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How Far Does the Rabbit Hole Go: The Interaction Between Set-Off Rights and the Voidable Preference Hypothetical in Chapter 7 Liquidation

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HOW FAR DOES THE RABBIT HOLE GO: THE INTERACTION BETWEEN SET-OFF RIGHTS AND THE VOIDABLE PREFERENCE HYPOTHETICAL IN CHAPTER 7 LIQUIDATION

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INTRODUCTION

Imagine a debtor is sliding towards bankruptcy.[1] The debtor sells off real estate of substantial value and eventually pays back the amount due on a loan extended by a bank-creditor. The debtor then simultaneously deposits the left-over sum from the real estate sale into an account, subject to the bank's security interest, with the same bank-creditor. A small amount of time passes, and the debtor petitions for bankruptcy under Chapter 7. In accordance with established duties,[2] the bankruptcy estate Trustee argues that that loan-fulfillment made by the debtor to the creditor before the petition is a preferential transfer. The Trustee argues that the debtor's payment of the outstanding loan balance puts the bank-creditor into a better position relative to other creditors and depletes the estate's value, thus prejudicing the unsecured and previously perfected classes.[3] Does it seem equitable to allow a simple simultaneous payment and deposit to reduce the remuneration available to all creditors?

Within the Bankruptcy Code (hereinafter the "Code") of 1978, Chapter 7 delineates the process of liquidating and distributing the non-exempt assets from a petitioning debtor to creditors.[4] A court-appointed Trustee oversees the liquidation and distribution process to maximize the

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1 *See Insolvency*, INVESTOPEDIA, https://www.investopedia.com/terms/i/insolvency.asp (last visited Feb. 11, 2018) (This condition is known as insolvency, which Investopedia defines as "when an organization, or individual, can no longer meet its financial obligations with its lender or lenders as debts become due.").

2 *See* Rhodes, *infra* note 25.

3 *See* 11 U.S.C. § 547(b)(5) (2012); COLLIER ON BANKRUPTCY ¶ 547 (Richard Levin & Henry J. Sommer eds., 16th ed.)

4 *See* 11 U.S.C. §§ 701-28 (2012); *see also* COLLIER ON BANKRUPTCY ¶ 700.01 (Richard Levin & Henry J. Sommer eds., 16th ed.) (delineating the general administrative procedure of Chapter 7 liquidation). In an average bankruptcy petition, the court will grant an automatic stay to protect the assets of the debtor and those of the estate. This will be followed by the appointment of a Trustee empowered to liquidate the non-exempt assets of the debtor, and distribute them pro-rata along the class-oriented schema of the Code. Secured creditors receiving their entirety before unsecured, and so on.

benefits for all creditors within each respective class.[5] As part of the Trustee's litany of responsibilities, the Trustee is invested with the ability to initiate an adversarial proceeding during the bankruptcy, otherwise known as a voidable preference action under Section 547 of the Code.[6] Voidable preference actions are an attempt to effectively unwind transactions that involve payments to creditors on behalf of antecedent liabilities within the period during which the debtor is considered by the court to have been insolvent.[7] These proceedings allow a Trustee to maximize the bankruptcy estate by seeking, for instance, to void a transfer to an unsecured creditor that would otherwise put that creditor in a better position relative to other creditors of the same category ahead of receiving their pro-rata share of the distribution of a debtor's assets.[8] Crucially, the court in a voidable preference action[9] is asked to construct a hypothetical Chapter 7 liquidation proceeding to determine if in fact—hypothetically—a transfer has benefitted an under-secured creditor, having made that party "better off" relative to other creditors of the same class.[10] If the court determines that, but for this hypothetical test and the rescindment of the disputed transfer, the creditor would be in a better position, then the transfer is deemed preferential and thus falls under the auspices of the Trustee to void it.[11] In this way, the courts have empowered the Trustee to protect the debtor's estate from depletion during the bankruptcy proceeding in an effort to seek out the most advantageous outcome for each class of creditors.[12]

The Code also recognizes creditors' right to ask the court to lift the stay[13] to allow a creditor to pursue a set-off right[14] against a debt owed

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5 *See* Rhodes, *infra* note 25, at 164-65.

6 *See infra* note 8.

7 *See* 11 U.S.C. § 547 (2012).

8 *See* 11 U.S.C. § 547(b)(5) (outlining the hypothetical test of a valid avoidable preference as a transfer of an interest of the debtor in property, "(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 [11 USCS §§ 701]; (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 [11 USCS §§ 101]"); *see also* COLLIER ON BANKRUPTCY ¶ 547.01 (Richard Levin & Henry J. Sommer eds. 16th ed.).

9 *See* 11 U.S.C. § 547 (b)(5).

10 *Id.*

11 *See* 11 U.S.C. § 547(b)(5) (2012). *See* Vern Countryman, *The Concept of a Voidable Preference in Bankruptcy*, 38 VAND. L. REV. 713 (1985).

12 *See* Countryman, *supra* note 11.

13 *See* 11 U.S.C. § 362(a) (2012). *See also* K&LNG, *Getting to Know Your Two Best Friends: The Rights of Setoff and Recoupment*, KLGATES: K&LNGALERT (Dec. 2005), http://www.klgates.com/files/Publication/56da8ca6-ba6a-4973-8fa4-3b2d8aaf05a5/Presentation/PublicationAttachment/77554d2e-5845-481f-9f1c-4f3a7f161e4d/ba1205.pdf (a general discussion of the right to set off being limited, not granted by the Code).

14 *See* Hall, *infra* note 15.

by the creditor to the petitioning debtor.[15] In a Section 553 set-off right action, subject to limitations laid out in the Code, though not including the section pertaining to voidable preferences, creditors may reduce the amount they owe the debtor by an amount that the debtor owes the creditor in return.[16] Important for discussion later on, one example of a mutual debt warranting applying a set-off right includes cash in a standard deposit account at the debtor's bank.[17] In practice, a creditor may try and interpret that when a payment is made briefly before a deposit is left to that same creditor, their right to set-off a mutual debt allows them to circumvent the distribution proceedings of the Code. Crucially, this right to set-off can create a Gordian knot in the context of the hypothetical test above in determining if an under-secured creditor undergoes an unwarranted improvement in position.[18]

In three parts, this Note will highlight the tension between Section 547 and Section 553 of the Code, with specific attention paid to the interaction between set-off rights and the hypothetical liquidation invoked by a court in a voidable preference action. This Note will propose adopting the Ninth Circuit's reasoning as a bankruptcy court standard when confronted with a similar conflict between the formalized tests in Sections 547 and 553, in an attempt to achieve a more equitable outcome. Adopting the Ninth Circuit's reasoning will empower a court to launch a further hypothetical preference action within the context of a hypothetical Chapter 7 liquidation, and to read a broader definition of when an interest in property has been transferred, in order to preserve the intentions of voidable preference law, and close a loophole in the determination of when a creditor surreptitiously improves its position per Section 553.

Part I will examine the mechanics and important policies underlying the Code, such as the equality of creditors in the same class, and the courts' focus on maximizing benefits to creditors, as seen in Chapter 7 liquidation proceedings. Part I will also survey Section 547 voidable preference law hypotheticals and Section 553 set-off rights which offer important insight for this Note. Part II will analyze the current legal analysis of transfers of interests in property Section 547 voidable preferences and Section 553 set-off rights, culminating in the Ninth Circuit's decision in *In re Tenderloin Health, FKA* (hereinafter *In re*

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15 Beverly J. Hall, *Recent Developments in Bankruptcy Law: Preferences and Setoffs: Sections 547 and 553*, 2 BANK. DEV. J. 49, 75-76 (1985).

16 *See* Stephen L. Sepinuck, *The Problem with Setoff: A Proposed Legislative Solution*, 30 WM. & MARY L. REV. 51, 51-52 (1988).

17 *See* COLLIER ON BANKRUPTCY ¶ 553.09 (Richard Levin & Henry J. Sommer eds., 16th ed.) (describing a basic outline of the interactions between set off rights and voidable preferences, including an example regarding bank accounts).

18 The facts of *In re Tenderloin* can be read in this light. I will discuss later the equities given rise to that may impact the adoption of a judge-made rule.

Tenderloin).[19] Finally, Part III will propose that bankruptcy courts adopt the Ninth Circuit's reasoning as a judge-made rule when faced with creditors utilizing claiming Section 553 set-off rights within the Section 547 voidable preference hypothetical. Part III ends with examining the rule's possible application in other circuit courts.

I. THE BANKRUPTCY CODE'S CHAPTER 7, VOIDABLE PREFERENCE ACTIONS, AND SET-OFF RIGHTS

A. *The Chapter 7 Liquidation and the Duties of the Trustee*

For debtors, resorting to Chapter 7 in anticipation of default on pre-petition liabilities is a viable way to stave off financial ruin and to prevent a run on the debtor's assets by creditors. Since its most recent incarnation in the Bankruptcy Code of 1978, Chapter 7 liquidation has stood to enforce major principles embodied in Bankruptcy law, namely: maximizing the bankruptcy estate in the interest of creditors, and preserving the equality among creditors of the same category.[20]

In an average proceeding, a debtor successfully petitioning a court for Chapter 7 is granted an automatic stay. A Trustee will liquidate any non-exempt assets in the debtor's possession, place that value in a bankruptcy estate under the Trustee's authority, and distribute the value among creditors according to their level of security interests.[21] Creditors are forbidden from launching actions against the debtor during the period of the automatic stay, though as will be discussed infra, petitions to lift the stay may be granted in circumstances like in Section 553 set-off actions.[22] Those creditors who have secured the debt owed to them on some collateral are due to receive up to the amount of the value of the property in question when the Trustee sells off assets to pay the creditors.[23] The proceedings then turn to those unsecured creditors, and are distributed pro rata among those without priority claims.[24] The ensuing distribution is akin to a sliding scale among creditors, with the overall objective for the court-appointed estate Trustee to maximize the distribution of the assets' value to creditors beyond those with valid and

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19 Schoenmann v. Bank of the West (In re Tenderloin Health, FKA*)*, 849 F.3d 1231 (9th Cir. 2017).ff

20 *See* COLLIER ON BANKRUPTCY ¶¶ 7.01-.99 (Richard Levin & Henry J. Sommer eds., 16th ed.).

