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Bankruptcy Law - In Re CHG International, Inc.: The Ordinary Course of Business Exception: What You See is What You Get

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BANKRUPTCY LAW

IN RE CHG INTERNATIONAL, INCORPORATED: THE ORDINARY COURSE OF BUSINESS EXCEPTION; WHAT YOU SEE IS WHAT YOU GET

I. INTRODUCTION:

In re CHG International, Inc.,¹ announced the Ninth Circuit's interpretation of 11 U.S.C. § 547(c)(2), the "Ordinary Course of Business" exception to a preferential transfer.² The *CHG* court examined the legislative history and the underlying policies behind section 547, and determined that the 1984 amendment was intended to exclude long-term debt from the exception, even though the amendment deleted the forty five day time limitation.³ Subsequently, relying on the *CHG* ruling, the Ninth Circuit decided *In re ZZZZ Best Co., Inc.*,⁴ again holding that long-term debts did not fall within the Ordinary Course of Business exception.⁵ The Supreme Court granted certiorari to *ZZZZ Best*, and reversed the Ninth Circuit interpretation of section 547(c)(2).⁶ This article will examine the

1. *In re CHG Int'l, Inc.*, 897 F.2d 1479 (9th Cir. 1989) (per Browning, J.; the other panel members were Alcaron, J., and Hall, J.).

2. *CHG*, 897 F.2d at 1487. 11 U.S.C. § 547(c)(2) (1982 & Supp. III 1985). A preference is a payment to a unsecured or undersecured creditor within ninety days prior to filing for bankruptcy, on an antecedent debt, which places the creditor in a better financial position than the debtor's other creditors. 11 U.S.C. § 547(b) (1982 & Supp. III 1985).

3. *CHG*, 897 F.2d at 1487.

4. 921 F.2d 968 (9th Cir. 1990), *rev'd sub nom.* *Union Bank v. Wolas*, Chapter 7 Trustee for the Estate of *ZZZZ Best Co. Inc.*, 50 U.S. ____, 112 S. Ct. 527 (1991).

5. *ZZZZ Best*, 921 F.2d at 969. The *ZZZZ Best* case involved a preferential transfer made to a creditor on an eight month line of credit. *ZZZZ Best*, 921 F.2d at 968. The Ninth Circuit determined that the eight month line of credit constituted long term debt. *Id.* at 969. In comparison, the *CHG* court, while not ruling specifically on what time period constitutes long term debt, found that the one year and seven month notes were long term debts. *CHG*, 897 F.2d at 1484. 11 U.S.C. § 547(c)(2) (1982 & Supp. III 1985).

6. *In re ZZZZ Best Co., Inc.*, 921 F.2d 968 (9th Cir. 1990), *rev'd sub nom.* *Union Bank v. Wolas*, Chapter 7 Trustee for the Estate of *ZZZZ Best Co., Inc.*, 50 U.S. ____, 112 S. Ct. 527 (1991). "In sum, we hold that payments on long-term debts, as well as payments on short-term debt, may qualify for the ordinary course of business exception to the trustee's power to avoid preferential transfers." *Union Bank*, 112 S. Ct. 533.

Ninth Circuit opinion of *In re CHG*,⁷ and discuss the Supreme Court ruling and its implications.

II. FACTUAL STATEMENT

In re CHG, involved several banking transactions between the debtor, CHG International ("CHG") and Barclays Bank PLC ("Barclays").⁸ Barclays made two loans to CHG, which were the subject of the preference action.⁹ Initially, Barclays advanced a one-year line of credit to CHG up to \$1,200,000, secured by a pledged certificate of deposit in the amount of \$1,200,000.¹⁰ This "CD" loan was renewed several times.¹¹

Barclays made a formal demand for payment the day before the promissory note became due.¹² Barclays advised CHG of its intention to foreclose on its security if the note were not paid.¹³ CHG made a \$14,224.99 interest payment on the CD loan, within ninety days of the filing of CHG's Chapter 11 petition.¹⁴

Barclays made a second loan of \$1,000,000 to CHG.¹⁵ This "real estate" loan was also evidenced by a promissory note requiring CHG to make monthly interest payments, with the principal coming due in seven months.¹⁶ CHG granted Barclays a deed of trust on eighty five acres of undeveloped waterfront

7. 897 F.2d 1479 (1990).

