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THE USE OF OHIO'S PREFERENCE LAW IN BANKRUPTCY: AN ALTERNATIVE TO SECTION 547 WITH A LONGER 'REACH-BACK' PERIOD

THOMAS D. BUCKLEY*

INTRODUCTION

Ohio is one of the few states with a preference law of general application among its debtor-creditor statutes.¹ Ohio Revised Code sections 1313.56 and 1313.57² give creditors an avoidance power

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1. Kentucky, Maryland, and New Mexico are the other states. KY. REV. STAT. ANN. § 378.060 (Baldwin 1981); MD. COM. LAW CODE ANN. § 15-101 (1990); N.M. STAT. ANN. §§ 56-9-1, 56-9-47 (Michie 1978). The Maryland statute incorporates into state law the preference provisions of federal bankruptcy law. A six-month statute of limitations is applicable in both Kentucky and New Mexico. KY. REV. STAT. ANN. § 378-070 (Baldwin 1981); N.M. STAT. ANN. § 56-9-2 (Michie 1978). West Virginia repealed a preference law of general application in 1986. See W. VA. CODE § 40-1-5, *repealed by* 1986 W. Va. Acts, c.166.

In Oklahoma, a preferential trust settled by an insolvent is deemed a trust for the benefit of all creditors. OKLA. STAT. ANN. tit. 24, § 31 (West 1987).

In many states, a preference transferred within a specified period of time before a general assignment for the benefit of creditors can be avoided by the assignee. See, e.g., PA. STAT. ANN. tit. 39, § 151 (1954) (four months); N.J. STAT. ANN. § 2A:19-3 (West 1987) (four months); CAL. CIV. PROC. CODE § 1800 (West 1982) (ninety days).

Preference laws applicable only to insolvent insurance companies or banks are found in over thirty states. See, e.g., ALA. CODE § 27-32-27 (1986) (insurance); ALASKA STAT. § 21.78.250 (1991) (insurance); CAL. FIN. CODE § 17639 (West 1989) (banking).

The Uniform Fraudulent Transfer Act makes preferences transferred to insiders voidable. Unif. Fraudulent Transfer Act § 5(b), 7A U.L.A. 639 (1985). See Frank R. Kennedy, *The Uniform Fraudulent Transfer Act*, 18 UCC L.J. 195, 204-05 (1986).

See generally STEFAN A. RIESENFELD, CREDITORS' REMEDIES AND DEBTORS' PROTECTION 439-41 (4th ed. 1987) (history).

2. Section 1313.56 states,

§ 1313.56: Appointment of a Receiver. A sale, conveyance, transfer, mortgage, or assignment, made in trust or otherwise by a debtor, and every judgment suffered by him against himself in

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similar to a bankruptcy trustee's avoidance power under federal bankruptcy law.³

A preference law can apply when an insolvent debtor makes a transfer to an unsecured creditor holding a preexisting claim. Because the debtor's insolvency means that other creditors, as a group, cannot receive as much satisfaction with respect to their claims, the effect of such a transfer is to "prefer" the transferee. If under preference law the bankruptcy trustee "avoids" the preferential transfer, the preferred creditor has to give up what it has received, its claim against the insolvent debtor is restored, and the property transferred becomes available for distribution ratably among all the creditors.

The Ohio preference law can be enforced by a nonpreferred creditor in an Ohio state court, while Bankruptcy Code section 547, "Preferences," is applicable in a federal bankruptcy case. In a bankruptcy case, however, a bankruptcy trustee cannot only invoke

contemplation of insolvency and with a design to prefer one or more creditors to the exclusion in whole or in part of others, and a sale, conveyance, transfer, mortgage, or assignment made, or judgment procured by him to be rendered, in any manner, with intent to hinder, delay, or defraud creditors, is void as to creditors of such debtor at the suit of any creditor. In a suit brought by a creditor of such debtor for the purpose of declaring such sale void, a receiver may be appointed who shall take charge of all the assets of such debtor, including the property so sold, conveyed, transferred, mortgaged, or assigned, and also administer all the assets of the debtor for the equal benefit of the creditors of the debtor in proportion to the amount of their respective demands, including those which are unmaturred.

Section 1313.57 states,

§ 1313.57: Knowledge of fraudulent intent material; mortgage in good faith. Section 1313.56 of the Revised Code does not apply unless the person to whom such sale conveyance, transfer, mortgage, or assignment is made, knew of such fraudulent intent on the part of such debtor. Said section does not vitiate or affect any mortgage made in good faith to secure any debt or liability created simultaneously with such mortgage, if such mortgage is filed for record in the county wherein the property is situated or as otherwise provided by law, within three days after its execution, and when, upon foreclosure or taking possession of such property the mortgagee fully accounts for the proceeds therein.

OHIO REV. CODE ANN. §§ 1313.56 & 1313.57 (Baldwin 1979).

3. 11 U.S.C. § 547 (1988).

the avoiding powers provided for under federal law, such as section 547, but the trustee can also add to the bankruptcy estate any assets that were transferred by the debtor before bankruptcy in a transaction which could have been avoided under state law by an unsecured creditor.⁴ The Ohio preference law is such a state law. Therefore, a bankruptcy trustee in an Ohio bankruptcy case, unlike bankruptcy trustees in nearly every other state, has two alternative preference theories to bring to bear against creditors that have received assets from a debtor before the filing of the bankruptcy petition. Since the Ohio preference law can be applied to transactions that would escape avoidance under Bankruptcy Code section 547, a bankruptcy trustee in Ohio has the potential to be a more powerful representative of general unsecured creditors than trustees in most other jurisdictions. This potential Ohio advantage, however, seems to have been generally overlooked. Sections 1313.56 and 1313.57 are rarely invoked. Yet it appears their use could have made a difference in the outcome in some recent cases.⁵ Moreover, with the increasing use of

4. "The trustee may avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is voidable under applicable law by a creditor holding an unsecured claim. . . ." 11 U.S.C. § 544(b) (1988). In a Chapter 11 bankruptcy case, where a trustee is not normally appointed, the debtor would be able to exercise both the Ohio and federal preference avoiding powers. 11 U.S.C. § 1107(a).

In states with preference statutes which are not of general application, use of the statute in conjunction with § 544(b) may be inhibited by limits built into the state law itself. *See supra* note 1. Thus, the Pennsylvania statute can not be invoked in a federal bankruptcy case unless the preference was followed within 120 days by an assignment for the benefit of creditors. *Copter, Inc. v. Gladwin Leasing, Inc.*, 725 F.2d 37 (3rd Cir. 1984). *Compare Zimmerman v. Frem Corp. (In re Kenval Mktg. Corp.)*, 69 Bankr. 922 (Bankr. E.D. Pa. 1987) (permitting trustee to use § 544(b) to avoid what an "assignee" but not a "creditor," as specified in § 544(b), could avoid under the state preference law). No such technical difficulties are presented by the Ohio Revised Code sections 1313.56 and 1313.57.

See Vern Countryman, The Use of State Law in Bankruptcy Cases (Part II), 47 N.Y.U. L. REV. 631, 661-62 (1972).

5. *NLRB v. Martin Arsham Sewing Co.*, 873 F.2d 888, *reh'g denied*, 882 F.2d 216 (6th Cir. 1989); *In re Hartley*, 52 Bankr. 679 (Bankr. N.D. Ohio 1985). *See also In re Hollar*, 100 Bankr. 892 (Bankr. N.D. Ohio 1989).

In *Martin Arsham*, the Sixth Circuit Court of Appeals denied the NLRB's petition to enforce an order imposing personal liability for a backpay award on the sole shareholder of a corporation. The corporation had gone through bankruptcy. Before bankruptcy, the stockholder had taken a security interest and assets from the corporation as security for an antecedent debt. The court said that the NLRB should have suggested recovery against the stockholder in
(continued)

the bankruptcy case on the basis of fraudulent conveyance law. 873 F.2d at 886, n.1. Further, to let the NLRB recover after bankruptcy would give it a priority not warranted by the Bankruptcy Code. *Id.* at 888. On rehearing, however, the court said, "No claim is made that the corporation did not owe Arsham the money. It was only the Bankruptcy Act which made the repayment of this antecedent debt a *preference* which could be set aside." 882 F.2d 216 (emphasis added). The debt was secured; however, the only preferential transfer avoidable under federal or state law was the grant of the security interest, which had been made on account of an antecedent debt. The security interest had been perfected 32 months before bankruptcy. Therefore, it was Ohio preference law, not "Bankruptcy Act" preference law, which might have avoided it. The trustee had not invoked Ohio preference law, however, in the bankruptcy proceeding.

In *Hartley*, the bankruptcy trustee tried to avoid the debtor's pledge of corporate stock to a bank creditor to cover overdrafts. The trustee relied on federal preference law and federal fraudulent conveyance law and lost on both theories. The preference argument lost because the pledge occurred between ninety days and one year before bankruptcy, and the trustee's characterization of the transferee as an insider was rejected. (Under federal preference law, a preference can be avoided only if it occurs within ninety days before bankruptcy, unless the transferee is an "insider" and a one-year "reach back" period applies. § 547(b)(4)(B)). The fraudulent conveyance case under § 548 of the Bankruptcy Code lost because 1) the antecedent debt incurred in running up the overdrafts was adequate consideration for the conveyance, and 2) the court followed cases in other jurisdictions holding that the debtor's intent to prefer, coupled with the bank creditor's knowing receipt of the preference, did not turn the transaction into a fraudulent conveyance. That kind of evidence in Ohio, however, would have established an Ohio preference, and the Ohio preference would have been voidable even though it occurred more than ninety days before the filing of the bankruptcy petition. The trustee, however, apparently made no argument based on Ohio preference law.

In *Hollar*, a \$2000 debt repayment made to the debtor's "girlfriend and future fiancée" more than 90 days, but less than one year, before the bankruptcy petition escaped avoidance under § 547 because the court found that the girlfriend was not an "insider." The debtor's intent to prefer and his girlfriend's knowledge of it were irrelevant under federal law and were not discussed; the nature of the relationship between the debtor and the transferee suggest that exploration of the intent and knowledge issues might have been fruitful for the trustee, had § 1313.56 been invoked.

In other cases, it is possible that application of Ohio preference law would have yielded greater preference recoveries because transfers made earlier than 90 days before bankruptcy, as well as within 90 days of bankruptcy, could have been recovered. *See, eg., In re Circleville Distributing Co.*, 84 Bankr. 502 (Bankr. S.D. Ohio 1988).

bankruptcy courts for the disposition of insolvency cases, the bankruptcy court is probably the most likely venue for invocation of Ohio's preference law in the future.⁶

This article traces the origins and history of sections 1313.56 and 1313.57 and, in so doing, delineates the scope of the power that creditors (and bankruptcy trustees) have under Ohio preference law. It then compares the elements of an Ohio preference with the elements of a federal preference. From a bankruptcy trustee's perspective, the state law has one significant advantage and several disadvantages.

The major advantage is that preferences which have occurred several years before bankruptcy can be avoided; the comparable period under federal law is ninety days, or, in some limited circumstances, one year.⁷ The disadvantages are that, to invoke the state law, the trustee must identify some creditor who, in fact, has a section 1313.56 claim; preferences in the form of money payments may not be avoidable at all (but the law on this point is not clear); and subjective mental elements must be established (the debtor's intent to prefer and the creditor's knowledge of it), which have no explicit counterparts in federal law.

While this article compares the federal and state preference rules, evaluating the practical significance of the differences between them, the relative strength of the two laws is less important than the fact that the bankruptcy trustee can choose whichever of the two laws is more effective with respect to any given prebankruptcy transaction. Thus, both laws might be applied in the same case, each to a separate transfer. Therefore, the real test of the importance of the Ohio preference law will have to be made in the courts when and if trustees begin to exercise this neglected avoidance power. This article may stimulate that process. *A priori*, however, it would appear that having two preference theories to apply is better than having only one.

6. Bankruptcy filings increased from 331,098 to 782,960 between 1980 and 1990. Federal Judicial Workload Statistics, Dec. 31, 1990, Administrative Office of the United States Courts, p. 11. There were 20,783 Chapter 11 filings, most of which represent business failures, in 1990, an increase of 14% over 1989. *Id.*

7. The advantage can be highly significant. See text accompanying notes 110-21, *infra*, with respect to the *Deprizio* case.

I. STATUTORY HISTORY

A. Nineteenth-Century Origins

Preference law first appeared in the Ohio statutes in 1835.⁸ At that time, some transfers in trust by insolvents for the benefit of fewer than all their creditors were already unenforceable under Ohio common law.⁹ It was not their preferential character, however, that made such transfers unlawful. Other factors were objectionable, such as the debtor's retention of the possibility of getting back what was transferred, or the imposition of a requirement that creditors give the debtor a complete release from liability in order to participate in the division of the trust assets.¹⁰ The objectionable terms meant that, while the debtor might not actually pay anyone, the transfer to a trustee put the debtor's property beyond the reach of other creditors.¹¹

8. An Act to amend the act directing the mode of proceeding in chancery.

Sec. 1. Be it enacted by the General Assembly of the State of Ohio, That all assignments of property hereafter made by debtors to trustees in consideration of insolvency and with design to secure one class of creditors and defraud others shall be held to enure to the benefit of all the creditors of the assignor, in proportion to their demands, and such trusts shall be subject to the control of Chancery as in other cases, and the court, if need be, may require security of the trustees for the faithful execution of the trusts, or remove them and take the execution thereof upon itself as justice may require.