21 *Id.*

22 *Id. See* 11 U.S.C. § 553 (2012).

23 *See* COLLIER ON BANKRUPTCY, *supra* note 20.

24 *Id.*

perfected security interests.[25] However, for many Chapter 7 petitioners, there may be nothing left for a large portion of unsecured creditors after the court exempts their essential assets deemed necessary for a "fresh start."[26] After processing the pro rata distribution and wrapping up oversight of the bankruptcy estate, the court will discharge personal liability of the petitioner to their debtors. Accordingly, unsecured and under secured creditors are well aware that receiving a higher proportion –rather than pennies on the dollar–for their outstanding interest in the estate of the debtor depends on their ability to find work-arounds to the traditional distribution process.[27]

Understandably, there is an inherent tension between the interests of the Trustee of the bankruptcy estate and creditors in general, with unsecured and under secured creditors in the arguably most precarious position.[28] Trustees are motivated by a fiduciary duty to maximize the distribution of the estate.[29] This objective is achieved by a rigorous adherence to the automatic stay.[30] A Trustee would be remiss to not seek to deter or fight any claim a creditor has to parts of what would otherwise become property of the bankruptcy estate. Without fail, the Trustee will attempt to utilize the Code's roster of adversarial actions to take advantage of any opportunity to unwind previous transactions and reclaim more property for distribution.[31] Juxtapose those motivations above with those of the creditor: faced with the possibility of losing out on recouping any of the amount of the liabilities owed them, it is in the best interest of unsecured and under secured creditors to take advantage of any of the provisions of the Code that may facilitate collection beyond that of the Chapter 7 pro rata distribution process.[32]

Thus, Sections 547 and 553 provide a glimpse into the inherent push and pull in the competing interests between the Trustee and creditors. On

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25 Steven Rhodes, *The Fiduciary and Institutional Obligations of a Chapter 7 Bankruptcy Trustee*, 80 AM. BANKR. L. J. 147, 164 (2006).

26 Elizabeth Warren, *Bankruptcy Policy*, 54 U. CHI. L. REV. 775, 785 (1987) ("Although some debtors are able to repay all their debts in bankruptcy, the statutory scheme presumes that some creditors will not enjoy repayment in full."). It is important to note here that while this is a general example, Chapter 7 for consumer debtors is more likely to result in the above than Chapter 7 for corporate debtors.

27 11 U.S.C. § 727 (2012).

28 Rhodes, *supra* note 25.

29 *Id.*

30 Rhodes, *supra* note 25, at 164-65; *see* 11 U.S.C. § 704 (2012) (enumerating the duties of the Trustee, including the reduction of assets for the use of the estate and to work in the best interest of both debtors and creditors).

31 For clarity, this note will be focused primarily on the adversarial action espoused in voidable preferences in § 547 of 11 U.S.C.

32 Again, and as will be discussed *infra* Part II, this note's attention will be primarily focused on the ability of a court to examine a creditors' claim of set-off rights within the Section 547(b)(5) hypothetical.

the one hand, there is the bankruptcy estate and a Trustee authorized to implement Section 547 and the doctrine of voidable preference actions. On the other hand, there are creditors with recognized Section 553 set-off rights.[33] If a creditor implements its set-off right successfully, the claimed set-off may be void proof, and the creditor can thus circumvent the pro rata distribution to walk away with an increased or complete debt fulfillment.[34] Since bankruptcy statutes are notorious for contrasting statutory interpretations, it is crucial to understand the nature of the statutes involved, and Congress' intent to propose a viable solution to aid interpretation and implementation of the Code's goals.[35]

B. *Section 547 Voidable Preference Actions*

Section 547 of the Code can trace its origin back through the last major iteration of federal bankruptcy law in 1898.[36] Now refined, the Section aims to achieve roughly the same goals, with focus on preventing an unnecessary depletion of the bankruptcy estate, as well as maximizing the return of property to creditors in the right order.[37] Under Section 547, Trustees are empowered to target transfers of interests in property to creditors on behalf of an antecedent debt when made within the debtor's period of insolvency.[38] If successful, the transfer can be reverted into the bankruptcy estate, enlarging the relative pie for unsecured and under secured creditors.[39] The starting point for voidable preferences as considered in the analysis below is with the five conditions of Section 547(b).[40]

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33 COLLIER ON BANKRUPTCY ¶ 553.02 (Richard Levin & Henry J. Sommer eds., 16th ed.).

34 *Id. See* Hall, *supra* note 15, at 76 (discussing the nature of set-off rights being exempted from preference actions). *See also* COLLIER ON BANKRUPTCY ¶ 553.09 (Richard Levin & Henry J. Sommer eds., 16th ed.) (expanding on the interaction between set-off rights and voidable preference actions).

35 *See* Megan McDermott, *A Few Predictions for Justice Gorsuch's Bankruptcy Jurisprudence*, 8 CALIF. L. REV. ONLINE 40 (2017) (explaining, in the context of Supreme Court Justices' approaches to bankruptcy law, how the field of bankruptcy jurisprudence is famous for broad and competing statutory interpretations, enticing legal scholars and creating plentiful issues regarding proper interpretation of statutory provisions).

36 Vern Countryman, *The Concept of a Voidable Preference in Bankruptcy*, 38 VAND. L. REV. 713, 721 (1985).

37 *See* Rhodes, *supra* note 25.

38 11 U.S.C. § 547 (2012).

39 *See id.* (to be voidable, the transfer must meet all requirements of the provision).

40 *Id.*

> [T]ransfer 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 ninety days and one year before the date of the filing of the petition,

A voidable preference is a pre-petition transfer of property from the debtor to or on the behalf of the creditor in regards to an antecedent debt that occurs in the period of the petitioner's insolvency.[41] The movant seeking to avoid a transfer must show that the pre-petition transfer is (1) to or for the benefit of a creditor; (2) on account of an antecedent debt; (3) made while the debtor is considered insolvent; (4) on or before ninety days prior to the filing of the petition, or on or before ninety days to one year preceding the petitioning, if the transferee is an insider; and (5) allows the creditor to receive more than if the case were a Chapter 7 liquidation, the transfer had not been made, and the creditor received payment according to the provisions of the Code.[42] If all the above conditions are met, the Trustee can avoid that transfer of property pursuant to its power as representative of the bankruptcy estate.[43] There is no requirement to demonstrate an intention behind the transfer in question; this is in contrast to the notion of a fraudulent transfer.[44] Barring any exemptions included in Section 547, the court will allow the Trustee to unwind that transaction and recover the assets to be liquidated and distributed among creditors.[45]

As a policy, the voidable preference action promotes the principles of the Code in two important ways. First, an action targeting pre-petition transfers may deter creditors from expending an inefficient amount of capital by jockeying to try and salvage return on their outstanding debts outside of the pro rata distribution process.[46] Second, through

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> 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 . . . .

Id. (citations omitted).

41 11 U.S.C. § 547 (2012). *See* COLLIER ON BANKRUPTCY ¶ 547.01 (Richard Levin & Henry J. Sommer eds., 16th ed.).

42 11 U.S.C. § 547(b) (2012). *See* John Ames, *Preferences and Fraudulent Transfers Under the Bankruptcy Code: A Primer in* Pain, THE AMERICAS RESTRUCTURING AND INSOLVENCY GUIDE 2008/2009 (2008), http://www.americasrestructuring.com/08_SF/p107-115%20Preferences%20and%20fraudulent%20transfers.pdf (emphasizing that each component must be met).

43 *See* COLLIER ON BANKRUPTCY ¶ 547 (Richard Levin & Henry J. Sommer eds., 16th ed.) (outlining the role of the Trustee in general, and the role of the Trustee in voiding preferential transfers in particular).

44 *See* COLLIER ON BANKRUPTCY ¶ 547.03 (Richard Levin & Henry J. Sommer eds., 16th ed.) (detailing how the old notion of the importance of intent has not carried over into the 1978 enactment of the Federal Bankruptcy Code and future amendments).

45 *Id. See* 11 U.S.C. § 547(c)(5) (2012). This note will focus on the exemptions barring avoidance under Section 547(c)(5), in particular the security interest provisions.

46 *See* Countryman, *supra* note 36 (discussing the policy behind Congress's adoption of the § 547 preference action).

streamlining the ordering of liquidation and distribution, courts have a chance to maximize a bankruptcy estate for the benefit of the largest number of creditors possible, while also increasing economic efficiency.[47] Scholars have emphasized that, in line with the principles stated above, voidable preference actions aim to preserve the integrity of the bankruptcy estate, focusing on whether or not a pre-petition transfer diminishes what would otherwise go to support the outstanding debts owed other creditors who have not—fully or in part—secured their positions.[48] Some scholars even argue that the ability of the Trustee to void transfers under a judicial lien goes to the very heart of the Code's organizing principle.[49] A proper weight should be given to the duty of the Trustee in pursuit of voiding fraudulent and preferential transfers alike, despite any ambiguity in setoff rights.[50]

The lynchpin for purposes of analysis infra is the Section 547 voidable preference action's construction of a hypothetical Chapter 7 liquidation and the court's application of the "greater amount" test.[51] As detailed in Section 547(b)(5), the Code directs the bankruptcy courts to determine how a pre-petition transfer of property from the debtor to the creditor impacts that creditor in relation to the creditors of other classes. Besides the factual components in a Section 547 action, such as determining when the debt occurred, and who is paying on behalf of whom, the Section 547(b)(5) hypothetical requires the construction of a fictional Chapter 7 liquidation to determine if, but for the transfer in question, the creditor in question would not receive more from the pro rata distribution relative to creditors of other classes.[52] If the other components of Section 547 have been met, then a positive answer to the hypothetical—that the transfer allows the creditor to receive more from a

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47 *Id. See* J. Henk Taylor & Justin Henderson, *Preferences*, AM. B. ASS'N: BUS. L. TODAY (March, 2010), https://apps.americanbar.org/buslaw/blt/2010-03-04/taylor-henderson.shtml.

