IN RE IOWA PREMIUM SERVICE CO.: WHEN IS A DEBT INCURRED UNDER 547(C)(2) OF THE BANKRUPTCY CODE

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INTRODUCTION

The Bankruptcy Reform Act of 19781 (The Bankruptcy Code) made substantial changes in the rules governing preferential transfers. The Bankruptcy Code collects in one section provisions which not only define preferential transfer2 but also exempt from the trustee’s power to avoid certain transfers that would otherwise be preferential.3 This is a central departure from prior law4 which

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2. Id. § 547(b) provides as follows:
   (b) Except as provided in subsection (c) of this section, the trustee may avoid any transfer of property of the debtor—
   (1) to or for the benefit of a creditor;
   (2) for or on account of an antecedent debt owned 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 90 days and one year before the date of the filing of the petition, if such creditor, at the time of such transfer—
       (i) was an insider; and
       (ii) had reasonable cause to believe the debtor was insolvent at the time of such transfer; 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.

4. The Bankruptcy Act of 1898, ch. 541, § 60, 30 Stat. 562, 562 (codified as 11 U.S.C. § 96 (1976)) defined which transfers were “preferential,” (§ 60(a)), and also contained the bankruptcy trustees avoiding powers, (§ 60(b)). As codified, it provided in part:
   (a)(1) A preference is a transfer, as defined in this title, or any of the property of a debtor to or for the benefit of a creditor for or on account of an
required extensive resort to judicial interpretation to determine whether a transfer was preferential under section 60(a) and thus avoidable under section 60(b). The new Bankruptcy Code seems to be drafted with a view towards limiting this resort to judicial interpretation. It does this in two ways. First, the Bankruptcy Code omits language of the prior law that required the trustee to prove in all cases that a transferEEer has "reasonable cause to believe that the debtor is insolvent," and it presumes that the debtor was insolvent ninety days prior to filing a petition. Second, the Bankruptcy Code creates categories of exempt transfers which, the legislative history of the Bankruptcy Reform Act suggests, are

antecedent debt, made or suffered by such debtor while insolvent and within four months before the filing by or against him of 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 benefited 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.


Except for the specific protection given subsequent unsecured credit advances afforded by § 60(c), the Bankruptcy Act left to the courts the task of properly applying § 60 to the myriad fact situations arising which presented preference problems. They did so principally in cases where the transfer to the creditor seemed to fit the preference definition in § 60(a), but which for one reason or another was viewed as not subject to the trustee's avoiding power of § 60(b). See note 5 infra; Ward & Shulman, supra note 3, at 16.

5. See, e.g., Jaquith v. Alden, 189 U.S. 78, 82 (1903) (net-result rule); Margolis v. Gem Factors Corp., 201 F.2d 803, 805 (2d Cir. 1953) (no reason to believe insolvent); Engstrom v. Wiley, 191 F.2d 784, 687-88 (9th Cir. 1951) (late cashing of check not on account of antecedent debt where parties intended cash transaction); Blauvelt v. Walker, 72 F.2d 915, 916 (4th Cir. 1934) (wages were current expense, and thus not antecedent debt).

6. Bankruptcy Act of 1898, ch. 541, § 60, 30 Stat. 562 (codified as 11 U.S.C. § 96 (1976)). The Bankruptcy Reform Act makes knowledge of insolvency in this sense necessary only if the transferee is an insider. 11 U.S.C. § 547(b)(4)(B)(ii) (1982). The "reasonable cause to believe" requirement was seen by the Congress as a major and unwarranted impediment to the trustees' avoiding powers under § 60: "Finally, the requirement that the trustee prove the state of mind of his opponent is nearly insurmountable, and defeats many preference actions. The amount of litigation it causes is too great when the requirement itself does not further any necessary bankruptcy policy." H.R. Rep. No. 555, 95th Cong., 2d Sess. 178, reprinted in 1978 U.S. CODE CONG. & AD. NEWS 5963, 6139; S. REP. No. 989, 95th Cong., 2d Sess. 87, reprinted in 1978 U.S. CODE CONG. & AD. NEWS 5787, 5873. These reports are substantially identical with regard to 11 U.S.C. § 547 (1982).

7. 11 U.S.C. § 547(f) (1982) states that, "For the purposes of this section, the debtor is presumed to have been insolvent on and during the 90 days immediately preceding the date of the filing of the petition."

designed to overrule or codify and perhaps in some cases expand the judicial interpretations of the Bankruptcy Act.9

Notwithstanding these changes, questions arise which are not clearly resolved by the statutory language. Such was the case in In re Iowa Premium Service Co.,10 in which the United States Court of Appeals for the Eighth Circuit was called upon to determine when a debt for accrued interest on a promissory note is incurred for purposes of the "ordinary course payments" exception to the trustee's avoiding powers under section 547 of the Bankruptcy Code.11 The court clearly applied the proper standard when it concluded that a debt is incurred under section 547(c)(2) "on the date upon which the obligor first becomes legally bound to pay that interest."12 However, it is much less clear whether the court properly applied that standard to the interest payments in question. This discussion will examine the court's reasons for its interpretation of section 547, and will suggest that those reasons do not support the conclusion. Further, it will argue that the congressional policy expressed in section 547(c)(2) indicates these interest pay-

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9. S. REP. NO. 989, supra note 6, at 5874. The report states:

The second exception protects transfers in the ordinary course of business (or of financial affairs, where a business is not involved). For the case of a consumer, the paragraph uses the phrase "financial affairs" to include such nonbusiness activities as payment of monthly utility bills. If the debt on account of which the transfer was made was incurred in the ordinary course of both the debtor and the transferee, if the transfer was made not later than 45 days after the debt was incurred, if the transfer itself was made in the ordinary course of both the debtor and the transferee, and if the transfer was made according to ordinary business terms, then the transfer is protected. The purpose of this exception is to leave undisturbed normal financial relations, because it does not detract from the general policy of the preference section to discourage unusual action by either the debtor or his creditors during the debtor's slide into bankruptcy.

Id.

Courts applying § 60(a) of the Bankruptcy Act of 1898 often exempted payments made by businesses of current business expenses, primarily because these payments represented no diminution of the debtor's estate, or were not considered antecedent debts. See note 5 supra; 3 W. COLLIER, COLLIER ON BANKRUPTCY (MB) § 60.23, at 873 (14th ed. 1975). Section 547(c)(2) gives similar protection to "ordinary course" payments and expands that protection to include payments by consumers of non-business debts.

