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ESSAY

CLEARER CONCEPTIONS OF INSIDER PREFERENCES

PETER A. ALCES*

It is axiomatic in the general debtor-creditor law that an impecunious debtor may pay her creditors in the order she chooses, preferring some over others with impunity. It is axiomatic in the bankruptcy law, however, that a creditor accepts a preference at its peril: if the bankruptcy trustee¹ establishes that an insolvent debtor has paid the creditor during the "preference period," the trustee may recover that payment and leave the creditor with a claim against the property of the bankruptcy estate.² Although the normative bases of the preference law are vague,³ it is clear that if the debtor is insolvent, a payment to one creditor in anticipation of bankruptcy reduces the payment that other creditors will realize in the bankruptcy distribution of assets.⁴

The creditor in a position to exact a preference may impose pressure on the debtor, or the principals of the debtor, that is inimical to the interests

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1. In a Chapter 11 "Reorganization," a "debtor-in-possession" may be the representative of the debtor if a trustee has not qualified under Bankruptcy Code section 322. See 11 U.S.C. § 1101(1) (1988).

2. Succinctly, the trustee may recover as a preference any transfer to or for the benefit of a creditor, on account of an antecedent debt, made within ninety days of bankruptcy (or within one year if the creditor is an insider), that enables the transferee to receive more than she would have received in a liquidation of the debtor's assets. See 11 U.S.C. § 547 (1988).

3. See generally Vern Countryman, *The Concept of a Voidable Preference in Bankruptcy*, 38 VAND. L. REV. 713, 747-49 (1985).

4. If a debtor has five creditors, each of whom is owed \$100, and total assets of only \$250, each creditor would receive \$50 in the debtor's bankruptcy. A payment of even \$50 to one creditor within ninety days of bankruptcy will result in a preference because that creditor would assert the remaining \$50 claim in the debtor's bankruptcy and, were the first transfer not avoidable, receive an additional distribution when the other creditors receive their distribution from the remaining \$200 in assets.

of the debtor and its other creditors.⁵ The debtor forced to prefer one creditor over another may compromise the debtor's financial position in ways that impair the financial well-being of the debtor. It may be that had the debtor not preferred one creditor over others, the debtor would have been free to utilize its assets in a way that would enhance the value of the debtor, rather than just the value of the manipulative creditor's interest in the debtor.

To the extent, then, that the preference law is designed to avoid conduct that may impair the financial integrity of troubled businesses, it sensibly distinguishes some preferential payments from others.⁶ Not all payments that are preferential are inimical to the interests of the debtor and the debtor's other creditors. The Bankruptcy Code (Code) provides for the avoidance of transfers that benefit an insider,⁷ someone in the position to control or manipulate the debtor, even if the same transfer would not have been avoidable had it benefitted a creditor not in the position to manipulate. The trustee in bankruptcy is not required to establish actual manipulation in fact.

Because it is not feasible to determine the bona or mala fides of all preferential transferees before deciding whether to subject transactions between them and the debtor to heightened scrutiny,⁸ the Code's preference provision relies on an ostensibly certain proscription: transfers that benefit insider⁹-creditors made by an insolvent¹⁰ debtor within one-year

5. Because no real sanction exists for taking a preference, beyond return of the preferential transfer, creditors are generally well-advised to take the preference and then wait to see whether the trustee will try to recover it. Even if the trustee does bring a preference action, the trustee will have the burden of establishing the elements of a preference before the transfer can be avoided. "For the purposes of this section, the trustee has the burden of proving the avoidability of a transfer under subsection (b) of this section" 11 U.S.C. § 547(g) (1988).

6. The exceptions of subsection 547(c) also serve to distinguish some pre-bankruptcy transfers from others by excepting certain transactions from avoidance to the extent that they are consistent with generally recognized commercial purposes and expectations. See 11 U.S.C. § 547(c) (1988).

7. "An insider is one who has a sufficiently close relationship with the debtor that his conduct is made subject to closer scrutiny than those dealing at arms [sic] length with the debtor." S. REP. NO. 989, 95th Cong., 2d Sess. 1 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5810.

8. The "badges of fraud" developed in the fraudulent conveyance law as a response to the cost (and uncertainty) of determining actual fraudulent intent. The development of the constructive fraud bases of fraudulent conveyance avoidance further refined the badges of fraud to eliminate determinations of intent. See generally PETER A. ALCES, THE LAW OF FRAUDULENT TRANSACTIONS ¶ 5.01[2] (1989) [hereinafter ALCES, FRAUDULENT TRANSACTIONS] and Peter A. Alces & Luther M. Dorr, Jr., *A Critical Analysis of the New Uniform Fraudulent Transfer Act*, 1985 U. ILL. L. REV. 527.

9. See 11 U.S.C. § 101(31) (Supp. IV 1992), which defines "insider." The definition is illustrative rather than exhaustive insofar as it begins with the modifier "includes." "In [11 U.S.C.]—'includes' and 'including' are not limiting." 11 U.S.C. § 102(3) (1988). See also *supra* note 7.

prior to bankruptcy¹¹ are avoidable to the extent that they are preferential.¹²

If *ABC* Co. makes a preferential transfer to its president, Jane Roe, an insider,¹³ within ninety days of bankruptcy, the trustee may recover that transfer as a section 547 preference. Indeed, that would be the case whether or not Roe was president of *ABC*. If the same transfer were made to Roe six months prior to bankruptcy, however, the trustee might be able to recover it from Roe even though the trustee could not recover a transfer in the same amount from an ordinary, non-insider, trade creditor of *ABC*.¹⁴ Curiously, though, if *ABC* makes a transfer to Roe who is president of the company, but who is not a creditor of *ABC* and holds no claim against the company, the trustee would not be able to recover the amount of the transfer on a preference theory.¹⁵ Creditor status has nothing to do with control, but is determinative of the insider's preference exposure.

The reason supporting enhanced scrutiny of relations between a debtor and its insiders is the persistent concern that those in a position to manipulate the debtor at the expense of those not so positioned are more likely to manipulate. And perhaps, just perhaps, we do not care whether the insider actually manipulated the debtor; it is enough that the insider was in the position to do so. It may be sufficient, to our equitable sense, to conclude that when a business is failing, those who managed it into that condition are subordinated to those not so postured. This conclusion is entirely consistent with the general bankruptcy distribution scheme: pay

10. Though the debtor is presumed to have been insolvent for the ninety days preceding bankruptcy, no such presumption exists in the case of transfers to an insider made more than ninety days but less than one year prior to bankruptcy. 11 U.S.C. § 547(f) (1988).

11. "[T]he trustee may avoid any transfer of an interest of the debtor in property . . . made . . . between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider." 11 U.S.C. § 547(b)(4)(B) (1988).

12. That is, transfers are avoidable as preferences to the extent that they enable the transferee to receive more than the transferee would have received in a Chapter 7 liquidation of the debtor's assets. 11 U.S.C. § 547(b)(5) (1988).

13. As president of the debtor, Roe would be an insider according to the terms of subsection 101(31)(B)(ii), "officer of the debtor." 11 U.S.C. § 101(31)(B)(ii) (Supp. IV 1992).

