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*LEVIT v. INGERSOLL RAND FINANCIAL CORP.**: THE DEMISE OF INDEPENDENT PREFERENCE LIABILITY UNDER §550(a)

The United States Bankruptcy Code[1] seeks to prevent the unfair and inequitable distribution of a debtor's assets prior to bankruptcy.[2] In order to facilitate this, the Code allows the trustee to recover or "avoid" any transfer of the debtor's property having the effect of preferring one creditor over others of equal status.[3] Where the transfer meets the required elements of a voidable "preference"[4] under §547(b)[5], it can be avoided at the trustee's option. Aside from

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* 874 F.2d 1186 (7th Cir. 1989).

1. 11 U.S.C. §§ 101-1330 (1982 & Supp. IV 1986). Section 547 determines what transfers are subject to avoidance while section 550 provides the recovery provisions for avoided transfers. *See infra* note 28 on the separation of avoidance and recovery.

2. *In re* Western World Funding, Inc., 54 Bankr. 470, 474 (Bankr. D. Nev. 1985). *See H.R. Rep. No.* 595, 95th Cong., 1st Sess. 177-78 (1978) ("[T]o facilitate the prime bankruptcy policy of equity in distribution of the debtor's assets."). *See also* note 91 for a discussion of the purpose of §547(b).

3. This power to avoid transfer of the debtor's property has been defined as "the power to extinguish any property interests held by entities other than the debtor in property that belonged to the debtor prior to bankruptcy but that was transferred away or in property of the estate." Jackson, *Avoiding Powers in Bankruptcy*, 36 STAN. L. REV. 725, 725 n.1 (1984). *See H.R. Rep. No.* 595, 95th Cong., 1st Sess. 177 (1977), *reprinted in* 1978 *U.S. Code Cong. & Admin. News* 5963, 6138; *Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. No.* 137, 93rd Cong., 1st Sess., pt.I, at 18 (1973) (comprehensive listing of the specific powers of the trustee in bankruptcy).

4. Although the term "preference" is not defined by the Code, it is commonly interpreted to be any action by the debtor to pay or secure the claim of one creditor to the exclusion of the rest. BLACK'S LAW DICTIONARY 1342 (5th ed. 1979). The concept of preferential transfers was derived from early English fraudulent conveyance law which sought to recover transfers made with the intent to hinder, delay, or defraud creditors. Countryman, *The Concept of a Voidable Preference in Bankruptcy*, 38 VAND. L. REV. 713, 719 (1985). The term was defined under the Bankruptcy Act of 1841 as a transfer made "in contemplation of bankruptcy, and for the purpose of giving a 'preference or priority over the general creditors'." 5 Stat. 440 (1841), *repealed* 5 Stat. 614 (1843). *See* Countryman, *supra*, at 706-07.

5. Section 547(b), which sets out the elements of a preference, provides that:

(b) Except as provided in subsection (c) of this section, The Trustee may avoid any transfer of an interest of the Debtor in property-

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

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

(3) made while the debtor was insolvent;

(4) made-

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

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

(i) was an insider; and

establishing the elements of a preference, §547(b)(4) limits the preference recovery period to 90 days before the filing date of the petition in bankruptcy.[6] However, this recovery period is extended to one year if the creditor receiving such transfer is an "insider."[7] This period is referred to as an "extended preference-recovery period."[8]

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

(5) that enables such creditor to receive more than such creditor would receive if-

(A) the case were a case under Chapter 7 of this title;

(B) the transfer had not been made; and

(C) such creditor received payment of such debt to the extent provided by the provisions of this title.

11 U.S.C. §547(b) (1983).

This section was amended by the Bankruptcy Amendments and Federal Judgeship Act of 1984 ("BAFJA"). *Pub. L. No.* 95-353, 98 *Stat.* 333 (1984). These amendments are only applicable to cases in which the debtor's petition in bankruptcy was filed 90 days after July 10, 1984. BAFJA at §553(a). Prior to 1984, this section applied the one year insider preference recovery period only if the insider "had reasonable cause to believe the debtor insolvent at the time of such transfer." §547(b)(4)(B)(ii).

See Kenan v. Fort Worth Pipe Co. (In re George Rodman, Inc.), 792 F.2d 125 (10th Cir. 1986) "In general, a 'preference' exists when a debtor makes payment or other transfer to a certain creditor or creditors, and not to others . . . . Such favoritism is prohibited by 11 U.S.C. §547(b) when a debtor is in bankruptcy." *Id.* at 127. It is well documented that a debtor has a common-law right to dispose of his or her property, and to prefer one creditor over another; however, once the threat of impending bankruptcy becomes apparent, these preference provisions impose a duty upon the debtor to treat its creditors fairly. Kapela v. Newman, 649 F.2d 887, 890, 24 C.B.C. 297 (1st Cir. 1981); Johnson-Baillie Shoe Co. v. Bardsley, Elmer & Nichols, 237 F.2d 763, 767 (8th Cir. 1916).

6. Prior to 1984, the trustee had to prove both insolvency of the debtor at the time of the transfer under §547(b)(3), and that transferee has reason to believe the debtor was insolvent under §547(b)(4)(B)(ii). However, in enacting the 1984 amendments, Congress created a rebuttable presumption of debtor insolvency for the ninety days preceding a petition in bankruptcy. Adelman, *Who is An Insider after the 1984 Amendments to Section 547(b)(4)(B)?*, 5 BANKR. DEV. J. 195 202-03 n.51. "[P]resumption of insolvency reflects Congressional recognition that most debtors are insolvent during the 90 days preceding bankruptcy."

7. The Code defines the term "insider" as follows:

insider includes -

(A) if debtor is an individual -

(i) relative of the debtor or of a general partner of the debtor;

(ii) partnership in which the debtor is a general partner;

(iii) general partner of the debtor; or

(iv) corporation of which the debtor is a director, officer or person in control;

(B) if the debtor is a corporation -

(i) director of debtor;

(ii) officer of the debtor;

(iii) person in control of the debtor;

(iv) partnership in which the debtor is a general partner;

(v) general partner of the debtor; or

(vi) relative of the general partner, director, officer, or person in control of the debtor;

11 U.S.C. §101(30) (1984). *See also Adelman*, supra note 6.

8. 11 U.S.C. § 547(b) (1982 & Supp. IV 1986). For a discussion of section §547(b), see *supra* notes 1-2.

