AVOIDANCE OF PREFERENCES AND FRAUDULENT TRANSFERS UNDER SWEDISH BANKRUPTCY LAW

BY

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1. INTRODUCTION*

1.1. *Bankruptcy law in transformation*

Bankruptcy law is a field of law that is always of topical interest, not least in times that are characterized by economic crises and an increase in economic crime. In the USA, a large-scale reform of bankruptcy legislation at the Federal level was carried through in the late 1970s (the Bankruptcy Reform Act of 1978). In England, work is at present in progress on a reform. France brought in a new bankruptcy act in 1967, but work has already started on new legislation. In the German Federal Republic, where bankruptcy law is a very hotly-debated issue indeed, no new legislation has been introduced, though a start has at any rate been made on preparing the reform work. As yet another example in this connection mention may be made of the proposed Bankruptcy Convention that has been submitted within the Common Market.

In Sweden, the law relating to bankruptcy has been gradually reformed during the last decade and some of the new legislation has emerged as a result of cooperation between the Nordic countries. Denmark enacted a new bankruptcy act in 1977, while in the case of Norway the new legislation is expected shortly—some of it has already been passed. Finland, too, took part in the legislative work but no bill has yet been introduced.

There seem to be two main approaches in the reform of bankruptcy law. There is, on the one hand, the desire in various countries for uniform rules in this sphere. This was one of the ideas underlying the Scandinavian reforms. The French legislation enacted in 1967 reflected in a number of respects a desire to harmonize French bankruptcy law with that in force in the remaining countries of the European Communities. It is quite obvious that this aim lies behind the proposed European Communities Bankruptcy Convention.

The other main approach is a reaction to the fact that under existing conditions the rules relating to bankruptcy have not functioned in the way the authorities had hoped. In some countries there has been a rapid escalation of the number of bankruptcies, while in other countries the problem is that the statutory bankruptcy procedure has largely been evaded. The outcome in all cases is that the distribution to bankrupts' creditors is too small. When all the

* The subject of this essay is dealt with in more detail in a treatise by the author to be published in 1984.

preferential creditors have received their share—to the extent that the assets even suffice to pay them—there is nothing left to cover the "equitable distribution" that the bankruptcy process was designed to achieve. This has led to references being made in German legal writing to "the bankruptcy of the bankruptcy process". It is also possible to discern a change in attitude to the function of the bankruptcy process in countries that used to regard as its main purpose an equitable distribution between the creditors, and whose legislation does not permit the debtor to be discharged of his debts in the bankruptcy with a view to enabling him to start afresh once the bankruptcy proceedings have been completed. It is now emphasized more than it used to be that account must be taken of the need to reorganize the firm, of the prevention of an unwarranted loss, of the fear of unemployment, and so on.

In the above-mentioned reform work the rules relating to avoidance of preferences and fraudulent transfers occupy an important place. In Swedish law these rules are collected in one category entitled *återvinning i konkurs* (avoidance in bankruptcy).[1]

Rules of this type, which are to be found in bankruptcy laws everywhere, though they may be drawn up differently, make it possible for the trustee in bankruptcy to avoid otherwise lawful transactions undertaken a certain time prior to a bankruptcy that prejudiced the interests of the creditors, for example, by favouring one of them at the expense of the others. The rules governing avoidance are closely connected with what was originally the basic idea behind the process of bankruptcy, namely the principle of creditor equality (*par condicio creditorum*), according to which a debtor's assets are to be distributed equally between the creditors in accordance with fixed rules in those cases where the assets are not sufficient to pay all his creditors. This prevents a "struggle of all against all", reflected in a race for the assets among the creditors themselves, but also in a fight between the debtor and the creditors as a group. As the effects of a bankruptcy do not normally make themselves felt prior to the moment bankruptcy becomes effective, whereas the struggle for the assets of the debtor is likely to have started as soon as the debtor's financial difficulties became more or less apparent, it is, however, essential that the legal machinery affords an opportunity of intervening against transactions undertaken a certain time *prior to* the bankruptcy. The bankruptcy rules must not be rendered ineffective as a result of the debtor's assets having disappeared just before he is declared bankrupt. This intervention takes place by the application of the rules governing avoidance.[2] These rules are directed against measures that lead to

[1] The German equivalent is "Anfechtung im Konkurs" and the French one is "inopposabilités" (and "action paulienne").

[2] It should be added that in English law the "doctrine of relation back" also in its way serves the same purpose.

individual creditors being favoured at the expense of the creditors as a group, as well as against any other measures that result in a reduction of the debtor's assets or in further debts that will prejudice the interests of the creditors. The main purpose of the legislation of avoidance is thus to ensure that the purpose of the bankruptcy procedure is not rendered ineffective as a result of transactions undertaken a certain time before the bankruptcy. In other words, the rules must make it possible to intervene against transactions undertaken in order to evade the consequences of an imminent bankruptcy.

In the Scandinavian legislative cooperation great importance was attached to the rules governing avoidance and a far-reaching agreement has been reached.[3] In American law the need for new rules relating to voidable preferences was stated to be an important reason for a reform and during the legislative work the change of voidable preferences law was paid more attention than any other material issue. In the course of the legislative work in England, it was stated "that the law regarding voluntary settlements, fraudulent preferences, fraudulent conveyances, etc., is, to say the least, unsatisfactory",[4] and in the discussion in Germany the present rules on avoidance have been given as one of the reasons why the bankruptcy procedure is not working properly.