48 David G. Carlson, *Claims & Opinions: Tripartite Voidable Preferences*, 11 BANK. DEV. J. 219, 230-31(1995).

49 *See* David G. Carlson, *Bankruptcy's Organizing Principle*, 26 FLA. ST. U. L. REV. 549 (proposing that the Code's organizing principle—its modus vivendi—is better understood under a "strong arm" theory, whereby the estate is created by the establishment of the ability of the Trustee to exert a judicial lien on all the property of the debtor. This power gives rise to fraudulent transfer law and voidable preference law and, as such, is a more aggressive image of the Code that envisions an active Trusteeship at its heart).

50 *Id.*

51 Alvarado v. Walsh (In re LCO Enters.), 12 F.3d 938, 941 (9th Cir. 1993) (noting that, "[this] . . . 'greater amount' test, requires the court to construct a hypothetical chapter 7 case and determine what the creditor would have received if the case had proceeded under chapter 7.") (citations omitted).

52 *See* 11 U.S.C. § 547(b)(5) (2012); COLLIER ON BANKRUPTCY ¶ 547.03 (Richard Levin & Henry J. Sommer eds., 16th ed.) (requiring all five elements to be present for a court to affirm a preference to be voidable, hinging on testing if the creditor would be better off relative to other creditors of the same class).

Chapter 7 liquidation relative to other creditors—will most likely warrant the transfer to be voided.[53] This follows the Supreme Court's holding in *Palmer Clay Products Co. v. Brown*. In that case, a creditor had appealed a lower court's decision rejecting the creditor's claim that the Trustee had to demonstrate a more exacting measure of how each transfer made during insolvency by the debtor was providing the creditor a greater percentage of recovery than during distribution.[54] The court held that a payment could be found to be a preference if, at the time of the petition, rather than at the time the alleged preferential payment is made, the overall effect of the transfer is to place the creditor in a better position relative to creditors of that same class.[55] Importantly, the Supreme Court held that the appropriate standard involves making a determination of the actual result of the transfer in question at the time of the petition.[56]

In juxtaposition to the adversarial actions available to the Trustee on behalf of the bankruptcy estate, consider the extent and intent of the rights of creditors in a Chapter 7 liquidation as detailed in Section 553.

C. *Section 553 Set-Off Rights, Limitations, and Applications*

A hold-over from Roman law and a right embodied by state law and non-bankruptcy-related federal law, Section 553 may provide creditors with an avenue to attempt to satisfy cross-demands arising from debts owed to a debtor.[57] The underlying policy of Section 553 has been expressed as an attempt to avoid the "absurdity of making A pay B when B owes A."[58] If argued successfully, then an unsecured or under secured creditor will be able to negate the effects of the automatic stay of bankruptcy and proceed to claim a set-off right against the debtor, with the ultimate objective being that of securing a higher amount on their outstanding claims against the debtor in question.[59] Under Section 553,

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53 Considering any exemptions under 11 U.S.C. § 547(c)(5) (2012) (exempting security interests withstanding any improvement in position test).

54 Palmer Clay Products Co. v. Brown, 297 U.S. 227, 228 (1936).

55 *Palmer Clay Products Co.*, 297 U.S. at 229 ("[a] payment which enables the creditor 'to obtain a greater percentage of his debt than any other of such creditors of the same class' is a preference.").

56 *Id.*

57 *See* COLLIER ON BANKRUPTCY ¶ 553.02 (Richard Levin & Henry J. Sommer eds., 16th ed.) (emphasizing the historical recognition of set-off as an equitable right); Maria Ehlinger, *The Differences Between the Right to Setoff Under 11 U.S.C. § 553 and 11 U.S.C. § 558*, 6 ST. JOHN'S BANKR. RESEARCH LIBR. NO. 11 (2014); Stephen L. Sepinuck, *The Problem with Setoff: A Proposed Legislative Solution*, 30 WM. & MARY L. REV. 51, 51-52 (1988) (illuminating the Roman origins of the law).

58 Citizens Bank of Maryland v. Strumpf, 516 U.S. 16, 19 (1995) ("the absurdity of making A pay B when B owes A" (quoting Studley v. Boylston National Bank, 229 U.S. 523, 528 (1913)).

59 COLLIER ON BANKRUPTCY ¶ 553.02 (Richard Levin & Henry J. Sommer eds., 16th ed.).

unsecured creditors are offered a route by which they may ask the court to lift the stay and claim a previous transfer of property to be considered a valid set-off against a debt owed to the petitioner.[60] If a court is to determine whether an outstanding claim owed by a debtor is the subject of a valid pre-petition set-off, then it is crucial to note that that amount would be immune to the effects of a voidable preference action.[61]

The Section 553 application of set-off rights is a key tool available to creditors in their pursuit of a more advantageous position in relation to other creditors.[62] Though not actually granted within the Code,[63] the Section 553's provisions recognize and demarcate the parameters of a valid set-off right.[64] As a matter of procedure, creditors will launch a set-off right action by petitioning the court to temporarily lift the automatic stay of bankruptcy.[65] This action is categorized as a counter claim in the parlance of bankruptcy procedure.[66] The creditor will then have to demonstrate that their claim is a valid manifestation of the right to set-off a mutually-owed debt.[67] To do so, the creditor will have to comply with provisions of the Code by a preponderance of the evidence and show that the debt arose before the petition date among the same parties acting in the same capacity.[68] This "mutuality of debt" requirement mitigates the risk of set-off rights being launched against fraudulent transfers, as well as set-offs being utilized against debts accrued by a third party to a transaction.[69] As a tool, clever creditors can circumvent the pro rata distribution process by using set-off rights to further secure their position.

Against other unsecured or under secured creditors, a successful set-off right action will not just benefit the creditor in relation to those in the same category, it may actually place the creditor into an entirely separate position.[70] Under the Code, an unsecured or under secured creditor with a valid set-off right will have their claim classified as a secured interest, guaranteeing payment to that amount.[71] Creditors with a valid and

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60 11 U.S.C. § 553 (2012).

61 *See* COLLIER ON BANKRUPTCY ¶ 553.02 (Richard Levin & Henry J. Sommer eds., 16th ed.) (under the definition of "transfer" *supra*, a set-off cannot be considered a transfer and thus cannot be targeted in a voidable preference action). Consider explaining more ATL.

62 COLLIER ON BANKRUPTCY ¶ 553.11 (Richard Levin & Henry J. Sommer eds., 16th ed.).

63 Rights to set-off are delineated in relevant state law and federal statutes, not in the Code.

64 Sepinuck, *supra* note 57.

65 COLLIER ON BANKRUPTCY ¶ 553.05 (Richard Levin & Henry J. Sommer eds., 16th ed.).

66 COLLIER ON BANKRUPTCY ¶ 553.11 (Richard Levin & Henry J. Sommer eds., 16th ed.).

67 *Id.*

68 11 U.S.C. § 553 (2012); COLLIER ON BANKRUPTCY ¶ 553.02 (Richard Levin & Henry J. Sommer eds., 16th ed.).

69 *See* Sepinuck, *supra* note 57.

70 *See* 11 U.S.C.S. § 506(a)(1) (2012).

71 *Id.*

manifested[72] set-off right cannot be subject to a voidable preference action.[73] Within the Code, a Section 547 voidable preference action can only utilize the Trustee's authority to expand and protect the integrity of the bankruptcy estate by targeting valid pre-petition transfers.[74] Since the Code omits the word "set-off" from its definition of what constitutes a transfer, a set-off theoretically puts that creditor's claim out of the reach of a Trustee.[75]

Section 553(b) recognizes a bypass to Section 547 avoidance for set-offs in line with those imagined by Section 547. If the creditor manifests its pre-petition setoff claim, the Section grants the Trustee the ability to recover part of the pre-petition setoff from the creditor.[76] A pre-petition claim is one made while the court would consider the debtor to be insolvent, a presumed policy being that 553(b) no longer applies as a penalty for creditors that wait until the automatic stay to attempt to recover from a mutual debt.[77] The Trustee may recover up to the amount that the set-off improved the creditor's position in recovering what is owed on an outstanding debt relative to certain benchmarks in the pre-petition period.[78] This test therefore acts to measure the level of "insufficiency" vis-á-vis the debtor's financial ability to pay his debts pre-petition.[79]

Relevant here, the Ninth Circuit Court of Appeals reiterated in *In re Bernard* that as for a deposit account, the transfer of funds to the bank serves to pass title immediately and creates a creditor-debtor relationship between the two parties such that the bank owes the owner of the deposit account up to the amount deposited.[80] The nature of bank deposits will be helpful to illustrate the limitations of Section 553(b).

To illustrate a set-off right executed pre-petition and subject to Section 553(b), imagine a bank has a claim against a debtor for $20,000. Ninety days before the debtor files for bankruptcy—the period during which the court considers the debtor insolvent—that debtor has $10,000 in deposit at the same bank. Ninety days before the petition, there is a

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72 As opposed to a claim to set-off that has not been properly filed.

73 COLLIER ON BANKRUPTCY ¶ 553.09 (Richard Levin & Henry J. Sommer eds., 16th ed.).

74 11 U.S.C. § 547(b)(5) (2012).

75 *See* 11 U.S.C. § 101 (2012).