1835 Ohio Laws 13, § 1.

See William H. Rose & Paul Hunsinger, *Transfers in Fraud of Creditors, Ohio Law and the Uniform Act*, 9 OHIO ST. L.J. 571 (1948), n.88.

9. *Atkinson & Rollins v. Jordan Ellis & Co.*, 5 Ohio 293 (1832).

10. *Id.* at 304.

11. In *Atkinson*, the court stated,

It seems to us clear . . . that the clause in the assignment . . . prohibiting any creditor from availing himself of any portion, except within ninety days he executed a release for his whole debt, is a manifest attempt, on the part of these debtors, to place all their property beyond the reach of creditors, by ordinary legal process, and coerce from them a release of their entire demands upon the possible contingency of realizing something out of the effects, after the expenses, securities, and preferred creditors are satisfied, and as such is void against creditors. The case before us is a strong one to show the injustice of such proceedings. The debtor, the trustees, and only three or four of a large number of creditors have executed the assignment, while, by its operation, property to the amount of nineteen thousand dollars, is held under it beyond the reach of legal process. An effort is

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The Ohio courts did not draw the analogy, but it would appear that setting up such a trust was akin to other tactics for evading creditor process, long recognized as "acts of bankruptcy," which brought down on debtors the force of early punitive bankruptcy laws.¹²

By contrast, a forthright, no-strings-attached transfer to a preferred creditor was tolerated.¹³ Granting such a direct preference was a debtor's right; getting a preference was a diligent creditor's reward.¹⁴ Yet, at the same time, if neither the debtor nor creditor had taken steps to create a preference, equity favored equality among creditors and the equal division of an insolvent's assets.¹⁵

The 1835 statute's targeting of those trusts intended "to secure one class of creditors and defraud others" indicates that the legislature identified preferential trusts with the misconduct of a debtor who puts assets beyond the reach of other creditors and thus defrauds them. The purpose of the law, however, was not to specify what was wrong, but to provide a better remedy for the wrong than that provided by the

made by it to procure releases from the general creditors, without the possibility of their obtaining one cent. The preferred creditors alone, who are postponed until the expenses, securities, and fees are paid, have claims upon this nineteen thousand dollars for upward of thirty thousand dollars? Can this be considered as fairly devoting the property of insolvent debtors to the payment of their debts?

Atkinson, 5 Ohio at 304.

12. See, e.g., The Statute of Bankrupts, 13 Elizabeth, c.7 (1570) made keeping to one's house, or leaving the realm, "acts of bankruptcy." See Louis Edward Levinthal, *The Early History of Bankruptcy Law*, 66 U. PA. L. REV. 223 (1918).

13. *Stevenson v. Agry*, 7 Ohio (pt.2) 247 (1836).

14. "It seems, therefore, nothing more than the exercise of the legal right of a debtor to prefer one creditor to another, and the creditor thus preferred, reaps no other harvest than the law secures to the vigilant." *Id.* at 249.

15. In 1844, the court stated,

Naked justice between creditors consists in an equal distribution of the debtor's property among all, in the same proportion. The law sometimes protects preferences either to encourage vigilance, or to leave the acts of parties uncontrolled, when not directly wrong; but the rule of equity is the rule of equality, whenever it can exert its power; and it is this rule which the statute endeavors to follow, when it operates upon assignments.

Bancroft v. Blizzard, 13 Ohio 30, 40 (1844). The "statute" referred to was the 1838 reenactment; see *infra* note 17.

courts.¹⁶ For, absent the statute, the particular creditor who objected to the debtor's attempt to cut off access to assets would have recovered the asset itself and thus received a preference. Instead, under the statute, equity's goal of equal sharing among all creditors would be achieved: the transfer would stand, but the trust created would be administered by the Chancery court on behalf of all the creditors. Thus, the 1835 statute reflected the tension in official attitude toward preferences; preferences were tolerated when debtors exercised the freedom to grant them or creditors exercised the vigilance to take them, but preferences were not acceptable when courts awarded them to prevailing plaintiffs as remedies for debtor misconduct.

In 1838, the statute was amended and reenacted, and a "design to prefer," literally, was proscribed for the first time.¹⁷ In the courts, however, the idea that prevailed was that the statute's real target was a

16. See the suggestion to this effect made by the codifier, Revised Statutes c.1290 (Curwen 1853), footnote 1, p.2239.

17. Section 3 states,

Sec. 3. Assignments of property in trust, which shall be made by debtors to trustees in contemplation of insolvency, with the design to prefer one or more creditors to the exclusion of others, shall be held to enure to the benefit of all the creditors in proportion to their respective demands; and such trusts shall be subject to the control of chancery, as in other cases, and the court, if need be, may require security of the trustees for the faithful execution of the trusts, or remove them and appoint others, as justice may require." 1838 Ohio Laws 56, 57, § 3.

The 1838 statute was reenacted in substantially the same form in 1853.

An Act Declaring the effect of assignments to Trustees, in contemplation of Insolvency. Section 1. Be it enacted by the General Assembly of the State of Ohio, That all assignments of property in trust, which shall be made by debtors to trustees in contemplation of insolvency, with the design to prefer one or more creditors, to the exclusion of others, shall be held to enure to the benefit of all the creditors, in proportion to their respective demands, and such trusts shall be subject to the control of the courts, which may require security of the trustees for the faithful execution of the trusts, or remove them and appoint others, as justice may require.

"Sec. 2. That this act shall take effect on the first day of July, eighteen hundred and fifty-three." 1853 Ohio Laws 463, Act of March 14, 1853. This repealed the Act of March 14, 1838, "the act directing the mode of proceeding in chancery." 1853 Ohio Laws 163. The March 14, 1853 law is also at Revised Statutes c.1290, §§ 1 & 2, at pp. 2239-40(Curwen 1853).

debtor's attempt to put assets out of reach of creditors by means of a trust.¹⁸ Judicial emphasis on assignments *in trust* reflected not only the precise words of the statute, but also the continuing attitude that what was wrong was not granting or taking a preference but using a trust to put assets beyond the reach of other creditors. A trust for the benefit of less than all creditors, when created by an insolvent, was equated with such an attempt to evade creditor process. An outright grant, not in trust, was enforceable even though preferential.¹⁹ When some creditors, through their vigilance, got more than a pro rata share of an insolvent debtor's assets, a "just preference" was the result, and the courts did not interfere.²⁰

In 1859, the legislature repealed the 1838²¹ statute and replaced it with a preference law that was part of a comprehensive legislative treatment of assignments for the benefit of creditors.²² In the same

18. *Doremus v. O'Harra*, 1 Ohio St. 45 (1852) (declining to follow *Mitchel v. Gazzam*, 12 Ohio 315 (1843) which had given the statute a broader reading); *Atkinson v. Tomlinson*, 1 Ohio St. 237 (1853); *Webb v. Brown*, 3 Ohio St. 246 (1854); *Harkraider v. Leiby*, 4 Ohio St. 602 (1855); *Dickson v. Rauson*, 5 Ohio St. 218 (1855); *Bagaley & Co. v. Waters*, 7 Ohio St. 360 (1857); *Justice v. Uhl*, 10 Ohio St. 170 (1859).

19. In *Atkinson*, the court reasoned,

We suppose that the legislature, as the language imports, intended to provide for a case where a trustee is interposed, with the controlling intent on the part of the debtor, of giving one creditor an advantage over another, and that the statute does not apply to the case of a creditor seeking and obtaining, in good faith, a lien on the property of the debtor for the purpose of securing his debt.

Atkinson v. Tomlinson, 1 Ohio St. at 243 (1853).

20. *Webb v. Brown*, 3 Ohio St. 247, 262 (1854).

21. It had been re-enacted in substantially the same form in 1853. See *supra* note 17.

22. 1859 Ohio Laws 56, "An Act Regulating (*sic*) the mode of administering assignments in trust for the benefit of creditors." The relevant parts of the 1859 text provided

Sec.16 All assignments in trust to a trustee or trustees, made in contemplation of insolvency, with the intent to prefer one or more creditors, shall inure to the equal benefit of all creditors in proportion to the amounts of their respective claims, and the trusts arising under the same shall be administered in conformity with the provisions of this act.

Sec.17 All transfers, conveyance or assignments made with the intent to hinder, delay or defraud creditors, shall inure to the equal benefit of all creditors in proportion to the amounts of their respective

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1859 enactment, the legislature also provided for the avoidance of fraudulent conveyances. The law thus acquired the basic features that it has retained up until the present time, voiding both preferences and fraudulent conveyances and allowing for the appointment of a receiver. The statute was further revised in 1863 with respect to fraudulent conveyances²³ and minor revisions were made in 1878.²⁴ By 1880, the fraudulent conveyance law was codified as section 6344 and the preference law as section 6343 of the Revised Statutes.²⁵

Judicial interpretation of the preference statute was the same before and after these revisions. According to the courts, the only preferences to which the statute applied were assignments made *in trust*.²⁶ Under the statute it remained an individual debtor's prerogative to grant preferences to preferred creditors, so long as the recipient of the preferential transfer was paid and did not merely hold

claims, and the probate judge, after any such transfer, conveyance or assignment shall have been made with the intent aforesaid, on the application of any creditor, shall appoint an assignee according to the provisions of this act, who, upon being duly qualified, shall proceed by due course of law to recover possession of all property so transferred, conveyed or assigned, and to administer the same as in other cases of assignments to trustees for the benefit of creditors.

The function of the preference provision, within the larger law on assignments for the benefit of creditors, was to turn assignments for the benefit of preferred creditors into the kind of assignment for all creditors that the statute regulated. However, only the property actually assigned by the debtor in the preferential trust was to be administered for the benefit of all creditors; other property of the debtor not made part of the preferential trust was not affected.

23. 1863 Ohio Laws 8.

24. 1878 Ohio Laws 935, 938 stated,

Sec. 9. All assignments in trust to a trustee or trustees, made in contemplation of insolvency, with the intent to prefer one or more creditors, shall inure to the equal benefit of all creditors, in proportion to the amount of their respective claims, and the trusts arising under the same shall be administered in conformity with the provisions of this chapter.

25. REVISED STATUTES §§ 6343, 6344 (1880).

26. *Cross v. Carstens*, 31 N.E. 506, 507 (1892); *Citizens Nat'l Bank v. Wehrle*, 9 Ohio Cir. Dec. 330 (Erie Cir. Ct. 1897). At the turn of the century, the statute's focus, according to the courts, continued to be on debtor efforts to put assets beyond the reach of creditors.

the property, as a trustee would, for others.²⁷ Yet, at the same time the courts were developing a different, nonstatutory, nontolerant, antipreference common law applicable, not to individuals, but to corporations and partnerships.²⁸ In the next legislative development, the older, narrower, and relatively more tolerant policy toward individual debtors who granted preferences was replaced by rules more like those that the courts were applying to business entities.

B. *Turn-of-the-Century Developments*

In 1898, Revised Statutes sections 6343 and 6344 were completely rewritten. The fraud and preference provisions were both placed in section 6343.²⁹ The new section 6344 provided for the appointment of a

27. "The right of preference rests upon the natural right to acquire and control property. The *jus disponendi* is necessarily an element of ownership. To authorize the citizen to acquire property would be of little use if he had not the corresponding right to dispose of it." *Cross v. Carstens*, 31 N.E. at 510. "[I]n Ohio a failing debtor, knowing his insolvency, and in contemplation of assigning for the benefit of creditors, has a right to prefer one or more creditors to others, if he does so in good faith and hinders other creditors no more than is incidental to the preference [made]. . . ." *Id.*

28. *Rouse v. Merchant's Nat'l Bank*, 22 N.E. 293 (Ohio 1889); *Damarin v. Huron Iron Co.*, 26 N.E. 37 (Ohio 1890); *Benedict v. Market Nat'l Bank*, 10 Ohio Cir. Dec. 505 (Hamilton Cir. Ct. 1890); *See also Bosche v. Toledo Display Horse Co.*, 7 Ohio Cir. Dec. 374 (Lucas Cir. Ct. 1897); *First Nat'l Bank v. McKinney*, 9 Ohio Cir. Dec. 1 (Cuyahoga Cir. Ct. 1898); *Kit Carter Cattle Co. v. McGillin*, 11 Ohio Cir. Dec. 413 (Cuyahoga Cir. Ct. 1900).

