while the security interest was unperfected) buyer, lessee or lien creditor); 11
Section 103(a) of the Bill would have revised Bankruptcy Code § 544(a) by adding to a trustee’s arsenal the rights and powers of a hypothetical good-faith purchaser of property who gave value, relied on incorrect information in a public record, and either (i) took possession of the property (even if the property was not of a type that in fact could be possessed) or (ii) took steps to make the purchaser’s interest invulnerable to a judicial lien creditor. The trustee would have enjoyed these new rights and powers even if no such actual purchaser existed and even if no incorrect information regarding the challenged transfer actually existed in a public record.

Some examples will help explain the huge, adverse effect Section 103(a) would have had on routine secured transactions. Consider first a typical secured financing in which Dealer (say, a car dealer) obtains needed capital by borrowing funds from Lender and granting to Lender a security interest in Dealer’s existing and future inventory of new automobiles, together with all receivables arising out of sales or leases of the inventory, including installment sale contracts and leases. Normally, Lender would perfect its security interest by filing a financing statement covering the inventory and receivables. Because Lender’s perfected-by-filing security interest is invulnerable to a subsequent judicial lien creditor, Dealer’s bankruptcy trustee cannot avoid it under § 544(a)(1). Section 103(a) would have reversed the result. It would have provided the trustee with the rights of a hypothetical “buyer in ordinary course of business” of the inventory, who, under UCC Article 9, would take free of Lender’s perfected security interest. The trustee also would have enjoyed the rights of a hypothetical ordinary-course purchaser of the installment sale contracts and leases (“chattel paper”) arising from Dealer’s sale or lease of its inventory, who takes possession of the chattel paper and gives new value. Because such a purchaser would take free of Lender’s perfected security interest under UCC Article 9, Dealer’s trustee’s new rights as

U.S.C. § 546(b) (prohibiting avoidance under § 544 when a generally applicable law, such as U.C.C. § 9-317(e), permits later perfection to achieve priority over intervening claimant, even though an interest in property is not perfected at the time the bankruptcy petition is filed).

24 Employee Abuse Prevention Act of 2002 (Durbin-Delahunt), S. 2798, H.R. 5221, 107th Cong. § 103(a).

25 Readers who are interested in a more detailed critique of Section 103 should consult the Appendix.


27 See U.C.C. §§ 9-320(a) (rights of buyer in ordinary course): 1-201(9) (defining “buyer in ordinary course”).

28 See UCC § 9-102(a)(11), defining “chattel paper” in part as:

a record or records that evidence both a monetary obligation and a security interest in specific goods, a security interest in specific goods and software used in the goods, a security interest in specific goods and license of software used in the goods, a lease of specific goods, or a lease of specific goods and license of software used in the goods.

29 See id § 9-330(a), (b) (certain purchasers of chattel paper in the ordinary course of
a hypothetical good-faith purchaser would have enabled the trustee to avoid Lender’s perfected security interest in the chattel paper.\footnote{See Employee Abuse Prevention Act of 2002 (Durbin-Delahunt), S. 2798, H.R. 5221, 107th Cong. § 103. As the Report noted: In like manner, [Section 103] also would permit avoidance of security interests perfected by filing in instruments (such as promissory notes), documents of title, and securities. U.C.C. §§ 9-330, 9-331. Note that most of the good faith purchase rules discussed in this section (UCC §§ 9-320, 9-330, and 9-331) had very similar antecedents that would have produced identical results under former (i.e., pre-revision) UCC Article 9. See Former U.C.C §§ 9-307; 9-308; 9-309. REPORT, supra note 12, at 6 n.7.} In short, Section 103(a) would have turned a typical secured creditor, to whom the Bankruptcy Code normally awards the value of its collateral, into an unsecured creditor, who shares prorata in unencumbered assets. This result would have obtained even if (i) Lender and Dealer had acted in good faith and bargained at arm’s length, (ii) Lender had perfected its security interest by filing a financing statement in the proper filing office, and (iii) the information in the filed financing statement had been complete and in all respects correct.

How could a lender protect its security interest against its debtor’s future bankruptcy if Section 103(a) were in effect? Arguably the lender’s taking physical possession of the inventory and chattel paper would provide protection, inasmuch as the lender’s actual possession might override a trustee’s hypothetical possession. But, as the Report observed, taking possession of the collateral “would be practically impossible in the case of most inventory financing and . . . often is not practical in the case of chattel paper.”\footnote{Id. at 6.} On the other hand, the trustee’s hypothetical possession might be read, quite plausibly, to override (or substitute for) the lender’s actual possession.\footnote{The Report explained further: The same reasoning might be applied to [a] secured party that has “control” of intangible assets such as uncertificated securities or security entitlements, even if actual possession were impossible. . . . On this reasoning even security interests perfected by possession or control would be vulnerable in bankruptcy. Id.} Under this reading, even the lender’s actual possession of the inventory and chattel paper would not protect its security interests from avoidance.

Now consider the application of the expanded strong-arm avoidance power to a perfected security interest in equipment. Unlike the case of inventory and chattel paper, Article 9 provides no broad good-faith purchaser protection for purchasers of equipment encumbered by a perfected security interest. Even so, Section 103(a) would have empowered trustees to avoid the perfected security interest. It would have conferred on a trustee hypothetical reliance on
hypothetical incorrect information in the filing office. Under UCC section 9-338(2), a purchaser who relies on certain incorrect information in a financing statement takes free of a security interest perfected by that financing statement.33 Even if Section 103(a) is construed narrowly, to apply only to cases where a good-faith purchaser’s rights depend on its having relied on incorrect information (and not, for example, to cases where a good-faith purchaser prevails solely because of its status as a good-faith purchaser),34 it would have permitted trustees to avoid perfected-by-filing security interests in equipment—and virtually all other security interests perfected by filing.

B. The Trustee’s Power to Avoid Preferences—Bankruptcy Code Section 547

Section 103 of the Bill would have expanded not only a trustee’s “strong-arm” power under Bankruptcy Code § 544(a) but also the power to avoid preferences under § 547. Section 547 generally empowers the trustee to avoid, as a preference, a transfer of property (including the creation of a security interest) made by an insolvent debtor to a non-insider creditor within 90 days before a bankruptcy filing if the transfer is on account of an antecedent debt.35 One cannot determine whether a transfer occurred during the 90-day period or was made on account of an antecedent debt without first determining when the transfer was made. Bankruptcy Code § 547(e) addresses this timing issue in a somewhat complicated fashion. In general, the timing of a transfer turns on whether and when a transfer is “perfected,” as the term is used in § 547.36

A security interest or other transfer that is not “perfected” for the purpose of preference avoidance usually can be avoided. This is because a transfer that is “not perfected before the later of (i) the commencement of the case; or (ii) 10 days after such transfer takes effect between” the parties is deemed to have been made “immediately before the filing of the [bankruptcy] petition.”37 A transfer made immediately before the petition is filed would have been made within the 90-day period and for an antecedent debt, thereby satisfying two significant elements of an avoidable preference.

Section 547 currently provides that a transfer of personal property

33 See U.C.C. § 9-338(2).
34 See REPORT, supra note 12, at 7 (discussing this limited reading).
36 See id. § 547(c)(2)(B). Bankruptcy Code § 547(c)(2)(A) makes an exception. The transfer occurs at the time it becomes effective between the parties if the transfer is perfected no more than ten days after that time.
37 Id. § 547(c)(2)(C).
or fixtures is perfected when it becomes invulnerable to a judicial lien obtained by a creditor on a simple contract.38 A security interest that is perfected under UCC Article 9 meets this test; a security interest that is unperfected under UCC Article 9 does not.39 By replacing the judicial lien creditor test with a good-faith purchaser test, Section 103(b) of the Bill would have significantly affected the time when allegedly preferential transfers occur.40 Under Section 103(b), a security interest would not be “perfected” for the purpose of preference avoidance even if the security interest was “perfected” under UCC Article 9,41 as long as the security interest could have been subordinated to, or cut off by, a claim of a good-faith purchaser. Thus, in most cases the security interests in inventory, chattel paper, and equipment discussed above in connection with strong-arm avoidance also would be avoidable as preferences under Section 103(b) because those security interests are vulnerable to hypothetical good-faith purchasers who relied on hypothetical incorrect information in the public record.

There are other security interests that would be exposed to preference avoidance were the judicial lien creditor test replaced by a good-faith purchaser test. Consider a consumer buyer of consumer goods from another consumer.42 Such a buyer normally cuts off a purchase-money security interest in the goods if the secured party has relied on automatic perfection43 and has not filed a financing statement.44 Being vulnerable to the rights of an innocent purchaser, the perfected security interest would not have been “perfected” under Section 103(b) and thus would have been vulnerable to preference avoidance. As the Report explained, “The Act would instantly change the cost/benefit analysis by forcing the [purchase-money] secured party to go the trouble and expense of filing a financing statement in order to have a security interest that is effective in bankruptcy. These costs would, of course, be passed on to the consumer.”45

38 See id. § 547(e)(1)(B).
39 See U.C.C. § 9-317(a)(2) (an unperfected security interest is subordinate to the rights of a judicial lien creditor).
40 See Employee Abuse Prevention Act of 2002 (Durbin-Delahunt), S. 2798, H.R. 5221, 107th Cong. § 103(b). This subsection would have replaced the phrase “creditor on a simple contract cannot acquire a judicial lien” with the phrase “good-faith purchaser for value of such fixture or property that reasonably relied on available information cannot acquire an interest.”
41 See U.C.C. § 9-308(a) (providing that a security interest is perfected if it has attached and any required public notice has been given, e.g., by filing).
42 This example appears in the REPORT, supra note 12, at 8-9.
43 See U.C.C. § 9-309(1) (purchase-money security interest in consumer goods is perfected when it attaches).
44 See id. § 9-320(b), (c). The statement in the text assumes that, as required in U.C.C. § 9-320(b), the consumer buyer does not know about the security interest and gives value. Id.
45 REPORT, supra note 12, at 9.
II. OTHER PRINCIPLES THAT MAY UNDERLIE SECTION 103

Having established that the sponsors' statements concerning the modest effect of Section 103 were inaccurate (even if the sponsors may have believed them to be correct), we now examine a series of alternative assumptions, explanations, and justifications that might underlie the proposal. We begin by asking whether any principled bankruptcy policy justifies the sponsors' narrow, stated goal of overriding the effects of Revised Article 9 in bankruptcy or their broader goal of protecting employees of, and retirees from, bankrupt firms. We then examine several other principles that might be thought to justify Section 103 and consider whether those principles are consistent with prevailing bankruptcy policies.

