An Argument for Creating an Exception to § 547 for Payments on Intraday Overdrafts

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ABSTRACT: Banks routinely advance intraday or "daylight" credit to their customers by provisionally honoring checks that overdraft the customer's account. Banks can dishonor these provisionally honored checks before midnight on the day after the check is presented. Under the terms of the Bankruptcy Code, these provisional credits create a corresponding claim, such that repayment of the claim may be a preferential transfer. Nevertheless, courts have found that provisional credit does not create a claim under the Code because finding otherwise would lead to banks prematurely freezing accounts and correspondingly halting liquidity in payment systems. This Note affirms these policy considerations as not only sound financial policy, but also sound bankruptcy policy. But because bankruptcy court decisions have only persuasive—not precedential—value, costly litigation will continue to dispute whether provisional credits create claims such that repayments are preferential transfers. Identifying banks' ability to dishonor payment as the dispositive fact, and noting that courts have an obligation to follow the Code, this Note proposes that Congress amend the Code to provide an exception for payments on intraday overdrafts. The proposed amendment would allow courts to pursue sound policy without questionable interpretation of the Bankruptcy Code.

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I. INTRODUCTION

Every day, businesses take advantage of delayed check settlement procedures to get short-term credit.[1] When a bank customer writes a check that overdrafts the corresponding account, banks may provisionally honor the check on the expectation that the customer will cover the negative balance before the bank's acceptance of the debt becomes final. This short-term credit is called an intraday overdraft. Some intraday overdrafts can run into the millions—in a recent case, a business ran up a single intraday overdraft of over $5 million.[2] This Note analyzes whether these intraday overdrafts should be considered "debts" under the Bankruptcy Code. A recent bankruptcy court decision addressing this question noted that "[w]hether an intraday overdraft may constitute a debt for preferential transfer purposes is certainly a complicated and difficult question on which courts have disagreed," but ultimately found that these overdrafts are not extensions of credit.[3]

This question has serious implications for banks, which would face liability if intraday overdrafts were considered extensions of credit. To minimize their liability, banks would freeze accounts and stop payments because—if intraday overdrafts were extensions of credit—payment on the intraday overdraft could be avoided as a preferential transfer.[4] If this were the case, the bank would be unable to recover the overdrafted amount and so be exposed to liability on the overdraft. This exposure, arising every time banks extend intraday overdraft credit, would likely result in banks freezing overdrafted accounts and prompting a fiscally dangerous loss of liquidity in payment systems. Courts have prevented this undesirable consequence by rejecting the Code's expansive definition of "debt" in the context of provisional credit.

This Note argues that, contrary to the case law, intraday overdrafts do fall within the definition of "debt," such that repayment may constitute a preferential transfer. It also argues that this result is untenable because of the implications for the financial system and future bankruptcy litigants. This Note expands on the policy conversation from a proceduralist perspective and demonstrates how the current Code provisions actually undermine the proceduralist conception of bankruptcy law's proper role. It proposes that

1. David Clark Scott, *Fed to Take Some Bounce Out of Corporate 'Daylight Overdrafts,'* CHRISTIAN SCI. MONITOR (July 24, 1987), http://www.csmonitor.com/1987/0724/fdraft.html ("[E]very day corporations and banks 'bounce' over $120 billion—and never pay a cent. These 'daylight overdrafts' are legitimate.").

2. *See* Sarachek v. Luana Sav. Bank (*In re* Agriprocessors, Inc.), 490 B.R. 852, 857 (Bankr. N.D. Iowa 2013).

3. *Id.* at 877–78.

4. Preferential transfers are payments to creditors in the months before bankruptcy. The Trustee is able to avoid these payments and get the money back from the creditor. It is under § 547 that the Trustee may avoid these prepetition transfers. 11 U.S.C. § 547 (2012). The elements of § 547 are outlined in Part II.B.

Congress amend the Code to make an exception for intraday overdrafts under § 547, which provides the statutory framework for whether a repayment is a preferential transfer. Examining the relevant law on preferential transfers in the context of intraday overdrafts, this Note identifies that courts have considered the creditor's ability to dishonor the overdrafted checks as a sufficient basis for treating intraday overdrafts as standard debts. This fact should guide an effort to amend the Code.

Part II explains bankruptcy policies and the two goals—equality of distribution and maximizing the benefit to creditors—that come into conflict when applied to intraday overdrafts. This Part also explains the relevant provisions of the Bankruptcy Code and payment systems law. Part III argues that intraday overdrafts fall under the current Bankruptcy Code definition of "debt." Part III also examines the case law holding that intraday overdrafts *do not* fall under the definition of "debt," but on the basis of payment systems policy instead of interpretation of the Code. Part IV shows that intraday overdrafts put bankruptcy policies in tension, and argues that maximizing the benefit to creditors over time should be valued over short-term equality of distribution. Part IV further argues that, because courts have an obligation to follow the Code, and important bankruptcy and payment systems policies are threatened by applying the current Code definitions, Congress should amend the Code to provide an exception for provisional credit. This Note concludes by noting the current dilemma in applying the Code to intraday overdrafts and how the proposed amendment would resolve this dilemma.

II. BANKRUPTCY PURPOSES, PREFERENTIAL TRANSFERS, AND INTRADAY OVERDRAFTS

This Part explains the primary purposes of bankruptcy law, the elements of preferential transfers (paying close attention to the definition of "claim"), and the specifics of intraday overdrafts.

A. *MITIGATING THE EFFECTS OF FINANCIAL FAILURE ON BOTH DEBTORS AND CREDITORS*

Bankruptcy law in the United States "serves to mitigate the effects of financial failure"[5] on both debtors and creditors. It gives debtors a fresh start by discharging their obligations and protecting certain essential property from liquidation. In turn, bankruptcy law also protects creditors by instating a Trustee, who is responsible for maximizing the distribution to creditors.

To mitigate the effects of financial failure on the debtor, bankruptcy discharges[6] a debtor's financial obligations. In fact, "[t]he Supreme Court has long and often stated that '[t]he principal purpose of the Bankruptcy Code is

5. 1 COLLIER ON BANKRUPTCY § 1.01[1] (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2014).

6. Discharge means that the creditor is enjoined from collecting the debt. *See* 11 U.S.C. § 524.

to grant a fresh start to the honest but unfortunate debtor.'"[7] The discharge of debts is the most important part of giving the debtor a fresh start.[8] To ensure that the debtor gets this fresh start, all prepetition[9] claims against the debtor—with a few exceptions[10]—are discharged in the bankruptcy.[11] Consistent with efforts to provide debtors with broad protections, the Code defines "claim" expansively.[12] It addresses not only the debtors' pending financial obligations, but also exempts some of the debtor's property from liquidation and distribution to creditors.[13]

Creditors enjoy protections as well.[14] Their protections promote equality among creditors who may attempt to get more than their fair share of the debtor's assets and give assurance that the Trustee will try to maximize the estate for the benefit of all creditors.[15]

Because a debtor would not be in bankruptcy if she were able to pay all her debts, she will most likely default on some of her obligations.[16] Accordingly, bankruptcy law expects that some of her obligations will go unfulfilled because there is not enough money to go around.[17] As a result, some creditors will get less than they are legally entitled to.[18] Therefore, unlike debtor–creditor law, where the creditor and the debtor are battling over whether there is an obligation or how the debtor will pay that obligation, bankruptcy law often pits creditor versus creditor in a battle for the debtor's

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7. 1 COLLIER ON BANKRUPTCY, *supra* note 5, at 1-4 (second alteration in original) (quoting Marrama v. Citizens Bank of Mass., 549 U.S. 365, 367 (2007)).

8. *Id.* at 1-9 ("[D]ischarge enables the debtor to begin a new financial life . . . provid[ing] the debtor with a fresh start.").

9. "Prepetition" means "[o]ccurring before the filing of a petition"; i.e., before the case commenced. *See* BLACK'S LAW DICTIONARY 1373 (10th ed. 2014).

10. 11 U.S.C. § 523(a) (listing debts that are excepted from discharge).

11. *Id.* § 524; *see also* 1 COLLIER ON BANKRUPTCY, *supra* note 5, at 1-9 ("[S]ection 524 voids any judgment against the debtor to the extent that it is a determination of the debtor's personal liability on a claim subject to the discharge, which will typically be all claims that arose before the commencement of the case.").

