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Clear Thinking About Insider Preferences: A Reply

Jay Lawrence Westbrook*

Only so strange a creature as a law professor could grow excited about the effect of the decision in *Levit v. Ingersoll Financial Corp.*[1] on indirect-preferences in bankruptcy. I wrote about that subject in these pages about a year ago in an Article called *Two Thoughts About Insider Preferences.*[2] I recently drew a passionate response (the "Response") from a fellow professor, Peter Alces.[3] I had written in defense of *Levit*, which had been the target of unrelenting attack.[4] Imagine my surprise at being attacked by a supporter of *Levit*. This brief Reply[5] is intended to strengthen the case for retaining the rule in *Levit*, which the recent Response inadvertently has undermined.

The essence of the *Levit* case is that a lender who persuades an insider to guarantee its loan effectively extends the preference period against itself to one year, because of the indirect benefit to the insider guarantor arising from any payment of the guaranteed debt.[6] The fact that the insider benefits from payment causes the lender's preference exposure to be extended to the one-year period applicable to preferences made to insiders. Many argued that *Levit* discouraged the obtaining of

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1. 874 F.2d 1186 (7th Cir. 1989).
2. Jay L. Westbrook, *Two Thoughts About Insider Preferences*, 76 MINN. L. REV. 73 (1991).
3. Peter A. Alces, *Rethinking Professor Westbrook's* Two Thoughts About Insider Preferences, 77 MINN. L. REV. 605 (1993).
4. *See* Westbrook, *supra* note 2, at 73 n.2.
5. Because it is so late in the year, the editors were able to give me only a very limited space in which to respond unless I were willing to delay response until November, 1993. Among other things, so late a publication date might postdate congressional action on *Levit*.
6. Because of my limited space, I refer the reader to my original article for a summary of *Levit*. *See id.* at 75-76.

perfectly legitimate guaranties. I defended *Levit* by distinguishing more-legitimate guaranties from less-legitimate ones and arguing that *Levit* would not operate to discourage the more-legitimate ones.[7]

I also defended a constraint Judge Easterbrook imposed on the rule developed in his *Levit* opinion. The constraint made the rule applicable only where the insider had a reimbursement claim against the debtor, that is, where the insider was a creditor.[8] I defended this limitation against the argument that it would give rise to the risk that routine waivers of reimbursement by insiders would obviate the *Levit* rule.[9] I argued that attempted waivers should not weaken the *Levit* rule, because such waivers need never be recognized and enforced by the courts.[10]

Professor Alces believes I botched the defense of *Levit* (which he supports passionately, except for its failure to go nearly far enough[11]). Regrettably, he offers no *Levit* defense of his own, but only a debater's brief criticizing my Article. In the process, he makes a number of odd mistakes. The two principal categories of mistakes are these: first, he ignores all my primary and strongest arguments supporting *Levit* in favor of critiquing the secondary and tertiary points, thus making *Levit* look much less defensible than it is, no doubt to the joy of the well-heeled lobbyists plotting its demise; and second, he misreads the facts of the central hypothetical to which the second half of the Article is devoted, producing utter analytical confusion.

Given considerations of space and the varying interests of readers, from the general to the technical, this Reply is organized for ease of reference. The Reply begins with the primary policy points, the points about which congressional staffers, among others, will be most concerned. It then touches on the policy implications of the boundaries *Levit* establishes for its

7. *Id.* at 80.

8. Levit v. Ingersoll Rand Fin. Corp., 874 F.2d 1186, 1189-92 (7th Cir. 1989). One important result would be that payments to lenders would not be subject to the one-year preference period where the insider was not a guarantor so that any benefit to the insider would be relatively unquantified and indirect. Westbrook, *supra* note 2, at 96-97.

9. Westbrook, *supra* note 2, at 87-88.

10. *Id.* at 88.

11. *E.g.*, Alces, *supra* note 3, at 627 (arguing that *Levit*'s creditor requirement must be abrogated).

own doctrine. Finally, it addresses some of the points that are important only to those with a technical interest.

I. PRIMARY POLICY ISSUES

There were two policy arguments of greatest importance in my Article. First, *Levit* states a desirable rule because it will not discourage lenders from getting legitimate guaranties, but will discourage lenders from getting guaranties that have no purpose but to leverage preferential treatment for the lenders; and second, attempted waivers of *Levit* should not be enforced. The rest of the Article was devoted to more technical points that I hope were interesting and of some value, but these two points were the key policy arguments. The Response ignored them both and in doing so made *Levit* look far less defensible than it really is.