8. *CHG*, 897 F.2d 1479 (9th Cir. 1990). CHG is a Washington Corporation involved in real estate development. *Id.* Barclays is a British bank doing business in Seattle, Washington. *Id.*

9. *Id.* at 1480. At the time of CHG's bankruptcy filing both loans were undersecured. *Id.*

10. *Id.* CHG executed a promissory note, which required CHG to make monthly interest payments on the unpaid principal balance. *Id.* Westside Federal Savings and Loan held the Certificate of Deposit. *Id.*

11. *Id.* CHG continued to make its monthly interest payments under the first note during the renewal periods. *Id.* CHG only missed one monthly interest payment on the CD loan. *Id.*

12. *Id.*

13. *Id.* CHG contacted Westside, who held the CD and requested Westside to cash the CD and transfer the proceeds to Barclays. *Id.* Due to a penalty for early withdrawal, the value of the CD was reduced to \$1,164,125.32. *Id.*

14. *Id.* This was the first so-called preferential transfer. *Id.* CHG filed for bankruptcy protection on December 5, 1985, therefore any transfer to a creditor after September 6, fell within the ninety day preference period. *Id.*

15. *Id.* This was a seven month term loan, secured by a deed of trust on real property. *Id.* CHG held an executory real estate contract on the Vashon Property. *Id.* at 1480-81.

16. *Id.* Barclays held a deed of trust that was junior to a deed of trust granted to Westside, securing a loan in the approximate amount of \$2,000,000. *Id.* Barclays was also junior to the interest of several contract vendors. *Id.* at 1481.

property, known as the Vashon property, valued at \$500,000.¹⁷ At the time of CHG's bankruptcy filing, the principal of the second loan had not been reduced.¹⁸

The eighty five acres of undeveloped land was appraised as part of a larger parcel containing 127 acres.¹⁹ CHG defaulted on the underlying real estate contract subsequently forfeiting its interest in the Vashon property to the numerous contract vendors who were owed \$350,000.²⁰

As additional security for the second loan, CHG executed an additional note for \$500,000, secured by a deed of trust on a second parcel of real estate, known as the Richland property.²¹ This deed of trust was subordinate to a deed of trust granted to Washington Mutual Savings and Loan, securing a loan in the principal amount of \$2,122,500.²² The Richland property was sold at a nonjudicial foreclosure sale under the Washington Mutual deed of trust and purchased by Washington for \$2,351,041.97.²³

In the course of the loan interest payments, CHG misses only one payment under the first and the second loan.²⁴ CHG made an interest payment to Barclays on the second real estate loan which was within the ninety day preference period.²⁵

17. *Id.* at 1480-81. This property was located on Vashon Island and was purchased by CHG under a separate, executory real estate contract. *Id.* Barclays held a deed of trust that was junior to a deed of trust granted to Westside, securing a loan in the approximate amount of \$2,000,000. *Id.* Barclays was also junior to the interest of several contract vendors. *Id.* at 1481.

18. *Id.* CHG filed its voluntary petition on December 5, 1985, and the second note was due on December 28, 1984. *Id.*

19. *Id.* The market value for the entire 127 acres was no more than \$510,000. *Id.* CHG only held title to 85 acres out of the 127. *Id.*

20. *Id.* This wiped out Barclays' security interest in the property, rendering Barclays undersecured. *Id.*

21. *CHG*, 897 F.2d at 1481. The second parcel of real estate was located in Richland, Washington. *Id.*

22. *Id.* Washington Mutual held the first deed of trust on the Richland property securing a loan to CHG. *Id.*

23. *Id.* The nonjudicial foreclosure wiped out Barclays' junior interest in this property leaving Barclays unsecured on its second loan to CHG. *Id.*

24. *Id.*

25. *Id.* See 11 U.S.C. § 547(b)(4)(A) (1982 & Supp. III 1985). The date of CHG's voluntary filing was December 5, 1984, therefore, the preference period extended back to include any payments made after September 6, 1984. See *supra* note 14. See also note 2, for a definition of a preference.