29. 1898 Ohio Laws 290. The two sections were amended to read as follows:

Sec. 6343. Every sale, conveyance, transfer, mortgage or assignment, whether made in trust or otherwise, by a debtor or debtors, and every judgment suffered by him or them, and every act or device done or resorted to by him or them, in contemplation of insolvency, or with a design to prefer one or more creditors to the exclusion in whole or part of others, and every sale, conveyance, transfer, mortgage, or assignment made, or judgment suffered by a debtor or debtors, or procured by him or them to be made, in any manner, with intent to hinder, delay or defraud creditors, shall be declared void as to creditors of such debtor or debtors, at the suit of any creditor or creditors, as hereinafter provided, and shall operate as an assignment and transfer of all the property and effects of such debtor or debtors, and shall inure to the equal benefit of all creditors of such debtor or debtors in proportion to the amount of their respective demands, including those which are unmaturing. And every such sale, conveyance, transfer,

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trustee in cases of both preferences and fraud,³⁰ under the earlier codification, the appointment of an "assignee" had been called for only in cases of fraud. Four other significant changes were brought about by the 1898 amendments. First, the category of property dispositions subject to preference avoidance was expanded to include, in addition to assignments, "every sale, conveyance, transfer or

mortgage or assignment made, and every such judgment suffered, and every such act or device done or resorted to, by any debtor or debtors, in the event of a deed of assignment being filed within ninety (90) days after the giving or doing of such thing or act, shall be conclusively deemed and held to be fraudulent, and shall be held to be void as to the assignee of such debtor or debtors, whereupon proof shown, such debtor or debtors was or were actually insolvent at the time of the giving or doing of such act or thing, whether he or they had knowledge of such insolvency or not. Provided, that nothing in this section contained shall vitiate or affect any mortgage made in good faith to secure any debt or liability created simultaneously with such mortgage, if the same be filed for record in the county wherein the property is situated, or as otherwise provided by law, within three (3) days after its execution, and where upon foreclosure or taking possession of such property the mortgagee fully accounts for the proceeds of such property.

Sec. 6344. Any creditor or creditors, as to whom any of the acts or things prohibited in the preceding section are void, whether the claim of such creditor or creditors has matured or will thereafter mature, may commence an action in a court of competent jurisdiction to have such act or things declared void, and such court shall appoint a trustee according to the provisions of this chapter, who upon being duly qualified shall proceed by due course of law to recover possession of all property so sold, conveyed, transferred, mortgaged or assigned, and to administer the same for the equal benefit of all creditors, as in other cases of assignments to trustees for the benefit of creditors. And any assignee as to whom any thing or act mentioned in the preceding section shall be void, shall likewise commence a suit in a court of competent jurisdiction to recover possession of all property so sold, conveyed, transferred, mortgaged or assigned, and shall administer the same for the equal benefit of all creditors as in other cases of assignments to trustees for the benefit of creditors; provided, that where such assignee fails or declines, upon notice by any creditor or creditors to institute such suit, such creditor or creditors may themselves institute such suit within five days after serving notice upon such assignee to commence such suit, and the procedure and administration shall be the same as is herein before provided for suits commenced by any creditor or creditors.

30. When appointed, the § 6344 trustee was to administer only the property preferentially or fraudulently assigned. *Id.*

mortgage," "every judgment suffered," and "every act or device resorted to" by the debtor.³¹ Second, such sales, conveyances, transfers, mortgages, and assignments were covered by the amended provision, whether they were made "in trust or otherwise." Third, the new law provided that, if any proscribed "act or device" were followed within ninety days by a general assignment for the benefit of creditors, then the earlier and preferential disposition was "conclusively deemed" to be fraudulent and void.³² Lastly, the 1898 amendments provided that a voidable preference or fraud operated as a transfer of all the debtor's property, not only the property preferentially or fraudulently transferred, for the benefit of all creditors. Before 1898, only the property preferentially or fraudulently transferred was administered for the benefit of all creditors.³³

In 1902, a further revision added language making the transferee's knowledge of the debtor's "intent to defraud" a condition of voidability.³⁴ Since the new language applied whether the

31. *Id.* at 30.

32. This statutory imputation of wrongdoing to the debtor, tied to the initiation of an insolvency proceeding within the next 90 days, was deleted soon thereafter. *See* the 1902 revision, *infra* note 34.

33. The new § 6343 also, and anomalously, made any of these debtor actions voidable if done either "in contemplation of insolvency, or with a design to prefer." A 1902 revision removed the probably inadvertent "or" from § 6343 making the language read, "Every . . . transfer . . . made . . . in contemplation of insolvency, *and with a design to prefer.*" (emphasis added). *See infra* note 34.

34. As amended in 1902, § 6343 provided as follows:

Every sale, conveyance, transfer, mortgage or assignment, made in trust or otherwise by a debtor or debtors, and every judgment suffered by him or them against himself or themselves in contemplation of insolvency, and with a design to prefer one or more creditors to the exclusion in whole or in part of others, and every sale, conveyance, transfer, mortgage or assignment made, or judgment procured by him or them to be rendered, in any manner, with intent to hinder, delay or defraud creditors, shall be declared void as to creditors of such debtor or debtors at the suit of any creditor or creditors as hereinafter provided, and shall operate as an assignment and transfer of all the property and effects of such debtor or debtors, and shall inure to the equal benefit of such creditor or creditors in proportion to the amount of their respective demands, including those which are unmatured. Provided, however, that the provisions of this section shall not apply unless the person or persons to whom such sale, conveyance, transfer, mortgage or assignment be made, knew of such fraudulent intent on the part of such debtor or debtors, and provided further, that nothing in this section contained, shall vitiate or affect any

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plaintiff's case was based on preference or fraud, this change, dealing as it did with only what the transferee knew about the debtor's "intent to defraud," did not harmonize with the rest of the statute.³⁵ The 1902 revision also eliminated the reference to general assignments for the benefit of creditors which might occur within the ninety days following the preference.³⁶

The 1898-1902 amendments transformed Ohio preference law. The expanded categories of covered transfers, and the coverage of such transfers whether they were made "in trust or otherwise," clearly added to the types of property dispositions susceptible to avoidance.³⁷ Much more significantly, however, the latter change also disconnected preference law from its origins as a device to combat debtor efforts to defeat creditor process by setting up a trust. Since trusts were no longer the focal point of the preference statute, the change meant that a preference was no longer just a shorthand description of a certain method, involving the use of trusts, which some debtors had used to prevent creditor access to assets. Preferences had been declared wrong in themselves. This change itself was directly related to, and best understood in connection with, the part of the amendment making all of a debtor's property (not just the part preferentially transferred) subject to pro rata distribution among all the debtor's creditors. That change contemplated a

mortgage made in good faith to secure any debt or liability created simultaneously with such mortgage, if such mortgage be filed for record in the county wherein the property is situated, or as otherwise provided by law, within three (3) days after its execution, and where, upon foreclosure or taking possession of such property, the mortgagee fully accounts for the proceeds of such property.

1902 Ohio Laws 608.

35. The Ohio Supreme Court later repaired the drafting damage in *Carruthers v. Kennedy*, 166 N.E. 801 (Ohio 1929). See *infra* text at notes 73-74.

36. See *supra* note 34.

37. In 1910, the Sixth Circuit Court of Appeals stated,

The difference between the old [pre-1898] section and the new [post-1902] one is that the former declared that assignments made to a trustee in contemplation of insolvency and with intent to prefer or delay creditors should inure to the equal benefit of all creditors . . . while the latter declares all instruments, including assignments that are made in trust or otherwise by a debtor . . . shall be declared void. . . .

In re Farrell, 176 Fed. 505, 509-10 (6th Cir. 1910).

collective state liquidation proceeding of all the debtor's assets, triggered by a preference.

It is in the context of such a collective insolvency proceeding that modern preference law, which treats a preference as a preference and not as a merely deviant use of a trust, makes sense. For preference law today is a deterrent device, intended to dissuade debtors and creditors from attempting to gain individual advantages, the achievement of which will reduce the total pool of assets available for distribution among all creditors in the collective insolvency case that follows.³⁸ In that context, the function of preference law is to preserve the advantage of a collective proceeding for creditors as a class, and not to protect creditors against the efforts of a debtor to put assets beyond their reach. Preference law served that earlier function in the free-for-all race for assets which characterized debtor-creditor relations in the absence of a bankruptcy-type collective insolvency proceeding. It was in that pre-1898 context that Ohio's policy favoring a debtor's freedom to dispose of property, even if preferentially, and reward a creditor's diligence, made sense. But the logic of a modern collective insolvency proceeding, a proceeding that includes preference avoidance, necessarily subordinates the nineteenth-century policy of tolerance for debtor-creditor freedom of action.

This change in Ohio preference law in 1898 is even more fully understandable in light of the federal development that was occurring at the same time: in 1898, Congress was putting a federal bankruptcy law back on the books. Extrinsic evidence in the federal reports indicates that the Ohio amendments of 1898 were influenced by the Bankruptcy Act of 1898.³⁹ Internal evidence of the affinity can also be

38. See THOMAS H. JACKSON, *THE LOGIC AND LIMITS OF BANKRUPTCY LAW* 125-26 (1986).

39. See *Irwin v. Maple (In re Gaskill)*, 252 Fed. 10 (6th Cir. 1918).

These [Ohio preference] provisions disclose some legislative purposes that cannot well be mistaken. A number of transactions are now denounced as preferences in addition to the one forbidden by the old statute. It is worthy of notice that this change originated in 1898 (93 O.L. 290), the year in which the federal bankruptcy statute was enacted; and in view of some features of resemblance between the two enactments, as, for instance, those in relation to preferences, it is not too much to say that the two legislative bodies were in these respects moved by the same considerations; nor can well-considered interpretations that have been placed upon the federal or the state provisions of kindred character be safely ignored, when passing upon either the one or the other. Considering the statutory changes made in Ohio, they serve to show the purpose of the new statute. . . . This enlargement in scope discloses a legislative purpose to establish a

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found: the establishment in 1898 of a "reach-back" period before the making of an assignment for the benefit of creditors, during which time preferences were "conclusively deemed" void, seems patterned on the Bankruptcy Act's model. However, the elimination in 1902 of that reference to a later assignment for the benefit of creditors clearly indicates that the Ohio policy against preferences was not limited to situations in which they were followed by such general assignments.⁴⁰

Changes subsequent to the 1898-1902 revisions were modest and nonsubstantive. In 1910, the relevant parts⁴¹ of sections 6343 and 6344 became sections 11104 and 11105 of the Ohio General Code.⁴² The fraud and preference laws from section 6343 were kept together in section 11104, to which was added a provision for the possible appointment of a "receiver" (formerly referred to as a "trustee"). The receiver was to administer all the debtor's assets, not only the assets preferentially or fraudulently transferred, for the benefit of all creditors. The part of section 6343 dealing with transferee knowledge became section 11105. Except for minor stylistic variations, General Code sections 11104 and 11105 are the same as sections 1313.56 and 1313.57 of the Ohio Revised Code, the Ohio preference law as it now appears on the books.⁴³ Thus, in statutory terms, the elements of an

comprehensive rule of equality in place of the old system of inequality in the distribution of an insolvent's assets among his creditors.

Id. at 18.

40. Application of the Ohio preference law was never restricted to situations in which a general assignment for the benefit of creditors had occurred; many states have laws which are so limited. *See supra* note 1.

41. The provision in § 6344 for the appointment of a receiver to administer the preferentially or fraudulently transferred assets (but not all the rest of the debtor's assets) became § 11106.

42. OHIO GENERAL CODE §§ 11104 and 11105 (1910); *see Carruthers v. Kennedy*, 166 N.E. 801, 802 (Ohio 1929). Additionally, a nonrelevant amendment in 1908 was enacted which temporarily added a bulk sales law to § 6343; this bulk sales law later became Ohio General Code § 11102 and was declared unconstitutional in *Williams & Thomas Co. v. Preslo*, 95 N.E. 900 (Ohio 1911).

43. Section 11104 stated,

Sec. 11104. Receiver, appointment of. A sale, conveyance, transfer, mortgage, or assignment, made in trust or otherwise, by a debtor or debtors, and every judgment suffered by him or them against himself or themselves in contemplation of insolvency and with a design to prefer one or more creditors to the exclusion in whole or in part of others, and a sale, conveyance, transfer, mortgage, or assignment made, or judgment procured by him or them to be
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Ohio avoidable preference have remained the same since early in this century.

Under the current Revised Code, a property disposition, which was made in contemplation of insolvency with a design to prefer one or more creditors, who knew of the debtor-transferor's intent to "defraud," can be voided by a creditor, if the creditor's suit is brought in a timely fashion. In such a suit, a receiver may be appointed by the court.⁴⁴ The next section of this article examines each of these elements and demonstrate how the judiciary, in this century as in the last, has continued to play an important role in determining the preference statutes' meaning and practical significance.

II. ELEMENTS OF AN OHIO PREFERENCE

A. *A Property Disposition*

While the 1898 amendments had clearly expanded the scope and the function of the Ohio preference law, the part of the amendment

rendered, in any manner, with intent to hinder, delay or defraud creditors, shall be void as to creditors of such debtor, or debtors at the suit of any creditor or creditors. In a suit brought by a creditor or creditors of such debtor or debtors for the purpose of declaring such sale void, a receiver may be appointed who shall take charge of all the assets of such debtor or debtors, including the property so sold, conveyed, transferred, mortgaged, or assigned, and also administer all the assets of the debtor or debtors for the equal benefit of the creditors of the debtor or debtors in proportion to the amount of their respective demands, including those which are unmatured.

