Indirect Preferences: Recovery under Sections 547 and 550 of the Bankruptcy Code

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INDIRECT PREFERENCES:
RECOVERY UNDER
SECTIONS 547 AND 550
OF THE BANKRUPTCY CODE

Levit v. Ingersoll Rand Financial Corporation

I. INTRODUCTION

Can a lender who does not demand a personal guarantee on a corporate loan be in a better position than one who does? Financial institutions routinely obtain a personal guarantee from an officer of the debtor corporation. If the corporation defaults on the loan, the lender can pursue the officer-guarantor to cover the debt. Lenders may re-evaluate this daily practice in light of the May 15, 1989 decision in Levit v. Ingersoll Rand Financial Corp.\(^2\)

The issue in Levit was whether to extend the preference-recovery period for outside creditors from ninety days to one year when an inside guarantor is benefitted. Although the majority of federal district and bankruptcy courts had held that such an outside creditor was subject to the ninety day preference-recovery period of section 547(b)(4)(A) of Title 28,\(^3\) Levit presented a question of first impression for the United States Court of Appeals for the Seventh Circuit. Judge Easterbrook held that under the United States Bankruptcy Code (Code) a bankruptcy trustee may recover a debtor corporation's payment to an "outside creditor"\(^4\) made within one year before the petition for bankruptcy if the payment benefitted an "inside guarantor"\(^5\) of the debtor.\(^6\) The decision might

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1. 874 F.2d 1186 (7th Cir. 1989).
2. Id.
4. An "outside creditor" is any creditor to whom a debtor owes a debt. The distinction is made because the Bankruptcy Code refers to "insiders" who have a basis for control over the debtor. 11 U.S.C. § 547(b)(4)(B) (1988); see also id. § 101(30).
5. For a discussion of "inside guarantor," see infra notes 41-62 and accompanying text.
6. Levit, 874 F.2d at 1200-01.
impact the lender practice of acquiring an inside guarantee on corporate loans.

The *Levit* case addressed three different debtor pre-bankruptcy payment situations that the bankruptcy trustee sought to include in the one year preference period of section 547(b)(4)(B): (1) delinquent federal withholding tax payments,\(^7\) (2) payments on employee welfare and pension plan notes that benefitted an inside guarantor,\(^8\) and (3) payments to outside creditors that benefitted inside guarantors. This Note will focus on the third situation.

### II. THE FACTS

The City of Chicago awarded V.N. Deprizio Construction Company a contract to extend a subway system to O'Hare Airport.\(^9\) Because of financial difficulties during the project, Deprizio Co. borrowed money from Ingersoll Rand Financial Corporation.\(^10\) Richard Deprizio, the firm's president, and his brothers personally guaranteed the loan.\(^11\) During the year preceding the petition, Deprizio Company made

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7. *Id.* at 1191-92. Deprizio Company had made substantial payments on delinquent federal withholding taxes in the year before bankruptcy. *Id.* at 1188. Regarding these payments, the court held that "insiders who may be liable on account of the firm's failure to pay taxes are not 'creditors' because they do not hold 'claims' against their firms." *Id.* at 1200. Accordingly, delinquent taxes paid more than ninety days before the filing may not be recovered under section 550(a). *Id.*

8. *Id.* at 1192-94. When Deprizio Company fell behind in making required payments to pension and welfare funds, it executed notes in favor of the plans and Richard Deprizio co-signed the notes. *Id.* at 1188. Regarding payments to these plans in the year prior to bankruptcy, the court held: pension and welfare trusts may recover from insiders only to the extent state law allows that under rules for disregarding the corporate form, or the insiders make contractual commitments enforceable under section 515 of ERISA. When state law supports "veil piercing" it does so on the ground that the investor and the firm are a single entity, which precludes the insider from holding a "claim" against the firm. The Trustee therefore may not recover payments to pension and welfare trusts made more than 90 days before the filing, unless those trusts negotiated for and received contractual guarantees from insiders—in which event the funds should be treated just like any other outside creditor. *Id.* at 1200.

9. *Id.* at 1187.

10. *Id.* Deprizio Company had also borrowed from the City of Chicago, CIT Group/Equipment Financing, Inc. (CIT), and Melrose Park Bank & Trust. *Id.*

11. *Id.* Richard Deprizio co-signed the note to Melrose Park Bank & Trust. In addition, he and his brothers guaranteed the debts to the other lenders. *Id.*
payments on the Ingersoll Rand loan. The company filed a Chapter 11 petition under the Bankruptcy Code of 1978 before finishing the project.

The bankruptcy court appointed Louis W. Levit the trustee in bankruptcy for the estate of V.N. Deprizio Construction Company. Levit filed an adversary proceeding against the lender. He sought to recover the payments to it made more than 90 days but within the year before the petition in bankruptcy. Levit argued that the payments made to the outside creditor benefitted inside co-signers and guarantors. Therefore, the payments were avoidable preferences under sections 547 and 550 of the Code.

12. Id.
15. Levit, 874 F.2d at 1188.
16. Id. The outsider creditors were Ingersoll Rand Financial Corporation, the pension and welfare funds, and the Internal Revenue Service. Id. at 1187-88.

17. 11 U.S.C. § 547 (1988). Section 547(b) reads:
(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 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 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.

11 U.S.C. § 547(b) (1983). This is the 1983 version of the statute. In 1984, Congress amended the voidable preference section to eliminate the requirement set forth in subsection (b)(4)(B)(ii) that an insider have "reasonable cause to
The bankruptcy judge, Robert L. Eisen, denied the trustee's request and dismissed the complaint for failure to state a claim upon which relief could be granted. Judge Eisen held that the trustee could not avoid the payments to the outside creditor made more than ninety days but within the year before the petition in bankruptcy. He maintained it would be inequitable to require surrender of funds from a good believer the debtor was insolvent at the time of the transfer. See 11 U.S.C. § 547 (b)(4)(B)(ii) (1988). The original action was filed in 1983, before the effective date of the amendment. Therefore, the 1983 version controls.