14. That would be the case even if the transfer to the trade creditor benefitted the trade creditor more than the transfer to Roe benefitted Roe. For example, if *ABC* Co. owed Roe \$100 and *GEF* Supply Co., a trade creditor, \$500, a transfer of \$500 to *GEF* Supply Co. would not be avoidable, but a transfer of only \$100 (or, for that matter, \$1) to Roe would be avoidable.

15. Such a transfer might, however, be avoidable as a fraudulent transfer under section 548 of the Code. See 11 U.S.C. § 548 (1988); see also Robert C. Clark, *The Duties of the Corporate Debtor to Its Creditors*, 90 HARV. L. REV. 505, 513 (1977) (surveying the complementary nature of the trustee's avoiding powers).

creditors before owners.¹⁶

From the foregoing premises, how should the preference law treat a transfer made more than ninety days but less than one-year before the debtor-corporation's bankruptcy that is not made directly to the insider but, instead, *benefits* the insider? Consider the case of a loan made by Bank to *ABC Co.* that is guaranteed by Jane Roe, the president of *ABC*. When the financial fortunes of *ABC* begin to flounder, a circumstance of which Bank is well aware because Bank maintains the accounts of *ABC* and periodically requires an audit of *ABC's* finances, Roe realizes that she will be liable for the debt of *ABC* to Bank if *ABC* fails to pay Bank. More potentially alarming, Roe's guaranty of the *ABC* indebtedness is secured by a mortgage on Roe's personal residence, not an atypical arrangement. Thus, if *ABC* fails to pay Bank, Bank will proceed against Roe, perhaps foreclosing its mortgage on Roe's residence to the disappointment of Roe and her family.

Certainly, one reason that Bank required Roe's guaranty and the mortgage on Roe's residence to secure her performance of the guaranty was to ensure that Roe, an insider of *ABC*, took very seriously the indebtedness of *ABC* to Bank, as seriously as any "homeowner" would take the mortgage on her own home. Bank is aware that an individual is likely to pay the mortgagee or landlord before paying his or her Book-of-the-Month Club obligations. Given the limited liability realities of the corporate form, absent the secured guaranty, an individual might be less concerned about the liabilities of the corporation than about personal obligations. So, the secured guaranty agreement is a way for lenders to circumvent the realities of limited liability provided by the corporate form. It is a means available to larger lenders but seldom available to general trade creditors. When the financial fortunes of *ABC* dim, Bank may remind Roe of Bank's ability to put her out of house and home if Bank is left holding an unsecured (or undersecured) claim in *ABC's* bankruptcy.¹⁷ Bank will be in the position

16. The "absolute priority" rule of Code Chapter 11, "Reorganizations," requires that a reorganization plan provide for the full payment of creditors before any distribution may be made to owners of the corporate debtor. 11 U.S.C. § 1129(b)(2)(B)(ii) (1988).

17. A transfer is avoidable as a preference only *to the extent* that it enables the transferee to receive more than the transferee would have received in a Chapter 7 liquidation of the debtor's assets. Thus, if a fully secured creditor receives a transfer within the ninety days prior to bankruptcy, no part of that transfer will be avoidable as a preference. See *In re Arcadia Elec. Serv., Inc.*, 66 B.R. 164 (Bankr. W.D. La. 1986); *Braunstein v. Eastern Airlines Employees Fed. Credit Union (In re Fitzgerald)*, 49 B.R. 62 (Bankr. E.D. Mass. 1985); *Gilbert v. Gem City Sav. Ass'n (In re Hale)*, 15 B.R. 565 (Bankr. S.D. Ohio 1981). If an undersecured creditor receives a transfer within the preference period, that transfer may be avoidable *to the extent* that the transfer reduces the difference between the value of the collateral security and the outstanding indebtedness, the deficiency. See 11 U.S.C. § 547(b)(5) (1988).

to bring to bear the pressure that an insider can assert against *ABC* because Bank controls the person who controls *ABC*.

Enter *Levit v. Ingersoll Rand Financial Corp.*¹⁸ Writing for a panel of the United States Court of Appeals for the Seventh Circuit, Judge Frank Easterbrook confronted an issue that had confounded the lower courts in the Seventh and the other circuits:¹⁹ whether a trustee in bankruptcy can recover a preferential transfer made to a lender that benefitted an insider of the debtor who had guaranteed the indebtedness and as a consequence of the payment to the lender had its exposure on the guaranty reduced or eliminated. Counsel for creditors argued that the transferee, the lender, was not itself an insider.²⁰ Thus, the fact that the transfer benefitted the lender

This preference element codifies the United States Supreme Court's decision in *Palmer Clay Prods. Co. v. Brown*, 297 U.S. 227 (1936).

An interesting issue, not considered in this Essay, is whether the *entire* transfer would be avoidable given the language of section 547, or whether *only* that portion of the transfer that enables the transferee to receive more than she would have in a Chapter 7 liquidation is avoidable. In the event that a court reads the statutory language strictly, and avoids all of the transfer, leaving the transferee to assert a claim in the bankruptcy proceeding for the full amount of its claim (the recovered preference as well as the recovered non-preferential portion of the transfer), Professor Westbrook's focus on "benefit" rather than "transfer" would be further undermined. See *infra* part IV. I am indebted to Dean Daniel Keating for drawing this important question to my attention.

18. 874 F.2d 1186 (7th Cir. 1989).

19. For a survey of the pre-*Levit* case law concerning recovery of insider preferences from a non-insider transferee, see *ALCBS, FRAUDULENT TRANSACTIONS*, *supra* note 8, at ¶ 6.02[2][a]. For cases that allow recovery from non-insider creditors, see, e.g., *Lowrey v. UPG, Inc.* (*In re Robinson Bros. Drilling, Inc.*), 877 F.2d 32 (10th Cir. 1989); *Billings v. Zions First Nat'l Bank* (*In re Granada, Inc.*), 110 B.R. 548 (Bankr. D. Utah 1990); *McColley v. Navaro Gem Ltd.* (*In re Candor Diamond Corp.*), 68 B.R. 588, 592 (Bankr. S.D.N.Y. 1986); *In re Arcadia Elec. Serv., Inc.*, 66 B.R. 164, 166-67 (Bankr. W.D. La. 1986); *Herman Cantor Corp. v. Central Fidelity Bank* (*In re Herman Cantor Corp.*), 15 B.R. 747 (Bankr. E.D. Va. 1981).

For cases that have not sanctioned recovery against the non-insider creditor, see, e.g., *T.B. Westex Foods, Inc. v. Federal Deposit Ins. Corp.* (*In re T.B. Westex Foods, Inc.*), 950 F.2d 1187 (5th Cir. 1992); *Covey v. Northwest Community Bank* (*In re Helen Gallagher Enters.*), 126 B.R. 997 (Bankr. C.D. Ill. 1991); *Baumgart v. Hobart Corp.* (*In re Freewerth Enters.*), 125 B.R. 505 (Bankr. N.D. Ohio 1991); *In re Installation Servs., Inc.*, 101 B.R. 282 (Bankr. N.D. Ala. 1989); *Coastal Petroleum Corp. v. Union Bank & Trust Co.* (*In re Coastal Petroleum Corp.*), 91 B.R. 35 (Bankr. N.D. Ohio 1988).