CHG filed its petition for relief under Chapter 11 of the United States Bankruptcy Code on December 5, 1984.²⁶ Two years later, CHG filed an adversary complaint in the bankruptcy court alleging that it was entitled to recover the two interest payments made to Barclays within the ninety day preference period pursuant to section 547(b).²⁷ Barclays brought a motion for summary judgment based on its affirmative defense, the ordinary course of business exception.²⁸ The bankruptcy court denied the motion, finding as a matter of law that section 547(c)(2), the ordinary course of business exception to preferences, was not available to Barclays because the subject debts were long-term loans not ordinary trade credits.²⁹ The bankruptcy court granted CHG's counter motion for summary judgment, characterizing the two interest payments as preferences, and awarding judgment against Barclays in the total amount of \$30,007.55, including prejudgment interest and costs.³⁰

Barclays appealed to the district court, this time conceding that the interest payments were preferential transfers, but contesting the finding that the payments did not fall into the ordinary course of business exception.³¹ Agreeing with Barclays' position, the district court held that section 547(c)(2) did include long-term debt.³² CHG then appealed the District court's findings to the Ninth Circuit.³³

26. *CHG*, 897 F.2d at 1481. CHG filed its voluntary petition pursuant to 11 U.S.C. § 301, which provides:

A voluntary case under a chapter of this title is commenced by the filing with the bankruptcy court of a petition under such chapter by an entity that may be a debtor under such chapter. The commencement of a voluntary case under a chapter of this title constitutes an order for relief under such chapter. 11 U.S.C. § 301 (1982 & Supp. III 1985).

27. *CHG*, 897 F.2d at 1481. Barclays argued that the payments were not preferential and asserted an affirmative defense maintaining that the payments fell within the ordinary course of business exception to the avoidance of preferential transfers. *Id.* Section 547(b) grants the authority to recover property for the benefit of the bankruptcy estate as part of the debtor's general powers of avoidance. 11 U.S.C. § 547(b) (1982).

28. *CHG*, 897 F.2d at 1481.

29. *Id.* The court relied on the pre-1984 language of §547(c) which required forty-five days in accordance with trade billing cycles. *Id.* See 11 U.S.C. § 547(c)(2)(B) (1982), which provided: "made not later than 45 days after such debt was incurred." *Id.*

30. *CHG*, 897 F.2d at 1481 n.1.

31. *Id.* at 1481.

32. *In re CHG Int'l., Inc.*, 87 B.R. 647 (W.D. Wash. 1988) *rev'd* 897 F.2d 1479 (9th Cir. 1990) (relying on *In re Iowa Premium Service Co. Fuel and Oil Supply*, 695 F.2d 1109, 1111 (8th Cir. 1984); *In re Terminaling, Inc.*, 72 B.R. 752, 762 (S.D. Tex. 1987)).

33. *CHG*, 897 F.2d at 1481.

III. BACKGROUND

A. 11 U.S.C. § 547(B); PREFERENCE

Section 547(b) gives a trustee or debtor in possession the power to avoid certain transfers of the debtor's property made within ninety days prior to filing bankruptcy, which results in a benefit to one creditor, to the detriment of other creditors.³⁴ The preference rules were designed to ensure an orderly and equitable distribution of payments to the debtor's creditors within the months immediately preceding the filing of a bankruptcy petition.³⁵ Without this protection there is the risk that the debtor's bankruptcy estate or property might be depleted by major creditors or that creditors would "race to the courthouse" to dismember the debtor during its decline into bankruptcy.³⁶

However, the bankruptcy code contains seven exceptions to the preference rule which allow the debtor to obtain some credit prior to bankruptcy and allow creditors to retain payments for certain types of transactions immediately prior to bankruptcy.³⁷ If the seven exceptions of section 547(c) were not available, the debtor's probability of sliding into bankruptcy, during severe financial troubles, would greatly increase.³⁸

34. 11 U.S.C. § 547(b) (1982 & Supp. III 1985), provides:

"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.*

35. In the Matter of Xonics Imaging, Inc., 837 F.2d 763, 765 (7th Cir. 1988). See generally McCoid, *Bankruptcy Preferences and Efficiency: An Expression of Doubt*, 67 VA. L. REV. 249 (1981).

36. *In re Hancock Nelson Mercantile Co., Inc.*, 122 B.R. 1006, 1010 (Bankr. D. Minn. 1991). See H.R. REP. NO. 595, 95th Cong. 1st Sess. 373, reprinted in 1978 U.S. CODE CONG. & ADMIN. NEWS 5787, 5874, 6329.

37. *Xonics*, 837 F.2d at 765-66. See generally 11 U.S.C. §547(c)(1)-(7) (1982 & Supp. III 1985).

38. *Xonics*, 837 F.2d at 765; *Hancock*, 122 B.R. at 1010.

