Physics Informs Law: Analyzing Legal Issues that Turn on the Scale of Observation

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Abstract

Payments made to creditors on the eve of a debtor’s bankruptcy raise two fundamental legal questions: how should commercial law and bankruptcy law harmonize when they intersect, and to what extent should the latter preempt the former? Superficially, the answers might appear clear. Bankruptcy law avoids preferential transfers to creditors of an insolvent debtor’s property made within ninety days prior to its bankruptcy. Under the Constitution’s Supremacy Clause, federal bankruptcy law should preempt inconsistent state commercial law governing the transfers. Under commercial law, however, most monetary transfers come from property of the debtor’s bank, not from property of the debtor. Logically, therefore, bankruptcy law should not even apply to those transfers.

Unfortunately, most courts, including the U.S. Supreme Court, hold that these transfers can be avoided as preferential because judges miss the crucial fact that the payments are not transfers of a debtor’s property. This Article argues that this extraordinary judicial failure arises because commercial and bankruptcy law have different scales of observation: the former views transactions from a detailed or “micro” perspective, whereas the latter views transactions from a broader or more “macro” perspective. This difference parallels physics, in which quantum mechanics accurately describes micro interactions in the physical world whereas classical (Newtonian and Einsteinian) physics accurately describes interactions from a more macro perspective. Just as recognizing these different scales of observation informs our understanding of the physical world, a similar recognition should inform our legal understanding. That recognition is critical; its absence is causing courts mistakenly to avoid up to hundreds of millions of dollars of payments annually.

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Physics Informs Law
INTRODUCTION

Physics addresses the interaction of matter and energy in the physical world.\(^2\) Although the classical physics formulated by Newton and Einstein describes that interaction in the world as we ordinarily see it,\(^3\) quantum mechanics more precisely describes that interaction at a micro level involving sub-atomic particles.\(^4\) An accurate understanding of the physical world thus turns on the scale of observation.\(^5\)

\(^4\) See, e.g., Tom Siegfried, Quantum Reality, SCIENCE NEWS, available at https://www.sciencenews.org/century/quantum-physics-theory-revolution-reality-uncertainty (quantum mechanics is “the theory for describing the physics of the microworld, where atoms and molecules interact”). For example, the uncertainty principle of quantum mechanics holds that it is impossible to precisely and simultaneously determine both the position and momentum of a sub-atomic particle. See Uncertainty Principle, in Merriam-Webster Dictionary, available at https://www.merriam-webster.com/dictionary/uncertainty%20principle.
An accurate understanding of intersecting bodies of law can also turn on the scale of observation. Different bodies of law are not always mutually consistent. Some bodies of law, such as bankruptcy law, should be interpreted broadly and thus viewed at a macro level. Other bodies of law, such as commercial law, should be interpreted narrowly and thus viewed at a more micro level. The intersection of these bodies of law can make legal outcomes uncertain.

This Article examines how the intersection of bankruptcy and commercial law creates uncertainty whether a transfer of money may be avoided (that is, rescinded) as preferential. This “preferential transfer uncertainty” arises because bankruptcy law avoids transfers of an insolvent debtor’s property, made within ninety days prior to its bankruptcy, that prefers certain creditors over others. Most such transfers are monetary repayments of debt claims. The intersection of bankruptcy and commercial law, however, can obscure whether those monetary transfers involve...

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6 See, e.g., Christoph Engel, Inconsistency in the Law: In Search of a Balanced Norm, MAX PLANCK INST. FOR RESEARCH ON COLLECTIVE GOODS Preprint No. 16 (2004) (observing that “the law is not always consistent,” and arguing that should not be problematic because “consistency comes at a price”). Cf. Andrew Allan Higgins, The Rule of Law Case Against Inconsistency and in Favour of Mandatory Civil Legal Process, 39 OXFORD J. LEG. STUD. 725 (2019) (arguing that deciding similar questions of fact or law in multiple judicial proceedings creates a risk of inconsistent outcomes, and examining methods for avoiding inconsistency); Brian Tamanaha, Understanding Legal Pluralism: Past to Present, Local to Global, 30 SYDNEY L. REV. 375, 375 (2008) (observing that legal “pluralism” creates “multiple uncoordinated, coexisting or overlapping bodies of law”).

7 Cf. infra notes 14-16 and accompanying text (discussing bankruptcy law).

8 Cf. infra note 25 and accompanying text (discussing commercial law).

9 Commercial and bankruptcy law can also intersect in other ways that create uncertainty. For example, when the securities industry changed its practice of investors directly holding securities to an indirect holding system (see Prefatory Note to UCC Article 8 (Investment Securities), describing the indirect holding system), there was uncertainty about the relative rights of investors in those securities and creditors of intermediaries holding those securities. For other examples of how the intersection of commercial and bankruptcy law can create uncertainty, see Steven L. Schwarcz & Nicole T. Phillips, Adjudicating Business and Commercial Disputes: Fixing Failures, in VERBINDUNGLINlien IM RECHT 629-38 (Festschrift for Prof. Christoph G. Paulus, 2022).

10 11 U.S.C. § 547(b). The above summary of § 547(b) is simplified to help the reader understand preferential transfer uncertainty.

11 See, e.g., John D. Ayer et. al., Overview of Avoidance Actions, 23 AM. BANKR. INST. J. 26, 56 (2004) (“Most preferences involve payment of money to satisfy a debt . . . .”). There is nothing fraudulent about these repayments of debt claims; rather, the preferential transfer uncertainty reflects the bankruptcy law policy of equality of distribution. See infra note 19.
the debtor’s property or, instead, property of the debtor’s bank. The resulting uncertainty has serious real-world consequences; this Article argues that it causes as much as half a billion dollars of payments annually to be mistakenly avoided in bankruptcy cases.

Bankruptcy courts routinely observe, and the U.S. Supreme Court has implicitly assumed without meaningful analysis, that such monetary transfers involve the debtors’ property and thus can be avoided. These decisions reflect a “macro” view of the world as bankruptcy courts, as well as bankruptcy practitioners, ordinarily see it. They tend to overlook that at the more micro level of commercial law, monetary payments are transfers of a bank’s, not a debtor’s, property. There may be several reasons for this neglect.

One reason may be that bankruptcy judges and practitioners are not systematically versed in commercial law. Another reason may be that they assume, without getting into details, that federal bankruptcy law would preempt inconsistent state commercial law governing the transfer. Perhaps the most important reason is that bankruptcy judges and practitioners focus broadly to advance bankruptcy law’s rehabilitative and distributional equality policies.