12. *See infra* Part II.C.

13. *See* 11 U.S.C. § 522(b) (listing exempt property interests).

14. 1 COLLIER ON BANKRUPTCY, *supra* note 5, at 1-4.

15. *See id.* ("[T]hrough orderly and centralized liquidation or through reorganization or rehabilitation, creditors of equal priority receive ratable and equitable distributions designed to serve 'the prime bankruptcy policy of equality of distribution among creditors of the debtor.'" (quoting Union Bank v. Wolas, 502 U.S. 151, 161 (1991))); *see also infra* text accompanying notes 23–29 (discussing the role and responsibility of the Trustee).

16. Elizabeth Warren, *Bankruptcy Policy*, 54 U. CHI. L. REV. 775, 785 (1987) ("By contrast with state law, which sees only one default, bankruptcy begins with a presumption of default on every obligation the debtor owes.").

17. *Id.* ("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.").

18. *Id.*

estate.[19] Thus, distribution of the debtor's estate "is the center of the bankruptcy scheme."[20] And bankruptcy law focuses on balancing the rights of creditor against creditor,[21] with certain creditors getting certain special treatments.[22]

Therefore, bankruptcy is a distribution system—distributing the debtor's remaining assets to the creditors while also distributing the cost of the debtor's default among those to whom the debtor was obligated.[23] The Trustee in bankruptcy is tasked with orchestrating this distribution.[24] The Trustee is an officer of the court appointed by the United States Trustee to represent the bankruptcy estate.[25] It is the Trustee's responsibility "to collect and liquidate the property of the estate and to distribute the proceeds to creditors."[26] As a result, the Trustee owes a variety of duties to the estate's creditors and the debtor, but is not an agent of the creditors.[27] One of these duties is often referred to as the duty "to maximize the value of the estate" but is better understood as the "duty to maximize the *distribution* of the estate" to creditors.[28] To make sure the distribution is fair, the Code gives the Trustee the power to avoid prepetition transfers that favor one creditor over another because such transfers go against "the prime bankruptcy policy of equality of distribution among creditors of the debtor."[29] These transfers are called

19. *See id.* ("[B]ankruptcy disputes are better characterized as creditor-versus-creditor, with competing creditors struggling to push the losses of default onto others.").

20. *Id.*

21. *See id.* ("Bankruptcy disputes do not share the debtor-versus-creditor orientation of state collection law. In bankruptcy, with an inadequate pie to divide and the looming discharge of unpaid debts, the disputes center on who is entitled to shares of the debtor's assets and how these shares are to be divided.").

22. *See id.* at 786 (surveying some of the "hard choices" the Bankruptcy Code makes about the relative priority of creditors).

23. *See id.* at 790 ("Bankruptcy is simply a federal scheme designed to distribute the costs among those at risk.").

24. Steven Rhodes, *The Fiduciary and Institutional Obligations of a Chapter 7 Bankruptcy Trustee*, 80 AM. BANKR. L.J. 147, 154–55 (2006).

25. *Id.* at 155 ("[T]he trustee is designated as the 'representative of the estate.' The cases interpret this designation to accomplish two distinct purposes—to demonstrate the trustee's fiduciary role, and to establish the trustee's capacity to sue or be sued on behalf of the estate." (footnotes omitted)).

26. EXEC. OFFICE FOR U.S. TRS., U.S. DEP'T OF JUSTICE, HANDBOOK FOR CHAPTER 7 TRUSTEES 4-1 (2012), *available at* http://www.justice.gov/ust/eo/private_trustee/library/chapter07/docs/ch7hb2012/Handbook_for_Chapter_7_Trustees.pdf.

27. Rhodes, *supra* note 24, at 154–55.

28. *Id.* at 164–65 (internal quotation marks omitted). The Trustee is motivated to maximize the value of the estate because the Trustee's commission is paid out of the "moneys disbursed or turned over in the case by the trustee to parties in interest, excluding the debtor, but including holders of secured claims." 11 U.S.C. § 326(a) (2012). Thus, the amount the Trustee receives is partially determined by how much he is able to disburse to creditors. *Id.*

29. 1 COLLIER ON BANKRUPTCY, *supra* note 5, at 1-4 (quoting Union Bank v. Wolas, 502 U.S. 151, 161 (1991)). For example, say A owes both X and Y $100, but because he only has $100 he can't pay both of them. A therefore files for bankruptcy. But right before A files for bankruptcy,

preferential transfers, or avoidable preferences, and are explained below in Subpart B.[30] One element of a preferential transfer is that it makes payment on an antecedent debt.[31] Thus, if intraday overdrafts are considered "debts" under the Code, repayment may be a preferential transfer and avoidable by the Trustee.

B. Preferential Transfers

A preferential transfer is a prepetition transfer that has the effect of favoring one creditor over another.[32] The Trustee can avoid preferential transfers and recover the money or property back from the creditor, undoing the transfer.[33] The Trustee then includes the recovered assets in the debtor's estate that is distributed to the various creditors. Because the Trustee is able to avoid preferential transfers, they are also called "avoidable preferences." This Subpart explains preferential transfers by detailing the elements of a preferential transfer and discussing the policies underpinning why preferential transfers are avoidable.

To avoid transfers that occurred before the debtor filed for bankruptcy, the Trustee must show that (1) the transfer was "to or for the benefit of [the] creditor"; (2) the transfer was "on account of an antecedent debt"; (3) "the debtor was insolvent" at the time of the transfer; (4) the creditor received more than he would have received had the transfer not occurred; and (5) the transfer occurred within 90 days before the filing of the bankruptcy petition.[34] When these five elements are met, the Trustee can—acting as the representative of the bankruptcy estate's creditors[35]—avoid the transfer.[36]

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he pays X $75. That means that there is now only $25 left in A's estate to be divided between X and Y in bankruptcy. If the Trustee wasn't able to avoid the $75 transfer from A to X, Y would only get $12.50 of the estate and X would get $12.50 plus the $75 he got before A filed for bankruptcy. Thus, the majority of the loss would fall on Y. Because A's $75 prepetition transfer to X resulted in X getting more than his fair share, the transfer did not treat similarly situated creditors similarly, and so is voidable as a preferential transfer.

30. EXEC. OFFICE FOR U.S. TRS., *supra* note 26, at 4-12 to -13.

31. *See infra* note 34 and accompanying text.

32. 5 COLLIER ON BANKRUPTCY, *supra* note 5, at 547-9.

33. *Id.*; *see also* BLACK'S LAW DICTIONARY, *supra* note 9, at 1805 ("[*Voidable*] describes a valid act that may be voided rather than an invalid act that may be ratified.—Also termed *avoidable*.").

34. 11 U.S.C. § 547(b) (2012); *see also* Vern Countryman, *The Concept of a Voidable Preference in Bankruptcy*, 38 VAND. L. REV. 713, 747–48 (1985) ("All that the trustee need show to avoid transfers within the ninety day period is that the debtor was insolvent at the time of the transfer . . . that the transfer was to or for the benefit of a creditor, for or on account of antecedent debt; and that the transfer had a preferential effect." (footnote omitted)).

35. 9B AM. JUR. 2D *Bankruptcy* § 2175 (2006).

36. *Id.* But note that the transfer is not *void*; instead, it is *voidable*, that is, it is valid until it is avoided. *Id.* Thus, the Trustee must take action to avoid the transfer. 8A C.J.S. *Bankruptcy* § 670 (2006).