20. According to the "two-transfer" approach, each payment to a lender on account of a debt guaranteed by an insider creates two transfers, one to the lender and the other to the insider-guarantor. "Section 550(a) allows recovery only 'to the extent that a transfer is avoided' under § 547, and the two-transfer approach implies that the transfer to Lender has not been 'avoided' at all." *Levit*, 874 F.2d at 1195.

In *Goldberger v. Davis Jay Corrugated Box Corp.* (*In re Mercon Industries, Inc.*), 37 B.R. 549 (Bankr. E.D. Pa. 1984), a case applying the two-transfer approach to insulate the non-insider transferee, Judge Goldhaber reasoned:

As applied to the case before us, the single transfer of funds to Goldman effected two transfers under the Code, due to the secondary liability of the guarantors. One transfer was

should not be sufficient to support recovery from the lender.

Judge Easterbrook saw the issue differently and I believe more clearly. For Judge Easterbrook, resolution of the issue required no more than a straightforward application of Code sections 547 and 550. Under section 547 the preferential transfer benefitted an insider, a creditor of the debtor, by virtue of the common-law reimbursement right of all guarantors.²¹ Section 550 provides for the recovery of such transfers from “the initial transferee [Bank] of such transfer or the entity for whose benefit such transfer was made [Roe].”²² That is, the trustee could recover the amount of the transfer from either the lender, the initial transferee, or the insider, the “entity” benefitted by the transfer. The lender, in turn, if the trustee recovered the preference from the lender, could proceed against the insider-guarantor according to the terms of the guaranty.

Judge Easterbrook was careful to point out, however, that not all transfers to lenders who had taken an insider’s guaranty would be avoidable as preferences: only those that were not insulated by the exceptions of section 547(c).²³ For present purposes, foremost among those is the subsection (c)(2) “ordinary course” exception, which provides that transfers on account of an antecedent debt are not avoidable if they are made:

(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;

• • • •

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

(D) according to ordinary business terms.²⁴

from the debtor to Goldman in satisfaction of the primary indebtedness. The other was the transfer to the guarantors in satisfaction of their contingent liability. Although the second transfer is not evinced by the passage of anything other than the transfer of funds to Goldman, the effect of the transfer is manifest in the satisfaction of the guarantors [sic] contingent liability. Since the Code dictates that there are two transfers rather than one, liability of the guarantors under § 547(b) need not be predicated on a finding of an avoidable transfer to Goldman, since a finding of liability on one transfer is independent of the other, rather than derivative.

37 B.R. 549, 552 (Bankr. E.D. Pa. 1984) (footnote omitted). See also *In re Aerco Metals, Inc.*, 60 B.R. 77, 82 (Bankr. N.D. Tex. 1985) (citing *Mercon* to support finding in favor of non-insider transferee).

21. See RESTATEMENT (THIRD) OF SURETYSHIP § 14 (Tent. Draft No. 1, 1992) and RESTATEMENT OF SECURITY § 104 (1941). See also JOHN HANNA, CASES AND MATERIALS ON SECURITY 378-82 (2d ed. 1940); LAURENCE P. SIMPSON, HANDBOOK ON THE LAW OF SURETYSHIP 165-264 (1950); ARTHUR A. STEARNS, THE LAW OF SURETYSHIP 439-528 (5th ed. 1951) (surveying the cases that have recognized the reimbursement right).

22. 11 U.S.C. § 550(a)(1) (1988).

23. See 11 U.S.C. § 547(c) (1988).

24. 11 U.S.C. § 547(c)(2) (1988).

Therefore, so long as the lender accepts ordinary course payments within one year preceding bankruptcy, the trustee will be unable to recover these payments. Insofar as the United States Supreme Court has, post-*Levit*, determined that regularly scheduled payments on long-term debt are payments in the ordinary course for purposes of section 547(c)(2),²⁵ the lender taking such ordinary course payments has nothing to fear of *Levit* avoidance.

Counsel for lenders were nevertheless aghast at the *Levit* result and have gone to some lengths to describe their outrage in various law journals.²⁶ In the midst of the falling sky, Professor Jay Westbrook offered a qualified defense of *Levit*.²⁷ His defense was provocative, but seriously flawed. I wrote a Response to the Westbrook Article (Article) which identified deficiencies in his analysis and suggested that a much better case could be made for *Levit*.²⁸ Westbrook then wrote a passionate Reply that was sharply critical of my Response.²⁹ This essay-rejoinder will put *Levit*, the Westbrook/Alces differences, and the consequences of our differences in perspective.

I. CONTOURS OF THE CONTROVERSY

Levit sanctions recovery from a lender that has benefitted at the expense of the debtor's other creditors by utilizing *control* obtained through the lender's having taken an insider's personal guaranty of the debtor's obligation to the lender. Westbrook argued that the rule of *Levit* works because it effectively, albeit serendipitously, distinguishes some guaranties (and guarantors) from other guaranties (and guarantors).³⁰ In addition, Westbrook contended that the limit imposed on *Levit* by the section 547

25. See *Union Bank v. Wolas*, 112 S. Ct. 527 (1991). Judge Easterbrook anticipated the *Wolas* holding: "To the extent the debtor paid on time, the creditor is protected by the current version of § 547(c)(2), the 'ordinary course' rule." *Levit*, 874 F.2d at 1200.

26. See, e.g., Donald W. Baker, *Repayments of Loans Guaranteed by Insiders as Avoidable Preferences in Bankruptcy: Deprizio and Its Aftermath*, 23 U.C.C. L.J. 115 (1990); John Stephen Cullina, Comment, *Recharacterizing Insider Preferences as Fraudulent Conveyances: A Different View of Levit v. Ingersoll Rand*, 77 VA. L. REV. 149 (1991); Andrew J. Nussbaum, Note, *Insider Preferences and the Problem of Self-Dealing Under the Bankruptcy Code*, 57 U. CHI. L. REV. 603 (1990).

27. Jay Lawrence Westbrook, *Two Thoughts About Insider Preferences*, 76 MINN. L. REV. 73 (1991) [hereinafter *Article*].

28. Peter A. Alces, *Rethinking Professor Westbrook's Two Thoughts About Insider Preferences*, 77 MINN. L. REV. 605 (1993) [hereinafter *Response*].

29. Jay Lawrence Westbrook, *Clear Thinking About Insider Preferences: A Reply*, 77 MINN. L. REV. 1393 (1993) [hereinafter *Reply*].

30. *Article*, *supra* note 27, at 80.

“creditor” requirement is logical, or at least operates as though it were.³¹

The two types of guaranties described by Westbrook are the “true” guaranty and the “pure leverage” guaranty.³²

A true guarantor is one who gives personal security (for example, stocks and bonds) to support the guaranty or one who is financially able to respond to a judgment on the guaranty (for example, a person with other substantial business interests). By contrast, a leverage guarantor is one who puts up no security for the guaranty and is unlikely to be able to pay any judgment on the guaranty.³³

According to Westbrook, a lender would not be inclined to take the leverage guaranty after *Levit* because doing so would only extend the preference period from ninety days to one year without affording the lender the financial protection provided by the true guaranty.³⁴

My Response to Westbrook demonstrated that, where preference law is concerned, it is facile to understand the incentives that operate on a lender only in terms of the financial condition of the guarantor *at the time that the guarantor executes the guaranty* in favor of the lender. The financial condition of the guarantor may either improve or deteriorate between the time the guaranty is executed and the time the lender would want to impose pressure on the guarantor to cause the debtor to prefer the lender over the debtor’s other creditors.³⁵

Even more curious, however, is Westbrook’s conclusion—without any citation of empirical support³⁶—that the impecunious insider, the insider who granted a leverage guaranty, would be more inclined to succumb to the lender’s pressure to effect the type of preference avoidable per *Levit*.³⁷ My Response demonstrated that there was no reason to believe that the

31. *Id.* at 86-98.