In *Levit v. Ingersoll Rand Financial Corp.*,[9] the United States Seventh Circuit Court of Appeals considered whether the trustee can recover transfers beyond ninety days from an outside creditor when that transfer benefits an inside creditor or guarantor.[10] The court upheld the application of the extended preference-recovery period and allowed recovery from the outside creditors where the creditor holds an insider's guarantee.[11]

On April 13, 1983, the V.N. Deprizio Construction Company ("Debtor") filed a petition for reorganization under Chapter 11 of the Bankruptcy Code.[12] The court subsequently appointed Louis W. Levit as trustee ("Trustee").[13] Prior to the filing of the petition, the Debtor borrowed from several creditors,[14] among them, the defendant-appellant, Ingersoll Rand Financial Corporation ("Ingersoll").[15] It secured these loans[16] by granting senior liens on the equipment purchased with the borrowed funds.[17] The Debtor also had outstanding debts to Melrose Park Bank & Trust,[18] to several employee

9. 874 F.2d 1186 (7th Cir. 1989).

10. *Id.*

11. *Id.* at 1200-01.

12. *Id.* at 1186. *See also In Re* V.N. Deprizio Constr. Co., 86 Bankr. 545, 548-49 (N.D. Ill. 1988).

13. *In re* V.N. Deprizio Constr. Co., 58 Bankr. 478 (N.D. Ill. 1986). *See also* note 3 for discussion of the trustee's avoiding power.

14. Levit v. Ingersoll Rand Financial Corp., 874 F.2d 1186, 1188 (7th Cir. 1989). In 1980, Debtor was awarded $13.4 million in contracts for work on the Chicago subway extension to O'Hare Airport. *Id.* at 1187. The City of Chicago made loans of $2.5 million to Debtor to ensure completion of the project before the mayoral primary election in February, 1983. *Id.* Debtor took out additional loans from CIT Group/ Equipment Financing, Inc. (CIT), and Melrose Park Bank & Trust (Melrose), to purchase equipment. *Id.* Debtor also fell behind in employee pension plan contributions required under several collective bargaining agreements, and executed notes to the Employee Plans for the balance owing. *Id.* at 1188. Lastly, Debtor failed to remit withholding taxes to the U.S. Internal Revenue Service for amounts withheld from employee salaries. *Id.*

15. *Id.* at 1188. The separate appeals of Melrose (No. 88-3091) and CIT (No. 88-3092) were consolidated with Ingersoll's appeal (No. 88-3093) for determination by the Seventh Circuit. *Id.*

16. *See supra* note 14 for identification of the other creditors involved. The only loans, per se, were taken from Ingersoll, CIT, and Melrose Park Bank. Levit v. Ingersoll Rand Financial Corp., 874 F.2d 1186, 1887 (7th Cir. 1989). The amounts owing to the various Employee Plans were delinquent pension fund contributions required under the various collective bargaining agreements to which Debtor was bound. *Id.* at 1188; 26 U.S.C. §§ 1-7873 (1986). The tax obligation is, of course, required under the Internal Revenue Code. *Id.*

17. *See Deprizio*, 86 Bankr. at 549. The loans from Ingersoll and CIT which were used to purchase construction equipment were fully-secured by senior interests in that equipment. *Id.* These lenders were fully-secured in that the entire amount of the indebtedness could be realized from liquidation of the collateral held, in this case, the construction equipment. *See generally Restatement of Security* §115, Special Note, 308-09 (1941). *See also* Nimmer, *Security Interests in Bankruptcy: An Overview of Section 547 of the Code*, 17 Hous. L. Rev. 289, 293 n.10 (1980).

18. *See supra* notes 13-15 for discussion of the other creditors involved and the nature of their claims.

pension and welfare plans for delinquent contributions required under collective bargaining agreements,[19] and to the federal government for withholding tax obligations.[20]

Richard N. Deprizio, the president of the Debtor, co-signed the note to Melrose Park Bank & Trust.[21] In addition, both Richard and his brothers,[22] executed guarantees to several of Debtor's other lenders.[23] When the Debtor fell behind in payments to the Employee Plans, it executed notes in their favor secured by junior interests in the same equipment in which Ingersoll held senior interests.[24] Richard Deprizio also co-signed the notes to several of the Employee

19. The Employee Plans argued that the Employee Retirement Income Security Act ("ERISA"), 29 U.S.C. §1001-1461 (1974), should not provide the basis for enlarging their liability under the bankruptcy laws. Joint Brief for Appellants at 40, Levit v. Ingersoll Rand Fin. Corp., 874 F.2d 1186 (7th Cir. 1989) (Nos. 88-3091 through 88-3093) [hereinafter "Ingersoll Brief"]. The argument is based on the premise that although ERISA imposes personal liability on the individual in control of a corporation, that individual does not have a claim against the Debtor and, therefore, cannot be a creditor within the meaning of the Code. *Id.* at 41. *See infra* note 52 and accompanying text for a discussion of the terms "claim" and "creditor".

20. The transfers received by the United States were challenged on the basis that the Internal Revenue Code imposes personal liability on a corporate officer for failing to remit the taxes withheld from employee salaries. 26 U.S.C. §7501, *In re* V.N. Deprizio Constr. Co., 86 Bankr. 545, 555 (N.D. Ill. 1988). *See also* Monday v. United States, 421 F.2d 1210 (7th Cir. 1970). The IRS argued that this individual is independently liable rather than secondarily liable as a guarantor for the taxes. Brief for the United States at 32-33, Levit v. Ingersoll Rand Fin. Corp., 874 F.2d 1186 (7th Cir. 1989) (Nos. 88-3091 through 88-3093) [hereinafter "U.S. Brief"]. Thus, the United States argued that because the individual owed the amounts directly to the Government, they did not hold a "claim" against Debtor for the same amount. *Id.* Therefore, the United States contended that the amounts remitted prior to the bankruptcy were not preferences. *Id.* The Seventh Circuit adopted this reasoning and found the tax payments were not recoverable because the transfers did not benefit the individual "as a creditor." *Levit*, 874 F.2d at 1192. *See infra* note 52 for a discussion of the terms "claim" and "creditor".

21. Levit v. Ingersoll Rand Financial Corp., 874 F.2d 1186, 1187 (7th Cir. 1989). Deprizio, as president of the Debtor, falls within the definition of insider under §101(30)(B)(ii). *See supra* note 7 for a discussion of the term "insider" under §547(b).

