

DEPRIZIO DEAD YET? BIRTH, WOUNDING, AND ANOTHER ATTEMPT TO KILL THE CASE

Steve H. Nickles*

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* C.C. Hope Chair in Financial Services and Management, Wake Forest University School of Law and Babcock Graduate School of Management. For his enormous help in tracing legislative histories I thank my colleague, Howard Sinclair, a reference librarian at Wake Forest University School of Law. Nothing ever gets done right without such help. This Article is based on a presentation given at the National Conference of Bankruptcy Judges on October 19, 2000, in Boston, Massachusetts.

INTRODUCTION

In 1989, the United States Court of Appeals for the Seventh Circuit decided *Levit v. Ingersoll Rand Financial Corp. (In re V.N. Deprizio Construction Co.)*,¹ widely known as *Deprizio*. It is a preference case under § 547 of the Bankruptcy Code (“Code”).² A preference is a pre-petition transfer that the trustee can avoid for the benefit of the estate under § 547(b).³ Avoidance is generally limited, however, to transfers made within ninety days before the bankruptcy filing.⁴ The reach-back period is longer, and so § 547(b) is more powerful when the transfer prefers an insider.⁵ A

¹ 874 F.2d 1186 (7th Cir. 1989).

² 11 U.S.C. § 547 (1994).

³ 11 U.S.C. § 547(b). This section states:

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

Id.

⁴ See 11 U.S.C. § 547(b)(4)(A).

⁵ In general terms, an insider is a natural or fictional relative of the debtor. Precisely, the term “insider” includes:

- (A) if the 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 the 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 a general partner, director, officer, or person in control of the debtor;
- (C) if the debtor is a partnership —
 - (i) general partner in the debtor;

preference to an insider is avoidable if the transfer is made as far back as one year before the bankruptcy filing.⁶

The main holding in *Deprizio*, very simply stated, is this: the trustee can recover a payment made directly to *any* creditor, even a noninsider creditor (which the court in *Deprizio* calls an *outside creditor*⁷), that is made as far back as one year before the debtor's bankruptcy if the payment amounts to an indirect, avoidable preference to another creditor who is an insider.⁸ The unique aspect of the holding is that in such a case, a noninsider creditor who is the direct, initial transferee is unprotected by the absence of a preference to her. This means that the necessary elements of a § 547 preference are not met when applied to the direct transfer to

- (ii) relative of a general partner in, general partner of, or person in control of the debtor;
- (iii) partnership in which the debtor is a general partner;
- (iv) general partner of the debtor; or
- (v) person in control of the debtor;
- (D) if the debtor is a municipality, elected official of the debtor or relative of an elected official of the debtor;
- (E) affiliate, or insider of an affiliate as if such affiliate were the debtor; and
- (F) managing agent of the debtor.

11 U.S.C. § 101(31) (1993).

⁶ See 11 U.S.C. § 547(b)(4)(B).

⁷ See *Levit v. Ingersoll Rand Fin. Corp.*, 874 F.2d 1186, 1188 (7th Cir. 1989).

⁸ See *id.* at 1194-1200. For in-depth commentaries on *Deprizio* written shortly after the case was decided, see Donald W. Baker, *Repayments of Loans Guaranteed by Insiders as Avoidable Preferences in Bankruptcy: Deprizio and Its Aftermath*, 23 UCC L.J. 115 (1990); Marc L. Hamroff & Robert S. Cohen, *One Year Preference Recoveries Can Extend to Lenders and Other Non-Insider Creditors*, 96 COM. L.J. 153 (1991); Robert F. Higgins & David E. Peterson, *Is There a One-Year Preference Period for Non-Insiders?*, 64 AM. BANKR. L.J. 383 (1990); Scott C. Barney, Comment, *Bankruptcy Preferences and Insider Guarantees*, 51 LA. L. REV. 1047 (1991); Henk J. Brands, Note, *The Interplay Between Sections 547(b) and 550 of the Bankruptcy Code*, 89 COLUM. L. REV. 530 (1989); John Stephen Cullina, Note, *Recharacterizing Insider Preferences as Fraudulent Conveyances: A Different View of Levit v. Ingersoll Rand*, 77 VA. L. REV. 149 (1991); Joseph A. Friedman, Comment, *Lender Exposure Under Sections 547 and 550: Are Outsiders Really Insiders?*, 44 SW. L.J. 985 (1990); Timothy S. Johnson, Comment, *Lending with Guaranties After Deprizio—Lenders, Guard Your Coiffers; the Courts and Trustees Are at the Gate*, 29 DUQ. L. REV. 121 (1990); Charles Louis McBride, Jr., Comment, *Bankruptcy—Insider Preferences—The Approach of the Fifth Circuit Court of Appeals to the Issue of Non-Insider Liability for Preferential Transfers Benefitting Insider Guarantors*, 60 MISS. L.J. 387 (1990); Joseph Haynes Murphy, Case Comment, *Bankruptcy Law—The Extension of One Year Preference Periods to Insider Guaranteed Debts of the Bankrupt—Levit v. Ingersoll Rand Financial Corp.*, 874 F.2d 1186 (7th Cir. 1989), 24 SUFFOLK U. L. REV. 198 (1990); Andrew J. Nussbaum, Note, *Insider Preferences and the Problem of Self-Dealing Under the Bankruptcy Code*, 57 U. CHI. L. REV. 603 (1990); James A. Rodenberg, Note, *Indirect Preferences: Recovery Under Sections 547 and 550 of the Bankruptcy Code*, 55 MO. L. REV. 327 (1990); Mark E. Toth, Comment, *The Impossible State of Preference Law Under the Bankruptcy Code: Levit v. Ingersoll Rand Financial Corp. and the Problem of Insider-Guaranteed Debt*, 1990 WIS. L. REV. 1155; Bethaney J. Vazzana, Comment, *Trustee Recovery of Indirect Benefits Under Section 547(b) of the Bankruptcy Code*, 6 BANKR. DEV. J. 403 (1989).

the noninsider creditor. Specifically, a noninsider creditor is indirectly subjected to the longer reach-back period of one year that applies only to insider creditors under § 547.

Deprizio holds, first, that satisfying the elements as to the insider creditor is sufficient to avoid the transfer in general under § 547.⁹ Second, recovery from the noninsider creditor is based on another statute, § 550,¹⁰ which allows recovery from the initial transferee of any transfer avoided under § 547.¹¹ In sum, the preference is to the insider creditor, not the noninsider creditor, but recovery can come from the noninsider creditor.

In 1994, Congress responded to this holding—and maybe more—by amending § 550¹² to include a new subsection: § 550(c).¹³ This addition denies *recovery* from the noninsider creditor in such a case if the transfer was made between ninety days and one year before the bankruptcy.¹⁴

The common complaint is that Congress thereby overruled *Deprizio*. This conclusion is a short-handed generalization that is not necessarily true. The amendment explicitly limits recovery from the noninsider creditor under § 550. On its face, however, the amendment says nothing about a less noticed, but important, implication of the *Deprizio* holding. Specifically, a preference is void or avoidable and consequential under § 547 wholly apart from § 550.¹⁵ If this implication of *Deprizio* is correct, § 547 avoidance, by itself, can still result in avoiding an indirect or trilateral

⁹ See *Levit*, 874 F.2d at 1195-96.

