Bankruptcy Code Preempts State Law Grace Period

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national bank's charter. Because the Consumer Act is a regulatory scheme, not a usury law entitled to deference under the NBA, Glidden concluded that the Consumer Act does not warrant deference with respect to lending by national banks. Glidden also opined that the fee imposed by the Consumer Act is structured more in the way of a regulatory fee than a revenue-raising (tax) device and thus, considering the use of the proceeds of the Consumer Act fee, cannot be properly assessed against national banks under 12 U.S.C. section 548.166

Finally, Glidden opined that the notice portion of the Consumer Act is separately preempted by 12 U.S.C. section 484,167 which vests exclusive power of visitation over national banks in the OCC.168

The Glidden letter is noteworthy for the breadth of its statements of the scope of federal preemption.169

V. Conclusions

The full effect and ramifications of the Greenwood Trust decision are unclear. Regardless of the outcome of Greenwood Trust on appeal, significant legal issues relating to the scope of federal preemption and to the application of choice-of-law analysis to interstate consumer credit transactions may remain unresolved. The filing of several class actions around the country is a clear consequence of Greenwood Trust. While the litigation involving Safran Bank also holds the possibility of an adjudication of some of these issues, additional litigation, on appeal or otherwise, seems inevitable. The effect that the pronouncements of regulators like the OCC, evidenced by the Glidden letter’s broad vision of federal preemption under the NBA, may have on these issues is uncertain, although such opinions were given no deference by the Greenwood Trust court. While the litigation of federal issues continues, the Pizzagalli decision demonstrates continuing uncertainties in the regulation of interstate consumer credit transactions at the state law level, particularly with respect to licensing statutes. Because of the number of unresolved issues and because the business of lending cannot wait for Congress to act or the courts to decide, these and other developments in the future can be expected to have a significant impact on lenders and the nature and direction of interstate consumer credit transactions.

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1 See Harrell, Miller, & Woodward, Update on U.C.C. — Other Law Conflict, 40 Consumer Fin. L. Q. Rep. 335, 341-343 (1991). In some cases the extended grace period is provided under the state’s motor vehicle act (for a security interest in a vehicle) rather than the OCC.


3 The grace period at UCC § 9-301(2) and § 9-312(4) for perfection of a purchase money security interest is ten days after the debtor receives possession of the collateral. By unsolicited amendment in 1980, the grace period was extended to 40 days for new transactions.

4 The “reference period” is generally the 90 day period prior to bankruptcy, but may be one year if the credit is an “insider” of the debtor. See 11 U.S.C. § 547(b)(4)(A). An “insider” is defined at 11 U.S.C. § 101(3).


6 See, In re Endicott, 94 Bankr. at 803, excepted in Harrell, Miller, & Woodward, supra note 1, at the note at 91.

7 In re Bemidji, 918 F.2d 928 (11th Cir. 1990).


10 See, 11 U.S.C. § 547(b)(4)(A), and Glidden v. Manley-Ferguson, 353 F.2d 986 (9th Cir. 1965), cert. denied, 384 U.S. 970.

11 See 11 U.S.C. §§ 547(h)(4), and Glidden v. Manley-Ferguson, 353 F.2d 986 (9th Cir. 1965), cert. denied, 384 U.S. 970.


14 918 F.2d 928.

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Case Note: Bankruptcy Code Preempts State Law Grace Period

By Alvin C. Harrell

A previous article in this journal discussed the split among the circuits concerning the relationship between the ten day grace period for perfection of a purchase money security interest under Bankruptcy Code section 547(b)(4), and the larger grace periods applicable in some states by reason of nonuniform UCC amendments or other state law.1 This case note will update that analysis by describing two unpublished orders, from the U.S. Bankruptcy Court for the Western District for Ohio, that provide the most thorough judicial analysis of the relevant issues since Judge Kelley decided In re Burnett.2 The choice of applicable law (state law or the Bankruptcy Code) is crucial with regard to the status and priority of a purchase money security interest perfected outside the ten day bankruptcy grace period but within an extended state grace period,3 during the Bankruptcy Code "preference period."4