18. 11 U.S.C. § 950(a)-(c) (1988). Section 550 provides in part:
(a) Except as otherwise provided in this section, to the extent that a transfer is avoided under section 544, 545, 547, 548, 549, or 724(a) of this title, the trustee may recover, for the benefit of the estate, the property transferred, or if the court so orders, the value of such property, from—
(1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or
(2) any immediate or mediate transferee of such initial transferee.
(b) The trustee may not recover under section (a)(2) of this section from—
(1) a transferee that takes for value, including satisfaction or securing of a present or antecedent debt, in good faith, and without knowledge of the voidability of the transfer avoided; or
(2) any immediate or mediate good faith transferee of such transferee.
(c) The trustee is entitled to only a single satisfaction under subsection (a) of this section.

Id.

19. Levit, 874 F.2d at 1188. See infra notes 41-62 and accompanying text for discussion of avoidable insider preferences.


21. In re V.N. Deprizio Constr. Co., 58 Bankr. 478, 480 (Bankr. N.D. Ill. 1986), rev'd, 86 Bankr. 545 (Bankr. N.D. Ill. 1988). Judge Eisen adopted the two-transfer theory of In re Mercon Industries, Inc., 37 Bankr. 549 (Bankr. E.D. Pa. 1984). In re Deprizio, 58 Bankr. at 480. The theory maintains that when an inside guarantor is present, any payment to an outside creditor is actually two transfers—one to the outside creditor and one to the inside guarantor. The preference recovery period for the two are different. Id. See infra notes 70-74 and accompanying text. The judge concluded that the trustee could not prove that the outside creditor was an insider and had reasonable cause to believe that the debtor was insolvent at the time, as required by section 547(b). In re Deprizio, 58 Bankr. at 480. Therefore, the trustee could only recover from the inside guarantor. Id.
faith outside creditor who did not act in concert with the inside guarantors.  

Levit filed an interlocutory appeal. On appeal, Judge Paul E. Plunkett, United States District Court for the Eastern Division of the Northern District of Illinois reversed and remanded. Judge Plunkett instructed the bankruptcy court to determine (1) whether the payments identified by the trustee occurred, (2) whether an insider received a benefit from any particular payment, and (3) whether section 547(c) protected any of them. Judge Plunkett held that all payments made to the outside creditor between ninety days and one year before the filing of the bankruptcy petition were recoverable from the creditor when such creditor had a legally enforceable right to recover from the inside guarantors. In a separate appeal, the district court followed Judge Plunkett's opinion.

Judge Plunkett certified the question under section 1292(b) of Title 28, and the Seventh Circuit granted leave to appeal. Judge Easterbrook held that "the preference-recovery period for outside creditors is one year when the payment produces benefit for an inside creditor, including a guarantor."

III. LEGAL BACKGROUND

The court certified the issue on appeal as "whether the Trustee may recover from an outside creditor under § 550(a)(1) a transfer more than 90 days before the filing that is avoided under § 547(b) because of a benefit for an inside creditor." The question falls within the area of

22. In re Deprizio, 58 Bankr. at 481.
23. Levit, 874 F.2d at 1188.
24. In re Deprizio, 86 Bankr. at 556. Judge Plunkett held that "payments that the debtor made to its outside creditors on obligations guaranteed by insiders were subject to expanded preference period in determining whether transfers constituted avoidable preferences." Judge Plunkett also held "all payments from one year to ninety days before the filing of the petition in bankruptcy made to creditors who, by operation of their guarantee or by operation of law, had a legally enforceable right to recover from Debtor's insiders are subject to preference rules of the Bankruptcy Code and are recoverable from non-insider recipients of the payments." Id. at 553.
25. Id. at 556.
26. Id. at 553.
27. Levit, 874 F.2d at 1188 n.1. "One creditor's appeal from the bankruptcy court was assigned to Judge Leinenweber, who held the case in abeyance pending Judge Plunkett's opinion and followed his decision in a brief order." Id.
28. Id. at 1188.
29. Id. at 1192.
30. Id. at 1194.
bankruptcy law commonly referred to as the "law of preferences." 31 Since the passage of the Code, courts have differed as to the preference-recovery period for transfers to outside creditors that benefit an inside guarantor. Should the presence of an inside guarantor in a transfer extend the preference-recovery period for an outside creditor from ninety days to one year?

A. Bankruptcy Preferences Provisions

The preference provisions of the Code 32 operate to prevent creditors with knowledge of a pending bankruptcy from receiving any of the debtor's assets to the detriment of creditors who have no knowledge of the pending bankruptcy. 33 The purpose of the preference provisions "is to proscribe those transactions that represent attempts, conscious or unconscious, to rearrange the distribution scheme that falls into place upon the filing of a bankruptcy petition." 34 The bankruptcy trustee can recover payments from any creditor that are determined to be preferential and are made within a specified time prior to the bankruptcy petition.

One commentator has noted that "[t]he bankruptcy preference laws have been hailed as 'the single greatest contribution of the Bankruptcy Act to the field of commercial law.'" 35 When a bankrupt debtor does not have enough assets to pay all creditors in full, the question becomes one of who will get how much of the available assets. "Bankruptcy,


32. The sections relevant to this discussion are 11 U.S.C. §§ 547, 550 (1983). Preferences are defined as "transfers that favor one existing creditor over another." Jackson, Avoiding Powers in Bankruptcy, 36 STAN. L. REV. 725, 728 (1984). Jackson discusses the role of the preference provisions within the bankruptcy process.

33. Judge Easterbrook described the policy underlying this concept as:

The trustee's power to avoid preferences (the "avoiding power") is essential to make the bankruptcy case a collective proceeding for the determination and payment of debts. Any individual creditor has a strong incentive to make off with the assets of a troubled firm, saving itself at potential damage to the value of the enterprise. Many a firm is worth more together than in pieces, and a spate of asset-grabbing by creditors could dissipate whatever firm-specific value the assets have . . . . All creditors gain from a rule of law that induces each to hold back. Levit, 874 F.2d at 1194.