Bankruptcy law

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12 See infra notes 23-25 and accompanying text.
13 See infra note 30 and accompanying text.
14 See infra notes 39-56 and accompanying text.
15 Cf. infra note 48 and accompanying text (observing that none of the litigation counsel for the leading U.S. Supreme Court case on the preferential transfer issue even raised the question of whose funds were being transferred).
16 See infra notes 22-25 and accompanying text (observing that under commercial law, the monetary payments are transfers of a bank’s, not a debtor’s, property).
17 Cf. Craig A. Gargotta, Who Are Bankruptcy Judges and How Did They Become Federal Judges?, FED. LAW., Apr. 2018, at 11-12 (candidates for bankruptcy judgeships need only “attest to their competency in bankruptcy”).
18 Cf. infra notes 108-112 and accompanying text (discussing the constitutional issues).
19 See, e.g., Donald R. Korobkin, Rehabilitating Values: A Jurisprudence of Bankruptcy, 91 COLUM. L. REV. 717, 773 (1991) (observing that the “bankruptcy process is designed to provide this larger perspective” of debtor rehabilitation) and id. at 780 (“One of the most basic maxims in bankruptcy law is that similarly situated claims are to be treated equally.”); Lawrence Ponoroff, Bankruptcy Preferences: Recalcitrant Passengers Aboard the Flight from Creditor Equality, 90 AM. BANKR. L.J. 329, 354 (2016) (the Bankruptcy Code pursues “a more robust fresh start for debtors, greater creditor equality, and enhanced prospects for debtor survival ….”). Cf. Douglas G. Baird, Bankruptcy’s Uncontested Axioms, 108 YALE L.J. 573, 578 (1998) (comparing the views of “traditionalist” bankruptcy judges and practitioners, who believe in bankruptcy’s
gives debtors a wide range of powers to achieve that, including the power to avoid preferential transfers. Sitting as courts of equity, bankruptcy judges embrace an exceptionalist role whereby they wield widespread discretion and apply “rough justice” in exercising those powers. Viewed at that outwardly macro level, any payment of an insolvent debtor’s creditors within 90 days of the debtor’s bankruptcy would appear, intuitively, to come from the debtor’s property. The fungibility of money would support that intuitive view by further obscuring the source of the funds.

At the micro level of commercial law, however, those monetary transfers do not involve the debtors’ property. The reason is that, other than for retail payments (for example, a consumer paying from a digital wallet or simply physically handing cash to a creditor), virtually all monetary transfers are made through banks. As later explained, if a debtor requests a bank to pay a creditor and if the bank accepts that request, the bank will transfer the money from its own funds. Being a transfer of the bank’s (not the debtor’s) property, such payment should not be avoidable as a preference. After making such payment, however, the bank would have a right to be reimbursed from the debtor and any such reimbursement payment could itself be avoidable as a preference.

rehabilitative policies, with the views of “proceduralist” law-and-economics scholars who “worry intensely about how rules in bankruptcy affect behavior elsewhere”).


22 In re Tribune Co., 972 F.3d 228, 245 (3d Cir. 2020).

23 Such as Venmo or PayPal. See Part I.D, infra.

24 See infra note 90 and accompanying text.

25 See infra note 54 and accompanying text.
Resolution of the preferential transfer uncertainty requires an integrated perspective, viewing bankruptcy law from its macro perspective and commercial law from its micro perspective. Resolving that uncertainty is not only important to the integrity of law but also has real economic significance because virtually all bankruptcy cases involve alleged preferential monetary transfers. Although there are no publicly available data for the amount of those transfers, a rough annual estimate might take into account the yearly bankruptcy filings multiplied by the average preferential monetary transfer per filing. Just focusing on Chapter 11 (corporate reorganization) bankruptcies, there were 5,986 filings for the year ended June 30, 2023, 4,429 for the year ended June 30, 2022, and 6,871 for the year ended June 30, 2021, for an average during that three-year period of 5,762 filings annually. If the aggregate amount of preferential monetary transfers per filing averaged only $100,000, that would yield $57,620,000 of such transfers annually. In the author’s experience, though, preferential transfers can be much larger in Chapter 11 cases. In one such case for which the author recently served as an expert witness on preferences, for example, the alleged preferential transfer was $284 million.

Assuming that the aggregate amount of preferential monetary transfers per filing averaged as much as $1,000,000, that would yield up to $570,620,000 of such transfers annually. Furthermore, the author’s experience is that Chapter 7 (liquidation) bankruptcies often involve preferential monetary transfers. The average number of those filings for the three-year period ended June 30, 2023 was 271,587. If the aggregate amount of preferential monetary transfers per Chapter 7 filing were just $10,000, that would yield $27,158,700.

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The author therefore estimates that the aggregate yearly amount of preferential transfers may be between eighty-five million and half a billion of dollars. Whether or not these transfers should be avoided depends on the resolution of the preferential transfer uncertainty.

Resolving that uncertainty is also essential for preserving commercial law expectations, which is critical to economic efficiency. Uncertainty can increase the cost of funding:

Although strict adherence to [commercial law] requirements may at times lead to harsh results, efforts by courts to fashion equitable solutions for mitigation of hardships experienced by creditors in the literal application of [those] requirements may have the undesirable effect of reducing the degree of reliance the market place should be able to place on [commercial law] provisions. The inevitable harm doubtless would be more serious to commerce than the occasional harshness from strict obedience.

The National Bureau of Economic Research has found that “uncertainty has a direct effect on investment” and that “greater uncertainty tends to make investment less desirable” and “exerts a strong negative influence on investment.” The Southern District of New York found in one instance that uncertainty “would both impair bank financing and increase the costs of obtaining

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29 $57,620,000 + $27,158,700 = $84,778,700.
30 $570,620,000 + $27,158,700 = $ 597,778,700.
34 Id. at 3.
such financing.”

Uncertainty also creates a deleterious impact on “households’ access to small credit” and “leads to higher loan interest rates and default probabilities.”

Focusing on preferential transfer uncertainty as a common theme, this Article proceeds as follows. Part I identifies and examines examples of courts failing to interpret the intersecting provisions of bankruptcy and commercial law based on their different scales of observation. Part I.A discusses the Supreme Court’s decision regarding when payment of a check can be avoided as preferential. Part I.B discusses a bankruptcy court’s decision regarding when payment of a letter of credit can be avoided as preferential, and its impact on the multi-billion dollar letter-of-credit market. Parts I.C and I.D, respectively, explain how electronic funds transfers and other payment mechanisms can similarly raise preferential transfer uncertainty.

Based on those examples, Part II of the Article proposes that in resolving preferential transfer uncertainty (or any similar uncertainty involving the intersection of two or more bodies of law with different scales of observation), one should first analyze the uncertainty from the standpoint of each relevant body of law and its respective scale. Thereafter, one should examine how those analyses best fit together. Part II also applies that resolution to preferential transfer uncertainty, analyzing it from the standpoint of bankruptcy law and commercial and their respective scales and examining how those analyses best fit together.

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38 See infra notes 74-76 and accompanying text (discussing In re Twist Cap, Inc., 1 B.R. 284, 285 (Bankr. M.D. Fla. 1979)).
Finally, Part III of the Article tests the proposed resolution of preferential transfer uncertainty by examining its consequences. To that end, Part III.A examines how the resolution comports with the Supremacy Clause of the Constitution, Part III.B examines its impact on bankruptcy and commercial law statutory policies, Part III.C examines its relationship with agency law, and Part III.D examines its market impact.

I. EXAMPLES

A. Checks

The decision in *Barnhill v. Johnson*\(^{39}\) shows that confusion about the scale of observation can mislead even the U.S. Supreme Court. The controversy concerned when payment of a check under the Uniform Commercial Code ("UCC") should be preferential, and thus avoidable, under the Bankruptcy Code. A check is a type of draft: a request\(^{40}\) from one party, \(X\) (the drawer), to \(X\)'s bank (the drawee bank) to pay a third party, \(Y\) (the payee).\(^{41}\) Once the drawee bank accepts that request, it becomes independently obligated to make that payment.\(^{42}\) After making that payment, the drawee bank has a reimbursement claim against the drawer.\(^{43}\)

In the *Barnhill* case, the drawer of the check was insolvent. More than 90 days before its bankruptcy, the drawer delivered the check to one of its creditors. Within that 90-day period, the drawee bank paid the check.\(^{44}\)


\(^{40}\) In UCC parlance, this is referred to as an “order.” UCC § 3-104(e). Notwithstanding the connotation of an order as being a mandatory command, the UCC clearly states that an order is not binding on a bank until the bank accepts it. UCC § 3-408.