A. Should the Avoidance Powers Be Expanded to Restore the Pre-2001 Regime?

The section-by-section analysis of the Bill suggests that Section 103 was necessary because Revised Article 9 deprived judicial lien creditors of certain rights to "set aside suspect transactions." Two specific characteristics that Section 103 would have afforded to a trustee as a hypothetical good-faith purchaser—the purchaser's hypothetical reliance on hypothetical incorrect information in the public record and its hypothetical possession of the collateral transferred—lead us to consider first whether Section 103 can be justified by either of two specific provisions of Revised Article 9 that distinguish between lien creditors and purchasers: UCC section 9-338, which relates to incorrect information in the public record, and UCC section 9-312(a), under which a security interest in promissory notes and other instruments may be perfected by filing.

1. Should the Trustee Have the Powers of a Reliance Purchaser under UCC Section 9-338?

UCC section 9-338 provides, perhaps, the most plausible and
modest basis for enacting a new avoidance power in response to changes made by Revised Article 9. That section, which has no antecedent in Former Article 9, enables certain purchasers, but not lien creditors, to cut off or achieve priority over an earlier perfected security interest. Section 9-338 protects a purchaser only if the competing security interest is perfected by a filed financing statement that contains certain incorrect information and only if the purchaser reasonably relied on the incorrect information in giving value. The relevant incorrect information for these purposes is the information specified in UCC section 9-516(b)(5): a mailing address for the debtor, an indication of whether the debtor is an individual or an organization, and, if the financing statement indicates that the debtor is an organization, a type of organization for the debtor, a jurisdiction of organization for the debtor, and the debtor’s organizational identification number or an indication that the debtor has none.

To assess whether a trustee in bankruptcy should have the rights of a purchaser under UCC 9-338, it is necessary to understand the role section 9-338 plays in the Article 9 scheme. If any of the section 9-516(b)(5) information is missing, the filing office may reject the filing; indeed, it is required to do so. If, however, the filing office accepts the filing notwithstanding the missing information, the filing nevertheless may be effective to perfect a security interest.

Comment 3 to UCC section 9-520 explains some of the thinking behind this statutory structure:

The information required by Section 9-516(b)(5) assists searchers in weeding out “false positives,” i.e., records that a search reveals but which do not pertain to the debtor in question. It assists filers by helping to ensure that the debtor’s name is correct and that the financing statement is filed in the proper jurisdiction.

If the filing office accepts a financing statement that does not give this information at all, the filing is fully effective. Section 9-520(c).

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48 If a qualifying purchaser is not a secured party (e.g., is a buyer), it “takes free” of the perfected security interest. See UCC § 9-338(2). If the purchaser is a secured party, the perfected security interest is subordinate to the purchaser’s security interest. See id. § 9-338(1).
49 See id. § 9-338.
50 See id. § 9-516(b)(5).
51 See id. §§ 9-516(b); 9-520(a).
52 See id. §§ 9-502(a) (specifying information required in an effective financing statement to be the name of the debtor, the name of the secured party or its representative, and an indication of the collateral covered by the financing statement); 9-520(c) (providing that a filed financing statement containing information specified in § 9-502(a) and (b) is effective even if the filing office is required to refuse to accept it for filing). A secured party who intentionally includes incorrect information in a financing statement in order to mislead third parties could be found to have acted in bad faith, with the result that its security interest might be subordinated even to a purchaser who did not qualify for protection under section 9-338. See id. §§ 1-203 (contract or duty under UCC imposes obligation of good faith); 9-102(43) (defining “good faith” as “honesty in fact and the observance of reasonable commercial standards of fair dealing”).
The financing statement also generally is effective if the information is given but is incorrect; however, Section 9-338 affords protection to buyers and holders of perfected security interests who give value in reasonable reliance upon the incorrect information.53

This approach induces a secured party to include potentially useful information in the public record, thereby providing a higher quality of public notice. But it does so without exposing the filing secured party to the risk that its security interest will be unperfected, and thus vulnerable to judicial lien creditors and the debtor’s bankruptcy trustee, if some information is missing or inaccurate.54 UCC section 9-338 was designed to strike a rough balance—to impose consequences that are large enough to induce secured parties to provide correct information, but are not so large as to induce the expenditure of substantially greater resources than the benefits of correct information likely would warrant. Towards this end, section 9-338 rewards a competing secured party or other purchaser with a senior claim to collateral only if that purchaser proves that it was aware of the contents of a financing statement and actually and reasonably relied on the incorrect information.

Section 9-338 protects a very narrow class of purchasers outside bankruptcy. Even if one thinks the class should be expanded to include the debtor’s trustee in bankruptcy, Section 103 is drafted much too broadly. As the Report noted:

The Act’s expanded avoidance powers could be curbed by revising it to address only (i) the rights of a good faith purchaser that relies on incorrect information under UCC § 9-338 and (ii) cases in which the public registry actually contains incorrect information in connection with the particular transfer to be avoided. Under this approach, for example, if a financing statement on file actually contained incorrect information that did not render a security interest unperfected under UCC Article 9, the trustee would have the rights of a hypothetical purchaser that hypothetically relied on the actually incorrect information.55

On examination, however, even this scaled-back version of Section 103 would be inconsistent with the stated rationale for Section 103. An error in the section 9-516(b)(5) information is hardly indicative of a suspect transaction, let alone an abuse that robs employees and retirees of their earnings and retirement savings. Also, this scaled-back version of Section 103 would do much more than simply restore the trustee’s avoidance powers to their pre-Revised Article 9 status. It would expand

53 Id. § 9-520 cmt. 3.
54 There are a number of reasons why inaccurate information may appear in a financing statement. For example, clerical errors may lead to transpositions of numbers in addresses and organizational identification numbers. As the consequences of inaccuracies increase, presumably the costs of ensuring accuracy will rise.
55 REPORT, supra note 12, at 15 (emphasis added).
the trustee's avoidance powers substantially beyond those the trustee enjoys under Bankruptcy Code §§ 544(a)(1) and 547(b) as they applied to secured transactions under Former Article 9. With the exception of the debtor's mailing address, Former Article 9 did not require a financing statement to include the information now relevant to section 9-338. Any avoidance power based on inaccuracies in the other relevant information necessarily would expand, and not merely restore, the avoidance power. As a practical matter, Section 103 would have expanded the avoidance powers even had it been limited to hypothetical reliance on errors with respect to the debtor's mailing address. Less than a handful of reported decisions under Former Article 9 held a financing statement to be insufficient because it provided an incorrect or incomplete address for the debtor.

Moreover, incorrect information gives rise to a subordination or cut-off under section 9-338 only "to the extent that" the purchaser gave value "in reasonable reliance" on it. Because a trustee in bankruptcy cannot actually give value, actually rely on incorrect information, or actually be reasonable in its reliance, the only way to give the trustee the powers of a section 9-338 purchaser is to provide the trustee with hypothetical reasonable reliance in hypothetically giving value. Thus, even under a narrowed version of Section 103, the trustee could avoid a security interest completely based on its hypothetical reliance in every case in which any portion of the relevant information proved to be incorrect.

Section 103 arguably could have been narrowed even more, to place on the trustee the burden of showing at least that it would have been reasonable for a purchaser to rely on the incorrect information in the filed financing statement. But with no actual purchaser, no actual reliance, no actual value given, and no actual context or circumstances surrounding the hypothetical purchase, that burden no doubt would be

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56 See Former U.C.C. § 9-402(1) (specifying information required in an effective financing to include "a mailing address of the debtor").

57 Our examination of the Uniform Commercial Code Reporting Service case digest for Former UCC section 9-402 revealed only four reported decisions (indexed under "Address requirements") in which an incomplete or inaccurate address was the basis for a determination that a financing statement was ineffective. See Uniform Commercial Code Reporting Service, U.C.C. Search, Case Digest, supra note 7. In one of these decisions, In re Michelle's Hallmark Cards & Gifts, Inc., 219 B.R. 316 (Bankr. M.D. Fla. 1998), the debtor's name was wrong, as well. The other three decisions were decided decades ago, and two of them were decided by the same judge. See In re Wood, 33 B.R. 375 (Bankr. D. Idaho 1983); In re Brawner, 7 U.C.C. Rep. Serv. 565 (Bankr. D. Me. 1970); In re Brawner, 6 U.C.C. Rep. Serv. 1031 (Bankr. D. Me. 1969). Some courts, albeit a minority of those that have considered the issue, have held financing statements to be adequate under Former section 9-402 even in the complete absence of a debtor's address where no prejudice existed. Lines v. Bank of California, 467 F.2d 1274 (9th Cir. 1972); Riley v. Miller, 549 S.W.2d 314 (Ky. 1977); In re Fowler, 407 F. Supp. 799 (W.D. Okla. 1975); In re French, 317 F. Supp. 1226 (E.D. Tenn. 1970).

58 U.C.C. § 9-338(1), (2).
easy to meet. Section 9-338 itself contemplates that a purchaser could reasonably rely on any of the relevant incorrect information. In effect a trustee might meet this sort of burden merely by showing that it is conceivable that a purchaser could actually and reasonably rely on the incorrect information.

Because a trustee’s 9-338-based avoidance powers must necessarily arise out of a hypothetical purchaser’s hypothetical reliance under hypothetical circumstances, it is impossible for those powers to mimic, or even reasonably approximate, the actual risks that section 9-338 imposes outside bankruptcy. In striking the balance reflected in section 9-338, the drafters of Revised Article 9 expected that actual and reasonable reliance on incorrect information would occur only on “rare occasions.” Under the Bill’s hypothetical reliance standard, however, a trustee may “convert a rare event in the real world into an automatic event in bankruptcy.”