35. Id. at 175.
then, exists to constrain creditors (and others) from attempting to promote their individual interests when doing so would be detrimental to the group of claimants.\textsuperscript{36}

Specifically, the preference laws prevent creditors from changing their existing position among all other creditors in anticipation of a bankruptcy proceeding.\textsuperscript{37} These laws focus on "relationships among creditors in light of the advantages of a collective proceeding, not on relationships between creditors and their debtor."\textsuperscript{38} Thus, "[p]reference law is concerned . . . with creditor's postloan attempts to collect from a languishing debtor, and thereby to escape from the class of unsecured creditors into a class of paid (or secured) creditors, made with an eye to opt out of the incipient collective proceeding."\textsuperscript{39} The preference laws in effect undo what otherwise would often be a legitimate transaction if not for the debtor's insolvency. Therefore, the "courts struggle to do equity within the confines of an unambiguously worded statute."\textsuperscript{40}

B. The Relationship Between Sections 547 and 550

Operation of the preference provisions involves two separate actions: (1) avoidance and (2) recovery. Section 547 governs avoidability while section 550 determines recoverability.\textsuperscript{41} Section 547 of the Code defines the circumstances under which a trustee can avoid a preferential transfer to a creditor.\textsuperscript{42} Section 550 of the Code defines from whom the avoided transfer may be recovered.\textsuperscript{43} In other words, the trustee looks to section 547 to decide if a transfer may be avoided and then looks to section 550 to see from whom the transfer may be recovered.

Section 547 enables a trustee to avoid any transfer that is either (1) to a creditor or (2) for the benefit of a creditor.\textsuperscript{44} Therefore, the first question to be resolved is whether an inside guarantor is a creditor for section 547 purposes. The Code defines a creditor as an "entity that has

\textsuperscript{36} Jackson, supra note 32, at 728. Jackson refers to the available assets as a "pie" and states that "[b]ankruptcy is designed to assure that the asset 'pie' is as large as possible." \textit{Id.}

\textsuperscript{37} \textit{Id.} at 759. Creditors would seek to satisfy their individual rights by obtaining payment before the bankruptcy proceeding freezes all the debtors assets. Preference laws deter such potential asset grabbing by allowing the trustee to "reach back" and undo the actions of individual creditors. \textit{Id.}

\textsuperscript{38} \textit{Id.} at 757.

\textsuperscript{39} \textit{Id.} at 760.

\textsuperscript{40} Nutovic, supra note 34, at 175 n.61.

\textsuperscript{41} \textit{Id.}


a claim against the debtor that arose at the time of or before the order for relief concerning the debtor.\textsuperscript{45} Therefore, to be considered a creditor, the inside guarantor must have a claim against the debtor. The code defines a claim as a "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured."\textsuperscript{46} Thus, to be considered a creditor, the inside guarantor must have a right to payment from the debtor and the right can be contingent.

Courts and commentators have generally concluded that the inside guarantor is a creditor because the guarantor has a contingent right to payment.\textsuperscript{47} One commentator maintains that it is settled law that "a guarantor is a creditor holding a contingent claim that exists from the date of the execution of the guarantee."\textsuperscript{48} In the event of default by the debtor, if the lender collects from the guarantor, the guarantor becomes subrogated to the lender's entitlements and can collect from the corporation. Therefore, the inside guarantor of a corporate debt is a creditor in bankruptcy proceedings because the guarantor has a contingent right to payment from the debtor if the guarantor must make payment to the outside creditor.\textsuperscript{49} Judge Easterbrook took this position concerning the inside guarantor in \textit{Levit}.\textsuperscript{50}

The preferential transfer involving an inside guarantor is known as an "indirect" preference.\textsuperscript{51} In an indirect preference, a preferential payment to an outside creditor also indirectly prefers the creditor's inside guarantor. The indirect preference is based on section 547(b)(1) which provides that a preference may be based on a transfer "for the benefit of a creditor."\textsuperscript{52} The inside guarantor is liable on the debt to the outside creditor in the event of a default by the debtor. Therefore,

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45. \textit{Id.} § 101(9)(A).
46. \textit{Id.} § 101(4)(A).
47. \textsc{4} \textsc{Collier on Bankruptcy} ¶ 547.04 (15th ed. 1989) (A guarantor or surety for the debtor, or an endorser of notes or checks, will be a creditor under the Code because the guarantor holds a contingent claim against the debtor that becomes fixed when the guarantor pays the creditor whose claim was guaranteed or insured. Consequently, assuming that all other elements of a preference exist, transfers to a guarantor, surety, or indorser are avoidable as transfers "to" the "creditor" guarantor, surety, or indorser.).
49. \textit{Levit}, 874 F.2d at 1190.
50. \textit{Id.} at 1190 (a guarantor has a contingent right to payment from the debtor: if Lender collects from Guarantor, Guarantor succeeds to Lender's entitlements and can collect from Firm).
52. 11 \textsc{U.S.C.} § 547(b)(1) (1988).
\url{https://scholarship.law.missouri.edu/mlr/vol55/iss1/22}
the inside guarantor benefits from any payment by the debtor to an outside creditor because every reduction in the debt to the outside creditor reduces the guarantor's exposure.53 Because the guarantor is a creditor with an antecedent claim who is a beneficiary of the debtor's payment to the outside creditor, the transfer to the outside creditor is also a preference to the inside guarantor.54

Thus, under section 547, the lender (Ingersoll) was an outside creditor and the guarantor (Deprizio) was an inside creditor. In other words, the preferential payment that was avoidable under section 547 was a preference to both an inside creditor and an outside creditor.

The second aspect of the avoidance provisions of section 547 that is important to this discussion is the "reachback" provisions.55 Basically, even though a transfer is a preferential transfer, the trustee may not attack it unless it was made within one of the time periods established in section 547(b)(4). The Code establishes two different preference-recovery timeframes, depending on whether the transfer was to an outsider or an insider.56 The cases and commentators universally agree that the preference-recovery period for an inside creditor is one year57 and for an outside creditor is ninety days.58 The Code defines "insider" in section 101(30).59 Since a guarantor is almost always an insider of the debtor, the inside guarantor is also an inside creditor for preference-recovery purposes.

Direct transfers to inside creditors have universally been treated as subject to the one year preference-recovery period. The difficult situation arises with the indirect preference. Since the inside guarantor is also an inside creditor, which preference-recovery period should govern transfers to an outside creditor that also benefit an inside guarantor? This is the issue confronted in the Levit case. Since the preference is to an outside creditor and for the benefit of an inside

53. Levit, 874 F.2d at 1190.
54. Nutovic, supra note 34, at 187.
57. Id. § 547(b)(4)(B).
58. Id.
59. Id. § 101(30). Section 101(30) provides:
   (B) if the debtor is a corporation-
   (i) director of the debtor;
   (ii) officer of the debtor;
   (iii) person in control of the debtor;
   ....
   (vi) relative of a general partner, director, officer, or person in control of the debtor;

Id.
guarantor, should the ninety day outsider or the one year insider preference-recovery period govern? In other words, does the benefit to the inside guarantor subject the outside creditor to the one year preference-recovery period of section 547(b)(4)(B)? Courts have looked to section 550 of the Code to resolve this issue.