¹⁰ 11 U.S.C. § 550(a) (1994). This section provides:

Except as otherwise provided in this section, to the extent that a transfer is avoided under section 544, 545, 547, 548, 549, 553(b), or 724(a) of this title, 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 transfer or the entity for whose benefit such transfer was made; or
- (2) any immediate or mediate transferee of such initial transferee.

Id.

¹¹ See *Levit*, 874 F.2d at 1196-97.

¹² 11 U.S.C. § 550.

¹³ *Id.* § 550(c).

¹⁴ The exact language is:

If a transfer made between 90 days and one year before the filing of the petition—

- (1) is avoided under section 547(b) of this title; and
- (2) was made for the benefit of a creditor that at the time of such transfer was an insider; the trustee may not recover under subsection (a) from a transferee that is not an insider.

Id.

¹⁵ See *Levit*, 874 F.2d at 1195-96.

preference¹⁶ to the insider creditor as against both her and also the noninsider creditor despite § 550(c), unless this provision implicitly overrules this piece of *Deprizio* too.

This Article very briefly revisits the *Deprizio* case to explain the essential facts that are pertinent here and to bring to the surface more noticeably the implicit suggestion that § 547 can operate independently of § 550.¹⁷ Next, I briefly explain the new § 550(c) and a case in which the court makes a proper, limited application of the provision¹⁸ to protect a noninsider creditor against recovery of damages for a preference to an insider creditor made beyond the usual ninety-day reach-back period.

Then, I consider a *Deprizio*-like, trilateral preference case that applies § 547 avoidance with great consequence to a noninsider creditor without relying on § 550 and thereby avoiding the defense of the new § 550(c).¹⁹ The transfer to the noninsider creditor is avoided or nullified even though the preference to the insider creditor was beyond the ninety-day reach-back period. I consider these fundamental issues: (i) whether § 547 provides endogenous avoidance that is an independent remedy applicable apart from § 550;²⁰ and (ii) if so, does the new § 550(c)²¹ apply to, and thereby overrule, this remedy.²² This second issue leads to hypothesizing about how the United States Supreme Court would answer the question under the principles of statutory interpretation that the Court has repeatedly, though not always consistently, applied to bankruptcy law.²³

Finally, I look at a provision in the bankruptcy reform legislation of 1999, passed by both houses of Congress, that clearly recognizes the failure of § 550(c) to protect noninsider creditors

¹⁶ The term “trilateral transfer” is synonymous with indirect preference. This means a direct transfer from *D* to *A* indirectly amounts to a preference to *B*, who is not a direct recipient of the preference but benefits from it.

In the customary *trilateral preference* case, the debtor transfers an interest in property to a non-insider creditor within one year—but not within ninety days—of bankruptcy. The trustee, representing the unsecured creditors of the debtor, seeks to avoid the transfer under § 547(b) and to recover from the non-insider under § 550(a), on the theory that the transfer benefited the insider guarantor by reducing the guarantor’s exposure on the debtor’s obligation.

In re Sufolla, Inc., 2 F.3d 977, 979 (9th Cir. 1993) (emphasis added).

¹⁷ See *infra* Parts II.A-B. For a detailed description and analysis of the case, see authorities cited *supra* note 8.

¹⁸ See *infra* Part III (discussing *In re Vaughn*, 244 B.R. 631 (Bankr. W.D. Ky. 2000)).

¹⁹ See *infra* Part IV (discussing *In re Williams*, 234 B.R. 801 (Bankr. D. Or. 1999)).

²⁰ See *infra* Parts V.A-C.

²¹ 11 U.S.C. § 550(c) (1994). See *supra* note 14.

²² See *infra* Part VI.

²³ See *infra* Part VI.

from avoidance and tries again to kill, completely, *Deprizio*.²⁴ The issue about the relationship between §§ 547 and 550 and the question of how the Supreme Court would interpret § 550(c) will mostly become moot if and when this provision does become law.

I. THE ESSENTIAL *DEPRIZIO*

A. *Facts*

In 1980, V.N. Deprizio Construction Co. ("Deprizio Co.") started work on extending the Chicago subway system. Various lenders financed the company in this venture. After a while, Deprizio Co. dug itself a financial hole. Most pointedly, the company failed to make required payments to its employees' pension and welfare plans. Deprizio Co. remedied the default by executing promissory notes payable to the plans. Notes to some of the plans were also cosigned by company president Richard Deprizio, an "insider"²⁵ in bankruptcy terms.

In April 1983, Deprizio Co. filed for bankruptcy. Before the filing, the company had made payments to the pension plans on the notes the company had given them. The effects of payments on the notes cosigned by Richard were to reduce his personal liability and thereby indirectly benefit him. The trustee argued that this reduction in Richard's liability was a § 547 avoidable preference.²⁶ Also, the appropriate reach-back period under § 547 was one year because Richard was an insider.²⁷

Well, Richard was dead—financially and otherwise. So the trustee sought recovery of the amount of the preference from the pension plans, which had actually received the company's payments that concomitantly reduced Richard's personal liability and thereby gave him a preference. The trustee argued on the basis of § 550(a)²⁸ that these pension plans were liable for Richard's preference. To the extent that a payment or other transfer is avoided under § 547, the trustee can recover the transfer

²⁴ See H.R. 833, 106th Cong. § 1116 (1999); S. 625, 106th Cong. § 1114 (1999). The House and the Senate versions are not identical and, as of the middle of summer 2000, no official conference committee had been appointed to work a compromise. So, nothing had been enacted when this presentation was prepared. Moreover, President Clinton had threatened a veto. See President's Letter to Congressional Leaders on Bankruptcy Reform Legislation, 36 WEEKLY COMP. PRES. DOC. 1547 (June 29, 2000) (issuing a veto threat against the bankruptcy reform bill).

²⁵ See *Levit v. Ingersoll Rand Fin. Corp.*, 874 F.2d 1186, 1187 (7th Cir. 1989). Richard was an insider with respect to the debtor company because he was an officer of the company. See 11 U.S.C. § 101(31)(B)(ii) (1994).

²⁶ See 11 U.S.C. § 547(b) (1994).

²⁷ See *id.* § 547(b)(4)(B).