76 COLLIER ON BANKRUPTCY ¶ 553.08 (Richard Levin & Henry J. Sommer eds., 16th ed.).

77 COLLIER ON BANKRUPTCY ¶ 553.02 (Richard Levin & Henry J. Sommer eds., 16th ed.) ("Bankruptcy code provides more advantageous treatment for creditors who wait until after bankruptcy to exercise set-off rights.")

78 COLLIER ON BANKRUPTCY ¶ 553.09 (Richard Levin & Henry J. Sommer eds., 16th ed.).

79 *Id. See* Ben Caughey, *A Creditor's Right to Setoff: When Does a Creditor Impermissibly Improve Its Position?*, 29-JAN AM. BANKR. INST. J. 32 (Dec.-Jan., 2011); 11 U.S.C. § 553 (2012).

80 Bernard v. Sheaffer (In re Bernard), 96 F.3d 1279 (9th Cir. 1996). *See also* Robert Laurence, *The Application of Section 553 Set-Off Analysis to Pre-Bankruptcy Negative-Balance Checking Account Activity*, 12 BANKR. DEV. J. 101, 110-11 (1995).

difference of $10,000 between the amount claimed by the bank and the amount the bank owes the debtor. This leads to an inability to cover the claim and is called an insufficiency. Twenty days before the debtor files for bankruptcy, he deposits another $5,000 into the account, thereby reducing this insufficiency from $10,000 to $5,000. The bank may see some signs of an imminent default on outstanding loans extended to the debtor, and may therefore wish to capitalize on the opportunity to improve its chances of recovering a higher amount on the outstanding debts. The bank claims a set-off right to the whole account of $15,000, twenty days prior to the bankruptcy petition. Because the insufficiency twenty days prior is less than the insufficiency at the benchmark of ninety-days prior, the bank has improved its position pre-petition from an insufficiency of $10,000 to $5,000. Accordingly, the Trustee is empowered under Section 553(b) to recover the $5,000 improvement, while the bank may claim the remaining $10,000 from the account.[81] This hypothetical is meant to demonstrate, specifically, when an insufficiency exists at the beginning of the ninety-day period prior to petition.[82]

As it currently stands, the Section 553(b) recovery provision operates pursuant to the major principles of the Code discussed above. To deter creditors from "seizing the moment" and claiming set-off at a point pre-petition where a creditor increased the amount it owes the debtor, Section 553(b) empowers the Trustee to recover the improvement for the bankruptcy estate, much like a voidable preference action in Section 547.[83] According to Congress, a major concern arose from the notion that creditors, including banks, ". . . holding mutual accounts with the debtor would foresee a bankruptcy filing and scramble to secure a better position by decreasing the 'insufficiency' to the detriment of the other creditors."[84] Though not a perfect analogy, it is helpful to consider this "improvement in position" measurement from Section 553(b) in relation to a transfer of property from a debtor to a creditor that may put the creditor in a better position for remunerative relief relative to other creditors in the same category.[85]

II. RECONCILING THE HYPOTHETICAL CHAPTER 7 LIQUIDATION WITH

81 *See* Laurence, *supra* note 80.

82 COLLIER ON BANKRUPTCY ¶ 553.09 (Richard Levin & Henry J. Sommer eds., 16th ed.).

83 *Id.*

84 Lee v. Schweiker, 739 F.2d 870, 877 (3d Cir. 1984) (citing H.R. Rep. No. 95-595, 95th Cong. 2d Sess. at 185, 1978 U.S. Cong. & Ad. News at 6145).

85 *See id.*

Did the Ninth Circuit get it right in engaging in a hypothetical preference action to void the deposit claimed by the Bank-Creditor in part under its proposed right to set-off within the hypothetical Chapter 7 liquidation, and finding that the deposit was a voidable preference? The central issue here is whether the Code empowers a bankruptcy court to find a reasonable Trustee successful in a hypothetical preference action within the context of a hypothetical Chapter 7 liquidation, qualifying a deposit of funds as a transfer under the Code's definition and thereby permitting the Trustee to void the transfer and deny secured status to a creditor.[86] In answering this question in the affirmative, this Note will highlight the Ninth Circuit's decision in *In re Tenderloin* as an attempt to propose an equitable solution in the context of current practice, and the legislative history behind both Section 547 and Section 553, as well as Congress' intent in defining "transfer."

A. *Embracing Bankruptcy's Use of Hypotheticals and a Broad Interpretation of "Transfer"*

The Ninth Circuit's reasoning turns on a liberal interpretation of the flexibility of hypothetical applications and "transfer" throughout the Code, turning to recent decisions and interpretation as to Section 547(b)(5) allowing further hypothetical preference actions.[87] In support of this evaluation, consider the following applications of hypothetical constructs in Chapter 11 reorganizations and Chapter 13 adjustment of an individuals' debts with a regular income.

In a Chapter 11 reorganization, a business or organization will petition the court in an attempt to discharge its current debts and continue on with its operations: the outcome depends on examining a hypothetical Chapter 7 liquidation.[88] A petitioner must demonstrate a Chapter 11 reorganization plan's compliance with congressionally-mandated minimum requirements,[89] consent being sought from each class of creditors involved in the matter.[90] A central measure involved in

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86 This analysis wrestles with how, in part, a court may negate security rights by way of voidable preference in the face of Section 553.

87 Schoenmann v. Bank of the West (In re Tenderloin Health, FKA), 849 F.3d 1231, 1235-36 (9th Cir. 2017).

88 COLLIER ON BANKRUPTCY ¶ 1100.01 (Richard Levin & Henry J. Sommer eds., 16th ed.).

89 *Id. See, e.g.*, 11 U.S.C. § 1129 (2012); COLLIER ON BANKRUPTCY ¶ 1129.02 (Richard Levin & Henry J. Sommer eds., 16th ed.).

90 11 U.S.C. § 1129; *see also* COLLIER ON BANKRUPTCY ¶ 1129.02 (Richard Levin & Henry J. Sommer eds., 16th ed.).

determining if a Chapter 11 plan will be compliant with the mandated minimum requirements is laid out in Section 1129, which provides for the confirmation of a Chapter 11 plan.[91] Among the other pre-requisites before confirming a plan within Section 1129, sub-section 1129(a)(7)(A) provides that a court can *only* give the green light if each holder has accepted the plan, or if no creditor will be worse off in terms of recouping their outstanding claims than if the case had been under a Chapter 7 liquidation. *In re Affiliated Foods, Inc.* demonstrated a bankruptcy court interpreting the statute's use of the hypothetical as requiring an estimate of probable values and successful causes of action, including preference actions.[92] Far from "an exact science," the court does not go so far as to allow a determination of value to be entirely composed of assumptions.[93] Regardless, the application of the comparison measure to what would be received under Chapter 7 liquidation is considered a cornerstone of the Chapter 11 practice.[94] Therein, courts are asked to determine the value to be attained by selling off assets, requiring consultation and speculation based on a number of external factors such as the event of a "fire-sale" and the disposition of contingent liabilities.[95] As 7,442 filers relied on Chapter 11 reorganizations in 2017 alone, it is clear that resorting to the hypothetical construction of a Chapter 7 liquidation is a cornerstone of bankruptcy practice writ large.[96]

A similar freedom to include the occurrence of voidable preference actions in Section 547(b)(5) hypothetical liquidations has also been interpreted by bankruptcy courts in Chapter 13 adjustment of debts of an individual with regular income.[97] Section 1325 deals with the requirements that a plan of adjustment must meet to be confirmed by the court petitioned by the debtor.[98] Sub-section 1325(a)(4) sets forth what is known as the "best interest" test.[99] Much like the comparison to the results of a Chapter 7 liquidation procedure in the reorganization of an entity under Chapter 11, Chapter 13 intends, per the leading bankruptcy treatise, to put classes of creditors in no worse a position than they would

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91 11 U.S.C. § 1129(a)(7)(A) (2012).

92 In re Affiliated Foods, Inc., 249 B.R. 770, 788 (Bankr. W.D. Mo. 2000).

93 *Id.*

94 COLLIER ON BANKRUPTCY ¶ 1129.02 (Richard Levin & Henry J. Sommer eds., 16th ed.).

95 *See id.* (considering the cornerstone to be the individual guaranty).

96 U.S. BANKRUPTCY COURTS REPORT F-5A ON BUSINESS AND NONBUSINESS BANKRUPTCY COUNTY CASES COMMENCED, BY CHAPTER OF THE BANKRUPTCY CODE, DURING THE 12-MONTH PERIOD ENDING DECEMBER 31, 2017, http://www.uscourts.gov/sites/default/files/data_tables/bf_f5a_1231.2017.pdf (though a substantial number, Chapter 11 reorganizations accounted for only .94% of all bankruptcies filed in 2017).

97 *See infra* note 99.

98 11 U.S.C. § 1325(a)(4) (2012).

99 *See id.*; COLLIER ON BANKRUPTCY ¶ 1325.05 (Richard Levin & Henry J. Sommer eds., 16th ed.) (individual consent of the claimants is unnecessary, unlike in Chapter 11).

be if the debtor's assets were liquidated and distributed pro rata.[100] In the Chapter 13 "best interests" context, the amount to be distributed to each unsecured claimant may not be less than would be received if the estate was being distributed under the Chapter 7 procedure, which calls for a hypothetical exercise.[101] While each unsecured claimant does not need to provide consent to the plan, the "best interests of the creditors" test stands in to ensure a more equitable distribution, especially for those claimants.[102] Importantly, the court may be asked to ascribe a liquidation value to the assets under consideration in the adjustment of debts of an individual with regular income while considering the success of a concurrent voidable preference action. *In re Larson*, a Minnesota bankruptcy case, provides support for the notion that the court should have no issue allowing for the possibility of a Trustee to use his authority to void potential preferential transfers, in line with Section 547 of the Code, when ascribing liquidation values to the assets of a debtor with regular income.[103] There, the court dealt with an interest under fraudulent transfer, but the inclusion of consideration for hypothetical preference actions within a hypothetical Chapter 7 liquidation remains telling.[104] It is not beyond the pale to determine that in confirming a plan in the Chapter 13 context, a court may conjure up a hypothetical preference action within a Chapter 7 liquidation.[105]

B. *The Inclusion (or Exclusion) of Facts Indicating Possible 553 Set-off Rights in a Chapter 7 Liquidation Hypothetical*

Consider where the court in *In re Tenderloin* found itself.[106] The question for the court to decide turned on whether or not to believe that a reasonable Trustee would void the amount deposited by the debtor with the bank-creditor in addition to the payment made on behalf of the antecedent debt in a series of voidable preference actions. In addition, at the time of the action, the creditor had not sought to exert a set-off right yet. The question also involved a supplementary hypothetical for the court to engage in: whether a further hypothetical preference action can

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100 COLLIER ON BANKRUPTCY ¶ 1325.05 (Richard Levin & Henry J. Sommer eds., 16th ed.).