10. 695 F.2d 1109 (8th Cir. 1982).
11. 11 U.S.C. § 547(c)(2) states:
   (c) The trustee may not avoid under this section a transfer—
   
   (2) to the extent that such transfer was—
   
   (A) in payment of a debt incurred in the ordinary course of business or financial affairs of the debtor and the transferee;
   (B) made not later than 45 days after such debt was incurred;
   (C) made in the ordinary course of business or financial affairs of the debtor and the transferee; and
   
   (D) made according to ordinary business terms . . . .
12. 695 F.2d at 1112.
ments are not excepted. Finally, it will argue that the court's holding provides an unsound foundation upon which subsequent judicial interpretations of section 547(c) exceptions may be based.

FACTS AND HOLDING

Iowa Premium Service Co., Inc. (IPSCO) borrowed $400,000.00 from the First National Bank of St. Louis (Bank) on November 13, 1979, and signed a promissory note payable to the Bank. The note provided for interest, computed at 1⅓% over prime, payable monthly. The note was subject to payment on demand and subject to prepayment. The note by its terms matured on July 31, 1980.

IPSCO made interest payments on May 8, June 12 and July 15 representing interest accrued in each of the preceding months. On July 31, 1980, IPSCO filed for relief under Chapter 11 of the Bankruptcy Code, and thereafter as debtor-in-possession began proceedings to avoid as preferential transfers the interest payments made to the Bank. The Bank argued that the transfers were protected from the trustee's avoiding power under section 547(c)(2).

The United States Bankruptcy Court for the Southern District of Iowa, and, on appeal, a panel of the Eighth Circuit Court of Appeals found that the payments were preferences, and that section 547(c)(2) was inapplicable because the payments were made more than forty-five days after the debt was incurred. The Eighth Cir-

13. *Id.* at 1110.
14. *Id.*
15. The Bankruptcy Judge, Judge Stageman, found that interest payments were made on "May 18, June 12, and July 15, 1980." *In re* Iowa Premium Serv. Co., 12 Bankr. 597, 598 (Bankr. S.D. Iowa 1981). If May 18, rather than May 8 was the actual date of payment then even under the Bank's argument, which the Eighth Circuit accepted, some of the payment on May 18 would be for interest earned more than 45 days prior to that payment. See 695 F.2d at 1110.
16. 695 F.2d at 1110.
18. As debtor-in-possession IPSCO exercised all the powers of a trustee in a Chapter 7 liquidation case. *Id.* § 1107; 695 F.2d at 1110.
19. *Id.* The parties agreed that all the elements of a preferential transfer under § 547(b) were present, and also that the interest payments were made in the ordinary course of business. The only issue remaining was whether the transfers were made not later than 45 days after the debt was incurred. *In re* Iowa Premium Serv. Co., 12 Bankr. at 590. The bank argued that the debt for interest was incurred each day the interest accrued. IPSCO argued the debt was incurred on November 13, 1979, the date the note was executed. *Id.*
20. *In re* Iowa Premium Serv. Co. 676 F.2d 1220, 1222 (8th Cir. 1982). The panel consisted of Circuit Judges Ross and McMillian, and Senior Circuit Judge Gibson. Judge Gibson dissented from the panel's decision. *Id.*
cuit, sitting *en banc*, reversed, holding that for purposes of section 547(c)(2) the debt for interest payments was incurred on the date such interest accrued, since that was the date upon which the obligor first became legally bound to pay that interest.21

**BACKGROUND**

**THE PREFERENCE SECTION**

A principal goal of the national bankruptcy laws has always been the equal treatment of creditors of the same class.22 Equality of treatment would be severely threatened if a debtor could arbitrarily decide which of his creditors should be preferred, and then pay those creditors on the eve of Bankruptcy. To prevent this the Bankruptcy Act in section 6023 and the current Bankruptcy Code in section 547(b)24 give the trustee the power to avoid preferential transfers.

The Bankruptcy Code generally defines a preferential transfer25 as any transfer of an interest in the debtor's property to or for the benefit of a creditor, on account of an antecedent debt, made while the debtor was insolvent26 within ninety days of bankruptcy, which enables that creditor to obtain more than if the case were a liquidation case under Chapter 7.27

The trustee may avoid all such transfers except those falling within the exceptions set forth in section 547(c).28 The exceptions include transfers which are: contemporaneous exchanges of property of the debtor given for new value;29 payments made in the ordinary course of business or financial affairs of the debtor;30 purchase money security interests in the debtor's property;31 to a

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21. 695 F.2d at 1112. Judges Ross, Heaney and McMillian dissented. *Id.*
22. *See* 4 W. COLLIER, COLLIER ON BANKRUPTCY (MB) § 547.03 (15th ed. 1984); H.R. REP. NO. 595, supra note 6, at 6138-39.
25. *Id.* § 101(40) provides:
   In this title—
   (40) 'Transfer' means every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property, including retention of title as a security interest.
26. The debtor is presumed insolvent during the 90 days prior to filing the bankruptcy petition. *Id.* § 547(f).
27. *Id.* § 547(b).
28. *Id.* § 547(c)(1)-(6).
29. *Id.* § 547(c)(1).
30. *Id.* § 547(c)(2).
31. *Id.* § 547(c)(3).
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creditor who subsequently makes additional unsecured advances to the debtor, to the extent of those advances; a security interest in inventory or receivables, to the extent such transfer does not result in a net improvement of the creditor's secured position between the ninetieth day prior to bankruptcy and the date of bankruptcy; or a statutory lien unavoidable under section 545 of the Bankruptcy Code.

Under these provisions, a creditor who has received a transfer of an interest in a debtor's property under circumstances satisfying the requirements of section 547(b) must fit himself within one of the section 547(c) exceptions to retain that interest. The elimination of the "reasonable cause to believe" language, together with the presumption of insolvency almost certainly will increase the number and kind of transfers which will qualify as preferences under section 547(b). As a result, cases involving the section 547(c) exceptions seem likely to present the most frequent opportunity for courts to interpret and execute congressional policy in the preference area.