The intent behind the avoided transfer is irrelevant.[37] All that matters is the transfer's effect on the bankruptcy estate and on the rights of the other creditors.[38]

Avoiding preferential transfers promotes good policy for two primary reasons.[39] First, it keeps creditors from wasting resources by "racing to the courthouse to dismember the debtor" while the debtor is insolvent.[40] Because creditors know that any payments they extract from the debtor are avoidable, they are unlikely to waste resources on collection actions.[41] The freedom from collection actions during periods when the debtor is close to insolvency allows the debtor more time to get back on track financially and potentially avoid default and bankruptcy.[42] If the Trustee was unable to avoid preferential transfers, creditors—fearing for their ability to recover from the debtor—would engage in "costly jockeying" to get payment.[43] Thus, the law of avoidable preferences eliminates inefficient expenditure on the part of creditors seeking to get their share and so maximizes the aggregate wealth of the creditors.[44] As a result, preferential transfer law supports an important policy goal of bankruptcy law—maximizing the value of the debtor's estate to creditors.[45]

Second, avoiding preferential transfers ensures that the debtor's assets are distributed equally among similarly situated creditors.[46] It assures creditors that even if another creditor obtains payment in the months leading up to bankruptcy, that payment will be avoidable and the creditor will receive its fair share because the payment will be undone.[47] As a result, preferential transfer law supports the creditor-based bankruptcy policy of dividing the bankruptcy estate equally among similarly situated creditors.[48]

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37. This is in contrast to fraudulent transfers (another kind of prepetition transfer that the Trustee can avoid), which do require, among other things, actual or constructive mens rea on the part of the debtor. 11 U.S.C. § 548(a)(1); *see also* 25 AM. JUR. PROOF OF FACTS 3D § 3, at 591 (2014) ("Actual fraud . . . is made with actual intent to hinder, delay, or defraud an existing or future creditor.").

38. 8A C.J.S. *Bankruptcy*, *supra* note 36, § 670.

39. 5 COLLIER ON BANKRUPTCY, *supra* note 5, at 547-9.

40. *Id.*

41. *See id.*

42. *Id.* ("The protection thus afforded the debtor often enables the debtor to work a way out of a difficult financial situation through cooperation with all of the creditors.").

43. RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 545 (8th ed. 2011).

44. *Id.*

45. *See supra* Part II.A.

46. 5 COLLIER ON BANKRUPTCY, *supra* note 5, at 547-9.

47. *See id.*

48. Epstein v. Official Comm. of Unsecured Creditors of the Estate of Piper Aircraft Corp. (*In re* Piper Aircraft Corp.), 168 B.R. 434, 440 (S.D. Fla. 1994) ("One of the basic policies of the Bankruptcy Code is the equal treatment of similarly situated creditors."), *aff'd as modified*, 58 F.3d 1573 (11th Cir. 1995).

As they relate to intraday overdrafts, the most important element of avoidable preferences is the requirement that they apply only to payment on an "antecedent debt." The following Subpart examines the requirement in more detail. Then, Part III will apply this definition to determine whether an intraday overdraft should be considered an "antecedent debt," such that repayment could be avoided.

C. Antecedent Debt

In the Bankruptcy Code, a Trustee can only avoid a transfer made "for or on account of an antecedent debt owed by the debtor before such transfer was made."[49] The term "antecedent debt" is not defined in the Code, but courts have considered a debt antecedent if it was incurred before the transfer—that is, "the debt must have preceded the transfer."[50] Because a debt is incurred only after the debtor "becomes legally bound to pay," a transfer made before a legal obligation arises is not preferential.[51] In other words, unless you owe a debt, it is impossible to pay it off.[52] As a result, deciding when a debtor becomes legally bound to pay is an important part of deciding whether a transfer was made "for or on account of an antecedent debt."[53] Of course, questions of "antecedent debt" are inconsequential if there is no debt to begin with, and the Bankruptcy Code provides us with the definition of "debt."[54]

In the Bankruptcy Code, "debt" is defined as a "liability on a claim."[55] Because the definition of "debt" depends on the definition of "claim," courts have considered the two terms coextensive—there is no distinction between them.[56] As a result, when deciding if something is a debt, courts look to the

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49. 11 U.S.C. § 547(b)(2) (2012).

50. 5 COLLIER ON BANKRUPTCY, *supra* note 5, at 547-30.

51. Laws v. United Mo. Bank of Kan. City, 98 F.3d 1047, 1050 (8th Cir. 1996) (citation omitted) (internal quotation marks omitted).

52. *Id.*

53. *See* 5 COLLIER ON BANKRUPTCY, *supra* note 5, at 547-30 & n.72 (citing cases where the dispositive issue was when the debtor became legally obligated to pay).

54. 11 U.S.C. § 101(12).

55. *Id.*

56. *See* Johnson v. Home State Bank, 501 U.S. 78, 84 n.5 (1991) ("'[D]ebt,' which is defined under the Code as 'liability on a claim,' has a meaning coextensive with that of 'claim' as defined in § 101(5)." (citation omitted)); Lindsey, Stephenson & Lindsey v. Fed. Deposit Ins. Corp. (*In re* Lindsey, Stephenson & Lindsey), 995 F.2d 626, 628 (5th Cir. 1993) ("[T]here is no distinction between 'debt' and 'claim' for the purpose of the Bankruptcy Code."); *see also* Sigmon v. Royal Cake Co. (*In re* Cybermech, Inc.), 13 F.3d 818, 822 (4th Cir. 1994) ("By defining debt as liability on a claim, Congress did not impose an additional element, namely that legal liability be established through litigation. [W]hen a claim exists, so does a debt. They are but different windows on the same room." (alteration in original) (citation omitted) (internal quotation marks omitted)).

definition of "claim."[57] Accordingly, when discussing the definition of "debt," this Note will, like the courts, use the Bankruptcy Code definition of "claim."[58]

The Bankruptcy Code defines "claim" as a creditor's "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured."[59] These terms are not defined in the Bankruptcy Code, so courts "are guided here by the plain meaning of those terms."[60]

With respect to the definition of claim, the Supreme Court has stated "that Congress intended by this language to adopt the broadest available definition."[61] The expansiveness of this definition is "central to the policy" of giving the bankrupt debtor a "fresh start" post-bankruptcy.[62] Congress's intent to "adopt the broadest available definition" of claim has been "repeatedly reiterated" by the Supreme Court, which has "declined all invitations to exclude rights to payment from the definition of claim."[63] Thus, "claim"

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57. *See* 2 COLLIER ON BANKRUPTCY, *supra* note 5, at 101-81 ("For purposes of determining whether a debt is a claim, section 101(5), which defines 'claim,' should be consulted to decide whether the debt or demand gives rise to a right of payment and can qualify under that section.").

58. *Id.*; *see also In re Cybermech, Inc.*, 13 F.3d at 822 (finding that *debt* and *claim* are coextensive within the context of preferential transfers); *cf.* Jeffries v. Buckley (*In re* Buckley), 404 B.R. 877, 884 (Bankr. S.D. Ohio 2009) (finding that a litigant's "attempt to differentiate the concepts of 'claim' and 'debt' [had] absolutely no support in the caselaw").

59. 11 U.S.C. § 101(5)(A); *see also* Bonnie Kay Donahue & Bryan D. Graham, *Definition of a Claim*, 9 J. BANKR. L. & PRAC. 275, 292 (2000).

> When an obligation depends on the happening of some future event, it is contingent. The classic example of a contingent claim is a contractual claim against the debtor by a surety, guarantor or endorser. These claims are contingent because they do not arise until the maker fails to pay. The surety is obliged to satisfy the debtor's primary obligation only on the occurrence of a condition precedent.

Id. A right to payment is "nothing more nor less than an enforceable obligation," *Johnson*, 501 U.S. at 83 (quoting Pa. Dep't of Pub. Welfare v. Davenport, 495 U.S. 552, 559 (1990)) (internal quotation marks omitted), but it does not have to rise to a cause of action to be a claim. *See infra* note 91 and accompanying text.

60. *In re* Mattera, 203 B.R. 565, 570 (Bankr. D.N.J. 1997) (citing United States v. Ron Pair Enters., Inc., 489 U.S. 235, 242 (1989)).

61. *Johnson*, 501 U.S. at 83 (citing *Davenport*, 495 U.S. at 558, 563–64; Ohio v. Kovacs, 469 U.S. 274, 279 (1985)); *see also In re Buckley*, 404 B.R. at 890.

> The House and Senate Reports for the Bankruptcy Reform Act of 1978 state Congress's rationale for adopting very broad definitions of the terms "claim" and "debt": By this broadest possible definition . . . the bill contemplates that all legal obligations of the debtor, no matter how remote or contingent, will be able to be dealt with in the bankruptcy case. It permits the broadest possible relief in the bankruptcy court.

Id. (quoting S. REP. NO. 95-989, at 22 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5808; H.R. REP. NO. 95-595, at 309 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6266).

62. *In re Buckley*, 404 B.R. at 891 (quoting *In re* Chateaugay Corp., 87 B.R. 779, 795 (S.D.N.Y. 1988)) (internal quotation marks omitted); *see also supra* Part II.A.