B. ORDINARY COURSE OF BUSINESS EXCEPTION

In re CHG, discussed section 547(c)(2) which is commonly referred to as the ordinary course of business exception to a preferential transfer.³⁹ Section 547(c)(2) allows a creditor to except a preferential transfer if the transfer was in payment of a debt incurred in the ordinary course of business of the debtor and the transferee and the transfer was made according to ordinary business terms.⁴⁰

Prior to the enactment of the 1978 Bankruptcy Code, the Bankruptcy Act did not contain a comparable provision to section 547(c)(2).⁴¹ Instead, the courts created the "Current Expense" rule.⁴² The current expense rule covered situations in which the debtor's payments to a creditor, immediately preceding bankruptcy, did not diminish the estate, because the debtor received tangible goods in the exchange.⁴³ The overhaul of the bankruptcy system in 1978 created three comparable subsections.⁴⁴

39. *CHG*, 897 F.2d at 1482-84. See *supra* note 2 for an explanation of a preference.

40. 11 U.S.C. § 547(c)(2), which provides:

(2) to the extent that such transfer was:

(A) in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee;

(B) made in the ordinary course of business or financial affairs of the debtor and the transferee; and

(C) made according to ordinary business terms. *Id.*

See H.R. REP. NO. 5174, 98th Cong., Pub. L. 98-353. See also *CHG* at 1483 n.3, for a brief discussion of the section 547(c)(2) legislative evolution.

41. See § 60 of the 1898 Bankruptcy Act, as amended and codified in 11 U.S.C. § 96 (1976). This section provides in relevant part:

"(a)(1) A preference is a transfer, as defined in this title, of any of the property of a debtor to or for the benefit of a creditor for or on account of an antecedent debt, made or suffered by such debtor while insolvent and within four months before the filing by or against him the petition initiating a proceeding under this title, the effect of which transfer will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class.

(b) Any such preference may be avoided by the trustee if the creditor receiving it or to be benefitted thereby or his agent acting with reference thereto has, at the time when the transfer is made, reasonable cause to believe that the debtor is insolvent. Where the preference is voidable, the trustee may recover the property...." *Id.*

42. *National Bank of Jacksonville*, 112 F.2d 380, 382 (5th Cir. 1940); 3 COLLIER ON BANKRUPTCY ¶ 60.23 (14th ed. 1977).

43. *Jacksonville*, 112 F.2d at 382.

44. See 11 U.S.C. § 547(c)(1), (c)(2), and (c)(4) (1982 & Supp. III 1985). See *infra* note 60 for a definition of the contemporaneous exchange rule.

As originally enacted in 1978, section 547(c)(2) contained an additional element requiring that the payment, to the creditor, occurred within forty-five days after the debt was incurred.⁴⁵ The forty-five day rule was designed to allow payments of essentially short-term trade credit.⁴⁶ The rule was designed to leave undisturbed normal financial relationships, and resulted from the House Judiciary Committee's judgment that thirty days represented the normal credit term, with an additional fifteen day period for preparation of a bill and payment by the debtor.⁴⁷

In 1984, pursuant to the Bankruptcy Amendment and Federal Judgeship Act ("BAFJA"), Congress amended the code to eliminate the forty-five day limitation.⁴⁸ The BAFJA was necessitated by the Supreme Court ruling in *Northern Pipeline Construction Company v. Marathon Pipeline Co.*,⁴⁹ holding the bankruptcy jurisdictional system unconstitutional.⁵⁰ By removing the forty-five day limitation, and not imposing a new or different time requirement, Congress appeared to have expanded the protection of section 547(c)(2) to a potentially wide variety of transactions which it previously deemed unworthy of protection.⁵¹ Because the section did not contain a time constraint, arguably all debts, both long-term and short-term, could fall into the section, as long as the debts could meet the other remaining requirements of the section.⁵²

45. 11 U.S.C. § 547(c)(2)(B) (1982). See *supra* note 29. See also *Fidelity Savings and Investment Co. v. New Hope Baptist*, 880 F.2d 1172, 1174 (10th Cir. 1989).

46. *In re Finn*, 909 F.2d 903, 907 (6th Cir. 1990).

47. Broome, *Payment on Long-Term Debt as Voidable Preferences: The Impact of the 1984 Bankruptcy Amendment*, 1987 DUKE L. J. 78, 97 (1987) [hereinafter Broome]. See H.R. REP. NO. 595, 95th Cong. 1st Sess. 373, reprinted in 1978 U.S. CODE CONG. & ADMIN. NEWS 5963, 6329; SEN R. NO. 989, 95th Cong. 2d Sess. 88, reprinted in 1978 U.S. CONG. CODE & ADMIN. NEWS 5787, 5874.