As noted in the previous Quarterly Report article, in In re Hamilton the Fifth Circuit ruled that it is a simple matter of state versus federal law, so that the shorter federal grace period must prevail.5 This ignores the important interpretational and policy issues, relating to the statutory language and the overall relationship between the UCC and the Bankruptcy Code, that led Judge Kelley to conclude in Burnett that federal law incorporates the state law rules on perfection in this circumstance.6 Subsequent to Hamilton, the 11th Circuit adopted the Burnett result, but like the Fifth Circuit it did not specifically address many of the relevant issues, creating a split among the circuits but providing very little guidance as to the interpretational issues involved.7

Recently, however, an unpublished Order from the U.S. Bankruptcy Court for the Western District of Ohio addressed these issues in greater detail.8 Together with a subsequent Order from the District Court affirming the Bankruptcy Court’s Order,9 this represents the most thorough judicial analysis of the relevant issues since Judge Kelley’s opinion in Burnett.10 In Heiser the lender (GMAC) financed the purchase of a pickup truck. The lien entry form perfecting the security interest was received by the motor vehicle agent within 15 days after the date of execution of the form, thereby complying with the requirements for priority under Oklahoma law.11 The debtors then filed a petition under Chapter 7 of the Bankruptcy Code within 90 days, so that perfection of the security interest constituted a transfer from the debtor to the secured party on behalf of an antecedent debt,12 and hence an avoidable preference,13 unless one of the exceptions applied.14

Relying on Bemidji,15 the secured party argued that its security interest fell within the exception for a purchase money security interest at 11 U.S.C. subsection 547(b)(4). Subsection 547(b)(4)(B) requires that such a security interest be perfected within ten days after the debtor receives possession of the collateral. Again relying on Bemidji, the secured party argued that the effective date of perfection is to be determined pursuant to subsection 547(b)(4)(B) (which defines the effective date of perfection for purposes of section 547).

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occur at early termination if a lessor were permitted to recover an excess wear and tear charge that was not based upon the actual repair cost.

V. Clarifying Provisions Inserted in Response to Esoteric Legal Issues Posed by Automobile Lease Transactions

The proposed automobile leasing measure also includes several provisions that are designed to clarify various esoteric issues posed by automobile lease transactions. For example, the bill would clarify the status of purchase option leases by amending the MVRSA to make clear that purchase option leases of automobiles are not retail installment sales covered by the MVRSA unless the purchase option is "for no other or for a nominal consideration." Under the bill, the lessor would also clarify the impact on automobile lease transactions of several other New York State consumer credit laws which were enacted long before vehicle leasing became popular with consumers. One such example would be the treatment of financed sales of goods or services which are incidental to an automobile lease transaction. To this end, the bill would add to the New York Retail Installment Sales Act ("RISA") provisions that would express:

ly exempt from the RISA goods or services that are sold or leased in connection with an automobile lease transaction governed by the proposed MVRLA. It also would amend the insurance premium financing article of the New York Banking Law in a manner that is intended to clarify that such articles do not affect "the inclusion of amounts for insurance in retail lease agreements in accordance with the motor vehicle retail leasing act."

VI. Conclusion

The proposed New York State automobile leasing legislation is the product of a lengthy and somewhat controversial attempt to subject automobile lease transactions to comprehensive state regulation. While the testimony submitted in connection with the public hearing conducted by the Assembly Committee on Consumer Affairs and Protection suggests that there were some contentious moments during the process, the diverse participants in the legislative process have laid the foundation for what ultimately may become a landmark piece of consumer protection legislation. Nevertheless, there are several outstanding technical and substantive issues which should be resolved before the legislation is enacted into law. For example, various aspects of the early termination and capitalized cost provisions of the legislation still engender lively debate among persons interested in the legislation. However, even if the proponents and critics of the legislation are not able to resolve their few remaining differences, it is possible that other state legislatures may use the proposed New York State automobile leasing legislation as a model for comprehensive state regulation of an increasingly popular means of retail distribution. Indeed, the Pennsylvania General Assembly has followed the lead of its New York counterpart and currently is considering a proposed Motor Vehicle Retail Leasing Act which, although apparently modeled on the New York legislative bill, differs radically in several significant respects. As the size of the automobile leasing industry continues to grow, other states might well be expected to follow suit.