63. 2 COLLIER ON BANKRUPTCY, *supra* note 5, at 101-39.

encompasses all possible creditors and gives them an opportunity to have their claims against the debtor adjudicated and—most likely—discharged.[64] Because "claim" is defined so broadly, and "debt" and "claim" are coextensive, "debt" is therefore also defined broadly.[65]

A subset of traditional claims, contingent claims are claims that may or may not arise depending on some future event.[66] The "classic example[]" of a contingent claim is a guarantor who only has a claim if the principal defaults.[67] Part III will analyze whether intraday overdrafts are contingent claims under the Bankruptcy Code and will expand on the definition of "contingent claim." But first, the next Subpart explains how intraday overdrafts arise and the obligations and timeframes they create.

D. INTRADAY OVERDRAFTS

An intraday overdraft is a negative account balance that occurs after a check is provisionally settled but before payment becomes final.[68] When a bank receives a check that draws on an account with insufficient funds, the bank can either immediately dishonor ("bounce") the check, or honor it.[69] A provisional settlement occurs when a bank honors a check.[70] It is provisional because the bank can still dishonor the check (and get its money back) before

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64. *See* Warren, *supra* note 16, at 787 ("The Bankruptcy Code clearly rejects the alternative of leaving future claimants uncompensated. It defines 'claim' broadly to pull future creditors into the debtor's distribution plan and to require participation by anticipated claimants.").

65. *See* 2 COLLIER ON BANKRUPTCY, *supra* note 5, at 101-81 ("If a claim exists under that broad definition, a debt also exists . . . ."). In fact, one court provided the following formulation of debt in the context of preferential transfers: "The definition of 'debt' can therefore be restated as 'a liability for payment, whether or not such liability is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured.'" Official Comm. of Unsecured Creditors of Enron Corp. *ex rel.* Enron Corp. v. Whalen (*In re* Enron Corp.), 357 B.R. 32, 47 (Bankr. S.D.N.Y. 2006).

66. *See In re* Blehm, 33 B.R. 678, 679 (Bankr. D. Colo. 1983) ("Generally, the courts have considered as contingent debts those claims which depend either as to their existence or their amount on some future event which may not occur at all or may not occur until some uncertain time.").

67. *Id.*; Covey v. Nw. Cmty. Bank (*In re* Helen Gallagher Enters., Inc.), 126 B.R. 997, 1000 (Bankr. C.D. Ill. 1991) ("[M]any cases have held that guarantors are classic examples of creditors holding 'contingent' claims.").

68. Sarachek v. Luana Sav. Bank (*In re* Agriprocessors, Inc.), 490 B.R. 852, 857 (Bankr. N.D. Iowa 2013).

69. *Id.* at 857–58. Many banks provisionally honor checks as a courtesy to their customers. *See id.*

70. *Id.* at 864. Note that a provisional settlement occurs every time a collecting bank presents a check to a payor bank for payment, not just when there are insufficient funds. A provisional settlement simply means that the bank can still get the money back. Also, if the check is presented to the payor bank "for immediate payment over the counter"—and the bank pays—payment is final and these check-clearing procedures do not apply. U.C.C. § 4-301(a) (2011) ("If a payor bank settles for a demand item other than a documentary draft presented otherwise than for immediate payment over the counter before midnight of the banking day of receipt, the payor bank may revoke the settlement and recover the settlement . . . .").

the payment becomes final.[71] Article 4 of the Uniform Commercial Code ("UCC") governs payment systems and dictates when a payment becomes final.[72] A payment becomes final when the bank can no longer dishonor the check. Under the UCC, this is the "midnight deadline."[73] The UCC midnight deadline "imposes upon payor banks a strict obligation to return dishonored checks prior to midnight of the next business day after the date of receipt of the item."[74] For example:

> A bank customer has a balance of $100 in his checking account at First National Bank but writes a $200 check to his landlord. The landlord deposits the check into her savings account at Second American Bank. Second American sends the check through its clearing house back to First National's computer center. First National's computer center begins the process of posting and ultimately determines that there are insufficient funds in its customer's account. The bank decides to dishonor the check by midnight of the banking day following the banking day of receipt in order to avoid liability for the $200.[75]

Therefore, writing a check for a higher value than is in the account leads to an intraday overdraft, but it only becomes a true overdraft if the negative account balance carries past the midnight deadline.[76] It is the midnight deadline that transforms an intraday overdraft into a true overdraft.[77]

True overdrafts are often simply referred to as "overdrafts." When there is a true overdraft, the account holder owes the bank the amount of negative balance in their account.[78] As a result, the bank undeniably has a claim against their customer—the debtor—for that amount.[79] And because the bank has a

71. *In re Agriprocessors, Inc.*, 490 B.R. at 864.

72. *Id.* at 864–66.

73. *Id.*

74. John M. Norwood, *The Impact of Federal Regulations on the UCC Midnight Deadline*, 125 BANKING L.J. 817, 827 (2008); *see also* U.C.C. § 4-104(a)(10) ("'Midnight deadline' with respect to a bank is midnight on its next banking day following the banking day on which it receives the relevant item or notice or from which the time for taking action commences to run, whichever is later.").

75. Susan J. Murr, *When the Clock Strikes Twelve, Is It Really Midnight?: U.C.C. Section 4-302 and the Midnight Deadline*, 2 ANN. REV. BANKING L. 191, 191 (1983) (footnotes omitted).

76. U.C.C. § 4-302(a).

77. *Id.*; *see also* U.C.C. § 4-215(b) ("If provisional settlement for an item does not become final, the item is not finally paid.").

78. *See In re Agriprocessors, Inc.*, 490 B.R. at 857 n.3 ("[A] true overdraft creating a debt does not occur until the midnight deadline has passed and the provisional settlement has become final." (internal quotation marks omitted)).

79. *Id.* at 881 ("[I]t is well-established that provisional settlement amounts that are not cured or zeroed out by the midnight deadline do become true overdrafts and thus extensions of credit." (internal quotation marks omitted)).

claim, the debtor has a corresponding obligation: a debt.[80] Thus, if the debtor makes a transfer to the bank to pay off that debt, it is a transfer on account of an antecedent debt, and may be avoidable as a preferential transfer.[81] But because the bank can dishonor the check before midnight, does the bank have a claim against their customer *before* the midnight deadline transforms it into a true overdraft? Under the terms of the Bankruptcy Code, it does.[82] This is addressed in the next Part.

III. INTRADAY OVERDRAFTS AND THE DEFINITION OF "DEBT"

Although it is clear that true overdrafts are antecedent debts, whether an intraday overdraft constitutes a debt is "a complicated and difficult question."[83]

A. Intraday Overdrafts Under the Terms of the Bankruptcy Code

This Note concludes that intraday overdrafts are antecedent debts under the terms of the Bankruptcy Code. There are two ways that an intraday overdraft can be resolved before the midnight deadline: the bank can dishonor the check, or the customer can cover the overdraft.[84] "Covering" means the customer makes a deposit into the overdrafted account that raises it above a negative balance.[85] But the fact that the customer can cover the overdraft is irrelevant. Covering is not a contingency that resolves the obligation—rather, it is a payment on the obligation. Thus, the only contingency that differentiates intraday overdrafts from true overdrafts is the bank's ability to dishonor the check.[86]

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80. 11 U.S.C. § 101(12) (2012).

81. *Id.* § 547.

82. The case law addressing this question has found that intraday overdrafts *do not* result in a debt. This Note presents an argument based from the terms of the Bankruptcy Code, while the case law is based purely on policy. *See infra* Part III.

83. *In re Agriprocessors, Inc.*, 490 B.R. at 878. See *infra* Part III.B for a discussion of the case law addressing this question.

84. *In re Agriprocessors, Inc.*, 490 B.R. at 857–58.

> [The bank manager] described several options he believed he had on that second day. He could have the Bank immediately dishonor and return the check for insufficient funds—i.e., bounce the check. He could decide to have the Bank immediately honor the check and create an overdraft in the account. He could also wait on the customer to provide funds by cash, check, or wire transfer to cover the intraday overdraft before the midnight deadline.

Id. (internal quotation marks omitted).

85. *Id.* at 858.