What changes, then, have taken place in the reform of the rules governing avoidance? In spite of the differences in other respects the American and the Swedish (Scandinavian)[5] reforms do in fact exhibit the same characteristics. The new rules were intended to result in enlarging the possibilities of avoidance, at the same time as account is still taken of the demands of business life. The possibility of avoidance has been enlarged, mainly as a result of the virtual removal of the pre-conditions of bad faith (i.e. the requirement that the transferee had "reasonable cause to believe" that the debtor was insolvent, and so on), plus the fact that it has now become easier for the trustee to fulfil his burden of proof as it is now presumed that the debtor is insolvent during the critical period—in Swedish law in the way that evidence regarding insolvency is not demanded at all in most cases; in these cases the presumption is not rebuttable—and also that the possibility for avoidance where insiders are concerned has been enlarged. On the other hand, the purpose of adapting the rules to the realities of business life has a restrictive effect. In Swedish law this

[3] The Swedish legislative material is to be found in *SOU* 1970:75 and *Prop.* 1975:6, the Danish material in *Betænkning* no. 606/1971, the Norwegian in *NOU* 1972:20 and *Ot.prp.* no. 50 (1980–81). Where Finnish law is concerned reference is made to *Kommittébetänkande* 1978:37.

[4] Interim report of the insolvency law review committee (the Cork Committee) Cmnd. 7968, London 1980, chap. 2, para. 30.

[5] Even if the rules agree in most—though not in all—respects, in what follows I refer to Swedish law. As regards Danish law, reference may be made to Munch, *Konkursloven af 1977*, 2nd ed. Copenhagen 1980, Ørgaard, *Konkursret*, 2nd ed. Copenhagen 1977, and as regards Norwegian law to Braekhus, *Konkursrett. Utvalgte emner*, Oslo & Bergen & Tromsø 1970.

is most clearly shown through the introduction of an exception for ordinary payments; in American law more far-reaching exceptions are made.

The most sweeping feature, however, seems to be the objectivisation of the rules. It is in this light one should see the French rules on avoidance, which were not changed to any considerable extent in the 1967 reform; these rules were objective even before that. Mention may also be made of the fact that the preliminary draft of the bankruptcy convention within the European Communities was accompanied by a proposal for a uniform law containing, *inter alia,* rules on avoidance. These rules were objective and had been modelled (among other things) on the previous French rules. In the 1980 draft of the convention, however, the uniform law has virtually disappeared; there remain only two articles that are without importance in this connection.

If the rules governing avoidance—and therewith bankruptcy law—are to be made more effective the question then arises of how the line is to be drawn between permitted and prohibited transactions, in order, on the one hand, to achieve this effect, but, on the other, to avoid anything that prevents legitimate commercial transactions or pushes the debtor into bankruptcy by adding to his financial difficulties. The purpose of this paper is to show how the Swedish legislator has attempted to resolve this conflict and, at the same time, seek to shed light on the problems that can arise and indicate how they have been solved in Swedish law.

In what follows, a survey is first given of the structure and content of the Swedish rules on avoidance. Thereafter follows a more detailed presentation of the rules which refer specifically to those which have, in practice, proved the most important, i.e. the rules regarding avoidance of payment of debts and of transactions securing antecedent debts.

1.2. *Survey of the Swedish rules on avoidance*

Formally, the Swedish Bankruptcy Act dates from 1921, but as is indicated above it has since 1970 gradually been revised in almost every respect. The present rules relating to avoidance (secs. 28–40) were introduced in 1975. The Act covers all legal entities, private persons, businessmen, companies, etc., so the rules relating to avoidance are the same for everyone. Proceedings in respect of avoidance are undertaken in the first place by the trustee in bankruptcy.[6]

According to Swedish law a debtor who has been declared bankrupt is not

[6] The Swedish concept "konkursförvaltare" has been translated "the trustee", although Swedish law has no counterpart to the trust. The Swedish "trustee in bankruptcy" acts as "agent" for the debtor and the creditors. However, the difference is not likely to matter very much in the present context.

discharged from those of his debts that are not paid as a result of a distribution in a bankruptcy. However, the extent of this responsibility is limited by the fact that a legal person can cease to exist, for example, after a bankruptcy. In that event the usual course is that the property that belongs to the legal person is transferred to another legal person, who then carries on the business. Mention may also be made of the fact that there is a chance of the debtor avoiding bankruptcy by arranging a composition with his creditors, and thereby being discharged from all his debts.[7] However, going into bankruptcy is much more usual than arranging a composition. In certain cases of composition the rules relating to avoidance can be applied, though in general the rules apply only in a bankruptcy. A proposal that avoidance should also be available to a creditor suing for a distraint was not accepted.[8] Nor is there in Swedish law any *actio pauliana* principle that also has validity outside bankruptcy.

The legislative approach to the transactions the legislator wishes to prevent by means of the process of avoidance can vary in different ways. For example, the American legislator has chosen to emphasize the real financial consequences of a transaction instead of adopting a more technical approach. As against this, the Swedish legislator has indicated certain specific transactions which—with some exceptions—can always be tackled. At the same time, though, a general possibility is available in certain circumstances to secure the invalidation of unwarrantable acts in the law. This is done by presenting a general rule as a main rule that is supplemented by a number of special rules dealing with certain specific transactions. It could, however, be pointed out that no matter how the rules are phrased they all ultimately refer to transactions of the same type, namely certain payments, secured transactions, gifts, and so on.

The Swedish rules on avoidance are now built up as follows. The basic rule is to be found in sec. 30, where it is stated that if certain transactions have unfairly resulted in a particular creditor being favoured before others or in the debtor's assets being rendered inaccessible to the creditors or in an increase in his debts, such transactions can be invalidated, providing, *on the one hand,* that the debtor was or became insolvent as a result of his action (in Swedish law the word "insolvent" means that the debtor cannot pay his debts as they fall due), and, *on the other hand,* that the transferee knew or ought to have known of the debtor's insolvency *as well as* of the circumstances that made the transaction an unfair one. The prerequisite "unfair" is a central concept in this section. In what follows, the rule is referred to as "the general rule".

This general rule may be said to illustrate the cases that the legislator really

[7] Such an agreement can also be made in bankruptcy. On the other hand, such agreements are of rare occurrence.

[8] *Prop.* 1980/81: 8, Part 1, pp. 346 ff.

wishes to discourage. It is clear, though, that this rule cannot on its own be an effective weapon against the transactions in question. Here we meet once again the obstacles which under the earlier law limited the rules regarding avoidance and to some extent blunted their effectiveness, namely the prerequisite of bad faith ("knew or ought to have known") and the requirement of insolvency that is to be proved by the trustee in bankruptcy. For this reason, the method chosen in the new legislation is to indicate, alongside the general rule, certain situations which, viewed objectively and typically, may be regarded as "unfair" and where bad faith on the part of those involved may be presumed. Of course, the choice of these situations must be based on a general, average assessment.