Section 550 of the Code governs the recoverability of a preferential transfer.60 A trustee may recover a preferential payment from either the "initial transferee" or "the entity for whose benefit such transfer was made."61 Thus, the trustee may recover a preference from either the outside creditor (initial transferee) or the inside guarantor (entity for whose benefit such transfer was made) or both. However, under section 547, the preference recovery period is longer for the inside creditor than for the outside creditor. Therefore, the problem becomes one of whether to extend the preference-recovery period for outside creditors from ninety days to one year when there is an inside guarantor. Since the trustee can recover from either the inside guarantor or the outside creditor, which preference-recovery period should control the transfer? Should the preference-recovery period be extended for an outside creditor when a preferential payment benefits both an inside guarantor and an outside creditor? Section 550 does not resolve the issue. The minority of courts say yes, while the majority say no.62

C. Judicial Approaches

The federal district and bankruptcy courts have historically used three different approaches to establish the recovery period when a preferential payment benefits both an inside guarantor and an outside creditor: (1) equitable, (2) literal, and (3) two-transfer.

60. For a general discussion of section 550, see 4 COLLIER ON BANKRUPTCY, supra note 47, ¶ 550.01-.04.
61. 11 U.S.C. § 550(a)(1) (1988). 4 COLLIER ON BANKRUPTCY, supra note 47, ¶ 550.02 n.8, indicates that the use of "or" allows the trustee to recover from any combination of the transferees mentioned in the Code section.
62. For a recent summary and discussion of the minority and majority positions, see Brands, Note: The Interplay Between Sections 547(b) and 550 of the Bankruptcy Code, 89 COLUM. L. REV. 530 (1989).

Brands argues that the outside creditor should not be exposed to the one year preference-recovery period merely because there is an inside guarantor. Id. at 531. He maintains that the outside creditor is protected by section 550(b)(1) because the activities of the outside creditor are not the basis for the preference. Id. at 547. Thus, the outside creditor is an initial transferee liable under section 550(a)(2), but is protected by section 550(b)(1). Id. at 547-48. This is a new approach that has never been taken in a judicial proceeding.
The majority of the courts have held that inside guarantees do not expose outside creditors to the one year preference-recovery period.\(^{63}\) These courts generally do not deny that the transfer to the outside creditor also benefits an inside guarantor/creditor. However, they argue that extending the preference-recovery period for the outside creditor to one year because of the benefit to the inside guarantor would be inequitable.\(^{64}\) "It has long been recognized that a preference action is a creature of equity and that the bankruptcy courts, in employing the doctrine, are to apply equitable principles."\(^{65}\)

In *In re T.B. Westex Foods, Inc.*,\(^{66}\) the court stated that "[i]n some circumstances, a literal application of section 550(a) would permit the trustee to recover from a party who is innocent of wrongdoing and deserves protection. In such circumstances the bankruptcy court should use its equitable powers to prevent an inequitable result."\(^{67}\) The court concluded that even if the transfer qualified as a one year preference-recovery under section 547(b)(4)(B) because of the inside guarantor, "it would be inequitable to allow recovery to the Debtor under Section 550 where the initial transferee is not an insider and where payments to it were not made within ninety (90) days of filing."\(^{68}\) Thus, the equity argument contends that it surely could not be the drafters' intent to give a better creditor position to a lender who does not demand a personal guarantee than to one who does.\(^{69}\)

A minority of courts have held that the outsider creditor is subject to the one year preference-recovery period because of the literal meaning of sections 547 and 550.\(^{70}\) This "literal interpretation" approach

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64. See, e.g., 4 COLLE r ON BANKRUPTCY, supra note 47, ¶ 550.02.

65. *In re Midwestern Cos.*, 96 Bankr. at 225.


67. *Id.* at 80. The court cited 4 COLLE r ON BANKRUPTCY, supra note 47, ¶ 550.02, for authority. *Id.*

68. *Id.* at 81 (citations omitted).

69. 4 COLLE r ON BANKRUPTCY, supra note 47, ¶ 547.02.

maintains that a literal reading of the Code requires extending the preference-recovery period for an outside creditor to one year when an inside guarantor is present.\textsuperscript{71} They reason that section 547 allows the transferee to recover from the inside guarantor if a preferential transfer was made within the one year period before the bankruptcy petition. Thus, the preference-recovery period for the transfer is one year. Then, section 550(a) allows the trustee to collect from either the initial transferee (the outside creditor) or the one for whose benefit the transfer was made (the inside guarantor).\textsuperscript{72} Since the inside guarantor is an inside creditor, the preference period for recovery under section 550 is one year and recovery can be made from either the inside guarantor or the outside creditor.\textsuperscript{73} This is the position taken by Judge Easterbrook which will be discussed later.\textsuperscript{74}

Two courts have used a third approach.\textsuperscript{75} These courts reasoned that, when an inside guarantor is present, a transfer by the debtor is actually two transfers—one to the outside creditor in satisfaction of the primary indebtedness and one to the inside guarantor in satisfaction of the contingent liability.\textsuperscript{76} The outsider is subject to the 90 day preference-recovery period of section 547(b)(4)(A) while the insider is subject to the one year period of section 547(b)(4)(B). Under this rationale, the trustee can recover from the outside creditor and the inside guarantor if the transfer occurred within ninety days prior to the petition for bankruptcy; but only from the inside guarantor if the transfer occurred within one year but before ninety days prior to the petition. After discussing the other two approaches to the problem, the bankruptcy court in Deprizio adopted the two-transfer theory and held the trustee could not recover from Ingersoll Rand.\textsuperscript{77}

IV. THE LEVIT DECISION

In Levit, the Seventh Circuit Court of Appeals began with a discussion of the purpose for a bankruptcy trustee's power to avoid preferences.\textsuperscript{78} The goal in bankruptcy proceedings is to distribute the