A. LENDER DISINCENTIVE TO TAKE PURE-LEVERAGE GUARANTIES

The first important policy consideration is that *Levit* will not much discourage the type of insider guaranties that may be regarded as legitimate, but will provide some disincentive for less-legitimate guaranties. Less-legitimate guaranties are those that have no purpose except to provide leverage for preferring the lender over other creditors of the debtor company. The Response simply ignores this crucial issue.[12]

In *Two Thoughts*, I distinguished "true" from "pure-leverage" insider guarantors. A true guarantor is one who gives personal security (for example, stocks and bonds) to support the guaranty or one who is financially able to respond to a judgment on the guaranty (for example, a person with other substantial business interests).[13] By contrast, a leverage guarantor is one who puts up no security for the guaranty and is unlikely to be able to pay any judgment on the guaranty.[14] Both types of guaranties give the lender leverage over insiders. They are distinct in that a true guaranty also has a legitimate value, the provision of greater wealth to protect the lender, while the leverage guaranty has only the illegitimate purpose of providing

12. A recent court of appeals decision refers to *Two Thoughts* and summarizes this, my major point, perfectly. *See* Travelers Ins. Co. v. Cambridge Meridian Group, 980 F.2d 792, 798 n.12 (1st Cir. 1992).

13. *See* Westbrook, *supra* note 2, at 80.

14. *See id.*

leverage for a lender preference.[15]

Levit makes any insider guaranty less desirable to a lender than it would be without the *Levit* rule, because the guaranty may transform a payment made during the year before bankruptcy (say, six months before) into a preference, while absent the guaranty it would not have been. Nonetheless, I suggested that *Levit* would not much discourage banks from taking true insider guaranties, because any *Levit* recovery of a preference from the lender could be reclaimed by a claim over against the security, or the solvent insider, in the same action.[16] By contrast, a bank or other lender might be discouraged by *Levit* from taking a pure-leverage guaranty from an impecunious insider, because the guaranty might make a payment recoverable as a preference when it otherwise would not have been and yet the insider would not be able to reimburse the lender for the recovery.[17]

Following *Levit*, an insider guaranty backed by security or a solvent guarantor still makes a loan much more bankable than it would be without the guaranty. But after *Levit* an insider guaranty that offers only leverage over the company is probably a net detriment because of its effect in extending the preference period without providing additional wealth to back the loan. Thus, smart loan officers will read *Levit* to mean they should continue to get true guaranties, but should be less eager about pure-leverage guaranties. As long as putting up personal wealth for the lender's exclusive benefit continues to be viewed as a legitimate way to generate small business finance,[18] that distinction is just what we should want. Therefore, the distinction tends to take the wind out of the sails of *Levit* critics who say *Levit* means the end to all insider guaranties and therefore a terrible harm to small business.[19]

Professor Alces's Response addresses for pages the effect of the true/leverage guaranty distinction on the *insiders'* conduct, which was distinctly my secondary point. The Response does not discuss the effect on lenders' conduct, which is a far more important point.

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15. Either guaranty can also serve to provide "commitment" from an insider, which may be a legitimate lender concern. *See id.* at 79. I ignore that aspect for the moment, in the interest of space and clarity.

16. *See id.* at 81.

17. *See id.*

18. *But see id.* at 79 n.30 (leaving open the ultimate legitimacy of reserving certain assets for the lender's exclusive protection).

19. *See id.* at 86.

Professor Alces insists throughout on talking of "good" and "bad" guaranties,[20] implying that I see the *Levit* rule as a "sanction."[21] Indeed, the Response discusses at length how my approach requires distinguishing good from bad guaranties.[22] *Levit* extends the preference period to one year for payments to insiders whether they are "true" or "leverage" guarantors. I never suggested any change in that result. Nor would anything I said force the courts to determine the lender's "intention."[23] To distinguish between economic and behavioral effects that are socially or economically acceptable and unacceptable, and to favor *Levit* because it discourages the unacceptable while not discouraging the acceptable, has nothing to do with having to prove intention or ascertain moral desserts.