101 *Id.*

102 *See* COLLIER ON BANKRUPTCY, *supra* note 78 (individual consent of the claimants is unnecessary, unlike in Chapter 11). *See also* 11 U.S.C.S. § 1325(a)(4) (1978).

103 In re Larson, 245 B.R. 609, 614 (Bankr. D. Minn. 2000) (". . . look not only at the Debtor's asset . . . but [also] consider the recovery of assets by the trustee through fraudulent transfer and preference actions.")

104 *See id.*

105 *See* Schoenmann v. Bank of the West (In re Tenderloin Health, FKA), 849 F.3d 1231 (9th Cir. 2017) (this is how the Ninth Circuit chose to interpret the "best interests" test).

106 *See* Introduction, *supra*.

consider a Section 553 right that had not been exercised within a hypothetical Chapter 7 liquidation.[107]

The *In re Tenderloin* case saw the Ninth Circuit deal with the Gordian-knot above, centered on the applicability of facts not reflected in the record entering into a court's Chapter 7 hypothetical in the face of an alleged right to set-off.[108] The petitioning debtor's (D) Trustee had moved for a voidable preference action, targeting the payment made by the debtor to the bank-creditor (C).[109] The payment had been made within the previous ninety days, from D to C on behalf of the pre-existing debt existing between the two.[110] Therefore, the Trustee claimed that this transfer was ripe for consideration as a voidable preference. The Trustee argued that if C was allowed to keep the payment made by the D, then the C would be put in a better position relative to other unsecured creditors, in conflict with interpreted purposes of the Code.[111] In response, C claimed that despite the possible categorization of the debt payment as a voidable preference, the remaining amount deposited with the bank by D after selling off real estate and paying down its debt would serve to act as a valid set-off, negating the existence of a voidable preference.[112] C reasoned that as a deposit with the bank, the amount therein, at the least, would be considered a mutual debt warranting a future set-off, to be exercised post-petition; thereby exempting the set-off from the Section 553(B) improvement in position test.[113] Even if the payment preference was voided, there would be a fully secured amount in the form of the deposit account available for the bank to utilize.[114] D's Trustee thus put forth the argument that a reasonable Trustee would move to void the deposit amount in addition to the payment made on behalf of the pre-existing debt, and that the court could successfully find the existence of a preferential transfer here.[115] Therefore, the Ninth Circuit considered whether to allow negating a possibly valid set-off right in the face of facts that might adhere to a less equitable outcome for unsecured creditors. The Ninth Circuit grounded their answer in the idea that a

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107 *See In re Tenderloin Health*, 849 F.3d at 1234.

108 *Id.*

109 *Id.* at 1233.

110 *Id.*

111 *Id.*

112 *See In re Tenderloin Health*, 849 F.3d at 1234 ("[C]oncluding that Schoenmann could not show that BOTW received more than it would have in a hypothetical liquidation where the debt payment had not been made.").

113 *See id. See also* COLLIER ON BANKRUPTCY ¶ 553.09 (Richard Levin & Henry J. Sommer eds., 16th ed.) (detailing the treatment of Section 553 in avoidance considerations).

114 *See* Schoenmann v. Bank of the West (In re Tenderloin Health, FKA), 849 F.3d 1231, 1241 (9th Cir. 2017) ("Schoenmann concedes that BOTW would have a right of setoff in the hypothetical liquidation.").

115 *See id.* at 1236.

reasonable Trustee would be successful in voiding not only the debt payment, but also the deposit made to the bank in a hypothetical Chapter 7 liquidation.[116]

The Ninth Circuit therefore agreed with the Trustee. In *In re Tenderloin*, the court ultimately held that, facts permitting and as long as no other independent provision of the Code was infringed upon, a court could entertain this kind of hypothetical preference action in the face of a potential set-off right within a larger Chapter 7 hypothetical.[117] This result further established that in this secondary hypothetical, the preference action within the larger hypothetical, the amount deposited after the payment was a transfer that depleted the estate to the prejudice of unsecured creditors, and was a valid use of the strong-arm of voidable preference law.[118] In finding so, the court looked to legislative history and current bankruptcy practices at large to derive a practical application beyond the plain meaning of the text.[119]

To support its interpretation, the court points to language found in the House Report regarding Section 547(b) preference actions in support of Section 547's hypothetical flexibility.[120] Specifically, the Report does not impose a limit to the tools by which the court achieves a proper "distribution" under the Code's voidable preference action provisions.[121] With language referring to the purpose of the provision as an attempt to achieve equality for creditors of the same class, the Report demonstrates a broad approach to achieving this effort.[122] In addition, the court points to the language of the report in its acceptance of a court applying the "greater amounts" test in conjunction with an evaluation of the permissiveness of the claim as a whole, invoking the court's ability to take a global perspective on the preference action.[123] The Ninth Circuit took this analysis as a green-light for evaluating the nature of both the debt payment and the deposit in the name of promoting the equality of all unsecured creditors and the enlargement of the bankruptcy estate.[124]

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116 *Id.*

117 *Id.* at 1245.

118 *Id.*

119 *Id.*

120 *See* H.R. Rep. No. 95-595 (1977).

121 *Id.*, at 86.

122 *In re Tenderloin Health*, 849 F.3d at 1236 ("'A preference is a transfer that enables a creditor to receive payment of a greater percentage of his claim against the debtor than he would have received if the transfer had not been made and he had participated in the distribution of the assets . . . .' H.R. Rep. No. 95-595, at 177 (1977) . . . The phrase 'participate[s] in the distribution' leaves room to assume the hypothetical chapter 7 Trustee might initiate preference actions in conjunction with the 'distribution' of the assets of the estate.").

123 *See* H.R. Rep. No.95-595, at 372 (1978) (invoking "allowability" in the evaluation a preference action).

124 *See supra* note 122.

Beyond the legislative history, the court surveyed how courts and scholars, including the Ninth Circuit, have considered hypotheticals arising out of other provisions of the Code akin to those directly under the Chapter 7 liquidation process, surveying the possibility to subsume Section 553 by voidable preference action.[125] The instructive jumping off point to begin an examination of the application of the hypothetical in the context of voidable preference actions comes from the Supreme Court in its ruling in *Palmer Clay Products Co. v. Brown*.[126] There, the Supreme Court held that the preference action determines the result of the "greater amounts" test in relation to the position of the creditor on the day of the bankruptcy petition, as opposed to the time of the transaction in question.[127] This deference to an "actual effect" on the bankruptcy estate analysis demonstrates the importance of determining the ability of the bankruptcy estate to quickly and equitably pay out to creditors the outstanding amount of debt owed by the petitioner.[128] Though focused on the timing of the preferential transfer in determining its existence, the decision makes an attempt at understanding both timing and intent in relation to voidable preference actions.[129] Importantly, the Court takes into account Congress' intention in determining the purpose of the hypothetical construction for a preference action.[130]

The Minnesota bankruptcy court offered guidance on the consideration of additional post-petition facts, like the viability of a Section 553 right, in preference actions in the context of a Chapter 13 plan.[131] Regarding the confirmation of a Chapter 13 plan, the Code calls for a test to determine if in fact the plan is in the "best interest of the creditors."[132] Derived from Section 1325, the court takes it upon itself to determine if the creditors would receive more under the suggested plan than if they received a distribution under a Chapter 7 liquidation.[133] This consideration, in the reasoning of the Minnesota bankruptcy court, requires a consideration of a recovery of assets by the Trustee pursuant to both fraudulent transfers per Section 548 and voidable preferences per

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125 *See* Schoenmann v. Bank of the West (In re Tenderloin Health, FKA), 849 F.3d 1231, 1245-46 (9th Cir. 2017).

126 *See* Palmer Clay Products Co. v. Brown, 297 U.S. 227 (1936).

127 *Id.* at 229 (determining if a creditor has received a preference by examining the "actual effect of the payment as determined when bankruptcy results.").

128 *See id.*

129 *Id.*

130 *Id.*

131 *See* In re Larson, 245 B.R. 609 (Bankr. D. Minn. 2000).

132 *See* 11 U.S.C. § 1325(a)(3), (4) (2012) (outlining how to determine what would be a plan that would act in the "best interest of the creditors"). *See* COLLIER ON BANKRUPTCY ¶ 1325.05 (Richard Levin & Henry J. Sommer eds., 16th ed.) (individual consent of the claimants is unnecessary, unlike in Chapter 11).