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\item \textsuperscript{71} For a thorough discussion of the literal approach, see \textit{In re} Midwestern Cos., Inc., 96 Bankr. 224, 224-25 (Bankr. W.D. Mo. 1988).
\item \textsuperscript{72} \textit{In re} Installation Servs., Inc., 101 Bankr. 282, 286 (Bankr. N.D. Alabama 1989).
\item \textsuperscript{73} Id.
\item \textsuperscript{74} See infra notes 108-11 and accompanying text.
\item \textsuperscript{76} \textit{In re} Mercon Indus., Inc., 37 Bankr. at 552.
\item \textsuperscript{77} \textit{In re} Deprizio, 58 Bankr. at 480-81.
\item \textsuperscript{78} Levit, 874 F.2d at 1194.
\end{itemize}

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available assets equitably. All creditors have a strong incentive to acquire assets of a troubled firm before bankruptcy proceedings begin. By doing so, they may avoid the possibility of receiving less than full value on their debt. The preference sections of the Code seek to prevent this "asset grabbing" and keep the common asset pool intact. Thus, the trustee's avoiding powers serve to discourage asset grabbing in two ways:

[F]irst, they eliminate the benefit of attaching assets out of the ordinary course in the last 90 days before the filing, so that the rush to dismember a firm is not profitable from a creditor's perspective; second, they assure each creditor that if it refrains from acting, the grabbing by any other creditor will be returned to the common pool.

The court then addressed the preference-recovery period issue. Insiders present a special problem for the Code. Insiders will be the first to know that a firm is financially in trouble. Thus, "if insiders and outsiders have the same preference-recovery period, insiders who lent money to the firm could use their knowledge to advantage by paying their own loans preferentially, then putting off filing the petition in bankruptcy until the preference period had passed." Therefore, the Code established a longer preference-recovery period for direct transfers to insiders than for direct transfers to outsiders.

The court recognized, however, that Deprizio did not personally lend money to the debtor. Rather, he personally guaranteed a loan from an outside lender. As a guarantor, Deprizio was personally liable for the debt if the debtor defaulted. Thus, the transfer in *Levit* was not

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79. Id.
80. Id.
81. Id.
82. Id.
83. Id.; see also Jackson, *supra* note 32, at 759. By reaching back to undo the actions of individual creditors, preference law deters such potential grabbing, thereby protecting the creditors' bargain. However, it seems unlikely that the preference law will serve to discourage the so-called "asset grabbing." In reality, creditors are still most likely to zealously protect their interests in a potentially insolvent situation. The penalty for a preferential transfer is that the creditor has to return the asset. The alternative is the risk that the transfer will not be considered preferential or the filing of the petition will be later than one year from the transfer. Under that situation, the creditor would lose the asset to the more aggressive creditor. Thus, it actually seems unlikely that the preference provisions will discourage asset grabbing.
84. *Levit*, 874 F.2d at 1195.
85. Id.
directly to an insider. The transfer was to an outside creditor and for the benefit of an inside guarantor.

The court reasoned that inside guarantors could serve their own interests by inducing the debtor to pay the guaranteed creditors preferentially.\textsuperscript{87} If they could do so prior to ninety days before the filing of the bankruptcy petition, under the majority equitable approach,\textsuperscript{88} they could be benefitted to the detriment of other creditors. Therefore, the court maintained that a one year recovery period for inside guarantors should help prevent last-minute asset grabbing.\textsuperscript{89} The court focused its arguments on the need to deter inside guarantors from benefiting themselves by making preferential transfers to outside creditors and then postponing the bankruptcy petition to take advantage of the ninety day preference-recovery period for outside creditors.

The court then examined the three approaches historically used to establish the preference-recovery period when a transfer benefits both an inside guarantor and an outside creditor. The court first looked at the two-transfer theory. Judge Easterbrook reasoned that the two-transfer theory is not supported by the structure of the Code or the legislative history behind it.\textsuperscript{90} The theory equates "transfer" with "benefit received."\textsuperscript{91} The Code, however, defines a transfer as "[e]very mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property, including retention of title as a security interest and foreclosure of the debtor's equity of redemption."\textsuperscript{92} Thus, a transfer is a "disposition" of property from the debtor's standpoint, not a benefit received from the creditor's perspective.\textsuperscript{93} "A single payment, therefore, is one 'transfer', no matter how many persons gain thereby."\textsuperscript{94} The court concluded that the language of the Code cannot support a two-transfer interpretation.

The court next looked for legislative history to support the two-transfer theory. Judge Easterbrook argued that legislative history did

\textsuperscript{87} Levit, 874 F.2d at 1195.

\textsuperscript{88} See supra notes 63-65 and accompanying text.

\textsuperscript{89} Levit, 874 F.2d at 1195.

\textsuperscript{90} Id. at 1195-97.

\textsuperscript{91} Id. at 1195. The premise is that since both the inside guarantor and the outside creditor receive a benefit, two transfers effectively occur—one to the guarantor and one to the outside creditor. Thus, since there are two benefits, the theory holds that there must be two transfers. One payment is treated as though it is in reality two.


\textsuperscript{93} Levit, 874 F.2d at 1195.

\textsuperscript{94} Id. at 1196.
not discuss the situation.\textsuperscript{95} Ingersoll Rand Financial Corporation had argued that this silence meant Congress intended to preserve the practice under the Bankruptcy Act of 1898 of recovering payments only from those to whom the transfer represented a preference.\textsuperscript{96} The court reasoned that "[i]t is not the law that a statute can have no effects which are not explicitly mentioned in its legislative history."\textsuperscript{97} The court explained that wholesale changes in the preference-recovery structure of the Code meant that the pre-Code practices were not useful to interpret the current Code provisions.\textsuperscript{98} Therefore, the court concluded that the two-transfer approach lacked statutory support.\textsuperscript{99}