22. *Levit*, 874 F.2d at 1187. Richard Deprizio's brothers are also insiders of the Debtor pursuant to §101(30)(B)(vi) for being a relative of an officer or person in control of the Debtor. *See supra* note 7 for a discussion of the scope of the term "insider".

23. *See supra* note 14 for a discussion of the creditors involved.

24. The facts that junior interests were issued on collateral already subject to senior interests creates the situation in which CIT finds itself. The insiders guaranteed the loans from the junior lienholders, but the senior liens were fully secured by the collateral. *See infra* notes 14-18 for a discussion of lien superiority. The Trustee alleged that an insider benefited upon payment to CIT even though no insider guaranteed the debt. *Levit*, 874 F.2d at 1200. However, the Trustee's theory was that every payment to the senior lienholder (CIT) increases the amount of security available for the junior lienholders holding the insider guarantees, thereby reducing the insider's exposure on the guarantee to the junior lienholder. *Id.* The court recognized that the issue was not presented in this appeal but, in being fully-secured, the senior lienholder's position would not be improved relative to a Chapter 7 liquidation as required by §547(b)(5), and the payments would not be voidable. *Id.*

Plans.[25] Finally, after defaulting in its withholding tax obligation to the federal government, the Debtor made substantial payments to satisfy this obligation during the year preceding bankruptcy.[26]

The Debtor's Chapter 11 reorganization case was subsequently converted to a Chapter 7 liquidation.[27] The Trustee instituted adversary proceedings under §547 and §550 of the Code[28] to recover any payments made to these creditors more than 90 days, but less than one year before bankruptcy.[29] The Trustee contended that the one year insider preference period should apply to outside creditors if the transfer either directly or indirectly benefited parties who were insiders.[30]

The Bankruptcy Court dismissed the Trustee's complaints.[31] It found that the defendant creditors were not insiders[32] and, therefore, were not liable for payments made more than 90 days prior to

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25. *Levit*, 874 F.2d at 1188.

26. The court noted a conflict over the amounts of the transfers, if any, made to the United States IRS during the year before Debtor's petition in bankruptcy. *Id.* The district court also noted that the amounts remitted within one year of the petition were unknown because the Debtor's records were in the custody of the FBI pending an investigation of Deprizio's affairs. *In re* V.N. Deprizio Constr. Co., 86 Bankr. 545, 549 (N.D. Ill. 1988). The United States claims that based upon their current information, no such payments were made in the year before bankruptcy. U.S. Brief, *supra* note 20, at 4 n.5 (motion to remand for determination of whether any payments were made was denied by the district court).

27. *Deprizio*, 86 Bankr. at 549.

28. §550(a) provides as follows:

> Except as otherwise provided in this section, to the extent that a transfer is avoided under section . . . 547 . . ., the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property, from—
>
> (1) the initial transferee of such transferor the entity for whose benefit such transfer was made; or
>
> (2) any immediate or mediate transferee of such initial transferee.

11 U.S.C. §550(a).

Under the former Bankruptcy Act of 1898, *see infra* note 76, §60(a) defined a preference and recovery was made pursuant to §60(b). *Id.* The Code, however, bifurcates the treatment of avoidance and recovery issues. *Deprizio*, 86 Bankr. at 550. *See* H.R. REP. No. 595, 95th Cong., 1st Sess. at 375, *reprinted in* 1978 *U.S. Code Cong. & Admin. News* at 6331-32; S. REP. No. 989, 95th Cong., 2d Sess. at 90, *reprinted in* 1978 *U.S. Code Cong. & Admin. News* at 5876. Therefore, the trustee is limited to avoiding only those transfer defined as avoidable preferences under §547(b) and must rely on §550(a) to recover. *See also*, Nutovic, *The Bankruptcy Preference Laws: Interpreting Code Sections 547(c)(2), 550(a)(1), and 546(a)(1)*, 41 BUS. LAW. 175, 186 (1985).

29. Levit v. Ingersoll Rand Financial Corp., 874 F.2d 1186, 1188 (7th Cir. 1989). The Trustee challenged the transfers to the lenders (Ingersoll, CIT, and Melrose), the Employee Plans, and the United States, none of which were insiders themselves. *See supra* notes 14-20 for a discussion of the position each creditor occupied.

30. *Levit*, 874 F.2d at 1190.

31. *In re* V.N. Deprizio Constr. Co., 58 Bankr. 478, 480 (N.D. Ill. 1986).

32. *See supra* note 5 for a discussion of the term "insider" as it is used in §547(b). *Deprizio*, 58 Bankr. at 480.

the date of filing of the petition.[33] Although the challenged transfers may have indirectly benefitted an insider, the bankruptcy court adopted the view that each payment constituted two distinct "transfers."[34] The bankruptcy court found that the outside creditor received the direct benefit of payment while the insider received the indirect benefit of extinguished contingent liability.[35] Therefore, the bankruptcy court held that, while that portion of the "transfer" benefiting the insider was avoidable during the extended preference recovery period, the portion benefiting the outside creditor was subject only to the ordinary 90 day preference period.[36]

On interlocutory appeal, the district court reversed the bankruptcy court.[37] Rejecting the two-transfer theory,[38] the court held that a transfer which benefits an insider is avoidable under §547 if it is made within one year before bankruptcy, and is not specifically excluded under §547(c).[39] The court remanded the case to the bankruptcy court for determinations on whether the challenged transfers benefitted any insiders and, if so, whether such transfers are excludable under §547(c).[40]

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33. The court cited to the inability to prove element (4) under §547(b), that the creditor was an insider with reasonable cause to believe the debtor was insolvent. *Deprizio*, 58 Bankr. at 480.

34. This "two-transfer" theory is based on the definition of "transfer" under §101(50). *See infra*, note 50 for the text of 11 U.S.C. §101(50). The theory holds that the definition is broad enough to support the conclusion that the satisfaction of contingent liability of a guarantor constitutes a transfer to the guarantor that is independent of and separate from the transfer to the lender. *In Re* Mercon Indus., Inc., 37 Bankr. 549, 552 n.3 (Bankr. E.D. Pa. 1984). Under a theory that each transfer is separate, the trustee must satisfy the elements of §547(b) as to each transfer. Therefore, the trustee may only avoid the transfer to the insider because the trustee cannot prove element (4) under §547(b) as to the outside creditor. *See supra* note 5 for text of §547(b).

35. *Deprizio*, 58 Bankr. at 480-81. *See also* note 62 for a discussion on the contingent nature of the guarantor's claim against the debtor.

