1994 Bankruptcy Reform Act Fails to Resolve Split Over Purchase Money Grace Period

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1994 Bankruptcy Reform Act Fails to Resolve Split Over Purchase Money Grace Periods

By Alvin C. Harrell*

I. Background

The Official Text of the Uniform Commercial Code ("UCC") provides a series of ten day grace periods for the perfection of a purchase money security interest.1 Prior to the Bankruptcy Reform Act of 1994, the U.S. Bankruptcy Code provided a similar ten day grace period at section 547(c)(3)(B),2 to protect the purchase money security interest from avoidance as a preferential transfer if the debtor filed bankruptcy within 90 days.3 Many states, however, determined that ten days was an inadequate time period. This was also determined to be true for similar grace periods under state certificate of title laws with regard to security interests in motor vehicles, where perfection may be delayed while the secured party seeks to obtain the vehicle certificate of title.4 This delay may exceed ten days because the selling dealer is slow to process the paperwork required for issuance of the title (if the collateral is a new vehicle) or because a previous secured party is holding the title until the loan payoff check has cleared, among other reasons.

As a result many states have provided grace periods that exceed ten days, either as part of their certificate of title lien-entry systems or by non-uniform amendment to the UCC. If a secured party perfected within such an extended state law grace period, but outside the former ten day grace period at Bankruptcy Code section 547(c)(3)(B), and the debtor filed bankruptcy within 90 days, there was a potential conflict between the Bankruptcy Code ten day grace period at section 547(c)(3)(B) and the longer state law grace period.

With a few exceptions,5 the early cases (including a significant U.S. Court of Appeals decision6) treated the issue as a simple conflict between state and federal law, with the latter of course prevailing.7 However, later cases began to recognize that the Bankruptcy Code specifically defers to state law to determine the effective date of perfection for purposes of the section 547 preference rules.8 Therefore, if the secured party perfects within a state law grace period, and that law provides for perfection to be effective as of a prior date (a so-called "relation-back" effect), and that prior effective date is within the Bankruptcy Code ten day grace period at section 547(c)(3)(B), the security interest should be immunized from attack as a preference even if the act creating perfection occurred outside the bankruptcy grace period.9

The two most recent U.S. Court of Appeal decisions10 recognize this view, which seems to reflect the plain meaning of the statutory language, if not the intended policy.11 Nonetheless, there continues to be a split of authority among the cases, with some courts using a presumed Congressional intent as a basis for determining the meaning of section 547(c)(1)(B).12

II. The 1994 Bankruptcy Reform Act

Addressing this issue as part of the 1994 Bankruptcy Reform Act, Congress revised section 547, extending the section 547(c)(3)(B) grace period from ten to 20 days. By itself this does not address the relationship between Bankruptcy Code sections 547(c)(3)(B) and 547(e)(1)(B) and the state law grace periods, though it likely does reduce the issue to an academic matter. Most lenders will be able to meet the new 20 day grace period at revised section 547(c)(3)(B); only if a secured party fails to do so, but perfects within an extended state law

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4. Alternatively, perfection within ten days after the debtor received the collateral and cleared the debt could be deemed a transfer to the creditor on behalf of the manufacturer. See UCC § 9-313(4).
7. See, e.g., Case Note: In re Harrington (In re Harrington 47 Consumer Fin. L. Q. Rep. 149 (1994)).
9. See Case Notes, supra note 6. Obviously this analysis will not help if the effective date of perfection under state law is outside the Bankruptcy Code grace period. See id. and In re Barringer, 95 B.R. 43 (Bankr. N.D. Ill. 1989).
10. See In re Barringer, 95 B.R. 43 (Bankr. N.D. Ill. 1989); In re Hauser, 91 F.3d 710 (11th Cir. 1996); In re Musial, 94 F.3d 542 (3d Cir. 1996). Barringer includes a particularly good discussion of the issue.
11. The divergent meaning of § 547(e)(1)(B) is to incorporate the effective date of perfection under state law for purposes of § 547(c)(3)(B).
grace period that provides an effective date of perfection within the 20 day period at section 547(c)(3)(B), will the issue be revived.

Nonetheless Congress apparently sought to specifically resolve the relationship between the state and federal grace periods. The 1994 revisions also changed Bankruptcy Code section 547(e)(2)(A), by inserting the words "except as provided in subsection (c)(3)(B)." This may have been intended to sever the relationship between sections 547(c)(3)(B) and 547(e)(2)(A), in an effort to preclude the incorporation of state law to supplement the grace period in section 547(c)(3)(B).

Arguably, however, the 1994 revision was ineffective to accomplish this purpose. The revisions effectively preclude use of section 547(e)(2)(A) in calculating the grace period at section 547(c)(3)(B), but that was never the issue. Section 547(e)(2)(A) defines the date of a "transfer" (now, for all section 547 purposes except subsection (c)(3)(B)). This may be relevant for other issues, e.g., whether transfers between the debtor and secured party were contemporaneous under section 547(e)(1). But the significant issue under section 547(e)(3)(B) is the effective date of perfection, not the date of transfer. This is determined under section 547(e)(1)(B), and section 547(e)(2)(A) is irrelevant to this analysis.

Section 547(e)(1)(B) was not affected by the 1994 revisions, and therefore the Hesser analysis remains valid. For purposes of the grace period at section 547(c)(3)(B), the effective date of perfection is determined under state law, pursuant to section 547(e)(1)(B). This means that, in a proper analysis, a secured party may still combine (or "tack") the Bankruptcy Code grace period at section 547(c)(3)(B) (now extended to 20 days) and certain state law grace periods, as in Hesser. As a result, the newly extended 20 day grace period at section 547(c)(3)(B), in conjunction with a state law grace period, may result in some truly generous total grace periods.

For example, in Oklahoma the Motor Vehicle Act provides a grace period of 15 days after the execution of the lien entry form. If the lien entry form is executed on the 20th day after the debtor received possession of the collateral (within the new Bankruptcy Code section 547(c)(3)(B) grace period), and the security interest is perfected under the lien entry system within 15 days thereafter, the security interest would be protected from attack as a preference, even though it was not perfected until 35 days after the debtor signed the note and received the collateral.

It is quite possible that this was not what Congress intended. However, Congress spoke with unusual clarity when it designed sections 547(e)(3)(B) and 547(e)(1)(B). As a result, the effective date of perfection, for purposes of determining compliance with section 547(e)(3)(B), is to be determined under state law pursuant to section 547(e)(1)(B). The Bankruptcy Reform Act of 1994 does not change this analysis.

[The author is chair of an American Bar Association Uniform Commercial Code Committee Task Force on Certificate of Title Laws. The Task Force is studying state certificate of title laws and lien entry systems, and their relationship to UCC Article 9 and other laws. If you would like to participate in the work of the Task Force, or receive copies of its reports, please contact the author at the address shown on the inside cover page.]

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