The court next looked at the equity approach. Even though Ingersoll Rand Financial Corporation did not make an equity argument for a ninety day recovery period, Judge Easterbrook addressed it because it is the majority approach.\textsuperscript{100} He reasoned that even if equity arguments were admissible,\textsuperscript{101} they would not help.\textsuperscript{102} First, he argued that the free market adjusts regardless of the length of the preference-recovery period. In other words, faced with the possibility of the longer preference-recovery period because of the inside guarantor, creditors will charge slightly higher rates of interest and monitor debtors more closely. The creditors will receive the competitive rate of return in financial markets—the same risk—adjusted rate they would have received with a 90-day preference-recovery period.\textsuperscript{103} "A rule may injure debtors and creditors by foreclosing efficient business arrangements and increasing the rate of interest low-risk borrowers

\begin{footnotes}
\footnotetext{95}{Id.}
\footnotetext{96}{Id.}
\footnotetext{97}{Id. (quoting Pittston Coal Group v. Sebben, 109 S. Ct. 414, 420-21 (1988)).}
\footnotetext{98}{Levit, 874 F.2d at 1197. The court points out that the Code separates the identification of avoidable transfers (§ 547) from the identification of those who must pay (§ 550). Id. This structural change has no antecedents in the 1898 Act. It also creates for the first time the principle that transfers may be recoverable from either transferee or beneficiary. Id. at 1196.}
\footnotetext{99}{Id.}
\footnotetext{100}{Id. at 1198.}
\footnotetext{101}{Judge Easterbrook notes his previous rebuff to "equity arguments." Id. at 1197. Equity arguments must operate within the confines of the Code and cannot be used to rewrite rules that Congress has affirmatively and specifically enacted. Id. Because the Code specifically addresses the issue in the instant case, equity arguments are not appropriate.}
\footnotetext{102}{Id. at 1198.}
\footnotetext{103}{Id. (creditors will receive the competitive rate of return in financial markets—the same risk-adjusted rate they would have received with a ninety-day preference-recovery period).}
\end{footnotes}
must pay, . . . but inefficiency is not inequity. Thus, the extended preference-recovery period is not inequitable because outside creditors can protect themselves from any possible adverse effects.

Judge Easterbrook argued in the alternative that it would be inequitable to refuse to extend the preference-recovery period when an inside guarantor is involved. Without the extended preference-recovery period, an inside guarantor can manipulate the Code to make preferential payments in the face of pending insolvency. Judge Easterbrook concluded that it cannot be inequitable to require the outside creditors to pursue the inside guarantors, when they bargained for exactly that recourse.

The court concluded that the plain language of the Code required an extended preference-recovery period for outside creditors when an inside guarantor was present. The court adopted the reasoning of the district court. The court argued that section 547 establishes the transfer to the outside creditor as an avoidable preference that benefits an inside guarantor. Since the transfer benefits the inside guarantor, the preference-recovery period for the transfer is one year. Then, section 550 authorizes the trustee to recover the preference from either the outside creditor or the inside guarantor. In summary, the court held that "the preference-recovery period for outside creditors is one year when the payment produces a benefit for an inside creditor, including a guarantor."

V. ANALYSIS

A. Literal Interpretation Approach

Judge Easterbrook decided the Levit case based on the literal interpretation approach used by a minority of courts. However, a literal reading of the Code may not require the trustee to use the same
preference-recovery period for the inside guarantor and outside creditor.

In *In re Midwestern Companies, Inc.*,\(^{112}\) decided at almost the same time as *Levit*, the United States District Court for the Western District of Missouri held that the preference-recovery period for all outside creditors is ninety days, even when an inside guarantor is present. The court argued that "[section] 550(a)(1) was not intended to expand the Trustee's right to recover preferences as provided in [section] 547."\(^ {113}\) The court noted that section 547 provides for two different and distinct preference-recovery periods depending on whether the creditor is an insider or an outsider.\(^ {114}\) This distinction would disappear if courts read section 550 to extend the outsider preference-recovery period when an inside guarantor is involved.\(^ {115}\) The court maintained that the time limit distinctions established in section 547 should be applied to section 550. Therefore, the court held that when an inside guarantor is present, the trustee may recover from the guarantor any preferential payments made within one year of the bankruptcy petition or may recover from the outside creditor or insider guarantor any preferential payments made within ninety days.\(^ {116}\) Thus, it is possible that a literal reading of sections 547 and 550 could restrict a trustee to a ninety day preference-recovery period for all outside creditors, even when there is an inside guarantor.

**B. Equity Approach**

The plight of the outside creditor with an inside guarantor may not warrant the use of equitable principles. Easterbrook and others\(^ {117}\) maintain that the outside creditor who gets an inside guarantee is not a helpless victim of the system who needs equitable relief.\(^ {118}\) The


\(^{113}\) Id. at 173 (quoting *In re Cove Patio Corp.*, 19 Bankr. 843, 845 (Bankr. S.D. Fla. 1982)).

\(^{114}\) Id.

\(^{115}\) Id. The court concluded that "there would be no need to distinguish between insiders and non-insiders for purposes of determining avoidability if recovery from insiders and non-insiders alike would occur anyway." Id.

\(^{116}\) Id.

\(^{117}\) *See, e.g.*, Nutovic, supra note 34, at 195-97; Pitts, supra note 31, at 353-56.

\(^{118}\) Brands, supra note 62, at 539. "This conclusion is based on the theory that the lender, by accepting an inside guarantee, has created an 'identity of interest' with the insider... The identity of interest theory holds that because the lender demanded the guaranty in order to profit from the insider's preferential behavior, recovery from the lender is not inequitable." Id.
outside creditor in this situation is not the typical arms-length creditor. In reality, the outside creditor obtains the inside guarantee for the purpose of gaining preferential treatment should the debtor's financial position require discriminating payments. Thus, "[b]y taking the guarantee of insiders, the creditor generally creates pressure on those presumed to be in control of the debtor to afford it preferred treatment." One commentator concluded that "their indirect control of the debtor corporation certainly detracts from the notion that their plight merits special consideration so that the written words of Congress should not, in equity, be applied to them." Thus, if the outside creditor uses the inside guarantor mainly to manipulate potential insolvency, where is the need for equitable protection?

Congressional intent seems to be contrary to any attempt to alter the results of the preference provisions of the Code with the equitable approach. The preference provisions are a mechanical test to be applied without any reference to the knowledge or culpable intent of any party to the transaction. Thus, one commentator concluded that "Congress presumably defined preferences in such a way because it felt that trustees should not be hampered by the difficult task of proving subjective questions of knowledge and intent, and that the importance of this policy outweighed occasional inequities to creditors." Another commentator concluded that it is not the "courts' function to expound bankruptcy policy in a manner wholly divorced from the congressional scheme." Thus, the inside guarantor situation does not present a strong enough case for proper use of equitable powers.