48. H.R. REP. NO. 5174, 98th Cong., Pub. L. 98-353, 98 Stat. 333 (1984). See *CHG* 897 F.2d at 1483.

49. 458 U.S. 50 (1982).

50. *Marathon*, 458 U.S. 50, 87 (1982); "We conclude that 28 U.S.C. § 1471 (1976 ed. & Supp. IV), as added by § 241(a) of the Bankruptcy Act of 1978, has impermissibly removed most, if not all, of the "essential attributes of the judicial power" from the Art. III district court, and has vested those attributes in a non-Art. III adjunct. Such a grant of jurisdiction cannot be sustained as an exercise of Congress' power to create adjuncts to Art. III courts." *Id.* See App. 3 COLLIER ON BANKRUPTCY, ¶ XX-1 (15th ed. 1988).

51. Morris, *Substantive Consumer Bankruptcy Reform in the Bankruptcy Amendments Act of 1984*, 27 WM & MARY L. REV. 91, 122-123 (1985). (arguing that the 1984 amendment expands protection of Section 547(c)(2) to "virtually all timely payments of installment obligations"). The leading bankruptcy treatise states that it is arguable that the elimination of the forty-five day limit allows long-term debt to be excepted. 4 COLLIER ON BANKRUPTCY, ¶ 547.10 (15th ed. 1988).

52. *CHG*, 897 F.2d at 1483 n.5.

The forty-five day rule was criticized as overbroad and underbroad, both too vague and too precise.⁵³ The argument was that the rule was vague because it was too difficult to tell when a debt was incurred; it was too precise because it was designed to reflect the thirty day billing cycle plus the fifteen day invoicing cycle, and it was rigidly insensitive to variations in business practices.⁵⁴

Congress hastily eliminated the forty-five day requirement from the ordinary course of business exception, due in part, to Congress' preoccupation with the jurisdictional crisis facing the bankruptcy court system resulting from the Supreme Court ruling in *Marathon*, that the bankruptcy jurisdictional system was unconstitutional.⁵⁵ The legislative history accompanying the 1984 amendment to section 547(c) is scant and it is unclear how Congress intended the deletion to affect the application of the section.⁵⁶ Neither the House nor the Senate held hearings on the bill.⁵⁷ However, the Congressional record contains statements from senators Dole and DeConcini, pertaining to the elimination of the forty-five day requirement, stating that the amendment to section 547 will relieve buyers of commercial paper with maturities in excess of forty-five days from the charges of preferential transfers.⁵⁸

53. *In re Control Electric*, 91 B.R. 1010, 1013 (Bankr. N.D. Ga. 1988). See Broome, *supra* note 47 at 100; Weisberg, *Commercial Morality, the Merchant Character, and the History of the Voidable Preference*, 39 STAN. L. REV. 3, 129-130 (1987) [hereinafter Weisberg]. See also Fortgang & King, *The 1978 Bankruptcy Code: Some Wrong Decisions*, 56 N.Y.U.L. REV. 1148, 1167-70 (1981).

54. Weisberg, *supra* note 53 at 130 n.529.

55. H.R. REP. NO. 5174, 98th Cong. 1st Sess. Pub. L. 98-353. See *supra* notes 48-50 and accompanying text; *Marathon*, 458 U.S. 50, 87 (1982).

56. *In re Control Electric*, 91 B.R. 1010, 1013 (Bankr. N.D. Ga. 1988); *In re Finn*, 909 F.2d 903, 906 (6th Cir. 1990); *CHG*, 897 F.2d at 1484.

57. Broome, *supra* note 47 at 88.

58. 130 CONG. REC. S. 8887, 8897 (1987); *Fidelity Savings and Investment Co.v. New Hope Baptist*, 880 F.2d 1172, 1180 (10th Cir. 1989). See App 3 COLLIER ON BANKRUPTCY ¶ XX-80 (15th ed. 1988);

DeConcini: "I know that the Senator from Kansas, along with the Senator from South Carolina, was the principal sponsor of this provision deleting subsection (c)(2) of section 547 of the Code, and I would like to clarify two points regarding the effect of this change.

Am I correct that the elimination of the 45-day restriction in subsection (c)(2) of section 547 will relieve buyers of commercial paper with maturities in excess of 45 days of the concern that repayments of such paper at maturity might be considered as preferential transfers?