ANALYSIS

THE EIGHTH CIRCUIT'S TREATMENT OF INTEREST PAYMENTS UNDER SECTION 547(c) (2)

In Iowa Premium Service the court first observed that the Bankruptcy Code does not define when a debt is incurred. It fur-

32. Id. § 547(c) (4).
33. Id. § 547(c) (5).
34. Id. § 547(c) (6).
35. See S. REP. NO. 989, supra note 6, at 5874. The legislative history reveals that:

Subsection (c) contains exceptions to the trustee's avoiding power. If a creditor can qualify under any one of the exceptions, then he is protected to that extent. If he can qualify under several, he is protected by each to the extent that he can qualify under each.

Id.

As an example, a debtor may make a payment to an unsecured creditor during the preference period which may be to satisfy debts which were incurred both before and after the 45 day limit stated in § 547(c) (2). That part of the payment attributable to the older debt would thus not be protected, and would normally be recovered by the trustee under § 550. However, if that same creditor were to make a subsequent, unsecured advance to the debtor, in an amount equal to or greater than the older debt payment, § 547(c) (4) would protect the payment.

36. See note 6 supra.
37. See note 7 supra.
38. 695 F.2d at 1111. The court stated that:

The Bankruptcy Act does not define when a debt is incurred. It does define "debt" as "liability on a claim." 11 U.S.C. § 101(11) (Supp. III 1979). The Act defines a "claim" as a:

(A) right to payment, whether or not much right is reduced to
The court noted that the House and Senate Reports accompanying the Code are also silent on the question. Accordingly, it reached its conclusion, “that an interest debt is not incurred until the interest accrues,” based on prevailing bankruptcy case law. Further, the court stated that its conclusion was consistent with the language and policy behind the Bankruptcy Code preference rules.

**Case Law**

Case law indicates, the court said, that for purposes of section 547(c)(2) a debt is incurred when the debtor first becomes legally obligated for its payment. Here, the court found, that could only be when interest accrued: “There can be no doubt that IPSCO was not legally bound to pay interest when the note was executed; it had no obligation to pay interest until it used the money.” Consequently, the court reasoned, since the debtor had no obligation until it used the money, and since it used the money daily, the “obligation” arose new each day.

The court also concluded that while there appeared to be a split of authority on the applicability of section 547(c)(2) to installment payments, only two cases, *In re Goodman Industries, Inc.*
and In re Ken Gardner Ford Sales, Inc.,\textsuperscript{47} had directly addressed the interest issue. In Goodman, the United States Bankruptcy Court for the District of Massachusetts had held that interest debts are incurred when the loan is made.\textsuperscript{48} In Ken Gardner, the United States Bankruptcy Court for the Eastern District of Tennessee had held that such debts are incurred as interest accrues.\textsuperscript{49} The Eighth Circuit found Ken Gardner more persuasive.\textsuperscript{50} The Goodman case was unpersuasive, the court said, because it failed to provide any reasons for its holding.\textsuperscript{51} This seems a fair criticism, since in Goodman the court does not appear to appreciate the distinction between principal and interest payments.\textsuperscript{52} On the other hand, the decision in Ken Gardner cannot be said to have addressed the issue directly, since that court reached its conclusion based in part on the absence of a “new value” requirement in section 547(c)(2).\textsuperscript{53}

The cited bankruptcy cases thus do not provide a clear answer to this question. However, the logic of the generally recognized tests for determining when a debt is incurred seem to point to a conclusion contrary to that reached by the Eighth Circuit.

\footnotesize{1981) (holding that interest payments for interest accrued within the previous 45 days were protected under § 547(c)(2)).}

\textsuperscript{46} 21 Bankr. 512, 521-22 (Bankr. D. Mass. 1982).


\textsuperscript{48} 21 Bankr. at 521-22.

\textsuperscript{49} 10 Bankr. at 648.

\textsuperscript{50} 695 F.2d at 1112.

\textsuperscript{51} Id.

\textsuperscript{52} 21 Bankr. at 521-22. The question not addressed directly by the Goodman court is when does the “debtor assume the obligation”? The Goodman court’s language seems to apply to principle as well as interest. It may be that the court agreed with the court in Barash, that § 547(c)(2) is “aimed at transactions which, although they are technically credit transactions, are not intended to remain unpaid for a long time . . . . Although the ‘normal payments’ exception in § 547(c)(2) protects consumer transactions as well as trade credit, the installment debts involved here do not fall within the statutory design.” Barash, 658 F.2d at 511. The Goodman court stated that “[l]ong-term credit is not within the § 547(c)(2) exception.” Goodman, 21 Bankr. at 522.

The minority in Iowa Premium Service believes the distinction between principle and interest to be meaningless: “For the reasons we stated earlier, we deem that assertion to be a distinction without a difference.” 695 F.2d at 1114 (Ross, J., dissenting). Those reasons no doubt reflect the dissents belief that the court in Barash is right, and that the character of the loan as long-term credit disqualifies it from the § 547(c)(2) exception. This may be so, but it is unresponsive to an argument which proceeds on the assumption, as the majority’s does, that all debts are to be treated equally. Id. at 1112.

\textsuperscript{53} 10 Bankr. at 647. Apparently the Gardner court believed that absence of a “new value” requirement in § 547(c)(2) demonstrated a congressional intent that a “binding obligation” could arise without a concurrent exchange of consideration. Id. Whatever the merits of this view, it certainly provides no support for the Eighth Circuit court’s holding, which is predicated upon such a concurrent exchange.
The Eighth Circuit's general statement of the meaning of "incurred" is clearly in line with authority. Virtually all the cases and commentators apply similar tests. They look to when the debtor received that which he bargained for, as opposed to when he received a bill for it. This interpretation seems consistent with the Bankruptcy Code's definitions of "claim" and "debt," which look to a creditor's right to receive payment whether that right is fixed or contingent. Once a debtor has received consideration, under circumstances where payment is intended, the creditor's "right to payment" arises, even though the debt's amount or payment date may be uncertain. However, it is not always clear when the debtor has received the consideration upon which the creditor's "claim" is based, and it is on this point that the Eighth Circuit's reasoning seems questionable.