\(^{41}\) UCC § 3-104(e) (Am. Law Inst. & Unif. Law Comm’n 1977). The drawer is thus a customer of the drawee bank.

\(^{42}\) See UCC § 3-409 (defining acceptance) & 3-3-413 (defining the obligation of a bank upon acceptance to pay the draft).


\(^{44}\) *Barnhill*, 503 U.S. at 393–403.
The drawer’s trustee in bankruptcy argued that the creditor would have to return the payment because it constituted a preferential transfer of the drawer’s property under § 547(b) of the Bankruptcy Code. The Court heard the appeal in order to determine when the transfer of property occurred: on the date the check was delivered to the creditor (outside the 90-day preference period), or on the date the bank paid it (within that 90-day period).

The Court held that the transfer occurred on the date the bank paid the check, and therefore was preferential. That decision implicitly viewed the transfer from a macro level, that payment of a check transfers money from a drawer to its creditor. The Court overlooked the micro view: When a check is paid, whose property is being transferred? Remarkably, none of the litigation counsel raised that question.

Viewed from a micro level, payment of a check constitutes a transfer of the drawee bank’s funds, not of the drawer’s funds. This reflects that a checking account is a type of deposit account, and deposit accounts evidence loans from a depositor—in this case, the drawer—to its bank. Money collected from depositors does not sit in a segregated bank account in trust for the

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45 Id. at 395. Section 547 of the Bankruptcy Code allows avoidance of transfers of property of the debtor if, among other things, such transfers were made on or within 90 days preceding the filing of the bankruptcy petition. 11 U.S.C. § 547(b)(4)(A). More specifically, avoidance requires that the transfer (1) be to or for the benefit of a creditor; (2) be for or on account of an antecedent debt owed by the debtor; (3) be made while the debtor was insolvent; (4) be made on or within 90 days before the date of the filing of the petition; and (5) gives the creditor more than it would receive under a liquidation. 11 U.S.C. § 547(b).

46 Barnhill, 503 U.S. at 394–95.

47 Id. at 399.

48 This is the author’s conclusion after reviewing the litigation briefs.

49 See, e.g., American Banking Institute, Deposit Accounts as Collateral Under Revised Article 9 (2002), available at https://www.abi.org/abi-journal/deposit-accounts-as-collateral-under-revised-article-9 (“The ‘deposit account’ definition includes virtually all bank accounts except for certificates of deposit.”).

depositors; rather, it belongs to, and is used (for example, to make business loans) by, the bank. 51
Because the bank does not hold the depositor’s money, 52 it necessarily pays a check from its own
money. 53 After paying the check, the bank has a reimbursement claim against the depositor. 54
Because the bank’s money, not the drawer-depositor’s money, is used to pay the check, that
payment cannot be preferential vis-a-vis the drawer. 55

Ironically, the Court in Barnhill acknowledged that it was the bank’s money that was
used to pay the check without interpreting that fact’s significance to bankruptcy law. The Court
observed that “[t]he drawee bank honored the check by paying it. At that time, the bank had a
right to ‘charge’ the debtor’s [that is, the drawer’s] account—i.e., the debtor’s claim against the
bank was reduced by the amount of the check—and petitioner no longer had a claim against the
debtor.” 56

Arguably, therefore, the Barnhill decision is dicta, not a holding, about preferential
transfer uncertainty. The only court to have directly focused on that uncertainty 57 nonetheless

of a bailment, the law transforms into a loan; where ordinary people expect a bailor-bailee
relationship, the law creates a creditor and a debtor.”).

51 Harker, supra note 50, at 561 (“[T]he very concept of legal reserve requirements presupposes
that a certain supplementary fraction of each bank’s deposits will not be held in reserve, and that
such fraction of deposits will be used by banks in their discretion and possibly contrary to the
intentions of a substantial portion of depositors.”).

account” does not “consist[] of money belonging to the depositor and held by the bank. [Rather],
it consists of nothing more or less than a promise to pay, from the bank to the depositor”).

53 A bank keeps reserves on hand for the purpose of paying such requests. In the event that the
amount to be paid surpasses the amount of reserves a bank has set aside for such purposes, the
bank must liquidate its assets to pay such requests. See Harker, supra note 50, at 559–62
(explaining fractional reserve banking).

54 See supra note 43 and accompanying text.

“when The Bank of California paid the amount appearing on the face of the checks to The San
Francisco Bank, it paid out its own money and not that of plaintiff”).

56 Barnhill, 503 U.S. at 399–400 (citations omitted).

57 Prior to the Barnhill case, courts reached similar conclusions without setting forth their
reasoning. See, e.g., In re Howe, 235 F. 908 (D. Mass. 1916) (holding, without clear explanation,
that a payee of a check is not entitled to retain payment made by the drawee bank after the
drawer’s bankruptcy petition).
relied on *Barnhill* as if it were dispositive of the issue. *In re Southern Indus. Banking Corp.*\(^{58}\) concerned whether payment of a cashier’s check, drawn on and paid by a bank at the request of a debtor, involved a transfer of property of the debtor or of the bank. Referencing *Barnhill*, and without engaging in any independent analysis, the bankruptcy court held it involved the former.\(^ {59}\) The court thus avoided the payment as preferential.

**B. Letters of Credit**

The *Barnhill* case involved payment of a check. Like checks, letters of credit are widely used as payment instruments. Furthermore, in many ways, letters of credit and checks are similarly structured.\(^ {60}\)

Recall that a check is a request from one party, X, to X’s bank to pay a third party, Y; that once X’s bank accepts that request, it becomes independently obligated to make that payment; and that after making that payment, X’s bank has a reimbursement claim against X.\(^ {61}\) Letters of credit are similarly structured. They begin with a request from one party, X (the applicant\(^ {62}\)), to X’s bank (the issuer\(^ {63}\)) to pay a third party, Y (the beneficiary\(^ {64}\)), under a letter of credit.\(^ {65}\) Once X’s bank accepts that request and issues the letter of credit, it becomes independently obligated to make that payment.\(^ {66}\) After making that payment, X’s bank has a


\(^{59}\) Id., 189 B.R. at 707.

\(^{60}\) Guarantees that are issued pursuant to the International Chamber of Commerce’s Uniform Rules for Demand Guarantees (URDG 2010 revision), ICC Publication #758 (“URDG 758”), are also common payment instruments. In the author’s experience, they typically are issued as commercial substitutes for letters of credit.

\(^{61}\) See supra notes 40-43 and accompanying text.

\(^{62}\) See UCC § 5-102(a)(2) (defining X in the scenario above as the “Applicant,” the “person at whose request . . . a letter of credit is issued”).

\(^{63}\) See UCC § 5-102(a)(9) (defining X’s bank in the scenario above as the “Issuer” of the letter of credit).

\(^{64}\) See UCC § 5-102(a)(3) (defining Y in the scenario above as the “Beneficiary” of the letter of credit).

\(^{65}\) The applicant is thus a customer of the issuer. Cf. supra note 41 (observing that the drawer of a check is a customer of the drawee bank).