The special cases that are subject to rules—from now on the term "the special rules" will be used—are mainly those where the debtor conceals his property by making *gifts* within a certain period of time before his bankruptcy, where the debtor gives up a major part of his right in the event of a *division of the joint property* of spouses upon their separation or the spouse's death, where a creditor forces himself ahead of the others by suing for a *distraint* immediately prior to the bankruptcy, and, not least, where the debtor favours a creditor —voluntarily or after pressure—some time prior to the bankruptcy by *repaying a debt* or *securing an antecedent debt* without a preferential right.[9] A payment can be avoided in three cases, namely if it has been made by means other than those normally used, has been made in advance, or is so large as to seriously weaken the debtor's financial position. In all these cases an exception is made for payments that can be considered ordinary. Consequently, the vague term "ordinary" is of crucial importanc. Mention may also be made of the exception that is made for the payment of tax debts that fall due and of a maintenance payment under family law, if the amount is due to be paid and the person receiving the maintenance payment has not been unfairly favoured.

In none of the situations now mentioned is there any requirement that the transferee was aware of the debtor's financial position or that the transferee was favoured in preference to the debtor's other creditors. Nor is there any requirement regarding special intent on the part of the debtor. The rules are *objective.*

During the legislative work undertaken in Scandinavia it was the Danes and the Norwegians who gave most support to the idea of objective rules; the Norwegian rules already in existence lacked any prerequisites of bad faith. The reason for framing the rules in this way was not only to make avoidance easier. An additional reason was given to the effect that in present-day society the

[9] Avoidance can also be made of a payment for salaries, fees or pensions to insiders as well as of a transfer to pension funds. As regards transactions with insiders, see below.

general changes in commercial life have made the question of insight on the part of the transferee less relevant. The size of business enterprises has grown and business connections now extend over vast distances. New forms of credit granting have developed. For obvious reasons the creditors of a business enterprise cannot usually be assumed to possess day-to-day knowledge of its financial position. When the creditor is a company or state or municipality it will also be difficult to decide the identity of the physical person whose insight has to be taken into account.[10]

Even so, the question of the transferee's good or bad faith has not become completely irrelevant. Bad faith on the part of the transferee is relevant in three different situations. The *first* of these, as we have seen, arises when the general rule is to be applied, as regards both the prerequisites and the effects of avoidance. The *second* is concerned with the legal effects of avoidance according to the special rules. Even if the intention of the special avoidance rules is that they affect transactions where the parties have typically acted in bad faith, one must nevertheless take account of the fact that they will also affect transactions where the transferee has in reality acted in "good faith". In view of this it is reasonable that, in contrast to what used to be the case, the objectivisation of the rules should result in the effects of the avoidance system being formulated on the assumption that the transferee acted in good faith. This has led to a general alleviation of the effect of avoidance on the transferee, in certain cases generally, in others if special reasons exist (for example, the very fact of the transferee's good faith in the case in question). The most interesting innovation is that the legislator has provided for the possibility of modifying the effects of avoidance, provided always that special reasons exist for this. Here, too, the good faith of the transferee is an important factor to be taken into account. Such modification, though, is to be based on an assessment of all the circumstances and may only be made in exceptional cases. The *third* respect in which good faith is a decisive element arises when the property the avoidance refers to has been transferred to a third person. Avoidance can then be effected from this third party if he knew or ought to have known the circumstances on which the right of avoidance against the debtor's transferee was based.

The formation of the critical period, that is to say, the period of time during which a transaction cannot be undertaken without risk of avoidance, varies greatly in different countries, as regards both the starting point of the period and its duration. In these respects, too, the present Swedish rules display a certain resemblance to the current American ones. In Swedish law the period of vulnerability as a principal rule is reckoned backwards from the *filing of the petition*. The duration of the period—which is now longer than it was be-

[10] *Prop.* 1975: 6, pp. 93 f., 132 f.

fore—varies somewhat. For preferences it is three months, for gifts it is six months or one year and under the general rule it is five years.

As was indicated in the introduction, special rules now apply in respect of *insiders*. An insider relationship may be based either on family ties or on a financial connection with a debtor who is a merchant, a corporation or a partnership, etc. During the legislative work the most discussed point was the classification as an insider of "the person who as a result of a leading position exercises a decisive influence on business operations undertaken by the businessman or legal person" (sec. 29a(2) no. 3). Apart from transactions undertaken within the usual period of vulnerability avoidance can also be made from an insider in respect of transactions undertaken prior to, but within two years of, the filing of the petition, if the insider is unable to prove that the debtor was not insolvent nor became so as a result of the transaction. When the general rule is applied the period for insiders is unlimited.

The number of avoidance cases has increased sharply since 1975, when the present rules came into force. When avoidance becomes a reality in practice what are usually involved in the first place are, on the one hand, gifts—though these cases rarely seem to give rise to complicated legal problems—and, on the other hand, payments, secured transactions relating to antecedent debts, as well as an application of the general rule. In addition, it is—quite naturally—not unusual for the transferee to claim for modification of the effects of avoidance. Another issue that often comes up, more or less explicitly, is concerned with the general requirement that the transaction must have prejudiced the creditors.

In what follows, attention will be focused on the situations just mentioned, except where the avoidance of gifts is concerned. In section 2 the general rule will be discussed and section 3 will deal with the requirement of prejudice. The Swedish attitude to avoidance of payment and of transfers of security interests that are created to satisfy an antecedent debt is presented in sections 4 and 5. The possibility of modification is dealt with in section 6.