36. *In re* V.N. Deprizio Constr. Co., 58 Bankr. 478, 480-81 (N.D. Ill. 1986). The bankruptcy court adopted the reasoning of *Mercon Industries, Inc.*, 37 Bankr. 549 (E.D. Pa. 1984). The court in *Mercon* found that a single payment to an outside creditor effected two separate and distinct transfers due to the secondary liability of the guarantor. *Id.* at 551. While holding the transfer to the outside creditor in payment of the primary debt was not avoidable, the court held the transfer to the insider-guarantor in extinguishing their contingent liability was a separate avoidable transfer under §547(b). *See supra* note 34 for a discussion of the two-transfer theory.

37. *Deprizio*, 86 Bankr. at 556.

38. *Id.* at 551. The court found that both *Mercon* and the bankruptcy court below "misperceived" the nature of a "transfer." *Id. See infra* note 50 for the text of 11 U.S.C. §101(50) defining "transfer."

39. *Deprizio*, 86 Bankr. at 550. Although the court cites to the exclusions under 11 U.S.C. §547(c), they are irrelevant here due to the lack of detail in the record.

40. *Deprizio*, 86 Bankr. at 556. The court recognized that the scope of its decision was narrow because of the five elements required to avoid a transfer, the appeal only addressed two of them. *Id.* In remanding, the district court directed the bankruptcy court to determine if the other elements were met, whether any insider actually benefited, and whether the transfers allowed the creditors to receive more than they would have under the other provisions of the Code. *Id.*

The Seventh Circuit affirmed the district court on the question presented.[41] The main issue the court resolved[42] was whether the trustee may recover from an outside creditor, a transfer made more than 90 days before bankruptcy, because such payment benefits an insider guarantor.[43] The court concluded that the preference-recovery period is one year, not 90 days, when the payment produces a benefit for an insider creditor or guarantor and §550(a) allows recovery from outside creditor as "initial transferee".[44]

The *Levit* court began its analysis by noting that no other appellate court has addressed the effect of insiders' guarantees on the preference-recovery period.[45] It also noted that most lower courts have held the guarantee of an insider is insufficient grounds to justify extending the preference-recovery period and allowing recovery from innocent outside lenders.[46] The court found such holdings to result from the perceived inequity of treating outside creditors who require contractual guarantees differently from outside creditors who do not.[47] Although considering the difference in treatment war-

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41. Levit v. Ingersoll Rand Financial Corp., 874 F.2d 1186, 1200-01 (7th Cir. 1989). The court only affirmed the district court in allowing recovery from outside creditors, any transfers made within one year of bankruptcy where an insider benefits from the transfer. *Id.* The court reversed the district court on the preference liability of the transfers to the United States and the Employee Plans which did not have a contractual guarantee from an insider. *Id.* Although the court refused to find the tax payments avoidable beyond ninety days, the payments to the Employee Plans could still be avoided if secured by an insider's guarantee. *Id.* at 1200.

42. *See supra* notes 19-20 for a discussion of the court's reasoning on the lesser issues of avoiding payments to tax obligations and employee pension plans.

43. *Levit*, 874 F.2d at 1194.

44. *Id.* at 1200-01.

45. *Id.* at 1187. The court did have an opportunity to express its views on the issue in Bonded Fin. Services, Inc. v. European American Bank, 838 F.2d 890 (7th Cir. 1988), but the discussion was admittedly dicta because the issue was not before the court.

46. Levit v. Ingersoll Rand Financial Corp., 874 F.2d 1186, 1189 (7th Cir. 1989). The court noted that four courts in addition to the district court below have applied the extended preference recovery period: *In re* Robinson Bros. Drilling, Inc., 97 Bankr. 77 (W.D. Okla. 1988), *appeal pending*, No. 88-8090 (10th Cir.); *In re* Coastal Petroleum Corp., 91 Bankr. 35 (Bankr. N.D. Ohio 1988); *In re* W.E. Tucker Oil, Inc., 42 Bankr. 897 (Bankr. W.D. Ark. 1984); *In re* Big Three Transportation, Inc., 41 Bankr. 16 (Bankr. W.D. Ark. 1983). The following cases refused to extend the preference recovery period on the grounds that to do so would be inequitable: *In re* T.B. Westex Foods, Inc., 96 Bankr. 77 (Bankr. W.D. Tex. 1989) (alternative holding); *In re* Midwestern Companies, Inc., 96 Bankr. 224 (Bankr. W.D. Mo. 1988); *In re* C-L Cartage Co., 70 Bankr. 928 (Bankr. E.D. Tenn. 1987); *In re* Aerco Metals, Inc., 60 Bankr. 77 (Bankr. N.D. Tex. 1985); *In re* R.A. Beck Builder, Inc., 34 Bankr. 888 (Bankr. W.D. Pa. 1983); *In re* Duccilli Formal Wear, Inc., 18 Bankr. 1180 (Bankr. S.D. Ohio 1982); *In re* Cove Patio Corp., 19 Bankr. 843 (Bankr. S.D. Fla. 1982); *In re* Church Buildings & Interiors, Inc., 14 Bankr. 128 (Bankr. W.D. Okla. 1981).

47. *Levit*, 874 F.2d at 1189. The courts following the equity approach have done so in reliance on the views of the leading bankruptcy treatise which states:

> In some circumstances, a literal application of §550(a) would permit the trustee to recovery from a party who is innocent of any wrongdoing and deserves protection. In such circumstances, the bankruptcy court should use its equita-

ranted because the guarantee alters the ordinary debtor-creditor relationship,[48] the court based its holding on what it called an "ordinary" reading of the statute.[49]

The court referred to §101 of the Code for definitions of the terms "transfer,"[50] "insider,"[51] and "creditor"[52] as they are employed in §547(b). The court found that §101(50) defines a "transfer" as a disposition of property by any means.[53] Under this definition, the court held that a single payment is one transfer regardless of how many parties gain from the payment.[54] In so holding, the court rejected the bankruptcy court's "two-transfer" theory as con-

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> ble powers to prevent an inequitable result . . . . Otherwise, a creditor who does not demand a guarantor can be better off than one who does.

4 COLLIER ON BANKRUPTCY ¶ 550.02, at 550-58 (15th ed. 1988) (footnotes omitted). *See* cases cited *supra* note 46, adopting the equitable approach.