\(^{66}\) See UCC §§ 5-106(a) & 5-108(a).
The only significant difference between an issued letter of credit and an accepted draft is that payment of the former is conditioned on the beneficiary’s submission to X’s bank of conforming documents.

In a typical letter of credit, for example, the applicant is a buyer, and the beneficiary is the seller, of goods. Normally, the seller will not ship the goods without assurance of being paid. To provide that assurance, the buyer may request its bank to issue a letter of credit in favor of the seller. If the bank agrees, it will issue the letter of credit, the payment of which is conditioned on the seller submitting to the bank documents specified in the letter of credit that evidence delivery of the goods to the shipper (such as a bill of lading). After making that payment, the bank has a reimbursement claim against the buyer.

Confusion about the scale of observation at the intersection between letter-of-credit law and bankruptcy law has also confused courts. In In re Twist Cap, for example, a bank issued letters of credit for the account of a company that later went into bankruptcy. The company was obligated to reimburse the bank if the letters of credit were paid, an obligation that was secured by the company’s property. After the letters of credit were issued but before they were paid, the company filed for bankruptcy and sought to restrain the bank from honoring the letters of credit. On the grounds that payment would be preferential, the bankruptcy court enjoined the bank from honoring the letters of credit. The Twist Cap court, like the Supreme Court in Barnhill, thus regarded a bank’s payment as transferring the debtor’s, not the bank’s, property.

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67 See UCC § 5-108(i)(1).
68 A lesser difference is that a letter of credit, unlike a draft, is not transferable unless it provides that it is transferable. UCC § 5-112(a).
69 See UCC § 5-102(a)(10). In other words, a check is an unconditional order from a bank’s customer to its bank to pay a third party, whereas a letter of credit is a conditional order from a bank’s customer to its bank to pay a third party (the condition being satisfied if certain required documents are delivered to the bank).
70 See UCC § 1-201(b)(6) (defining a “Bill of lading” as a “document of title evidencing the receipt of goods for shipment issued by a person engaged in the business of directly or indirectly transporting or forwarding goods”).
72 Id.
73 Id. at 285–86.
The decision in *Twist Cap* profoundly upset commercial expectations. Letters of credit were created precisely to protect the beneficiary (the seller of goods) in the event that the buyer of goods became insolvent.\(^{74}\) In destroying the expectation of protection in the face of insolvency, *Twist Cap* caused a “reaction of the capital markets [that] was volcanic.”\(^{75}\) Industries that frequently used letters of credit saw the decision as a threat, at least one rating agency stopped giving investment-grade ratings when letters of credit were used, and municipalities lamented their loss of access to cheap credit as a result of the decision.\(^{76}\) It took years for the courts to finally rectify the *Twist Cap* decision and restore faith in the value of letters of credit.\(^{77}\)

Some believe “there is still a risk that a court may enjoin a post-petition draw under a letter of credit, at least for a short period, upon finding special circumstances.”\(^{78}\) Nonetheless, the majority view is that “[w]hen the issuer honors a proper draft under a letter of credit, it does so from its own assets and not from the assets of its customer who caused the letter of credit to be issued.”\(^{79}\) At least one case implicitly explains why that does not undermine bankruptcy preference law. In *In re P.A. Bergner & Co.*,\(^{80}\) the court held that funds paid by the applicant to

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\(^{76}\) Dolan, supra note 74, at 388–89.

\(^{77}\) The leading case that restored that faith was *In re Page*, 18 B.R. 713 (D.D.C. 2002). The bank issuing a letter of credit required its customers’ indemnification obligations to be secured by collateral. The federal district court set aside a lower-court’s injunction on payment, reasoning (correctly) that payment would come from the bank, not from the customers who were now in bankruptcy. *Id.* at 716. Paying the letter of credit would give the bank a reimbursement claim against its customers. (Compare *supra* note 54 and accompanying text, observing that after paying a check on behalf of the depositor, the bank has a reimbursement claim against the debtor.) That reimbursement claim, however, would be stayed by the customers’ bankruptcy. *In re Page*, 18 B.R. at 716.

\(^{78}\) Kimberly S. Winick, *Tenant Letters of Credit; Bankruptcy Issues for Landlords and Their Lenders*, 9 AM. BANKR. INST. L. REV. 733, 741–742 (2001). *Cf.* Wysko Inv. Co. v. Great Am. Bank, 131 B.R. 146, 147 (D. Ariz. 1991) (“This Court holds that Sec. 105 does allow the Bankruptcy Court to enjoin letters of credit, but this should be confined to unusual circumstances.”).

\(^{79}\) Matter of Compton Corp., 831 F.2d 586, 589 (5th Cir. 1987).

\(^{80}\) 140 F.3d 1111 (7th Cir. 1998).
reimburse the bank “were recoverable as preferences.”  

The applicant had requested Bank One Milwaukee, N.A. to issue letters of credit in favor of two beneficiaries. Shortly before the applicant filed for bankruptcy, it made certain reimbursement payments to Bank One to cover the bank’s payments that would be made under the letters of credit. The applicant, in bankruptcy, successfully sued the bank to recover those reimbursement payments as voidable preferences.

C. Electronic Funds Transfers

Although the number of payments made by checks might exceed the number made by electronic funds transfers (also called wire transfers), the dollar volume of the latter “far exceeds” the dollar volume of the former. Conceptually, wire-transfer payments closely resemble payments by check. In form, wire transfers are drafts: a request, or order, from one party, X, to X’s bank to pay a third party, Y. Once X’s bank accepts that request, it orders (that is, requests) Y’s bank to make that payment to Y. Once Y’s bank accepts that order, it becomes independently obligated to make that payment:

Although Article 4A follows convention in using the term ‘funds transfer’ to identify the payment from X to Y . . . , no money or property right of X is actually transferred to Y. X pays Y by causing Y’s bank to become indebted to Y in the amount of the payment.

After making that payment, Y’s bank has a reimbursement claim against X’s bank, which turn has a reimbursement claim against X.

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81 Id. at 1113.
82 Id. at 1114.
83 Prefatory Note, UCC Article 4A.
84 Cf. id. (“There is some resemblance between payments made by wire transfer and payments made by . . . paper-based checks . . . .”).
85 See UCC §§ 4A-103(a)(1) & 4A-104(a).
86 See Off. Cmt. No. 1, Case #1, to UCC § 4A-104.
87 Prefatory Note, supra note 83. See also UCC § 4A-209.
88 See UCC § 4A-402. Cf. Prefatory Note, supra note 83 (“When X’s bank executes X’s payment order the bank is entitled to receive payment from X and may debit an authorized account of X.”).
The issue of preferential transfer uncertainty is thus identical for both electronic funds transfers and checks. In both cases, the payment superficially appears to be made from party X, a debtor, to party Y, a creditor. Nonetheless, viewed from a micro level, the payment constitutes a transfer of a bank’s funds, not of the debtor’s funds. After making the payment, the bank has a reimbursement claim that, ultimately, is against the debtor. Therefore, because the bank’s money, not the debtor’s money, is used to pay the creditor, that payment cannot be preferential vis-a-vis the debtor.

D. Other Payment Mechanisms

PayPal and Venmo are among the most widely used other payment mechanisms. These payment mechanisms also raise uncertainty as to whether a transfer of money may be avoided as preferential. A close examination suggests, however, that the resolution of that uncertainty should be different for these payment mechanisms.

