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Barnhill v. Johnson and Payment by Check on the Eve of Bankruptcy: Implications for the Real Estate Attorney

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BARNHILL V. JOHNSON AND PAYMENT BY CHECK ON THE EVE OF BANKRUPTCY: IMPLICATIONS FOR THE REAL ESTATE ATTORNEY

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For parties to a real estate transaction, one of the critical aspects of the transaction is the transfer of value between the parties. The success of the transaction - not to mention the ability of attorneys to meet their statutory and professional responsibilities - depends on the certainty of the transfer of value.¹ In the 1992 decision Barnhill v. Johnson,² the United States Supreme Court clarified that, for purposes of determining whether a debtor made a transfer within the 90-day period prior to bankruptcy, a transfer made by check occurs on the date the check is honored and not on the date of delivery or receipt. The Court’s decision reverses judicial decisions favoring the date of receipt³ and thus increases the risk of nonpayment at least slightly.

The dispute in Johnson centered around checks that were delivered before but honored during the 90-day period preceding the filing of bankruptcy. Under § 547(b) of the Bankruptcy Code, the trustee for the bankrupt estate may recover transfers of the debtor’s property made within 90 days of the bankruptcy filing.⁴ Section 101(54) defines "transfer" broadly to include "every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property."⁵ In resisting recovery of the check payment, petitioner Barnhill argued that a § 101(54) transfer occurred on the date he received the check, which was outside the 90-day period. As support, he relied on the breadth of the definition of transfer and argued that, at the very least, delivery of a check constituted a conditional transfer.⁶

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³For some examples, see P. Alces, The Law of Fraudulent Transactions § 6.02[5][b], at 6-24 n.76 (1989).


⁵Id. § 101(54).

⁶112 S.Ct. at 1390.
In rejecting the petitioner's arguments, the Court focused on principles of commercial and bankruptcy law. Under commercial law principles, mere "receipt of a check gives the recipient no right in the funds held by the bank on the drawer's account." 1 Until the moment of honor the debtor retains full control over disposition of the account and the account remains subject to a variety of actions by third parties. 2 Numerous events occurring between delivery and presentment could result in dishonor. 3 Additionally, § 3-409 of the Uniform Commercial Code clearly states that a check is not an assignment of any funds available for payment. 4 While the creditor/payee might have a cause of action against the debtor/drawer once the check is delivered, 5 this interest could not, in the Court's view, be characterized as an interest in the debtor's property, the account with the drawee bank. A § 101(54) transfer of part of the debtor's interest in the bank funds would not occur until the date of honor. 6

Nor was the Court persuaded by petitioner's reliance on the accompanying legislative history for § 547(c) of the Bankruptcy Code. That legislative history indicated that "[p]ayment is considered to be made when the check is delivered for purposes of sections 547(c)(1) and (2)." 7 In rejecting petitioner's argument, the Court noted that the legislative history applied only to § 547(c) and not to § 547(b), the section containing the 90-day preference rule. As the Court explained, § 547(c) "establishes various exceptions to § 547(b)'s general rule permitting recovery of preferential transfers." 8 These exceptions "are designed to encourage

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7The Court examined rights and duties under state commercial law even though the task of determining the meaning and timing of transfers is a matter of federal law because the Code's definition of "transfer" includes references to "property" and "interest[s] in property." In the absence of controlling federal law, property and interests in property are, in the words of the Court, "creatures of state law." Id. at 1389.

8Id. at 1390.

9Id. at 1391.

10Id. at 1390. Examples given by the Court included an account closing, a third-party lien, and wrongful dishonor. Id.

11U.C.C § 3-409(1). In his treatise on fraudulent transactions, Professor Peter Alces prefers the § 3-409 rationale, noting that the Court's interpretation of a payee's interests in a check is "not a completely accurate view of the commercial paper law." P. Alces, supra note 3, at S6-23 (Supp. No. 2, 1992). As he points out, "from the time a payee receives a check, the payee has a sufficient interest in it to support a conversion against someone who thereafter takes an action inconsistent with the payee's title to the instrument." Id.

12See 112 S.Ct. at 1390 & n.8.

13Id. at 1390.