32. “Insider guarantees may be divided into two categories: true guarantees and pure-leverage guarantees.” *Id.* at 80.

33. *Reply, supra* note 29, at 1395 (citing *Article, supra* note 27, at 80).

34. Westbrook states:

But after *Levit* an insider guaranty that offers only leverage over the company is probably a net detriment because of its effect in extending the preference period without providing additional wealth to back the loan. Thus, smart loan officers will read *Levit* to mean that they should continue to get true guaranties, but should be less eager about pure-leverage guaranties.

Reply, supra note 29, at 1396; *Article, supra* note 27, at 80-86.

35. *Response, supra*, note 28, at 621-23.

36. *See Reply, supra* note 29, at 1404 n.58.

37. “[I]t seems quite plausible that the pure-leverage guarantor will have more reason to react to lender pressure by preferential payment rather than by risking all on the success of the business.” *Article, supra* note 27, at 84.

pure-leverage guarantor would be any more predisposed to prefer the lender than a true guarantor; indeed, I established that there was good reason to believe that the true, solvent guarantor, with more to lose than the insolvent guarantor, would be more inclined to succumb to the lender's pressure.³⁸

The second portion of Westbrook's Article was devoted to a defense of the "creditor" requirement. Recall that given the formulation of Code sections 547 and 550, a transfer is only avoidable as a preference if it is made to or for the benefit of a creditor of the debtor. If the insider is a guarantor of the debtor's obligation to the lender, the insider would be a creditor of the debtor because upon the insider's payment of the guaranteed indebtedness, the guarantor would have a right to reimbursement from the debtor.³⁹ Of course, if the insider-guarantor were to waive that right to reimbursement, creditor status might be denied and the transfer to the lender would then not have been for the benefit of a *creditor* and thus not avoidable as a preference.

Westbrook concluded that the creditor requirement is worthwhile because it provides a nice limitation on the scope of preference avoidance. Westbrook argued that boilerplate waivers of the right to reimbursement should not be enforceable.⁴⁰ However, he determined that benefit to a non-guarantor insider, an insider who is not a creditor of the debtor, should not provide the basis for preference avoidance, even in cases in which a lender had imposed pressure on the insider to exact a preferential payment. Westbrook concluded that other bankruptcy policing mechanisms provide the basis to avoid the consequences of pressure that results in such indirect benefit to an insider.⁴¹

38. *Response*, *supra* note 28, at 616-21.

39. *See supra* note 22 and accompanying text.

40. Westbrook asserts that an important policy statement in his Article was that "attempted waivers of *Levit* should not be enforced." *Reply*, *supra* note 29, at 1395; *see also Article*, *supra* note 27, at 88 ("The most straightforward response to this concern would be to hold such waivers void for preference purposes.").

41. "I suggested that the [creditor] requirement provides a constraint that roughly divides control of insider abuse through the preference power from more general abuse-control doctrines like fiduciary duty, fraudulent conveyance, and equitable subordination." *Reply*, *supra* note 29, at 1399. Westbrook also stated:

The creditor requirement distinguishes the example from the insider-guarantee case, notwithstanding the fact that both involve the same bankruptcy policy. That result is appropriate because the insider abuse in this example presents a marginal, idiosyncratic case that is ill-suited to the application of the more formulaic preference rules. This sort of insider abuse requires a more case-specific rule. In this instance, state law self-dealing doctrines are the obvious choice. On other facts, the actual-intent fraudulent conveyance doctrine may be a more useful approach.

Article, *supra* note 27, at 94.

My Response took issue with Westbrook's defense of the creditor requirement. Westbrook distinguished between the direct benefit realized by an insider-guarantor who is a creditor of the debtor by virtue of the reimbursement right and the indirect benefit realized by an insider who was not a creditor, either because she was not a guarantor or because she had waived the right to reimbursement.⁴² He supported that distinction by opining that the value of the benefit realized by the insider would be the measure of the avoidable preference and it would be too difficult to accurately value that indirect benefit in terms that would accommodate application of the preference law.⁴³ My Response demonstrated that nothing in the preferential transfer provisions of the Code contemplates avoidance based on the benefit realized by the transferee; the focus is, instead, on the amount of the *transfer*.⁴⁴

In sum, I believe the *Levit* case is sound, but not for the reasons Westbrook posited. The rule of the case works precisely because it overcomes the insubstantial (and dubious) bases of distinguishing among guaranties posited by Westbrook.⁴⁵ Further, I would refine the doctrine by eliminating the creditor requirement.⁴⁶ The foundation of Westbrook's and my disagreement is the control concept, particularly, and the nature of preference liability more generally.

42. Westbrook stated:

The distinction from *Levit* lies in the indirect connection between the corporation's payment and the insider's benefit, unlike the insider-guarantee situation where payment often bears a dollar-for-dollar relationship to the insider's benefit. The technical, legal difference from *Levit* is that the insider possesses no rights against the corporation regarding the debt . . . and therefore lacks creditor status for the purposes of section 547.

Article, supra note 27, at 94.

43. Westbrook noted:

If we were to decide that this rough proxy approach was too imprecise . . . we could eliminate the creditor requirement in the insider-preference cases by amending section 547(b)(1) The change in qualification would impose additional costs. One cost would involve quantifying the benefit the insider receives to determine the amount of the voidable preference, because only the amount of the benefit should be avoidable.

Article, supra note 27, at 96.

44. I responded:

[T]he amount of the *transfer* to the lender would be the amount of the preference, not the value of the *benefit* the insider realizes as a result of the preference Though Westbrook may believe that only the amount of the benefit should be avoidable, there is nothing in the language of section 547 to support that conclusion. The only reference to 'benefit' is in section 550(a)(1), but the provision does not define a preference; it only describes the parties from whom a preferential transfer may be recovered.

Response, supra note 28, at 631.

45. *Id.* at 621-25.

46. *Id.* at 629-33.

The *Levit* issues would not vanish with congressional abrogation of the decision.⁴⁷ Westbrook and I share a common fear: each of us believes that if the powers that be understand *Levit* in the way the other understands it, the *Levit* doctrine's demise will be hastened.⁴⁸ My Response tested Westbrook's conclusions by applying them in context; he is troubled that I broke down the tidy, but incomplete, compartments into which his Reply (but not his first Article) put them. Because Westbrook's Reply reveals even more profoundly the deficiencies of his model (as well as the gulf between us), I confront the Reply points seriatim and emphasize the impact of our differences (and occasional agreement) on preference principles generally.