48. *Levit*, 874 F.2d at 1198. *See also Deprizio*, 86 Bankr. at 552-53. Several commentators considering the issue have found that lenders will often accept an insider's guarantee for its "control value." *See, e.g.*, Nutovic, *The Bankruptcy Preference Laws: Interpreting Code Sections 547(c)(2), 550(a)(1), and 546(a)(1)*, 41 BUS. LAW. 175, 196 (1985)(by taking the guarantee of an insider, the creditor ensures not only recourse to the assets of the guarantor, but in some instances, preferential treatment by the debtor); Pitts, *Insider Guaranties and the Law of Preferences*, 55 AM. BANKR. L.J. 343, 354 (1981)("[b]y procuring an insider's guarantee, (creditor) has fostered an identity of interest between itself and Guarantor that is qualitatively different from, and presumably stronger than, the identity of interest between Guarantor and debtor's other creditors.").

49. *Levit*, 874 F.2d at 1198.

50. *Id.* at 1190. The Code defines "transfer as:

> [E]very mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property, including retention of title as a security interest and foreclosure of the debtor's equity of redemption;

11 U.S.C. §101(50)(Supp.III 1979). The court found that the avoidability is an attribute of the transfer rather than of the creditor. *Levit*, 874 F.2d at 1195.

51. *See supra* note 7 for a discussion of the term "insider" as it is employed in the Code.

52. Levit v. Ingersoll Rand Financial Corp., 874 F.2d 1186, 1189-90 (7th Cir. 1989). The Code states that the term "creditor" means—

> (A) entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor;
> (B) entity that has a claim against the estate of a kind specified in section 348(d), 502(f), 502(h) or 502(i) of this title;

11 U.S.C. §101(9) (1984). The court noted that this definition necessarily implicates the term "claim". *Levit*, 874 F.2d at 1189. The Code defines a claim as:

> (A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured or unsecured;

11 U.S.C. §101(4) (1984).

53. *Levit*, 874 F.2d at 1195. This view of the term transfer dates back to pre-Code practice. *See* Pirie v. Chicago, Title & Trust Co., 182 U.S. 438 (1901). In holding the payment of money was a transfer, the Court stated that transfer is used in it most comprehensive sense, and is intended to include "every means and manner that property can pass from the ownership and possession of another." *Id.* at 441. *See also* Irving Trust Co. v. Kaminsky, 22 F. Supp. 362 (S.D. N.Y. 1937)(same).

54. *Levit*, 874 F.2d at 1196. *But see* cases cited *supra* note 46 for courts that have adopted the two-transfer theory.

trary to the clear wording of the statute.[55]

The appellate court similarly rejected the two-transfer approach as unsupported by the qualifying language of §550(a).[56] The court stated that the purpose of the language, limiting recovery "to the extent that a transfer is avoided," is to provide for situations where less than all of a particular transfer may be avoided,[57] not because a single payment may be multiple transfers.[58] The court noted that the failing of the two-transfer theory resulted from its equating "transfer" with "benefit received" rather than with payments made, as defined by the Code.[59]

In determining the relationship between the "creditor" and "insider," the court utilized a simple hypothetical. In this hypothetical, a lender extended a loan to a debtor secured by a guarantee of one of the debtor's officers.[60] The officer-guarantor, clearly an "insider,"[61] held a contingent right to reimbursement from the debtor because the lender may be forced to collect on the guarantee.[62] The *Levit* court noted that anyone with such a right to payment from a debtor also holds a "claim" against that debtor.[63] Under §101(9) of the Code, any person holding a claim against the debtor is also a

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55. *Levit*, 874 F.2d at 1196. The court found that the Code consistently defines a transfer from the debtor's perspective rather than the creditor's. *Id.* at 1195-96. *See also* Pitts, *Insiders Guaranties and the Law of Preferences*, 55 *Am. Bankr. L.J.* 343 (1981).

56. *Levit*, 874 F.2d at 1196. The court reported finding no greater support for the two-transfer theory in the legislative history than in the text of the Code. *Id.*

57. *Id.* at 1196. The court notes that under §547(b)(5), a transfer is avoidable only to the extent it is more than the creditor would have received in a liquidation under Chapter 7. *Id.* The exceptions to the trustee's avoiding power set forth in §547(c) also provide for situations where less than all of a given transfer may be avoided. *Id.*

58. *Id. But see* sources cited *supra* note 34.

59. Levit v. Ingersoll Rand Financial Corp., 874 F.2d 1186, 1195 (7th Cir. 1989).

60. *Id.* at 1190. The court adopted the hypothetical from the Trustee's argument which was based on the interdependent nature of §547 and §550. *Id.* The court used a similar analysis in Bonded Fin. Services v. European American Bank, 838 F.2d 890 (7th Cir. 1988)(stating, in dicta, that where guarantor is an insider, the preference period is one year).

61. *Levit*, 874 F.2d at 1190. In being an officer of the corporate debtor at the time of the transfer, the guarantor is also an insider under §101(30)(B)(ii). *See supra* note 7 for the text of §101(30).

62. *See supra* note 52 for text of 11 U.S.C. §101(4) and §101(9), defining "claim" and "creditor". It is well-settled that a guarantor is a creditor holding a contingent claim that exists from the date of the execution of the guarantee. Cooper Petroleum Co. v. Hart, 379 F.2d 777 (5th Cir. 1967); Paper v. Stern, 198 F. 642 (8th Cir. 1912). The claim is contingent in that it has the potential of becoming fixed when the guarantor pays the creditor the amount the guarantee secures. Nutovic, *The Bankruptcy Preference Laws: Interpreting Code Sections 547(c)(2), 550(a)(1), and 546(a)(1)*, 41 *Bus. Law* 175, 187, n. 59, *citing H.R. Rep. No.* 595, 95th Cong., 1st Sess., pt. 1, at 310 (1978) [hereinafter House Report] *reprinted in* 1978 *U.S. Code Cong. & Admin. News* at 6266.

63. *See supra* note 52, setting out text of 11 U.S.C. §101(4) which defines "claim".