I make that point only because it is so prominent in the Response. The more important point is that Professor Alces takes the broad position that there can be no distinction between true guaranties and leverage guaranties. He does not contend that my distinction is not conceptually valid, or important, but rather that it is "untenable,"[24] because a given guaranty might be only partially a "true" one or the guaranty might change in character over the life of the loan.[25]

It is hard to see how this point is relevant to my major contention about *Levit*'s effect on lender incentives. Although Professor Alces ignores the argument about the effect on lender incentives, surely he would not have claimed that a bank officer is incapable of making a reasonable judgment about which security for a guaranty is *likely* (in an admittedly uncertain world) to be good or what insider guarantors are *likely* to be good for paying the guaranty. (If he would claim that, he may not be a loan officer in any bank of mine.) If a loan officer can make those kinds of judgments, then a bank will take insider guaranties when the discounted value of the

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20. *See, e.g.*, Alces, *supra* note 3, at 614.

21. *See id.* at 622. It is even stated I want to "punish" the lender for a "bad" guaranty. *Id.* at 614.

22. *See, e.g.*, Alces, *supra* note 3, at 615.

23. *See id.* at 614.

24. *See id.* at 621.

25. *See id.* at 621-25. In that connection, there are certain arguments in the Response to which I do not reply because I do not understand them. The paragraph on page 622 of the Response containing the following sentence is exemplary: "Because *Levit* avoidability occurs at the time of the corporate debtor's bankruptcy, the lender may avoid insider preference exposure despite the good commercial reasons of the lender when it first took the guaranty." *Id.* at 622.

wealth behind them[26] apparently exceeds the disadvantage of an extended preference period. If your bank's loan officer is a better golfer than "figurer," just tell her or him to take the guaranty "if you're pretty darn sure they're good for it personally," and let it go otherwise.

For these reasons, I assume Professor Alces concedes the point about *Levit*'s effect on lender conduct, but his ignoring it in his Response makes the case for *Levit* look much weaker than it really is.

B. NON-WAIVER

Part of the holding in *Levit* could be read to permit a de facto waiver of its protections by the insider guarantor at the time of the original loan and guaranty. If such waivers were effective, they would instantly become part of every lender's guaranty boilerplate.[27] I argued that such waivers are unenforceable.[28] The Response ignores my argument and offers no non-waiver argument of its own. As a consequence, it strongly implies that *Levit* is routinely waivable and by so doing guts *Levit* without a congressional shot being fired. Yet the Response is from a passionate *Levit* supporter.[29]

The second part of *Two Thoughts* was devoted to the *Levit* holding that its rule is triggered only where the insider guarantor is entitled to reimbursement from the debtor company and therefore is a "creditor" of the debtor.[30] This holding could be read to mean that a waiver of reimbursement by the insider guarantor in the loan documents would eliminate application of *Levit* by eliminating the insider's "creditor" status. I took the position that such a waiver should not be enforced because it has no economic or other legitimate purpose except to operate as a prospective waiver of the estate's preference rights. Such a waiver between the insider and the preferred lender obviously should be unenforceable.[31]

Professor Alces's Response completely ignores the non-

26. Discounted, obviously, by the perceived risk of decline in value over the life of the loan.

27. *See* Westbrook, *supra* note 2, at 87.

28. *See id.* at 88.

29. Actually, Professor Alces is ambivalent, saying at one point that his article does not offer a defense of *Levit*. *See* Alces, *supra* note 3, at 634. In the next two sentences, however, he presents himself as a supporter of *Levit*. *See id.* at 634-35.

30. *See* Westbrook, *supra* note 2, at 86-98.

31. *See id.* at 88.

waiver argument. Instead, he discusses a case upholding waiver[32] and says "the 'creditor' requirement must be abrogated."[33] He offers no argument to show that Judge Easterbrook erred in *Levit* by imposing the creditor requirement nor does he explain how to avoid the plain words of the statute.[34] Presumably, therefore, Professor Alces is demanding congressional abrogation. Pending that highly unlikely event, the concession as to waiver by the Response leaves *Levit* gutted. Here, as with lender incentives, the Response ignores the forest for the trees and in the process harms the cause it purports to champion.

II. THE CREDITOR REQUIREMENT

Now we have come to the point where a simple misreading of the facts of my primary hypothetical leads to utter confusion in the Response and no doubt in many readers as well. As before, I first must state the point that really matters in the discussion and then turn to the source of confusion in the Response.