Dole: That is correct, assuming that the ordinary course of business or financial affairs and ordinary business terms requirements are met." *Id.*

IV. COURT'S ANALYSIS

The Ninth Circuit relied upon the 1978 and 1984 legislative history of section 547(c)(2).⁵⁹ First, the court examined whether Congress in 1984, by eliminating the forty-five day requirement, intended to fundamentally change the scope of the ordinary course exception to include more than transactions which were substantially contemporaneous exchanges.⁶⁰ The court examined the legislative history, the commentators and cases, and concluded that the correct view was that section 547(c)(2) did not apply to long-term loans.⁶¹

Analyzing the 1984 amendment to section 547(c)(2), the court found that Congress initially used the forty-five day period because it believed the forty-five days reflected the typical billing cycle of transactions intended to qualify within the exception.⁶² The forty-five day limit was widely criticized by consumer lenders, trade creditors and paper issuers, as not accurately reflecting their billing cycles, therefore, Congress eliminated the requirement.⁶³ The court points out that a literal and superficial reading of the rule allows long-term debt to fall within the exception.⁶⁴

However, the court observed that the majority of cases hold that section 547(c)(2) does not apply to long-term loans.⁶⁵ These cases found that either Congress did not intend section 547(c)(2) to except long-term debt from avoidance, long-term debt is not incurred in a debtor's ordinary course of business, or both.⁶⁶ The Ninth Circuit agreed with the *Bourgeois* court reasoning, that Congress did not intend to change the spirit of

59. *CHG*, 897 F.2d at 1482-84.

60. *Id.* at 1483. See 11 U.S.C. § 547(c)(1) (1982 & Supp. III 1985) (the contemporaneous exchange rule). A contemporaneous exchange occurs when the debtor pays the creditor almost simultaneously within receipt of the goods. *Id.*

61. *CHG*, 897 F.2d at 1482. "[We] conclude that interest payments on long-term debt were not intended to be covered under the ordinary course of business exception...." *Id.*

62. *Id.* See *supra* note 47 and accompanying text.

63. *CHG*, 897 F.2d at 1482.

64. *Id.* at 1484. However, the court opposed a literal reading based on its interpretation of Congress's intent in eliminating the forty-five day requirement in 1984. *Id.* at 1483-84.

65. *Id.* (relying on *In re Bourgeois*, 58 B.R. 657 (Bankr. W.D. La. 1986); *In re RDC Corp.*, 88 B.R. 97 (Bankr. W.D. La. 1988); *In re Jackson*, 90 B.R. 793 (Bankr. D.S.C. 1988); *In re Control Electric*, 91 B.R. 1010,1017 (Bankr. N.D. Ga. 1988)).

66. *CHG*, 897 F.2d at 1484.

the section from dealing mainly with trade credit transactions which are substantially contemporaneous exchanges.⁶⁷

The *Bourgeois* court found that to hold such payments on long-term loans as within the ordinary course of business within the meaning of section 547(c)(2) "would be to flout the clear intent of that subsection, and the entire policy of the preference provisions as a whole."⁶⁸ Such a holding would virtually strip the preference provisions of the Code of all meaning.⁶⁹ To further explain its holding, the Ninth Circuit argued that if the exception were to include long-term debt, the effect of the preference provision would be neutralized by allowing almost every kind of payment a debtor makes during the ninety day period.⁷⁰

The court found that the majority of courts that considered whether long-term debt fell within the exception after the 1984 amendment, followed *Bourgeois*.⁷¹ *In re RDC Corp.*,⁷² maintained that long-term loans were antecedent debts in the traditional sense because the monthly payments of interest did not represent ongoing trade transactions.⁷³ The decision

67. *Id. Bourgeois*, 58 B.R. at 657. The *Bourgeois* court held that principal and interest payments by the debtor to a bank on long-term loans were not intended by the 1984 Amendment to fall within section 547(c)(2). *Id.* at 660. In *Bourgeois*, the trustee brought a preference action against Bank of Lafayette and Guaranty Bank & Trust. *Id.* Similar to Barclays in *CHG*, the bank did not dispute that the elements of section 547(b) were met. *Id.* Instead, their argument maintained that the payments fell within section 547(c)(2), the ordinary course of business exception. *Id.* See *supra* note 60 for definition of contemporaneous exchange.