"creditor."[64] Therefore, in determining that any payment made to reduce the guaranteed debt is a benefit to the guarantor (insider-creditor),[65] the court, as to the hypothetical, found the one year preference-recovery period applied because the payments were "for the benefit of" an "insider creditor."[66]

Applying this reasoning to the transfers challenged in *Levit*, the court found the payments both avoidable and recoverable from the outside creditor holding the guarantee of an insider.[67] The court stated that because the 1978 Code does not separately identify avoidability (§547)[68] and recoverability (§550),[69] pre-1978 practices are not reliable guides for interpreting the relationship between §547 and §550.[70] The court rejected the creditors' contention that the silence in the legislative history indicates Congress' intent to allow pre-1978 practices to continue,[71] specifically, recovering payments only from those creditors who meet all the elements of a preference.[72] The court concluded, however, that the lack of legislative history evincing an intent to discontinue these practices is insufficient to justify a departure from the "unambiguous" language of the Code.[73] Therefore, the court held that transfers benefiting insider guarantors are avoidable for one year, and the plain wording of

64. *See* 11 U.S.C. § 101(4), which defines "claim."

65. Levit v. Ingersoll Rand Financial Corp., 874 F.2d 1186, 1190 (7th Cir. 1989) (footnote omitted).

66. *Id.* The court noted that if the guarantor is an insider, the Debtor's payments reduce the guaranteed debt and the guarantor's exposure to liability. *Id.* Therefore, the transfers were "for the benefit of" guarantor (who is also an insider) and avoidable under §547 (b)(1) and (b)(4)(B).

67. *Levit*, 874 F.2d at 1200-01.

68. *See supra* note 5, setting forth the text of 11 U.S.C. §547(b).

69. *See supra* note 28 for a discussion of the separation of avoidance and recovery under the 1978 Code.

70. Levit v. Ingersoll Rand Financial Corp., 874 F.2d 1186, 1197 (7th Cir. 1989). The court cites United States v. Ron Pair Enterprises, 109 S. Ct. 1026 (1989). The Supreme Court in *Ron Pair*, premised its holding pre-Code practice unreliable on the absence of conflict with other provisions of the Code. 109 S. Ct. at 1033. *See infra* notes 90-93 for a discussion of the rule of statutory construction in *Ron Pair.*

71. *Levit*, 874 F.2d at 1197 (citing Chan v. Korean Air Lines, Ltd., 109 S.Ct. 1676 (1989); *Ron Pair*, 109 S. Ct. at 1030). The Court in *Chan*, interpreting a provision of the Warsaw Convention (49 U.S.C.A.App. §1502 note), held itself powerless to insert an amendment to a multinational treaty where the text was determined to be clear. *Chan*, 109 S. Ct. at 1683-84.

72. *See supra* note 5, setting forth the elements of a preference under 11 U.S.C. §547(b).

73. *Levit*, 874 F.2d at 1196-97. In reaching this conclusion, the court cites Pittston Coal Group v. Sebben, 109 S.Ct. 414 (1988). The Court In *Pittston Coal* stated that "[i]t is not the law that a statute can have no effects which are not explicitly mentioned in its legislative history." 109 S.Ct. at 420-21. *See, e.g.*, United States R.R. Retirement Bd. v. Fritz, 449 U.S. 166, 180 (1980)('[W]e have historically assumed that Congress intended what it enacted."); Harrison v. PPG Industries, Inc., 446 U.S. 578, 590 (1980)(finding nothing in legislative history to contradict clear wording of statute). *But see* notes 85-88 and accompanying text discussing the significance of no legislative indication of intent to change consistently applied principles.

§550(a) allows recovery from innocent outside creditors as well as from the guarantor.[74]

In allowing recovery from the outside creditor, the *Levit* court unjustly expanded the scope of preference liability to include creditors to whom the transfer did not constitute a preference. Accordingly, the decision is flawed in two related aspects. First, the court abolished the well-established rule of judging creditors independently for preference liability. In so holding, the court has unilaterally effected a drastic change in bankruptcy law without legislative authority. Second, the court improperly interpreted §550 to expand preference liability beyond that necessary to achieve the goals of the preference provisions. In particular, allowing recovery from innocent outside creditors fails to discourage preferential behavior by insiders. In allowing an implementation provision (§550) to dictate the scope of preference liability under the Code, the new relationship between §547 and §550 announced in *Levit* amounts to "the tail wagging the dog."

The Seventh Circuit unjustly concluded that a transfer is recoverable from an outside creditor because it effected a preference as to the insider-guarantor.[75] In reaching its conclusion, the court disregarded a well-established body of case law, decided under the Bankruptcy Act of 1898 (the "Act"),[76] requiring the trustee to prove all elements of a preference as to the creditor from whom recovery is sought.[77] The Act, like the Code, allowed the trustee to recover preferences from both the creditor receiving the transfers, as well as from the creditor who benefited as a result.[78] The language of §60(b) of the Act (as amended in 1938),[79] was essentially the same as

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74. *See infra* notes 93-97 and accompanying text discussing the flaws in the court's literal interpretation of §550(a).

75. Levit v. Ingersoll Rand Financial Corp., 874 F.2d 1186, 1200-01 (7th Cir. 1989).

76. Act of July 1, 1898, ch. 541, 30 Stat. 544, as set forth in 3 COLLIER ON BANKRUPTCY ¶ 60.05 at 771 (14th Ed. 1977). Current version at 11 U.S.C. §547(b) (1976)(repealed by 11 U.S.C. §401(a))(Supp. 1978).

77. This principle was recognized in the classic case of Dean v. Davis, 242 U.S. 438 (1917). In *Dean*, the Supreme Court denied recovery from the initial transferee where another party was actually preferred. *Id.* at 443. This situation (borrowing money on a secured basis to pay an unsecured creditor) has been ruled on by the Fourth, Fifth, and Eleventh Circuits, and all held only the unsecured creditor liable. *See, e.g., In re* Air Conditioning, Inc. of Stuart, 845 F.2d 293 (11th Cir. 1988); *In re* Compton Corp., 831 F.2d 586 (5th Cir. 1987); Aulick v. Largent, 295 F.2d 41, 52 (4th Cir. 1961).

78. §60(b), 52 Stat. 870 (1938).