86. The midnight deadline is not a contingency. The fact that time has to pass before it becomes a true overdraft simply means that the obligation has not matured. An unmatured obligation is a type of claim specifically contemplated by the Code. *See* Official Comm. of Unsecured Creditors of Enron Corp. *ex rel.* Enron Corp. v. Whalen (*In re* Enron Corp.), 357 B.R. 32, 49 (Bankr. S.D.N.Y. 2006).

This contingency does not keep intraday overdrafts from being defined as "debts" because the Code expressly includes contingent debts.[87] An obligation to pay a creditor may depend, as to existence or amount, on either the occurrence or the timing of some future event and still constitute a debt under § 547.[88] Additionally, "[t]he fact that a contingency has not yet been triggered does not insulate a creditor from a preference action,"[89] and the fact that a cause of action has not yet arisen does not preclude finding that there is a claim.[90] Therefore, even where a debtor's obligation on a debt is contingent on some future action or event, it is still considered an antecedent debt for preference purposes.[91]

In the context of intraday overdrafts, the event that transforms the provisional settlement into final payment is the bank's decision to forgo revoking the overdrafting check before the midnight deadline.[92] Because there is no doubt that a true overdraft is a debt,[93] and an intraday overdraft

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> [Although the creditor] did not have an enforceable right to payment at the time the [transfer] was made, he clearly did have an unmatured right to payment that preceded the [transfer]. A "debt" was created at the time the Agreement was signed, and as that debt preceded the [transfer], [it] was made "for or on account of an antecedent debt." . . . That the [transfer] was made one day before the obligation matured and became due is thus not relevant.

Id.

87. 11 U.S.C. § 101(5) (2012).

88. Kallen v. Litas, 47 B.R. 977, 982 (N.D. Ill. 1985) (citing *In re* UNR Indus., Inc., 29 B.R. 741, 745–46 (N.D. Ill.1983)), *rev'd on other grounds sub nom.* Kallen v. Ash (*In re* Brass Kettle Rest., Inc.), 790 F.2d 574 (7th Cir. 1986).

89. Hutson v. Greenwich Ins. Co. (*In re* E-Z Serve Convenience Stores, Inc.), 377 B.R. 491, 498 (Bankr. M.D.N.C. 2007).

90. *See* Sigmon v. Royal Cake Co. (*In re* Cybermech, Inc.), 13 F.3d 818, 822 (4th Cir. 1994).

> Royal obtained a "claim" against Cybermech when Cybermech received and deposited Royal's payment for the machines on August 3, 1987. The fact that Royal did not have a cause of action against Cybermech until August 24 is irrelevant, because the Code does not limit the definition of "claims" to actual causes of action.

Id.

91. *In re Enron Corp.*, 357 B.R. at 49 ("While, as Whalen notes, Baxter did not have an enforceable right to payment at the time the Baxter Transfer was made, he clearly did have an unmatured right to payment that preceded the Baxter Transfer."); *see also* Energy Coop., Inc. v. SOCAP Int'l, Ltd. (*In re* Energy Coop., Inc.), 832 F.2d 997, 1002 (7th Cir. 1987).

> It is irrelevant that SOCAP's ultimate recovery for ECI's breach was contingent on SOCAP's willingness to pursue its remedy for breach and on the future rise or fall of the crude oil market. Whether or not a claim and debt exist does not depend on whether a creditor chooses to pursue its claim. Furthermore, under the Bankruptcy Code's broad definition, a contingent claim is still a claim; and, as we have seen, when a claim exists, so does a debt.

Id.

92. *See supra* Part II.D.

93. Saracheck v. Luana Sav. Bank (*In re* Agriprocessors, Inc.), 490 B.R. 852, 876 (Bankr. N.D. Iowa 2013) ("Even the Bank here recognizes that 'true overdrafts' are extensions of credit.").

will become a true overdraft contingent upon the bank's decision not to dishonor the check,[94] an intraday overdraft is an antecedent debt under the Bankruptcy Code.

The Code should control this decision,[95] but nevertheless courts addressing this question have effectively ignored the Code, and made their findings on the basis of payment systems policy.[96] The next Subpart looks at the case law addressing the status of intraday overdrafts. Every court has held that intraday overdrafts do not constitute an antecedent debt,[97] but they have made their findings on the basis of payment systems policy, not the Code definitions.[98]

B. Payment Systems Policy and the Courts' Treatment of Intraday Overdrafts

This Subpart returns to an exposition of the relevant law, explaining that the cases addressing whether intraday overdrafts are antecedent debts have not reached their conclusions based on the Code, but based on payment systems policy.

In the most recent case to address the issue, *In re Agriprocessors*, the debtor wrote hundreds of checks during the 90-day preference period for amounts exceeding what it held in its account.[99] The bank automatically paid these checks, but immediately called the debtor to ensure that it would cover the overdraft amount before the midnight deadline.[100] The debtor usually covered these amounts, and ultimately did so in this instance, but after the debtor filed for bankruptcy, the Trustee attempted to recover the payments as avoidable preferences.[101] The single greatest intraday overdraft, and the amount that the Trustee sought to recover from the bank, was $5,134,582.68.[102] The court held that the payments were not avoidable preferences because the overdrafts were provisional—not true—overdrafts.[103]

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94. *See supra* Part II.D.

95. Jeffries v. Buckley (*In re* Buckley), 404 B.R. 877, 883 & n.4 (Bankr. S.D. Ohio 2009) ("The plain language of the Code makes clear, then, that the existence of a claim turns on whether a creditor has a right to payment, not whether that right to payment has been reduced to judgment. And the Court must follow this plain statutory language.").

96. *See infra* Part III.B.

97. *See In re Agriprocessors, Inc.*, 490 B.R. at 871–76 ("This Court believes that [the cases relied on by the Trustee] are distinguishable from this case.").

98. *See infra* Part III.B.

99. *In re Agriprocessors, Inc.*, 490 B.R. at 857 ("In the ninety days before bankruptcy, Debtor wrote hundreds of checks totaling multi-millions of dollars on account 1430.").

100. *Id.* at 857–58.

101. *Id.*

102. *Id.* at 858 ("In total, the Trustee seeks to avoid 'at least' $5,134,582.68, the largest one-day negative balance in account 1430 during the ninety day preference period—i.e., the greatest single extension of credit during the period.").

103. *Id.* at 878; *see also* Morin v. HSBC Bank USA (*In re* Aapex Sys., Inc.), Nos. 98-20728, 00-2073, 2004 WL 2898130, at *3 (Bankr. W.D.N.Y. Dec. 14, 2004) (finding that intraday overdrafts

In these cases, the bank could have dishonored the checks before the midnight deadline. But, in *In re Sophisticated Communications, Inc.*, a bank issued a series of cashier's checks that overdrafted a customer's account to the tune of $690,934.54.[104] The court found that this created an antecedent debt[105] because banks cannot dishonor cashier's checks and are therefore obligated to pay them.[106] As a result, the court found that when the debtor paid the overdraft, it addressed an antecedent debt and so constituted an avoidable preference.[107] The *Agriprocessors* court distinguished *Sophisticated* specifically on the basis that cashier's checks are not dishonorable:

> Unlike regular checks settled through the clearinghouse, which the bank only learns of on day two after a provisional settlement has occurred, a bank knows of the cashier's checks it issues immediately. When issuing a cashier's check, the issuing bank *guarantees payment of the funds and immediately withdraws the funds to cover the check* from the customer's account. Thus, at the time of issuing the checks, the payor bank knew or should have known there were insufficient funds on deposit and knew it was taking a credit risk.[108]

But *Agriprocessors* did not make these decisions based on the Bankruptcy Code definitions. Instead, they were based on the federal financial policy of maintaining liquidity in the banking system.[109] In fact, the *Agriprocessors* court explicitly acknowledged that it did not want to adopt a rule that "would pin banks between the strong federal policy in favor of expedited funds availability and a Bankruptcy Code that treats advances as loans and their reduction as preferences."[110] The court cited language from cases describing the disastrous financial policy implications of treating intraday overdrafts as debts,[111] finding that doing so would disrupt "the policy favoring the ready

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are not debts for the purposes of avoidable preferences); Jacobs v. State Bank of Long Island (*In re* AppOnline.com, Inc.), 296 B.R. 602, 616 (Bankr. E.D.N.Y. 2003) (same).