55. Research has found only one court which holds that a debt is incurred, for purpose of the 45 day limit, only when the bill for services has been sent. See In re Thomas W. Garland, Inc., 19 Bankr. 920, 928 (Bankr. E.D. Mo. 1982).

Most commentators have rejected the "billing date" construction. See 4 W. COLLIER, supra note 22, at ¶ 547.38; Levin, supra note 54, at 187; Kaye, supra note 3, at 184. The reasons for rejecting this interpretation are given by Kaye, supra note 3, at 184:

Could one argue, then, that what was really intended was to say that any payment, otherwise satisfying the provision, made within 45 days of due date is not a preference? This is not what Code § 547(c)(1) [sic] says. Even if it did, inequities would abound here as well, as a "due date" can be an arbitrary affair. If the due date were the critical date, those creditors who billed irregularly, and at their discretion, could merely make sure debtor was willing and able to pay (at least within 45 days) before billing him, i.e. before making the debt "due." Gas, phone and credit card creditors, indeed the intended archetypal creditors to benefit from this exception, would not have this billing flexibility. In addition, allowing 45 days from due date for non-preferential payment is quite a generous time allowance even for debts with fixed due dates.

Id.

However, the authors of 2 W. NORTON, NORTON BANKRUPTCY LAW & PRACTICE (Callaghan) § 32.17-18 (1981) suggest that with respect to certain wage claims and utility services the billing date is the date the debt is incurred. They reason that such payments are normal transactions not attended by unusual collection actions, and are often important to the debtors continued operation. They suggest the same for short term credit, such as credit card payments, but would not use due dates for long term or installment credit transactions. Id. § 32.18.

56. The court also supports its conclusion that IPSCO had no obligation to pay interest until it used the money by comparing use of money to use of property under a lease, use of a credit card by its holder, and use of electricity by an electric utility customer. 695 F.2d at 1111-12. As to each of these, courts have concluded that
The court adopted language from Collier on Bankruptcy to the effect that a debt is incurred "when the debtor obtains a property interest in the consideration exchanged giving rise to the debt." It further concluded that the "consideration exchanged" was the daily use of the money. Thus, the court reasoned, the debtor, Iowa Premium Service Co., obtained a property interest in the use of the $400,000 loan each day, but only for that day. On day one the debtor had no property interest in the use of the money on day two, since the loan could be prepaid, or paid on demand prior to day two. Under this view, a series of "debts" is incurred as each day ends without repayment of the principal.

Does it make any sense to view the "consideration exchanged" in this manner? Consideration is usually defined, at least in con-

a debt is incurred when the property is used. In re Clothes, Inc., 35 Bankr. 489, 491 (Bankr. D.N.Dak. 1983) (lease payments are given for new consideration each payment period); In re Naudain, Inc., 32 Bankr. 871, 874 (Bankr. E.D. Pa. 1983) (utility service debt is incurred when electricity used); In re Hersman, 20 Bankr. 569, 572 (Bankr. N.D. Ohio 1982) (credit card debt incurred when used to purchase goods); In re Brown, 20 Bankr. 554, 556 (Bankr. S.D.N.Y. 1982); In re Mindy's, Inc., 17 Bankr. 177, 179 (Bankr. S.D. Ohio 1982); In re Ray W. Dickey & sons, Inc., 11 Bankr. 146, 148 (Bankr. N.D. Tex. 1980) (telephone service charge for long distance call incurred when call made). Similar results have been reached where personal services have been performed, but billed later. See, e.g., In re Naudain, Inc., 32 Bankr. 875, 879 (Bankr. E.D. Pa. 1983).

Except for the lease cases, all the above involved current exchanges actually enhancing a debtor's estate. The property purchased with the credit card adds value, the electricity used or phone calls made presumably permit the debtor to advance some business or personal purpose, the personal services are useful to the debtor. In this sense these cases are similar to the "current expense" cases under § 60 of the Bankruptcy Act of 1898, supra note 4 (codified as 11 U.S.C. § 96 (1976)). See Kaye, supra note 3, at 202. The "current expense" rule rested in large part on the recognition that payments for such expenses are not really for an "antecedent debt" because they do not diminish the estate. New value roughly equivalent to the payment came in, or at least made continued operation of the business possible. Id. Section 547(c)(2) seems to rest on a similar foundation, and these decisions are thus correct. See note 96 and accompanying text infra.

As the dissent argues, however, the same cannot be said for interest payments. Regardless of how interest accrues, the principal is at all times in the hands of the debtor. If is difficult to see, in any practical business sense, how the debtor's estate is enhanced by the daily "use" of the money. 695 F.2d at 1114 (Ross, J., dissenting). The same may be said for monthly lease payments, since permitting the lessee to retain possession seems very much the same as permitting a debtor to retain use of money. Perhaps in many cases a lessor will have continued obligations with respect to the leased property; if so, those obligations can be fairly seen as new value. See In re Mindy's, Inc., 17 Bankr. at 179.

67. 695 F.2d at 1112.
68. Id. The court stated that, "It is clear that this definition would apply to interest payments once one understands that the use of the money for another day is new consideration each day." Id.
69. Id. at 1111-12.
70. The dissent in IPSCO clearly thinks not. Id. at 1113. Judge Ross, dissenting, said that, "Section 547(c)(2) was not intended to cover the kind of transaction
What did IPSCO bargain for, the daily use of $400,000, or the use of that $400,000 for the term of the loan subject to certain loan provisions which would shorten the term? Surely it is the latter. While a borrower does seek the "use" of that which is borrowed, once he has the property in his possession he has that "use" until he relinquishes possession. IPSCO's promise to pay interest would thus be given in exchange for the loan. It seems to strain the notion of "bargain" to suggest that a debtor promises to pay interest in exchange for the creditor's daily forebearance from demanding payment of the principal.

Further, the Eighth Circuit's view of consideration seems inconsistent with the Bankruptcy Code's definition of "new value," as well as with the relationship of value to consideration under traditional contract law.

Consideration has always involved the idea of exchange: the contracting parties give up something they have in order to obtain something they do not have. This carries with it the notion that the parties will have something "new" in their "estates." Thus, for

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before the court. IPSCO had received the full consideration and was obligated to the Bank for the full amount for much more than 45 days before the interest payments were made." Id.