A PayPal user, for example, holds a “Balance Account” which represents a claim by the user against PayPal for the amount of any balance in the account. So far, that claim parallels a customer’s claim against a bank deposit account. That parallel may end, however, when the user orders PayPal to pay a third party. Rather than transferring its own funds to the third party,
PayPal appears simply to debit the payment amount from the user’s “Balance Account” and to credit that amount to the third party’s “Balance Account.”\textsuperscript{95} Effectively, that would transfer from the user to the third party the relevant amount of the user’s claim against PayPal. A claim is a right to payment, which is property.\textsuperscript{96} The payment therefore would occur by the user transferring an interest in its property to the third party. That transfer would be preferential if the other statutory requirements of § 547(b) are met.\textsuperscript{97}

Venmo payments appear to be made in a similar fashion. A Venmo user holds a “Venmo Account,” which represents a claim by the user against Venmo for the amount of any balance in the account.\textsuperscript{98} When the user orders Venmo to pay a third party, however, Venmo does not transfer its own funds to the third party. Rather, it simply debits and credits the respective Venmo accounts.\textsuperscript{99} Again, that transfer of a claim would be preferential if the other statutory requirements of § 547(b) are met.\textsuperscript{100}

\textbf{II. PROPOSING A RESOLUTION}

Determining whether payments to creditors constitute potentially preferential transfers of a debtor’s property or non-preferential transfers of a bank’s (or other financial intermediary’s)
property requires an analysis of how bankruptcy and commercial law intersect. The threshold question is whether the payment itself is a transfer of the debtor’s property.\textsuperscript{101}

Because that question arises under bankruptcy preference law, bankruptcy courts—aided by bankruptcy practitioners—normally answer it in the first instance. Their answers tend to be informed by bankruptcy law’s macro scale of observation, under which payments to a debtor’s creditors outwardly appear to come from the debtor.\textsuperscript{102}

The actual mechanics of the payment, however, are governed by commercial law.\textsuperscript{103} For checks, letters of credit, and wire transfers, which effectuate most non-retail payments, a close examination of commercial law makes clear that the payment is a transfer of a bank’s property, not of the debtor’s property.\textsuperscript{104} In contrast, an examination of commercial law indicates that payments made by debtors using PayPal or Venmo are indeed transfers of the debtor’s property.\textsuperscript{105}

To resolve preferential transfer uncertainty, this Article therefore proposes (the “proposed resolution”) that payments made by way of checks, letters of credit, and wire transfers should not be preferential under bankruptcy law.\textsuperscript{106} Part III next tests the proposed resolution by examining its consequences.\textsuperscript{107}

\textsuperscript{101} See supra note 10 and accompanying text.
\textsuperscript{102} See supra notes 15-22 and accompanying text.
\textsuperscript{103} Although the author does not want to overdraw the analogy, the fact that, viewed from a micro level, the “mechanics” of payment are governed by commercial law has a parallel to the fact that quantum “mechanics” describes the micro-level interaction of particles. See supra note 4 and accompanying text.
\textsuperscript{104} See supra notes 39-90 and accompanying text.
\textsuperscript{105} See supra notes 96-97 and accompanying text.
\textsuperscript{106} Stated more broadly, when two or more bodies of law intersect, ask if they have different scales of observations. If so, analyze the issue from the standpoint of each relevant body of law and its respective scale, and then examine how those analyses best fit together.
\textsuperscript{107} Cf. RICHARD POSNER, LAW, PRAGMATISM, AND DEMOCRACY 59 (2003) (arguing that legal reasoning may not exist as an independent concept, and that what really matters is consequences); NEIL MACCORMICK, LEGAL REASONING AND LEGAL THEORY 129-51 (Chapter VI, Consequentialist Arguments) (1994) (discussing the importance of consequences in legal reasoning).
III. TESTING THE PROPOSED RESOLUTION

To test the proposed resolution, subpart A examines how it comports with the Supremacy Clause of the Constitution, subpart B examines its impact on bankruptcy and commercial law statutory policies, subpart C examines its relationship with agency law, and subpart D examines its market impact.

A. Constitutional Law

The proposed resolution advances commercial law over bankruptcy law in determining that certain payments should not be preferential. Students of constitutional law might ask why federal bankruptcy law does not, under the Supremacy Clause,\textsuperscript{108} simply preempt inconsistent state commercial law for resolving preferential transfer uncertainty. Admittedly, if bankruptcy law governed payment mechanics, it could preempt commercial law. As next explained, however, state law, not federal law, governs payment mechanics. The relevant state law—commercial law—provides that payments under checks, letters of credit, and wire transfers are made from a bank’s, not from the debtor’s, property.

In \textit{Butner v. United States},\textsuperscript{109} a unanimous Supreme Court adopted the position, already held by the Second, Fourth, Sixth, Eighth, and Ninth Circuits,\textsuperscript{110} that property rights are determined by state law—even when such rights are being analyzed in a federal bankruptcy case:

\begin{quote}
Property interests are created and defined by state law. Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding. Uniform treatment of property interests by both state and federal courts within a [s]tate
\end{quote}

\textsuperscript{108} The Supremacy Clause of the Constitution, which provides that the Constitution and federal law are the supreme law of the land, makes federal law override inconsistent state law. U.S. CONST. art. VI, § 2.
\textsuperscript{109} 440 U.S. 48 (1979).
\textsuperscript{110} \textit{Id.} at 51-52.
serves to reduce uncertainty, to discourage forum shopping, and to prevent a [debtor] from receiving “a windfall merely by reason of the happenstance of bankruptcy.”  

Although there are no cases directly on point, the Court’s logic appears to apply not only to property rights per se but also to state-law contract rights. Uniform treatment of contracts likewise would reduce uncertainty and would prevent a debtor from receiving a windfall merely by filing bankruptcy to impair rights under those contracts. Furthermore, property is merely a bundle of rights, and it would be inconsistent to treat unbundled rights, such as contract rights, differently from bundled rights for purposes of this analysis.

The only open question is whether, in analyzing preferential transfer uncertainty, “some federal interest requires a different result.” Subpart B.1 below explains why no federal interest requires that.

B. Statutory Policies

Next consider the impact of the proposed resolution on bankruptcy and commercial law statutory policies.

1. Bankruptcy Law Policy. In analyzing preferential transfer uncertainty, state commercial law, not federal bankruptcy law, should govern the payment mechanics unless (as discussed above) some federal interest requires a different result. Bankruptcy law advances two essential federal interests: debtor rehabilitation and equality of distribution. As next discussed, neither interest would require federal bankruptcy law to govern the payment mechanics.

111 Id. at 55 (quoting Lewis v. Manufacturers Nat’l Bank, 364 U.S. 603, 609 (1961) (citation omitted)).
113 See supra notes 108-111 and accompanying text.
114 See supra note 19.
Preferential transfer uncertainty starts as a question of bankruptcy preference law: whether a transfer of an insolvent debtor’s property within 90 days prior to bankruptcy can be avoided.\textsuperscript{115} The principal goal of bankruptcy preference law is to facilitate the policy of equality of distribution.\textsuperscript{116} Superficially, applying state commercial law to the transfer might appear to undermine that goal because it would enable a creditor that is preferentially paid under a check, letter of credit, or wire transfer to retain the payment (because the payment would not be regarded as being made from the debtor’s property).\textsuperscript{117} As explained below, however, applying state commercial law to the transfer would only shift the debtor’s ability to recover the preference from the creditor to the bank. That shift would not undermine the policy of equality of distribution.