104. Feltman v. City Nat'l Bank of Fla. (*In re* Sophisticated Commc'ns, Inc.), 369 B.R. 689, 699–700 (Bankr. S.D. Fla. 2007), *opinion clarified on denial of reconsideration*, Ch. 7 Case No. 00-17635-BKC-RAM, Adv. No. 02-1526-BKC-RAM-A, 2007 WL 2257604 (Bankr. S.D. Fla. Aug. 1, 2007).

105. *Id.*

106. U.C.C. §§ 3-411 to -412 (2011).

107. *In re Sophisticated Commc'ns, Inc.*, 369 B.R. at 699–700.

108. *In re Agriprocessors, Inc.*, 490 B.R. at 877 (emphasis added).

109. *Id.* at 873–75.

110. *Id.* (quoting Laws v. United Mo. Bank of Kan. City, 98 F.3d 1047, 1051 (8th Cir. 1996)) (internal quotation marks omitted); *see* Part III (discussing how intraday overdrafts fall under the definition of "claim"); *see also* Andrew Kull, *Ponzi, Property, and Luck*, 100 IOWA L. REV. 291, 293 & n.4 (2014) (noting that bankruptcy courts—ostensibly following the equitable origins of bankruptcy—sometimes apply "a discretion that does not exist"). But like Professor Kull, my intention is "not to criticize the courts for ignoring the rules," *id.* at 293, but to examine the merit of the rules.

111. *In re Agriprocessors, Inc.*, 490 B.R. at 873–75.

negotiability of checks and other instruments [and] would affect the movement of checks along the highway of commerce."[112] Moreover, the court reasoned that banks would incur great costs in an attempt to avoid the possibility of liability in these cases:

> If each routine deposit occurring when a company's account is in the overdraft position were voidable as a preference, banks would potentially be exposed to substantial liabilities, or would modify their procedures by increasing the costs of preclearing checks for all customers, or by discontinuing the useful practice of permitting overdrafts. Moreover, attaching preference liability to overdrafts would lead to premature freezing of accounts.[113]

The court further "not[ed] that a rule treating provisional advances as an extension of credit 'would be inconsistent with the parties' expectations and their view of the banking relationship' and 'such a rule might cause banks to terminate a service that is invaluable in today's economy.'"[114]

As a result, the courts, understandably concerned about the consequences of finding that intraday overdrafts are debts, have unanimously ruled against applying "a Bankruptcy Code that treats advances as loans and their reduction as preferences."[115] Thus, in spite of the language of the Code definitions,[116] courts have invariably found that intraday overdrafts are not debts due to the implications for payment systems policy. Part IV discusses this issue in the context of bankruptcy policy and uses a Cosean analysis to show that future litigation of this issue is, under current law, inevitable, inefficient, and unnecessary.

IV. Excepting Intraday Overdrafts from Preference Liability

As discussed in Part II, the two overarching purposes of bankruptcy are to provide the debtor with a fresh start and to maximize the estate for creditors. Likewise, there are two primary policies behind avoiding preferential transfers: ensuring that creditors do not "rac[e] . . . to dismember the debtor,"[117] and ensuring equal distribution of the debtor's estate to creditors.[118] In the context of intraday overdrafts, because there is no reason for a bank to "rac[e] . . . to dismember the debtor,"[119] equal distribution is the

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112. *Id.* at 873 (quoting Jacobs v. State Bank of Long Island (*In re* AppOnline.com, Inc.), 296 B.R. 602, 619 (Bankr. E.D.N.Y. 2003)) (internal quotation marks omitted).

113. *Id.* at 874 (quoting Bernstein v. Alpha Assocs., Inc. (*In re* Frigitemp Corp.), 34 B.R. 1000, 1020 (S.D.N.Y. 1983)) (internal quotation marks omitted).

114. *Id.* at 873 (quoting *Laws*, 98 F.3d at 1051–52).

115. *Id.* at 878 (quoting *Laws*, 98 F.3d at 1051) (internal quotation marks omitted).

116. *See supra* Part III.A.

117. 5 COLLIER ON BANKRUPTCY, *supra* note 5, at 547-9.

118. *See supra* Part II.A.

119. 5 COLLIER ON BANKRUPTCY, *supra* note 5, at 547-9.

only remaining rationale for making repayments on intraday overdrafts avoidable. But in this context, maximizing the estate and ensuring equal distribution are in tension.[120] This Part looks at competing conceptions of the purpose of bankruptcy law to explain this tension and to argue that maximizing the estate should be valued over equality of distribution. This Part also applies a Cosean analysis to the problem, finding that, in a world of zero transaction costs, creditors would bargain for banks to extend intraday credit free from preference liability. Thus, to avoid continued costly litigation, a clear and controlling legal rule is needed to decisively settle the intraday overdraft issue in favor of good bankruptcy and payment systems policy.

A. *THE BANK AS CREDITOR*

Because banks are able to dishonor a check before the midnight deadline, there is no reason for them to expend resources "racing to the courthouse to dismember the debtor" for an intraday overdraft.[121] Instead of suing to recover from the debtor (a costly remedy),[122] a bank can simply dishonor the check before the midnight deadline to avoid taking the financial loss in the first place.[123] Because a bank therefore has no reason to try to collect from its customer,[124] one of the primary policy rationales behind preferential transfers—preventing a "race to the courthouse"—does not apply to intraday credit. Thus, the sole policy rationale supporting avoiding preferential transfers in the context of intraday overdrafts is "the prime bankruptcy policy of equality of distribution among creditors of the debtor."[125] This policy encompasses both equalizing distribution to creditors and maximizing their recovery.[126] And in the context of intraday credit, these policies come into tension.

B. *RESOLVING CONFLICTING POLICY CONCERNS*

Every time one creditor receives payment from a debtor, there are less funds available for other creditors.[127] As a result, if intraday overdrafts are not debts, such that payments to banks during the 90-day preference period are

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120. *See infra* Part IV.B.

121. 5 COLLIER ON BANKRUPTCY, *supra* note 5, at 547-9.

122. POSNER, *supra* note 43, at 546.

123. *See supra* Part II.D.

124. It is unclear if there is even a cause of action for provisional credit. But even if there is not a cause of action, that does not keep there from being a claim under the Code. *See supra* note 90 and accompanying text.

125. 1 COLLIER ON BANKRUPTCY, *supra* note 5, at 1-4 (quoting Union Bank v. Wolas, 502 U.S. 151, 161 (1991)) (internal quotation marks omitted). For an explanation of how avoiding preferential transfers ensure equal distribution among creditors, see *supra* text accompanying notes 46–48.

126. Providing the debtor with a fresh start, though a central policy of bankruptcy law, is not implicated in the context of preferential transfers. *See supra* Part II.A.

127. *See supra* text accompanying notes 46–48.

unavoidable, banks may receive a greater share from the debtor than other creditors. Thus, declining to treat intraday overdrafts as debts may lead to unequal distribution to creditors.[128]

On the other hand, declining to treat intraday overdrafts as debts actually maximizes the return for creditors collectively over the long run.[129] Were banks forced to protect themselves from avoidable preferences by dishonoring all intraday overdrafts, debtors in difficult financial situations would lose an important financial service.[130] In fact, one court found that:

> Like the termination of basic utilities, premature termination of such essential payment and collection services at the first suggestion of insolvency would turn many a lean spell for companies into sure bankruptcy. In the end, such a rule would hurt more creditors than it would help, "would in many cases make banks hesitate to honor checks given to third persons, would precipitate bankruptcy and so interfere with the course of business as to produce evils of serious and far-reaching consequence."[131]

As these broad consequences make clear, although making payments on intraday overdrafts unavoidable may result in the unequal division of an estate in particular bankruptcy proceedings, over time, creditors will collectively benefit from fewer premature bankruptcy proceedings involving only temporarily insolvent debtors.[132] Thus, there is a tension between the policy of equal distribution among the parties before the court, and the policy of promoting efficient longer-term incentives.[133]

This tension reflects the long-standing divide between traditionalists and proceduralists on the proper role of bankruptcy law.[134] Traditionalists believe

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128. *See supra* note 29.

129. *See infra* text accompanying notes 134, 148–50. This is a proceduralist perspective: bankruptcy should seek to maximize the efficiency of pre-litigation activity. *See infra* text accompanying note 140.

130. *See supra* text accompanying note 114.