Perhaps a very different statutory approach might meet both the objection to the hypothetical nature of a trustee’s rights and the argument that a section 9-338-based avoidance power in bankruptcy would materially increase the section 9-338 risk that a secured party faces outside bankruptcy. Consider an avoidance power that would allow the trustee to assert the rights of an actual purchaser who, on the date of the bankruptcy filing, had an actual right to take free of, or to subordinate, a security interest under section 9-338. This power would be somewhat analogous to the trustee’s power to assert the rights of actual unsecured creditors to avoid certain transfers (mainly fraudulent transfers) under Bankruptcy Code § 544(b)(1). However, the analogy fails because, at the time a debtor enters bankruptcy, a creditor whose

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59 See U.C.C. § 9-338 cmt. 2 (“On rare occasions, a subsequent purchaser of the collateral (i.e., a buyer or secured party) may rely on the misinformation to its detriment.”). Outside bankruptcy the burden on an actual purchaser to prove reasonable reliance would be quite difficult to meet. Consider the example mentioned in the Report.

[A]ssume a prospective purchaser searches the public record and finds a financing statement filed against the debtor’s correct name. The searcher, however, notices that the address given for the debtor is not correct. In order to benefit from UCC § 9-338, the searcher would be required to convince a court that it acted reasonably in purchasing the collateral in reliance on its belief that the financing statement filed against the debtor’s correct name was not filed against the debtor, but actually was filed against someone else altogether.

REPORT, supra note 12, at 16 n.28.

60 Id. at 17.

61 See 11 U.S.C. § 544(b)(1). Under the accepted interpretation of this section, a trustee may avoid a transfer for the benefit of all unsecured creditors, not just for the benefit of creditors who actually have the power of avoidance, and the trustee may avoid a transfer in its entirety, not merely to the extent of the claims held by creditors who actually have the power of avoidance. See Moore v. Bay, 284 U.S. 4 (1931) (applying § 70e of the Bankruptcy Act, 11 U.S.C. § 110e (1976) (repealed effective Oct. 1, 1979), the predecessor to Bankruptcy Code § 544(b)(1)). The Court’s decision in Moore has been criticized frequently. For a summary of the criticisms, see CHARLES JORDAN TABB, THE LAW OF BANKRUPTCY § 66, at 346-48 (1997).
avoidance power the trustee asserts under § 544(b) has only the potential ability to avoid transfers; it has not actually done so (by acquiring a nonavoidable judicial lien, for example). In contrast, a purchaser with senior rights under section 9-338 has actually achieved senior status through its actual and reasonable prebankruptcy reliance. What would be the effect of giving the trustee the rights and powers of an actual purchaser who holds a senior interest? It would be bizarre (as well as patently unfair) to enable the trustee to displace the actual reliance purchaser for the benefit of the creditors generally, that is, to avoid not only the avoidable security interest but the reliance purchaser’s otherwise nonavoidable interest as well. Alternatively, perhaps the reliance purchaser’s interest could stand while the trustee avoids, for the benefit of all creditors, any remaining interest held by the junior competing secured party. That result would be inconsistent, however, with the effort to moderate Section 103 to merely mimic nonbankruptcy risks in bankruptcy. And it would clearly contravene the accepted policy implemented by the Bankruptcy Code of limiting the rights of a trustee under § 544(b)(1) to those of actual unsecured creditors.

In sum, even a narrowed Section 103 approach would conflict with the sponsors’ stated goal of restoring the avoidance powers as they were exercised before UCC Article 9 was revised. Any attempt to confer a section 9-338-based avoidance power on bankruptcy trustees either would expand the risks posed to holders of perfected security interests well beyond those that obtain outside bankruptcy or would unjustifiably expropriate the priorities and interests of the very reliance purchasers that section 9-338 is intended to protect.

In his response to this Article, Professor Ted Janger takes

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62 See, e.g., UNIFORM FRAUDULENT TRANSFER ACT §§ 7(a) (2003) (stating general remedies of creditor as to avoidable transfers); 7(b) (providing that, if court so orders, a judgment creditor may levy execution on asset transferred by debtor in an avoidable transfer), 7A U.L.A. 339-40 (1999).

63 It also would follow the unfortunate precedent of Aho v. Bay. See supra note 61.

64 See COLLIER ON BANKRUPTCY ¶ 544.09[1], at 544-18 (15th ed. 2003).

65 The Report noted two additional undesirable consequences of a narrowed UCC section 9-338-based Section 103. First, because the inclusion of section 9-338-related incorrect information does not destroy perfection, one might expect more inaccuracies in that information than in the perfection-related information. Thus, the Report observed, enactment of Section 103 would render avoidable many security interests perfected before Section 103 became effective. REPORT, supra note 12, at 16-17. In addition, the Report predicted that enactment of Section 103 would prompt many state legislatures to repeal section 9-338 or eliminate the section 9-516(b)(5) information from financing statements. Id. at 17.

In short, both the underlying concept and the drafting of Section 103 were fundamentally flawed. Given this conclusion, it is understandable that two of the Report’s co-authors, widely respected for their drafting skills and substantive expertise in the law of secured transactions and bankruptcy, declined the invitation of a prominent bankruptcy academic to redraft Section 103 so that it would “work.”
exception to section 9-338. We take Professor Janger's principal factual claim to be that unsecured creditors sometimes make credit decisions in reliance on incorrect information contained in financing statements. From this he argues that section 9-338 unfairly discriminates against unsecured creditors because it benefits only purchasers, including secured parties.

Perhaps a more coherent and straightforward statement of Janger's complaint would be that he believes that the information relevant to section 9-338 should be required as a condition of perfection along with the information currently specified in section 9-502. Under such a revision, if any of that information were seriously misleading then the financing statement would not be effective and the security interest would be avoidable under the current version of the strong-arm power. Janger acknowledges that this type of incorrect information would be seriously misleading to an unsecured creditor only in "rare cases." Another plausible method of meeting Janger's concerns would be to add lien creditors who actually rely on incorrect information to the class of persons benefited by section 9-338. Indeed, that would address precisely the unfair discrimination that Janger claims to be imposed by section 9-338. But given how rare such actual reliance would be in practice, Janger's concern seems trivial.


67 This is implicit in Janger's argument for a "simple solution" that would subject all information to the "seriously misleading" standard of UCC section 9-507 and Former section 9-402(8). Id.

68 See supra text accompanying notes 22-23.

69 Janger, supra note 66, at 110. The cases may be even more rare than Janger surmises. He offers an example in which a prospective unsecured creditor searches the New York filing office and discovers a properly filed financing statement naming a New York corporation as debtor but indicating that the debtor is incorporated in Delaware. We doubt the prospective creditor would be acting reasonably if it concluded that the financing statement was filed against a Delaware corporation having a different name and extended credit in reliance on that conclusion (i.e., we doubt that the incorrect information is seriously misleading). Financing statements naming Delaware corporations are supposed to be filed in the Delaware filing office. See U.C.C. §§ 9-301(1); 9-307(e); 9-102(a)(50). The debtor named in the New York filing is a New York corporation. At most, the information in the financing statement would prompt a reasonable searcher to inquire further. This might well be the case, even where, as in Janger's footnote 22, the financing statement sufficiently names both a New York and Delaware corporation.

70 We wonder whether a prospective unsecured creditor ever truly extends credit in reasonable reliance on the perception that nothing has been filed against the debtor. A security interest perfected after the credit was extended nonetheless would have priority over a subsequent judicial lien that the unsecured creditor might obtain. See U.C.C. § 9-317(a)(2)(A). At most, a lien creditor might actually rely on incorrect information in deciding to incur the time, trouble, and expense of obtaining a judicial lien.

As to the materiality of Janger's concerns, consider as well the small number of reported decisions in which financing statements were determined to be ineffective because of an incomplete or inaccurate debtor's address under Former Article 9. See supra note 57. Indeed, the
Another response to Janger’s concern would be to eliminate all information from financing statements except the information specified in section 9-502.\(^1\) This would have the benefit of excluding some incorrect information from the public record, but no doubt at the expense of keeping a much greater amount of accurate information out of the public record. Yet that clearly would have been the result of the Article 9 drafting and enactment process had the drafters not devised the structure implicating reasonable reliance under section 9-338 as a substitute for requiring additional information as a condition of perfection. As the Report noted, “[t]he drafters of Revised UCC Article 9, and the state legislatures that have enacted it, would never have required this additional [non-section 9-502] information to be included in a financing statement if the result of an inaccuracy would be the certain avoidance by the debtor’s trustee in bankruptcy.”\(^2\)

The information that should be required for perfection by filing and the appropriate scope of the priority rule in section 9-338 are matters about which reasonable persons might quibble, but they are not matters we address in this Article. Janger’s concerns have little, if anything, to do with the proposition that we are advancing here, that is, that expanding the trustee’s avoidance powers to include the rights of hypothetical good-faith purchasers of personal property and fixtures would represent an enormous, and unjustified, extension of those powers.

2. Should the Trustee Have the Powers of a Reliance Purchaser under UCC Section 9-330(d)?

Section 103 would have given the trustee the rights of a good-faith purchaser for value who took possession of the transferred property (i.e., the collateral), even if the property was not of a type that in fact could be possessed. This emphasis on possession leads us to inquire whether the section may be justified as a response to the Revised Article 9’s perfection and priority rules governing security interests in promissory notes and other instruments.

Under section 9-330(d), a purchaser of an instrument has priority over a security interest in the instrument perfected by a method other

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\(^1\) That would reinstate the formal requisites of a financing statement under Former section 5-402(1), with the exception of the debtor’s address and the debtor’s signature.

\(^2\) REPORT, supra note 12, at 17. We also doubt that the drafters of the revisions would have favored retaining the debtor’s address as a component of the information necessary for perfection.
than possession, if the purchaser gives value and takes possession of the instrument in good faith and without knowledge that the purchase violates the rights of the secured party. Comparing this rule to the corresponding rule in Former section 9-308, which also subordinated perfected security interests in instruments to purchasers who took possession of the instrument, one might wonder what the fuss is about.

