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Delaware Bankruptcy Court Holds Section 547(c) "Substantially Contemporaneous" Requirement is Governed by a Totality of the Circumstances Analysis

By William H. Schorling and Shanisa Darby[1]

The District of Delaware Bankruptcy Court, in *Burtch v. Connecticut Cmty. Bank (In Re J. Silver Clothing, Inc.)*, (Bankr. D. Del. 2011), recently addressed the relationship between § 547(c)(1)(B) and § 547(e)(2) of the Bankruptcy Code. In 2004, Connecticut Community Bank, N.A., d/b/a Greenwich Bank and Trust Company ("the Bank ") gave J. Silver Clothing, Inc. ("the Debtor") a revolving credit loan in exchange for a first lien on the Debtor's assets. Two days after the parties entered into the loan agreement, the Bank's counsel mailed the required UCC-1 Financing Statement to perfect its security interest. The UCC-1 was rejected by the Delaware Division of Corporations for failure to properly list the Debtor's address. The Bank's counsel mailed a corrected UCC-1 two days after receiving the rejected UCC-1. The Division of Corporations stamped the Bank's second UCC-1 as filed 28 days after the loan. The Debtor subsequently filed for bankruptcy and the chapter 7 Trustee brought a preference action against the Bank, claiming that the transfer of the security interest to the Bank was not substantially contemporaneous with the granting of the loan, as required by 547(c)(1)(B).

In determining whether the Debtor's grant of a security interest was substantially contemporaneous with the Bank's loan to the Debtor, the Bankruptcy Court faced an issue that has not been addressed by the Third Circuit: whether § 547(e)(2) functions as a bright line limit on the requirement set forth in § 547(c)(1)(B) that a transfer must be both, intended by the debtor and the creditor to be a contemporaneous exchange, and, in fact, be a substantially contemporaneous exchange to be exempt from a Trustee's avoidance powers. Section 547(e)(2), as in effect at the time, provided a 10 day time limit (since amended to provide a 30 day time limit) for the parties to perfect a transfer in order for the transfer to occur at the time the security interest is effective. If not perfected within the period provided in § 547(e)(2), the transfer of the security interest will be deemed to occur at the time it is perfected. The Court held that § 547(e)(2) does not limit the substantially contemporaneous requirement of § 547(c) and accepted the interpretation held by the majority of the Courts of Appeal, that a court must examine the totality of the circumstances to determine if a transfer is substantially contemporaneous.

The Court concluded that the 10-day limit in § 547(e)(2) serves the independent "essential purpose of determining when a transfer is made, which must be established in order to ascertain whether the transfer occurred during the preference period."[2] The Court found that the modifier "substantial" requires that the court use a flexible case-by case analysis.[3] The Court relied on the decision in *Hayes v. Lemmertz*, 329 B.R. 136 (Bankr. D. Del. 2005), which

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[2] Burtch (*In Re* J. Silver Clothing, Inc.) v. Connecticut Cmty. Bank, at *19.
[3] *Id.* at *18. (internal quotations omitted)

the Court concluded "likely . . . reject[ed] the 10-day, bright line rule."[4] The Court also held that in examining the totality of the circumstances it will look into "the reason for delay, the intent of the parties, and the possibility of fraud."[5]

In applying the foregoing to the circumstances of the case, the Court found that "a twenty-eight day delay does not disqualify a transfer from being deemed substantially contemporaneous." The Court found that the Bank promptly submitted a UCC-1 only two days after the transfer, and that the error in the Debtor's address on the form, which caused the initial rejection of the statement and delay, was "not purposeful" nor due to any "lack of concern" of the parties.[6] The Court also noted that no third parties were prejudiced by the delay and granted summary judgment in favor of the Bank, concluding that the Bank had a "secured, valid, and perfected security interest" in the assets.[7]

In summary, the requirement in § 547(c)(1)(B) of the Bankruptcy Code that a transfer be "substantially contemporaneous," to be exempt from a Trustee's avoidance powers, is not limited by the time period in § 547(e)(2), but is dependent upon an analysis of the totality of the circumstances, including the intent of the parties, the reason for delay, and the possibility of fraud. The decision is important to secured creditors who perfect their security interest outside the 30 day period in § 547(e)(2) because they still may be able to defend against avoidance by establishing that the perfection of the security interest was substantially contemporaneous.

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[4] *Id.* at *19.
[5] *Id.* at *20.
[6] *Id.* at *21.
[7] *Id.* at *21, 26.