14Id. at 1391 (quoting 124 Cong. Rec. 32400, 34000 (1978)).

15112 S.Ct. at 1391.
creditors to continue to deal with troubled debtors on normal business terms by obviating any worry that a subsequent bankruptcy filing might require the creditor to disgorge as a preference an earlier received payment."\textsuperscript{16} Because of "this specialized purpose," the Court saw no reason to apply the legislative history of § 547(c) to § 547(b).\textsuperscript{17}

The dissenting opinion of Justices Stevens and Blackmun maintained that a § 101(54) transfer of property "occurs on the date the check is delivered to the transferee, provided that the check is honored within 10 days."\textsuperscript{18} According to the dissent, this approach is consistent with established commercial practices\textsuperscript{19} and with § 101(54)’s broad definition of transfer, which includes "'every mode, ... absolute or conditional, ... of ... parting with property.'"\textsuperscript{20} Further, the dissent stressed that "'[n]ormally ... the same terms have the same meaning in different sections of the same statute.'\textsuperscript{21}

Because \textit{Johnson} involved ordinary checks, the implications of the decision for real estate transactions involving certified and cashier’s checks are unclear. On the one hand, both types of checks involve the same timing problem raised by ordinary checks; a gap in time still exists between a check’s issuance and payment. Further, although the drawee bank is primarily liable on certified and cashier’s checks,\textsuperscript{22} the commercial law concept of honor requires more than acceptance or primary contract liability. Under 1-201(21) of the Uniform Commercial Code, "honor" means "to pay or to accept and pay."\textsuperscript{23} On the other hand, certified and cashier’s checks arguably give the creditor/payee a claim against the debtor’s bank or account sufficient to transfer a property interest under § 101(54) of the Bankruptcy Code; with a certified check this claim arguably arises because the drawee bank has accepted the obligation

\textsuperscript{16}Id.

\textsuperscript{17}Id. Although the Court does not address the issue of timing under § 547(c), one possible implication of its discussion of the legislative history argument is that the Court would use the date of delivery for purposes of § 547(c).

\textsuperscript{18}Id. at 1392 (Stevens, J., dissenting).

\textsuperscript{19}Id. Commercial practices identified by Stevens include the practice of treating the date of delivery as the date of payment when a check is subsequently honored by the drawee bank and the tax rule allowing deductions of expenses paid by checks that are delivered by December 31 but that are not honored until the next calendar year. \textit{Id}.

\textsuperscript{20}Id. (parts of quoted definition omitted) (quoting § 101(54)).

\textsuperscript{21}112 S.Ct. at 1393.

\textsuperscript{22}See U.C.C. § 3-413(1); Butler, \textit{supra} note 1, at 16-17. For a discussion of the legal implications of various methods of remittance, see Alces, \textit{Media of Remittance in the Evolving Payment System}, 12 \textit{Real Property Section Newsletter} 14 (Nov. 1991).

\textsuperscript{23}U.C.C. § 1-201(21).
to honor the check as presented,24 and with a cashier's check it arises because the drawee bank is also the drawer, a party having direct contract liability on the check.25 In Johnson the Court stressed that, "[i]n the absence of any right against the bank or account," the recipient of a check received no interest in the debtor's property until honor of the check.26 Certified and cashier's checks arguably give the recipient such a claim against the drawee bank.

Resolution of the timing issue raised by certified and cashier's checks is important. Because real estate closings generally involve one-time payments, they would not otherwise fall within the § 547(c)(2) exception for transfers made in the ordinary course of business.27 In any event, the Johnson decision makes it clear that the sooner checks are honored, the better.

24 See id. § 3-410(1).

25 See id. § 3-413(1).

26 112 S.Ct. at 1391.

27 Mortgage payments made on a long-term basis generally should fall with the ordinary course of business exception unless the form of payment suddenly changes. See P. ALCES, supra note 3, § 6.03[2][a], at 6-45 (1989) & S6-36 (Supp. No. 2, 1992); see also id. § 6.03[2] (1989 & Supp. No. 2, 1992) (discussing the ordinary course of business exception). A discussion of the implications of § 547(c) for real estate transactions is beyond the scope of this article. See generally id. § 6.03 (discussing the § 547(c) exceptions).