²⁸ See *id.* § 550(a).

or its value either from the person who benefitted from the transfer (Richard) or from the initial transferee of the transfer (the pension plans).²⁹

The pension plans disagreed, most specifically with regard to payments made more than ninety days before the debtor filed bankruptcy. The reach-back period for preferences to noninsider creditors is ninety days.³⁰ Although Richard was an insider and thus subject to the longer one-year reach-back period, the plans themselves—so they argued—were not insiders and therefore were not liable for anything beyond the ninety-day reach-back for noninsider creditors.³¹

B. *Deprizio's Obvious Holding and Veiled Dictum:
Independence of §§ 547 and 550*

The pertinent question in *Deprizio* was, therefore, “whether the Trustee may recover from an outside creditor [the pension plans] under § 550(a)(1) a transfer more than 90 days before the filing that is avoided under § 547(b) because of a benefit for an insider creditor.”³² On this question the court answered yes: “[T]he preference-recovery period for outside creditors is one year when the payment produces a benefit for an insider creditor, including a guarantor.”³³

This answer and the liability of the pension plans are based on a two-part reasoning. First, the payments to the pension plans were § 547 avoidable preferences to Richard, an insider, to the extent the payments benefitted him by reducing his personal liability on the notes to the pension plans that he cosigned.³⁴ Second, to this extent (which is calculated according to the § 547, one-year reach-back period for insiders³⁵), the noninsider pension plans were liable along with Richard on the basis of § 550(a)³⁶ because the pension plans were the initial transferees.³⁷

The opinion itself and later commentaries focus mainly on the issue whether each payment to the pension plans that benefitted Richard Deprizio personally should be treated and judged as a single transfer under § 547 or as two transfers—one transfer to the

²⁹ See *id.* § 550(a)(1).

³⁰ See *id.* § 547(b)(4)(A).

³¹ See *Levit v. Ingersoll Rand Fin. Corp.*, 874 F.2d 1186, 1190-92 (7th Cir. 1989).

³² *Id.* at 1194.

³³ *Id.* at 1200-01.

³⁴ See *id.* at 1194-96.

³⁵ See 11 U.S.C. § 547(b)(4)(B).

³⁶ See *id.* § 550(a)(1).

³⁷ See *Levit*, 874 F.2d at 1196-97.

pension plans and another transfer to Richard.³⁸ If the latter, as the pension plans argued, then:

Treating each payment as two transfers, one to Lender [the pension plans] and the other to Guarantor [Richard Deprizio], . . . § 550(a) limits the trustee to recovery from Guarantor [Richard Deprizio]. Section 550(a) allows recovery only “to the extent that a transfer is avoided” under § 547, and the two-transfer approach implies that the transfer to Lender [the pension plans] has not been “avoided” at all.³⁹

Therefore, no recovery at all against the pension plans was justified under § 550 because, if the separate transfer to the pension plans was not a preference and therefore was not avoidable under § 547, then there was no avoidance as to the pension plans so as to trigger a § 550 recovery from them.

The court rejected this two-transfer approach, saying:

Sections 547 and 550 both speak of a transfer being avoided; avoidability is an attribute of the transfer rather than of the creditor. While the lenders want to define transfer from the recipients’ perspectives, the Code consistently defines it from the debtor’s. A single payment therefore is one “transfer,” no matter how many persons gain thereby.⁴⁰

And, if a payment that is a transfer is a preference as to anyone under § 547, then the transfer is avoidable under § 547 and allows recovery under § 550 against anyone named in § 550. This occurs even against someone as to whom the transfer was not directly an avoidable preference under § 547. In sum, to the extent of avoidance as to anyone under § 547, liability applies to everyone described in § 550.

Implicit in this reasoning is the narrower dictum that avoidance as to anyone under § 547 is avoidance as to everyone under § 547.⁴¹ By extension, if consequences flow from avoidance alone under § 547, then these consequences apply to everyone who received or benefitted from the transfer, including a noninsider creditor who received the transfer as long as one year before the debtor’s bankruptcy filing.

³⁸ See *id.* at 1194-96. See generally commentaries cited *supra* note 8.

³⁹ *Levit*, 874 F.2d at 1195.

⁴⁰ *Id.* at 1195-96. Other courts and commentators accepted the two-transfer approach, but not everyone agreed. See Paul T. Wrycha, Comment, *Judicially Excepting the Literal Logic in Levit: Advocating the Implementation of the Fortuitous Recipient Exception*, 75 MARQ. L. REV. 237 (1991) (outlining different approaches the courts adopted in addressing this issue).

⁴¹ The court writes: “[A]voidability is an attribute of the transfer rather than of the creditor.” *Levit*, 874 F.2d at 1195 (emphasis added).

II. SUBSECTION 550(C) AND A CASE OF CLEARLY CERTAIN
APPLICATION: *IN RE VAUGHN*

In direct response to *Deprizio*, Congress in 1994 added § 550(c),⁴² which provides:

If a transfer made between 90 days and one year before the filing of the petition—

- (1) is avoided under section 547(b) of this title; and
- (2) was made for the benefit of a creditor that at the time of such transfer was an insider;

the trustee may not recover under subsection (a) from a transferee that is not an insider.⁴³

Applied to the facts of *Deprizio*, this provision would protect the pension plans against *recovery* of damages under § 550(a). Remember that the trustee in *Deprizio* sought money damages from the pension plans to remedy the indirect preference to Richard Deprizio that resulted when Deprizio Co. made payments to the plans toward company debts on which Richard was also personally liable and whose individual liability was thereby reduced. Under § 550(c), as applied according to its explicit terms, the trustee in *Deprizio* could not have recovered from the pension plans the amount of such payments made more than ninety days before bankruptcy.

In a recent case, *In re Vaughn*,⁴⁴ the bankruptcy court actually applied § 550(c) in such a clearly certain, correct way. The barest facts are these: (i) Walter is the debtor who eventually filed bankruptcy; (ii) he owed his grandson, Christopher, a debt; (iii) Christopher owed the bank a debt; (iv) six months before Walter's bankruptcy, Walter paid Christopher's debt to the bank and thereby satisfied Walter's debt to Christopher; (v) after Walter's bankruptcy, the trustee sued the bank to recover the payment Walter made to the bank, claiming avoidable preference. Christopher was an insider creditor because he was related to Walter,⁴⁵ but the bank was a noninsider creditor. The payment was for Christopher's benefit and, because he was an insider, the one-year reach-back period of § 547 applied. The payment to the bank was arguably an avoidable preference to Christopher under § 547. The trustee then sought recovery under § 550 from the bank, the initial transferee.

The trustee lost because the new § 550(c) protected the bank against recovery under § 550. Judge Roberts wrote:

⁴² 11 U.S.C. § 550(c) (1994).

⁴³ *Id.*

⁴⁴ 244 B.R. 631 (Bankr. W.D. Ky. 2000).

⁴⁵ See 11 U.S.C. § 101(31)(A)(i) (1993).

[E]ven if the transfer was ultimately determined to meet the requirements of a preferential transfer under § 547(b), Trustee would still be precluded from recovering the transferred monies from Exchange Bank. The language of § 550(c) unequivocally states that Trustee may not recover a preferential transfer from a transferee that is not an insider, if the transfer occurred outside of the general 90 day preference period.⁴⁶

So, even if the payment to the bank was an avoidable preference to Christopher, § 550(c) stopped the trustee from recovering the amount of the payment from the bank.

III. AN UNCERTAIN CASE LIMITING § 550(C): *IN RE WILLIAMS*

Very much like *Deprizio* and *Vaughn* in concept, but also very different in the remedy sought, is another recent case, *In re Williams*.⁴⁷ In *Williams*, the debtor and his wife got a bank loan for the purchase of a manufactured home. The bank took a security interest in the home, but this transfer (a lien) did not occur—for bankruptcy purposes—until weeks later. Also, the transfer occurred more than ninety days, but less than one year, prior to the debtor's bankruptcy filing.⁴⁸

Everybody agreed that the creation of the lien benefited debtor's wife, an insider. Because the wife was an insider, the one-year reach-back period of § 547 applied. So, the transfer to the bank, the lien itself, was an avoidable preference to the wife.

