The Supreme Court Finks on Purchase-Money Grace Periods

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By Alvin C. Harrell

I. Grace Periods for Purchase Money Security Interests

A. Introduction and Background

For nearly 20 years the courts have split in several different directions) on the relationship between the Bankruptcy Code section 547 grace period for perfecting a purchase money security interest and equivalent state law grace periods.

Many states have created grace periods longer or different than the 20 day grace period at Bankruptcy Code section 547(c)(3)(B). This in turn may depend on the relation between grace period and equivalent state law grace periods.

Since many consumer debtors apparently make major credit purchases (including vehicles) just prior to filing bankruptcy, and since creditors of title lien entry perfection cannot be effectuated without the debtor's subsequent acquisition of the certificate of title, there is a significant possibility that a vehicle lender will be perfecting a purchase money security interest within the preference period and on behalf of an unsecured debt. The ability of such a lender to enforce its security interest in bank-

II. The Court of Appeals’ Cases

The U.S. Courts of Appeal have differed widely in their analyses of these issues. The best of these cases is Webb v. General Motors Acceptance Corp. (In re Hesser),1 which recognized that the Bankruptcy Code grace period at section 547(c)(3)(B) did not extend the 20 days of the debtor's possession,2 thereby recognizing that the lender financing the purchase of a vehicle is dependent on the willingness of the dealer or prior lender to process the paperwork and release the necessary documents to the new lender in timely fashion, before the new lien entry form can be filed. Thus, in a variety of circumstances, lenders cannot file the new form necessary for lien entry perfection within 20 days of the date the debtor receives possession of the collateral, state law grace periods which reflect this reality, and the relation between them and Bankruptcy Code section 547 is of paramount importance.

B. Court of Appeals’ Cases

The U.S. Supreme Court resolved these issues in Fidelity Financal Services v. Fink,3 holding that under section 547(c)(1)(B) the security interest was perfected on the date the forms were filed, not as of the date that perfection was effective as against lien creditors. In Fink, the secured party mailed the application necessary to perfect its purchase money security interest 21 days after the debtor took possession of the vehicle, well within the applicable 30 day grace period under state law, but just outside the 20 day preference period at Bankruptcy Code section 547(c)(3)(B). Under state law, the effective date of perfection as against lien creditors was within the section 547(c)(3)(B) grace period. The Supreme Court's opinion was based on the following.

In the face of this clear Bankruptcy Code section 547(c)(1)(B) reference to state law, In re Hamilton4 held (without significant analysis) that state law is not relevant because it is preempted by federal law. Fitzgerald v. First Security Bank of Idaho5 ignored the applicable definition of "perfection" at section 547(c)(3)(B) (reference 20 day grace period), thus creating a false conflict between state and federal law. Even some cases that recognized a role for state law did not provide a proper or thorough analysis of the statutory text.6 Whatever the merits of the U.S. Supreme Court's decision in Fink (discussed below), the Supreme Court has yet to provide a clear and sound statutory analysis compared to most of the prior appellate decisions.

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A. Introduction

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1. 11 U.S.C. § 547(c)(3)(B) ("20-day grace period for the debtor to perfect a purchase money security interest")
2. E.g., General Motors Acceptance Corp. (In re Hesser), 874 F.2d 1111 (2d Cir. 1989), and 11 U.S.C. § 547(c)(3)(B) ("the 20-day grace period"), case law recognizing that grace period extends only to "perfected security interests";
3. In re Fink, 867 F.2d 1363 (9th Cir. 1989)
4. 867 F.2d 1363 (9th Cir. 1989)
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7. In re Hamilton, 867 F.2d 1363 (9th Cir. 1989)
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equally related and more directly applicable provision (Bankruptcy Code section 522(b)(3)), which specifically applies in conjunction with sections 546 and 547, supporting a contrary view. Section 522(b)(3) speaks of "any act to perfect," indicating that Congress intended to specify the act of perfection as opposed to the effect of perfection capable of doing so. In the absence of similar language in section 547(c)(1)(B), and in the view of the reference in section 547(c)(1)(B) to the effect of perfection, it seems fair to conclude that the latter refers to the time as of which perfection is effective as against liens (슷다, that section 547(c)(1)(B) says) rather than using section 546(b) in isolation as the basis for a negative inference to the contrary.