Applying state commercial law to the transfer means that the payment would be regarded as being made from the bank’s property.\textsuperscript{118} After making that payment, the bank would have a right to be reimbursed by the debtor.\textsuperscript{119} Any such reimbursement, being a transfer of the debtor’s property, could itself be avoided as preferential if made within 90 days prior to bankruptcy while the debtor was insolvent.\textsuperscript{120} Again, this merely shifts the debtor’s ability to recover the preference from the creditor to the bank. In principle, that shift should be neutral from the debtor’s standpoint.\textsuperscript{121}

Neither would that shift impact the distribution of property, or the equality thereof, made to other creditors of the debtor. To understand why, assume that an insolvent debtor has $100 of assets and $200 of debt. In liquidation, each holder of debt claims would recover 50 cents on the dollar. If the debtor preferentially paid $70 to a holder of a $70 debt claim, that would

\begin{footnotesize}
\textsuperscript{115} See supra notes 9-10 and accompanying text.
\textsuperscript{116} See, e.g., Begier v. IRS, 496 U.S. 53, 58 (1990); In re Melon Produce, 976 F.2d 71, 73 (1992).
\textsuperscript{117} See supra note 16 and accompanying text.
\textsuperscript{118} See supra note 117 and accompanying text.
\textsuperscript{119} See supra note 43 and accompanying text.
\textsuperscript{120} 11 U.S.C. § 547(b). Cf. supra notes 80-82 (explaining why reimbursement by a debtor, of a bank paying a letter of credit, could be avoided as preferential).
\textsuperscript{121} Cf. Levitt v. Ingersoll Rand Fin. Corp. (In re Deprizio), 874 F.2d 1186, 1190 (7th Cir. 1989) (extending the preference period when payment of a loan reduces the amount payable under an insider guarantee).
\end{footnotesize}
significantly impair the recovery of the other debt claims (thereby impairing equality of
distribution).\textsuperscript{122} In bankruptcy, however, the debtor, being insolvent, could avoid (and thereby
recover from the creditor) that preferential payment if it had been made within 90 days before the
bankruptcy.

If that same debtor made the $70 payment by check, it could not, in bankruptcy, avoid
that payment because it came from the drawee bank’s (not the debtor’s) property. However, that
payment by itself would not impair the recovery of the other debt claims (and thus would not
impair equality of distribution) because the debtor’s assets would remain at $100.\textsuperscript{123} Preferential
transfer uncertainty nonetheless would arise if, after making that $70 payment, the drawee bank
obtains reimbursement of that amount from the debtor. That would, again, significantly impair
the recovery of the other debt claims.\textsuperscript{124} In bankruptcy, though, the debtor, being insolvent, could
recover that reimbursement payment from the drawee bank if it had been made within 90 days
before the bankruptcy.

Nor would that shift undermine the bankruptcy policy of debtor rehabilitation. Recovery
of a preferential transfer can facilitate that policy by enabling the debtor to get back assets that it
could potentially use in its reorganization.\textsuperscript{125} Because a drawee bank usually seeks
reimbursement after it pays a check,\textsuperscript{126} a debtor’s reimbursement payment typically would be

\textsuperscript{122} Paying that $70 would reduce the debtor’s assets to $30 ($100 minus $70) and would reduce
its debt to $130 ($200 minus $70). The holders of the remaining debt claims would then recover
only 23 cents (as opposed to 50 cents) on the dollar.
\textsuperscript{123} The debtor’s assets would remain at $100 because the $70 check payment is made from the
drawee bank’s, not the debtor’s, property.
\textsuperscript{124} \textit{Cf. supra} note 122 and accompanying text (discussing that impairment). If the drawee bank
obtains a $70 reimbursement from the debtor, that would again reduce the debtor’s assets to $30
($100 minus $70). Similarly as before, the holders of the debtor’s remaining debt claims—
aggregating $130 ($200 minus the $70 paid by check)—would recover only 23 cents (as opposed
to 50 cents) on the dollar.
\textsuperscript{125} \textit{See, e.g., H.R. REP. NO. 595, 95th Cong., 1st Sess. 177-79 (1977)\textsuperscript{126} (House Committee Report
accompanying the Bankruptcy Reform Act of 1978, stating that the purpose of preference law is
two-fold, debtor rehabilitation and equality of distribution).
\textsuperscript{126} \textit{Cf. F. Garland Russell, Jr., Article 4: Bank Deposits and Collections, 29 Mo. L. REV. 411, 411
(1964)} (observing that the drawee “bank has to reimburse itself through charging the account of
its depositor for amounts which it has paid”).
made at a later date—which would be more likely to be within the 90-day preference period, and thus avoidable.\textsuperscript{127} Moreover, if the debtor files for bankruptcy before the bank receives reimbursement, the bank’s right to reimbursement would be stayed\textsuperscript{128}—leaving it with merely a claim in the bankruptcy case.

\textbf{2. Commercial Law Policy.} One of the most fundamental commercial law policies is consistency of interpretation, which protects expectations and thereby increases efficiency and reduces funding costs.\textsuperscript{129} Viewing the payment of a check as coming from the bank’s property, not the debtor’s, for resolving preferential transfer uncertainty would be consistent with the view—long respected under other provisions of commercial law—that such payment comes from the bank’s property.

For example, a certified check—which is merely a check that a bank has accepted,\textsuperscript{130} meaning the bank has agreed to pay the check as presented\textsuperscript{131}—is viewed as an obligation of the bank to pay from its own property.\textsuperscript{132} That obligation therefore should be respected under bankruptcy law even if the drawer of the check goes bankrupt.\textsuperscript{133} That same rationale should apply to, and similarly resolve, preferential transfer uncertainty: a payment that is made from the bank’s, not the drawer’s, property cannot be preferential.

Another question concerning commercial law policy is whether there is, or should be, a different policy for checks and other drafts, on the one hand, and letters of credit, on the other

\textsuperscript{127} \textit{Cf.} In re P.A. Bergner & Co., \textit{supra} note 80 (holding that funds paid by the applicant to reimburse the bank “were recoverable as preferences”).
\textsuperscript{128} See 11 U.S.C. § 362(a).
\textsuperscript{129} \textit{Cf. supra} notes 31-32 and accompanying text (observing that preserving commercial law expectations is critical to economic efficiency).
\textsuperscript{130} \textit{See} UCC § 3-409(d): “‘Certified check’ means a check accepted by the bank on which it is drawn.”
\textsuperscript{131} UCC § 3-409(a).
\textsuperscript{132} \textit{Cf.} UCC § 3-411(b) (assigning liability to a bank that wrongfully refuses to pay its certified check).
hand. A basis for possibly differentiating those policies is that letters of credit traditionally are governed by the so-called independence principle, which generally provides that the obligation of a letter-of-credit issuer to pay a beneficiary is independent of the underlying business transaction. In the Bergner case, for example, the court stated that “letters of credit really are different from other financing mechanisms, and [the issuer-bank’s] position does not reflect the independent obligations that ran from the bank to the beneficiaries.”

The independence principle does not, however, address whether or not payment of a letter of credit comes from the bank’s property. Rather, it states that the bank’s obligation to make the payment is independent of defects in the underlying business transaction. This is a part of a broader commercial law principle of transferability, which varies the principle of nemo dat in order to reduce transaction costs by obviating the beneficiary’s need to conduct due diligence on the underlying business transaction. That broader commercial law principle applies to checks and other negotiable instruments and to buyers in the ordinary course of goods.