The trustee did not seek to recover a payment or other money from the bank, as happened in *Deprizio* and *Vaughn*. Instead, the trustee sought only to avoid the lien. The bank relied on § 550(c), which says the trustee may not recover under § 550(a) from a transferee that is not an insider if the transfer, as here, was made beyond ninety days before bankruptcy and for the benefit of an insider creditor.⁴⁹

The trustee responded that § 550(c) did not apply. Indeed, the trustee argued that the entire § 550 was inapplicable. The

⁴⁶ *In re Vaughn*, 244 B.R. at 633 (emphasis added).

⁴⁷ 234 B.R. 801 (Bankr. D. Or. 1999).

⁴⁸ Here is a little more detail: The debtor created a purchase-money security interest in the bank's favor on June 7, 1996. This interest was not perfected until July 29. For purposes of § 547(b), the security interest was not given or transferred until the time of perfection. See 11 U.S.C. § 547(e)(2) (1994). "The debtor filed his Chapter 7 bankruptcy petition, herein, on December 12, 1996. Thus, the perfection of the defendant's security interest in the mobile home [i.e., the transfer of the debtor's property] occurred more than 90 days, but less than one year prior to the bankruptcy filing." *Williams*, 234 B.R. at 802. The issue of applying an exception to preference under 11 U.S.C. § 547(c) was not before the court.

⁴⁹ See 11 U.S.C. § 550(c) (1994).

trustee relied solely on § 547, arguing that even though § 550(c) “bars any ‘recovery’ by the trustee [N]o ‘recovery’ is necessary in this case.” Rather, the security interest of the defendant is avoided pursuant to § 547(b), after which the lien of the defendant is preserved for the benefit of the estate pursuant to § 551”⁵⁰ The effects, of course, are that the value of the home, unencumbered by the bank’s lien, fills the estate, and the bank is left with an unsecured debt.⁵¹

The bank disagreed about the relationship between §§ 547 and 550 and, more specifically, the meaning and reach of “recovery” and defenses under § 550. The bank argued that: “‘recovery’ under § 550 is necessary to give the trustee an effective remedy, since the lien and its value is the property that the trustee seeks to ‘recover’. Since recovery is barred, the trustee’s claim must fail.”⁵²

In other words, the bank argued that avoidability under § 547 is nothing in itself. It is not an independent remedy. Nothing can happen under § 547 except through § 550, and § 550(c) protects the bank’s lien against any preference remedy by the trustee.

Judge Radcliffe sided with the trustee. Importantly, his holding has two parts. First, § 547 affords “a remedy separate and distinct from the ability to ‘recover’ pursuant to § 550.”⁵³ Second, the new § 550(c) applies only to § 550 “recovery,” not to § 547 avoidance.⁵⁴

IV. IS “AVOIDANCE” UNDER § 547 INDEPENDENT OF “RECOVERY” UNDER § 550?

Judge Radcliffe said yes in *Williams*.⁵⁵ My bankruptcy treatise⁵⁶ said yes way back in 1992. I wrote then about the consequences of avoidance,⁵⁷ after writing extensively about avoidance itself.⁵⁸ I even imagined a trilateral preference case such as *Williams* and concluded that avoidance under § 547 is

⁵⁰ *Williams*, 234 B.R. at 803-04.

⁵¹ The effects may be even larger. See generally David Gray Carlson, *Bankruptcy’s Organizing Principle*, 26 FLA. ST. U. L. REV. 549 (1999); Marshall E. Tracht, *Insider Guaranties in Bankruptcy: A Framework for Analysis*, 54 U. MIAMI L. REV. 497, 540 (2000).

⁵² *Williams*, 234 B.R. at 804.

⁵³ *Id.* at 804.

⁵⁴ *Id.* at 804-05.

⁵⁵ See discussion *supra* Part IV.

⁵⁶ See 1-3 DAVID G. EPSTEIN, STEVE H. NICKLES & JAMES J. WHITE, *BANKRUPTCY* (Practitioner Treatise Series 1992).

⁵⁷ See *id.* §§ 6-79 to -90.

⁵⁸ See *id.* §§ 6-1 to -78.

independent and valuable apart from § 550. Here, in two parts, is a review of my analysis of these issues, which is directly relevant to this Article.

A. *The Various Consequences of Avoidance, In General*

The legal bases on which the trustee can avoid a transfer of property are the trustee's avoiding powers. There are three major consequences of avoidance that motivate a trustee to use those powers: (i) nullification of the transfer as against the trustee, (ii) preservation of the transfer for the benefit of the estate, and, in some cases, (iii) recovery of the property from the transferees or from other people who benefitted from the avoided transfer.⁵⁹

The principal consequence of avoidance is nullification. Nullification fundamentally means that the transfer is retroactively ineffective and that the transferee legally acquired nothing through the transfer.⁶⁰

Preservation is an avoiding power that can be utilized to defeat transfers that were subordinate to the avoided transfer under nonbankruptcy law.⁶¹

Recovery is another bankruptcy remedy for avoidance that makes transferees of the affected property. In addition, people for whose benefit the transfer was made are also personally accountable to the estate for the return of the property or for its value. Recovery is not always necessary or even useful after avoidance, but avoidance is always necessary for recovery.⁶²

Consider the following hypothetical problem that illustrates and contrasts the functions of the above three consequences.

Suppose that, six months before filing bankruptcy, the debtor, D, gave an insider creditor, IC, a perfected Article 9 security interest in goods to secure an antecedent debt of \$13,000. The same property was subject to a competing security interest for \$9,000 in favor of a bank, B, a non-insider creditor. B acquired its interest a year before IC, but perfected a few days after IC. Thus, IC enjoyed priority.

In the six-month period preceding bankruptcy, D paid IC \$3,000 on the secured debt. B was paid nothing.

When D files bankruptcy, the goods (which are now worth only \$10,000 because of market forces) become property of the bankruptcy estate because, despite the security interests that D created, D retained title to and thus an interest in the goods. On the other hand, the property remains subject to the security

⁵⁹ See EPSTEIN ET AL., *supra* note 56, at 200-01.

⁶⁰ See *id.* at 201.

⁶¹ See *id.*

⁶² See *id.*

interests of IC and B. If their liens are valid in bankruptcy, they can eventually recover the property and satisfy their secured claims from its value without sharing it with anyone.

Soon after D's bankruptcy case commences, both IC and B ask for relief from the automatic stay for the purpose of enforcing their security interests in the goods. Simultaneously, the trustee seeks to avoid their interests. The trustee convinces the bankruptcy court that the security interest to IC was an avoidable preference under section 547(b). The preference period as to IC is one year because she was an insider. No section 547(c) exception applies. The bankruptcy court will order that the security interest to IC is avoided. This judgment effectively deems, as a matter of law, that the secured transaction between IC and D never occurred. It is nullified. Thus, IC's claim for the balance of the debt owed her, \$4,000, is unsecured. IC becomes a general unsecured creditor of the estate.