OHIO GENERAL CODE (1938).

Section 11105 stated,

Sec. 11105. Knowledge of fraudulent intent, material; mortgage, provisions as to. The provisions of the next preceding section shall not apply unless the person or persons to whom such sale, conveyance, transfer, mortgage or assignment is made, knew of such fraudulent intent on the part of such debtor or debtors, nor shall anything in such section vitiate or affect any mortgage made in good faith, to secure any debt or liability created simultaneously with such mortgage, if such mortgage be filed for record in the county wherein the property is situated, or as otherwise provided by law, within three days after its execution, and when, upon foreclosure or taking possession of such property, the mortgagee fully accounts for the proceeds thereof.

Ohio General Code (1938).

44. OHIO REV. CODE ANN §§ 1313.56 and 1313.57.

adding sales, conveyances, transfers, mortgages, acts and devices, and judgments to the assignments initially targeted by the statute was soon given a highly restrictive reading by the Ohio Supreme Court. In 1903, in *National Bank of Commerce v. Gettinger*,⁴⁵ the court held, on alternative grounds, that a preferential transfer made in 1901 was not avoidable. The first ground was that the transferee was in good faith and unaware of the debtor-transferor's purposes. Inasmuch as knowing participation in the preference by the transferee became an explicit statutory condition for avoidance under the 1902 amendment, the court's holding on this point adds little to the statute's meaning today. The other ground for the decision, however, is remarkable. The court stated that direct money payments to a preferred creditor were not covered by the statute. It reasoned that, if "payments" had been intended to be covered, the legislature would have said so expressly and listed "payments" among other modes of disposition recently added to the statute. As the opinion explained,⁴⁶

The Legislature having omitted the word 'payment,' this court cannot read it into the statute by construction; and especially is this true when we never had any legislation in this state against receiving payment of honest claims, and when such a construction would render the constitutionality of the act doubtful.⁴⁷

The court's reference to constitutionality was unexplained but probably based on an apprehension that voiding the preference would violate the Ohio Constitutional provisions on either due process or equal protection.⁴⁸

The *Getttinger* interpretation of the 1898 statutory language is particularly surprising today because of the all-inclusive meaning given the words "transfer" and "conveyance" in contemporary statutes.⁴⁹ But the court's narrow reading of the statute should have

45. 68 Ohio St. at 396-97.

46. "The word 'payment' is as familiar, and as well understood as the words, 'sale, conveyance, transfer, mortgage, or assignment,' and if the general assembly had intended to legislate against payments, it would have used that word." *Id.*

47. *Id.*

48. See references to these points in the argument of counsel in *Getttinger*, 68 Ohio St. at 396-97.

49. Under the Uniform Fraudulent Conveyance Act, "'Conveyance' includes every payment of money, assignment, release, transfer, lease, mortgage or pledge of tangible or intangible property, and also the creation of any lien or encumbrance." Uniform Fraudulent Conveyance Act § 1, 7A U.L.A.

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been equally surprising in 1903. For, as indicated above, the 1898 amendments to the preference law did not occur in a vacuum. It was a modern preference law that Congress wrote in 1898, and such a preference law that the Ohio Legislature was apparently trying to write in the same year and in 1902. It was apparently not the preference law for which the Ohio Supreme Court was ready in 1903, in *Gettinger*, because money payments of antecedent debts are obviously as incompatible with the policy behind a real preference law as any other "conveyance" or "transfer" to which a debtor might resort. Indeed, if any distinction is to be drawn among forms of preferences, money payments are among the most objectionable. A direct transfer of an asset, such as money, depletes a debtor's estate and thereby increases the risk of the debtor's ultimate collapse. Direct transfers of debtor assets are, therefore, more detrimental to creditors collectively than the granting of a mortgage, which merely redistributes debtor assets and does not diminish the debtor's productivity on behalf of the creditors as a group.⁵⁰

Is *Gettinger* still good law? Does section 1313.56 not make avoidable what is probably the most common example of preferential behavior, the simple paying of antecedent debts with money?

The evidence on the continued viability of *Gettinger* is mixed. As noted above, its inherent weaknesses are manifest; the court reversed the policy distinction between money payments and other kinds of preferences, allowing the money payments to escape avoidance, while voiding mortgages. The court's holding on money payments was only an alternative basis for decision, and its constitutional rationale is no longer persuasive because voiding a preference today implicates neither due process nor equal protection.

427 (1985). The Uniform Fraudulent Transfer Act provides: "'Transfer' means every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with an asset or an interest in an asset, and includes payment of money, release, lease, and creation of a lien or other encumbrance." Uniform Fraudulent Transfer Act § 1(12), 7A U.L.A. 639 (1985). In the words of the Bankruptcy Code, "transfer" means every mode, direct or indirect, absolute or conditional, voluntary or involuntary, or disposing of or parting with property or with an interest in property, including retention of title as a security interest and foreclosure of the debtor's equity of redemption. 11 U.S.C. § 101(50).

50. See DOUGLAS G. BAIRD & THOMAS H. JACKSON, CASES, PROBLEMS, AND MATERIALS ON BANKRUPTCY, (2d ed. 1990) 426; cf. THOMAS H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW 128 (1986).

In Ohio, *Gettinger* has been followed only in cases in which there were alternative bases for the results reached.⁵¹ In other words, no preference has ever escaped avoidance under section 1313.56 solely because it was a money payment.

Moreover, preferential money payments actually have been avoided under sections 1313.56 and 1313.57 in federal court. The federal cases, however, did not address the money payment issue. Furthermore, they relied upon a combination of both sections 1313.56 and 1313.57 and corporate common law. In *In re Berman*,⁵² a bankruptcy case, the Sixth Circuit stated that the referee correctly summarized the law of Ohio as follows:

Ohio follows the rule that the property and assets of a corporation constitute a trust fund for the payment of its debts, and that an insolvent corporation which has ceased to do business can not by transfer of its property to one of its creditors in payment of antecedent debts create a valid preference to that creditor over its other creditors. When such a situation occurs, the property transferred may be traced and recovered unless the holder is a bona fide purchaser for value, and without notice.⁵³

The court also cited both statutory and corporation preference cases.⁵⁴ The preference was avoided. The creditor had received an

51. See *Erie R.R. Co. v. Fulton*, 19 Ohio Law Abstracts 70 (Ohio App. 1935). "A preference created by an insolvent debtor by the payment of an honest debt in cash or current exchange is lawful in Ohio, both under the common law and under § 11104 of the General Code, since this section does not apply to payment." *Id.* at 70. In *Erie R.R.*, the court also pointed out that the payment to a depositor was in the ordinary course of business, and that the debtor-bank was continuing to operate, although it was seized and liquidated several months later by the superintendent of banks. Reliance on the debtor's intent to continue operating meant the court had in mind law the developed in corporation preference cases, pursuant to which it was not a preference to pay a bill so long as the corporation had no intention of ceasing to operate. Thus the "payment" point is diluted by this other factor. See *Rouse v. Merchants' Nat'l Bank* 22 N.E. 293 (Ohio 1889), and *Damarin v. Huron Iron Co.* 26 N.E. 37 (Ohio 1890).

52. 343 F.2d 125 (6th Cir. 1965).

53. *Id.* at 126-27.

54. The court cited *Stellwagen v. Clum*, 245 U.S. 605 (1918); *George T. Smith Middlings Purifier Co. v. McGroarty*, 136 U.S. 237 (1890); *Carruthers v. Kennedy*, 166 N.E. 801 (1921); *Rouse v. Merchants' Nat'l Bank*, 22 N.E. 293 (1889); and *In re Lee*, 129 F. Supp. 920 (N.D. Ohio 1955).

assignment of a money claim against an insurance company, which was tantamount to a cash payment.⁵⁵

Actual cash payments were avoided as preferential in *Conroy v. Schott*,⁵⁶ in which the trustee in bankruptcy invoked sections 1313.56 and 1313.57 to avoid repayments⁵⁷ made to a preferred creditor who, over a five-year period, had engaged in more than six hundred separate transactions with a debtor running a Ponzi⁵⁸ scheme. Checks were endorsed over to the referee, and other repayments came from the debtor's checking accounts.⁵⁹ *Gettinger* was cited, discussed, and distinguished in *Conroy*⁶⁰ but not with respect to the "money payment" nature of the preferences received. In *Conroy*, the Sixth Circuit looked to *Gettinger* only for what it had to say about the referee's defenses based on good faith and lack of knowledge.

The Sixth Circuit has also applied sections 1313.56 and 1313.57 to money payments outside of bankruptcy, on behalf of the Internal Revenue Service.⁶¹

There is no intrinsic reason why Ohio courts could not hear cases to avoid preferential money payments. In *Malone v. Summer Co.*,⁶² the substantive preference law invoked was section 60 of the Bankruptcy Act of 1898. The bankruptcy trustee sued to recover the preference in an Ohio trial court. The issue, resolved in the trustee's favor, was whether Ohio courts could exercise jurisdiction over money payment preference cases when the cases were based on federal law. The *Malone* court noted that the meaning of the word "conveyance" had expanded since the *Gettinger* decision in 1903; Ohio had adopted the Uniform Fraudulent Conveyance Act in 1961, in which "conveyance" expressly includes "every payment of

55. "The 'payment' [in *Berman*] was not of cash or currency but there is a striking resemblance to cold cash in such a claim." 244 N.E.2d 485, 492 (Ohio App. 1968).

56. 363 F.2d 90 (6th Cir. 1966).

57. The trustee invoked both state law and § 70(e) of the Bankruptcy Act of 1898. Section 70(e) was the counterpart in the Bankruptcy Act of 1898 of the present § 544(b).

58. "The term 'Ponzi scheme' designates an investment scam in which the promoters of the investments promise the initial investors substantial returns and then fund those returns by diverting the principal contributions of subsequent investors." PETER ALCES, *THE LAW OF FRAUDULENT TRANSACTIONS* 6-51 (1989).

59. 363 F.2d at 92.

60. *Id.*

61. *Delia v. Commissioner*, 362 F.2d 400 (6th Cir. 1966); *United States v. Adams Bldg. Co.*, 531 F.2d 342 (6th Cir. 1976).

62. 244 N.E.2d 485 (Ohio App. 1968).

money."⁶³ The broader definition of "conveyance" in the Uniform Fraudulent Conveyance Act only applies, however, within that statute itself; it does not purport to modify the meaning of "conveyance" as used in section 1313.56, which is what the *Gettinger* court had determined. Therefore, the holding in *Malone* is not inconsistent with *Gettinger*.

Despite all indications of its weakness, *Gettinger* has never been overruled. While not venerable, it is old precedent. It is arguable, therefore, that money payment preferences are not avoidable under section 1313.56. However, if section 1313.56 were to be applied in the future as it has been already in the Sixth Circuit, Ohio preference law would treat *Gettinger's* (alternative) money payment holding as an archaic relic of nineteenth-century thinking misplaced in the context of a modern collective insolvency proceeding.⁶⁴

B. *Contemplation of Insolvency*

"Insolvency" in section 1313.56 means the inability to pay debts as they become due, rather than balance sheet insolvency.⁶⁵ "Contemplation" of insolvency denotes awareness of either actual or impending insolvency, which then motivates the making of a transfer.⁶⁶ A preferential transfer thus might occur before a debtor

63. See *supra* note 49. The Uniform Fraudulent Transfer Act replaced the Uniform Fraudulent Conveyance Act in Ohio in 1990. See OHIO REV. CODE ANN. §§ 1336.01-1336.11 (Baldwin 1991). As defined in the Uniform Fraudulent Transfer Act, "transfer includes "payment of money." *Id.* § 1336.01(L).

64. By the time *Gettinger* was decided, the United States Supreme Court had already rejected the argument that money payments could not be federal preferences. *Pirie v. Chicago Title and Trust Co.*, 182 U.S. 438 (1901) (holding that "transfers of property" as used in section 60 of the Bankruptcy Act of 1898 meant money payment preferences as well as all others). *Pirie* was apparently not cited to the Ohio Supreme Court in *Gettinger*. See 68 Ohio St. at 396-97.

65. "[I]nsolvency exists when a person is unable to pay his debts according to the ordinary usages of trade." *Prose v. Beardsley*, 18 Ohio App. 211, 216 (1924).