61. See, e.g., Restatement (Second) of Contracts § 71 (1981). It states:
   (1) To constitute consideration, a performance or a return promise must be bargained for.
   (2) A performance or return promise is bargained for if it is sought by the promisor in exchange for his promise and is given by the promisee in exchange for that promise.

Id.

62. The opinion, in Iowa Premium Service, states that the note by its terms matured on July 31, 1980, or some eight and one-half months from its execution. 695 F.2d at 1110.

63. 11 U.S.C. § 547(a)(2). It provides:
   "new value" means money or money's worth in goods, services, or new credit, or release by a transferee of property previously transferred to such transferee in a transaction that is neither void nor voidable by the debtor or the trustee under any applicable law, but does not include an obligation substituted for an existing obligation.

Id.

64. In Wisconsin & Michigan Ry. v. Powers, Mr. Justice Holmes gave what is generally regarded as the classic definition of the bargained-for-exchange element in consideration:
   In the case at bar, of course the building and operating of the railroad was a sufficient detriment or change of position to constitute a consideration if the other elements were present. But the other elements are that the promise and the detriment are the conventional inducements each for the other.

191 U.S. 379, 386 (1903). Contract law has departed from the "classical" definition in some areas, such as promissory estoppel. See, e.g., Restatement (Second) of Contracts § 90 (1981). However, the classical definition remains applicable where the emphasis is on "exchange" of "consideration," as in Iowa Premium Service.
example, "bargaining" to receive something one already possesses is normally not consideration sufficient to support a new promise. Similarly, the Bankruptcy Code's definition of "new value" in section 547(a)(2) seems to reflect the same emphasis on some addition to the debtor's estate, something previously not possessed by the debtor. While section 547(c)(2) makes no mention of new value, tying the date a debt is incurred to the date consideration is advanced seems to focus on something new coming into the debtor's estate. It strains the meaning of consideration to view the "use of the money for another day . . . [as] new consideration each day." Finally, the Eighth Circuit's treatment of daily use of money as daily infusions of new consideration seems likely to expand the scope of the section 547(c) exceptions in installment loan cases well beyond that intended by Congress. If daily use is "new consideration", interest payments to a creditor during the preference period will be insulated from the trustee's avoiding power not only to the extent such payments are for interest accrued during the prior forty-five days, but also to the extent subsequent "new value" is advanced under section 547(c)(4). Since "new value" in section 547(a)(2) includes "new credit," it logically follows, using the court's reasoning, that each day the creditor permits the debtor to use money after an interest payment has been made will be "new

66. 11 U.S.C. § 547(a)(2) (1982). This statute has been interpreted to require enhanced value to the debtor's estate. See In re Duffy, 3 Bankr. 263, 266 (Bankr. S.D.N.Y. 1980). [The court refused to call forebearance to repossess a rented vehicle new value under § 547(c)(1).]
67. 695 F.2d at 1112. This is not to say that use of the money each day could never be consideration for the promise to pay each day's interest. It suggests only that in the usual case once the debtor has money in his possession he no longer bargains for its use. His promise to pay interest in such a case, whether on a daily, weekly or monthly accrual basis, is made to induce the initial loan, not the use of the money or the forebearance from demanding early payment. See In re Duffy, 3 Bankr. at 266.
68. 11 U.S.C. § 547(c) (1982) states:

   The trustee may not avoid under this section a transfer—
   . . .
   (4) to or for the benefit of a creditor, to the extent that, after such transfer, such creditor gave new value to or for the benefit of the debtor—
   (A) not secured by an otherwise unavoidable security interest; and
   (B) on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor . . .

Id.
value” netted out against that payment. Thus, assume a debtor makes an interest payment to a creditor on the eighty-ninth day prior to bankruptcy. Under the Eighth Circuit’s holding this payment would be unavoidable under section 547(c)(2) to the extent it is payment for interest accrued during the forty-five days immediately prior to the payment. If the loan is not called during the next eighty-nine days, and if no further interest payments are made by the debtor during that time, the creditor would have eighty-nine days of “new credit” to net against the interest payment. (The section 547(c) exceptions are in this sense cumulative.)

It follows that the creditor receiving an interest payment on the eighty-ninth day prior to bankruptcy may keep as much of that payment as represents forty-five days interest under section 547(c)(2), plus up to eighty-nine days interest “advanced” subsequently and netted out under section 547(c)(4). This means installment loan creditors fortunate enough to bill interest on that date will be entitled to keep payments for interest which accrued as much as 134 days prior to that payment. Surely Congress cannot have intended this bonanza to be reaped by one who in reality does nothing more than forebear demand of principal payment. This seems particularly true when one considers that any payment of principal during the preference period would be avoidable by the trustee under section 547(b), at least where the loan was made more than forty-five days before that payment.

This discussion suggests that the meaning of “debt incurred” for accrued interest is not clear from the “plain language and usual meaning” of the statute. While the court’s holding is certainly a possible interpretation of section 547(c)(2), it is a poor application

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69. See In re Naudain, Inc., 32 Bankr. 871, 873 (Bankr. E.D. Pa 1983). In Naudain the payments were to an electric utility which continued to provide electric service after the payment. Id. at 872. The Court accepted the debtor-in-possessions concession that 547(c)(4) applied to such subsequent advances. Id. at 875. See also In re Hersman, 20 Bankr. 569, 575 (Bankr. N.D. Ohio 1982) (subsequent credit card purchase may be used to net out prior payments to credit card issuer); cf. In re Rustia, 20 Bankr. 131, 136 (Bankr. S.D.N.Y. 1982) (“[R]enewed availability of a line of credit to the extent of payments made on account of an existing debt cannot be considered as the extension of new credit.”).

70. This assumes, as was stipulated in IPSCO, that the payments are made in the ordinary course. 695 F.2d at 1110. It further assumes the loan is unsecured and either “subject to prepayment” or payable on demand, so as to be sufficiently “contingent.” Id. at 1111. Presumably the courts holding would be inapplicable to cases where the debtor’s repayment obligation was not so contingent, although the dissent in Iowa Premium Service did not believe this to be a significant limitation. Id. at 1113 (Ross, J., dissenting).

71. See S. Rep. No. 989, supra note 6, at 5874 (quoted in note 35 supra).


73. Iowa Premium Service, 695 F.2d at 1112.
of consideration principles. Moreover, the effect of its holding seems to extend the protection of section 547(c)(2) to payments beyond the scope of congressional intent, and protects a creditor congress did not wish protected.