The trustee cannot avoid B's security interest as a preference. The preference period as to B (a non-insider) is 90 days, and B's security interest was created and perfected beyond the 90-day period preceding bankruptcy. The trustee is not defeated, however. Another consequence of avoiding the transfer to IC is that the transfer (i.e., the security interest that D gave IC) is automatically preserved for the benefit of the estate. This preservation means that the trustee can use the avoided interest to reduce or eliminate secured claims that were subordinate to it under non-bankruptcy law. Outside of bankruptcy IC enjoyed priority over B. In bankruptcy the trustee can assert the priority of IC's avoided, though preserved, interest and thereby avoid and thus nullify B's interest to the same extent that IC had priority over B under state law. B, too, thus becomes a general unsecured creditor because IC's avoided lien equaled the property's value and would therefore have entirely squeezed out B's interest under state law.

The goods were fully encumbered at the beginning of D's bankruptcy. Now the goods are completely unencumbered. The trustee has freed their value, \$10,000, for the benefit of the estate and its general creditors. A trustee's principal goal in exercising her avoidance powers is increasing the size of the estate.

The trustee is not finished. She wants the \$3,000 that D paid IC during the six months before the bankruptcy case commenced. It is not property of the estate. The debtor had no interest in it when the case commenced. The payment, however, was preferential and avoidable under section 547(b). No preference exception applies. The transfer, i.e., the payment of the money, was nullified when the bankruptcy court

ordered that the transfer be avoided. In this instance, however, the nullification is a hollow victory. The property is not in the trustee's control. IC has it, and avoidance in itself does not constitute a judicial command for the return of the affected property or for other accountability with respect to it.

When the trustee wishes not only to nullify a transfer but also to impose accountability on third parties with respect to it, she must go beyond avoidance of the transfer and recover the affected property from the transferee. A person from whom the trustee can recover is liable for the property itself or its value. It is through the recovery process that the trustee holds third parties personally accountable for the property involved in an avoided transfer. Whatever is recovered from them thereupon becomes property of the estate.

Therefore, after avoiding the \$3,000 payment from D to IC, the trustee will ask the bankruptcy court, in the same or a different proceeding, to order recovery of the money. In so ordering, the court will enter a judgment against IC directing her to return the money to the trustee for the benefit of the estate. It is even possible that B could be liable for the money. When the requirements of recovery are met, the class of persons liable to the trustee is not limited to people who received the transferred property from the debtor. The class can include subsequent transferees who never dealt with the debtor and people who benefited from the transfer even though they never received the property from anyone.

Avoidance is a requirement for recovering from IC or B, but is not sufficient cause in itself to support recovery from anyone. The requirements of recovery go beyond avoidance, primarily because recovery carries defenses, which are different from defenses to the trustee's avoiding powers. Thus, it is possible for the trustee to succeed in avoiding a transfer but fail to recover the affected property from anyone. Whether this happenstance is a total loss for the trustee in practical terms depends on whether nullification and preservation are themselves practically meaningful in the case. They always occur as consequences of avoidance regardless of the trustee's ability or inability to recover the affected property or its value.⁶³

B. *The More Particular Argument that Avoidance Is Independent of Recovery*

When the Code describes the trustee's principal avoiding powers, it does so by stating that the trustee "may avoid."⁶⁴ These powers have been effectively exercised in many cases in which the

⁶³ *Id.* at 201-03.

⁶⁴ 11 U.S.C. §§ 544(a), (b), 545, 547(b), 548(a), (b) (1994).

courts have ordered transfers “avoided.” However, the Code does not clarify whether there is any effect of avoidance in itself.

It is possible to conclude that the significance of avoidance can be defined primarily by § 550, which governs recovery from transferees of avoided transfers.⁶⁵ As Professor Stefan Riesenfeld has written: “The effects of avoidability are spelled out in §§ 550 and 551[, which govern preservation of an avoided transfer].”⁶⁶ Recoveries pursuant to § 550, and preservation based upon § 551, are undeniably consequences of avoidance. However, they do not totally define avoidance.⁶⁷

Avoidance of a transfer is important apart from §§ 550 and 551. This is illustrated by the following: The trustee’s principal avoiding powers are not defined by terms used in other sections of the Code. The provisions flatly declare that the trustee “may avoid” and do not provide that the trustee may recover under § 550, or preserve under § 551. The words in the Code itself imply that avoidance diverges from recovery and preservation and is itself meaningful. In addition, the word “avoid” is an active verb that is commonly understood to mean “to make legally void: annul.”⁶⁸ A failure to interpret it in this manner would read the word out of the Code. Furthermore, the Code provides distinct statutes of limitations regarding avoidance and recovery. The different limitation periods would not have been necessary if avoidance were meant to be defined only in terms of recovery. Moreover, Congress intended to separate and distinguish “between the concepts of avoiding a transfer and recovering from the transferee.”⁶⁹ This separation can only be meaningful if avoidance is itself separately meaningful.

Finally, the few courts that have examined this issue “have generally concluded that avoidance is separately meaningful from recovery.”⁷⁰ However, the issue rarely arises because, in reality, a trustee will seek recovery from transferees at the same time that she seeks to avoid the transfer. Therefore, “recovery and avoidance are procedurally combined within the applicable periods of limitation, and there is no reason to determine their separate effects.”⁷¹

⁶⁵ See 11 U.S.C. § 550(a).

⁶⁶ STEFAN RIESENFELD, CASES AND MATERIALS ON CREDITORS’ REMEDIES AND DEBTORS’ PROTECTION 681 (4th ed. 1987).

⁶⁷ See *In re Mako, Inc.*, 127 B.R. 471 (Bankr. E.D. Okl. 1991).

⁶⁸ MERRIAM-WEBSTER’S COLLEGIATE DICTIONARY 80 (10th ed. 2000).

⁶⁹ H.R. REP. NO. 95-598, at 375 (1978), *reprinted* in 1978 U.S.C.C.A.N. 5963, 6331.

⁷⁰ EPSTEIN ET AL., *supra* note 56, at 204.

⁷¹ *Id.*

The difference between avoidance and recovery can be seen when a debtor relies on § 522(f) to avoid a lien on exempt property when the statute of limitation on recovery under § 550 bars recovery from a transferee. In these cases, the majority of courts have held that § 550 does not limit all of the debtor's avoidance power under § 522(f).⁷² The courts have, in effect, articulated separate, independent effects of avoidance and recovery. They have implicitly defined avoidance as nullifying the lien or other interest created in the affected property by allowing debtors to rid their property of liens apart from recovery under § 550. Some of these courts have explicitly defined recovery and limited it to retrieving the affected property in the hands of third-party transferees.⁷³ If the affected property has not itself been transferred, then recovery is not necessary.