The answer lies elsewhere in the revisions, specifically in the method of perfection that is available for security interests in instruments. Under Former Article 9, long-term perfection in an instrument could not be achieved by filing; the secured party needed to take possession. Revised Article 9 adds filing as an acceptable method of perfection. This change means that a judicial lien creditor no longer can avoid a security interest in an instrument where the secured party has filed a financing statement but has not taken possession.

As is the case with section 9-338, the perfection-by-filing rule in section 9-312(a) implicates good-faith transactions and not corporate abuses. And, as is the case with section 9-338, the Bill is so broad that it would have affected a world of perfected security interests that were invulnerable to judicial liens under Former Article 9. Article 9 has always contained non-temporal priority rules that, like section 9-330, favor certain later-in-time claimants, including secured parties. While the 1994 revisions to UCC Article 8 and the recent revisions to Article 9 added additional non-temporal priority rules to accommodate developing financing patterns, filing remains Article 9's principal

73 See U.C.C. §§ 9-330(d); 9-102(a)(47) (defining "instrument").
74 The class of purchasers whom Revised Article 9 protects differs in some ways the class protected by Former section 9-308. Compare U.C.C. § 9-330(d), with Former U.C.C. § 9-308(a), (b). Under section 9-330(d) a purchaser of an instrument need not take possession in the ordinary course of business as Former section 9-308(a) and (b) required.
75 See Former U.C.C. § 9-304(1).
76 See U.C.C. § 9-312(a) (stating that "[a] security interest in . . . instruments . . . may be perfected by filing.")
77 As we explained elsewhere, perfection by filing for security interests in instruments may materially reduce transactions costs. See Steven L. Harris & Charles W. Mooney, Jr., Revised Article 9 Meets the Bankruptcy Code: Policy and Impact, 9 AM. BANKR. INST. L. REV. 85, 96 (2001) [hereafter Harris & Mooney, Policy and Impact]. "A perfection-by-filing rule ‘avoids the costs and impracticalities of taking possession when the collateral consists of large numbers of instruments.’" Id. n.57 (quoting Steven L. Harris & Charles W. Mooney, Jr., How Successful Was the Revision of UCC Article 9? Reflections of the Reporters, 74 CHI.-KENT L. REV. 1357, 1361 n.16 (1999)). It also "makes it unnecessary to determine whether a particular writing is an instrument or to make alternative assumptions, necessitating both filing and taking possession." Id.
78 See supra discussion Part I.A.
79 For example, the predecessor to UCC section 9-330 was Former section 9-308, which was quite similar to the newer version. Compare U.C.C. § 9-330, with Former U.C.C. § 9-308. Former UCC section 9-309, which preserves the rights of certain good-faith purchasers under UCC Articles 3, 7, and 8, is carried forward in UCC section 9-331. Compare U.C.C. § 9-331, with Former U.C.C. § 9-309.
80 See e.g., U.C.C. §§ 9-327 (stating priority rules for security interests in deposit accounts);
method of giving public notice. Although it would be feasible to craft a narrow avoidance power that would restore the pre-revision result, we see no bankruptcy policy that would require, or even be able to justify, doing so. Indeed, we expect that permitting perfection by filing against instruments will increase the likelihood that unsecured creditors learn that a debtor's instruments have been encumbered. To the extent that the objections to sections 9-338 and 9-312(a) arise from a belief that secret liens are antithetical to bankruptcy policy, it seems odd that the belief would lead one to object to perfected-by-filing security interests in instruments.

B. Would Scaling Back Security Interests in Bankruptcy Generally Benefit Employees and Retirees?

The sponsors of the Bill touted its virtues as a benefit for employees and retirees (presumably former employees). The following passage, taken from the August 1, 2001 press release issued by Congressman Delahunt and Senator Durbin, exemplifies their claims:

Prompted by the recent wave of corporate bankruptcies, Senator Dick Durbin (D-IL) and Congressman Bill Delahunt, D-MA) today unveiled tough legislation to curb abuses that deprive employees and retirees of their earnings and retirement savings when businesses collapse.

"From Enron to Polaroid, the recent wave of bankruptcies has left tens of thousands of employees without jobs, retirees without pensions or health insurance—while corporate assets are diverted to executive bonuses and off-book transactions," Delahunt said.

"Some have asked, 'Why introduce this bankruptcy bill at this time?' To put it simply, there is no better time," Durbin said. "The confidence of American workers and retirees has been severely


81 See U.C.C. § 9-310(a) (providing general rule that filing is necessary to perfect all security interests). At least one commentator has claimed that Revised Article 9 has created a "bifurcated" system of perfection, with one set of standards applicable to priority over judicial lien creditors (the trustee in bankruptcy) and another applicable to priorities among competing security interests. See G. Ray Warner, The Anti-Bankruptcy Act: Revised Article 9 and Bankruptcy, 9 AM. BANKR. INST. L. REV. 3, 32-35 (2001). For a contrary view, see Harris & Mooney, Policy and Impact, supra note 77, at 95-97.

82 Professor Janger shares this expectation. See Janger, supra note 70, at 107-08 (suggesting that unsecured creditors rely on the Article 9 filing systems). Under Former Article 9, a security interest in instruments other than proceeds could be perfected only by possession or temporarily. See Former U.C.C. § 9-304(1).
shaken by an epidemic of corporate greed and corruption. This bill says that if a company goes bankrupt and engages in unfair practices in the process, the forgotten victims—employees and retirees—won't be asked to pay the price."  

And, as reported by CongressDaily, "[a]sked in an interview today whether the [Bill] was meant to be viewed as an alternative or complement to the pending bankruptcy reform legislation, Durbin responded: 'That was a bankruptcy bill for corporations. This is a bankruptcy bill for workers.'"  

We have already demonstrated that Section 103 cannot be understood to address "abuses," "corporate greed," or "unfair practices." In this section we consider whether enactment of Section 103 (or a narrower version, such as that outlined in the previous section) would be likely to accomplish the sponsors' larger expressed goal, that of promoting the interests of employees and retirees. We conclude that enactment of Section 103 in any form would be unlikely to accomplish this result.

One knowledgeable source indicated that the Bill's sponsors focused first on provisions that would enhance the preferential treatment that the Bankruptcy Code already gives to claims of employees and retirees. These provisions ultimately appeared in Title II of the bill. Sometime later the sponsors and their staffs realized what may have been obvious—more preferential treatment for employees and retirees would be hollow unless sufficient assets were available for satisfaction of their claims. The provisions in Title I, including Section 103, were included so that "plundered assets" would be recoverable for this purpose.

No one can deny that employees or retirees who hold claims against a firm in bankruptcy will benefit by having more assets

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83 Press Release, supra note 2.
84 CONGRESSIONDAILY (August 1, 2002), at http://nationaljournal.com/about/congresstabley.
85 See supra discussion Part I.
86 Sec. e.g., 11 U.S.C. §§ 507(a)(3) (2004) (affording priority to certain claims for wages, salary, or commissions); 507(a)(4) (affording priority to certain claims for contributions to an employee benefit plan); 1114 (requiring payment and restricting modification, of retiree benefits).
87 "Title II of the bill provides a number of remedies to help ensure that once the plundered assets have been recaptured for the estate, employees and retirees have the opportunity to assert their claims to a fair share of the proceeds." Press Release, supra note 2.
88 Interview conducted by Charles W. Mooney, Jr. with congressional staff member (December 12, 2002).
89 Press Release, supra note 2. Of course, it is preposterous to suggest that the transfers of collateral that would have been recovered under Section 103 constitute "plundered assets" as opposed to legitimate commercial transactions. In a secured transaction "assets of an equal or greater value (e.g., loaned funds or purchased property) come in as the debtor's property consisting of new assets, a feature the sponsors have not mentioned." REPORT, supra note 12, at 14 n.22.
available for the payment of unsecured claims and, where applicable, priority claims. But once one assumes, as we do, that the firms against which most employees and retirees hold claims are not in bankruptcy, this observation sheds little, if any, light on whether employees and retirees generally would have benefited from Section 103’s greatly expanded power to avoid perfected security interests. The observation fails to take into account that the treatment of secured claims in bankruptcy affects the cost and availability of secured credit. One ought not simply have assumed that, after enactment of Section 103, all would remain constant and the financial picture of debtors would be identical in bankruptcy except for the fact that collateral would be recovered for the benefit of employees and retirees. This is not how the world works. Were Section 103 to become applicable to a proposed secured credit transaction, prospective creditors would take into account its effects. If a proposed security interest would have been avoidable under Section 103, then the credit either would not have been extended at all or would have been extended in a smaller amount or at a higher cost. If the credit were not extended, then the debtor would not have acquired the loan proceeds or property in the credit transaction and those funds or property would not have become part of the debtor’s estate in bankruptcy.

The Report emphasized this instrumental effect of Section 103 on the extension of credit, as did the President’s Working Group in its trenchant explanation that the Bill would harm the very employees and retirees that its sponsors claimed would be its beneficiaries. The most direct victims would have been employees and former employees whose employers would not have obtained necessary credit or would have done so only in lower amounts or at higher costs. Credit contractions also would have affected those individuals whom potential employers would have lacked the financial resources to hire in the first place. Employees and retirees of firms that never would have entered bankruptcy probably would have borne the brunt of Section 103’s effects. On the other hand, the instrumental effects of Section 103 also would have fallen on employees and retirees of bankrupt firms that had

90 The statement in the text assumes that the firm’s bankruptcy estate would not otherwise pay the relevant claims in full. The Bill would have expanded the asset base not only by expanding the avoidance powers, see Employee Abuse Prevention Act of 2002 (Durbin-Delahunt), S. 2798, H.R. 5221, 107th Cong. § 103, but also by subordinating certain secured claims to certain claims of retirees. See id. § 203; see also 11 U.S.C. § 726(a) (order of distribution to holders of claims).