II. LENDER ACTION AND GUARANTOR REACTION

In the Reply, Westbrook explains that his first Article was *primarily* about lender's actions and incentives and only *secondarily* about insider-guarantor's reactions to the lender's demands.⁴⁹ He says that I ignored his assertion of that important distinction.⁵⁰ However, one of the primary arguments of my Response was that Westbrook's failure to appreciate the symbiotic relationship between the lender's actions and guarantor's reactions is fatal to his thesis.⁵¹

To deny that relationship, the coincidence of interest that is the very object of the lender when the lender takes the insider guaranty, is to fail to

47. It now seems that comprehensive bankruptcy legislation is not imminent. Indeed, it could be Fall of 1994 before legislation works its way through both houses of Congress. Telephone Interview with Suzanne Bingham, Armstrong & Associates (July 12, 1993) (Ms. Bingham represents lobbying interests concerned with bankruptcy legislation).

48. *Response*, *supra* note 28, at 608; *Reply*, *supra* note 29, at 1405-06.

49. "[F]irst, he ignores all my primary and strongest arguments supporting *Levit* in favor of critiquing the secondary and tertiary points . . ." *Reply*, *supra* note 29, at 1394. "Professor Alces's Response addresses for pages the effect of the true/leverage guaranty distinction on the *insiders'* conduct, which was distinctly my secondary point. The Response does not discuss the effect on lenders' conduct, which is a far more important point." *Id.* at 1396.

50. *Id.*

51. "Westbrook argues that as a matter of fact the lender who has taken a good guaranty will not be required to disgorge payments on the guaranteed debt." *Response*, *supra* note 28, at 616. However, Westbrook's argument depends upon the assumption that a judgment-proof guarantor, the party who, by definition, makes a bad or pure leverage guaranty, will have more incentive to raid the business-debtor's coffers . . . than would the good 'judgment-worthy' guarantor . . . This may be a specious distinction. The guarantor's *incentive* could just as likely be a function of how much the guarantor has to lose . . . as it is a function of the guarantor's apprehension about personal bankruptcy.

Id. at 617.

appreciate the force of Judge Easterbrook's opinion in *Levit*.⁵² The opinion is preoccupied with control; it concerns the lender's ability to exert control over the debtor by putting pressure on the individual that controls the debtor. Further, the control issue exists independent of *Levit* and would remain a crucial question in bankruptcy whether or not *Levit* survives.⁵³ Thus, a great deal is at stake in deciding to ignore the control concept by denying the conceptual basis of Judge Easterbrook's opinion in *Levit*: the lender takes an insider guaranty to gain control at the ultimate expense of the other creditors of the debtor.

To separate lender incentives and actions from their necessary consequences—the insider-guarantor's reactions—is shortsighted. Action and reaction (pressure and control) in this setting are so inextricably intertwined that it is impossible to understand one without understanding the other. My Response understood the lender's conduct in terms of its consequences. Westbrook ignores their interrelation.

Westbrook would find a "true" (and unassailable) guaranty when the lender takes a mortgage on the personal residence of the guarantor (so long as the value of the house exceeds the amount of the loan guaranteed).⁵⁴ I am sure that such a guaranty would yield the very type of improper leverage that preference proscriptions are designed to police.⁵⁵ Any candid counsel for a lender will acknowledge that the lender gets a mortgage on the guarantor's house in order to focus the guarantor's

52. Judge Easterbrook explained:

[S]o an extended recovery period for payments to outside creditors that benefit insiders could contribute to the ability of the bankruptcy process to deter last-minute grabs of assets. . . . [A]ll the trustee's recovery does is ensure that those entitlements (as modified by any statutory priorities)—rather than the efforts of insiders to protect their own interests, or the cleverness of outsiders in beating the 90-day deadline—determine the ultimate distribution of the debtor's net assets.

Levit, 874 F.2d 1186, 1195.

53. See 11 U.S.C. § 510 (1988) ("equitable subordination") and 11 U.S.C. § 548 (1988) ("fraudulent transfers").

54. "A common example is a bank requirement that a small business person guarantee a loan . . . and secure that guarantee with a mortgage on the guarantor's home. If the recoverable equity at least equals the amount of the company's debt, then it is a true guarantee." *Article, supra* note 27, at 80 (footnote omitted). In the Reply, he refers only to personal wealth in the form of stocks and bonds: "A true guarantor is one who gives personal security (for example, stocks and bonds) to support the guaranty . . ." *Reply, supra* note 29, at 1395. Perhaps the shift in focus was significant: it is easier to discern manipulation when the lender has taken a mortgage on the insider's home than when the insider has pledged only investment securities to support a guaranty.

55. "[T]he judgment-worthy guarantor, the guarantor who makes good guaranties, is always better off causing the corporate debtor to make the preferential payment because the probability of the guarantor's ultimate preference liability . . . is always less than 1.0." *Response, supra* note 28, at 618.

attention on its loan; rarely would the lender want to foreclose such a mortgage to realize the market value of the residence. Its greatest value is as a lever. Westbrook's refusal to recognize the principles of action and reaction in the insider guaranty context precludes his appreciating that point.

More startling, however, is Westbrook's failure to respond to the argument that comprised a full third of my Response: the observation that the lender-guarantor relationship is dynamic and that, even were Westbrook's conceptions of incentives accurate, the incentives evolve over the course of the guaranteed loan. Insofar as Westbrook's first Article and the Reply focus on the lender-guarantor relation and the financial circumstances of the guarantor solely at the time the guaranty is taken,⁵⁶ I discern no value in his speculation concerning the incentives that motivate the lender and operate on the guarantor during the preference period, the year before bankruptcy, and perhaps many years after the lender's loan officer has decided to take the guaranty.

Westbrook either fails to recognize the relational dynamic of guaranty agreements or denies that relational contract principles inform the lender-guarantor (insider) relationship.⁵⁷ My critique of his model recognized the consequences and incidents of that relationship over the course of the guaranteed indebtedness; his conclusions rest on a static conception of the control relationship. I would have a bankruptcy reform commission take into account the control that a lender could impose on the debtor through the lender's imposition of leverage on an insider *during the preference period*; Westbrook would freeze the frame at the time the loan officer decides to take the guaranty, perhaps long before the preference period, and long before the loan becomes a problem for the lender.

56. Although Professor Alces ignores the argument about the effect on lender incentives, surely he would not have claimed that a bank officer is incapable of making a reasonable judgment about . . . what insider guarantors are *likely* to be good for paying the guaranty If a loan officer can make those kinds of judgments, then a bank will take insider guaranties when the discounted value of the wealth behind them apparently exceeds the disadvantage of an extended preference period.

Reply, supra note 29, at 1397-98 (footnote omitted).

57. Relational contracts are characterized by contracts in which "(1) the transaction extends over time, (2) parts of the exchange cannot be measured or specified [at the time the guaranty is executed], and (3) the interdependence of the parties to the exchange extends at any given moment beyond any single discrete transaction to a range of social interrelationships." Richard E. Speidel, *Article 2 and Relational Sales Contracts*, 26 LOY. L.A. L. REV. 789, 792 (1993) (quoting Lewis A. Kornhauser, *The Resurrection of Contract*, 82 COLUM. L. REV. 184, 190 (1982)). For a comprehensive treatment of relational contract theory, see generally Symposium, *Law, Private Governance, and Continuing Relationships*, 1985 WIS. L. REV. 461, 483-579.