66. The federal district court stated,

'Insolvency in this law means an inability to pay debts as they become due in the ordinary course of daily transactions, and if, from such a deranged state of his affairs and a sense of inability to meet his moneyed engagements, the debtor transfers property to a creditor, he is regarded as having done so in contemplation of insolvency. . . . This was Smith's situation, and all the facts surrounding the execution of the mortgage show that he acted in view thereof and with the intent to secure his existing indebtedness to Riker as well as to obtain a new loan

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actually loses the capacity to meet current obligations.⁶⁷ Circumstantial evidence can establish all elements of the preference, including contemplation of insolvency.⁶⁸

of \$800. Likewise Riker had knowledge of facts that would charge him with knowledge of Smith's insolvency in this sense and having participated in that intent to create a preference. Riker knew that Smith was hard up and short of cash. It is fairly inferable that he knew that by reason thereof Smith was unable at that time to pay his debts in the usual course of his daily transactions. He knew that Smith was unable to pay his debt when it matured. He knew Smith's willingness to agree to pay a commission of \$375 for a new cash loan of \$800. These facts and other attendant circumstances produce the conviction that Riker participated in Smith's forbidden intent, despite their present disclaimers.'

In re Wright Industries, Inc., 93 F. Supp 58, 65 (N.D. Ohio 1950), *quoting with approval*, *Lyons, Trustee v. Riker*, 29 Ohio Law Rep. 324 (1939).

67. The Ohio appellate court stated,

[I]t will be readily observed that the phrase relating to insolvency in section 11104 long antedates the definition of solvency made by the bankruptcy act, as the term appeared in the legislation of this state at least eighty years ago. The definition of the term in the bankruptcy act, therefore, has no application to the Ohio statute. . . .

. . . [The statute] does not denounce a deed made by an insolvent, but one made in contemplation of insolvency. . . . [The statute] was finally definitely determined that an act was in contemplation of insolvency if it were performed because either existing or anticipated insolvency were in the mind of the performer. . . .

. . . [The phrase] "in contemplation of insolvency," has endured; and it means now, as it meant then, that one was in contemplation of insolvency when he realized that either at the time or in the early future his deranged financial condition was or would be such that he would be unable to pay his debts as they became due.

Prose v. Beardsley, 18 Ohio App. 211, 217-18.

68. The federal district court stated,

The situation of the debtor making the assignment, and the design with which he made it, must be gathered from all the circumstances in the case. It is the motive, design, and situation of the assignor, that give character to the assignment, and bring it within the operation of the statute.

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C. *Design to Prefer*

In one sentence, section 1313.56 regulates both the "design to prefer" and the "intent to hinder, delay or defraud." They are distinct offenses.⁶⁹ A design or intent to prefer is not in itself fraudulent.⁷⁰

In re Wright Indus., Inc., 93 F. Supp. 58, 65 (N.D. Ohio 1950), quoting *Mitchell v. Gazzam* 315, 336 (1873).

69. "A conveyance made with intent to defraud creditors is one thing, and a conveyance to prefer creditors is another. The first imports moral turpitude, the other is only a recently prohibited act. *Van Iderstine v. National Discount Co.*, 227 U.S. 575 (1913)." *Prose v. Beardsley*, 18 Ohio App. 211, 214-15 (1924).

"[T]he origins of the preference are quite different from those of the fraudulent conveyance. . . . [I]t is not a fraudulent conveyance for a debtor to prefer a particular creditor. . . . Thus the preference, as such, cannot be treated as a fraudulent conveyance." GARRARD GLENN, *FRAUDULENT CONVEYANCES AND PREFERENCES* § 289, at 488-90 (1940).

Scholars advocating adoption of the Uniform Fraudulent Conveyance Act in Ohio recommended against repealing the statutory predecessor to section 1313.56 because of its coverage of preferences in addition to fraudulent conveyances. See William H. Rose & Paul O. Hunsinger, *Transfers in Fraud of Creditors, Ohio Law and the Uniform Act*, 9 OHIO ST. L.J. 571, 614 (1948).

70. In *Coder v. Arts*, the United States Supreme Court stated,

What is meant when it is required that such conveyances in order to be set aside shall be made with the intent on the bankrupt's part to hinder, delay or defraud creditors? This form of expression is familiar to the law of fraudulent conveyances, and was used at the common law, and in the statute of Elizabeth, and has always been held to require, in order to invalidate a conveyance, that there shall be actual fraud; and it makes no difference that the conveyance was made upon a valuable consideration, if made for the purpose of hindering, delaying, or defrauding creditors. The question of fraud depends upon the motive. . . . The mere fact that one creditor was preferred over another, or that the conveyance might have the effect to secure one creditor and deprive others of the means of obtaining payment, was not sufficient to avoid a conveyance; but it was uniformly recognized that, acting in good faith, a debtor might thus prefer one or more creditors. . . .

We are of opinion that Congress, in . . . using the terms "to hinder, delay or defraud creditors," intended to adopt them in their well-known meaning as being aimed at conveyances intended to defraud.

213 U.S. 223, 242 (1909) (citations omitted). The Missouri Supreme Court, in a frequently cited case, also supported the view that an intent to prefer is not necessarily fraudulent:

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As indicated above,⁷¹ the debtor's design or intent to prefer can be established by circumstantial evidence. For example, if the price of new credit from a creditor is the securing of old and delinquent obligations owed to the same creditor, an intent to prefer that creditor can be inferred.⁷²

D. *The Transferee's Knowledge of the Debtor's "Fraudulent Intent"*

Sections 1313.56 and 1313.57 are awkward partners because section 1313.56 deals with both preferences and fraudulent conveyances, while section 1313.57 makes the transfers described in section 1313.56 avoidable only if the transferee has knowledge of the transferor's "fraudulent intent." This language could mean that the transferee's knowledge was a factor only in fraudulent conveyance cases. It could also mean that preferences were avoidable under section 1313.56 only if the debtor's "design to prefer" somehow literally included "fraudulent intent." In 1929, the Ohio Supreme

The right of a debtor to prefer one creditor necessarily implies the right of such creditor to keep such preference. While the effect of such preference must, to the extent that it is made, necessarily be to defer or to hinder or delay other creditors, the mere knowledge of the preferred creditor that such will be its effect, and the debtor intended it should have that effect, will not be sufficient to avoid the transaction as to the creditor preferred.

Shelley v. Boothe, 73 Mo. 74, 77 (1880).

71. See *supra* text at note 68.

72. Such intent to prefer was inferred by the Ohio appellate court:

R.C. 1313.56 clearly prohibits the mortgaging of property to a creditor designed to be a preference over other creditors. The mortgage given to appellant was to secure an antecedent debt owed by the Coles to appellant. Prior to this mortgage, Mr. Cole had not made a payment on the antecedent debt for approximately two years. From the fact that Mr. Cole was delinquent on his payments to such a large extent, it can be reasonably inferred that this mortgage was made in contemplation of his insolvency. Mr. Cole's intentions were clear, the only way for him to obtain credit was to give appellant a mortgage on the property in question. He, therefore, had the requisite intent to prefer one creditor to the exclusion in whole or part of other creditors.

Diamond Savings & Loan v. Cole, No. 5-85-24, Ohio App. Oct. 29, 1986) (LEXIS, States library, Ohio file, App subfile).

Court, in *Carruthers v. Kennedy*,⁷³ resolved the matter by adopting the reasonable but textually strained position that section 1313.57's requirement that the transferee have knowledge of "fraudulent intent" means knowledge of fraudulent intent in fraud cases, and knowledge of "preferential" intent in preference cases.⁷⁴ To have held otherwise, or to have read an intent to defraud into the "design to prefer," would have been inconsistent with the legislative understanding that the design to prefer and the intent to defraud were two separate offenses. This legislative understanding was evidenced by the targeting of both preferences and fraudulent conveyances for avoidance in section 1313.56. Any other interpretation would also have been inconsistent with the historically recognized distinctions between preferences and fraudulent conveyances.⁷⁵ This difference between fraud and preference has been recognized even though, in a sense, every preference does to an extent "hinder or delay" the creditors who are not the beneficiaries of the preference. But the "hinder or delay" language, which comes down from the original Statute of 13 Elizabeth,⁷⁶ has not been read to create or enlarge the scope of the "fraudulent conveyance" idea to include conveyances that only "hinder" and conveyances that only "delay."⁷⁷ In other words, a fraudulent conveyance requires "fraud," and a preference, though it may hinder or delay, is not a fraud.⁷⁸ Intent to prefer is not equivalent to intent to defraud.

As in the case of the other elements of an Ohio preference, circumstantial evidence will support a finding that the transferee had knowledge of the debtor's intent to prefer.⁷⁹

73. 166 N.E. 801 (Ohio 1929).

74. In *Carruthers*, the Ohio Supreme Court stated,

It is therefore the true meaning of section [1313.57] that no transaction would be vitiated unless the purchaser knew of the design on the part of the vendor to prefer the vendee to the exclusion of the other creditors, or, if it was a transaction involving actual fraud, that he knew of the intent of the vendor to hinder, delay and defraud his creditors.

166 N.E. at 803.

75. See *Coder v. Arts*, 213 U.S. 223, 242.

76. Statute of Fraudulent Conveyances, 1571, 13 Eliz. c.5. The statute provides that "... fraudulent feoffments ... grants ... conveyances ... devised and contrived of malice, fraud ... or guile to the end, purpose and intent, to delay, hinder or defraud creditors ... shall be utterly void. ..."

77. See *Shelley v. Boothe*, 73 Mo. 74, 77 (1880).

78. See GLENN, *supra* note 69, at 488-90.

79. The Ohio appellate court has stated,

(continued)

E. Creditor

Section 1313.56 says that a preference "is void as to creditors . . . at the suit of any creditor." It does not say whether "any creditor" includes future creditors, meaning those who became creditors subsequent to the preference.⁸⁰ The courts, however, seem to have operated under the assumption that only a person who had a claim when the transfer occurred can maintain the action.⁸¹ Even in an early bankruptcy decision holding that subsequent creditors could, under section 6343, share in the recovery of property fraudulently conveyed, the court made clear that the state law action authorized by section 6343 had been brought, in fact, by creditors holding claims at the time of the fraud.⁸² It is not necessary to have reduced a claim to

It is apparent to this court from the record that appellant did have the required knowledge set forth in R.C.1313.57. In his deposition, Mr. Leiser, president of appellant corporation, testified that appellant had in its files the petition of bankruptcy of Ronald Cole. This petition gave appellant notice of Mr. Cole's financial problems, and that Mr. Cole had many other creditors. Mr. Leiser also testified that Cole was unable to obtain credit elsewhere. In light of these facts, it is clear that in order for Cole to obtain additional loans, although supported by additional collateral, he was forced to prefer appellant over other creditors. It is equally clear that appellant had knowledge of sufficient facts to charge it with knowledge of Cole's forbidden intent.

Diamond Savings & Loan v. Cole, No. 5-85-24 (Ohio App. Oct. 29, 1986) (Lexis, States library, Ohio file, App subfile).

80. "Future creditors" are protected by § 4 of the Uniform Fraudulent Transfer Act: "Transfers Fraudulent as to Present and Future Creditors." Uniform Fraudulent Transfer Act § 4, 7A U.L.A. 639 (1985).

81. See, e.g., *Prose v. Beardsley*, 18 Ohio App. 211 (1924), which does not expressly hold that the plaintiff creditors must have been creditors when the assignment was made, but does carefully specify that at least one of the plaintiffs was a creditor at that time. 18 Ohio App. at 211-12, and 216.

82. *In re Kohler*, 159 Fed. 871, 872 (6th Cir. 1908). The court made the point that were it not for such a rule, a debtor in failing circumstances could deliberately effect a preference in favor of existing creditors at the expense of anticipated future creditors by making a fraudulent conveyance. But for the rule adopted in *Kohler*, which distributes the recovered assets among all creditors, the fraudulently conveyed assets, once recovered, would benefit only the creditors existing when the fraudulent conveyance was made. *Id.* at 873-74. *Kohler* anticipated *Moore v. Bay*, 284 U.S. 4 (1931), under which all creditors,
(continued)

judgment in order to sue.⁸³ But the very existence of case law resolving that issue and referring to persons with such existing, but unresolved, claims as "subsequent" creditors⁸⁴ indicates that only a creditor who had a claim against the debtor at the time of the preference can bring suit under section 1313.56.⁸⁵

F. *The Time for Suit*

There is no "reach-back" period in section 1313.56 analogous to the ninety-day and one-year insider reach-back periods in section 547 of the Bankruptcy Code. Therefore, a creditor and a bankruptcy trustee can avoid an Ohio preference no matter when the preference may have occurred, unless barred by limitations.

The leading authority on when an Ohio preference case does become time-barred is *Maas v. Miller*,⁸⁶ which was decided by the Ohio Supreme Court in 1898. In *Maas v. Miller*, the debtor made a transfer in February 1885 for the benefit of fewer than all his creditors. In May 1893, a nonpreferred creditor sued to have the transfer set aside. The plaintiff-creditor's case was framed in terms of fraud under section 6344 of the Revised Code.⁸⁷ The common pleas court and appellate court both ruled that the case was barred by the four-year fraud statute of limitations in section 4982 of the Revised Statutes.⁸⁸ The Ohio Supreme Court reversed and granted judgment for the plaintiff. The court stated that the record in the suit made out a

not just those eligible to void the transfer, share in what the trustee recovers under § 544(b).