91 Many traditional bankruptcy practitioners and academics continue to cling to this assumption nevertheless. See Douglas G. Baird, Bankruptcy’s Uncontested Axioms, 108 YALE L.J. 573, 589-92 (1998) (proceduralists, unlike traditionalists, emphasize the instrumental aspects of bankruptcy law); see also Harris & Mooney, Policy and Impact, supra note 77. at 97-111 (discussing the impact of Revised UCC Article 9 on unsecured creditors).

92 See REPORT, supra note 12. at 9-10, Letter to Paul H. Neill et al., supra note 17.
been unable to obtain necessary extensions of credit. The point is that one cannot make any responsible assessment of whether Section 103 generally would have harmed or benefited employees and retirees of firms, inside or outside of bankruptcy, without taking into account the instrumental effects of the provision, including its effects on the credit and financial markets.

Like the sponsors’ claim that Section 103 would have restored avoidance powers lost by the revision of UCC Article 9, the claim that Section 103 generally would have benefited employees and retirees is not supportable.

C. Is the Expansion of Avoidance Powers in Section 103 Consistent with Bankruptcy Policy?

Sections II.A and B above examined the sponsors’ stated justifications for Section 103 and found them unpersuasive. In this section we extract from the text of Section 103 several other, unstated principles that might be thought to underlie the proposed expansion of avoidance powers. We conclude that none of these principles reflects sound bankruptcy policy.

1. Should a Security Interest that Is Vulnerable to Any Other Claim under Any Circumstances Be Avoidable in Bankruptcy?

One possible basis for expanding the avoidance powers would be to put a trustee, as a representative of creditors, in a position as strong as that of every other person vis-a-vis a security interest. Otherwise posited, the argument would be that if anyone under any circumstances could take priority over or cut off a security interest, the trustee should have the rights and powers of that hypothetical person. For convenience, we refer to this avoidance power as the “most-favored-claimant” power. We find no sound bankruptcy policy basis for expanding the trustee’s avoidance powers along these lines.

One way to test the merits of the most-favored-claimant avoidance power is to ask whether it would promote the policies underlying the principal avoidance powers (i.e., the “strong-arm” power, the preference avoidance power, the power to avoid fraudulent transfers, and the power to avoid statutory liens). Consider first the “strong-arm” power, which

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93 These points raise empirical questions that we have explored elsewhere. See Steven L. Harris & Charles W. Mooney, Jr., Measuring the Social Costs and Benefits and Identifying the Victims of Subordinating Security Interests in Bankruptcy, 82 CORNELL L. REV. 1349 (1997).

94 See 11 U.S.C. §§ 544(a)(1) (“strong-arm” power); 544(b); 545 (statutory-lien avoidance).
confers upon a trustee the rights and powers of a hypothetical judicial lien creditor as of the time the bankruptcy case is commenced. The strong-arm power is best understood by viewing the trustee as a de facto judicial lien creditor for the benefit of all creditors. Just as creditors could have obtained judicial liens outside bankruptcy against property subject to an unperfected security interest, so a trustee obtains a judicial lien on their behalf in bankruptcy and may avoid the unperfected security interest. Because the strong-arm power avoids unperfected security interests for the benefit of creditors generally, it complements bankruptcy's equal (pro rata) sharing principle.

While the strong-arm power serves bankruptcy's policy of equality and mimics creditors' nonbankruptcy entitlements, the most-favored-claimant power would extend the trustee's avoidance powers much farther. As explained above, for example, under Section 103 (a version of the most-favored-claimant approach) the trustee would have been able to assert the rights of a hypothetical buyer in ordinary course of the debtor's inventory to cut off a security interest in the inventory even if the security interest was perfected. The effect of avoidance under the

547(b) (preference avoidance), 548 (fraudulent-transfer avoidance). The Bankruptcy Code contains other avoidance powers, but these are not relevant to the discussion. See, e.g., id. § 549 (postpetition-transfer avoidance).

95 See id. § 544(a)(1). Section 544(a) also arms a trustee with the rights and powers of a hypothetical creditor who obtains an execution that is returned unsatisfied, see 11 U.S.C. § 544(a)(2), and a hypothetical bona fide purchaser of real property, other than fixtures. See 11 U.S.C. § 544(a)(3). We discuss the latter provision infra Part II.C.2. David Carlson has argued that the trustee's strong-arm power is the organizing principle of bankruptcy. David Gray Carlson, Bankruptcy's Organizing Principle, 26 FLA. ST. U. L. REV. 549, 555-59 (1999) [hereinafter Carlson, Principle].

96 As we have explained elsewhere, traditionally, upon the commencement of an involuntary bankruptcy case, a trustee took possession of the debtor's assets, the creditors represented by the trustee thereby acquired a lien on the debtor's property. Although most bankruptcy petitions now voluntary, the result should be the same regardless of how a bankruptcy case is commenced. When a judicial officer takes control over the debtor's property for the benefit of creditors, the creditors (or their representatives) thereby should acquire a lien. Like any other lien that arises through the judicial process or through the exercise of a collective creditors' remedy, the lien that arises on bankruptcy should take priority over an unperfected security interest. See JOHN O. HONNOLD ET AL., SECURITY INTERESTS 441 (3d ed. 2000).

97 See U.C.C. § 9-317(a)(2)(A) (providing that an unperfected security interest in personal property or fixtures is subordinate to a person who becomes a lien creditor before the security interest is perfected); 9-102(a)(52) (defining "lien creditor").

98 Once a security interest is avoided, the value of the collateral is available for distribution to priority creditors and then to unsecured creditors on a pro rata basis. See 11 U.S.C. §§ 507(a) (priority claims); 726(a) (order of distribution to holders of claims). An unsecured creditor and the holder of an unperfected security interest are "equal," in the sense that either could have succeeded in appropriating the value of the collateral to the exclusion of the other—the secured party by perfecting its security interest and the unsecured creditor by acquiring a judicial lien. The strong-arm power in effect declares a "tie" among the unsecured creditors and the unperfected security interest; it preserves the unperfected security interest for the benefit of all. See TABB, supra note 61, § 6.5, at 338-39; THOMAS JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW 70-75 (1986).

99 See supra discussion Part I.A.
most-favored-claimant approach. then, would be to confer benefits on the debtor’s unsecured creditors that would not have been available under nonbankruptcy law.100

Consider next the trustee’s power to avoid preferences under Bankruptcy Code § 547. Preference law enables the trustee to avoid certain prebankruptcy transfers that result in giving a particular creditor more than its pro rata share of the debtor’s assets.101 Unlike the strong-arm power, preference avoidance does not generally mimic a nonbankruptcy priority rule.102 Instead, it “undoes payment and security of debt” that may be completely legitimate under nonbankruptcy law103 and may be completely invulnerable to an attack by unsecured creditors.

Preference law can be appreciated best by focusing on the effect of a prebankruptcy transfer to one creditor on the debtor’s other, nonpreferred creditors. Assets transferred to a creditor shortly before bankruptcy, whether as payment or as collateral, deplete the debtor’s estate. If the transfers were to stand, those assets would be unavailable in a Chapter 7 liquidation to satisfy the other creditors’ claims. The creditor who receives the prepetition transfer is said to have been preferred to the detriment of the other creditors. When a transfer is avoided as a preference under § 547(b), however, the assets (or their value) are restored to the debtor’s estate to be shared by all creditors.104

Traditional preference jurisprudence suggests that preference law is designed to promote equality of distribution among unsecured creditors.105 By recovering a preference from the preferred creditor,

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100 As the Report observed, “[t]he Act ... confers on unsecured creditors benefits that they could not have enjoyed outside bankruptcy.” REPORT supra note 12, at 11.

101 Section 547(b) provides for the avoidance of transfers, including security interests, of a debtor’s property that are made “to or for the benefit of a creditor ... on account of an antecedent debt.” 11 U.S.C. § 547(b). A transfer generally is not voidable unless it is made while the debtor is insolvent and within ninety days before the date that the debtor’s bankruptcy petition is filed. Id. The debtor is presumed to have been insolvent during the ninety-day period. Id. The ninety-day period is extended to one year if the creditor is an insider. Id. In addition, a transfer is avoidable only if it allows the creditor to obtain more than it would have obtained in a Chapter 7 liquidation case had the transfer not been made and had the creditor received its distribution in the Chapter 7 case. Id. This last element normally is easy for the trustee to establish. Unless the creditor would have received 100 % of its claim in Chapter 7 (i.e., unless the bankruptcy debtor is solvent), a prepetition payment necessarily improves the creditor’s position. The same can be said for a prepetition transfer of collateral to secure an antecedent unsecured debt.

102 Some states also have preference laws, however. See: e.g., 39 PA. CONS. STAT ANN. § 151 (2003).

103 See 11 U.S.C. §§ 550 (providing for recovery of avoided transfers); 551 (providing for automatic preservation of avoided transfer for the benefit of the estate).

preference law prevents the creditor from retaining payments and other transfers of property that otherwise would have been shared more widely. By putting the preferred creditor in the same position as the other creditors, who have not been preferred, preference avoidance blunts the advantage that certain creditors otherwise would have enjoyed.