131. Bernstein v. Alpha Assocs., Inc. (*In re* Frigitemp Corp.), 34 B.R. 1000, 1020 (S.D.N.Y. 1983) (quoting Studley v. Boylston Nat'l Bank of Bos., 229 U.S. 523, 529 (1913)).

132. *See infra* text accompanying notes 148–53; *see also* Daniel J. Bussel, *The Problem with Preferences*, 100 IOWA L. REV. BULL. 11, 17 (2014) ("[P]reference law is not and should not be a single-minded pursuit of equality of distribution without consideration of complementary, and even countervailing policies.").

133. This tension is not unique to intraday overdrafts. *See* Brook E. Gotberg, *Conflicting Preferences in Business Bankruptcy: The Need for Different Rules in Different Chapters*, 100 IOWA L. REV. 51, 59 (2014) ("Equal distribution, although it forms the underlying justification for pursuing preferences in the first place, is consistently undermined by the other important policies, particularly in the context of debtor reorganization.").

134. Douglas G. Baird, *Bankruptcy's Uncontested Axioms*, 108 YALE L.J. 573, 576–80 (1998); Ted Janger, *Crystals and Mud in Bankruptcy Law: Judicial Competence and Statutory Design*, 43 ARIZ. L. REV. 559, 566 (2001). Note that Warren subscribes to the traditionalist viewpoint, while Baird writes from a proceduralist prospective. Warren summarizes their respective positions as follows:

that bankruptcy law functions to guide the court in determining what the best outcome is for the *specific parties involved*.[135] This is done by examining and adapting to the debtor and creditors' unique situation and providing a framework for them to negotiate and work things out.[136] In this way, traditionalists argue that bankruptcy is a unique area of law because the court is not concerned with regulating pre-litigation activity through incentives to avoid litigation, but with balancing the interests of the parties before it.[137]

Proceduralists, on the other hand, argue that bankruptcy law—like torts (wanting fewer accidents) or contracts (wanting people to keep their promises)—is result-oriented.[138] In bankruptcy, the desired result is maximizing the collective wealth of creditors.[139] Accordingly, proceduralists believe that good bankruptcy law provides future parties with the proper

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> Professor Baird and I hold very different views of the purpose bankruptcy law serves. I see bankruptcy as an attempt to reckon with a debtor's multiple defaults and to distribute the consequences among a number of different actors. . . . By contrast, Baird has developed a coherent, unified view of bankruptcy that revolves around a single economic construct. According to Baird . . . all bankruptcy laws are to be tested by a single measure: whether they enhance or diminish the creditors' collective benefits.

Warren, *supra* note 16, at 777. But also note that Baird seems to think that these differences are largely methodological, and not a matter of first principles. *Cf.* Baird, *supra*, at 599 ("The fundamental difference between traditionalists and proceduralists lies in the questions they think are worth asking and the problems they think are worth studying.").

135. *See* Baird, *supra* note 134, at 593 (noting the traditionalist belief that a bankruptcy judge's discretion is a great value).

136. *See id.*

137. *Id.* at 596.

> The traditionalists believe the world of bankruptcy can be meaningfully separated from every other part of our legal universe. In other words, the traditionalists' axioms reflect a conviction that bankruptcy is fundamentally different from other kinds of legal regimes. This position is difficult for an instrumentalist to hold. But traditionalists are not instrumentalists; in much of their analysis, they rely more on intuition than cold reason. Traditionalists might even concede as much, though they might also add—with some justification—that the leap of faith the proceduralists make in embracing the efficacy and importance of markets relies on intuition every bit as much.

Id. Warren, a traditionalist, effectively concedes this: "Baird begins with hypothetical behavior and ends with firmly fixed answers. I begin with a historical observation about legal structures . . . and I end only with tentative conclusions and more complex questions." Warren, *supra* note 16, at 777–78.

138. Baird, *supra* note 134, at 595 ("One may be able to explain the differences between proceduralists and traditionalists not by identifying their axioms, but by examining their beliefs about what it is they think the bankruptcy laws can and should do. For the proceduralists, bankruptcy law should be treated the same as any other area of law, and other laws are conventionally justified on instrumentalist grounds. [For example, w]e justify tort law because it deters negligent behavior. . . . We enforce contracts because we want people to be able to count on promises that others make.").

139. *See id.*

incentives to alter their pre-litigation activity to achieve this result.[140] From a proceduralist perspective, bankruptcy law primarily exists to incentivize sound pre-litigation conduct.[141]

In other words, traditionalists think that bankruptcy law should be practiced *ex post*, seeking to achieve the best outcome with respect to the *particular parties* in a particular case,[142] and proceduralists think that it should be practiced *ex ante*, providing incentives for future parties to take the most efficient actions available.[143]

The problem of intraday overdrafts throws these opposing philosophies into sharp relief: if equal distribution for the parties in front of the court is the primary concern, then intraday overdrafts should be considered extensions of credit and their repayment should be an avoidable preference. This is because traditionalists are not concerned with the effects a rule may have on future parties, only the present litigants. Conversely, proceduralists, whose primary concern is incentivizing beneficial pre-litigation conduct, will elect an inequitable distribution of assets to the present parties if necessary to reduce the number and severity of future financial failures and consequent losses to creditors.

The reasoning of the *Agriprocessors* court is thus in line with proceduralists insofar as it considers future effects. Those courts reasoned that bankruptcy law should not present a barrier to "the strong federal policy in favor of expedited funds availability."[144] Proceduralists would use a similar analysis, looking at future effects instead of simply doing justice to the present

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140. Donald R. Korobkin, *The Role of Normative Theory in Bankruptcy Debates*, 82 IOWA L. REV. 75, 118 (1996).

141. Donald R. Korobkin, *Rehabilitating Values: A Jurisprudence of Bankruptcy*, 91 COLUM. L. REV. 717, 732 (1991).

142. Baird, *supra* note 134, 589–90; *see also id.* at 589 ("The traditionalists believe that bankruptcy law can largely ignore ex ante effects and that it can push parties in beneficial directions in which they would not otherwise go.").

143. *Id.* at 579–80.

> In short, the traditional bankruptcy experts believe that: (1) the preservation of firms (and therefore jobs) is an important and independent goal of bankruptcy; (2) contemplation of the rights and needs of the parties before the court matters more than the effects on incentives before the fact; and (3) bankruptcy judges should enjoy broad discretion to implement bankruptcy's substantive policies. The proceduralists, on the other hand, believe that: (1) the preservation of firms is not an independent good in itself; (2) ex ante effects are important; and (3) the judge, after controlling for the biases and weaknesses of the parties and resolving the legal disputes, must allow the parties to make their own decisions and thereby choose their own destinies.

Id.

144. Sarachek v. Luana Sav. Bank (*In re* Agriprocessors, Inc.), 490 B.R. 852, 878 (Bankr. N.D. Iowa 2013) (citation omitted) (internal quotation marks omitted).

parties.[145] But, with one exception,[146] these courts have not examined the effect their holdings would have on future debtors and creditors, but considered only the effect on the national payment system as a whole.[147]

Even though the courts' did not rely on the benefits to future debtors and creditors when arriving at their holdings, these benefits provide further support for the policy-based rationale that underpinned those decisions. From a proceduralist viewpoint, banks should not be penalized for extending intraday credit because it maximizes creditor wealth over the long term.[148] Were they to face penalties, banks may force wavering debtors into bankruptcy, where creditors may not receive complete repayment.[149] Thus, the strict equality of distribution approach—following the traditionalist concern for the parties *in a specific case*—fails to recognize that avoiding transfers that cover provisional overdrafts would be inefficient because it "would hurt creditors more than help."[150] Thus, although creditors in each case may wish to recover payments made to banks to cover intraday overdrafts, they would be harmed in the long run if they were able to do so.

This leads to the possibility of a "creditors bargain" model: a hypothetical negotiation where, before the bankruptcy, creditors would bargain together for an allocation of their rights and the debtor's assets.[151] In this model, creditors would certainly bargain for banks to extend intraday credit without fear of preferential transfer liability. They would do so because the intraday credit allows debtors another chance to stay afloat by allowing them until the midnight deadline to secure the funds necessary to cover the overdraft. Intraday credit ensures that debtors are not prematurely forced into bankruptcy, where creditors are unlikely to recover the full amount of their claims. Because the transaction costs of this bargain are prohibitively high in reality, it will never occur.[152] But, assuming zero transaction costs, creditors would reach this bargain because it is in all creditors' best interests to free banks from liability on intraday overdrafts.[153] Since this bargain would occur

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145. *See supra* note 138.