2. THE GENERAL RULE

2.1. *Introduction*

The historical origin of the avoidance rules is the *actio pauliana* in Roman Law. According to the rules concerning *actio pauliana* a transaction could be invalidated if the debtor acted with the intention of prejudicing his creditors and the transferee was aware of the debtor's intent. The idea behind the rule—the debtor has acted "unlawfully" and the transferee is his accomplice—lies behind most of the avoidance rules in force internationally. In many countries there is also a rule that specifies the prerequisites mentioned—intent to prejudice on the part of the debtor and bad faith on the part of the transferee—and this principle often applies in as well as outside bankruptcy (just as it also did in Roman Law). Alongside this there is often a rule regarding the invalidation of transactions that have prejudiced the creditors and where the transferee has acted in bad faith.

The "pure" *actio pauliana* principle is not to be found in our present legislation. There was such a rule in the earlier law, but because of the stringent conditions regarding avoidance it was hardly of any importance in practice. Cases where it was applied could, for example, be concerned with the avoidance of a gift to a wife or child. In the present rules, as may have been seen in section 1.2 above, there is instead a general rule regarding the invalidation of unfair transactions that led to prejudice and where the transferee acted in bad faith. There is no requirement of intent to defraud, etc., on the part of the debtor. The rule is now so remote from the original *actio pauliana* principle that there is no requirement that the debtor himself has "behaved badly". This is connected, on the one hand, with the meaning of the requirement of unfairness and, on the other, with the fact that the unfairness can be on either side; the rules governing avoidance are directed against unfair acts undertaken by the creditor as well as by the debtor. Where the transferee is concerned it is enough that bad faith in the usual meaning is present—knowledge is no longer required.

The general rule is to be found in sec. 30 of the Bankruptcy Act and reads as follows: "A transaction which unfairly results in a certain creditor being favoured before others, or in the debtor's property being placed out of reach of the creditors, or in an increase in his debts, is invalidated if the debtor was insolvent or became so as a result of his action and if the other party knew or ought to have known of the debtor's insolvency and of the circumstances which made the act an unfair one." The respite is five years, though for insiders it is unlimited.

The prerequisites set forth in the section are therefore as follows. To begin with, a transaction must have been undertaken. In certain circumstances passivity may be accepted as a "transaction". In addition, the transaction must have been prejudicial in one of the three ways that are stated. One could say that this illustrates a general requirement of prejudice that is not stated specifically in the rest of the sections. This requirement of prejudice is discussed in more detail in section 3 below. The debtor must also have been insolvent or have become insolvent as a result of the transaction. The requirements of prejudice and insolvency in the sense of sec. 30 need not mean that the prejudice and the insolvency are immediate consequences of the transaction itself only. It is sufficient that the effect is produced as a result of the transaction together with some subsequent supervening occurrence. One example of this is where the debtor sells property at the correct price and then makes the proceeds inaccessible to the creditors. A further prerequisite is that the prejudicial development must have come about in an unfair way. This prerequisite, whose application has caused problems in practice, is discussed in more detail under 2.2. Finally, the transferee must have acted in bad faith.

According to the wording it is assumed that the debtor himself has undertaken the transaction ("his action"), which could therefore exclude avoidance of, for example, an unauthorized act made by a creditor. However, what is of particular importance in this respect is the extent to which the courts will accept passivity on the part of the debtor as a transaction. This passage would seem to have come into existence as a result of an editorial error when the Swedish bill was being drafted, since the expression "the measure" was replaced by "his action".

Finally, mention should be made of the fact that the general rule contained in sec. 30 is not secondary to the special rules, but can be applied even when, according to some objective section, the prerequisite is complied with (and vice versa). This can be important since in certain cases the legal effects of an avoidance according to sec. 30 may be more beneficial to the estate in bankruptcy. Of course, it may also be that the respite in the special section (which is of course a good deal shorter) has already expired.

2.2. *Unfair transactions*

That the prejudicial development must have been caused in an unfair way or, in other words, that the transaction that is called in question must have been unfair, is laid down as an independent, objective prerequisite. Consequently, the prerequisite of unfairness applies alongside the other prerequisites in sec. 30, though its independent, practical importance is presumably not as great as one might think. Its importance is more likely to lie at the theoretical level.

What does the prerequisite of unfairness amount to? I would like to express it as follows:

In the *travaux préparatoires* on the current rules for avoidance the usual argument is repeated that the aim of the avoidance process is to prevent "disloyal" arrangements, though there is no really detailed indication of what is meant by the word "disloyal". However, its meaning must be closely linked to what is stated in section 1.1 above to be the general purpose of the rules regarding avoidance. I would like to summarize it by saying that a "disloyal" arrangement is one that has been caused by the debtor's financial problems and the suspicion that he faces bankruptcy; in short, it is a transaction undertaken in order to evade the consequences of an imminent bankruptcy.

In the foregoing it also emerged that sec. 30 is the principal rule among those dealing with avoidance, where an indication is given of the transactions the rules for avoidance are generally intended to discourage. Apart from the fact that the transaction has been prejudicial and has led to insolvency, the only objective distinguishing feature that sec. 30 has given to the transaction that can result in avoidance is that it has been *unfair*. In my opinion, therefore, the only meaningful interpretation is to assign to the term "unfair" a meaning that corresponds to that of the word "disloyal". There is no reason to suppose that any additional qualification over and above disloyalty is called for by the requirement of unfairness. Thus, unfair and disloyal refer to the same set of circumstances and to say that a transaction is unfair means that it has been undertaken in order to evade the consequences of a possible bankruptcy. To this one should add, however, the general condition that what must, in all fairness, be at issue here is a transaction that does not involve a trifling sum of money.

How, then, is one to judge objectively whether a transaction can be characterized as unfair? Here the following points of view would seem to be relevant. If avoidance is to be effected all the prerequisites in the section must be complied with, that is to say, including the requirements relating to prejudice, insolvency and bad faith. For this reason, when judging whether an arrangement has been unfair one may take as the point of departure that the arrangement was prejudicial to the creditors, that the debtor was or became insolvent as a result and that the transferee either knew or at least ought to have known of the debtor's insolvency and of other circumstances of importance. Furthermore, if the situation is as outlined, that is, if the debtor is or becomes insolvent as a result of an arrangement and the transferee knows or ought to know of it, etc., then, objectively speaking, it ought to be possible to assume that the arrangement was made in the knowledge that bankruptcy was imminent, unless other circumstances indicate the opposite. What has been said means that as the requirements relating to prejudice, insolvency and bad faith are complied with—which they must be to enable avoidance to be made according to sec. 30—then the *starting point* must simply be that the transaction was unfair.