83. See *Sechrist v. Veres*, 9 Ohio Op. 492 (Ohio Ct. Com. Pl. 1937), and cases discussed therein.

84. *Id.*

85. In contemporary bankruptcy terms, a "creditor" is anyone holding a "claim," and a claim may be "disputed," "unmatured," or "unliquidated." Bankruptcy Code §§ 101(10) and (5).

86. 51 N.E. 158 (Ohio 1898).

87. The preference and fraud provisions of what is now section 1313.56 were then stated in sections 6343 and 6344, respectively, of the Revised Statutes. See *supra* text at note 25.

88. Section 4982 then provided, in part, as follows: "Within four years[:] An action for trespass upon real property. . . . An action for the recovery of personal property. . . . An action for an injury to the rights of the plaintiff not arising on contract and not hereinafter enumerated. An action for relief on the ground of fraud. . . ." 1884 Ohio Laws 210. Section 4982 is now OHIO REV. CODE ANN. § 2305.09 (Baldwin 1985).

preference case under section 6343 of the Revised Statutes.⁸⁹ Therefore, the four-year fraud statute of limitations in section 4982 was inapplicable. The supreme court did not say what statute of limitations did apply. But granting judgment for the plaintiff meant that the section 6343 preference case was clearly not barred by the passage of over eight years between preference and lawsuit.⁹⁰

Is *Maas v. Miller* still good law? With respect to its holding that the fraud statute of limitations does not apply to a preference, *Maas v. Miller* is apparently as correct today as it was in 1898. With respect to the rest of the case, however, and specifically the granting of judgment eight years after the preference, its conclusion is less reliable.

Section 6343, the statute on which judgment was granted in *Maas v. Miller*, is the direct statutory ancestor of the preference provision in today's section 1313.56. Some differences exist, however. Today's law, unlike its counterpart ninety years ago, does not automatically turn every preference into an assignment for the benefit of creditors.⁹¹ Nor does its operation depend upon the establishment of a trust by the insolvent debtor.⁹² In other respects, however, particularly the nonfraudulent nature of the debtor conduct proscribed by the statutes, the preference clauses of sections 6343 and 1313.56 are alike. Indeed, the 1898-1902 amendments, which came after *Maas*, made the

89. 51 N.E. at 161-62. The Supreme Court clearly identified the debtor misconduct as a preference: "As the undeniable effect of the transaction was to prefer McKenzie and Robb and the costs above named, that is enough to satisfy the requirement that the assignment 'shall have been made with intent to prefer one or more creditors.'" *Id.* at 161.

90. In *Maas v. Miller*, there was no discussion of laches, even though the facts suggested that the grantee-defendant might have been seriously prejudiced by the delay in suit. The grantee had used his own funds to pay taxes and other charges owed by the debtor, and he claimed to have expended more than the property was worth. 51 N.E. at 162.

It is clear from *Maas v. Miller* and other cases that the four-year statute does apply to fraud cases under § 1313.56. See *Stivens v. Summers*, 67 N.E. 884 (Ohio 1903), *Keidel Supply Co. v. Fair*, No. C-76831 (Ohio App. Feb. 8, 1978) (LEXIS, States Lib., Ohio file).

91. On the other hand, today's statute is an even more powerful general creditor weapon than old section 6343 was; if a receiver is appointed today, in the aftermath of a preference, all of the debtor's property is administered for the benefit of all the creditors. Under old section 6343, only the property that was subject to the preferential transfer was to be administered for the benefit of creditors. See *supra* note 22.

92. The Ohio Supreme Court, in *Maas v. Miller*, found that the conveyance and the debtor's arrangement with the grantee "created a trust"; express trust language had not been used. 51 N.E. at 161.

preference law function even less like a fraud law than it had before. Its scope had broadened beyond outright bad behavior, consisting of putting assets beyond the reach of diligent creditors, to include the more subtle, less morally repellant, and less "fraudulent" tactic of subverting a future collective insolvency proceeding. Since the basis for the supreme court's decision in *Maas v. Miller* was the irrelevance of fraud to the plaintiff's suit,⁹³ and since fraud is even less relevant to a section 1313.56 preference case today than it was in 1898, it seems reasonably clear that a section 1313.56 preference case is not subject to the four-year fraud statute of limitations which was held inapplicable in *Maas*.⁹⁴

It does not necessarily follow, however, that preference cases delayed more than eight years are not time-barred today. As noted above, *Maas v. Miller* did not specify what period of limitations did apply. What the court did say was,

This contract and the deed constituted one entire transaction, and should be construed together; and, when thus construed, that transaction, as has already been stated, was in law an assignment of the property involved for the benefit of creditors of the grantor, Miller. ***The issue respecting fraud and collusion was immaterial in this respect, because the *relief to which the plaintiff*, as the representative of the creditors of Miller, *was entitled*, under section 6343, Rev. St., upon the undisputed facts, did not depend upon the establishment of fraud, either actual or constructive, but *might properly rest on the fact that the deed and agreement created a trust*. And as a cause of action arising under that section does not depend

93. "The issue respecting fraud and collusion was immaterial . . . because the relief to which the plaintiff . . . was entitled under section 6343, Revised Statutes . . . did not depend upon the establishment of fraud. . . ." 51 N.E. at 163.

94. In *Maas v. Miller*, the court said that none of the other provisions in section 4982 applied. This eliminated from consideration a catch-all four-year provision covering actions for injuries "to the rights of the plaintiff not arising on contract and not hereinafter enumerated." From all that appears in *Maas v. Miller*, the preference case was not "hereinafter enumerated"; the Supreme Court opinion nowhere specified what limitation period did apply to it. As set out now in OHIO REV. CODE ANN. § 2305.09(D), the catch-all provision establishes a four-year limitation period "[f]or an injury to the rights of the plaintiff not arising on contract nor enumerated in sections 2305.10 to 2305.12, inclusive, 2305.14 and 1304.29 of the Revised Code." None of the referenced sections is applicable to a section 1313.56 preference case. The four-year catch-all provision, therefore, has no more application today to a preference than it did in 1898.

upon fraud, or fall within any other class of actions that section 4982, Rev. St., requires to be commenced within four years, the issue growing out of the averment that the cause of action in this case had accrued more than four years before the action was commenced was also immaterial.⁹⁵

This passage suggests that the presence of a "trust" may have had as much to do with the outcome in *Maas v. Miller* as did the absence of a fraud. Perhaps what the supreme court had in mind, but somehow did not mention (in granting judgment without alluding to the applicable statute of limitations in a case that had been appealed to it from the lower courts on the limitations issue), was an exception from all statutes of limitations applicable "in the case of a continuing or subsisting trust."⁹⁶ Whether an assignment in trust for the benefit of creditors is, in fact, a "continuing and subsisting trust" is questionable.⁹⁷ This hypothesis would explain, however, the supreme court's handling of the timeliness issue without specifying an applicable statutory period. If this analysis (and reading between the lines) of *Maas v. Miller* is correct, then the open-ended, eight-year-at-the-least period for bringing preference cases countenanced in *Maas v. Miller* cannot be relied upon today, for section 1313.56, unlike section 6343, is no longer linked to trusts nor necessarily

95. *Maas*, 51 N.E. 158, 163 (emphasis added).

96. The exception was then stated in section 4974 of the Revised Code. Section 4974 has become OHIO REV. CODE ANN. § 2305.22 (Baldwin 1990).

97. See *Irwin v. Lloyd*, 11 Ohio Cir. Dec. 212 (Hamilton Circuit Ct. 1900), *aff'd* 61 N.E. 157 (Ohio 1901).

It is the claim . . . that the statute of limitations . . . does not apply . . . that the trustee [under an assignment for the benefit of creditors] having in his hands money applicable to the payment of dividends to creditors makes it a case of a continuing and subsisting trust, which, under the provisions of section 4974, Revised Statutes, are not governed by our statute of limitations. But we think it clear that this claim is not well founded, and that this is not such a trust. As held in many cases in Ohio, this provision only applies to those technical and continuing trusts which are not recognized at law, but fall within the exclusive jurisdiction of chancery, and other trusts are not exempt from the statute.

Id. at 214-15.

See also *Yearly v. Long*, 40 Ohio St. 27, 32 (1883), holding that a constructive trust or implied trust is not a "continuing and subsisting trust" excepted from the operation of the statute of limitations.

connected with assignments for the benefit of creditors. The reasoning in *Miller*, therefore, if it did in fact depend on those outdated, trust-based preference characteristics, would not fit many preference cases pursuant to section 1313.56.

On the other hand, it must be recognized that displacement of the eight-year period allowed in *Maas v. Miller* depends on a conjecture about what the Ohio Supreme Court thought it was doing when it decided the case. Taken simply on its "preference" facts and its holding, *Maas v. Miller* would still mean that an eight-year-old transfer was not too old to be vulnerable to preference attack today.

In the end, however, because *Maas v. Miller* does not provide clear-cut specificity on the applicable statutory period, the case must be regarded as a somewhat doubtful authority. What, then, is the statutory period if the case's holding allowing an eight-year reach-back period is no longer the law?

While there is no direct authority on point, the statutory provisions most clearly applicable are either section 2305.07, which provides that "an action . . . upon a liability created by statute other than a forfeiture or a penalty, shall be brought within six years after the cause thereof accrued,"⁹⁸ or section 2305.14, which provides a ten-year time bar for cases not covered by other specific limitations periods.⁹⁹ If section 1313.56 can be read to create a liability on the part of the preferred creditor whose preference is avoided, then section 2305.07, on its face, applies to a preference case. Otherwise, by default, the ten-year period would be applicable.

Exact resolution of the timeliness issue, however, is probably not critical. All of the periods are longer, by far, than the federal reach-back period. And in a bankruptcy case, invocation of section 1313.56 will require proof that the preferential transfer had been made "in contemplation of insolvency" by a debtor who then stayed out of bankruptcy for whatever period elapsed between the preference and the commencement of the bankruptcy case. For that reason, the outside limits of the reach-back period possible under section 1313.56 are not going to be tested often.

98. OHIO REV. CODE ANN. § 2305.07 (Baldwin 1990). Section 2305.07 has been applied to the analogous case of director's statutory liability for a dividend distribution made by an insolvent bank. See *Hart v. Guardian Trust Co.*, 75 N.E.2d 570 (Ohio Ct. Com. Pl. 1945).

99. OHIO REV. CODE ANN. § 2305.14 (Baldwin 1990).

G. *The Appointment of a Receiver*

Section 1313.56's caption, "Appointment of a Receiver," is hardly informative with respect to the substantive avoiding powers provided for in that section.¹⁰⁰ The caption does reflect, however, the early legislative intent to allow all creditors to share ratably (via the instrumentality of the receiver) in the assets which the debtor had attempted to dispose of preferentially or fraudulently. Nevertheless, the appointment of a receiver under section 1313.56 is not mandatory.¹⁰¹ Unilateral creditor action, outside the context of a collective enforcement proceeding, has occurred,¹⁰² but it is inconsistent with the equality of distribution policy, which underlies preference law, to allow a single creditor to avoid a preference solely on its own behalf. All that such a suit accomplishes is the substitution of a different "preferred" creditor for the one originally and literally preferred by the debtor.¹⁰³ This anomaly is not encountered when

100. The caption appeared after the enactment of the Ohio General Code in 1910; see OHIO GENERAL CODE § 11104. (1910).

101. "[A] receiver *may* be appointed. . . ." (emphasis added) OHIO REV. CODE ANN. § 1313.56. See *Malone v. Summer & Co.*, 244 N.E.2d 485, 488 (Ohio App. 1968) suggesting that the court's discretion is limited to implementing some form of collective enforcement if a receiver is not appointed.

102. See, e.g., *Delia v. Commissioner.*, 362 F.2d 400 (6th Cir. 1966) (commissioner recovered the entire preference for the Treasury, invoking section 1313.56; perhaps there were no other creditors, or a tax lien was superior to all other creditor claims).

103. See *Smith v. Whitman*, 189 A.2d 15, 18 (N.J. 1963): "Yet if the transfer were set aside in favor of another creditor, there would be but a substitution of one preference for another." *Id.*

See also GLENN, *supra* note 69, § 289, at 490: "[A]wkward situations may arise when a State law undertakes to make preferences illegal without, at the same time, establishing a system of liquidation and attaching the preference provisions to the system."