Although the practical aspect of the creditor requirement is its relationship to waiver *vel non*, it has a more general intellectual interest. How does it fit within the *Levit* policy framework? Why require that the insider be a "creditor"? I suggested that the requirement provides a constraint that roughly divides control of insider abuse through the preference power from more general abuse-control doctrines like fiduciary duty, fraudulent conveyance, and equitable subordination.[35]

My primary point about the benefits of this constraint was that its abrogation would make too many transactions problematic *ex ante* by forcing elaborate consideration of indirect, unquantified, even contingent benefits to insiders from particular transfers by a debtor company. Imagine if every payment, grant of a security interest, or other transfer by a large company nine months before its Chapter 11 filing had to be evaluated as a possible preference because of an indirect benefit of some kind to one of its dozen directors or dozens of officers. I argued that the transaction costs of such a rule would probably

32. *See* Alces, *supra* note 3, at 626.

33. *Id.* at 627.

34. Bankruptcy Code § 547(b)(1) states as an element of a preference that the transfer must have been "to or for the benefit of a creditor." 11 U.S.C. § 547(b)(1) (1988).

35. *See* Westbrook, *supra* note 2, at 89-90.

be too great to justify the benefit of getting more thorough policing of insider abuse through the preference power, especially because other insider-abuse devices could be used to deal with the problems not addressed by preference law.[36]

The Response ignores this point and instead goes through an elaborate discussion of the "nexus" between the benefit to the insider and the transfer.[37] It would be pointless to pursue the argument here, however, because it rests entirely on a misreading of the central hypothetical in my Article.

The hypothetical involved a businesswoman, Jane Hackman, and her corporation, H Corporation. The corporation is having some cash-flow trouble. When Hackman seeks financing for another, separate venture, the bank demands and gets Hackman's agreement to cause H Corporation to pre-pay its loan as a quid pro quo for the bank's financing the new, separate Hackman venture. *Levit* does not apply because Hackman is not a guarantor of the H Corporation bank debt, but its policy arguably applies because the pre-payment would produce an indirect benefit for the insider Hackman and represented an abuse of her insider position.[38]

The Response gets this wrong. Its argument turns entirely on the assertion that my hypothetical involves "a lender who has taken an insider-guaranty."[39] As noted, the whole point of the hypothetical was that it did not involve a guaranty. The hypothetical was not ambiguous. My Article said, "The bank [demands] a guarant[y] of H Corporation's debt in exchange for financing for the new project, *but Hackman refuses*."[40] It goes on to repeat several times that the hypothetical does not involve an insider guaranty.[41]

The result of this muddling of the facts is that the Response does not address the important questions at all. It does address the problem of "benefit" analysis, discussed below. It does not consider, however, the extent to which it would or would not be helpful to have a broad range of alleged insider

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36. *See id.* at 91-92.

37. *See* Alces, *supra* note 3, at 625-27. On the technical question of measuring preference recovery by benefit, see *infra* part III.B.

38. *See* Westbrook, *supra* note 2, at 93-94.

39. Alces, *supra* note 3, at 627. A page later the Response says, "In Westbrook's hypothetical, the insider does have a claim against the debtor attributable to the specific debt she guaranteed . . . ." *Id.* at 628.

40. *See* Westbrook, *supra* note 2, at 93.

41. *See, e.g., id.* at 94 ("unlike the insider-guarant[y] situation"); *id.* ("The creditor requirement distinguishes the example from the insider-guarant[y] case . . . .").

abuse regulated by a wide-ranging preference power unconstrained by a direct connection between transfer and benefit to the insider. Nor does it explain how the "benefit" factor can be avoided, given the statutory language.[42]

III. THE TECHNICAL POINTS

Because of limited space[43] and the priority commanded by the points already discussed, my discussion of some interesting technical points will be rather more limited than I would like. I will address the two most important ones: the effect of *Levit* on the insider's incentives; and measurement of recovery by the amount of the benefit received by the insider.

A. EFFECT OF *LEVIT* ON INSIDERS' INCENTIVES

As discussed earlier, my primary argument that *Levit* has a benign influence on commerce was that it would not discourage bankers from taking "true" guaranties, but would discourage them from taking "pure-leverage" guaranties. Professor Alces ignored that argument in favor of a secondary point, my claim that *Levit* has a benign effect on insider conduct as well as the choices made by lenders.[44] The argument is secondary, technical, and complex, which may explain a certain confusion in the Response on this point. I distinguished insider incentives in a post-*Levit* world from those in a pre-*Levit* world. I was not, as the Response assumes, arguing that a true insider guarantor must always have less incentive to prefer the lender than does the leverage insider.[45] To restate the problem, we will look separately at the effect of insider-preference doctrine standing alone and then at the additional effect of *Levit*.