One could even go so far as to maintain that the most important *practical* function of the prerequisite of unfairness is to provide an opportunity of *excepting* certain transactions from avoidance, namely those transactions which, although the situation in other respects is as described in the rule, cannot even so be regarded as having been undertaken in order to evade the consequences of the debtor's bankruptcy. Yet another, special aspect of the prerequisite of unfairness is that it allows a certain amount of discretion in relation to present and future business practices.

It is hardly possible to say that the debtor has acted unfairly unless the transaction, for example a payment, has been committed "voluntarily". The meaning of this is, however, reduced by the fact that account is also taken of the action of the *creditor*. Should the debtor have been forced to pay under threat from the creditor the *former* cannot be held to have acted unfairly, but the unfairness can, on the other hand, then lie with the creditor. Consequently, when judging whether a transaction has been unfair, account should be taken of whether the debtor has been subjected to any particular pressure by the creditor. After all, one of the basic situations the avoidance rules are designed to counteract is precisely that in which a creditor has ensured himself payment by threatening and applying pressure on a debtor.

Mention can be made of 1978 NJA 194 in which the Supreme Court ruled that a certain "transaction" was unfair. The situation in this case was that the debtor, a company, had a checking account with credit facilities at a bank. The company's customers paid their bills into this checking account via a bank giro account linked to the account. In accordance with a general authorization given by the company the bank was permitted to deduct the sums paid into the checking account in order to pay off the overdraft on the checking account. The company became insolvent and suspended payments. The bank was informed of this, though the transactions continued as hitherto. The trustee in bankruptcy claimed recovery of the sums that had been paid into the checking account by the company's customers and deducted by the bank from the debt owed *subsequent to the date* on which the bank had learned that the company was insolvent. The Supreme Court found that the company had acted unfairly in that it had neglected (cf. above), as soon as it became insolvent, to ensure that the bank was no longer able to deduct the sums its customers had paid into the account, that is to say, it had neglected to revoke the authorization enabling the bank to make these deductions.

3. REQUIREMENT OF PREJUDICE

One condition that always applies if avoidance is to be granted is that the transaction must have prejudiced the interests of the creditors in a bankruptcy (the estate in bankruptcy).

It might seem that such a requirement is obvious enough in itself. The immediate assumption is that the creditors must have suffered some loss in order for avoidance to be granted. Generally speaking, there is no point in instituting avoidance proceedings if the creditors have not lost anything as a result of a transaction having been undertaken. Such proceedings would merely be accompanied by costs and inconvenience and be of no corresponding advantage to the estate in bankruptcy in question. Suppose, for example, that repayment of a secured debt were to be avoided even though at the time of repayment the debtor had received back the pledge, whose value was (at least) equal to the amount of the debt. As the avoidance means that each party will refund what he received, the avoidance would merely result in the estate in bankruptcy receiving back the money and the creditor the pledge, which he could then dispose of and obtain payment that way.

In actual fact, however, the question is not as simple as that. The fact is that much will depend on what more precisely is included in the requirement of prejudice and how the requirement is worded.

Strangely enough, the requirement of prejudice is not given in the text of the Act, at least where the special rules are concerned. As we noted in section 2.1 above, the requirement is exemplified, on the other hand, in the general rule and is also mentioned in the Swedish *travaux préparatoires*.[11] The requirement, which has not been lifted direct from the previous law but has been partially reformulated, has been given a somewhat diffuse wording and is perhaps not sufficiently well thought out in all respects.

According to the *travaux préparatoires,* the fact that the arrangement has prejudiced the creditors means that the debtor's financial position is thereby made worse.[12] This does not mean, however, that the debtor's overall financial position need have undergone any change. What is intended here is instead that the *distribution* must have been adversely affected for one, or some, or all of the creditors. It is sufficient that the distribution has been adversely affected for only one creditor, as, for example, could happen if property in which the creditor has a special prior claim is sold at a satisfactory price without the creditor being given his prior claim on the proceeds. As it is laid down in the *travaux préparatoires,* prejudice covers two principal situations. One is that the percentage distribution from the bankruptcy generally has fallen, the other is that changes have occurred in the relative positions of the creditors with the result that the distribution to one or more of them has fallen while that made to one or more of the others has increased.

In general, one could say that prejudice can arise in the three ways set forth in the general rule, that is, first, when a creditor is favoured at the expense of the others, secondly, when a reduction takes place in the assets that would have gone into the estate in bankruptcy and thirdly, when there has been an

[11] On the other hand, there is no mention of this in the Danish and Norwegian legislative material.
[12] *Prop.* 1975:6, pp. 99 f., 142. *SOU* 1970:75, p. 132.

increase in the debts that have to be paid with the aid of the assets. In the last-mentioned case, however, it is assumed that the service in return received by the debtor when the debt was incurred does not equal the debt incurred, as, for example, is the case when the debtor receives a loan on normal terms. If the debtor receives an acceptable consideration—that is to say, receives the equivalent in cash—no prejudice at all will exist (if it is not a question of changes in the relative positions of the creditors). For this reason, avoidance cannot take place in the event of such cash transactions, for example, or where the debtor pays a debt to a secured creditor and at the same time an equivalent amount of the collateral is placed at the disposal of the debtor. The sole fact that a creditor's claim ceases when he is paid does not affect matters since the debtor is not thereby supplied with an equivalent asset.

In contrast to what applied under the previous Swedish law there is as a rule no requirement that the debtor was or became insolvent as a result of the transaction for the special rules to apply. One can presumably say that there is a non-rebuttable presumption that the debtor was or became insolvent—after all the transaction must in most cases have been undertaken as late as within three months before the filing of the petition. On the other hand, insolvency is required for avoidance according to the general rule, for avoidance according to the special rules where insiders are concerned, as well as for the avoidance of gifts that have been made within a time-limit of less than one year but more than six months.