This justification is consistent with the current treatment of security interests under § 547. A security interest that is transferred on account of an antecedent debt is eligible for preference avoidance just like the transfer of any other interest in the debtor’s property.106 A security interest that is created in exchange for new value ordinarily is not avoidable as a preference.107 However, even a security interest that is created in exchange for new value may be avoided if perfection of the security interest is delayed such that the act of perfection might be a “last-minute grab” by the secured party.108

Some argue that preference law ought to do (and, at least to some extent, actually does) more than protect the bankruptcy rule of pro rata sharing. They assert that preference law should deter creditors from obtaining payment whenever the debtor approaches bankruptcy.109 In their view, preference law should be (and largely is) directed to “opt-out behavior”—acts by which creditors seek to remove themselves from an impending collective proceeding (bankruptcy) by “gun-jumping” and, in doing so, destroy value.110 While this vision may be plausible in some contexts, most agree that deterrence is, at best, an incomplete explanation and justification.111 Indeed, many creditors probably

106 See 11 U.S.C. §§ 547(b)(2), (c)(1); 101(54) (defining “transfer”).
107 See id. § 547(b)(2), (c)(1).
108 Under § 547(e), unless a transfer is perfected within ten days after it becomes effective between the parties, the transfer takes place at the time of perfection. See id. § 547(c)(2)(A), (B). For this purpose perfection occurs when a contract creditor could not obtain a judicial lien that is senior to the transferee’s interest. See id. § 547(c)(1)(B). Thus, in the case of an Article 9 security interest, perfection occurs under preference law at the time the security interest is perfected under Article 9, see U.C.C. § 9-317(a)(2), unless it is perfected under Article 9 within ten days after it attaches. See id. § 9-203(a)(b) (a security interest becomes enforceable when it attaches). Although the policy basis for this treatment of delayed perfection is not entirely clear, it is consistent with the equality-based justification for preference law. See HONNOLD ET AL., supra note 96, at 449-50 (identifying potential underlying policies as a policy against secret liens and an “anti-last-minute-grab” policy).
109 See, e.g., H.R. Rep. No. 595, 95th Cong., 1st Sess. 177-78 (1977) (voidable preference law may discourage creditors “from racing to the courthouse to dismember the debtor during his slide into bankruptcy”); JACKSON, supra note 98, 123-38.
110 For example, the removal of a key asset may diminish the value of the debtor’s business, and thus the amount available for distribution to creditors, by an amount substantially greater than the stand-alone value of the asset removed. When a preferred creditor receives cash, however, the detrimental effects on the value of the assets available for distribution to creditors are considerably smaller.
111 Deterrence (when it actually occurs) also serves the equality policy by causing the debtor’s
encourage a payment sooner rather than later in the hope that the 90-day period will elapse before a bankruptcy petition is filed.\textsuperscript{112}

One might argue that a most-favored-claimant avoidance power would serve both the equality and the deterrence policies of preference law. It would, as explained above, result in most secured parties becoming unsecured in bankruptcy,\textsuperscript{113} with the consequence that creditors would be deterred from taking security interests. However, this argument distorts the meaning of the equality and deterrence policies as those policies are currently understood. The equality principle does not require treating \textit{all} creditors equally. The Bankruptcy Code gives effect to statutory, consensual, and judicial liens.\textsuperscript{114} The equality principle refers to the equality of unsecured creditors and those whose property claims can be defeated by unsecured creditors. Moreover, the deterrence policy is directed towards “last-minute grabs” that deplete the debtor’s bankruptcy estate. This policy already applies with full force to the transfer of security interests.\textsuperscript{115} Section 103 would have converted preference law into a mechanism for avoiding security interests that were given in exchange for new value.

The third significant avoidance power is the power to avoid prebankruptcy fraudulent transfers. Bankruptcy Code § 548 empowers the trustee to avoid transfers where the debtor has \textit{actual intent to defraud} its creditors and purposefully attempts to put assets out of the creditors’ reach.\textsuperscript{116} It also empowers the trustee to avoid gifts and other transfers that are \textit{constructively fraudulent} because the debtor transferred the property when it was in poor financial condition and did not receive a “reasonably equivalent value” in exchange for the transfer.\textsuperscript{117} The trustee can avoid a transfer under § 548 only if the transfer was made within one year before the date on which a bankruptcy petition is filed.\textsuperscript{118} Fraudulent transfers based on actual or constructive fraud are avoidable outside bankruptcy as well.\textsuperscript{119}
Bankruptcy Code § 544(b) empowers the trustee to avoid transfers avoidable under nonbankruptcy law if an actual unsecured creditor had that power when the bankruptcy case commenced. Under § 544(b), the trustee is bound by (and may take advantage of) the applicable statute of limitations under nonbankruptcy law.

The policies underlying the trustee’s power to avoid fraudulent transfers afford no support for the creation of a most-favored-claimant avoidance power. The avoidance power under § 544(b) is somewhat analogous to the “strong-arm” power, in that it mirrors in bankruptcy the rights of creditors to avoid fraudulent transfers under nonbankruptcy law. As is the case with preferences, no expansion of this power, let alone the vast expansion that a most-favored-claimant rule would work, is needed to accomplish this result. § 544(b) applies to secured transactions with full force. Sections 548 and 544(b) also complement pro rata sharing in the same manner as do the strong-arm and preference avoidance powers: They return the value of fraudulently transferred assets (or their value) to the debtor’s estate. But, as we discussed, the equality goal does not require the general avoidance of security interests or other liens.

In summary, a trustee’s avoidance powers under current law derive primarily from the rights that unsecured creditors enjoy outside bankruptcy or complement the principle of equality and pro rata sharing. A most-favored-claimant avoidance power would have provided to unsecured creditors inside bankruptcy the rights that distinct claimants, such buyers of the debtor’s inventory in the ordinary course of business or new-value purchasers of chattel paper who take possession, enjoy outside bankruptcy. These and other distinct claimants enjoy these nonbankruptcy rights for sound commercial reasons. For example, the rule that ordinary-course buyers of inventory take free of perfected security interests promotes the expectations of both the secured party, who has entrusted the goods to the seller-debtor for the precise purpose of ordinary-course sales, and the buyer, who has

122 See Carlson, supra note 103, at 563-73 (conceptualizing fraudulent transfer avoidance as a part of the strong-arm organizing principle’s model of the trustee holding a judicial lien for the benefit of all creditors). We do not intend to suggest in this brief discussion that we think § 544(b), as it has been construed, represents sound policy. See supra note 61.
123 Section 548 likewise applies to secured transactions with full force. One might consider § 548 as mimicking nonbankruptcy powers but eliminating § 544(b)’s requirement that the trustee identify a specific unsecured creditor having the power to avoid the transfer in question. On the avoidance of fraudulent transfers in bankruptcy, see generally TABB, supra note 61, §§ 6.27-35, at 412-34.
124 A good-faith transferee who took a constructively fraudulent transfer for value has a lien on the property transferred to the extent of any value given in exchange for the transfer. See 11 U.S.C. § 548(c); UNIFORM FRAUDULENT TRANSFER ACT § 8(d) (2003), 7A U.L.A. 352 (1999).
125 See supra text preceding and following note 114.
no reason to expect that the secured party would object to his purchase. The reason for this rule has no application to creditors who acquire judicial liens. Likewise, the rules that protect ordinary-course purchasers of chattel paper for new value facilitate the acquisition of goods and promote the expectations of the parties. The reason for this rule, too, has no application to creditors who acquire judicial liens.

The fact that the good-faith purchaser priorities in Article 9 have a sound commercial basis also suggests that the most-favored-claimant principle cannot be justified by Bankruptcy Code § 545. This section, which empowers a trustee to avoid statutory liens that are not perfected at the time of the commencement of the case against a hypothetical bona fide purchaser that purchases the property at that time, addresses state-created liens that are enforceable only in bankruptcy. Inasmuch as the policy underlying the statutory-lien avoidance power in § 545 has no application to Article 9 security interests, it should come as no surprise that Congress expressly excluded security interests from the definition of “statutory lien.”

2. Should a Trustee’s Strong-Arm and Preference Avoidance of Security Interests in Personal Property and Fixtures Be Conformed to the Trustee’s Bona Fide Purchaser Status Applicable to Real Property?

The idea of giving a trustee in bankruptcy the rights and powers of a good-faith purchaser is not a new one. The trustee already enjoys

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126 See U.C.C. § 9-320(a) (buyer in ordinary course of business, as defined in UCC § 1-201(9), takes free of perfected security interest).

127 See id. § 9-330(a), (b) (priority of purchasers of chattel paper who take possession in the ordinary course of business).

128 Section 545 empowers a trustee to avoid statutory liens that are “not perfected or enforceable at the time of the commencement of the case against a bona fide purchaser that purchases the property at the time of the commencement of the case, whether or not such a purchaser exists.” Bankruptcy Code § 545(2).

129 See TABB, supra note 61, at 463 (“a state statutory lien that has a priority effect will be enforced in bankruptcy if it is bankruptcy-neutral”). Even if § 545(2) is also viewed as implementing the policy against “secret liens,” see id., it does not justify widespread avoidance of security interests. See infra note 145 and accompanying text.

130 “[S]tatutory lien” does not include security interest, whether or not such interest is provided by or is dependent on a statute and whether or not such interest is made fully effective by statute.” 11 U.S.C. § 101(53). “[S]ecurity interest” means lien created by agreement.” See id. § 101(51).

One might imagine a more modest version of the most-favored-claimant avoidance power, the “most-favored-secured-party” avoidance power, which would arm the trustee in bankruptcy with the rights of a hypothetical secured party who holds a security interest in the same collateral in which an actual secured party has perfected an otherwise unavoidable security interest. Although narrower in scope than the most-favored-claimant avoidance power, the most-favored-secured-party avoidance power is likewise not supported by any theory or policy immanent in the existing avoidance powers or otherwise.
those rights with respect to prepetition transfers of real property, other than fixtures. Substantially the same good-faith (bona fide) purchaser test applies under § 547(e)(1) for determining when a transfer of real property, other than fixtures, is perfected (which, in turn, determines when a transfer is made) for the purpose of preference avoidance. Would the goal of conforming the avoidance powers for transfers of personal property and fixtures to the powers applicable to transfers of real property provide a rational and appropriate justification for Section 103? We believe the answer is no.

The history of § 544(a)(3) is instructive in this regard. Bankruptcy trustees could not exercise the powers of a bona fide purchaser of real property under the strong-arm clause of the Bankruptcy Act of 1898 ("Bankruptcy Act"). This power was added to the strong-arm clause in 1978 with the enactment of Bankruptcy Code § 544(a)(3). The change was much less significant than it might first appear. Essentially the same result—the avoidance of unrecorded mortgages—often was achieved under the Bankruptcy Act’s preference avoidance power, section 60. Section 60a(2) of the Bankruptcy Act provided that a transfer of real property occurred when the transfer was “so far perfected” that it became invulnerable to the rights of a bona fide purchaser. If a transfer was never so perfected, it was “deemed to have been made immediately before the filing of the [bankruptcy] petition.” The result was that a transfer vulnerable to the rights of a hypothetical bona fide purchaser at the time a bankruptcy petition is filed fell within the then-applicable four-month preference period. If the other elements of a “preference” under section 60a(1) were satisfied, the transfer might be avoidable under section 60b. By adding § 544(a)(3) to the strong-arm avoidance power, the Bankruptcy Code generally conformed the strong-arm and preference bona fide purchaser tests for transfers of real property other than fixtures.