C. Exclusion Protection

In reality other Code provisions mitigate the potential burden to outside creditors from an extended preference-recovery period. The

119. Pitts, supra note 31, at 354. By procuring an insider's guaranty, Bank has fostered an identity of interest between Guarantor and Debtor's other creditors. Id. The outside creditor obtained the inside guarantee because "as a matter of economic and psychological reality, the personal guaranty of an insider may be better security for repayment before bankruptcy than legal interests in a debtor's property." Id.

120. Id.

121. Nutovic, supra note 34, at 195-96.

122. Id. at 196.

123. Id.

124. Id. at 197.

125. Pitts, supra note 31, at 361.

126. Nutovic, supra note 34, at 199.
Code contains provisions to protect most good-faith arms-length transactions from the effects of the preference law. These provisions exclude specific types of transfers from the trustee's avoidance powers. Judge Easterbrook argued that these protections "exclude from recovery the bulk of ordinary commercial payments." 127

First of all, section 547(b)(3) requires that the transfer be made while the debtor is insolvent. 128 Therefore, if the transfer did not occur when the debtor was insolvent, the trustee may not avoid it. In addition, section 547(b)(5) requires that the payment be more than the creditor would receive in bankruptcy. 129 Thus, the preferential transfer must exceed the amount the creditor would have received if the payment had come through a bankruptcy proceeding.

Section 547(c) 130 limits the trustee as to payments that may be

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127. Levit, 874 F.2d at 1199.
129. Id. § 547(b)(5).
130. Id. § 547(c). Section 547(c) provides in part:
The trustee may not avoid under this section a transfer-
(1) to the extent that such transfer was-
   (A) intended by the debtor and the creditor to or for whose
   benefit such transfer was made to be a contemporaneous
   exchange for new value given to the debtor; and
   (B) in fact a substantially contemporaneous exchange;
(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;
(3) that creates a security interest in property acquired by the
   debtor-
   (A) to the extent such security interest secures new value
   [in the nature of a purchase-money security interest]
   . . . .
(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 avoidable 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;
(5) that creates a perfected security interest in inventory or a
   receivable or the proceeds of either, except to the extent that the
   aggregate of all such transfers to the transferee caused a reduc-
avoided. For instance, the trustee may not avoid payments made in the normal course of conducting business between the parties.\textsuperscript{131} This "ordinary course" exclusion covers all transactions between the parties that are typical periodic financing arrangements.\textsuperscript{132} Furthermore, section 547(c) excludes fully secured creditors from the reach of the preference law.\textsuperscript{133} Thus, fully secured creditors are not subject to the preference-recovery period even if they have insider guarantors.\textsuperscript{134}

These section 547 exclusions are consistent with the intent of the Code to avoid only preferential payments. Thus:

The creditor is only worse off in one particular instance—when (i) receiving a payment between ninety days and one year prior to the filing of the debtor's petition, which is a preference to the insider-guarantor, and (ii) when the insider-guarantor is unable to respond to a judgment for the amount sought in the preference action.\textsuperscript{135}

Because of these limits on the trustee's avoidance powers, extending the preference-recovery period to one year for outside creditors when there is an insider guarantor would probably not change lender

\textsuperscript{131} U.S.C. § 547(c)(2) (1988). For instance, ordinary financing arrangements are covered by this "ordinary course" exclusion. \textit{Levit}, 874 F.2d at 1200. Also, when a creditor makes an unsecured loan guaranteed by an insider and requiring monthly payments over a number of years, this is covered by the ordinary course exclusion to the extent the debtor paid on time. \textit{Id.}

\textsuperscript{132} Nutovic, \textit{supra} note 34, at 196. "Because regular payments generally will be protected by the 'ordinary course' exception discussed in the first part of this article, it is only the unusual payments that will be subject to avoidance." \textit{Id.}

\textsuperscript{133} U.S.C. § 547(c)(3) (1988).

\textsuperscript{134} Judge Easterbrook explained that if a creditor is fully secured, then the "payment does not produce a benefit for the inside guarantor, whose exposure was zero." \textit{Levit}, 874 F.2d at 1199.

\textsuperscript{135} Nutovic, \textit{supra} note 34, at 197.
practices to any great degree.\textsuperscript{136} "Creditors will continue to take insider guarantees where the guarantor has meaningful assets."\textsuperscript{137} If the creditor is fully secured, the payments will be unaffected by the Code. Otherwise, the creditor could sue the guarantor on the assets just as if there were no insolvency problems. Thus, one commentator concluded that even if the preference-recovery period is extended to one year when an inside guarantor is present:

[C]reditors will forego obtaining an insider's guarantee only when the guarantor's assets are insufficient to back up the guaranteed debt and the reason for requesting the guarantee is merely to exert pressure on the insider. Discouraging guarantees taken for their control valve is desirable because it would promote "the essential purpose of the insider preference provision."\textsuperscript{138}

\textbf{D. Waiver of Indemnification}

The inside guarantor can remove the possibility of the one year preference-recovery period by refusing to be a "creditor." As discussed above, the guarantor is a creditor because of a contingent right to payment from the debtor. This contingent right qualifies the guarantor as a creditor and subjects the guarantor to the preference laws. Thus, if the guarantor waives all rights of indemnification from the debtor, the guarantor is no longer a contingent creditor and is therefore not subject to the trustee's avoidance powers.\textsuperscript{139} The outside creditor can control the situation by requiring the guarantor to expressly waive any right to indemnification from the debtor.\textsuperscript{140} Thus, this simple drafting

\begin{itemize}
\item \textsuperscript{136} "[I]t is unlikely that this will discourage lenders from extending credit."
\textit{Id.}
\item \textsuperscript{137} Id.
\item \textsuperscript{138} Id.
\item \textsuperscript{139} One commentator stated:
\begin{itemize}
\item Other protection that § 547 affords to the "creditor" are that she may know herself to be safe from preference attacks if she is not an insider and the transfer took place outside of the 90-day reach-back period, if she can claim the protection of one of the exceptions of § 547(c), or if she no longer is a "creditor" of the debtor. The last protection may be manipulated in the insider-guarantor situation: the insider can expressly waive all the rights she has as a guarantor of indemnification from the debtor. Through the simple expedient, the insider no longer qualifies as a "creditor" under §§ 547(b)(1) and 101(a).
\end{itemize}
\item \textsuperscript{140} Nutovic, supra note 34, at 197. Nutovic stated:
\begin{itemize}
\item Attorneys familiar with the preference laws are insisting on provisions in a guarantee that extend the guarantor's liability to any payments
\end{itemize}
\end{itemize}
technique allows the parties some protection from any harshness of an extended preference-recovery period.