We readily accept giving avoidance such a separate nullifying effect, but we reject limiting recovery to situations in which the affected property has been transferred. Section 550 permits a trustee, upon avoiding a transfer, to recover from transferees and other third parties "the property transferred" or its value. This phrase is sufficiently broad to include the property interest involved in the avoided transfer. Thus, a transferee of the avoided interest is liable for recovery under section 550 even though the affected *res* was not itself conveyed to her or anyone else. Taking this broad view of recovery does not diminish the separate, nullifying consequence of avoidance *per se*, which occurs even in the absence of recovery from transferees under section 550.⁷⁴

However, it can still be argued that the purpose of avoidance is to bring property within the bankruptcy estate to benefit the debtor and creditors. Accomplishing this purpose demands recovery because § 541(a)(3) includes within the estate "[a]ny interest in property that the trustee recovers under section . . . 550"⁷⁵ Avoidance achieves its intended purpose only through recovery, even if avoidance has a separate effect theoretically. Therefore a trustee must always recover under § 550 to give purposive meaning to avoidance.⁷⁶

The above argument disregards that "an automatic consequence of avoidance, beyond its nullifying effect, is preservation of the lien or other interest that is avoided, and that the preserved interest automatically becomes part of the estate

⁷² See, e.g., *In re Goydosick*, 94 B.R. 72 (Bankr. W.D. Pa. 1988).

⁷³ See, e.g., *In re Barnett*, 30 B.R. 119 (Bankr. N.D. Ala. 1983).

⁷⁴ EPSTEIN ET AL., *supra* note 56, at 205.

⁷⁵ 11 U.S.C. § 541(a)(3) (1994).

⁷⁶ See EPSTEIN ET AL., *supra* note 56, at 205.

without recovery.⁷⁷ Consequently, when a transfer is avoided, the interest that the transfer created becomes part of the estate. The interest merges with any residual interest in the debtor that passed to the estate when the bankruptcy case began.

However, voiding a transfer and automatically including the avoided interest within the estate is not a full remedy in some cases.

The transferee may have disposed of the transferred interest or the affected property by consuming it or by reconveying to a third person whose claim should be honored for overriding policy reasons; or, a transferee may effectively control the property despite the avoidance and consequent negation of her legal claim to it. In these and other circumstances in which the estate cannot easily or fully realize the value of the avoided interest, the trustee's further remedy is recovery, under section 550, from transferees and people who benefited from the avoided transfer.⁷⁸

In my opinion, the transferred interest automatically becomes part of the estate because avoidance, per se, legally annuls the transfer. Recovery is an additional step that makes beneficiaries and transferees personally accountable to the estate regarding the transferred property. Recovery offers an additional remedy whenever avoidance alone provides incomplete relief. However, it does not define avoidance by providing the exclusive remedy for it. Recovery is only necessary when annulling the transfer does not totally satisfy the estate.⁷⁹

C. *Another View of Even Greater Separation of §§ 547 and 550*

Professor David Gray Carlson, a leading scholar, would further separate §§ 547 and 550. Professor Carlson believes that § 550 is an even more limited supplement to the effect of § 547.⁸⁰ Professor Carlson believes that the most meaningful consequences of § 547 are, in nature, in rem and work in conjunction with the strong-arm power of § 544(a). He concedes § 550 adds in personam liability for some persons, including people who benefited from a preference but received nothing directly from the transfer. He also concedes that § 550 adds some defenses to in personam liability. Yet, Professor Carlson believes that § 550 is itself useless and even irrelevant on the in rem effects of § 547. Therefore, even though Professor Carlson not so gently disagrees

⁷⁷ *Id.* at 205-06.

⁷⁸ *Id.* at 206.

⁷⁹ *See id.* at 200-07.

⁸⁰ *See* Carlson, *supra* note 51, at 549.

with me that nullification under § 547 is supplemented by recovery under § 550,⁸¹ we agree that § 547 is independent and potent in and of itself. We only disagree on how independent they are and how potent § 547 is. However, our agreement is sufficiently wide that Professor Carlson would vote with me to affirm the result in *Williams*, though he would concur for different reasons.⁸²

V. DID CONGRESS INTEND § 550(C) TO TRUMP ANY
PREEXISTING INDEPENDENCE AND SEPARATE
CONSEQUENCES OF § 547 AVOIDANCE?

Suppose that Judge Radcliffe, Professor Carlson, and I are correct, as far as we agree, that § 547 avoidance is (to some lesser or greater extent) generally separate from § 550 recovery and that the result in *Williams* is correct under those provisions, prior to the addition of new § 550(c). The question remains whether Congress intended that § 550(c) would broadly apply so that its defense would reach beyond § 550 recovery and apply equally to avoidance under § 547.

In *Williams*, Judge Radcliffe decided that § 550(c) lacked such reach:

[T]he defendant maintains that it was clearly the Congressional intent to overrule the *Deprizio* line of cases. Mr. Josephson notes, however, that: "It may well be that Congress intended merely to fix the narrow problem of insider creditors having to repay *Deprizio*-like preferences."

The Supreme Court has made it clear that, in questions of statutory interpretation, the plain meaning of the statute is to be given effect. When a statute is clear (i.e., non-ambiguous), recourse to the legislative history is not appropriate.

Here, it is noteworthy that Congress chose to amend § 550 of the Code, the "recovery" statute. Had Congress intended to completely overrule the *Deprizio* line of cases and to prevent any adversary proceeding, such as the case at bar, the most effective method would have been to add another defense or exception to avoidance in §547(c). [Footnote 7: Section 547(c) already contains a number of defenses or exceptions to a trustee's avoidance action.] It is also noteworthy that there is no mention of § 550 in § 551.

... The trustee brings an avoidance action pursuant to § 547(b). If the trustee succeeds in avoidance, § 550(a) allows "recovery" of the property transferred if such recovery is necessary. In that event, the 1994 Amendment to § 550 protects

⁸¹ See *id.* at 620-21.

⁸² See 1 GRANT GILMORE & DAVID GRAY CARLSON, GILMORE AND CARLSON ON SECURED LENDING: CLAIMS IN BANKRUPTCY §4.07[A] (2d ed. 2000).

a non-insider creditor, such as the defendant in this case. Where, however, the property is already property of the estate pursuant to § 541 and the property has not been transferred to the creditor or some other third party prior to the filing of the bankruptcy, the trustee has no need for “recovery.” In such a case, where the trustee seeks merely to avoid a security interest, the security interest is avoided and automatically preserved for the benefit of the estate pursuant to § 551.⁸³

Would the Supreme Court affirm or reverse the above result? It could depend on how the Court approaches the problem. The Court might not reach the precise issue if it examined the relationship between §§ 547 and 550 and decided that the latter generally controlled the former, that is, that every remedy or consequence of avoidance under § 547 is dependent on § 550. So, even before § 550(c), “recovery” throughout § 550 included and limited avoidance under § 547. In this event, § 550(c) is a straightforward expansion of the preexisting control and limitation of § 550 over § 547.

Suppose, however, that the Court evaded this larger issue or decided that, in general, § 547 avoidance was separate from § 550 before the addition of § 550(c). Therefore, it would be possible that the narrow issue before the Court would be whether § 550(c), in and of itself, means something bigger in § 550(c) and has a wider scope than § 550 generally that reaches avoidance under § 547.