The preference situation is to be contrasted with the setting aside of a fraudulent conveyance by a single creditor. Such a creditor may, as a result, gain a greater interest in the property fraudulently transferred than that of other unsecured creditors; such an interest, in fact, may constitute an involuntary "preference" to the extent that it gives the creditor setting aside the fraudulent conveyance a larger share of the debtor's assets than the share received by each of the rest of the creditors. Nothing in fraudulent conveyance law or policy, however, is offended by unequal distribution of a debtor's assets. Indeed, the creditor successful in setting aside a fraudulent conveyance is rewarded for winning the "race of diligence" by getting a larger slice of the debtor's limited assets. See Joseph E. Ulrich, *Fraudulent Conveyances and Preferences in Virginia*, 36 WASH. & LEE L. REV. 51, 54-58 (1979).

section 1313.56 is invoked in bankruptcy; all unsecured creditors share equally in the assets recovered by the trustee under section 544(b).¹⁰⁴

III. OHIO PREFERENCE LAW AND FEDERAL PREFERENCE LAW COMPARED

A. *The Federal Preference*

An avoidable federal preference is a transaction that 1) satisfies all five conditions set out in Bankruptcy Code section 547(b),¹⁰⁵ and 2) does not fall within any of the seven exceptions from avoidance provided for in section 547(c).¹⁰⁶

104. See *Malone v. Summer & Co.*, 244 N.E.2d 485 (Ohio App. 1968) (suggesting that a bankruptcy trustee performs the same function that a receiver would perform when a preference is avoided under section 1313.56).

105. Section 547(b) provides,

Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property—

- (1) to or for the benefit of a creditor;
- (2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
- (3) made while the debtor was insolvent;
- (4) made—
 - (A) on or within 90 days before the date of the filing of the petition; or
 - (B) between 90 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; and
- (5) that enables such creditor to receive more than such creditor would receive if—
 - (A) the case were a case under chapter 7 of this title;
 - (B) the transfer had not been made; and
 - (C) such creditor received payment of such debt to the extent provided by the provisions of this title.

106. Section 547 (c) The trustee may not avoid under this section a transfer—

- (1) to the extent that such transfer was—
 - (A) intended by the debtor and the creditor to or for whose benefit such transfer was

(continued)

- made to be a contemporaneous exchange for new value given to the debtor; and
- (B) in fact a substantially contemporaneous exchange;
- (2) to the extent that such transfer was—
- (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;
- (B) made in the ordinary course of business or financial affairs of the debtor and the transferee; and
- (C) made according to ordinary business terms;
- (3) that creates a security interest in property acquired by the debtor—
- (A) to the extent such security interest secures new value that was—
- (i) given at or after the signing of a security agreement that contains a description of such property as collateral;
- (ii) given by or on behalf of the secured party under such agreement;
- (iii) given to enable the debtor to acquire such property; and
- (iv) in fact used by the debtor to acquire such property; and
- (B) that is perfected on or before 10 days after the debtor receives possession of such property;
- (4) to or for the benefit of a creditor, to the extent that, after such transfer, such creditor gave new value to or for the benefit of the debtor—
- (A) not secured by an otherwise unavoidable security interest; and
- (B) on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor;
- (5) that creates a perfected security interest in inventory or a receivable or the proceeds of either, except to the extent that the aggregate of all such transfers to the transferee caused a reduction, as of the date of the filing of the petition and to the prejudice of other creditors holding unsecured claims, of any amount by which the debt secured by such security interest exceeded the value of all security interests for such debt on the later of—

(continued)

Sections 547(b)(1) and (2) state the two threshold generic requirements for any preference: a transfer by a debtor on account of an antecedent debt.¹⁰⁷ The debtor's insolvency when the transfer occurs, the third requirement, is presumed.¹⁰⁸ Under section 547(b)(4), the transfer must have occurred within ninety days before the bankruptcy petition was filed, or, if the transferee is an "insider," within one year before the filing of the petition. The fifth condition for avoidance, found in section 547(b)(5), is that the transferee-creditor received more of the debtor's assets on account of the transfer than it would have received if the transfer had not been made.¹⁰⁹

-
- (A)
- (i) with respect to a transfer to which subsection (b)(4)(A) of this section applies, 90 days before the date of the filing of the petition; or
 - (ii) with respect to a transfer to which subsection (b)(4)(B) of this section applies, one year before the date of the filing of the petition; of
- (B) the date on which new value was first given under the security agreement creating such security interest;
- (6) that is the fixing of a statutory lien that is not avoidable under § 545 of this title; or
- (7) if, in a case filed by an individual debtor whose debts are primarily consumer debts, the aggregate value of all property that constitutes or is affected by such transfer is less than \$600.

107. The meaning of transfer "to" a creditor is self explanatory; a transfer "benefits" a creditor (without being "to" that creditor) when the debt is backed up by a surety. In that case, payment *benefits* the surety by reducing or discharging the surety's contingent liability. The surety, however, is also a creditor because it has a contingent claim against the debtor. The surety's claim is contingent on the debtor's failure to perform and the surety's performance in its stead. Thus, the direct payment to one creditor benefits the other creditor, the surety. The significance of referring both to transfers "to" a creditor and transfers "for the benefit" of a creditor is that the trustee can avoid both and, thus, recover the preference from either the direct obligor or the surety. See 11 U.S.C. §§ 101(5) ("claim"), and 101(10) ("creditor").

108. Section 547(f). The presumption pertains only to the last 90 days before the filing of the bankruptcy petition.

109. Section 547(b)(5) insulates fully secured creditors from preference attack. There are two reasons for this protection: a fully secured creditor who receives a transfer from the debtor is no better off than it would have been if the pre-petition transfer had not occurred because in that event it would receive 100% of its claim post-petition within the bankruptcy case; and, pre-petition transfers to fully secured creditors do not prejudice unsecured creditors because the debtor's equity in the collateral, which is available to meet the claims of unsecured creditors, increases dollar for dollar with every transfer to a fully secured creditor.

B. Advantages and Disadvantages: The Bankruptcy Trustee Perspective

As already indicated, Ohio preference law has one major advantage for a bankruptcy trustee and several disadvantages in comparison to section 547(b) of the Federal Bankruptcy Code.¹¹⁰ The advantage is a reach-back period measured in years instead of in days, as under federal law (although the federal reach-back period is one year if an insider is preferred). The disadvantages are the necessity of identifying a "real" creditor who possesses a section 1313.56 claim, the possible nonapplication of sections 1313.56 and 1313.57 to "money payment" preferences, and the need to establish the "mental" elements of an Ohio preference: the debtor's contemplation of insolvency and design to prefer, and the creditor's knowledge of the debtor's preferential intent.

C. Advantage: The Long Reach-Back Period

The lengthy Ohio reach-back period means that every assignment, conveyance, and other transfer within the scope of section 1313.56 remains potentially susceptible to avoidance if the insolvent transferor becomes a debtor in a bankruptcy case within the next six, eight, or ten years after the conveyance occurs. It is obvious that a period of uncertainty or repose of such duration significantly increases the risks undertaken by lenders.¹¹¹

The magnitude of the increased risk, compared to the normal bankruptcy preference exposure of ninety days, can be measured by considering the "consternation in the commercial lending industry"¹¹² caused by the decision of the Seventh Circuit Court of Appeals in the famous, or infamous, *Deprizio*¹¹³ case. In *Deprizio*, the

110. The other advantage is the non-application to an Ohio preference of the seven exceptions from federal avoidance set out in section 547(c).

111. This long period of uncertainty, or repose, exists in theory whether bankruptcy occurs or not; any creditor holding a claim when the transfer occurred could sue in state court to avoid it. But the probabilities of actual challenge based on sections 1313.56 and 1313.57 would seem to increase with bankruptcy. See *infra* text at note 124.

112. Donald W. Baker, *Repayments of Loans Guaranteed by Insiders as Avoidable Preferences in Bankruptcy: Deprizio and Its Aftermath*, 23 UCC L.J. 115 (1990).

113. *Levit v. Ingersoll Rand Fin. Corp.*, 874 F.2d 1186 (7th Cir. 1989). The case was known as *In re Deprizio* before it reached the Seventh Circuit and it is commonly referred to in the literature as *Deprizio*. The Sixth and Tenth Circuits have followed *Deprizio*. *Ray v. City Bank & Trust Co. (In re C-L Cartage Co.)*,
(continued)

circuit court held that the longer, one-year, "insider" federal preference reach-back period, not the standard ninety-day period, applied to preferences that were paid to noninsiders, provided the debt had been guaranteed by an insider. *Deprizio* was "[t]he big news of 1989,"¹¹⁴ and its preference holding "jolted the lending community."¹¹⁵ "Controversy and consternation over the . . . decision"¹¹⁶ ensued. It is predicted that *Deprizio* will lead to "alarming new litigation against financial institutions and other unsuspecting recipients of seemingly innocuous transfers."¹¹⁷ Its "chilling effect on the credit industry"¹¹⁸ and its possible "profound impact on preference law"¹¹⁹ have all been noted.

The *Deprizio* issue has elicited voluminous commentary in the legal literature,¹²⁰ including recommendations on how to create distinguishable situations¹²¹ and thus prevent the trustee from using a one-year reach-back period. *Deprizio's* holding meant that the reach-back period on federal preferences was four times longer than

899 F.2d 1490 (6th Cir. 1990); *Manufacturers Hanover Leasing Corp. v. Lowrey* (*In re Robinson Bros. Drilling, Inc.*), 892 F.2d 850 (10th Cir. 1989).

114. Albert J. Givray, *Letters of Credit*, 45 BUS. LAW. 2381, 2452 (1990).

115. *Id.* at 2453.

116. Peter L. Borowitz, *Waiving Subrogation Rights and Conjuring Up Demons in Response to Deprizio*, 45 BUS. LAW. 2151, 2159 (1990).

117. David I. Katzen, *Deprizio and Bankruptcy Code Section 550: Extended Preference Exposure Via Insider Guarantees, and Other Perils of Initial Transferee Liability*, 45 BUS. LAW. 511, 537 (1990).

118. *Id.* at 537.

119. Mark E. Toth, Comment, *The Impossible State of Preference Law Under the Bankruptcy Code: Levit v. Ingersoll Rand Financial Corp. and the Problems of Insider-Guaranteed Debt*, 1990 WIS. L. REV. 1155, 1167 (1990).

120. Borowitz, *supra* note 116, at 2152 n.2 cites to 14 commentaries. More have appeared in the meantime: See eg., Thomas D. Buckley, *Insider Guaranties: Their Effect On The Bankruptcy Preference "Reach Back" Period And Possible Use In Getting An "Ordinary Course" Exception From Avoidance*, 22 U. TOL. L. REV. 247 (1991); Marc L. Hamroff & Robert S. Cohen, *One Year Preference Recoveries Can Extend to Lenders and Other Non-Insider Creditors*, 96 COM. L.J. 153 (1991); Robert E. Higgins & David E. Peterson, *Is There A One-Year Preference Period for Non-Insiders?*, 64 AM. BANKR. L.J. 383 (1990); see also Givray, *supra* notes 114-15; Borowitz, *supra* note 116; Katzen, *supra* notes 117-18.

121. See Baker, *supra* note 112; Andrew J. Nussbaum, *Insider Preferences and the Problem of Self-Dealing Under the Bankruptcy Code*, 57 U. CHI. L. REV. 603 (1990); Barry L. Zaretsky, *Indirect Preferences Pose New Risk To Noninsiders and Secured Creditors*, 1989-90 COM. LENDING REV. 46 (1990); R. Jamison Williams, Jr. & Robert S. Bick, *Insider Guarantees: Emerging Theories of Preference Recoveries*, 69 MICH. B.J. 691 (1990).

preferred creditors had wanted and anticipated it to be.¹²² Ohio's reach-back period for preferences is far longer than that in *Deprizio*, and it applies regardless of whether an insider is involved. For a bankruptcy trustee, the Ohio reach-back period could prove to be an interesting and significant advantage over federal preference law.¹²³

D. Disadvantages of Ohio Law

1. Identifying a real creditor with a section 1313.56 claim

This disadvantage is built into every situation in which a bankruptcy trustee invokes state law under section 544(b). Under section 544(b), a trustee can avoid only those transfers that could be avoided under state law by some identifiable unsecured creditor of the debtor. Section 544(b) should be contrasted with the so-called "strong-arm" clause of section 544(a), under which the trustee can exert the rights under state law of "hypothetical" lien creditors. Under section 544(b), the trustee has a relatively "weak-arm" because of the necessity of finding a real creditor whose claim can be pursued. It is clearly harder to identify such a real creditor than it is to simply establish the elements of a cause of action, which is all the trustee must do to avoid a federal preference under section 547.

While there are relatively few reported state court cases involving sections 1313.56 and 1313.57, the infrequency of preference litigation does not in itself demonstrate that such "real" creditors are equally scarce. Some creditors with section 1313.56 cases may be owed so little that the cost of litigation would make the bringing of a suit impractical. Bankruptcy, however, may increase the incentives for

122. Most of the lower court decisions on the issue before *Deprizio* had held that the 90-day period applied to insider guaranteed claims; the scholarly literature was evenly split. *Levit v. Ingersoll Rand Fin. Corp.*, 874 F.2d 1186, 1189, (7th Cir. 1989).