The case supposed is demand for a payment on an insider-guaranteed loan where the payment may threaten the survival of the business.[46] The insider can either refuse payment and try to save the business or can cause the debtor to prefer the lender. If the business fails, the first course may lead to a suit on the guaranty by the lender. Absent an indirect preference

42. *See infra* note 63.
43. *See supra* note 5.
44. *See* Westbrook, *supra* note 2, at 84. Another secondary point was that *Levit* was not inconsistent with the "commitment" that lenders want from the principals of a small business. *See id.* at 81-83. In some respects the Response confused these two points. *See* Alces, *supra* note 3, at 617-20.
45. *See* Alces, *supra* note 3, at 617.
46. *See* Westbrook, *supra* note 2, at 83.

doctrine, there is no risk of suit in the second course. The insider has an incentive, of course, to save the business, but it is not reinforced by fear of a bankruptcy-trustee lawsuit if the business is risked by a payment to the lender. The true insider guarantor would have an especially powerful incentive to prefer in that situation, because that insider has personal wealth at stake—the security for the guaranty or the insider's other personal assets.

Fortunately, we do have an indirect-preference rule in the statute,[47] and the insider knows that it may lead to an indirect preference suit by the debtor-company's trustee. That will be true with or without the rule in *Levit*. The risk is much greater for the true guarantor,[48] because the trustee is much more likely to sue a solvent party.[49] Thus, the indirect-preference rule operates more powerfully to reduce the preference incentive of a true insider guarantor.

This counterbalancing risk of an indirect-preference suit somewhat reduces the net incentive for the insider to cause the preferential payment on the guaranteed loan. The effect is weak, as I noted in *Two Thoughts*, in the way that all preference incentives are inherently weak,[50] but it pulls in the right direction. The risk of an indirect-preference suit somewhat increases the chance that an insider will decide that saving the business is the better risk to take. As noted, it will have a more powerful effect on a true guarantor, because a trustee suit is a greater risk for that guarantor.[51]

All that comes from indirect-preference doctrine standing alone, without *Levit*. What is the effect of *Levit*? *Levit* adds

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47. *See* 11 U.S.C. § 547(b)(1) (1988).

48. This fact is the point that preoccupies the Response. *See* Alces, *supra* note 3, at 616-17. It applies to any suit by the lender or by the trustee, whether on the guaranty or to recover a preference.

49. Actually, the analysis can get much more complicated. For example, take the case where the guaranty is a true one because of security given for it, rather than the insider's overall wealth; the collateral for the guaranty is an exempt piece of property available to a creditor only by way of a voluntary security interest; and the insider has no substantial non-exempt wealth. On those facts, the trustee might not have an incentive to sue the true guarantor for an indirect preference absent the rule in *Levit*, because the resulting judgment would not be enforceable against the exempt property. Obviously, however, there will be many cases with other facts where the trustee will have that incentive against a true guarantor.

50. *See* Westbrook, *supra* note 2, at 86.

51. Because *Levit* will encourage lenders to get guaranties only (or primarily) from insiders who are true guarantors, more insider guarantors will be inclined to save the business rather than to prefer a lender.

the lender as a potential plaintiff in a suit against the insider. If the lender is not preferred, it will sue on the guaranty. If the lender is preferred, after *Levit* the trustee will sue the lender and the lender will sue over against the insider guarantor. The additional potential plaintiff somewhat increases the risk of suit against a true guarantor, but the increased risk is marginal, because the true guarantor's attractiveness as a defendant makes it highly likely the trustee would sue anyway. But it is possible—I do not say certain—that the *Levit* rule increases the risk of suit against a leveraged guarantor.[52]

As I noted in *Two Thoughts*, the leverage guarantor may think the lender is a more dangerous potential adversary.[53] A bank may sue an impecunious party where a trustee would not bother. The lender might want to make a point to other insiders and might be more interested in threatening "to bankrupt you" than would be a trustee, because the bank is more concerned with overall borrower motivation. Furthermore, an action over against the insider in a lawsuit already begun against the bank by the trustee is not very expensive and may be more likely than a lawsuit involving the insider alone. Thus, the effect of *Levit* may be to increase marginally the disincentive of a leverage guarantor to prefer the lender. Again, the effect may be weak, like most preference effects, but at least it is in the right direction.