III. THE FORCE OF CONTRACT

Because the insider-guarantor would have a right to reimbursement from the debtor in the event the guarantor pays the guaranteed indebtedness, the guarantor is a “creditor”⁵⁸ of the debtor, and the premise of section 547(b)(1) is satisfied.⁵⁹ If the insider-guarantor contractually waives that right, Westbrook is correct that such a waiver is tantamount to a waiver of *Levit*.⁶⁰ He and I agree that such waivers should not be enforceable, but he misreads my Response as failing to address the issue.⁶¹ I had explicitly reached a conclusion the opposite of that which Westbrook attributes to me.⁶²

Even beyond that error, however, Westbrook again separates a fact, the existence of a waiver of a right to reimbursement, from its consequences, avoidance of *Levit* by denying the guarantor creditor status. While he argues that waivers are unenforceable, he defends the creditor requirement as providing the means to limit *Levit* to “core” preference cases.⁶³ On the one hand, preferential transfers effected at the instance of insider-guarantors would be recoverable from either the lender-transferee or the benefitted insider-guarantor. Preferential transfers effected at the instance of mere non-guarantor insiders, on the other hand, would not be recoverable from either the preferred lender or the insider. The first type of preferential transfer would be “core” and the second “non-core” because such transfers would not benefit a creditor.

The only reason avoidance of the waiver is relevant is because of the

58. A “creditor” is an entity that holds a “claim” against the debtor. 11 U.S.C. § 101(10) (Supp. IV 1992). A “claim” means a “right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured.” 11 U.S.C. § 101(5)(A) (Supp. IV 1992). Therefore, the contingent claim to reimbursement of a guarantor is a sufficient “claim” to give rise to “creditor” status.

59. See 11 U.S.C. § 550(a)(1) (1988).

60. *Article, supra* note 27, at 87.

61. Westbrook: “I argued that such waivers are unenforceable. The Response ignores my argument and offers no non-waiver argument of its own . . . [The Response] strongly implies that *Levit* is routinely waivable . . .” *Reply, supra* note 29, at 1398.

62. “[T]he breadth of the Bankruptcy Code’s ‘creditor’ definition suggests that it might not be all that difficult for a court to find that the waiver is personal to the lender [and refuse to enforce it.]” *Response, supra* note 28, at 630 (footnote omitted). Further, the next full paragraph following that quoted language describes arguments that would support a court’s finding such waivers unenforceable.

63. “Instead, within the universe of cases involving insider-preference policies, the creditor requirement makes preference law applicable to core cases and inapplicable to marginal ones.” *Article, supra* note 27, at 95.

waiver's effect on the creditor status of the insider. To acknowledge one, waiver unenforceability, and deny the consequences, effective abrogation of the creditor requirement, is to obscure the very interrelation that animates *Levit*. Moreover, it is this interrelation that fixes the scope of preference law and the operation of contract principles in the more tort-than-contract-like ambiance of the bankruptcy fraudulent disposition dynamic. Westbrook's and my difference here, and its broader consequences for the bankruptcy law, is manifest in the conclusions we each draw from what Westbrook describes as the "central hypothetical to which the second half of [his first] Article is devoted."⁶⁴

Suppose the president of H Corporation, Jane Hackman, an entrepreneur with several business interests, owns a large portion of the corporation. Because H Corporation suffers some financial difficulty, including a cashflow problem, its bank lender becomes anxious about repayment. Hackman approaches the bank requesting financing of a shopping center, a new project in which H Corporation will have no part. The bank seeks to link the two ventures by demanding a guarantee of H Corporation's debt in exchange for financing for the new project, but Hackman refuses. The bank then informs her, somewhat inconsistently, that its policy against excessive exposure to the ventures of any one principal makes the new financing impossible unless H Corporation makes a substantial prepayment against its loan. Hackman causes H Corporation to make the payment and obtains the loan for the new project. Drained of cash following the repayment, H Corporation slowly expires, entering bankruptcy nine months later.⁶⁵

The point of his hypothetical is that though *Levit* preference policies may be implicated when an insider succumbs to pressure brought by the lender, *Levit* is inapposite unless the insider is a creditor of the debtor. Westbrook apparently endorses this conclusion. He corrects my misconstruction of the facts of that hypothetical. Westbrook then represents that he has thereby discovered and pulled the golden thread that would unravel the Response. In fact, he discovered only pyrite: my Response proceeded from the *assumption* that Westbrook *was* correct concerning the operation of the creditor requirement on the facts of his hypothetical.⁶⁶

I agree with Westbrook that Judge Easterbrook's opinion in *Levit* is a correct reading of the Code and that if the insider is not a creditor of the

64. *Reply*, *supra* note 29, at 1394.

65. *Article*, *supra* note 27, at 93.

66. "Assume [Westbrook] was right about the creditor requirement's application to [the facts of his hypothetical]. Is Westbrook then correct that there is good reason to exclude the facts of the hypothetical from the scope of *Levit*? No." *Response*, *supra* note 28, at 629 (footnote omitted).

debtor, no basis exists for *Levit* avoidance. However, I am considerably less comfortable with that conclusion than is Westbrook. I addressed the broader consequences that would flow from the conclusion that the preference law should only police lender pressure when the pressured insider is a creditor of the debtor. If the sole difference between the Jane Hackman hypothetical and the facts of *Levit* is the existence of a guaranty agreement, the point which the Reply goes to some pains to emphasize,⁶⁷ then the hypothetical is no different from the case in which a court would find a waiver enforceable. Recall, however, that Westbrook would not enforce such waivers.

I would impose insider preference liability on the lender in Westbrook's Jane Hackman hypothetical and he would not. Indeed, he would not even impose insider preference liability on Jane Hackman: "This [Jane Hackman] example illustrates the useful role played by the requirement that an insider be a creditor if a payment is to be regarded as an insider preference, despite the somewhat artificial and indirect nature of that role."⁶⁸ Westbrook argues that though Hackman certainly received a benefit, it was indirect and, therefore, the preference law should not provide the basis of recovery: "I doubt that the benefits of extending the insider-preference rules would justify these costs."⁶⁹

Westbrook would distinguish Hackman from an insider-guarantor who has waived the right to reimbursement and thus forfeited creditor status in a manner Westbrook would deem unenforceable. If the only distinction between Hackman and an insider-guarantor is a waiver that Westbrook would not enforce, what *reasoned* basis does Westbrook offer for the distinction? None. Both Hackman and an insider-guarantor are in *control* and the lender takes advantage of the insider's control. Westbrook describes the benefit to Hackman as indirect and the benefit to an insider-guarantor as direct. However, this distinction is as specious as the distinction between true and pure-leverage guaranties.

Westbrook never argues that there *should* not be recovery from the insider herself in the Jane Hackman hypothetical. In fact, the possibility of such recovery is the animating principle that supports his distinction

67. "*Levit* does not apply because Hackman is not a guarantor of the H Corporation bank debt . . . As noted, the whole point of the hypothetical was that it did not involve a guaranty." *Reply, supra* note 29, at 1400.

68. *Article, supra* note 27, at 94.

69. *Id.* at 97.

between true and pure-leverage guaranties.⁷⁰ It is the fear of such recovery that Westbrook believes motivates the true guarantor to resist lender pressure.⁷¹ However, if Westbrook were to himself take that creditor requirement as seriously as he urges it be taken, then he would eviscerate the basis of insider liability that supports his distinction among guaranties. In his hypothetical, Jane Hackman would not be liable on an insider-preference theory. The creditor requirement is that indiscriminate, that adventitious.