79. Although the Bankruptcy Law of 1978 first expressly provided for insiders, the special treatment of insiders dates back to the Act of 1898. *Id.* The amended §60(b) provided as follows:

> Any such preference [as defined in §60a] may be avoided by the trustee if the creditor receiving it or to be benefited thereby or his agent acting with reference thereto has, at the time when the transfer is made, reasonable cause to

§547(b) in that it allowed the trustee to recover "from any person who has received" the transfer if either creditor had reasonable cause to believe the debtor was insolvent.[80] Although expressly allowing preference liability based on another creditor having the requisite knowledge, the courts refused to permit preference liability by association and consistently tested the liability of transferees independently under §60(b).[81]

This approach to determining preference liability carries forward under the new Code in the absence of Congressional intent to abolish it. The United States Supreme Court in *Midlantic National Bank v. New Jersey Dep't of Environment Protection*, recently stated that judge-made rules consistently applied under the old Act continue to apply under the Code unless there is clear evidence of Congressional intent to change those rules.[82] In *Midlantic*, the Court held that a provision under the new Code, giving trustees an unqualified right to dispose of burdensome property, remains subject to the restrictions on abandonment that had been recognized under the old Act.[83] The Supreme Court found that if Congress intended to

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> believe that the debtor is insolvent. Where the preference is avoidable, the *trustee may recover* the property or, if it has been converted, its value *from any person* who has received or converted such property. (Emphasis added).

52 Stat. 870 (1938). Although §60(b) specifically allowed recovery of preferences from "any person", the court consistently refused to allow recovery from innocent outside creditors. *See, e.g.*, Cooper Petroleum Co. v. Hart, 379 F.2d 777, 780 (5th Cir. 1967); Fengold v. Green, 175 F.2d 247, 249 (2d Cir. 1949); Irving Trust Co. v. Manufacturers' Trust Co., 6 F. Supp. 185, 189-90 (S.D. N.Y. 1934); Paper v. Stern, 198 F. Supp. 642, 644-45 (8th Cir. 1912).

80. §60(b), 52 Stat. 870 (1938). As originally enacted in 1898, the trustee also had to prove the person receiving or benefiting from the transfer had "reasonable cause to believe" that the transfer was intended to be a preference. §60(b), 52 Stat. 544 (1938). Only after proving the creditor had reason to believe that debtor was both insolvent and intending the transfer as a preference could the trustee recover from "such person." *Id.* It is this dual subjective standard which explains the lack of cases where recovery of a transfer, voidable as to a third party, was even attempted against a recipient who lacked the "reasonable cause to believe." Pitts, *supra* note 55, at 350, n.37 (noting that no single reported case attempted or succeeded on a theory of liability by association).

81. *See supra* note 77 and accompanying text. *See, e.g.*, Cooper Petroleum Co. v. Hart, 379 F.2d 777, 780 (5th Cir. 1967); Fengold v. Green, 175 F.2d 247, 249 (2d Cir. 1949); Paper v. Stern, 198 F. Supp. 642, 644-45 (8th Cir. 1912); Irving Trust Co. v. Manufacturers' Trust Co., 6 F. Supp. 185, 189-90 (S.D. N.Y. 1934).

82. 474 U.S. at 501. The Court cites Edmonds v. Compagnie Generale Transatlantique, 443 U.S. 256 (1979) as follows:

> The normal rule of statutory construction is that if Congress intends for legislation to change the interpretation of a judicially-created concept, it makes that intent specific.

443 U.S. at 266-67. The Court went on to note that it has followed this rule "with particular care in construing the scope of bankruptcy codifications." *Midlantic*, 474 U.S. at 501.

83. *Midlantic*, 474 U.S. at 501. The trustee in *Midlantic* attempted to dispose of the debtor's waste oil processing facility comprised principally of contaminated oil. *Id.* at 498. As the trustee reasoned, §554(a) provided a right to abandon "any property of the estate that is burdensome to the estate or that is of inconsequential value

change or alter the standing interpretation of a judicially created concept, it would have made such intent specific.[84] In subsequent cases, the Supreme Court recognized that it is "highly unlikely" that Congress intended such a major change in bankruptcy law without mention of such intent in the legislative history.[85] In failing to attribute any significance to this absence of legislative history, the *Levit* court unilaterally changed bankruptcy law without legislative authority and created substantial uncertainty in an area formerly occupied by well-settled principles.

In addition to disregarding the pre-Code practice, the *Levit* court erred in interpreting §550(a) to reach a result in conflict with the purpose of §547(b).[86] In *United States v. Ron Pair Enterprises, Inc.*,[87] the Supreme Court stated that the plain meaning of legislation should be conclusive, "except where the literal application of the statute will produce a result demonstrably at odds with the intention of the drafters."[88] Although finding no such conflict in *Ron Pair*, the Court noted that literal interpretation is only appropriate where the result does not conflict with governmental interests or any other provision of the Code.[89] Therefore, the holding in *Levit* required consideration beyond the literal interpretation of §550, the

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to the estate." 11 U.S.C. §554(a) (as amended in 1984). The dissent contended that this language was absolute in its terms and limited the trustee's power to abandon only by considerations of the property's value to the estate. *Midlantic*, 474 U.S. at 509 (*Rehnquist, J.*, dissenting). The Court, however, held the trustee's abandonment power limited by the pre-Code restrictions as well as other current Code provisions. *Midlantic*, 474 U.S. at 506-07.

84. *Midlantic*, 474 U.S. at 501. *See* Muniz v. Hoffman, 422 U.S. 454, 458 (1975)(improper to infer that legislature, in revising the law, intended to change their policy unless such an intention be clearly expressed). *See also* Palmer v. Massachusetts, 308 U.S. 79, 85 (1939)("If this old and familiar (concept) was withdrawn. . .we ought to find language fitting for so drastic a change"); Swarts v. Hammer, 194 U.S. 441, 444 (1904)("[T]he intention would be clearly expressed, not left to be collected or inferred").

85. *See* United Savings Ass'n v. Timbers of Inwood Forest Associates, Ltd., 484 U.S. 365, 380 (1988) ("[I]t is most improbable that a major change in [bankruptcy law] would have been made without even any mention in the legislative history."). *See also* Kelly v. Robinson, 479 U.S. 36, 41 (1986) ("[W]e decline to hold that the new Bankruptcy Code silently abrogated another exception created by the courts construing the [Bankruptcy Act].").

86. *See infra* note 91 for a discussion of the purpose of §547(b).

87. 109 S. Ct. 1026 (1989).

88. *Ron Pair*, 109 S. Ct. at 1031 (quoting Griffin v. Oceanic Contractors, Inc., 458 U.S. 564, 571 (1982)).