On this basis, the effect of *Levit* on the leverage guarantor is potentially greater than its effect on the true guarantor, although it should reduce the preference incentives of both to some extent. I am not arguing that the preference rules operate more strongly on leverage guarantors generally;[54] indeed, the very fact that preference doctrine operates more weakly on such guarantors is the basis for saying that *Levit* may have a greater effect in reducing the preference incentives of those leverage guarantors.

B. Benefit Recovery

Ordinarily, we have no difficulty in measuring the amount of recovery when a transfer is voided as a preference: the en-

52. The Response correctly asserts that I have no empirical evidence on this point. *See* Alces, *supra* note 3, at 620. Neither, however, does the Response.

53. *See* Westbrook, *supra* note 2, at 83-84.

54. That is the position which the Response ascribes to me. *See* Alces, *supra* note 3, at 617.

tire transfer is recovered. In the more unusual case, where the transfer was only partially a preference, recovery under Bankruptcy Code section 550 is "to the extent that" it was preferential.[55] Thus, for example, if the debtor paid $800 to X, $400 on account of an old unsecured debt and $400 for newly delivered goods, $400 would be the recoverable preference.

There are some problems at the frontiers of preference law where the determination of the amount to be recovered becomes much more difficult. One notable instance is the indirect preference, and that is true whether or not we follow the rule in *Levit*. In my Article, I gave the following example in a footnote:

> In the case of an insider payment, I conclude that a preference includes only the portion of the transfer that benefits the insider, and, therefore, the trustee should recover only that portion. Thus, given a $100,000 unsecured debt to an unaffiliated lender, an insider guarant[y] limited to $50,000, full payment of the debt six months before bankruptcy, and insolvency on the transfer date, the trustee would avoid only $50,000 of the $100,000 payment. Any other result would ignore the central role of the "benefit" to the insider and would create a pointless distinction between making one or two payments. Acceptance of this analysis would eliminate some of the concerns about the *Levit* line of cases.[56]

Thus I offered the conclusion that the amount of recovery would be measured by the benefit to the insider.[57] The Response flatly rejects that conclusion, saying "the amount of the *transfer* to the lender would be the amount of the preference, not the value of the *benefit* the insider realizes."[58]

Professor Alces quotes my hypothetical, but never states what result he would assert to be correct. Nonetheless, based on the statement of principle quoted just above, I assume he would say that the trustee in the hypothetical case should recover $100,000. If the guaranty had been for only $5,000, the trustee would still, presumably, get back $100,000. This argu-

55. 11 U.S.C. § 550(a) (1988).

56. *See* Westbrook, *supra* note 2, at 96 n.91.

57. *Accord* Travelers Ins. Co. v. Cambridge Meridian Group, 980 F.2d 792, 796 (1st Cir. 1992). The relevance of this point was to a secondary argument supporting the "creditor" requirement in the insider situation. I argued that if recovery was measured by benefit, the problems that would be created by the elimination of the creditor requirement would be exacerbated by the need to value for recovery purposes the vague, indirect benefits received by a nonguarantor like the second-venture financing received by Jane Hackman in my hypothetical. *See* Westbrook, *supra* note 2, at 96-97.

58. Alces, *supra* note 3, at 631. The Response criticizes me for citing no authority, but cites none itself.

ment will certainly reinforce the claim by *Levit*'s opponents that it leads to extreme and unfair results and will therefore hasten its repeal by Congress. Beyond that pragmatic point, the cursory analysis in the Response gives short shrift to an important emerging problem and obscures the issues it presents.