The Supreme Court's Fink opinion may have misconstrued the role of section 546(b) in other ways as well. Section 546(b) clearly recognizes the state-law relation-back effect with regard to perfection, and this provision is limited to Bankruptcy Code section 546(b) and 547, (notably excluding section 547). From this the Court concluded that Congress must have intended that section 547(c)(3)(B) be subject to the relation-back effect of a state law grace period.24 It is hard to resist the implication that Congress quite specifically intended a state law grace period to prevail over any state rules permitting relation back.25

But this is not the logical implication at all. Section 547 is excluded from the broad rule at section 546 recognizing state law grace periods and relations-back because section 547 has its own set of rules, which must be more complex than the broad rule at section 546(b). Indeed, the multiple and diverse exceptions to avoidance at section 547(c). Section 547(c)(1)(B) recognizes state law perfection, priority and relation-back rules, for purposes of the purchase money exception at section 547(c)(3)(B), but not for purposes of the (essentially nonpurchase money) contemporaneous exchange of value exception at section 547(c)(1)(A). The latter has its own, more limited ten-day relation-back rule at section 547(c)(2)(A). Section 546(b) could not be applied broadly to section 546(b) because of the need to accommodate the separate rules at sections 547(c)(1) and 547(c)(2). This alone is not determinative of whether section 547(c)(3)(B) references state law perfection and priority rules for purposes of section 546(b). Section 547(c)(3)(B) also, as a substitute for section 546(b). Thus the exclusion of section 547 from section 546(b) in no way implicates a decision to override state law grace periods in all section 546 analyses; indeed the language of section 547(c)(1)(B) specifies precisely the contrary, and fits with section 546(b) to provide a consistent pattern throughout the Bankruptcy Code with regard to purchase money security interests.26

C. Policy and Historical Analyses

For advocates of the Supreme Court's Fink decision, the further bad news is that the Court's section 546(b) analysis represents the high point of the opinion. As noted infra, the Court buttressed its opinion with additional analyses of bankruptcy law and state law perfection, and with the Old Bankruptcy Act. But the relevance of such matters is questionable under this Court's own enunciated standards.27

Regarding policy, the Court stated that if it recognized state priority rules under section 547(c)(1)(B), the only effect of the "safety valve" (section 547(c)(3)(B) (tending the ten day grace period at section 547(c)(3)(B) to 20 days) would have been to expand the grace period to 20 days in those states with state law grace periods under 20 days,28 since in the other states grace periods of 20 or more days would already be available in bankruptcy via section 547(c)(1)(B) and state law. The Court concluded that this "would have accomplished very little.29 [And, of course, it is hard to understand why Congress would have wanted to do that.]30

In contrast, it is easy for your author to see why Congress might consider it important to provide a "floor" of 20 days to accommodate interstate lenders and private placements. The higher question is why any one would interpret this to inconsistently protect a purchase money transaction from the automatic stay (at section 542(b)(3) and section 546(c)(3)) or to provide for its avoidance under section 547(c).31

25. See also infra note 10.31
27. Id.
28. Id.
29. Id.
30. Id.

Finally, the Court invoked the rule of section 60 of the Old Bankruptcy Act,32 which was preempted state law grace periods in excess of 21 days. But the Bankruptcy Code grace period applicable at that time. It is a reasonable theory to maintain that Congress must have intended to carry this approach forward into the Bankruptcy Code. But it seems equally reasonable to believe that the Old Bankruptcy Act reached this point by very precisely and consistently defining the "business day" and the "day of default," and that such a language was not included in sections 547(c)(3)(B) or 547(c)(1)(B), which indeed seem to read to the contrary. Language similar to old section 56a(7)(3)(B) was included in Bankruptcy Code section 547(c)(2)(A),33 plausibly suggesting an intent to recognize state law grace periods for purchase money loans (under section 547(c)(1)(B)) which is not for other transactions (under section 547(c)(2)(A).34

III. Conclusion

In Fink the U.S. Supreme Court held that a creditor may invoke the [purchase money] loan exception of section 547(c)(3)(B) only by acting to perfect its security interest within 20 days after the debtor takes possession of the property.35 This decision is at least unequivocal, so that secured parties are forewarned of the possible consequences of delay. The Fink decision appears to prejudice further development of these issues in the courts, so that a solution for secured creditors (if there is to be one) must come from Congress. Perhaps secured creditors will be comfortably with the resulting 20 day grace period, and will not deem further a breach of contract. Nonetheless the Fink decision is disapproving in several ways. The Court's failure to more fully consider the relationship between sections 326, 546, and 547 seems significant. Additionally, the Court's heavy reliance on policy issues, legislative intent, and history in the face of an issue on which there is no basis for what may believe to the clear meaning of the statutory language is merely to be a foregone conclusion of policy issues. But their emphasis in Fink does not seem to bow well for a consistent plain meaning approach to statutory construction.

It is also disapproving that the Fink opinion was unanimous. One might have thought that at least one Justice would have censured the decision on the very serious and contrary analysis of the Tenth circuit in Urner, or the obvious alternative explanations of the relationship between sections 546(b) and 547 (and section 362(b)(3)), or the possible intent of Congress to recognize state law grace periods to accommodate the needs of local certificate of title and lien entry systems, or our implications for the federal systems. We are left with the disapproving of all. There may be a natural predisposition on the part of federal courts to avoid questions of all kinds that presume to parallel public interests, but that is inconsistent with our dual system of state and federal commercial, consumer and bankruptcy laws. Federal Bankruptcy law is built on an extensive foundation of state laws, particularly with regard to liens and lien priorities. In this view of the Federal Bankruptcy law, national decision to state law purchase money grace periods and priorities, at sections 362(b)(3), 546(c)(3)(B) is, in the present. To bliholes of this issue of federalism, by focusing on an assumed and overriding need for national uniform-
mity, is to turn one’s back on a pillar of our constitutional system.