As was suggested above, in Swedish law the word *insolvent* means that the debtor cannot pay his debts as they fall due. On the other hand, there is nothing in the legislative material as to whether "prejudice" assumes that the debtor's debts have exceeded his assets (in Swedish terminology that the debtor has been *insufficient*). As I see it, however, making such an assumption would seem to be most compatible with the definition of the requirement of prejudice that was made in the *travaux préparatoires*. If, on the other hand, the burden of proof in this respect is on the trustee in bankruptcy the result will be that the lightening of the trustee's burden will be largely nullified.

One question of crucial importance for the application of the requirement of prejudice, and for what has been said here, is the *point of time* to which the prejudice should relate.

First, it should be mentioned that in all the special avoidance cases the prejudice must be a "direct" consequence of the arrangement, which in this context means that the arrangement must be accompanied by some prejudice, without the presence of any additional factors. However, if avoidance is to be effected under the general rule it is sufficient for prejudice to have come about if the arrangement is accompanied by other factors, for example, if the debtor pledges property to the creditor at the same time as he receives a loan (and so no "direct" injury arises) and then invests the money abroad out of reach of the creditors.

In the Swedish *travaux préparatoires* it is also clearly stated that the decisive point of time for the coming into existence of the prejudicial effect in all the special avoidance cases is the date *on which the transaction takes place.*[13] This definition of the time is undoubtedly difficult to reconcile with the definition of the meaning of prejudice, that is to say, that the transaction must have adversely affected the distribution the creditors might receive through the debtor's bankruptcy. The prejudice to the interests of the creditors that arises at the point in time stated is hypothetical only and not real. The question is whether the transaction would have resulted in a poorer distribution for any one, or some, or all of the creditors, if the debtor had been declared bankrupt at the time the transaction was undertaken. The *real* prejudice emerges only when the distribution is finally settled. The requirement of a real causal connection between the act and the prejudice is not maintained either. A requirement of a real causal connection would presuppose that account was also taken of a circumstance such as that the prejudice would have occurred anyway. Let us, for example, suppose that the debtor sells assets cheaply and that these assets then fall in value so that when the bankruptcy occurs their value corresponds to the selling price. No account is taken of this.

It could be added, though, that the result in the example given may be affected by the rules relating to the effect of avoidance. If avoidance takes place the creditor returns the property and recovers his outlay, which in the case outlined means that the avoidance in itself is meaningless. Here it seems that this effect of the rules is reasonable. On the one hand, it is, to be sure, a question of who is to bear the risk for what happens after the arrangement, but, on the other hand, it is suggested in this particular example that the fixing of the price was not a pure invention.

However, what has just been said gives rise to yet another objection connected with the wording of the requirement of prejudice. The fact is that the legislator seems not to have considered fully the coordination between this

[13] *Prop.* 1975:6, p. 100, cf. p. 142. It is not always evident when this point of time comes since several elements can be required for the completion of the transaction. For example, a pledge requires both a security agreement and perfection. Normally this presumably means that "the transaction is undertaken" at the exact moment the parties are committed. Cf. Walin, *Materiell konkursrätt,* Stockholm 1980, pp. 109f. On the other hand, what is decisive for judging whether the transaction was undertaken during the period of vulnerability is the point of time for the perfection.

One prerequisite for avoidance of a preference in *American* law is that the transfer has enabled the creditor to recover a greater portion of the debt than he would have recovered in liquidation proceedings under chap. 7 of the Bankruptcy Act, if the transfer had not been made (see sec. 547(b)(5)). The decisive point of time therefore is when bankruptcy results. (Sec. 547(b)(5) codifies the rule in *Palmer Clay Products Co.* v. *Brown*, 297 US 227 (1936).) — In *English* law the corresponding date, on the other hand, is that on which the transaction takes place.

prerequisite and the rules relating to the effect of avoidance, that is to say, that when avoidance is effected each party must refund what he received (section 6 below). At first sight these two principles may appear to be quite compatible. One could in fact assert that the reason why the creditor should have his outlay returned to him is precisely that in this respect the transaction is not avoidable because the requirement of prejudice is not met. Suppose, however, that the value of the consideration the creditor handed over has changed during the period between the date on which the transaction was undertaken and the date on which the avoidance claim is settled. We can imagine a case where the debtor has paid a debt that was mainly but not wholly secured by a pledge, which was returned to him at the time of repayment. If the claim amounted to 150 000 SEK and the pledge at the time of repayment was worth 100 000 SEK (and no other complications are present) the requirement of prejudice is satisfied only in so far as a payment of 50 000 SEK is concerned. So all that could be avoided ought to be a sum of 50 000 SEK. If avoidance is effected and each party refunds what he received the result will be the one intended, provided that the pledge still possesses the same value. Suppose, however, that the pledge is worth only 75 000 SEK at the time the avoidance claim is settled. In that case a refund from each side will mean that the recovery involves a sum of 75 000 instead of 50 000 SEK. This can hardly be the intended result and will have to be put right, either by ensuring that the extent of the refund liability is decided according to the circumstances prevailing at the time that is decisive for the application of the requirement of prejudice or else by reducing the sum recovered—to the extent that such modification is possible. If the property has instead increased in value the problem will then be the reverse.

The question, then, is what are the reasons that argue in favour of making the date on which the transaction was undertaken the decisive point of time. This matter is not touched on in the *travaux préparatoires*. One reason could, however, be consideration for the transferee, an aspect that is particularly of importance when no prerequisites of bad faith restrict the possibility of avoidance. As far as possible the transferee must be able to judge the consequences of the transaction he undertakes, regardless of whether he knows or does not know that the debtor is insolvent. As a rule it would appear to be possible to judge whether the transaction would affect the distribution as a whole in a hypothetical bankruptcy that is thought of as taking place immediately after the transaction, for example, by reducing the debtor's assets. On the other hand, it may be more difficult to determine to what extent the transaction would change the distribution for the creditors by only causing changes in their relative positions.