In *Williams*, Judge Radcliffe is absolutely right when he says that, generally, the Supreme Court strictly construes the Bankruptcy Code.⁸⁴ Recently, in *Hartford Underwriters Insurance Co. v. Union Planters Bank*,⁸⁵ Justice Scalia reminded us that when interpreting the Code:

[W]e begin with the understanding that Congress “says in a statute what it means and means in a statute what it says there.” As we have previously noted[,] . . . when “the statute’s language is plain, ‘the sole function of the courts’”—at least where the disposition required by the text is not absurd—“is to enforce it according to its terms.”⁸⁶

And, if the plain language is the “most natural reading,”⁸⁷ then the “burden of persuading” the Court of another reading is “exceptionally heavy.”⁸⁸

⁸³ *In re Williams*, 234 B.R. 801, 805 (Bankr. D. Or. 1999) (citation omitted).

⁸⁴ *See id.* at 805.

⁸⁵ 530 U.S. 1 (2000).

⁸⁶ *Id.* at 6 (citations omitted).

⁸⁷ *Id.* at 9.

⁸⁸ *Id.*

Yet, even if Judge Radcliffe's reading of § 550(c) in *Williams* is the plain and most natural reading of the provision, the Supreme Court has not been fully consistent about when and how to look beyond the statutory language when interpreting the Bankruptcy Code.⁸⁹ It is possible that the burden of establishing a different, broader reading of the language is lighter when the questioned provision is an amendment to the Bankruptcy Code, such as § 550(c). Moreover, fairly direct, "relevant" legislative history suggests that in fixing *Deprizio*, Congress intended a more far-reaching solution. Senator Charles Grassley was influential in passing the 1994 amendments, including the *Deprizio* fix. He stated for the Congressional Record:

Our legislation overrules the *Deprizio* line of decisions and clarifies congressional intent that non-insider transferees should not be subject to the preference provisions of the Bankruptcy Code beyond the 90-day statutory period. Our aim is to encourage commercial lenders and landlords to extend credit to smaller business entities.⁹⁰

The committee reports agree that the intention of § 550(c) was to completely except noninsider creditors from any and all consequences and remedies of a preference that occurred to an insider creditor between ninety days and one year before the debtor's bankruptcy.⁹¹

⁸⁹ See Karen M. Gebbia-Pinetti, *Interpreting the Bankruptcy Code: An Empirical Study of the Supreme Court's Bankruptcy Decisions*, 3 CHAP. L. REV. 173 (2000).

⁹⁰ 140 CONG. REC. S14461 (daily ed. Oct. 6, 1994) (statement of Sen. Grassley).

⁹¹ The House report says:

Section 547 of the Bankruptcy Code authorizes trustees to recapture preferential payments made to creditors within 90 days prior to a bankruptcy filing. Because of the concern that corporate insiders (such as officers and directors) who are creditors of their own corporation have an unfair advantage over outside creditors, section 547 of the Bankruptcy Code further authorizes trustees to recapture preferential payments made to such insiders in their capacity as creditors a full year prior to a bankruptcy filing. Several recent court decisions have allowed trustees to recapture payments made to non-insider creditors a full year prior to the bankruptcy filing, if an insider benefits from the transfer in some way. Although the creditor is not an insider in these cases, the courts have reasoned that because the repayment benefitted a corporate insider (namely the officer who signed the guarantee) the non-insider transferee should be liable for returning the transfer to the bankrupt estate as if it were an insider as well. This section overrules the *DePrizio* line of cases and clarifies that non-insider transferees should not be subject to the preference provisions of the Bankruptcy Code beyond the 90-day statutory period.

H.R. REP. NO. 103-835, at 44-45 (1994) (citation omitted) (providing a section-by-section analysis regarding section 202 of H.R. 5116).

The Senate Report states:

This section is designed to overturn a line of decisions which have allowed trustees to recover payments made to noninsider creditors up to 1 year prior to the bankruptcy filing. Section 547 of the code allows for the recapture of

I suspect, however, that the Supreme Court would ignore this history and not look beyond the plain, limited language of § 550(c). In *Union Bank v. Wolas*,⁹² the Court was asked to interpret an amendment to § 547(c)(2), which is an exception to an otherwise avoidable preference protecting payments made in the ordinary course of business. As originally enacted, § 547(c)(2) was limited to payments made within forty-five days of the day the debt was incurred. In 1984, Congress amended the subsection to eliminate the forty-five-day limitation.

At the time, many people thought that the purpose of this change in § 547(c)(2) was to protect a wider range of payments on short-term debts only. The issue in *Wolas* was whether the amended § 547(c)(2) applied to protect payments on long-term debts as well. Consistent with the popular history of the 1984 amendment and a similar reading of “legislative history,” the court of appeals decided that the amended § 547(c)(2) was not available to long-term creditors, even though nothing on the face of the new amendment so restricted the exception.

The Supreme Court reversed the lower court’s decision. The legislative history was irrelevant. Even if Congress, in amending the statute, intended a strict reading of the change in § 547(c)(2), Congress nevertheless actually chose broader language.⁹³ The plain language of the amended statute broadened the exception for all creditors, not just for a subset of creditors that was foremost in the legislative mind. “The fact that Congress may not have

preferential payments made within 90 days of filing as well as those payments made within 1 year if the transferee is deemed to be an insider. *DePrizio* and its line of cases extend this recapture protection to noninsiders as well. The committee believes these cases were wrongly decided. This provision seeks to clarify previous congressional intent which held that a noninsider transferee should not be subject to the preference provisions of the code beyond the 90-day statutory period.

S. REP. NO. 103-168, at 48 (1993) (providing a section-by-section analysis regarding section 214 of S. 540).

Yet, in the very same law Congress included a change in § 546 that provides “limitations on avoiding powers.” Bankruptcy Reform Act of 1994, Pub. L. No 103-394, § 216, 108 Stat. 4126-27, and also a provision relating to the “nonavoidability of fixing of lien on tools and implements of trade, animals, and crops.” *Id.* § 310. So, it seems that Congress actually “recognized” the significance of avoidance itself and “knew” how to affect avoidance when necessary to do so.

Even the title of the public law section that changed § 550(c) argues that Congress understood a difference between recovery or liability and avoidance: “[L]imitation on liability of non-insider transferee for *avoided* transfer.” *Id.* § 202 (emphasis added). This argument is strengthened by the very language of § 550(c), which explicitly distinguishes avoidance under § 547 and recovery under § 550. *See* 11 U.S.C. § 550(c) (1994).

⁹² 502 U.S. 151 (1991).

⁹³ *See id.* at 155.

foreseen all of the consequences of a statutory enactment is not a sufficient reason for refusing to give effect to its plain meaning."⁹⁴

In fixing *Deprizio*, Congress may have intended a broad solution, but it actually enacted a more narrow remedy. It plainly amended only § 550, not § 547 itself. The plain meaning is that insiders are protected from damages under § 550(a) but not from avoidance under § 547(b). The plain language of § 550(c), and the structural fit of the amendment within the damages recovery provision of § 550, suggest very plainly and thus very strongly that the Court would limit § 550(c) to its literal terms. Noninsider creditors are protected from damages but not from avoidance.⁹⁵

VI. SECOND ATTEMPT BY CONGRESS TO KILL THE CASE: BANKRUPTCY REFORM ACT OF 1999

Congress apparently concedes (or, at least, worries) that § 550(c) only wounded *Deprizio*; that is, the provision protects noninsider creditors from recovery of damages but not from avoidance. Both the House and the Senate passed bankruptcy reform bills in 1999, and both bills would explicitly widen the protection for noninsider creditors. Each bill contains a "technical correction" that would directly amend § 547 itself to protect a noninsider creditor when a preference occurs to an insider creditor between ninety days and one year before bankruptcy.⁹⁶

⁹⁴ *Id.* at 158.