**LEGISLATIVE HISTORY AND POLICY OF SECTION 547(c)(2)**

The Eighth Circuit also supports its conclusion in *Iowa Premium Service* by suggesting that it promotes congressional policy. In fact the legislative history points to a contrary result.

The Bankruptcy Code as enacted in 1978 was the culmination of several years of congressional hearings and legislative action. The primary focus for congressional action was the report prepared by the Commission on Bankruptcy Laws of the United States (Commission Report), a group created by Congress in 1970 to study the bankruptcy laws. As the result of its study, the Commission proposed a bankruptcy statute which was introduced in both the House and the Senate in 1973. In 1974 a bill proposed by the National Conference of Bankruptcy Judges was introduced in the House. Both bills were subsequently introduced in the House and the Senate, and extensive hearings were held before the House Subcommittee on Civil and Constitutional Rights. As a result of those hearings a composite bill was introduced in the House in 1977. After further hearings, comments from bench and bar, and "mark-up" sessions, a "clean" bill derived from the com-
posite bill was introduced as H.R. 8200. H.R. 8200 was passed and sent to the Senate on February 8, 1978.

The Senate, meanwhile, proposed its own legislation, S. 2266, which was similar to H.R. 8200 in most substantive matters, but contained different Court and administrative provisions. After complex congressional and political maneuvering, including an attempt by the Chief Justice of the Supreme Court to stop passage of the bill, H.R. 8200, as amended by the Senate, was passed by both Houses on October 6, 1978, and signed into law by the President on November 6, 1978.

Thus, the legislative history and comments in the Senate Report and House Report accompanying H.R. 8200 must be considered in the light of the proposals and hearings which preceded that bill. In particular the proposals made by the Bankruptcy Commission and the Bankruptcy Judges with regard to preferences and excluded transactions must be consulted to better understand section 547(c)(2), the congressional accommodation of those two bills.

The Commission bill, introduced as H.R. 31, proposed two major changes in existing preference law. First, the bill defined "antecedent debt" to exclude certain kinds of debts:

Definition—for the purpose of this section the following definitions are applicable:

(2) The term 'antecedent debt' is a debt incurred more than five days before a transfer paying or securing the debt. The term 'antecedent debt' does not include (A) a debt for personal services, (B) a debt for utilities incurred within three months of the petition, (C) a debt for inventory paid for within three months of the delivery of the goods in the ordinary course of the debtor's business.

Washington & Lee University School of Law Library) [hereinafter cited as Mark-up Minutes].

85. Klee, supra note 75, at 951.
87. Klee, supra note 75, at 953.
88. Id. at 952-54. Mr. Chief Justice Burger objected to the elevation of bankruptcy referees to the status of bankruptcy judges. Id. at 954.
89. Id. at 955-57.
90. S. REP. No. 989, supra note 6.
91. H. REP. No. 595, supra note 6.
92. H.R. Doc. No. 137, supra note 76, at 16 (Part II). The Commission notes to this section state:

6. The use of 'antecedent debt' as a defined term to limit the scope of the section is a new approach. 'Antecedent debt' is defined in paragraph (1) of subdivision (g) as 'a debt incurred more than five days before' its payment or securing to save from attack short-term credit extensions. This over-
Second, the bill eliminated the requirement in section 60b that a transferee have "reasonable cause to believe" the debtor is insolvent because, the Commission believed, that requirement, "more than any other, has rendered ineffective the preference section of the present act."93

The Judges bill also eliminated the "reasonable cause to believe" language, and defined antecedent debt to exclude from preferential transfers those payments made to a creditor within thirty days from the creation of the debt.94

The importance of the elimination of the "reasonable cause to believe" language to an understanding of section 547(c)(2) cannot be overstated. The elimination was concurred in by virtually everyone, except certain creditors.95 However, the elimination re-

rules National City Bank v. Hatchkiss, 231 U.S. 50 (1913), which held the repayment before three p.m. of money "borrowed at ten a.m. to pay cash for stocks purchased which would, in the ordinary course of business, be pledged or delivered for cash elsewhere upon the same day, thus supplying the funds for repayment before . . . three p.m." was a preference. MacLachlan § 255, at 293. As a result of the definition, payments to employees (with specified exceptions), utilities, and suppliers in the ordinary course of business are not subject to preference attack. Payments of these debts are payments of antecedent debts under the case law interpreting the Act, but are protected since employee's trade creditors, and utilities ordinarily do not have reasonable cause to believe the debtor insolvent.

Id. at 169-70.

93. Id. at 204 (Part I). See, e.g., Vance v. Dugan, 187 F.2d 605, 606 (10th Cir. 1951) (burden of proof on trustee to prove reasonable cause to believe); Canright v. General Fin. Corp., 123 F.2d 98, 99 (7th Cir. 1941) (good faith of creditor presumed). Critics of the reasonable cause to believe language, which first surfaced in the 1938 amendments to the Chandler Act of 1938, ch. 575, § 60, 52 Stat. 869, 869-71 (codified as 11 U.S.C. § 96(b) (1976)) were quick to point out the burden this placed on the trustee, and that knowledge of insolvency was irrelevant to the primary goal of bankruptcy, equality of distribution. See, e.g., King, Proposed Amendments to the Chandler Act, 45 COMM. L.J. 36 (1940).

94. Lee, supra note 79, at 27. The Judge's bill, unlike the commission bill, made no specific exception for utility payments or inventory purchases. It did except payments made for personal services. Id. at 28.