133 *Id.*

Section 547.[134] Considering the facts, the bankruptcy court reversed a potential Chapter 13 plan confirmation by finding a breach of good faith and held that a reasonable Trustee—a hypothetical Trustee within the hypothetical "best interest of the creditors" test—would most likely prevail on a petition for fraudulent transfer.[135] Though the court did not need to determine if the hypothetical assets could be recovered by way of the hypothetical preference action on the facts of the case, the court determined that if they could find a reasonable Trustee would succeed in its petition for the action, then the court could continue with its analysis of the Chapter 7 liquidation distribution with the value of those assets in question added to the bankruptcy estate.[136] Here, a determination of bad faith and the notion that a reasonable Trustee would prevail in a hypothetical post-petition fraudulent transfer action goes to support the application of hypothetical actions within the hypothetical Chapter 7 liquidation as debated in *In re Tenderloin*.[137]

Chapter 11 of the Code also provides instruction on the application of Chapter 7 liquidation hypotheticals in its own context.[138] For the purposes of Section 1129(a)(7)(A)(ii), a court conducts the same "best interest of the creditors" test as conducted in Chapter 13 of the Code.[139] For a court to confirm a plan of reorganization, each holder of a claim at issue must receive property of value as of the date of the plan that is not in less than what the claimant would receive if the plan was conducted under a Chapter 7 liquidation.[140] In clarifying its application, the Ninth Circuit accepted that the Trustee's avoiding powers may affect the analysis of the Chapter 7 hypothetical liquidation.[141] For the purposes of the Ninth Circuit's analysis of the hypothetical regarding the bank-creditor and the deposit in question, these aforementioned provisions of the Code would support an application of the Trustees avoiding powers

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134 *See* In re Larson, 245 B.R. 609, 615, at n.2 (Bankr. D. Minn. 2000) (the bankruptcy court here does not consider any issues of fraudulent transfer as the transfer at issue occurred more than a year prior to the petition being filed) (discussing 11 U.S.C. § 548(a)(1) (2012)).

135 *Id.* at 615.

136 *See id.* ("I need only reach the conclusion that a Chapter 7 Trustee could be reasonably expected to succeed in setting aside the transfer.").

137 *In re Tenderloin*, 849 F.3d at 1238.

138 *See* discussion *supra* Part II Sub-Section A (discussing the interpretation of *In re Affiliate Foods*).

139 *See* 11 U.S.C. § 1129 (a)(7)(A)(ii) (2012) (outlining the process by which a court determines whether or not a plan is in the "best interests of the creditors"). *See* COLLIER ON BANKRUPTCY ¶ 1129.02 (Richard Levin & Henry J. Sommer eds., 16th ed.).

140 *See* 11 U.S.C. § 1129 (a)(7)(A)(ii).

141 *See* Schoenmann v. Bank of the West *(*In re Tenderloin Health, FKA), 849 F.3d 1231(9th Cir. 2017) (citing § 1129 in the argument that a Trustee's avoiding powers may affect the analysis of the hypothetical). *See also* COLLIER ON BANKRUPTCY ¶ 1129.02 (Richard Levin & Henry J. Sommer eds., 16th ed.).

to achieve a status of equilibrium among creditors within the same class.[142]

The Ninth Circuit's own interpretation of the role of post-petition facts within a hypothetical in the context of the Code offers important guidance here as well. The Circuit's decision in *Alvarado v. Walsh* (In re LCO Enters.) (hereinafter *LCO Enters.*) provides a clearer interpretation of the parameters of the court's logic regarding applying post-petition facts to a Chapter 7 hypothetical.[143] There, the facts regard a lessee-debtor rearranging a pre-existing lease with a lessor-creditor before sliding into bankruptcy and petitioning the court for reprieve under Chapter 11.[144] At the Trustee's petitioning, the court considered the validity of a voidable preference action on certain pre-petition payments made in service of the lease in question.[145] Again, the court was faced with the task of following the "greater amounts" test to determine if in fact the pre-petition lease payments prefer a lessor in an inequitable fashion as compared to other unsecured creditors. However, the nature of this question turns on the Code's treatment of leases assumed or rejected by the creditor involved.[146] Here, the Trustee attempted to persuade the court that the rent payments were in fact preferential transfers.[147] The Trustee argued that a reasonable Trustee faced with the same facts would have sought to reject the lease at hand.[148] If that had been the case, the lessor-creditor would have the right to recapture the property immediately and enter into the bankruptcy proceeding with a fully secured claim to the revenue from rent.[149] On the other hand, if the lease had been assumed, then the debtor-lessee may continue to utilize the property pursuant to the lease, and the lessor-creditor would have the right to receive an immediate correction to default by the lessee-debtor.[150] The lease had in fact been assumed by the parties, and the lessee-debtor retained use of the premises.[151] As such, the treatment of the payments in question were addressed by the Code's Section 365(b).[152] Section 365 acts as a caveat to preferential transfers

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142 *See In re Tenderloin Health*, 849 F.3d at 1245.

143 *See* Alvarado v. Walsh *(*In re LCO Enters.), 12 F.3d 938 (9th Cir. 1993).

144 *See id.*

145 *Id.*

146 *Id.* at 941.

147 *See id.* at 941.

148 *See id.* at 942 ("Thus, the Trustee seeks to obtain the benefits of both assumption and rejection, *i.e.*, continued possession of the property and recovery of the prepetition rent.").

149 *See* Alvarado v. Walsh *(*In re LCO Enters.), 12 F.3d 938, 941-42 (9th Cir. 1993) (properly conforming to 11 U.S.C. § 506(a) determining secured status requirements bestows preferred status on a claim.).

150 *Id.*

151 *See id.* at 942.

152 *See id.*

and treats unexpired leases separately from other antecedent debts.[153] Thus, the court would not be likely to consider the payment in question here a preferential transfer.[154] In the court's opinion, the lessee-debtor had sought to enlarge the bankruptcy estate by unwinding the pre-petition rent payments while also maintaining his domicile, a maneuver the court felt both to be in violation of the provisions of the Code and its underlying principles of equity.[155]

The Ninth Circuit's earlier disposition of post-petition facts entering into a hypothetical Chapter 7 liquidation does not pose an obstacle to apply in a judge-made rule.[156] As the bank-creditor would go on to argue in *In re Tenderloin*, the Ninth Circuit in *LCO Enters.* rejected the notion that a post-petition hypothetical may enter, nested as Russian dolls, into another hypothetical, but—and as the court in *Tenderloin* would eventually assert—this is not necessarily the case.[157] Essentially, the court established that the Section 547(b)(5) "greater amounts" hypothetical must be based on the actual facts of the case.[158] While noting that the court cannot engage in the "greater amounts" test hypothetical by simply creating a system of facts "from whole cloth," the court recognized that the hypothetical is not "conducted in a vacuum."[159] Importantly here, the pre-petition adoption of a lease triggers the application of Section 365(b), and the "greater amounts" test put the Ninth Circuit in the position of having to consider facts that were not reflective of the actual situation at the time of petitioning.[160] Unlike a set-off right left unexercised by a creditor, the lease's assumption was made clear in the Chapter 11 Reorganization plan.[161] This would have required the court to destroy the clear applicability of § 365(b).[162] Considering the particularity of its judgment in *LCO Enters.*, the court viewed the decision narrowly, focusing in greater detail on the necessity not to violate an independent provision of the Code in pursuit of a voidable

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153 *See* COLLIER ON BANKRUPTCY ¶ 365.02 (Richard Levin & Henry J. Sommer eds., 16th ed.) (further expanding on the nature of leases unexpired leases).

154 *See* Alvarado, 12 F.3d at 942 ("LCO's default was cured as required by § 365(b) and LCO retained possession of the property."); COLLIER ON BANKRUPTCY ¶ 365.01 (Richard Levin & Henry J. Sommer eds., 16th ed.) (outlining the treatment of executive contracts and unexpired leases under the Code).

155 *See supra* note 148.

156 *See* In re Tenderloin, 849 F.3d 1231, 1238 (9th Cir. 2017). *See infra* Proposal.

157 *In re Tenderloin*, 849 F.3d at 1238-40 (the court appears not to be willing to consider a limitation on its ability to justify the outcome of the hypothetical preference action in light of the crucial difference in the fact patterns of *LCO Enters.* and *In re Tenderloin*).

158 *Id.*

159 *See In re LCO Enters.*, 12 F.3d at 942; *In re Tenderloin*, 849 F.3d at 1238.

160 *In re LCO Enters.*, 12 F.3d at 942.

161 *Id.*

162 *In re Tenderloin*, 849 F.3d at 1239.

preference action.[163] This is not to say, in the eyes of the court, that, if the applicability of another provision of the Code has not been clearly triggered, the court cannot be liberal when considering the actions of a reasonable Trustee in the course of a "greater amounts" test hypothetical.[164] Thus, neither the Trustee nor the court are permitted to run amok and add facts to suit their needs for a beneficial result in a voidable preference action.[165] Parameters deter either from encroaching on the established territory of independent provisions when the facts clearly support its application.[166]

Finally, the Fifth Circuit offers persuasive guidance in contemplating an unexercised right post-petition entering into a Section 553 set-off right analysis.[167] *Braniff Airways v. Exxon Co.* presents similar facts to *Tenderloin*. Debtor's Trustee had petitioned the court to seek an unwinding of a pre-petition payment as a preferential transfer.[168] In response, the creditor asserted the right to set-off a pre-existing debt owed to the debtor.[169] Ultimately, the court would go on to overrule the lower court, deciding that the creditor's right to set-off was invalid in light of the absence of an "insufficiency" traditionally granting a right to set-off, in addition to the fact that the record did not allow the court to rule on whether a sufficient mutual debt existed at the time of the petition to warrant the creditor's application of a set-off right.[170] Crucially, it did not matter that the creditor's right to set-off was not negatively affected by the creditor's failure to implement a set-off right at that time. The right to a set-off would still enter into the analysis.[171] The Ninth Circuit highlighted this application in its explanation, holding that a hypothetical application of post-petition facts would not stop short at an application of some provisions of the Code and not others. The court rejected the idea that a Section 553 set-off right would be entered into an analysis

163 *See In re Tenderloin*, 849 F.3d at 1240 ("In light of this conflict, we conclude that *LCO* must be narrowly construed. To that end, courts that have followed *LCO*'s holding have done so when presented with the same statutory collision scenario.").