To sum up, the requirement of prejudice can, purely practically, be seen as a general heading under which a number of different questions are settled, for example, concerning the avoidance of cash transactions, or the avoidance of payment to preferential creditors, or the avoidance of payment with assets that would not have been included in the estate in bankruptcy. At the same time it also says something about the function of the avoidance rules. Thus the requirement of prejudice results in the preventive function of the avoidance rules becoming secondary in relation to the reparative one—something which in itself is not of course unusual—since the choice of avoidable situations is determined by whether there is a, certainly fictitious, need for repair. The following is another effect. One could say that the purpose of the avoidance rules to prevent arrangements made with the aim of avoiding the consequences of the bankruptcy benefits the creditors in general as well as the debtor himself; the distribution to the creditors increases and the debtor is protected against unwarranted pressure. However, the requirement of prejudice shows clearly that the protection of the debtor is a secondary matter, that is to say, it is for him a beneficial side effect of the main purpose of the avoidance rules, which is to protect the creditors. If the only prejudice inflicted is that the debtor is subjected to unauthorized pressures then the requirement of prejudice cannot in fact be said to have been complied with. Suppose, for example, that a creditor threatens to report the debtor to the police, or to "mark" him or something similar, if he does not pay his debt. Suppose also that in desperation the debtor then borrows an equivalent sum of money from someone else and immediately pays the aggressive creditor with the money. In this case nothing prejudicial to the creditors in the bankruptcy has occurred since the payment was made with money that would not otherwise have been included in the bankruptcy and as far as the estate in bankruptcy is concerned the transaction has merely resulted in a change of creditor. For this reason avoidance cannot be granted even though the debtor was subjected to threats and pressure by the creditor.

4. THE SPECIAL RULE RELATING TO AVOIDANCE OF PAYMENTS OF DEBTS

4.1. *Introduction*

The attitude taken towards payments made by the debtor to some creditor prior to the bankruptcy can vary somewhat in different legal systems. In American and English law all payments can be avoided, provided that the components of a preferential transfer are present. In German law a distinction is made between "congruous" and "incongruous" payments. An "incongruous" payment is one to which the creditor has no right, in that he either had no right to it at all (for example, because his claim was invalid) or had no right to it in the way it was made (such as payment in some unusual form) or had no right to it at the time it was made (such as payment in advance). However, avoidance can be effected in both cases, even if the prerequisites for this are different. In French law, too, there is a division between, on the one hand, payment in advance or in an unusual form and, on the other, payment of debts due by the ordinary means of payment. In the first case avoidance takes place according to an objective rule, while in the second a prerequisite is that the creditor acted in bad faith.

The previous Swedish avoidance rules were based on the idea that a payment of a debt at a time when the debtor was insolvent meant, in principle, that the creditor was favoured at the expense of the other claimants and for this reason ought to be avoidable. The possibility of avoidance also covered payments related to debts due if the creditor had reasonable cause to believe that the debtor was insolvent. Along with the objectivization of the rules the possibility of avoiding debts due was, however, restricted. As was noted above, there is—alongside the general rule—a special section relating to the avoidance of payment. Nowadays this section embraces three cases that are regarded as being especially suspect, namely payments by means other than the usual ones, payments in advance or of a size that appreciably worsen the debtor's financial position. A common precondition of avoidance, which at the same time is added to the present rule, is, however, that the payment cannot be regarded as "ordinary".

Consequently, according to this section the payment of debts due can only be avoided in two situations: namely, when payment has been made in an unusual form or when it has been so large as to worsen appreciably the debtor's financial position. In other respects, however, avoidance can take place according to the general rule if its prerequisites are complied with. This raises, however, the question of whether a payment of a due debt can be unfair at all.

One thing is that a *prejudice* has come about as a result of the payment. Even if the creditor has previously supplied an acceptable consideration (the amount of the loan) this is not sufficient. The fact is that the vast majority of creditors in a bankruptcy have previously supplied a consideration. In a bankruptcy the question is which of all these are to have their demands met. The starting point is that no one should without more ado be compensated before the others, but that distribution should take place in accordance with the rules relating to bankruptcy. For this reason, of the transactions undertaken during the period of vulnerability the only ones that are accepted are those that maintain the *status quo,* that is to say, which do not result in any prejudice at the point of time involved. The judgment must refer to the time at which the payment was made and here the debtor does not receive any consideration that gives him any equivalent asset.

That some prejudice has come about need not, however, *itself* result in the transaction being unfair. What is decisive, of course, is how the concept "unfair" is interpreted. As we saw in section 2.2 above, the meaning of this concept could probably be decided from a general point of view by saying that it refers to a transaction involving a not insignificant sum of money that is undertaken in order to evade the consequences of the debtor's bankruptcy. From this starting point one could say that the creditor's demand for payment appears as an unfair attempt to guarantee himself payment before the other creditors if he knows that the debtor is insolvent, and for this reason ought to be aware that bankruptcy, in which he himself will not have any preferential right, is going to occur. It may be observed that in the general rule it is required that the creditor acts in bad faith. However, unfairness can also lie in the debtor's circumstances. In the case in question it can be taken for granted that the debtor knows that he is insolvent and so ought to realize that he will not be able to pay all his creditors. In such circumstances it can be unfair towards the other creditors to pay one of them.

What is somewhat more difficult is to explain why, in Swedish law, avoidance can be made of payments that appreciably worsen the debtor's financial position, since here avoidance is made according to an objective rule which does not contain a requirement of bad faith on the part of the creditor. The fact that the payment can be unfair behaviour on the part of the debtor should not, on its own, constitute a reason for avoidance in such a case. The legislator has regarded a payment of this kind as being *typically* unfair. In arriving at this conclusion the starting point has probably been that both insolvency and bad faith are presumed to have been present and that for this reason the creditor cannot have avoided knowing that by receiving payment he would be more favourably placed than would have been the case if the debtor had taken account of his true ability to pay. If to this is added the fact that the sum paid must have been considerable we then have a picture of a payment that ought to be avoidable.