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131 See id. § 544(a)(3) (bankruptcy trustee has the rights and powers of a hypothetical bona fide purchaser of real property, other than fixtures, from the debtor).

132 See id. §§ 547(e)(1) (fixing time when perfection of transfer of real property other than fixtures occurs); 547(e)(2) (determining when a transfer is made by reference to whether and when the transfer is perfected).


135 Id. § 60a(2), 11 U.S.C. § 96a(2).

136 Id. Bankruptcy Code § 547(e)(2)(C) is to a similar effect. See 11 U.S.C. § 547(e)(2)(C).

137 See Bankruptcy Act § 60a(1), b, 11 U.S.C. § 96a(1), b (1976) (repealed effective Oct. 1, 1979). Preferential transfers avoidable under the Bankruptcy Act were those that (1) were made within the four-month period prior to the filing, “for or on account of an antecedent debt,” and while the debtor was insolvent and (2) enabled the creditor to obtain a greater recovery than other creditors of the same class. Bankruptcy Act § 60a(1), 11 U.S.C. § 96a(1) (1976) (repealed effective Oct. 1, 1979).

138 Under section 60b a preference could be avoided only if at the time of the transfer “the creditor . . . has . . . reasonable cause to believe that the debtor is insolvent.” See Bankruptcy Act
The difference between the test applied to transfers of personal property and fixtures (i.e., the judicial lien creditor test) for purposes of the strong-arm and preference avoidance powers, and the test applied to transfers of real property (i.e., the good-faith purchase test) generally reflects differences in state law relating to personal property and fixtures on one hand and real property on the other. In many jurisdictions a transfer of real property, such as by deed or mortgage, is valid against claims of the transferor's judicial lien creditors even if the transfer is not recorded in the proper real estate records. Consequently, if a trustee were given only the rights and powers of a hypothetical judicial lien creditor with respect to a transfer of real property, many secret, unrecorded transfers of real property would be invulnerable to avoidance. The bona fide purchaser test for real property then, effectively reflects a policy against secret liens and other transfers and in favor of publicity.

If any conformity is desirable, Section 103 has it backwards. The strong-arm and preference powers for transfers of real property should be conformed to those applicable to personal property and fixtures, as opposed to the other way around. Aside from fraud (actual or constructive), there would seem to be no bankruptcy policy against secret liens and thus no reason to arm a trustee with the power to avoid them if they cannot be avoided by creditors outside bankruptcy. In contrast, applying a good-faith purchaser test to transfers of personal property and fixtures would have disastrous effects on the credit markets, for the simple reason that certain distinct good-faith purchasers of personal property and fixtures have such powerful rights against even perfected security interests. As the Report explained:

a bona fide purchaser test for determining when a transfer of


139 See COLLIER ON BANKRUPTCY, supra note 64, § 547.06 [1], at 547-84.

140 Section 547(e) puts a premium on prompt performance of whatever act is necessary under local law to perfect a transfer of real property. This encourages open dealing and safeguards the debtor's general creditors from the problem created by the perfection of secret liens shortly before the debtor files a petition for relief under title 11. COLLIER ON BANKRUPTCY, supra note 64, § 547.06[3], at 547-85. Accord TABI, supra note 61, § 6.4, at 341 (“The probable intention of Congress [in enacting 11 U.S.C. § 544(a)(3)] was to deal broadly with the whole problem of ostensible ownership.”).

141 TABI, supra note 61, § 6.4, at 341 (“The difficulty is that there is no obvious bankruptcy policy that dictates resolving the ostensible ownership issue differently inside a bankruptcy case than it is under nonbankruptcy law.”). The best solution to the problem of secret real-property interests might be to reform nonbankruptcy law to afford judicial lien creditors rights with respect to unrecorded transfers. Cf. U.C.C. § 9-317(a)-(d) (providing that an unperfected security interest in personal property and fixtures generally is subordinate to the rights of judicial lien creditors, buyers, lessees, and licensees).

142 See supra discussion Part I.A.
personal property occurs for preference purposes was abandoned more than 50 years ago because it did not work and substantially impeded the development and use of secured credit. In 1950, Congress amended the Bankruptcy Act so as to override the (in)famous case of *Corn Exchange National Bank v. Klauder*. The then effective Bankruptcy Act conferred on the trustee, in exercising its power to avoid preferences, the rights of a hypothetical bona fide purchaser of personal property (assigned accounts receivable, in *Klauder*). *Klauder*, in effect, also gave the trustee the rights of a hypothetical purchaser that was the first assignee to give notice to the underlying account obligor. From the 1950 amendment forward, the test for transfers of personal property in the context of preference avoidance has been based on the priority of a hypothetical judicial lien creditor.

In sum, even if the good-faith purchaser test is justified for real property, differences between the law of real property and the law of personal property and fixtures make the test inappropriate for transfers of the latter.

### III. Lessons from the Auspicious Beginnings and Ignominious Demise of Section 103: Competence, Integrity, and Transparency in Law Reform

In the preceding Part we sought, without success, to identify a plausible rationale for an expansion of the trustee’s avoidance powers either along the lines of Section 103 or along the narrower lines of the sponsors’ explanation of the section. In this Part we suggest possible failures in the legislative process that may have led to this flawed legislation and to the striking conflict between the expression of the sponsors’ intentions and the effects of the Bill as introduced.

Section 103 is not the first poorly conceived, ill-advised, and badly drafted legislation introduced in Congress, and, no doubt, it is not the last. From one perspective, the legislative process worked. The eventual failure of the Bill, and Section 103 in particular, provides an example of a successful effort to oppose the enactment of unwise legislation. Yet the costs of resistance were high. A large number and wide range of interested organizations and individuals spent a great amount of time at considerable expense to thwart the bill. Lobbyists and lawyers do not come cheap. Even regulators within the federal government found it necessary to forge a prompt, coordinated response to explain to the sponsors that the legislation would wreak considerable

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143 318 U.S. 434 (1943).
144 REPORT, supra note 12, at 13 (some footnotes omitted).
harm to the very employees whom the sponsors claimed they wished to protect. The legislative process would have worked much better had Section 103 never been introduced or been scheduled for a committee hearing.

What went wrong? What lessons should we take from the introduction and eventual withdrawal of Section 103? We identify three aspects of this failure of the legislative process that may suggest useful lessons for those involved with law reform-related activities: competence, truthfulness, and transparency.

The individuals who participated in the drafting and review of Section 103 may have intended to craft a provision that merely would have rolled back the clock on Article 9 for purposes of the avoidance powers. If so, they certainly failed in their efforts. This raises a question of competence in drafting. Even more worrisome is the fact that anyone who understood Section 103 would have known that the sponsors’ stated explanation of its purpose was not correct. Any belief that Section 103, as drafted, was consistent with that explanation also would suggest a lack of competence, in understanding how the provision actually would work and how it would affect routine financing transactions.

Alternatively, the conflict between the sponsors’ explanation of Section 103 and its substance raises question of truthfulness and candor. We have no means of determining the sponsors’ subjective motivations for including Section 103 in the bill. From an objective perspective, however, there is reason to be skeptical that benefits for employees and retirees had much to do with the section, except perhaps in the most simplistic sense discussed above. Even if Section 103 would have freed up assets by avoiding security interests, these assets would have become available to satisfy all claims, not just the claims of employees and retirees. Viewed in this light, both Section 103 as originally proposed and the narrower versions discussed above can be seen as a direct assault on security interests, an assault that is unrelated to the interests of employees and retirees.

One might ask: If the sponsors actually believed that greater powers to avoid security interests would be best for employees and retirees (or anyone else), why then did Section 103 attack security interests only indirectly (through the hypothetical reliance purchaser relying on hypothetical incorrect information) rather than scale back

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145 See Letter from Paul H. O’Neill et al., supra note 17.
146 See supra note 94.
147 As we explain elsewhere, we doubt that it would have had that effect in any large measure going forward. See supra text following note 95. However, if Section 103 were enacted and its proposed retroactive application were upheld as constitutional, the Section might have had that effect in the case of pre-enactment secured transactions rendered avoidable by the retroactive effect.
secured claims more directly and straightforwardly? One answer may be that measuring avoidance powers by using the rights of a hypothetical nonbankruptcy claimant would be more in keeping with the traditions of the Bankruptcy Code.\textsuperscript{148} However, motives apart from the desire for statutory consistency may have been involved. Those who drafted Section 103 may have chosen to invoke the rights of a hypothetical good-faith purchaser to give the appearance of pursuing a principle different from a simple scale-back. An indirect attack would be more difficult to discover than a direct frontal assault. It is not inconceivable that UCC sections 9-338 and 9-312(a) may have been used as cover for the sponsors’ claim that the purpose of the section was merely to return to the status quo ante under Former Article 9.\textsuperscript{149}

We have been led to believe that some individuals involved in the process reasonably relied on others whom they believed to be competent and reliable. It may be that this reliance was misplaced, and that one or more otherwise competent individuals produced an unsatisfactory product or gave poor advice. It may also be that some individuals involved with Section 103 were quite competent but intended the broad impact that Section 103 actually would have had on secured financing rather than the comparatively modest effects claimed by the sponsors. We have been told that the sponsors of the Bill and some of their staff were surprised by the strength of the opposition to Section 103 and several other provisions of the Bill. This surprise may have resulted from the failure of the sponsors and their staffs to understand the wide impact that Section 103 would have imposed on routine transactions.\textsuperscript{150} The possibility that people upon whom the sponsors and their staff relied were not forthcoming in disclosing their intentions raises yet another question of candor.\textsuperscript{151}

Did someone fail to forthrightly inform the sponsors and their staff members about the true nature of Section 103? It is certainly possible that Section 103 was proposed and supported by bankruptcy experts who opposed Revised Article 9 and who wished to render many secured

\textsuperscript{148} See, e.g., 11 U.S.C. §§ 544(a), 547(c).