68. *Bourgeois*, 58 B.R. at 660. The court felt that due to the lack of legislative history surrounding the deletion of the forty five day rule, it had the authority to define the meaning and scope of the ordinary course of business exception in light of the amendment. *Id.* The court examined the goals and purposes behind section 547(b) and section 547(c)(2) and determined that Congress did not intend to fundamentally change the scope of the exception. *Id.* "The forty five day limit was eliminated so that the provisions of the Code would comport with normal business policies." *Id.* The court was of the opinion that the 1984 amendment removed only an arbitrary time limit, and that the spirit and intent of section 547(c)(2), i.e. the exemption from avoidance of trade credit transactions which are substantially contemporaneous exchanges, remained the same. *Id.* at 660-661.

69. *Id.* at 662.

70. *CHG*, 897 F.2d at 1484. In effect, the court was arguing that by including long-term debt into the exception, the exception would swallow the rule. *Id.*

71. *Id.* at 1485. (citing *In re RDC Corp.*, 88 B.R. 97 (Bankr. W.D. La. 1988); *In re Jackson*, 90 B.R. 793, (Bankr. D.S.C. 1988); *In re Control Electric, Inc.*, 91 B.R. 1010 (Bankr. N.D. Ga. 1988)).

72. 88 B.R. 97 (Bankr. W.D. La. 1988).

73. *RDC Corp.*, 88 B.R. at 97 (citing *Lingley v. Stuart Shaines, Inc. (In re Acme-Dunham Inc.)*, 50 B.R. 734, 741-42 (D.C. Me. 1985). An antecedent debt is a debt, owed by the debtor to the creditor, prior to the transfer to the creditor. See *In re Comark*, 124 B.R. 806, 811 (Bankr. C.D. Cal. 1991).

to pay them was made far in advance of the payment, at the time the loan was negotiated, and nothing is exchanged at the time of payment which helps the debtor to continue in business.⁷⁴

The court also addressed the issue of when the obligation to pay interest arose.⁷⁵ The court noted that under Washington law the obligation to pay interest arose when the promissory notes were signed, not when the interest payments were made.⁷⁶ In the district court, Barclays advanced the argument that the payment of interest was essentially a contemporaneous exchange, because the interest payments were incurred monthly when they became due.⁷⁷ *In re Western World Funding*⁷⁸ had previously rejected this argument, holding that a debt for principal and interest is incurred at the signing of the promissory note and the completion of the transfer of funds to the debtor.⁷⁹

The court reversed the district court's grant of summary judgment for Barclays and remanded to the district court with orders to reinstate the bankruptcy court's judgment in favor of CHG.⁸⁰ The court found specifically that Congress did not intend section 547(c)(2) to include payment on long-term debt.⁸¹

V. SUPREME COURT ANALYSIS

On December 11, 1991, the United States Supreme Court handed down a unanimous ruling on *Union Bank V. Wolas*,⁸² announcing the correct interpretation of section 547(c)(2).⁸³

74. *Acme-Dunham*, 50 B.R. at 741-42.

75. *CHG*, 897 F.2d at 1486.

76. *Id.* See *Pedersen v. Fisher*, 139 Wash. 28, 32, 245 P. 30, 32 (1926).

77. *In re CHG Int'l, Inc.*, 87 B.R. 647, 653 (W.D. Wash 1988).

78. 54 B.R. 470 (Bankr. D. Nev. 1985).

79. *Western World*, 54 B.R. at 477. The court in *Western World*, applied pre-1984 BAFJA law to the case, because the case was filed in 1982. *Id.* at 470. The debtor made substantial interest and principal payments to several creditors within the ninety day preference period prior to filing bankruptcy. *Id.* at 473. The creditors advanced the argument that the receipt of principal and interest was not on account of an antecedent debt [547(b)(2)] because the debt was incurred when it is due, not at time of the signing of the loan. *Id.* at 477. However, the court held that as soon as the promissory notes were signed, and the funds were transferred to the debtor, the creditor had a claim against the debtor. *Id.*

80. *CHG* 897 F.2d at 1487.

81. *Id.*

82. 50 U.S. ____, 112 S. Ct. 527 (1991).

83. *Union Bank*, 112 S. Ct. 527.