52. N.Y.A. 5445, § 2, 213th Sess. (1991) (proposed amendment to N.Y. Pers. Prop. Law § 301(3)(a)).

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under subsection 547(c)(1)(B) the effective date of perfection is to be determined by reference to state law: “[A] transfer ... is perfected when a creditor on a simple contract cannot acquire a judicial lien that is superior to the [security interest].” Under the applicable state law, proper submission of the lien entry form within the 15 day grace period would mean that the security interest is perfected from day one of that 15 day period, as against a lien obtained by a “creditor on a simple contract.” Since the security interest was perfected from the beginning of the 15 day period under Bankruptcy Code subsection 547(c)(1)(B), it was perfected within the ten day grace period at Bankruptcy Code subsection 547(c)(3)(B), and was entitled to protection under the exception for purchase money security interests at subsection 547(c)(3). Your author finds this rationale compelling as a matter of statutory interpretation, especially in view of the apparent propriety of the U.S. Supreme Court to follow the "plain meaning" of the statute in bankruptcy cases. Unfortunately in Hesser neither the Bankruptcy Court nor the District Court agreed. Instead the courts agreed with the debtor's argument that the time a transfer is made is determined pursuant to 11 U.S.C. section 547(c)(2), and under this provision a transfer is deemed to be made as of the first day of the month that the transfer is made, and not the date the transfer is made. As noted above, the effective date of perfection should be determined under §547(c)(1)(B) by reference to state law.


17. While this is a correct interpretation of § 547(e)(2), your author would argue that the section does not apply when the transfer is made, but the date it is perfected. These are two entirely distinct events. E.g., each epileptic patient will have an aura, but it is the date of the aura which is the effective date of perfection. Thus, the aura need not be considered unless the date of perfection is being referenced. If the effective date of perfection were the date the transfer is made, it would have no substantive significance, and the terms of bankruptcy would serve no purpose.

19. See, Columbus Vol. Bankr. Rep. 136 (216-12170) (even though 11 U.S.C. §547(e)(2) of the Code is a "local substantive code section" and is not part of the Bankruptcy Code, its provisions cannot be ignored when determining the effective date of perfection).
board must stop paying when it reasonably believes it is no longer substantially likely the IAP will prevail. What’s the chance the FDIC will think the board pulled the plug at precisely the right time? Consequently, it is highly unlikely that any board will authorize the ongoing payment of defense costs.

The FDIC no doubt feels that this kind of harsh treatment is richly deserved by the likes of David Paul and Charlie Keating. Regulation to the lowest common denominator may, however, ultimately prove shortsighted as directors and officers wake up to the risks these new rules present to decent and law abiding people. Consider civil money penalties, the area where honest IAPs face the most risk. CMPs are assessable in three tiers — the first applicable to any violation of law or regulation. CMPs are thus assessable not only for negligent conduct that results in a violation, but also for violations that occur despite reasonable precautions to avoid them. The volume and breadth of laws and regulations applicable to insured financial institutions is staggering. Ranging from the myriad of consumer laws (the acronyms of TILA, ECOA, FCRA, CRA, RESPA come to mind) to the safety and soundness regulations that cover virtually every aspect of the business, the law has become so complex and so pervasive that it is, without a scintilla of a doubt, impossible to comply with it all.

The risk is therefore very real for directors, officers and employees — even if they’re honest and conscientious. The FDIC, OTS and OCC will say that they exercise discretion in meting out penalties to CMPs. Trust me, Flounder.