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134 The precise text of the independence principle varies. In § 5-103(d) of the UCC, it reads as follows: the “[r]ights and obligations of an issuer [that is, the bank] to a beneficiary . . . under a letter of credit are independent of the existence, performance, or non performance of a contract or arrangement out of which the letter of credit arises . . . .” The In re P.A. Bergner & Co. case, discussed supra notes 80-82 and accompanying text, relied on the text set forth in the 1983 version of the UCP, Int’l Chamber of Commerce Pub. No. 400: Art. 3: “Credits, by their nature, are separate transactions from the sales or other contract(s) on which they may be based . . . .” Art. 4: “In credit operations all parties concerned deal in documents and not in goods, services and/or other performances to which the documents may relate.” In re P.A. Bergner & Co., 140 F.3d at 1115.

135 Guarantees issued pursuant to URDG 758 (see supra note 60) are subject to a similar independence principle, which is set forth in Article 5.a of those Rules: “A guarantee is by its nature independent of the underlying relationship and the application, and the guarantor is in no way concerned with or bound by such relationship. A reference in the guarantee to the underlying relationship for the purpose of identifying it does not change the independent nature of the guarantee. The undertaking of a guarantor to pay under the guarantee is not subject to claims or defences arising from any relationship other than a relationship between the guarantor and the beneficiary.”

136 See supra note 80 and accompanying text.

137 Id., 140 F.3d at 1119.

138 See UCC §§ 3-302 & 3-305.

139 To facilitate the sale of goods, commercial law gives buyers of goods, in the ordinary course of business, full unencumbered rights to those goods. See, e.g., U.C.C. § 9-320 (Am. Law Inst. & Unif. Law Comm’n 2018) (providing that a buyer of goods in ordinary course of business...
C. Agency Law

This subpart tests the proposed resolution by examining its relationship with agency law. Under the proposed resolution, payments to creditors made by way of checks, letters of credit, and wire transfers should not be preferential because the payment comes from property of a bank or other financial, not from property of the debtor. However, if that bank or other financial institution acts as an agent of the debtor when paying the creditor, should the payment be deemed to be preferential? Subdivision 1 next examines whether that bank or other financial institution acts as an agent of the debtor when paying the creditor. Assuming it does act as an agent of the debtor, subdivision 2 examines whether its payment should be deemed to be preferential.

1. Is the bank or other financial institution that pays a creditor from its own money an agent of the debtor that orders the payment to be made? Under English Commonwealth law, there is authority for viewing a drawee bank as acting as agent for the drawer when making a payment:

   The originator’s bank acts on behalf of the customer, and “the instruction which a customer gives to its bank to effect a transfer of funds is nothing more than an authorization from the customer (the principal) to the bank (the agent) to make payment.”

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takes free of a security interest created by the seller of the goods, even if the buyer knows of the security interest’s existence); U.C.C. § 2-403(2) (AM. LAW INST. & UNIF. LAW COMM’N 2018) (“Any entrusting of possession of goods to a merchant who deals in goods of that kind gives [the merchant] power to transfer all rights of the entruster to a buyer in ordinary course of business”).

In the United States, in contrast, “[t]he relationship between a bank and its depositor is that of debtor and creditor.”\textsuperscript{141} The bank is therefore not an agent of its depositor; accordingly, it would not be an agent if the depositor orders it to make a payment.

A U.S. Tenth Circuit doctrine regarding check payment indirectly relates to agency law. If a bank is a “mere conduit” for payment of a check or other draft, then payment by the bank would be deemed to be made by the party ordering the payment (e.g., the bank’s customer).\textsuperscript{142} A key criterion for determining whether a bank is a mere conduit is whether it exercises legal control over the source of the payment.\textsuperscript{143} If it exercises such control, the bank would not be a mere conduit. Because moneys deposited by a customer become property of the bank\textsuperscript{144} and the bank is not obligated to make a payment ordered by its customer,\textsuperscript{145} the bank exercises legal control over the source of the payment. Accordingly, payment by the bank should not be deemed to be made by its customer.

2. Would payment by an agent, from its own property, be deemed to be payment of the principal’s property for purposes of bankruptcy preference law? This question presumes that the bank or other financial institution that pays a creditor from its own money is an agent of the debtor that orders the payment to be made. The foregoing analysis (in subdivision 1 above) shows that presumption is false under American law. The discussion below therefore merely presupposes, arguendo, the validity of that presumption.

There are no authorities governing whether payment by an agent, from its own property, would be deemed payment of the principal’s property for purposes of bankruptcy preference law. Bankruptcy policy should not mandate that result because, after payment, the right of the bank

\textsuperscript{141} In re Johnson, 355 B.R. 103, 112 (C.D. Ill. 2006).
\textsuperscript{142} Rupp v. Markgraf, 95 F.3d 936 (10th Cir. 1996).
\textsuperscript{143} Cf. id. at 939 (“the minimum requirement of status as a ‘transferee’ is dominion over the money or other asset, the right to put the money to one’s own purposes”).
\textsuperscript{144} See supra note 52 and accompanying text.
\textsuperscript{145} UCC § 3-408.
(or agent) to be reimbursed would itself be subject to bankruptcy preference law.\textsuperscript{146} Moreover, mandating that result could create confusion for letters of credit.\textsuperscript{147}

Given an agent’s right to be reimbursed from its principal, one might argue that viewing payment by the agent from its own property as payment from the principal’s property would reflect commercial reality. The UCC often overrides property law in order to recognize important commercial realities that clash with the “arbitrary shifting” of rights based on property.\textsuperscript{148} No court, however, has advanced that argument. Furthermore, advancing that argument would confront the fact that bankruptcy law, more than the UCC, is traditionally tied to property law.\textsuperscript{149}

For these reasons, the proposed resolution should be consistent with agency law.

D. Market Impact

Overall, the proposed resolution should have neutral market impact.\textsuperscript{150} Although payments made by banks or other third parties to creditors of debtors could not be avoided as preferential, reimbursement payments made by debtors to those third parties might well be preferential, and thus avoidable.\textsuperscript{151}

There might, however, be a possible unintended consequence. The increase of payments to creditors of debtors, being non-preferential, would be generally offset by the reduction of

\textsuperscript{146} See supra notes 81-82 and accompanying text.
\textsuperscript{147} See supra notes 62-63 and accompanying text. That confusion would arise if the issuer-bank were deemed to be an agent of the applicant-debtor. Whether that is the case logically should parallel the analysis of whether a drawee bank on a check is the agent of the drawer/customer.\textsuperscript{148} Cf. Official Comment No. 1 to UCC § 2-509 (observing that the “underlying theory” of commercially allocating the risk of loss is to avoid “an arbitrary shifting of the risk with the ‘property’ in the goods”).
\textsuperscript{150} Courts appear to be paying greater attention to market impact. Cf. Mark J. Roe & Michael Simkovic, “Bankruptcy and the Rise of Market Valuation” (2024 working paper, at 3) (on file with author) (observing the “growing judicial deference to market valuations”).
\textsuperscript{151} See supra notes 79-82 and accompanying text.
reimbursement payments made by such debtors to the banks or other third parties initially making the payment. Because banks and other financial institutions usually are the bedrock of payment systems, the average third party initially making the payment is more likely to be a systemically important financial institution than the average creditor of a debtor. Given that premise, the reduction of reimbursement payments might have a material systemic impact. Being sophisticated, however, those institutions should be able to protect themselves, such as by requiring financially risky debtors to collateralize the reimbursement obligation.  