A recent case, *In re Cannon Ball Industries*,[59] illustrates the difficulty. The debtor, Cannon Ball, executed a secured note in the original amount of $750,000. Two of its shareholders guaranteed the note to the extent of $150,000. The debtor made payments of some $43,000 on the note during the year before bankruptcy, leaving around $400,000 owing on bankruptcy day.[60]

The trustee claimed a *Levit* preference and the court agreed, although unfortunately it did not state the amount of the recovery.[61] The opinion implies, however, that the full amount of the payment was recoverable.[62] This result is quite consistent with the analysis in the Response and inconsistent with the result for which I would argue.[63]

The defendant lender in *Cannon Ball* argued that the insiders received no benefit from the transfer because the payments never approached the guaranty limit.[64] The insiders still owed the full $150,000 guaranty amount after the payments had been made, so how had they benefited? The court found a benefit in the reduced probability that the shareholder-guarantors would have to pay.[65] By implication, the entire amount of the transfer would therefore be avoidable, no matter how small the reduction in the probability the guaranty would be called. I would have thought the proper result would be to value the benefit and make the recovery avoidable only "to the extent" of that benefit.[66]

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59. Cannon Ball Indus. v. Sequa Corp., 150 B.R. 929 (N.D. Ill. 1992).

60. *Id.* at 930.

61. *Id.* at 931.

62. *See id.*

63. *Cf.* Travelers Ins. Co. v. Cambridge Meridian Group, Inc., 980 F.2d 792, 802-03 (1st Cir. 1992) (holding that the "benefit" from contingent reduction of exposure of an insider's property on a non-recourse guaranty is not sufficient to trigger preference liability under § 547(b)(5)).

64. *Cannon Ball*, 150 B.R. at 931-32.

65. *Id.* at 931.

66. Theoretically, there is a payment, always the present value of $150,000 or less, for which the insider could sell a "put" of the guaranty, so that the buyer of the put would agree upon exercise of the put to assume the insider's liability. (The present value would be discounted from the probable date of the required payment.) To use an example like one used by the court in *Cannon Ball*, suppose a payment of $5,000 that reduced the loan to exactly

The point was tangential to my Article and there is certainly too little space here to analyze it fully. My view is that "benefit" to the insider generates the preference finding and therefore must bear some relationship to the amount avoided. That is what we do for other elements of a preference. When a payment is partially on account of an antecedent debt, we avoid that part. When a payment on an undersecured debt makes the transferee only partially better off than it would have been, we avoid the transfer "to the extent" of that improvement.[67] In the same way, why not avoid an "indirect benefit" transfer to the extent of the benefit?

It is worth noting that these issues do not arise from *Levit*, as such. They exist because of the indirect preference doctrine lodged within subsection (b)(1) of section 547 of the Code. Any indirect preference claim requires us to decide whether the amount recoverable is measured by the entire transfer or by the benefit to the insider. *Levit* merely adds the twist of making the lender-transferee, as well as the insider, liable for that amount. Its only policy or normative effect is to heighten the inequity of any result that is perceived to be inequitable.

I cannot imagine anyone being terribly comfortable with conclusions about these indirect-benefit recovery problems until we have seen more litigation, so I state them with appropriate modesty. I am certainly ready to revise my conclusions as we see more cases. But I also cannot think it could be right to interpret the effects of *Levit* as expansively as does the Response. To do so would introduce an intolerable level of uncertainty into business transactions. I am also sure that assertions that *Levit* must be so broadly understood will hasten its congressional execution.

CONCLUSION

Professor Alces and I both agree that *Levit* states a good

$150,000. That payment, made more than 90 days before bankruptcy, would likely improve the chances that the guarantors would not have to pay the full $150,000, assuming the company might pay something more before failing and no new credit would be extended. The payment the buyer of the put would be willing to accept to assume the guaranty might therefore be something less than $150,000 after the $5,000 payment had been made. The reduction in the price of the put on account of the $5,000 payment might be the benefit received by the insider and therefore the amount of the avoidable preference.

67. 11 U.S.C. § 547(b)(5) (1988). That is what we do, although I made the point in *Two Thoughts* that we have not settled on the theory by which we do it. *See* Westbrook, *supra* note 2, at 96 n.91.

rule and should be preserved. If he felt that I defended it badly, it would have been more helpful for him to offer a better defense. Instead, he limited himself to criticizing my effort and in the process undermined the case for *Levit*.

The most important reason to preserve the rule in *Levit* is that it provides some protection for entrepreneurs, their suppliers, and their customers from overreaching by lenders. The primary reasons for overruling it would be that lenders do not understand its differential effects as to true and leverage guaranties or do not trust their loan officers to make credit judgments as between true and leverage insider guarantors. Neither is a good reason for overruling *Levit*. Although it is likely *Levit* will be swept away by an uncaring legislature, it is just the sort of technical issue best left to the Bankruptcy Commission presently proposed in Congress. With luck, perhaps it will be.