In this environment, the FDIC should not restrict indemnity any more than the Congress has mandated. The FDIC should certainly not have made it so difficult to cover the cost of defense. It would have been sufficient to require a good faith determination of no intentional wrongdoing and an agreement for reimbursement if a final order was issued. The FDIC should also have taken advantage of the phrase “of the institution” and authorized insurance coverage for affiliated CMPs. Finally, the FDIC could have been very helpful to the attraction and retention of directors and officers had it limited the indemnification prohibition to cases of intentional wrongdoing; i.e. a board could indemnify for both expenses and liability unless the IAP acted in deliberate disregard of the law. Such a rule would put insured institutions on a relative par with the rest of industry. It is folly to assume that the banking industry can long and profitably operate on an unlevel playing field with the rest of the commercial world. Deposit insurance may justify extra regulation and supervision, but it is counterproductive to the ultimate goal of safety and soundness to impose a high level of risk on bank directors and officers. That risk, when finally appreciated, will drive the very kind of conscientious and risk averse director and officer the system needs out of the business.

In summary, the FDIC indemnification proposal expands the prohibition contained in the Crime Act by extending it to subsidiaries through a redefinition of a holding company, adding a reference to cease and desist orders, adding state enforcement proceedings and actions, adding a reference to charter and bylaw provisions, prohibiting institution purchased insurance coverage, and establishing rigid criteria for payment of ongoing defense costs.

VI. Conclusion

There can be no doubt that FIRREA substantially increased the obligations of and risks for insured institution officers and directors. It therefore seems an inopportune time to reduce compensation, but that is exactly what Congress did in the Crime Control Act provision restricting golden parachute payments. While the golden parachute restriction applies only to troubled institutions, anyone familiar with the process knows that it is not difficult in these times to fall within that category or close to it. A troubled institution, for example, is one failing any of the capital requirements (including an individual capital requirement), or one labeled “troubled” for any reason the federal regulators feel is appropriate. The parachute restriction is based on the assumption that a troubled condition cannot possibly occur if good management is present. Representative Price in fact said: “No one deserves such a windfall for failure…” Representa
tive Oakar said: “these people rewarded themselves for their failures.” The assumption is wrong. Troubled and near troubled institutions are those that most need good management. The golden parachute restrictions remove a significant part of the compensation package for executives of troubled and near troubled institutions, which can only serve to drive good management out of those institutions that need it most and at a time they need it most. The FDIC had the opportunity to limit the parachute restrictions; it unwisely chose instead to expand them.

The indemnification restrictions proceed on the erroneous assumption that enforcement actions require culpable conduct. They do not, and such things as civil money penalties are assessable for innocent good faith conduct that happens to transgress any of the banking laws and regulations. The FDIC had the opportunity to limit the indemnification prohibition to cases of intentional wrongdoing; instead it chose to expand the coverage. One can only hope the final rule will be substantially different from the proposal.


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are presented in these cases. This analysis, along with other discussion of the relative impact of subsections 547(e)(1)(B) and 547(e)(2)(A), in both the Bankruptcy and District Court Orders in Hesser, compare very favorably with the far more simplistic analysis in Hamilton (which failed even to acknowledge most of these issues).

Finally, the Hesser Orders refer to the apparent desire of Congress to create a uniform national perfection period for purposes of Bankruptcy Code section 547.21 While this appears to have been accomplished by Congress with regard to the date a transfer is made (pursuant to the 10 day grace period at subsection 547(e)(2)(A)), it does not appear to be the case with regard to the effective date of perfection, which is a different issue (governed by state law pursuant to subsection 547(e)(1)(B)). Nonetheless, as the Bankruptcy Court’s Order in Hesser notes,22 Bankruptcy Code subsection 547(e)(3)(B) was amended in 1984 to conform to the language governing the perfection grace period in the uniform text of the UCC at Article 9.

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22. Hesser I, slip op., supra note 8, at 8.
Bank and Thrift Associations Join Conference

The Kansas-Nebraska League of Savings Institutions, the North Dakota Bankers Association, and the Michigan League of Savings Institutions have become associated with the Conference on Consumer Finance Law. As a result each member institution of these associations, as well as various officers and directors of each group, will receive a subscription to the Quarterly Report. These associations join numerous other financial services associations across the country in support of the Conference goals of promoting education and scholarship in the field of banking and finance.