89. *Ron Pair*, 109 S. Ct. at 1032-33. The Court in *Ron Pair* distinguished both *Midlantic* and *Kelly* on the basis that the proposed interpretation of bankruptcy law was in conflict with significant state or federal laws and other aspects of the Code. *Ron Pair*, 109 S. Ct. at 1033. The Court then determined that the proposed interpretation of a Code provision allowing payment of interest on oversecured claims created no such conflict and furthered the goals of the provision, thus, the literal interpretation was held proper. *Id.* at 1030-31. *See also In re* Trans Alaska Pipeline Rate Case, 436 U.S. 631, 643 (1978)(literal reading improper where it would lead to unintended results or thwart the obvious purpose of the statute).

results must have been those intended by Congress.[90]

Initially, the principle purpose of §547(b) was to effect an equality of distribution among creditors, and to discourage insiders from using their superior knowledge of the debtor's condition to the detriment of other creditors.[91] It is §550, however, which implements the trustee's right to recover and specifies from whom recovery may be had.[92] The legislative history of §550 clearly indicates that the limiting phrase, allowing recovery only "to the extent that a transfer is avoided",[93] was intended to incorporate all the limitations on liability set forth in other provisions of the Code.[94] Therefore, although the *Levit* court correctly looked to the language of §550, that language must be interpreted with a view to accomplishing the goals of §547. Since the holding in *Levit* does not further the purposes for which the preference provisions were enacted, nor discourage misconduct by the insider, the court's interpretation of §550(a) results in a conflict with the purpose of §547(b), the provision which §550 was designed to serve. Therefore, it was error for the court to hold that the language of §550 compelled this result when the court failed to view the language in terms of serving the interests of §547.

In *Levit*,[95] the Seventh Circuit Court of Appeals departed from the majority view regarding the effect of insiders' guarantees on the preference-recovery period. The court held that when the guarantor

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90. It is well established that legislation should be interpreted in such a way as to give full effect and meaning to its general purpose. Commissioner v. Engle, 464 U.S. 206, 217 (1984). The *Engle* Court recognized a duty "to find that interpretation which can most fairly be said to be imbedded in the statute, in the sense of being harmonious with its scheme and with the general purposes that Congress manifested." *Id.* at 217. *See also* Automotive Parts Rebuilders Ass'n v. E.P.A., 720 F.2d 142, 159 n.66 (1983) (statutes should be interpreted in a manner that will effectuate the purposes for which they were intended).

91. H.R. REP. No. 95-595, 95th Cong., 1st Sess., at 177-78 (1978). *See In re* Xonics Imaging, Inc., 837 F.2d 763, 764 (7th Cir. 1988) (the principle purpose of §547 is to effect an equality of distribution and treat creditors of the same class equally and fairly). *See also* Phillips, *Insider Provisions of the New Bankruptcy Code*, 55 AM. BANKR. L.J. 363 (1981).

92. *See supra* note 28 for a discussion of how the Code separately defines avoidability and recovery.

93. 11 U.S.C. §550(a). *See supra* note 28 for text of §550(a).

94. The legislative history of §550 indicates that the qualifying phrase was intended to incorporate all §547 limitations:

> The liability of a transferee under §550(a) applies only "to the extent that a transfer is avoided." This means that liability is not imposed on a transferee to the extent that a transferee is protected under a provision *such as* §548(c) (Emphasis added).

124 CONG. REC. 32400, 34000 (1978). The earlier statements read: "[t]he words 'to the extent that' in the lead to this subsection are designed to incorporate the protection of transferees found in proposed 11 U.S.C. §549(b) and §548(c)." HOUSE REPORT, *supra* note 62, at 375; S. REP. No. 989, 95th Cong., 2d Sess. 90 (1978). The final draft, with the language "such as §548(c)," suggests that the "to the extent" qualification is intended to incorporate all provisions protecting transferees, not just §548(c).

95. 874 F.2d 1186.

is an insider of the debtor, the transfer is a preference and recovery may be had from either the guarantor or the outside creditor. The decision represents a substantial deviation from well-settled principles of both bankruptcy law and statutory construction. Because the question was generated on interlocutory appeal, the decision is of dubious nature until the court can rule on a complete record. For now, the *Levit* decision's departure from these established principles deprives commercial creditors of the ability to adequately predict the risks of extending credit and can be expected to have a "chilling effect" on commercial financing.[96] This effect will continue until another court, with a complete record to consider, can address this issue and do so with clarity.[97]

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96. The major concern over a rule of vicarious preference liability is that lenders can longer control their own exposure to the trustee's avoiding power. Judicial acceptance of this new rule would render even careful lenders liable for preference recoveries soley on the basis of third party dealings. This is most evident in the situation of the lender securing a loan with collateral that falls prey to junior liens. Previously incapable of being preferred, the fully-secured creditor may now be exposed to preference liability for the subsequent dealings of third party creditors choosing to secure their loan with an insider's guarantee. Ingersoll Brief, *supra* note 19, at 30-32. Under the *Levit* decision, preference actions arise anytime the secured creditor's collateral is subject to a junior lien. Any payments to the fully-secured creditor may be a preference to the junior lienholder because of the increase in the junior lienholder's equity in the shared collateral. Therefore, the *Levit* decision would allow recovery from the innocent fully-secured creditor as initial transferee simply by finding those payments constitute a preference as to some third party creditor. *Id.*

The decision will also make creditors less cooperative and forebearing when debtors begin to experience difficulties in meeting their obligations. Ingersoll Brief, *supra* note 19, at 33. Common "workout" devices such as guarantees and junior liens will now expose the lender to greater risk of preference liability. The result will be to provide the secured creditors and lenders with a strong incentive to foreclose and propel a troubled firm into bankruptcy at the first sign of trouble, taking non-avoidable post-bankruptcy payments, rather than risk the increased exposure to preference liability.

97. For now, the remedy of choice is to require the guarantor to surrender any and all rights of indemnification he or she may have from the debtor. In extinguishing this contingent claim, this procedure has the effect of removing the insider-guarantor from the definition of "creditor." *See supra* notes 60-66 and text accompanying for a discussion of the relationship of the terms "creditor" and "claim." Under such a scheme, the guarantor would separately acknowledge the surrender of its claim against the debtor should the guarantor be called upon to pay the amount the guarantees secures. This absence of a "claim" against the debtor would remove the guarantor from the definition of "creditor" under § 101(9) of the Code. 11 U.S.C. § 101(9) (1982 & Supp. IV 1986). Therefore, any payments made on the note will not be "to or for the benefit of" the insider-guarantor "as a creditor," and will not be subject to the extended preference recovery period. 11 U.S.C. § 547(b) (1982 & Supp. IV 1986).

* The author dedicates this article to the memory of his grandfather, John G. Klinowski, Sr. (1918-1989).