Moreover, the result does not provide uniformity; rather, within each state it creates drastic nonuniformity as between transactions in and outside of bankruptcy. Important as bankruptcy is, most transactions occur outside of bankruptcy, primarily under state law. After *Fink* the small percentage of these cases and issues resolved in bankruptcy must be given paramount consideration over the vast majority of related considerations, transactions and issues governed by state law. A creditor which cannot be sure of meeting the 20 day bankruptcy rule deadline, perhaps due to quirks in the local lien entry system or another party’s failure to relinquish possession of the certificate of title within sufficient time, may be compelled to cancel the transaction because the lender cannot prudently ignore the bankruptcy implications, even if bankruptcy is a very remote possibility. If we are going to imagine the intent of Congress, surely this was not it. A contrary decision in *Fink* would have created much greater uniformity at this practical level.

It is time for Congress, the federal agencies, and the Supreme Court to give greater attention to the importance of established state law policies and interests, rather than routinely assuming that federal interests should predominate. If the Supreme Court wants to decide important cases on the basis of a public policy analysis, that is its prerogative, and indeed the analysis in *Fink* could be a lot worse in this respect, but it is disappointing that not a single Justice saw fit to formally note the important issues regarding the relation between state and federal law that are implicated in this decision, despite strong arguments favoring a clear statutory mandate for deference to state law.

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44. In your author’s experience this is a common problem.

Recent Developments of Interest

(Continued from page 113)

the date of petition was filed. Another example is the proposal to partially overrule *Nedelman* by allowing cram-down of unsecured junior home mortgage liens. One proposal that is likely to split the creditor community is the proposed preemption of state exemption laws. National creditors are likely to endorse this proposal, in order to simplify their underwriting processes, while local creditors may regret this loss of state jurisdiction (and local control) as regards an important range of debtor-creditor law issues.

One thing seems clear: the Commission Report is the beginning, not the end, of the debate on these issues.

VIII. Federal Criminal Liability for False Statements

Those with experience in federal regulatory matters are probably aware of the extent to which federal banking, consumer and commercial law has become criminalized over the past two decades. This trend received a boost from the 1980s deposit insurance crisis, though the trend is far too broad and pervasive to be blamed on that single event. In any event, by now federally-regulated banking staff should be well aware of the need to exercise extreme caution in dealings with regulatory agencies and their representatives.

But the trend is evident in transactions well outside the banking context. The federal forfeiture laws have generated considerable publicity, and consumer credit providers have become accustomed to RICO allegations in almost every major consumer credit dispute. Criminal liability has also been extended to hospital billing practices and a wide variety of technical paperwork violations. Federal criminal laws are even being used as a weapon against bar checks.

All of this forms the backdrop for an important U.S. Supreme Court case that seemingly expands the potential for federal criminal liability in a wide variety of circumstances. In an opinion written by Justice Scalia in *Brogan v. United States*, the Court strictly construed 18 U.S.C. section 1001 to create potential liability for almost any knowing misstatement to a federal official. Previous caselaw had permitted an "exculpatory no" or general denial as an alternative to disclosure of every possible legal violation. In response to a federal inquiry, without liability under section 1001; these cases also generally limited liability under section 1001 to false statements that "pervert governmental functions." *Brogan* eliminates any such exceptions to liability.

*Brogan* apparently means that virtually any knowing misstatement to a federal agent is actionable under section 1001. The Court concluded that there is "no exception" to the broad language of section 1001, stating that criminal statutes should be read as broadly as they are written. The result is another layer of potential federal criminal liability for even minor errors.

This decision is consistent with the Court's previous efforts to uphold the plain meaning of statutory language, and is further evidence that the Su.

23. Proposal 1.4.1. Since this date is controlled by the debtor, who would file within 30 days of incurring such debt?

24. 502 U.S. 324.

25. Proposal 1.5.1.


27. See, e.g., ROBERT A. GROUD, CRIME AND PUNISHMENT AFTER THE S&L CRISIS, 46 CONSUMER FIN. L.Q. REP. 195 (1992); Daniel H. (Continued in next column)

27. (Continued from previous column)


32. 118 S. Ct. 905, 1998 WL 23131 (Jan. 26, 1998). See also Janet Novack, Just Stop "No Comment," Forbes, Feb. 21, 1998, at 43 ("Even if you are not under oath, it's a felony to lie to a federal agent.").

33. *Brogan*, 1998 WL 23131, at 4, citing, among other authorities, *Mower v. Taylor*, 107 F.3d 861 (8th Cir. 1994); United States v. Taylor, 937 F.2d 349 (7th Cir. 1999) ("If the main purpose of section 1001 is to prevent perjury, then courts are properly concerned.").

34. *Brogan*, id., at 11.

(Continued on page 119)