\textsuperscript{149} See generally supra discussion Part I (discussing the inconsistency between Section 103 and the sponsors’ claim that the section rolls back the revisions to UCC Article 9).

\textsuperscript{150} The fact that Senator Durbin has shown sensitivity to the concerns of businesses, including the small businesses that would have been likely to suffer had Section 103 been enacted, lends support to this hypothesis. See Mike Dorning, Senators reverse roles on business: Fitzgerald, Durbin buck party trends, CHI. TRIB., Aug. 26, 2002, at News 1 (“The liberal Durbin, son of a stevedore and a longtime ally of organized labor, increasingly is seen by many Illinois business leaders as the go-to man to represent their interests in the Senate.”). Some earlier bankruptcy reform efforts by Senator Durbin did not reflect the attitude reflected in Section 103. See, e.g., Consumer Bankruptcy Reform Act of 1998, S. 1301, 105th Cong. (1998); Consumer Bankruptcy Reform Act of 1999, S. 945, 106th Cong. (1999).

\textsuperscript{151} This also implicates the competence of the sponsors and staff members in their failure to appreciate the effects of Section 103 based on their own knowledge and experience.
transactions less effective, if not ineffective, in bankruptcy, thereby snatching victory from the jaws of the past defeat.\textsuperscript{152} This hypothesis finds at least some support in the Final Report of the National Bankruptcy Review Commission and in the process leading up to the Final Report.\textsuperscript{153} The fact that the Commission’s recommendations make little mention of the avoidance powers provides strong evidence that responsible, mainstream bankruptcy professionals and academics, at least, saw no need for a material expansion of those powers.\textsuperscript{154} We also have no reason to believe that the Commission had any concerns about the direction of Revised Article 9, the details of which (including the substance of what became section 9-338) were in the public domain as the Commission finalized its report in 1997.\textsuperscript{155}

\textsuperscript{152} The defeat, of course, was the overwhelming rejection of the opponents’ complaints about Revised Article 9. As the Report noted:
Following its unanimous approval in 1998, it was presented to the legislatures for adoption, a process that normally takes 8 to 10 years. Because of the strong national support, the need for immediate adoption, and the lack of any organized opposition to the changes, Revised UCC Article 9 was adopted by the legislatures in all 50 states and by the District of Columbia by July 1, 2001, and is now effective in all 50 states, the District of Columbia, and the U.S. Virgin Islands. Indeed, Revised UCC Article 9 enjoys the fastest adoption record in the more than 100-year history of the National Conference. Article 9 has been considered the “crown jewel” of the UCC for almost 50 years, being the most bold and innovative of the UCC’s articles. Why would the United States Congress wish to foist this important and successful domain of state law?

\textsuperscript{153} NATIONAL BANKRUPTCY REVIEW COMMISSION FINAL REPORT, BANKRUPTCY: THE NEXT TWENTY YEARS (1997) [hereinafter NBRC REPORT].

\textsuperscript{154} To the contrary, the Report noted that the NBRC Report recommended restricting the avoidance powers. See REPORT, supra note 12, at 13 & n.21, citing NBRC REPORT, supra note 153. Recommendations 3.2.1 at 797-98 (transfers of less than $5,000 may not be sought in action to avoid nonconsumer debt preference); 3.2.2 at 799-800 (preference recovery action of less than $10,000 must be brought in district in which transferee has principal business); 3.2.3 at 800-03 (strengthening protection from preference avoidance for ordinary-course payments); 4.2.11 at 955 (cut back on Bankruptcy Code § 545(2) bona fide purchaser test to provide federal tax lien greater protection from avoidance).

\textsuperscript{155} As the Report explained:
Moreover, the Commission must have been aware of the status of the planned revisions to UCC Article 9. By 1997 most of the substantive proposals already were on the table. For example, a provision substantially similar to UCC § 9-338 was included as § 9-335 in the 1997 drafts of the revised Article presented to The American Law Institute and the National Conference of Commissioners on Uniform State Laws.
Our conjectures concerning the competence or truthfulness of those involved with formulating and proposing Section 103 make us uncomfortable, but we know of no other means of exploring the possibilities for how the provision came to be. Understanding the process may make it less likely that the same mistakes will be made in the future, and avoiding future repeat performances is the chief point of our exercise.\textsuperscript{156}

Although it appears that the sponsors eventually came to appreciate the enormity of the detrimental impact that Section 103 and some other provisions of the Bill would have had,\textsuperscript{157} their approach was structured in a way that discouraged constructive debate and sheltered the process from essential expertise. A more transparent process would have attracted the attention of experts, such as the authors of the \textit{Report}, earlier in the process. Had that occurred, it is unlikely that Section 103 would have been included in the Bill. Section 103 was drafted behind the scenes. If the Bill is a fair example, and we believe that it may be, then cronyism is alive and well in the world of bankruptcy law reform.\textsuperscript{158} To the best of our knowledge Section 103 was introduced before the sponsors and their staff members consulted with organizations of bankruptcy professionals or organizations representing either the users or extenders of secured credit. Although the Bill was introduced on July 25, 2002, the sponsors’ first public statements on it were not issued until August 1, 2002, immediately before Congress was to adjourn until after Labor Day.\textsuperscript{159} August is, of course, a time when many vacations are scheduled; it is hard to imagine a period, other than year’s end, during which collective action in opposition to legislation would be more difficult to organize.\textsuperscript{160} Moreover, on August 28, 2002, the bill was scheduled for a hearing on September 5 before the full

\textsuperscript{156} The sponsors and their staff members knew whom they relied upon for advice concerning Section 103. They may elect to seek broader expert input in the future. One Congressional staff member indicated to one of the authors of the \textit{Report} that neither the staffer nor the legislator for whom the staffer works would again propose to modify the avoidance powers without first consulting experienced experts in the field of secured transactions.


\textsuperscript{158} The enormous influence of bankruptcy professionals in the bankruptcy-related legislative process over the years is well known. See David A. Skeel, Jr., \textit{Debt’s Dominion: A History of Bankruptcy Law in America} 14-16, 80-98 (2001).

\textsuperscript{159} See supra note 11.

\textsuperscript{160} Perhaps surprisingly, the authors of the \textit{Report} were able to produce it by the day following Labor Day.
Senate Judiciary Committee—affording barely more than a week’s notice to the public.\(^{161}\) Happily, the sponsors came to appreciate the strength and power of the opposition to the bill and canceled the hearing.\(^{162}\) Bankruptcy law is both highly technical and very important; it has an enormous impact on transactions and behavior outside bankruptcy. We would have hoped for a more considered approach from our elected officials.\(^{163}\)

Are there possible solutions that would avoid or render less likely another Durbin-Delahunt-like fiasco? We believe that it is worthwhile for the organizations of bankruptcy professionals to explore this question. We can imagine a system for a thorough vetting of all proposals to modify the Bankruptcy Code. One model is the formal judge-lawyer partnership structure for creating and modifying federal rules of practice, procedure, and evidence.\(^{164}\) Congress could create, for example, a standing committee supported by more specialized advisory committees, each populated by lawyers, judges, and academics. These committees would make recommendations on revisions of the Bankruptcy Code and comment on proposals for revision, taking into account input solicited from the public.\(^{165}\) While Congress could not guarantee not to reverse its course, such a system could contain powerful disincentives for Congress to ignore it by enacting “end-run” legislation.

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\(^{161}\) Of this week, the Labor Day weekend and the Friday preceding it comprised four days.


\(^{163}\) To be sure, we personally have been spoiled by our experiences with the law reform processes of the National Conference of Commissioners on Uniform State Laws and The American Law Institute.

\(^{164}\) For a summary of the process under which these rules are promulgated, see The Rulemaking Process, on website of the Judicial Conference of the United States, http://www.uscourts.gov/rules/proceduresum.htm. The Judicial Conference’s work is coordinated by its Committee on Rules of Practice and Procedure, often called the “Standing Committee.” \(id.\) The Standing Committee considers proposals for revision made by one of the five advisory committees (appellate, bankruptcy, civil, criminal, or evidence). \(id.\) With the Standing Committee’s approval, an advisory committee may circulate proposals to lawyers and judges for comment and hold public hearings. \(id.\) When the Standing Committee approves a recommendation for an amendment and the Judicial Conference, in turn, approves the Standing Committee’s recommendation, the Judicial Conference reports the recommendation to the Supreme Court by May 1. \(id.\) If the Supreme Court adopts the amendment it then transmits the amendment to Congress, which can reject, modify, or defer the amendment. \(id.\) Absent Congressional action, the amendment becomes effective on the following December 1. \(id.\) The National Bankruptcy Review Commission embodies another approach, but it was not successful in achieving any meaningful reform.

\(^{165}\) For decades the National Bankruptcy Commission (“NBC”) has studied the operation of bankruptcy and related laws and proposals for their reform. See National Bankruptcy Conference, Mission, available at http://www.nationalbankruptcyconference.org. (last visited Feb. 14, 2004). However, the NBC has no formal role in the legislative process.
CONCLUSION

Section 103 of the Bill began with a bang, and died with barely a whimper. There is, however, more to the story than the proposal, and eventual abandonment, of unwise legislation. In the end the sponsors and their staffs realized, we surmise, that Section 103 was ill-conceived and that they had been blindsided by some flawed advice.

As academics we take very seriously our role in the process of law reform on every level, whether we act in an official or informal capacity. As academics we believe that we must use our knowledge carefully and guard our professional reputations tenaciously. In giving advice and counsel to lawmakers we should observe a level of care and objectivity that is every bit as high as the duties that would apply in the representation of a client. We should not fear to offer our views publicly and candidly. These are the standards and values that we and our fellow co-authors of the Report brought to the project. We hope that our participation may have at least some small but lasting influence with the Bill’s sponsors and their staffs as well as on the continuing process of reforming bankruptcy law.