146. Bernstein v. Alpha Assocs., Inc. (*In re* Frigitemp Corp.), 34 B.R. 1000, 1020–21 (S.D.N.Y. 1983).

147. *See supra* Part III.B.

148. *See supra* notes 129–32 and accompanying text.

149. *See supra* notes 16–18 and accompanying text.

150. *In re Frigitemp Corp.*, 34 B.R. at 1020.

151. *See* Korobkin, *supra* note 140, at 117–19 (discussing the "creditors bargain" model).

152. R.H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1, 15 (1960) ("In order to carry out a market transaction it is necessary to discover who it is that one wishes to deal with, to inform people that one wishes to deal and on what terms, to conduct negotiations leading up to a bargain, to draw up the contract, to undertake the inspection needed to make sure that the terms of the contract are being observed, and so on. These operations are often extremely costly, sufficiently costly at any rate to prevent many transactions that would be carried out in a world in which the pricing system worked without cost.").

153. *See supra* text accompanying notes 131–32.

with zero transactions costs, it is the most efficient allocation of rights.[154] "Even when it is possible to change the legal delimitation of rights through market transactions, it is obviously desirable to reduce the need for such transactions and thus reduce the employment of resources in carrying them out."[155] Here, the optimal "delimitation of rights" is for banks to be free from preference liability on intraday overdrafts.

The *Agriprocessors* court recognized this optimal system; it "underst[oo]d the economic consequences of [its] decisions and . . . [took] these consequences into account when making [its] decisions."[156] Namely, the court recognized that defining intraday overdrafts as debt would be disastrous for payment systems policy. This Part expanded on that analysis by showing how creditors benefit from the results in these cases because they enact the bargain that creditors and banks would strike, and because "it is obviously desirable to reduce the need for such transactions and thus reduce the employment of resources in carrying them out."[157] But despite the *Agriprocessors* decision, transaction costs remain in the form of continued uncertainty and litigation over the status of intraday overdrafts in the Code. Although *Agriprocessors* is a decision with the force of law, it is only controlling in its local bankruptcy court.[158] Because intraday credit falls within the technical definition of "debt," litigation will almost certainly continue in other courts.[159] Moreover, and perhaps more importantly, the courts have an obligation to apply the Code according to its terms,[160] and "the delimitation of rights is also the result of

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154. Steven G. Medema, *Through a Glass Darkly or Just Wearing Dark Glasses?: Posin, Coase, and the Coase Theorem*, 62 TENN. L. REV. 1041, 1045 (1995) ("*The Problem of Social Cost* demonstrated that in a regime of zero transaction costs (the assumption of standard economic theory) negotiations would always lead to a solution which maximized wealth." (internal quotation marks omitted)).

155. Coase, *supra* note 152, at 19.

156. *Id.*; *see supra* text accompanying notes 109–16.

157. Coase, *supra* note 152, at 19.

158. Troy A. McKenzie, *Judicial Independence, Autonomy, and the Bankruptcy Courts*, 62 STAN. L. REV. 747, 782–83 (2010) ("[D]isputes that are resolved at the bankruptcy court level and go no further may create formal legal rules but ones with a reach limited to the local bankruptcy court."); *see also id.* at 784–85 ("[D]istrict judges in one district are not bound by the bankruptcy decisions of district judges in any other district. Moreover, in multi-judge district courts, there is no 'law of the district' binding district judges, so one district judge's decision in a bankruptcy appeal might not be followed by another district judge in the same district.").

159. Even though "a particular judicial decision may exert greater influence because of the persuasiveness of its reasoning or the reputation of the bankruptcy judge rendering the decision," that presumes that litigation has already commenced. *Id.* at 783 n.188. And this litigation will continue because "the vast majority of published cases decline to impose sanctions against a plaintiff or counsel in a failed preference action." Jeremy M. Campana & Garrett A. Nail, *Preference Actions and Diligence Requirements: Counsel Beware*, AM. BANKR. INST. J., July 2013, at 44, 51. Thus, Trustees have no reason not to bring the action, especially where the Trustee is simply seeking an application of the statute. *See supra* Part III.A.

160. *See* United States v. Ron Pair Enters., Inc., 489 U.S. 235, 241 (1989) ("[W]here, as here, the statute's language is plain, 'the sole function of the courts is to enforce it according to its terms.'" (citation omitted)).

statutory enactments."[161] To ensure that sound policy and proper statutory interpretation are consistent with one another, the next Subpart proposes an amendment to § 547 that would provide an exception for intraday overdrafts.

C. *An Exception to § 547 for Payments on Intraday Overdrafts*

Agriprocessors supports both payment systems policy and, as explained above, the policy of maximizing distribution to creditors over time to such a degree that creditors would freely bargain for the interpretation that those cases adopted.[162] But the feature that distinguishes provisional credit from non-provisional credit—and, by extension, non-antecedent debt from antecedent debt—is not whether it makes for sound financial policy, but whether the bank is able to unilaterally dishonor payment.[163] As a result, Congress should amend the Code to except intraday overdrafts from "antecedent debt." It would also remedy the discrepancy between the terms of the Code and their application in the context of intraday overdrafts.[164] This is a desirable outcome because "the sole function of the courts is to enforce [the Code] according to its terms,"[165] something that they have not done in the context of intraday overdrafts.[166]

In the cases, the fact that distinguished between provisional credit and non-provisional credit (intraday overdrafts versus true overdrafts) was the bank's ability to recover from a third party.[167] In light of this fact, the following should be added to § 547: "A payment made to a bank on account of an antecedent debt, while that bank is able to recover on its claim from a third party, is not a preferential transfer."

Because claims that a bank can resolve without recourse to the debtor do not fall within the scope of policy justifications for preferential transfers,[168] Congress should exempt these claims from preference liability.

V. Conclusion

There is currently a dilemma in applying the Code to intraday overdrafts. Courts have two options. Interpreting "claim" to not include intraday

161. Coase, *supra* note 152, at 28; *see also* Herbert Hovenkamp, *Fractured Markets and Legal Institutions*, 100 IOWA L. REV. 617, 655 (2015) ("Absolute rules are necessary when the social costs of the wrong outcome are high and we cannot trust participants to reach the correct outcome on their own, or else when permitting them to bargain itself imposes significant social risk.").

162. *See supra* Part IV.B.

163. *See* Sarachek v. Luana Sav. Bank (*In re* Agriprocessors, Inc.), 490 B.R. 852, 877 (Bankr. N.D. Iowa 2013) (distinguishing apparently similar cases on the basis that "there was not the same sort of transaction subject to dishonor").

164. *Compare* Part III.A, *with* Part III.B.

165. *Ron Pair Enters., Inc.*, 489 U.S. at 241 (quoting Caminetti v. United States, 242 U.S. 470, 485 (1917)) (internal quotation marks omitted).

166. *See supra* Part III.B.

167. *See supra* Part III.B.

168. *See supra* Part IV.

overdrafts would not only contravene current law,[169] but it would also restrict the relief available to future debtors.[170] Applying the terms of the Code as they are written, however, will threaten the liquidity of national payment systems and "produce evils of serious and far-reaching consequence."[171]

Instead, courts have chosen a third way: ignore the Code, and decide based on pure policy. But courts are tasked with applying the Code, not making policy judgments. And here courts have only obliquely noted that the Code directs a contrary result.[172] There is good reason for taking this third way, but Congress should make it unnecessary by providing a statutory exception for intraday overdrafts under § 547. Not only will this eliminate needless litigation, it will also ensure that the courts are no longer stuck "between the strong federal policy in favor of expedited funds availability and a Bankruptcy Code that treats advances as loans and their reduction as preferences."[173]

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169. *See supra* Part III.B.

170. *See supra* text accompanying notes 61–65.

171. Bernstein v. Alpha Assocs., Inc. (*In re* Frigitemp Corp.), 34 B.R. 1000, 1020 (S.D.N.Y. 1983).

172. *See supra* text accompanying notes 114–15.

173. Laws v. United Mo. Bank of Kan. City, 98 F.3d 1047, 1051 (8th Cir. 1996).