The difference between Westbrook and me is clear on this point. Westbrook believes that, in what he considers non-core cases, there should not be preference recovery against lender or insider. The creditor requirement accomplishes this result. I would abrogate the creditor requirement and permit recovery from the lender, the insider, or both, as the trustee deems appropriate.⁷² There is no middle ground, given the clumsy nature of the creditor requirement: the trustee either can recover the preference under section 547 from both lender and insider or cannot recover it from either of them.

Ultimately, the source of Westbrook's and my disagreement is our differing conceptions of the jurisprudence of fraudulent disposition law. I would extend the preference rules to reach the indirect benefit cases such as those posited by Westbrook. We both recognize that the issue would persist notwithstanding congressional abrogation of *Levit*.⁷³ Our difference on this point, therefore, warrants elaboration.

70. "The risk is much greater for the true guarantor, because the trustee is much more likely to sue a solvent party. Thus, the indirect-preference rule operates more powerfully to reduce the preference incentive of a true insider guarantor." *Reply, supra* note 29, at 1402 (footnotes omitted);

No bankruptcy trustee is likely to bring an action that will not result in fairly short-term collection, so an asset-poor guarantor may be safe Thus, it seems quite plausible that the pure-leverage guarantor will have more reason to react to lender pressure by preferential payment rather than by risking all on the success of the business.

Article, supra note 27, at 83-84.

71. "If the [preferential] payment threatens the survival of the business, the true guarantor is likely to resist. If making the payment destroys the business, the true guarantor will be an irresistible target for an indirect-benefit preference action by the trustee in bankruptcy." *Article, supra* note 27, at 83.

72. "My primary point about the benefits of [the creditor requirement] was that its abrogation would make too many transactions problematic *ex ante* by forcing elaborate consideration of indirect, unquantified, even contingent benefits to insiders from particular transfers by a debtor company." *Reply, supra* note 29, at 1399.

73. "It is worth noting that these issues do not arise from *Levit* . . ." *Id.* at 1406.

IV. "TRANSFER" AND "BENEFIT"

Westbrook's Reply reiterates that he utilized his Jane Hackman hypothetical to demonstrate the inefficacy of using the preference law to avoid transfers that result in only an indirect benefit to the insider: "Imagine if every payment, grant of a security interest, or other transfer by a large company nine months before its Chapter 11 filing had to be evaluated as a possible preference because of an indirect benefit of some kind to one of its dozen directors or dozens of officers."⁷⁴ Westbrook assumes that I would not find such a prospect chilling. Indeed, I would not, because I would recognize limitations on the insider-preference rule that are part of the Code and which Judge Easterbrook recognized in his *Levit* opinion. Limitations Westbrook has apparently chosen to ignore.

First, however, consider that no reason exists to avoid an indirect-benefit calculus, particularly when even Westbrook acknowledges in his first Article and in his Reply that the same type of creditor abuses would be policed by "other insider-abuse devices."⁷⁵ Presumably the very same analysis would be necessary under the complementary fraudulent disposition proscriptions now found in the Code.⁷⁶ Thus, the *Levit* insider preference rule actually saves time and effort because it provides a more efficient and less fact-specific means to get to the correct result when a lender has manipulated an insider in order to control the debtor. Even on his own Jane Hackman hypothetical, Westbrook posits lender manipulation.

Westbrook's and my disagreement about the very nature of preference law is manifest in the "Benefit Recovery" section of his Reply. There he discusses a recent decision of an Illinois bankruptcy court, *In re Cannon Ball Industries*.⁷⁷ I will accept, for the sake of argument, Westbrook's brief construction of the facts of that case in order to juxtapose our positions in terms that matter for the preference law beyond *Levit*. The

74. *Id.* at 1399.

75. *Id.* at 1399-1400. "[O]ther insider abuse devices could be used to deal with the problems not addressed by preference law." *Id.* In his original Article, Westbrook comments:

Inssofar as section 547 adopts a special rule for insiders, it is part of a complex web of bankruptcy rules that addresses the special risks to bankruptcy policy arising from insider abuses. In addition to insider-preference doctrine, these rules include several aspects of fraudulent conveyance law and the rules concerning breach of corporate fiduciaries duties."

Article, supra note 27, at 89.

76. See 11 U.S.C. § 510 (Equitable Subordination) and 11 U.S.C. § 548 (Fraudulent Transfers).

77. *Cannon Ball Indus. v. Sequa Corp. (In re Cannon Ball Indus.)*, 150 B.R. 929 (Bankr. N.D. Ill. 1992), *rev'd* 155 B.R. 177 (N.D. Ill. 1993); see *Reply, supra* note 29, at 1405-06.

bankruptcy court found a *Levit* preference when two shareholders executed \$150,000 guaranties of a single \$750,000 indebtedness. At the time of bankruptcy, \$400,000 remained unpaid on the note. The lender had accepted \$43,000 in payments during the one-year insider preference period. The opinion does not state the amount of the preference recovery, but according to Westbrook, “implies . . . that the full amount of the payment was recoverable. This result is quite consistent with the analysis in the Response and inconsistent with the result for which I would argue.”⁷⁸

Recall that the reason Westbrook would be uncomfortable with that result is because of the transaction costs associated with computing the quantum of the guarantor’s benefit.⁷⁹ However, in his version of the “proper result” those transaction costs are prominent: “I would have thought that the proper result would be to value the benefit and make the recovery avoidable only ‘to the extent’ of that benefit.”⁸⁰ In his footnote supporting that text, he suggests that the “benefit” realized by the guarantors could be determined by the amount of the “payment . . . for which the insider could sell a ‘put’ of the guaranty.”⁸¹ At this point it should occur to the reader that it could cost a good deal more in attorneys’ and accountants’ fees than the difference between \$43,000 and the determined value of the “put” to determine the chimerical value of the “put.”⁸² So long as that is true, it undermines Westbrook’s defense of a benefit rather than transfer analysis on the basis of transaction costs savings.

Perhaps most telling is the fact that Judge Easterbrook considered and rejected the very distinction between transfer and benefit that Westbrook urges. In concluding that the two-transfer test of the pre-*Levit* cases was erroneous,⁸³ Judge Easterbrook explained that “[t]he two-transfer approach equates ‘transfer’ with ‘benefit received.’ . . . The Code, however, equates ‘transfer’ with payments made. . . . [A]voidability is an attribute of the transfer rather than of the creditor. While the lenders want to define transfer from the recipients’ perspective, the Code consistently defines it

78. *Reply, supra* note 29, at 1405 (footnote omitted).

79. *See supra* note 74 and accompanying text.

80. *Reply, supra* note 29, at 1405.

81. *Id.* at 1405-06 n.66.

82. There is no market in such puts. There is no place where one could readily find these values and the cost of developing expert testimony concerning such values will increase with the degree of accuracy desired.

83. *See supra* note 20.

from the debtor's."⁸⁴

However, my difference with Westbrook on this point is obscured by his attributing to me a reading of a case I did not consider in my Response. In assuming that my conception of the preferential transfer law would result in avoidance of the full \$43,000 transfer, his analysis of *Cannon Ball* stops with subsection (b) of section 547.⁸⁵ I would apply subsection (c)(2), as would Judge Easterbrook, and determine that none of the \$43,000 transfer was avoidable so long as the transfer was made "in the ordinary course" of the debtor's business.⁸⁶ The impact of that exception on the *Levit* rule was expressly noted by Judge Easterbrook⁸⁷ and the exception's operation vindicates the very policies identified in his *Levit* opinion. So long as the exception would apply to *Cannon Ball* and similar cases, the court may conclude that there has been no abuse of leverage by the lender and no insidious exercise of control.