VI. CONCLUSION

The inside guarantor presents a difficult situation for the bankruptcy preference laws.\textsuperscript{141} It is fairly apparent that inside guarantors can manipulate an insolvency situation by making preferential payments to outside creditors to reduce their exposure in the face of bankruptcy.\textsuperscript{142} The one year preference-recovery period for them is very appropriate. The real problem is the innocence of the outside creditor. How much control does the outsider have over the actions of the guarantor? Why should an outside creditor be adversely affected because of the manipulative activities of an inside guarantor?\textsuperscript{143} In

\begin{center}
\text{made by the primary obligor subsequently recovered by a trustee.}
\text{Thus, if recovery is initially sought from the transferee, the transferee should have little difficulty in recovering from the guarantor.}
\end{center}

\textit{Id.}

\textsuperscript{141} Perhaps the best indication of the divided positions on this issue appears in two recent cases. On May 26, 1989, in \textit{In re Installation Services, Inc.}, 101 Bankr. 282 (Bankr. N.D. Ala. 1989), the United States Bankruptcy Court for the Northern District of Alabama, Southern Division, adopted the literal interpretation and allowed recovery from an outside creditor of a payment made between ninety days and one year from the bankruptcy petition because the creditor had an inside guarantor. However, on April 18, 1989, in \textit{In re Midwestern Companies, Inc.}, 102 Bankr. 169, 173 (Bankr. W.D. Mo. 1989), the United States District Court for the Western District of Missouri, held that a literal interpretation of the preference laws required a one-year preference-recovery period for outsider creditors, regardless of whether the creditor had an inside guarantor.

\textsuperscript{142} One commentator stated:

\begin{quote}
[Insiders] typically have a significant amount of control over the operations of the debtor. \ldots\ When the debtor's demise is imminent, the insiders who guaranteed the debtor's loan frequently hold enough sway with the debtor to cause it to pay off these guaranteed loans prior to the payment of other obligations. Consequently, the insiders have diverted the debtor [sic] resources to protect themselves.
\end{quote}

Nutovic, \textit{supra} note 34, at 195.

\textsuperscript{143} The minority of courts that have dealt with the issue have interpreted the Code's preference provisions as requiring that an outside creditor be subject to a one-year preference-recovery period if the creditor has an inside guarantee on the debt. \textit{Levit}, 874 F.2d at 1185; \textit{see also In re Deprizio}, 86 Bankr. at 552. This seems consistent with the Code's intent to discourage preferential payments by insiders in anticipation of bankruptcy. Jackson, \textit{supra} note 32, at 769; \textit{see also} Nutovic, \textit{supra} note 34, at 186. However, even though it serves to discourage the preferential actions of the inside guarantor, it is arguable that
Levit, the court held that the outside creditor very much controls the preferential payment and as such should be subjected to the insider one year preference-recovery period.

The courts seem to be struggling with policy issues because the Code is ambiguous concerning initial transferees in indirect preferences. However, policy arguments aside, the approach most true to the Code should maintain the preference-recovery distinction between inside and outside creditors that is found in section 547 of the Code.\(^{144}\) It does not seem to be a requirement of a literal interpretation of the Code to extend the preference-recovery period for outside creditors when there is an inside guarantor. Section 550(a) does not require the same preference-recovery period for inside guarantors and outside creditors. If a transfer is determined to be preferential under section 547, the trustee could recover from either the inside guarantor or the outside creditor if it was made within ninety days before the bankruptcy petition and from the inside guarantor alone if it was made between one year and ninety days before the petition.

This approach would negate the necessity of using equitable arguments to prevent a guaranteed debt from being in a worse bankruptcy position than a non-guaranteed debt. There is no need to extend the preference-recovery period to discourage asset grabbing because it is not likely that the preference reachback periods have any effect on an unsecured creditor’s desire to protect its position in light of a financially troubled debtor. The trustee could sue the inside guarantor on the preference transfer just as could the outside creditor. Thus, the inside guarantor has the same risk with regard to preferential transfers.

In the case of indirect preferences, the Code is not clear as to the length of the recovery period for the outside creditor. Thus, various interpretations have developed from equally competent and reasoned the extended preference-recovery period is unfair to the arms-length outside creditor. Therefore, based on equitable principles, the majority has refused to extend the ninety day preference-recovery period for outside creditors. Levit, 874 F.2d at 1189; see also In re Deprizio, 86 Bankr. at 552.

144. Section 547(b) expressly creates two different preference-recovery periods. See 11 U.S.C. § 547(b) (1988). This is even more significant because the distinction did not exist in the pre-Code bankruptcy laws. However, Judge Easterbrook’s well-reasoned opinion in Levit is a strong argument for extending the preference-recovery period. The main issue seems to be the possible deterrent effect of extending the preference-recovery period. If the inside guarantor indeed has an advantage, then a stronger case exists for extending the preference-recovery period when an inside guarantor is involved. However, if the preference-recovery law does not really affect the decisions of the inside guarantor, it would seem best to preserve the ninety day preference-recovery period for all outside creditors.
groups. Currently, policy arguments dominate the attempts to establish a recovery period for the indirect preferences. Either Congress or the United States Supreme Court must resolve this issue. Until then, lenders should continue to use established lending practices. "As with most other instances of enhanced exposure for lenders under the Code, the optimum advice may be to be aware of the risk, to compensate for it in other ways, but not to change basic business practices if those practices continue to make sense."145 Lenders should be aware that payments which qualify as preferences may potentially be avoided if there is an inside guarantor and the payment is received within one year before a petition in bankruptcy. Therefore, it may be the best approach for guarantors to draft the guarantor agreement such that the guarantor waives any rights to indemnity from the debtor. This would remove the inside guarantor from creditor status and prevent any possibility of extending the preference-recovery period to one year.

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145. Pitts, supra note 31, at 361.