The Kansas-Nebraska League of Savings Institutions represents 45 savings banks and savings and loan associations in the states of Kansas and Nebraska. Vice President Jeffrey D. Sonnich reports that a primary focus of the League is to help its members stay informed about legislative and regulatory changes that affect their business. While the League staff covers state and federal legislative and regulatory developments quite effectively, the Quarterly Report will supplement their efforts to help inform League members as to judicial and other related developments.

The North Dakota Bankers Association represents 150 member banks. James D. Schlotter is Executive Vice President. The North Dakota Association provides a variety of services to its members, including educational seminars, a basic banking school and participation in two graduate schools of banking, extensive government relations efforts, several publications (including a bi-weekly bulletin, a quarterly newsletter, and legislative, regulatory, and legal and compliance reports), various community outreach programs, insurance services, and other operational assistance programs. Once again, the Association views the Quarterly Report as a cost-effective means to supplement the educational benefits provided to its members.

The Michigan League of Savings Institutions represents 37 Michigan savings institutions with total assets of more than $30 billion. In addition to offering such traditional member services as government relations, educational programs and miscellaneous publications, the League owns two insurance subsidiaries which provide a wide variety of insurance products and services to its member institutions. League Executive Vice President Robert G. Howell notes that the increasing sophistication of savings industry executives and counsel requires that savings institutions have access to in-depth coverage of the legal issues and trends affecting the business. Howell feels that the Quarterly Report is a solid supplement to the other information services provided by the League to its members.

These organizations join financial services associations in more than twenty other states and Australia in support of the goals of the Conference. As most readers know, the Conference on Consumer Finance Law is an independent, nonprofit organization founded in 1927 by leaders of the American Bar Association and the financial services industry, for the purpose of promoting research, education and scholarship in matters relating to financial services law, and to provide a forum to facilitate the exchange of ideas for improving the law. The Quarterly Report is a primary vehicle for achieving these goals, although the Conference also sponsors seminars in various locations and conducts meetings in conjunction with the ABA.

The Conference membership consists primarily of financial services executives and their in-house and outside legal counsel, but also includes accountants, economists, professors, judges, regulators, and consumer advocates. All types and sizes of financial institutions and law firms are represented, from the largest financial holding companies and metropolitan law firms to the smallest community banks and thrills and solo practitioners. The Conference seeks to have all points of view represented, both in the membership and in the pages of the Quarterly Report. To that end, readers' comments and suggestions are solicited and all members are encouraged to submit articles or letters for publication.

On behalf of the Conference and the Quarterly Report, we welcome the Kansas-Nebraska League of Savings Institutions, The North Dakota Bankers Association, and the Michigan League of Savings Institutions to the Conference on Consumer Finance Law. As with all members, we appreciate your participation and support, solicit your comments, and look forward to a mutually beneficial relationship in support of our common objectives.

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journal ultimately concluded that even if the Hamilton result is superior on a policy basis its analysis is defective as a matter of statutory interpretation.36

Like so many issues confronting the bankruptcy courts today, these questions likely will have to be resolved by Congress or the U.S. Supreme Court before any kind of consistency and predictability can be achieved. In the meantime cases like Hesor (by addressing the relevant issues) will help to frame the discussion and develop a greater awareness of the issues involved, paving the way for ultimate resolution.27 At the same time the practical implications are clear: Lenders exceed the ten day Bankruptcy Code grace period at their peril, despite the plain language of Bankruptcy Code subsection 547(e)(1)(B).

27. Two other recent cases whose members are in this context. In re Weaver, 131 Bankr. 504 (S.D. Ohio 1991), the Dennis Court reversed the Bankruptcy Court's decision that lien entry notice proceedings for approximately two weeks after the sale was undue. The court concluded that no such notice is required until the sale was consummated. In re McCullom, 131 Bankr. 527 (D.D. Mass. 1991) is on appeal on similar facts.


25. (Continued from previous column)

24. Id. (citation omitted).

23. The District Court Order in Hesor observes that state law grace (Continued in next column)