Once more the difference between Westbrook and me is clearly

84. *Levit*, 874 F.2d 1186, at 1195-96. In the Reply, Westbrook points out that I had criticized his failure to cite authority for the proposition that the measure of a preference is the *benefit* realized by the transferee, but then failed to cite any authority for the assertion that the amount of the *transfer* rather than the value of the *benefit* received is recoverable preference. *Reply, supra* note 29, at 1404 n.58. The authority for my assertion is, as the text accompanying this footnote indicates, Judge Easterbrook's *Levit* opinion itself.

There are, additionally, other cases that have refused to equate benefit with transfer. See *Banner v. S.S. Pierce Co. (In re Pine Springs Farm & Casino, Inc.)*, 139 B.R. 90, 97 (Bankr. N.D.N.Y. 1992) (rejecting the two transfer approach because it "equates 'transfer' with 'benefit received'"); *Harrison v. Brent Towing Co., Inc. (In re H & S Trans. Co., Inc.)*, 110 B.R. 827, 831 (M.D. Tenn. 1990) (following *Levit* rejection of two transfer approach as incorrectly equating transfer and benefit), *aff'd* 939 F.2d 355 (6th Cir. 1991).

For other cases that have declined to follow the two-transfer analysis, see, e.g., *Lowrey v. First Nat'l Bank of Bethany (In re Robinson Bros. Drilling, Inc.)*, 97 B.R. 77 (W.D. Okla. 1988), *aff'd* 892 F.2d 850 (10th Cir. 1989); *Murphy v. Wainwright Bank & Trust Co. (In re Jameson Travel, Inc.)*, 147 B.R. 822 (Bankr. D. Mass. 1992); *Miller v. Steinberg (In re Marilyn Steinberg Enters. Inc.)*, 141 B.R. 587 (Bankr. E.D. Pa. 1992); *In re Installation Services, Inc.*, 101 B.R. 282 (Bankr. N.D. Ala. 1989).

85. The court was considering cross motions for summary judgment. It focused only on the existence of "benefit" under subsection 547(b); it had no reason to consider the application of a section 547(c) exception. See *Cannon Ball*, 150 B.R. at 930 ("The issue is whether the shareholders received a benefit which would render the payments avoidable as preferences under [s]ection 547(b).").

86. The Code provides: "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." 11 U.S.C. § 547(c)(2) (1988).

87. See *Levit*, 874 F.2d at 1199-1200; see also Barkley Clark, *Scheduled Debt Payments as Preferences: Paradigm of the Plain Meaning Rule*, 1 J. BANKR. L. & PRAC. 7 (1991). In *Union Bank v. Wolos*, 112 S. Ct. 527 (1991), the United States Supreme Court held that installment payments made on long-term debt may be deemed payments made in the ordinary course for purposes of the section 547(c)(2) exception. See also *Response, supra* note 28, at 617 n.43.

formulated by the control concept. If subsection (c)(2) were inapposite on the facts of *Cannon Ball*, an issue nowhere treated in the opinion, I would avoid the full amount of the transfer, \$43,000, because the amount of that transfer is the measure of the lender's control over the insider. *Levit* just makes it easier to reach that result than if we had to appraise the insider status of the lender who had taken the guaranty rather than the insider status of the guarantor.⁸⁸ The measure of the damage done to the other creditors of the debtor as a result of that exercise of control is the amount of the transfer.

Levit, whatever its destiny in the hands of a Congress subject to the pressures of special interests,⁸⁹ is something of a litmus test: we can tell a good deal about what one thinks of creditor-debtor relations by how one reacts to Judge Easterbrook's opinion. From that reaction we can tell a good deal about one's understanding of specific preference principles as well as general bankruptcy fraudulent disposition principles. There is that much at stake.

What matters for the insider preference law, even after *Levit*, is the nature of preference liability, a topic I treated at the beginning of my Response.⁹⁰ Westbrook does not take issue with my constructive fraud formulation of the preference law. It is the premise from which my conclusions necessarily flow. Due to time and space limitations,⁹¹ neither of us has comprehensively confronted the other's views on fundamental preference doctrine, although I am sure that is the source of our differences.

V. CONCLUSION

Westbrook and I have not said all that there is to say about *Levit*; indeed, we probably have not said all that *we* would have to say about *Levit*. However, because my Response confronted the provocative arguments

88. See 11 U.S.C. § 101(31) (Supp. IV 1992).

89. Westbrook and I agree on this point.

90. Response, *supra* note 28, at 609-14.

91. My Response and Westbrook's Reply were written under time and space constraints dictated by publishing exigencies. When Westbrook's Article was published, in the Spring of 1992, I was troubled by his analysis, but concluded that Congress was likely to abrogate *Levit* before the end of the year. When, in late October of 1992, Congress failed to pass the comprehensive bankruptcy legislation that would have insulated lender's from *Levit* liability, I determined that it would be worthwhile to respond to Westbrook's piece. My Response was published in February of 1993. In April of 1993, Westbrook submitted his Reply to my Response. I was not afforded the opportunity to begin work on this Essay until the Reply was formally published in June of 1993. The editors of the *Washington University Law Quarterly* were kind enough to adjust their normal article editing and production schedule to accommodate publication of this Essay in this issue.

raised by his Article and elicited his passionate Reply, and because the law reviews that have published our Articles have invested in this scholarly dialogue, it would be a dereliction of our collective duty as fiduciaries of the institution—disinterested legal scholarship—if we failed to formulate both the terms and consequences of those ideas.

Levit has caused many individuals and groups concerned with bankruptcy jurisprudence to come to terms with the issue of insider preferences. For the most part, most who have thought and written about the case have found reason to urge the decision's abrogation. Jay Westbrook and I, for very different reasons, have found a good deal to commend Judge Easterbrook's opinion. However, when we compare our conclusions, we find that what distinguishes our analyses may be more substantial than what distinguishes the anti-*Levit* forces from either of us. Westbrook and I do not understand the preference law in the same way; indeed, we probably do not understand debtor-creditor law in the same way.

This Essay has endeavored to formulate the terms of our disagreement and to suggest that if Westbrook and I can think carefully about a challenge facing the preference law and reach such diametrically opposed conclusions about the most fundamental fraudulent disposition issues, then there might be good reason for the keepers of the bankruptcy law flame to come to terms with the interests to be balanced in the control calculus. When an insider uses her position to realize benefits not available to creditors of the debtor, how does the bankruptcy law respond? By application of preference principles, or otherwise, or not at all? It should be clear that, correctly understood, *Levit* provides the means to police manipulation by insiders *as well as those who control the insiders*.

Levit is only one means to that end and maybe an imperfect one at that. If the decision and the logic supporting it is to operate effectively, then the creditor requirement should be abrogated. Short of that extreme and rather unlikely development, bankruptcy courts should deem the requirement satisfied whenever an insider is a guarantor of the debtor's liability to the lender that receives a preferential transfer.