164 *Id.* ("In sum, *LCO* does not bar us in this case from assuming in a hypothetical liquidation that the hypothetical Trustee would sue to recover the . . . deposit.").

165 *Id.*

166 The Ninth Circuit adopts this as a tenet of their reasoning. *See* Part III, *infra*.

167 *In re Tenderloin*, 849 F.3d 1231, 1238 (9th Cir. 2017).

168 Braniff Airways v. Exxon Co., 814 F.2d 1030, 1034 (5th Cir. 1987).

169 *Id.*

170 *Id.* at 1041.

171 *See id.* at 1032 ("We find that Exxon does have a right of setoff pursuant to 11 U.S.C. § 553(a), but that any setoff is potentially subject to being recovered by Braniff pursuant to 11 U.S.C. § 553(b).").

regardless of its actual occurrence when a hypothetical preference action would not.[172]

C. *Weighing the Equities of Set-Off Rights Against the Law of Voidable Preferences*

Considered an equitable right, Section 553 presents an interesting dilemma when put in the context of creditor's rights in the event of bankruptcy, as it comes into conversation with voidable preference law.[173] Scholars argue that the common law set-off right, as recognized in the Code, does not necessarily reflect a correct positioning relative to the rights of creditor to be treated equitably and equal to others of their class during bankruptcy.[174] All this calls into question how the lower courts in *In re Tenderloin* could allow for Bank of the West to move into bankruptcy with the improved position granted to it by a claim to set-off the deposit made by the debtor when, had the transfer been an additional payment and not an arbitrary deposit, voidable preference law would have been triggered.[175]

Looking to the legislative history on the role of set-off rights, it is possible to see a misguided attempt to encourage a situation in which creditors are rewarded for holding onto a mutual obligation in an attempt to reap that benefit during the bankruptcy distribution.[176] However, the result is a distinction in classification, putting a creditor with a plausible right to set-off into a secured class, even if the rationale behind the set-off does not map neatly onto the facts of the case.[177] In the hypothetical

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172 *See In re Tenderloin*, 849 F.3d at 1238 (9th Cir. 2017) ("That said, it would be odd to permit bankruptcy courts conducting hypothetical liquidations to look only to section 553, while ignoring chapter 5 provisions, like section 547.").

173 *See* Beverly J. Hall*, Recent Developments in Bankruptcy Law: Preferences and Setoffs: Sections 547 and 553,* 2 BANKR. DEV. J. 49, 75 (1985) (expanding on the conflict that grows out of the Code's limitations on set-off rights granted outside of the Code, and the powers of the Trustee to unwind preferential transfers).

174 *See* Lawrence Kalevitch, *Setoff and Bankruptcy*, 41 CLEV. ST. L. REV. 599, 628 ("The heavy scales of tradition make rather than measure such assumptions. It is more than likely that the present bankruptcy law receives assumptions about setoff's bankruptcy status from a past less affected by reason than politics.").

175 *See supra* Part I.

176 *See* H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 184 (1977), *reprinted in* 1978 U.S. Code Cong. & Admin. News 5963, 6144. *See also* John C. McCoid, II *Setoff: Why Bankruptcy Priority?* 75 VA. L. REV. 15 (1989) ("the power encourages banks to keep troubled debtors afloat when the debtor is 'sinking into financial difficulty.'").

177 Though a wider discussion is beyond the scope of this note, it would be relevant to discuss the intentionality behind security agreements and how set-off rights may or may not fall outside of the spectrum of an intentional agreement to provide a loan in exchange for collateral of value. *See* David G. Carlson, *Security Interests in the Crucible of Voidable Preference Law*, 1995 U. ILL. L. REV. 211, 274 (1995) (for a discussion of interests created in deposit accounts).

described above (derived from the facts of *In re Tenderloin*), we see this play out. Had the debtor held onto the amount leftover after liquidating the real estate, or deposited the amount with another bank besides the bank-creditor, the bankruptcy estate would be enriched.[178] For creditors, this could result in a relative windfall as the pool of property to which the unsecured would have claim to would grow.[179] However, due to the arbitrary nature of the deposit made by the debtor, the bank has fallen backwards into a right to set-off outside of the normal expectation of parties that would ordinarily have mutual obligations.[180] Importantly, scholars note that the doctrine of set-off rights in bankruptcy is legislatively imposed and dated.[181] Our modern interpretation of set-off rights is a holdover from English debtor-creditor law.[182] Given the code's predisposition towards equality throughout the collective process of bankruptcy, set-off rights seem a plausible counterweight.[183]

Despite these misgivings, any examination of the weight of set-off rights in light of the equities presented in the above hypothetical or any interaction between set-off rights and hypothetical Chapter 7 liquidations must contend with the Supreme Court's favorable reading of the right to set-off.[184] In *Citizens Bank v. Strumpf*, the Supreme Court came down in favor of a broad interpretation that a bank may deny a debtor's right to the property transferred to an account with the bank without violating the Code's automatic stay.[185] While Section 553 would not permit a creditor to make a move to off-set a mutual obligation arising between the debtor and the creditor once the petition has been granted and the automatic stay enacted, the Court held instead that the bank was acting within its

178 Schoenmann v. Bank of the West (In re Tenderloin Health, FKA), 849 F.3d 1231, 1244 (9th Cir. 2017) (the Ninth Circuit discusses that had the deposit instead stayed in escrow, it would have been consolidated into the estate).

179 *Id.* (the court discusses the end result instead being a beneficial interest going to one creditor alone).

180 *See* McCoid, *supra* note 176 ("it is far from clear, however, that carrying financially troubled debtors is a good thing. The consequence of doing so is perhaps more likely to further deplete the estate available to creditors on ultimate failure than to result in saving a struggling enterprise.")

181 *See id.* ("What cannot be ignored, however is that setoff in bankruptcy is a legislatively imposed doctrine. First Parliament, then Congress, adopted a concept at odds with the equality principle that otherwise dominates the collective process we call bankruptcy."). By legislatively imposed, I believe the author intends to draw a distinction between legislation that is passed down on behalf of representing a common-sense approach to an issue and legislation that does not represent either best practices or modern needs.

182 *Id.*

183 *See* COLLIER ON BANKRUPTCY ¶ 553.01 (Richard Levin & Henry J. Sommer eds., 16th ed.) (outlining a set-off right as permissive, not mandatory; offers degree of discretion to bankruptcy courts) (citing Photo Mechanical Servs. v. E.I. Dupont De Nemours & Co. (In re Photo Mechanical Sevrs.), 179 B.R. 604 (Bankr. D. Minn. 1995)).

184 *See* Citizens Bank v. Strumpf, 516 U.S. 16, 21 (1995).

185 *See id.* (the broad reading the Supreme Court takes in *Citizens* is representative of a possible unwillingness to end-run Congress and find invalid a statutory provision that collides with another).

authority to place an "administrative hold" on the funds and that this action did not rise to the level of an actual set-off action.[186] The Supreme Court adheres to, and supports, the right to set-off as it stands within the Code.[187] While not dispositive that set-off rights rise above the purpose or importance of voidable preference law in any interaction between set-off rights and voidable preference actions as evinced in the hypothetical from earlier,[188] it is also not the case that the Courts have established a clear victor among the two.[189]

III. PROPOSAL AND APPLICATION: THE ADOPTION OF A NEW JUDGE-MADE RULE

A. *Proposal*

To resolve ambiguity within the application of Section 553 set-off rights in the context of a Section 547(b)(5) "greater amounts" hypothetical Chapter 7 liquidation test, it may behoove bankruptcy courts to adopt the logic of the Ninth Circuit in *In re Tenderloin* as a judge-made rule for dealing with set-off rights that arise in instances of a larger Chapter 7 voidable preference "greater amounts" hypothetical. Specifically, the rule would allow a bankruptcy court to envision the result of a voidable preference action launched within a 547(b)(5) hypothetical liquidation when conducting the greater amounts test. Though a seeming refutation of plain-meaning tests within the Code, this rule would seek to harmonize set-off right limitations with the arm of the voidable preference provision and would alleviate the seeming inequities that may arise in a situation akin to that in front of the Ninth Circuit in *In re Tenderloin*.[190] An adoption to this effect would cast a large shadow across the legal landscape of the law of set-off rights in the Bankruptcy Code.[191] However, in terms of plain meaning, this reasoning arises from

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186 *Id.* at 19 ("Petitioner refused to pay its debt, not permanently and absolutely, but only while it sought relief under § 362(d) from the automatic stay," and finding this analysis to be sufficient to show that no set-off had occurred). *See* COLLIER ON BANKRUPTCY ¶ 362.01 (Richard Levin & Henry J. Sommer eds., 16th ed.)

187 *See* COLLIER, *supra* note 183.

188 See *supra* Part I, Sub-Section C C. Section 553 Set-Off Rights, Limitations (discussing the set-off right hypothetical).

189 Since *Citizens Bank v. Strumpf*, *In re Tenderloin* has been one of the few circuit court discussions with a holding on the issue here.

190 *See* In re Tenderloin, 849 F.3d 1231, 1238 (9th Cir. 2017) (discussing, in part, the inequities at play in a case in which by a seeming shift of semantics, a bank would walk away from an otherwise under secured loan with full remuneration in hand).