⁹⁵ The same conclusion was reached by other commentators soon after Congress added § 550(c). See Margaret Howard, *Avoiding Powers and the 1994 Amendments to the Bankruptcy Code*, 69 AM. BANKR. L.J. 259 (1995); Adam A. Lewis, *Did It or Didn't It? The Deprizio Dilemma*, 14 AM. BANKR. INST. J. 20 (1995); Lawrence Ponoroff, *Now You See It, Now You Don't: An Unceremonious Encore for Two-Transfer Thinking in the Analysis of Indirect Preferences*, 69 AM. BANKR. L.J. 203 (1995); cf. James M. Lawniczak, *Did Congress Always Say What It Meant in the Bankruptcy Reform Act of 1994*, 101 COM. L.J. 372, 381-84 (1996). More recent commentaries stick to the original conclusion. See generally Carlson, *supra* note 51, at 593-611; Tracht, *supra* note 51, at 540.

⁹⁶ The provision states:

SEC. 1116. PREFERENCES.

(a) IN GENERAL.—Section 547 of title 11, United States Code, is amended—

(1) in subsection (b), by striking "subsection (c)" and inserting "subsections (c) and (i)"; and

(2) by adding at the end the following:

"(i) If the trustee avoids under subsection (b) a transfer made between 90 days and 1 year before the date of the filing of the petition, by the debtor to an entity that is not an insider for the benefit of a creditor that is an insider, such transfer may be avoided under this section only with respect to the creditor that is an insider."

(b) APPLICABILITY.—The amendments made by this section shall apply to any case that is pending or commenced on or after the date of enactment of this Act.

H.R. 833, 106th Cong. § 1116 (1999); see also S. 625, 106th Cong. § 1114 (1999).

Specifically, the 1999 amendment would add this subsection to § 547:

If the trustee avoids under subsection (b) a transfer made between 90 days and 1 year before the date of the filing of the petition, by the debtor to an entity that is not an insider for the benefit of a creditor that is an insider, such transfer may be avoided under this section only with respect to the creditor that is an insider.⁹⁷

This language would flatly change the result in the *Williams* case. Existing § 550(c) protected the bank in *Williams* against liability for preference damages. It did not protect the bank against preference avoidance. The bank's security interest was, therefore, avoided by § 547, which the court decided was beyond the protective reach of § 550(c). The 1999 amendment, however, is part of § 547 and would explicitly protect the noninsider bank against avoidance.

The House report on this amendment thoroughly explains the possible failure of § 550(c) and the need for clarification to protect noninsider creditors from both recovery of damages under § 550 and avoidance under § 547.

Section 547 of the Bankruptcy Code authorizes trustees to avoid preferential payments made to creditors by a debtor within 90 days of filing, whether the creditor is an insider or an outsider. Because of the concern that corporate insiders (such as officers and directors) who are creditors of their own corporation have an unfair advantage over outside creditors, section 547 also authorizes trustees to avoid preferential payments made to insider creditors between 90 days and one year before filing. Several recent cases, including *DePrizio*, allowed the trustee to "reach-back" and avoid a transfer to a noninsider creditor which fell within the 90-day to one year time frame if an insider benefitted from the transfer in some way. This had the effect of discouraging lenders from obtaining loan guarantees, lest transfers to the lender be vulnerable to recapture by reason of the debtor's insider relationship with the loan guarantor.

Section 202 of the Bankruptcy Reform Act of 1994 [11 U.S.C. subsection 550(c)] addressed the *DePrizio* problem by inserting a new section 550(c) into the Bankruptcy Code to prevent avoidance or recovery from a noninsider creditor during the 90-day to one year period even though the transfer to the noninsider benefitted an insider creditor. The 1994 amendments, however, failed to make a corresponding amendment to section 547, which deals with the avoidance of

⁹⁷ H.R. 833; *see also* S. 625.

preferential transfers. As a result, a trustee could still utilize section 547 to avoid a preferential lien given to a noninsider bank, more than 90 days but less than one year before bankruptcy, if the transfer benefitted an insider guarantor of the debtor's debt.

Accordingly, section 1117 [renumbered 1116] makes a perfecting amendment to section 547 to provide that if the trustee avoids a transfer given by the debtor to a noninsider for the benefit of an insider creditor between 90 days and one year before filing, that avoidance is valid only with respect to the insider creditor. Thus both the previous amendment to section 550 and the perfecting amendment to section 547 protect the noninsider from the avoiding powers of the trustee exercised with respect to transfers made during the 90-day to one-year pre-filing period.⁹⁸

The Senate Report adds that this "technical amendment" is necessary because "[c]ourts ignored the [1994] amendments [that is, § 550(c)] and the legislative history [which is] why this [the 1999 amendment] is here."⁹⁹

CONCLUSION

Deprizio held that an indirect preference to an insider creditor between ninety days and one year before bankruptcy was avoidable under § 547 and that the direct transferee, even though a noninsider creditor, was liable for "recovery" of damages under § 550(a). Congress tried legislatively to overrule *Deprizio* by enacting § 550(c), which immunizes the noninsider creditor in such a case against any § 550 recovery. Section 550(c), however, does not protect the noninsider creditor against avoidance of the preference to the insider creditor, even though for the noninsider creditor, the transfer is not a preference. So, § 550(c) wounded *Deprizio* but did not kill the case.

In 1999, Congress again tried to kill *Deprizio*. This time it passed a measure that would amend § 547 itself to protect the noninsider creditor against avoidance to the same extent § 550(c) protects the creditor against recovery of damages.¹⁰⁰ If this amendment had become effective,¹⁰¹ it would have been the death knell for the most notorious aspects of *Deprizio*. However, because of President Clinton's veto of the Act, *Deprizio* lives on.¹⁰²

⁹⁸ H.R. REP. NO. 106-123, pt. 1, at 195 (1999).

⁹⁹ S. REP. NO. 106-49, at 63 (1999).

¹⁰⁰ See Bankruptcy Reform Act of 2000, H.R. 2415, 106th Cong. (2000)

¹⁰¹ See *supra* note 24.

¹⁰² See Memorandum of Disapproval of Bankruptcy Reform Act of 2000, 36 WEEKLY COMP. PRES. DOC. 1547 (Dec. 19, 2000).

Thus, something remains of *Deprizio*. Through the 1994 and 1999 amendments, Congress clearly recognized and endorsed the implicitly necessary notion that recovery under § 550 and avoidance under § 547 (and under the other avoiding powers, too) are separate. However, the degree of independence between recovery and avoidance is not clear, and all of the implications throughout the full range of avoidance powers and avoidance cases remain uncertain.