95. See H. REP. NO. 595, supra note 6, at 6139. In the hearings on H.R. 6, supra note 82, Mr. Klee, staff counsel, stated:

MR. KLEE: Now, the Commission thought that the second rationale of the debtor's volitional preference was something that should be condemned and so they removed the reasonable cause to believe requirement from the traditional elements. We—the Judges concurred in that and the National Bankruptcy Conference concurred in that. The creditors, on the other hand, said "my God, you know, we get all kinds of transactions in the ordinary course of business and we don't know that the debtor is insolvent [sic]. Why should we have to go back three months before the date of the filing of the petition"—and I might comment in passing that, under current law, it's four months—it was changed to three months as a compromise because of this deletion of reasonable cause—"why should we have to go back three months and undo all these transactions that have been done?" Therefore, as a balancing point—we agreed with them. We agreed that the ordinary course of business should be protected. If what you had was something that occurred in the ordinary course and was not truly antec-
quired some special provision to protect creditors who deal with a debtor on a short-term credit basis and who normally do not inquire into the debtor's solvency because of the short credit cycle. These creditors were the chief beneficiaries of the "reasonable cause to believe" language. The Bankruptcy Commission believed they deserved that protection because these short-term transactions really did not amount to a diminution of the debtor's estate, did not involve unusual transfers evidencing a prohibited "trace of diligence," and frequently were necessary to keep the debtor in business.\footnote{Congress shared that belief.}{96} Congress shared that belief.\footnote{See H.R. Doc. No. 137, supra note 76. "The commission also recommends that 'antecedent debt' be defined so as to exclude certain debts the payment of which does not infringe substantially on the goals of the preference provisions." Id. at 250 (Part I). Counsel at the hearings on H.R. 6, supra note 82, stated the staff's reasons for drafting § 547(c)(2) as they did:}{96} 

\begin{quote}
MR. KLEE: To the contrary, Mr. Drinan, the bills that you are reading from define antecedent debt in Section 4607 G to mean any debt that is more than five days old or more than thirty days old. If it was within that grace period, it wasn't an antecedent debt and it wouldn't be subjected to the preference section. What we're getting at here is checks. If you go in a store and, instead of paying cash, you write a check, nobody intends the writing of a check to be an extension of credit, in reality. But, in fact, that's what it is. In technical terms, it's an extension of credit. And, if people had to deal on a cash basis and all these checks were being set aside as voidable preferences, there would be havoc in the business world. What has been recognized is the need to exempt transactions that take place within a short period. The argument is what that period should be.

MR. LEVIN: The Commission picked ninety days for inventory and utilities, but, generally, what this is going to apply to is inventory and utilities and paycheck. So, that's why forty-five days was picked. There's no magic of forty-five days. It was just a question of trying to balance all of these policies. . . .

MR. BUTLER: Could all of these problems be avoided if we went back to the old reasonable cause problem?

MR. KLEE: Yes, but that would create a lot of other problems.

MR. BUTLER: The feeling of the draftsmen, I think of the Commission's and the Judges' bill and the National Bankruptcy Conference's proposal was that reasonable cause to believe pretty much affected the guts of the preference section because of the practicality of having to prove it and litigate it and that, whether the debtor prefers someone, whether they knew it or not, if it has a preferential effect, regardless of the intent on the part of the creditor, it should be avoided. This was an attempt to balance that out to say that, if you order goods on the first and the bill is sent out on the 30th, if you pay it by the 15th of the next month, that's OK and it shouldn't be upset.
\end{quote}

\footnote{S. Rep. No. 989, supra note 6, at 5874. "The purpose of this exception is to leave undisturbed normal financial relations, because it does not detract from the general policy of the preference section [which is] to discourage unusual action by either the debtor or his creditors during the debtor's slide into bankruptcy." Id.}{97}
In short, as most writers commenting on section 547(c)(2) agreed, that exception was designed primarily to afford protection to creditors receiving what technically were preferences, but which did not deserve to be avoidable preferences. For a number of reasons, as the Seventh Circuit in Barish v. Public Finance Corp. and the Iowa Premium Service dissent believed, creditors such as the Bank in Iowa Premium Service are not entitled to that protection.

First, and fundamentally, the Bank was not a creditor who lacked interest in the debtor's insolvency and was therefore unaware of it. Surely the Bank inquired into IPSCO's solvency when the $400,000.00 loan was made, and no doubt the Bank continued to monitor the debtor's financial condition. Presumably one of the reasons for the note's "demand" feature was to permit the Bank to act when and if it felt insecure. Thus, unlike the classic short term creditor, the Bank could, if it wished, protect against the debtor's insolvency in the usual manner, by requiring security. This option is not available to the utility providing electricity, the credit card issuer, or the thirty day trade creditor. These people usually have no occasion to consider such matters.

It is no answer to say, as the Iowa Premium Service court does, that the Bank really extends credit one day at a time, with interest to be paid monthly. The truth of the matter is that the Bank contemplated a loan of eight to nine months. That is, by any standard, a sufficiently long enough term to take the transaction out of the scope of section 547(c)(2).

Second, unlike a seller of goods or a provider of services, including credit, who expects reasonably prompt payment, the Bank adds nothing to the debtor's estate once the initial loan is made, regardless of how interest is billed. The true short-term creditor

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98. See 4, W. COLLIER, supra note 22, § 547.38; Kaye, supra note 3, at 201-02; Levin, supra note 54, at 186-87; Ward & Shulman, supra note 3, at 83-84. The authors single out the dissenting opinion in the Iowa Premium Service panel decision, as well as the Ken Gardner opinion, as examples of inaccurate legislative history analysis. Id. at 83 n.268. See also 2 W. NORTON, supra note 55, § 32.14 stating that:

[T]here is a basis for concluding that the protection is limited to short term credit. . . . Furthermore, there may be a rational, although unexpressed, basis for distinguishing short and long term credit. A restriction in scope of the protection given for "normal" payments may be justified as a method of identifying those payments that are often, although not necessarily, limited to relatively small amounts that have relatively limited impact on the estate.

Id.