**CONCLUSIONS**

The intersection of commercial and bankruptcy law creates uncertainties that have long confounded courts. The most critical uncertainty is whether transfers of money may be avoided as preferential.

Bankruptcy law avoids preferential transfers of an insolvent debtor’s property made to creditors within ninety days prior to its bankruptcy. In practice, most allegedly preferential transfers are of money. Under commercial law, paradoxically, nearly all transfers of money are made from property of the debtor’s bank, not from property of the debtor. In principle, therefore, those transfers should not be preferential. Even the U.S. Supreme Court, however, has failed to recognize this paradox, holding that such transfers are preferential.

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152 See, e.g., BANK FOR INTERNATIONAL SETTLEMENTS, PAYMENT SYSTEMS IN THE UNITED STATES (2003), available at https://www.bis.org/cpmi/paysys/UnitedStatesComp.pdf: “[T]here are numerous financial intermediaries that provide payment, clearing and settlement services” in the United States, id. at 433, including “more than 20,000 deposit-taking institutions” that “can be classified as commercial banks or as thrift institutions, such as savings and loan associations and credit unions.” Id. at 436.

153 See 11 U.S.C. § 547(b)(5) (providing that payment cannot be preferential if the party that is paid does not receive more than it would receive in a Chapter 7 liquidation of the debtor). Secured creditors are paid first in a debtor’s liquidation.

154 Cf. supra note 9 (discussing how the intersection of commercial and bankruptcy law can create uncertainties).

155 See supra notes 9-13 and accompanying text (referring to this uncertainty as preferential transfer uncertainty).
This Article attempts to resolve the resulting uncertainty. It argues that commercial and bankruptcy law have different scales of observation, the former taking a micro perspective and the latter taking a more outward, or macro, perspective. Physics provides an analogy: quantum mechanics accurately describes micro interactions in the physical world, whereas classical physics accurately describes interactions from a more macro perspective.

Just as recognizing these different scales of observation informs our understanding of the physical world, a similar recognition should inform our legal understanding. Based on that recognition, this Article explains why—contrary to the bankruptcy-law precedents—potentially hundreds of millions of dollars of payments made annually to creditors of insolvent debtors under checks, letters of credit, and electronic funds transfers\textsuperscript{156} should not be avoided as preferential.

Congress could choose legislatively to resolve the uncertainty.\textsuperscript{157} For example, if could clarify that certain bank payments\textsuperscript{158} are preferential by amending the Bankruptcy Code to add the following new subsection (5) to 11 U.S.C. § 547(a): “‘any transfer of an interest of the debtor in property’ shall include a transfer of property of a financial institution that creates a claim of such institution against the debtor for reimbursement of such transfer.”\textsuperscript{159} In that case, however, Congress should consider excluding letters of credit from the amendment in accord with the industry custom and practice that “letters of credit really are different from other financing mechanisms.”\textsuperscript{160}

\textsuperscript{156} Also called wire transfers.
\textsuperscript{157} For example, to clarify the uncertainty caused by the intersection of commercial and bankruptcy law under the indirect holding system for securities, the UCC was amended to add § 8-503, which provides that investors’ rights in securities are not subject to claims of creditors of the securities intermediary. Cf. note 9, supra (discussing that uncertainty).
\textsuperscript{158} This refers to the payments made to creditors of insolvent debtors under checks, letters of credit, and electronic funds transfers. See text accompanying note 156, supra.
\textsuperscript{159} Section 547(a) of the Bankruptcy Code sets forth definitions of terms applicable to § 547(b), which includes the operative language for avoiding preferential transfers. If § 547(a) were amended to add the proposed new subsection (5), such amendment would, under the Supremacy Clause, preempt inconsistent commercial law. See supra note 108 and accompanying text.
\textsuperscript{160} See supra notes 136-137 and accompanying text. Cf. supra notes 74-77 and accompanying text (discussing how the decision in the Twist Cap case affected the capital markets).
Although this Article focuses on preferential transfer uncertainty,161 its underlying thesis—that the scale of observation can inform our understanding of uncertainties arising out of the intersection of different bodies of law—is potentially broader. Other uncertainties arise out of the intersection of commercial and bankruptcy law.162 Uncertainties also can arise out of the intersection of other bodies of law.163 Further research might reveal how the scale of observation could inform our understanding of those uncertainties.164

The Article’s thesis, including its focus on preferential transfer uncertainty, should also have international application. Similar to U.S. law, the bankruptcy or insolvency law of other nations often avoids preferential transfers to creditors of an insolvent debtor’s property.165

161 See supra note 155.
162 Cf. supra note 9 (discussing those other uncertainties).
164 Those uncertainties also can arise out of the intersection of different precedents within a single body of law. Cf. Carpenter v. United States, 138 S. Ct. 2206, 201 L. Ed. 2d 507 (2018) (concerning a Fourth Amendment unreasonable-search-and-seizure question). The government had searched cell phone data to correlate the defendant’s locations over several months with a series of robberies. The majority ruled that the search violated the Fourth Amendment because it was performed without a warrant supported by probable cause. Although acknowledging that this “sort of digital data—personal location information maintained by a third party—does not fit neatly under existing precedents,” 138 S. Ct. at 2214, the majority held “that an individual maintains a legitimate expectation of privacy in the record of his physical movements as captured through” cell-site location information. 138 S. Ct. at 2217. In his dissent, however, Justice Thomas argued that the “case should not turn on ‘whether’ a search occurred. . . . It should turn, instead, on whose property was searched. . . . By obtaining the cell-site records of MetroPCS and Sprint, the Government did not search Carpenter's property.” 138 S. Ct. at 2235.
165 See, e.g., § 239 of the Insolvency Act 1986 (English law prohibiting preferences in order to better assure equality of distribution). Cf. supra note 116 and accompanying text (observing that
Likewise, under the commercial or banking law of other nations, payments made under letters of credit\(^\text{166}\) and wire transfers\(^\text{167}\) (and possibly under checks\(^\text{168}\)) may come from property of a bank, not from property of the debtor. Other nations therefore may well face the same or similar preferential transfer uncertainties as in the United States.

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\(^{166}\) The law governing cross-border letters of credit is uniform internationally. See International Chamber of Commerce, Uniform Customs and Practices (UCP). \(\text{Cf. supra} \) note 134 (discussing the \textit{In re P.A. Bergner & Co.} case, in which the letter of credit was governed by the 1983 version of the UCP).

\(^{167}\) \textit{See, e.g., Benjamin Geva, 1 The Law of Electronic Funds Transfers} § 4.02[2] (2023): “It is up to the beneficiary’s bank to decide whether to act [by sending its own funds to the beneficiary] solely on the payment message it received from the noncorrespondent offshore sender prior to receiving funds . . . .” \(\text{Cf. Barkley Clark & Barbara Clark, The Law of Bank Deposits, Collections, & Credit Cards} \) (2023 ed.) § 17.02[2][d] (discussing how “international wire transfers that involve bank correspondent networks” are “truly becoming a global set of rules” under which a bank may wire its own funds, after which it has a reimbursement claim).

\(^{168}\) Perhaps because checks are not as widely used outside the United States, research does not clearly reveal whether payments made thereunder come from the bank’s or the customer’s property.