Certiori was granted because of a conflict, between the Ninth and Sixth Circuits, in interpreting the section.⁸⁴ The Court held that section 547(c)(2) applied to long-term as well as short-term debts, overruling the Ninth Circuit approach and *ZZZZ Best*.⁸⁵

A. MAJORITY OPINION

1. *Textual Analysis*

First, the Court examined the text of the section, and determined that the most telling feature of section 547(c)(2) was the absence of any language distinguishing between long-term debt and short-term debt.⁸⁶ The Court noted that the section focused on whether the debt was incurred, and payment made, in the ordinary course of business, rather than focusing on a time limitation.⁸⁷ The clarity of the text imposed a heavy burden of persuading the Court that Congress intended to create or preserve a special rule for long-term debt.⁸⁸ Therefore, the Court concluded that the text provided no support for interpreting a distinction between long-term and short-term debt.⁸⁹

2. *Legislative History*

The Court went on to examine the legislative history surrounding the 1978 enactment of section 547(c)(2),⁹⁰ and the 1984 BAFJA amendments.⁹¹ First, the Court analyzed the 1984 amendment.⁹² The Court did not dispute the accuracy of the intent of the legislators in deleting the time limitation.⁹³ Instead, the Court reasoned that even though Congress may not have foreseen all of the consequences of the amendment, that

84. *Id.* at 529. See *In re Finn*, 909 F.2d 903 (6th Cir. 1990) (interpreting section 547(c)(2) to include long-term debt).

85. *Union Bank*, 112 S. Ct. at 533.

86. *Id.* at 530.

87. *Id.*

88. *Id.* (citing *U.S. v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 241-42 (1989)).

89. *Id.* at 530.

90. *Id.* at 530-31. Bankruptcy Reform Act of 1978, Act of Nov. 6, 1978, Pub. L. No. 95-598, 92 Stat. 2549.

91. *Union Bank*, 112 S. Ct. at 531. Bankruptcy Amendment and Federal Judgeship Act of 1984, Pub. L. No. 95-353, 98 Stat. 333.

92. *Union Bank*, at 531.

93. *Id.*

alone was not enough to refuse to give effect to the plain meaning of the section.⁹⁴

Next, the Court addressed the history of the voidable preference prior to the enactment of the Bankruptcy Code in 1978.⁹⁵ The Court discredited the argument that section 547(c)(2) was created as the statutory equivalent of the “current expense” rule.⁹⁶ Notably, the Court examined the other exceptions of section 547(c) which resolved a majority of the situations covered by the current expense rule.⁹⁷ The Court stated that additionally, Congress carefully examined the entire area of preferences and the exceptions when it completely rewrote the provisions in 1978.⁹⁸ Therefore, the text of section 547(c)(2) was a deliberate choice.⁹⁹

3. *Policy Argument*

Lastly, the Court examined the policy implications associated with section 547(c)(2), holding that the two basic intertwined policies, deterring a race to the courthouse, and equality of distribution, did not warrant a distinction between long and short-term debt.¹⁰⁰ The Court noted the equal distribution policy arguably supported the distinction.¹⁰¹ However, because the statutory text made no distinction, it precluded an analysis that separated the two policies.¹⁰²

The Court determined that the second policy applied equally to long and short-term creditors and indirectly furthers the goal of equal distribution.¹⁰³ Therefore, the Court was unwilling to follow the district court and the court of appeals conclusion that the policies behind section 547(c)(2) supported the distinction between long and short-term debt.¹⁰⁴

94. *Id.*

95. *Id.*

96. *Id.* at 532. *See supra* notes 42-44 and accompanying text.

97. *Union Bank*, 112 S. Ct. at 532. *See* 11 U.S.C. §547(c)(1)-(c)(7) (1982 & Supp. III 1985). *See supra* note 60 for an explanation of section 547(c)(1).

98. *Union Bank*, 112 S. Ct. at 532. *See supra* notes 45-47 and accompanying text.

99. *Union Bank*, 112 S. Ct. at 532-33.

100. *Id.* at 533.

101. *Id.*

102. *Id.*

103. *Id.*

104. *Id.*

B. CONCURRING OPINION

Justice Scalia concurred with the result reached by the majority.¹⁰⁵ However, Justice Scalia noted that it was regrettable that our legal culture credited and allowed such arguments to be addressed, when the statute was so “utterly devoid” of language that could remotely distinguish between long-term and short-term debt.¹⁰⁶

VI. CONCLUSION

By overruling the Ninth Circuit interpretation of section 547, the Supreme Court demonstrated its propensity to support the plain meaning doctrine. Justice Scalia’s concurring opinion chided the legal system for supporting an argument based on sketchy legislative interpretation and policy. The Supreme Court decision, signals that the 1978 Bankruptcy Code and the subsequent amendments should be construed literally.

*Janina M. Elder**

105. *Id.* at 534 (joining the majority in Parts II and III, responding to the legislative history).

106. *Id.* “Since there was no contention of a “scrivener’s error” producing an absurd result, the plain text of the statute should have made this litigation unnecessary and unmaintainable.” *Id.*

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