191 *See* Karen M. Gebbia-Pinetti, *Interpreting the Bankruptcy Code: An Empirical Study of the Supreme Court's Bankruptcy Decisions*, 3 CHAP. L. REV. 173, 184 (2000) (discussing conflicting

an attempt to preserve the purpose and duties of the Trustee in expanding the bankruptcy estate without doing away with the entirety of set-off rights as preserved in the Code at large.[192]

As such, the adoption would empower a bankruptcy court to entertain, for instance, a hypothetical voidable preference action within a hypothetical Chapter 7 liquidation.[193] As per the Court's reasoning, as long as the facts permit and no independent provision of the Code is at risk of collision by the results of the series of hypothetical considerations, a Court may consider what a reasonable Trustee would seek to achieve in a voidable preference action post-petition within the hypothetical Chapter 7 liquidation test of Section 547(b)(5).[194]

This type of adoption is supported by various bankruptcy court interpretations under different chapters of the Code, bankruptcy scholarship, as well as by the Ninth Circuit in the Chapter 7 context.[195] In its application, the provision would allow courts to better effectuate the purposes behind a strong-arm organizing principle of voidable transfers.[196] Courts may also be able to better effectuate the principle of expanding the bankruptcy estate and casting creditors of the same class as equal.[197]

Understandably, the situations in which the rule would be applied may be limited by the parameters set out by the Ninth Circuit.[198] A contested hypothetical preference action within a larger Chapter 7 liquidation hypothetical would be limited by relevant facts. The court would likely be wary of colliding with an independent provision of the Bankruptcy Code or straying into creating a hypothetical from "whole

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interpretive techniques among the Justices and the dilemma this gives rise to); Daniel J. Bussel, *Textualism's Failures: A Study of Overruled Bankruptcy Decisions*, 53 VAND. L. REV. 887, 888-90 (2000) ("it is one of the surest indexes of a mature and developed jurisprudence not to make a fortress out of the dictionary.")

192 *See* McCoid, *supra* note 176.

193 *In re Tenderloin*, 849 F.3d at 1245.

194 *Id.*

195 *See* In re Larson, 245 B.R. 609 (Bankr. D. Minn. 2000); Alvarado v. Walsh *(*In re LCO Enters.*)*, 12 F.3d 938 (9th Cir. 1993); Schoenmann v. Bank of the West *(*In re Tenderloin Health, FKA*)*, 849 F.3d 1231 (9th Cir. 2017).

196 Carlson, *supra* note 49. This approach would adhere more closely to the perception of the bankruptcy estate being the creature of a judicial lien. As such, the Trustee's powers for avoiding preferences and fraudulent transfers are sine qua non to the disposition of a bankruptcy court ruling on a conflict arising between set-off rights and voidable preference law.

197 *See id.*; *In re Tenderloin*, *supra* note 191.

198 Schoenmann v. Bank of the West (In re Tenderloin Health, FKA), 849 F.3d 1231, 1245 (9th Cir. 2017) ("We hold that courts may entertain hypothetical preference actions within Section 547(b)(5)'s hypothetical liquidation when such an inquiry is factually warranted, supported by appropriate evidence, and so long as the hypothetical preference action would not result in a direct conflict with another section of the Bankruptcy Code.")

cloth."[199] However, this application may still go the distance in resolving the ambiguity and tension arising around a fact pattern that pits the Code's protection of a creditor's right to off-set a mutual obligation against the ostensible purpose of the bankruptcy estate's Trustee in its pursuit to expand the estate and equitably distribute the assets therein among creditors of the same class.

An important counter-argument arises around the Sixth Circuit's interpretation of the ineligibility of bank deposits for voidable preference. In *Meoli v. Huntington National Bank*, the Sixth Circuit cited its holding from *In re Hurtado*, finding that a bank lacks "dominion and control" over deposits sufficiently to establish the deposit as a "transfer" per Section 547.[200] Indeed, if the Ninth Circuit were to hold the Sixth's Circuit's interpretation of transfer as such, the voidable preference argument would be moot. The Fourth Circuit has also adopted this interpretation. In their decision in *In re Whitley*, the court found that ". . . when a debtor deposits . . . funds into his own unrestricted checking account in the regular course of business, he has not transferred those funds to the bank that operates the account."[201] These holdings, however, appear to reject the direct Congressional report defining interest as "[a] transfer is a disposition of an interest in property. The definition of transfer is as broad as possible. Many of the potentially limiting words in current law are deleted, and the language is simplified."[202] As the Supreme Court has not further elaborated on what Congress meant by intending the definition of transfer to be as broad as possible, the Ninth Circuit's interpretation presents no bar to adopting this judge-made rule.

B. *Application*

The most prudent resolution to the legal questions in this Note may be the above-mentioned adoption of the Ninth Circuit's reasoning allowing for hypothetical preference actions within Section 547(b)(5) Chapter 7 liquidation hypotheticals granted a finding of appropriate facts.[203] Barring any run-in with an independent provision of the Code, judges in bankruptcy court proceedings may find the latitude to decide as the Ninth Circuit did.[204] Importantly, the judge-made rule discussed

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199 *See id.* (setting out the scenario in which the court would ostensibly reserve the right to consider a hypothetical preference action within the context of a larger Chapter 7 liquidation hypothetical test).

200 Meoli v. Huntington National Bank, 848 F.3d 716, 725 (6th Cir. 2017) (citing In re Hurtado, 342 F.3d 528-33 (6th Cir. 2003)).

201 Ivey v. First Citizens Bank & Trust Co. (In re Whitley), 848 F.3d 205, 210 (4th Cir. 2017).

202 S. Rep. No. 95-989, at 27 (1978).

203 *See supra* note 198.

204 *Id.*

earlier would support the court's ability to determine the most equitable path forward for the distribution of assets to creditors.[205]

In the case of *In re Whitley*, the interests of the unsecured creditors would have been arguably more equitably dealt with if the fraudulent transfers had been reverted to the bankruptcy estate.[206] Though the Fourth Circuit there dealt with Section 548, the application of the term "transfer" is central to a voidable preference action as well, and calls into question the factual relevancy of bank deposits which underpinned the facts of *In re Tenderloin*. If the Ninth Circuit's interpretation of congressional intent and practice were applied, it would be reasonable for the Fourth Circuit to have reverted the bank deposit to the estate, thereby practicing a degree of Code-specific equity for unsecured creditors.[207] If the Code envisions an equitable and speedy distribution of the assets of the bankruptcy estate, then it is in the best interest of the parties involved to adopt this rule encouraging a flexible approach to an already widely-applied hypothetical test and the terms central to the facts relevant to the Ninth Circuit's holding.[208]

The holding in *Meoli* can also be distinguished as to demonstrate the application of the Ninth Circuit's reasoning.[209] There, the Sixth Circuit was tasked with reviewing a request to allow a reversion of fraudulently transferred funds back to a bankruptcy estate.[210] The equities at play do not seem to favor an outcome in which the court, by interpreting "transfer" broadly, would be serving the efficiency and equality concerns of the Code.[211] Therefore, the decision can be read as one in which equities cut against finding the factual underpinnings of the Ninth Circuit's reasoning based on equities here.[212]

In discussing the already wide-spread practices mentioned above among both circuit courts and bankruptcy courts, and under multiple provisions and chapters of the Bankruptcy Code—despite an arguably

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205 *See* Bussel, *supra* note 191, at 891 ("In expounding a statute, we must not be guided by a single sentence or member of a sentence, but look to the provisions of the whole law, and to its object and policy.")

206 *See* Countryman, *supra* note 36, at 747 (recall the policies behind voidable preference law)*;* Rhodes, *supra* note 25 (discussion of the fiduciary duties of the Trustee to expand the bankruptcy estate to the best interest of the creditors).

207 *See supra* note 206.

208 *See supra* note 207. *See* discussion *supra* Part II and accompanying footnotes (though an approach that seems to highlight the "everyone is doing it" school of thought may not be persuasive to all courts, it offers best practices of the legal system).

209 Meoli v. Huntington National Bank, 848 F.3d 716, 725 (6th Cir. 2017).

210 *See id.*

211 11 U.S.C. § 548 (2012) (fraudulent transfer evaluates the avoidance of ill-gotten gains and ponders when a bank may have been complicit in accepting fraudulently conveyed property; though beyond the scope of this Note, it is relevant to mention that 548 envisions nefarious circumstances less challenging to the equities narrative conveyed in the hypothetical in the Introduction).

212 *See id.*

ambiguous presentation by the Federal Legislature--courts have taken it upon themselves to make the Code a living, breathing, and—most importantly—a workable document.[213]

CONCLUSION

The Code stands as an achievement in codifying hundreds of years of debtor-creditor law.[214] From English Parliament to United States Congress, the traditions regarding and ruling over the discharge of personal liability, the creation of a bankruptcy estate, and the distribution of assets to claimant creditors seeks to achieve a flexible and equitable answer to the problem of insolvency and default.[215] At its heart, the provisions of Section 547 and Section 553 take their place in a line of attempts to create a workable document that settles disputes arising around the transfer of property during the period of insolvency, as well as the issue of dealing with any conflicts arising out of mutual obligations.[216] Therefore, it should be no surprise that scholars and courts alike attempt to bring greater clarity to the legislature's efforts to bring order to conflicts around insolvency.[217] If anything, these problems around novel hypotheticals and fact patterns serve as a testing ground for any further clarification of the Code in the interest of both debtors and creditors. Though possibly controversial, adopting the Ninth Circuit's reasoning presents an opportunity to step back and reflect on how to apply some of the fundamental fairness baked into the Code to effectuate the equality of all bankruptcy participants.

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213 It is worthwhile to note that this note does not inherently view voidable preference law as superior or of more importance than set-off rights, but merely views that the application of best practices in dealing with the inclusion of post-petition facts would air on the side of expanding the rights of the Trustee to pursue a voidable preference within a 547(b)(5) greater amounts test, in line with the understood duties of the position.

214 *See* Kalevitch, *supra* note 174.

215 *See* Elizabeth Warren, *Bankruptcy Policy*, 54 U. CHI. L. REV. 775 (1987) (for an overview of bankruptcy policy and its role in society to effectuate collective action and recoupment under an efficient economic model).

216 *Id. See* Carlson, *supra* note 49.

217 *See* Bussel, *supra* note 191.