99. 658 F.2d 504, 512 (7th Cir. 1981).
100. 695 F.2d at 1113.
101. Id. at 1110.
who provides goods and services to the debtor shortly before payment is expected can be seen to have added to the debtor's estate. Payment to this creditor, though not a "contemporaneous exchange" under section 547(c)(1), does not constitute a depletion of the debtor's estate. On the other hand, in a situation like Iowa Premium Service, the debtor has the same amount of money for his use throughout each day, and that is not changed by the idea that "use of the money for another day is new consideration each day."102 The best that can be said for this view is that the Bank augments the debtor's estate by forebearing from calling the loan each day. As suggested earlier, this is a highly strained view of consideration in a transaction such as this, and courts have not followed it when faced directly with the issue.103

Finally, the Eighth Circuit's justification of its decision as consistent with the policy behind section 547(c)(2) simply misses the mark. The Court states: "If IPSCO's interpretation of the Act were adopted, banks would be in a disadvantaged position compared with trade creditors who deal in the sale of tangible goods. Putting banks in such a position would discourage them from giving loans to marginal debtors, which would increase the likelihood of bankruptcies."104 However, banks are not put in a "disadvantaged position" if they seek to protect repayment of principal or interest made within forty-five days of the date the loan was made. In such a case a bank, like other creditors, would get the section 547(c)(2) protection.105 Short-term loans may well deserve protection in the same sense that short term trade credit is protected, since arguably banks making such loans make less inquiry into the debtor's solvency at the time the loan is made and repaid. Further, such short-term loans do represent a true addition to the debtor's estate such that repayment shortly thereafter does not "diminish the estate" on account of an "antecedent debt," as those terms apply to section 547(c)(2). Finally, such loans might indeed be more readily made to "marginal" debtors if prompt repayment was protected under section 547(c)(2), and thus would help to keep a

102. Id. at 1112.
103. In re Duffy, 3 Bankr. 263, 266 (Bankr. S.D.N.Y. 1980) (court refused to treat forebearance to repossess a rental car as new value under § 547(c)(1)); see In re Rustia, 20 Bankr. 131, 136 (Bankr. S.D.N.Y. 1982) (mere availability of line of credit not viewed as extension of new credit under § 547(c)(4)).
104. 695 F.2d at 1112.
105. Some would argue otherwise. See Ward & Shulman, supra note 3, at 83-84 n.268. "The § 547(c)(2) exception was designed to deal with 'like-cash' trade creditors, service creditors, utilities and employees paid on monthly, biweekly, or weekly cycles." Id. Presumably for these writers installment lenders would never qualify for the § 547(c)(2) protection.
struggling debtor out of bankruptcy. These are all reasons for, and goals of, the section 547(c) (2) exception, and would support a conclusion that repayment of a short-term loan is not avoidable.

The same may not be said for long-term loans. There, the debtor's ability to repay seems a central consideration. Indeed, it seems highly unlikely that a bank would make an unsecured loan of any magnitude to a marginal debtor who may present repayment problems. When such a loan is made the bank is clearly taking a risk of nonpayment. However, that is the essence of extending credit. The bank is in the best position to evaluate that risk and take appropriate safeguards, such as requiring security. Section 547(c) (2), however, recognizes that although short term transactions technically are credit transactions, the creditor does not normally think about credit management. Its protection is neither necessary nor appropriate when a long-term lender does or should make such credit decisions.

The long-term lender does not add to the debtor's estate, once the initial loan is made, in the same sense that, for example, furnishing electricity to a business adds value. The amount of money the debtor has available for his financial problems can only be reduced by a bank's premature demand. This does not fit the idea of augmenting a debtor's estate which Congress had in mind in section 547(c) (2). Indeed, implicit in the Eighth Circuit's justification of its decision, that to hold otherwise would "discourage [banks] from giving loans to marginal debtors" is the recognition that the true consideration furnished by the Bank is the loan, not the daily forbearance.

Since none of the reasons advanced by the various proponents recommending changes included in section 547(c) (2) seem applicable to long term interest payments, the legislative history of that section should be read as excluding such payments.

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106. One could argue that a Bank could accomplish the same result as reached in IPSCO by "calling" the loan at the end of each day, or for that matter, each 45 day period, and remaking the loan. That may be so, if, in the ordinary course, the Bank actually demands payment. To the extent a Bank simply makes book entries to this effect, however, it would seem to fall outside § 547(c) (2) by analogy to the definition of "new value" in § 547(A) (2). This section states that new value does not include "an obligation substituted for an existing obligation." 11 U.S.C. § 547(A) (2) (1982). By a parity of reasoning a "new debt" should not be incurred merely by substituting a new promissory note for the old, without some actual funds being advanced. A Bank can no doubt protect itself by making only short-term loans which call for payment within the 45 day cycle. Presumably there are advantages to be gained by making longer term loans. If a Bank wishes to obtain those advantages it must be prepared to protect its investment. Section 547(c) (2) should not.

107. 695 F.2d at 1112.

108. Cf. id. The Court stated a reluctance to read long term lenders out of the
CONCLUSION

The Eighth Circuit's decision in Iowa Premium Service creates a bad precedent in two ways. First, its holding on the consideration issue seems likely to add to the uncertainty surrounding the meaning of "debt incurred" in section 547(c)(2). Second, by ignoring the limitations the legislative history shows Congress intended with respect to that section, the court has protected preferential transfers which bear no reasonable relation to the congressional goal of equality of treatment.

It may be that sufficiently compelling reasons exist for expanding the scope of section 547(c)(2) to include creditors such as the Bank in Iowa Premium Service. If so, Congress should do the expanding, not the courts. Statute when it stated, "[B]ut a court should not make such a decision absent evidence of a congressional intent to do so, especially when the plain language and usual meaning of the words are clear." Id. Normally such deference is proper. However, the admonition of the United States Supreme Court, in a case involving a Tenth Circuit Court of Appeals refusal to consider legislative history, seems applicable here. In Train v. Colorado Pub. Interest Research Group, Inc., 426 U.S. 1 (1976), the Court stated that:

To the extent that the Court of Appeals excluded reference to the legislative history of the FWPCA in discerning its meaning, the court was in error. As we have noted before: "When aid to construction of the meaning of words, as used in a statute is available, there certainly can be no 'rule of law' which forbids its use, however clear the words may appear on 'superficial examination.'"

Id. at 9-10 (quoting United States v. America Trucking Assns., 310 U.S. 534, 543-44 (1940).


Section 547(b) of Title 11, United States Code, is amended—

(3) . . . by adding at the end thereof the following new paragraph:

"(6) if such creditor at the time of such transfer had reasonable cause to believe the debtor was insolvent at the time of such transfer."

129 Cong. Rec. at S. 5343.

This legislation was still pending as of March 30, 1984, when Congress passed a one month stop gap measure designed to permit the bankruptcy courts continued existence, a step made necessary by the Supreme Court's decision in Northern Pipe Line Constr. Co. v. Marathon Pipe Line Co., 458 U.S. 50 (1982). See N.Y. Times, Mar. 31, 1984, at 27, col. 3.