123. Should the United States Supreme Court, or Congress, ultimately reject *Deprizio's* reading of the Bankruptcy Code, relegating trustees once again to the confines of a 90 day reach-back period even for insider guaranteed debt, the advantage of Ohio's longer, alternative, reach-back period would be even more pronounced. While there is now no conflict among the Circuit Courts of Appeals, lower courts in the Second, Third, and Fourth Circuits have declined to follow the *Deprizio* lead. *Rubin Bros. Footwear, Inc. v. Chemical Bank (In re Rubin Bros Footwear, Inc.)*, 119 Bankr. 416, 425 (S.D.N.Y.1990); *Performance Communications, Inc. v. First Nat'l Bank (In re Performance Communications, Inc.)*, 126 Bankr. 473, 476 (Bankr. W.D. Pa.1991); *Official Creditors' Comm. of Arundel Housing Components v. Georgia-Pacific Corp. (In re Arundel Housing Components, Inc.)*, 126 Bankr. 216, 219 (Bankr. D. Md. 1991).

invoking section 1313.56 for several reasons. A bankruptcy trustee's action based on section 1313.56, even if derived from the rights of a creditor with a very small claim, benefits all creditors, and, because the effect of avoiding a transfer under section 1313.56 is to undo it in its entirety, the stake at issue under section 1313.56 for a bankruptcy trustee is the amount of the preference itself, not the amount of any single small claim.¹²⁴ In addition, a bankruptcy petition signals the end of the period during which creditor forbearance or optimism about the debtor's prospects might have inhibited the starting of legal proceedings to vindicate claims. A bankruptcy trustee has no such inhibitions; the trustee's task is to immediately and vigorously maximize the debtor's estate using all means at its disposal, including all avoiding powers.

2. *The "money payment" exception under Ohio law*

If it were the law that money payments are not avoidable as preferences under section 1313.56, Ohio preference law would still apply to mortgages, security interests, and the granting of other property interests by debtors who intended to prefer some creditors over others. The avoidance power would be significantly weaker, however, if money payments were exempt.

Against the background of *de facto* precedent in the Sixth Circuit for applying sections 1313.56 and 1313.57 to money payments, and given the weakness of the old *Gettinger* decision's discussion of money payments and preference law, a reasonable possibility exists that federal courts in bankruptcy could conclude that Ohio law does not now exclude money payments from the scope of the preference sections. Were the federal courts to reach such a decision, then this "disadvantage" of the Ohio law would disappear.

3. *The "mental elements" required for an Ohio preference*

The parts of sections 1313.56 and 1313.57 dealing with the debtor's design to prefer and the creditor's knowledge of that intent have no direct counterparts in section 547. It is possible for a bankruptcy trustee to establish the five elements listed in section 547(b) and avoid a preference without any reference whatsoever to the debtor's intent or the preferred creditor's knowledge of the debtor's intent.

124. For example, in *In re Plonta*, 311 F.2d 44 (6th Cir. 1962), a bankruptcy trustee using the predecessor of § 544(b) avoided a lien securing a \$1600 indebtedness, based on the rights under state law of an unsecured creditor with a \$10 claim.

The creditor's knowledge of the debtor's insolvency had been an element of a preference under the Bankruptcy Act of 1898.¹²⁵ It was left out of the present Bankruptcy Code, except for insider-creditors, in part because it was thought that the high volume of litigation on the subject undermined the effectiveness of preference law.¹²⁶ Even insider-creditor knowledge of debtor insolvency was eliminated as a preference element in 1984.¹²⁷ It is clearly easier to establish the objective concrete facts specified in section 547(b) than it is to prove, in effect, not only those facts but also the attendant mental attitudes of the debtor and the creditor (as required by sections 1313.56 and 1313.57). In this respect, therefore, the federal law seems to be a more powerful avoidance tool than state law.

The comparison of federal and Ohio preference law is not complete, however, until the federal exceptions from avoidance are also considered. When the section 547(c)(2) "ordinary course"¹²⁸ exception is added to the federal avoidance equation, the "mental elements" that seemingly distinguished Ohio preference law from federal law become factors once again, according to the cases, under the federal law.

The leading case in the Sixth Circuit on the "ordinary course" exception is *In re Fulghum Const. Co.*¹²⁹ In *Fulghum*, the court said that "no precise legal test" applied in section 547(c)(2) cases, but that the "court must engage in a 'peculiarly factual' analysis."¹³⁰ In one of four positive references in *Fulghum* to the Eleventh Circuit's *Craig Oil* decision, the court added, "There is no allegation that the repayment . . . was in bad faith. See *In re Craig Oil* . . . (debtor's state

125. See § 60b of the Bankruptcy Act of 1898, ch. 541, 30 Stat. 544, 562 (repealed by the Bankruptcy Reform Act of 1978, Pub. L. No.95-598, title IV, Nov. 6, 1978, 92 Stat. 2682).

126. See Report of the Commission on Bankruptcy Laws of the United States, H.R. 93-137, 93d Cong., 1st Sess. 19 (1973).

127. Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No.98-353, 98 Stat. 333.

128. 11 U.S.C. §547(c)(2) 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 by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee;
 - (B) made in the ordinary course of business or financial affairs of the debtor and the transferee; and
 - (C) made according to ordinary business terms;"

129. 872 F.2d 739 (6th Cir. 1989).

130. *Id.* at 743.

of mind is relevant to determining if § 547(c)(2) exception is available). ***[N]othing in the record suggests that [the repayment] (sic) was related in any way to *pre-bankruptcy* planning."¹³¹ In *Fulghum*, the court held that, under all the circumstances, the section 547(c)(2) exception did apply.

In *Craig Oil*¹³² itself, the Eleventh Circuit, in declining to find that the "ordinary course" exception applied, had said that the debtor's state of mind was not "immaterial in applying the preference exception of section 547(c)(2)."¹³³ "Whenever the bankruptcy court receives evidence of unusual collection efforts, it must consider whether the debtor's payment was in response to those efforts."¹³⁴ The preferential payments in *Craig Oil* were made with cashier's checks. The debtor began paying the preferred creditor with cashier's checks after the preferred creditor had been invited by others to join in the filing of an involuntary bankruptcy petition against the debtor and had asked the debtor for a showing of good faith. The Eleventh Circuit found "no error in the lower court's consideration of Craig's motive for continued payment to Marathon. . . ."¹³⁵ On the other hand, the court added, "This state of mind alone cannot establish 'unusual' or 'extraordinary' action by the debtor. It merely goes to explain the unusual payment actions by the debtor in this case."¹³⁶

The reference in *Fulghum* to "pre-bankruptcy planning," which sounds like section 1313.56's "contemplation of insolvency," and the Sixth Circuit's approval in *Fulghum* of the use made in *Craig Oil* of state of mind to help determine whether a transaction was in the "ordinary course," indicate that mental attitudes can still make a difference in federal preference law.¹³⁷

131. *Id.* at 745. See *In re Craig Oil Co.*, 785 F.2d 1563 (11th Cir. 1986) (emphasis added).

132. *In re Craig Oil Co.*, 785 F.2d 1563 (11th Cir. 1986).

133. *Id.* at 1566.

134. *Id.*

135. *Id.*

136. *Id.*

137. There is also some apparently careless post-*Fulghum* dictum to the contrary, at the bankruptcy court level. "In determining whether the §547(c)(2) is applicable (sic), the creditor-transferee's knowledge or state of mind is irrelevant to the issue, unlike the former requirement under §60 of the Bankruptcy Act of 1898. The legislative history of §547 is clear to state that 'a creditor's state of mind has nothing whatsoever to do with the policy of equality of distribution. . . .'" *In re Cook United, Inc.*, 117 Bankr. 884, 888-89 (Bankr. N.D. Ohio 1990).

In *Cook United* the court rejected the creditor's argument that chronically late transfers were, nevertheless, in the "ordinary course" because in the utility-
(continued)

Hard evidence, such as a sudden switch to the use of cashier's checks for making payments, would point to a conclusion that a nonordinary course transaction had occurred, whatever the parties' mental attitudes might have been. Knowing that it was done to pacify the creditor (ie., to prefer it) and deter the creditor from putting the debtor into involuntary bankruptcy made the nonordinary course conclusion easier to reach in *Craig Oil*. But that kind of hard evidence would be probative on intent and knowledge, as well as on "ordinary course." Why, indeed, would a debtor ever pay one creditor, but not others, with cashier's checks, unless it wanted for some reason (such as purchasing its neutrality with respect to involuntary bankruptcy) to "prefer" that creditor? In other words, the same kind of evidence that would help support a finding of nonordinary course dealing under federal law would often tend to prove the mental attitudes under Ohio law as well.

The significance of debtor and creditor mental attitudes under section 547 should not be underestimated just because they get into the federal avoidance formula only by way of their relevance to an exception from avoidance. That exception has potential to become a major loophole in the power to avoid preferences under federal law. The possible widespread application and exploitation of the "ordinary course" exception is the inadvertent result of one of the changes Congress made in the Bankruptcy Code in 1984. Originally, the "ordinary course" exception had been intended to apply only to transfers with respect to short-term debt, such as telephone bills and other accounts with approximately monthly billing cycles. It was "a

creditor's business judgment, the debtor's late payments did not warrant discontinuance of service, deposit requirements, or other unusual terms or restrictions. The concrete facts ruled out application of §547(c)(2).

The court's strong language dismissing the relevancy of state of mind evidence in preference law may have been an example of what the Eleventh Circuit calls "sliding" away from the real issue. In *Cook United*, that issue was whether a §547(c) exception from avoidance applied; the § 547(b) preference elements had all been stipulated. In *Craig Oil* the Eleventh Circuit observed that

Marathon [the creditor] correctly concludes that a creditor's state of mind is now immaterial in finding a preference. In making this argument, Marathon slides away from the issue in this case—which is not whether there was a preference, but whether the preferred transfer was in the ordinary course of business. . . . It does not follow . . . that a debtor's state of mind or motivation is likewise immaterial in applying the preference exception of §547(c)(2)."

785 F.2d 1563, 1566 (11th Cir. 1986).

variant of the contemporaneous exchange exception."¹³⁸ This idea was codified in the form of a provision limiting the "ordinary course" exception to transfers on account of debt incurred within forty-five days of its repayment. Much litigation ensued concerning the calculation of the forty-five day period.¹³⁹ Congress' response was to eliminate the forty-five day rule in the 1984 amendments to the Bankruptcy Code.¹⁴⁰ The Supreme Court has now held that what is left of section 547(c)(2) means what it says: repayment of any debt, including long-term debt, qualifies for the section 547(c)(2) exception, provided the stated "ordinary course" standards are met.¹⁴¹ Thus, an exception created for creditors who earned it by putting value into a declining debtor shortly before getting it back out again has evolved, accidentally,¹⁴² into an exception potentially available to all creditors. As a result, under federal preference law, all transfers on account of antecedent debt made within the federal reach-back period may, nevertheless, escape avoidance if their recipients can establish that they were made in the "ordinary course." One can anticipate, therefore, that this exception, which calls into play the mental attitudes of both the debtor and the preferred creditor, will in the future, be a factor in an increasing number of federal preference cases.

Nevertheless, it is clear that a bankruptcy trustee's task is easier under the federal statute. In a situation in which the debtor makes a transfer on account of an antecedent debt, but is not acting because of awareness of present or impending insolvency, and has no intent to prefer (and there is, therefore, nothing for the creditor to have forbidden knowledge of) there will be no avoidance at all possible under Ohio preference law. Such a transfer may well be avoidable, however, under federal law. All that can be said about the significance in the federal context of the "missing" Ohio elements is

138. *In re Craig Oil Co.*, 785 F.2d 1563, 1567 (11th Cir. 1986).

139. *See, e.g.*, *Sandoz v. Fred Wilson Drilling Co. (In re Emerald Oil)*, 695 F.2d 833 (5th Cir. 1983); *Barash v. Public Fin. Corp.*, 658 F.2d 504 (7th Cir. 1981); *Wickam v. United American Bank (In re Property Leasing and Mgmt. Inc.)*, 46 Bankr. 903 (Bankr. M.D. Tenn. 1985).

140. Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No.98-353, 98 Stat.333.

141. *Union Bank v. Wolas*, 112 S. Ct. 527 (1991). The Sixth Circuit had earlier come to the same conclusion. *Gosch v. Burns (In re Finn)*, 909 F.2d 903 (6th Cir. 1990). *Union Bank* resolved a conflict between the Sixth and the Ninth Circuits. *See CHG Int'l, Inc. v. Barclay's Bank (In re CHG Int'l, Inc.)*, 897 F.2d 1479 (9th Cir. 1990).

142. Long-term lenders did not lobby for the amendment. *See Ragsdale v. Citizens & Southern Nat'l Bank, Inc. (In re Control Elec., Inc.)*, 91 Bankr. 1010, 1013 (N.D. Ga.1988).

that their absence creates a somewhat better possibility of nonavoidance because the situation may fit within the "ordinary course" exception under section 547(c)(2).

CONCLUSION

Ohio law provides bankruptcy trustees with an alternative preference avoiding power that can be invoked in situations in which the more familiar federal preference law is inapplicable. The Ohio alternative has the potential to be of real significance. Its longer reach-back period is clearly of major importance. On the other hand, the difficulties in establishing the elements of an Ohio preference could discourage its use. It will be interesting to see whether trustees in Ohio bankruptcy cases are able, in the future, to exploit the possibilities inherent in state preference law.