4.2. *Payment by means other than the usual ones, in advance and in an amount that appreciably worsens the debtor's financial position*

The fact that the debtor pays a debt by *means other than the usual ones* suggests, of course, that he would not have been able to pay in the usual way and that the creditor would not then have received any payment. From the general starting points adopted by Swedish law such a payment is therefore suspect. One usual objection made by the creditor in such cases can be that no payment at all has been made; the creditor objects, for example, that this has in actual fact been a question of a normal purchase paid for by way of set-off. The first task will therefore be to determine whether the transaction ought to be regarded as a purchase or as a payment. Only after it has been established that the transaction is to be regarded as a payment does the question arise of whether some unusual means of payment was involved. Here the starting point is that every means of payment not involving money and checks, etc., is unusual, though some importance may be attached to a possible custom that exists in the debtor's—or the creditor's—trade.

Avoidance of payment *in advance* (that is to say, generally speaking, of debts that are not due) raises two questions, among other things. The first is, on what date the debt is to be due for repayment. Here, there are two main possibilities—one is that the date of maturity must have been reached by the time payment was made, the other is that it is sufficient that the maturity day is reached by the time of the filing of the petition (or the equivalent). The argument presented why the second possibility would be satisfactory is that the payment could not have been avoided anyway if it had been made at the date of maturity.[14] Apart from the fact that it is, of course, not certain that the debtor would have been able to pay on the date of maturity, this line of reasoning assumes, on the one hand, that payment of due debts is not avoidable (at least not according to any objective rule), and, on the other hand, that the assessment of prejudice must have reference to the filing of the petition. If the decisive point of time for judging whether or not prejudice exists is the date on which the transaction was undertaken it follows that the same date ought also to be decisive in the context of what is now being discussed —payment of a debt that was not due when payment was made is prejudicial to the interests of the creditors, irrespective of whether the debt would have fallen due for payment when the petition was filed and a later payment would not therefore have been avoidable. What has been said above could be a reason why Swedish law nowadays requires the debt to have been due for payment when payment is made.

The other question is, what meaning must be assigned to the requirement that the debt must be "due for payment". In the previous Swedish law the formal date of maturity was strictly adhered to. This approach has now been modified, which is clear from the fact that the wording of the Act refers to payment "in advance"; by which is meant a payment prior to the *normal* maturity day. This amounts to both a restriction and a widening of the possibility of avoidance—a restriction because it is now possible to take into

[14] The statement refers to the rules in the 1862 Bankruptcy Act. See, for example, *NJA* II 1921, p. 442. Cf. the *French* Bankruptcy Act (loi no. 67–563 du 13 juillet 1967), art. 29, para. 2 no. 3.

account when the parties intended that the debt would normally have been repaid, a widening in that the parties cannot claim that the maturity day, purely formally, has arrived, as, for example, is the case when the debt is called in by invoking the acceleration clause, that is to say, a clause which allows the whole loan to be called in for payment, *inter alia,* if the debtor does not discharge his obligations to the creditor in the manner prescribed. The aforementioned change in the wording of the Act was, incidentally, brought about especially by the use of acceleration clauses, which are common in Sweden and other countries. A payment that is made after a debt is called in is, consequently, nowadays regarded as having been made in advance.

The possibility of the avoidance of payments of such a size as *appreciably worsen the debtor's financial position* was introduced in 1975. The rule which must be viewed against the background of the fact that the general possibility of avoiding payment of debts falling due disappeared at the same time, is the most difficult of the new rules to apply and one of those for which the legislative material provides least guidance. This ground for avoidance has come to the fore on a number of occasions in more recent case law, as a result of which the line of demarcation between invulnerable and vulnerable payments has been more clearly drawn.

The difficulty is to determine what is meant by the payment having appreciably worsened the debtor's financial position. In what respect must the payment have affected it? With what is the amount to be compared? One can visualize a number of different possibilities.

One is, of course, simply to look at the size of the sum *as such.* Sometimes one has the feeling that certain courts have taken this view of the matter, and this approach is linked to how in the previous law it was determined whether a gift had occasioned the donor "noticeable prejudice". Another possibility is to examine how the payment has affected the *distribution* to the other creditors in the bankruptcy. This interpretation is hinted at in the *travaux préparatoires.* However, if this recommendation is followed difficulties at once arise. A moment's thought will in fact make it clear that the percentage distribution cannot be the decisive factor. To begin with an increase of a percentage point or so could represent a considerable sum in distribution. Furthermore, the amount distributed in absolute figures varies according to the number of creditors. One could, for example, imagine two cases where the amount of payments and the assets in the bankruptcy agree but where the amount recovered in one case could go in its entirety to a preferential creditor and in the other is divided between a large number of non-preferential creditors, each of whom would not receive any appreciable increase in his distribution. Obviously these two cases cannot be handled differently. If account is to be taken of the distribution to the creditors then it must be the *total* distribution.

If one has come to the conclusion that account ought to be taken of the total distribution the question, however, is whether it may be more appropriate to go the whole way and instead make the comparison with the *assets* in the bankruptcy. In favour of this alternative there is also the fact that it could be easier for, say, the trustee in bankruptcy to get a clearer idea of the relationship to the assets than of the relationship to the proposed distribution. In a recent case the Supreme Court favoured this alternative.[15] But this does not mean that it has been decided how the amount must be related to the assets for it to be regarded as considerable. In the case mentioned it was a matter of a payment of 145 000 SEK and assets of some 5.7 million. This payment was not considered avoidable. In an even later case,[16] the Supreme Court found, however, that a payment corresponding to about 12 % of the assets had appreciably worsened the debtor's financial position. From now on it might be possible to assume that 10 % of the assets constitutes a target.

In my opinion there are certain arguments in favour of a fourth alternative, namely that which involves finding out how the payment has affected the debtor's *liquidity*. This approach seems to have occurred to the Danish and Norwegian legislator.[17] The deciding factor would in that case be how the payment affected the debtor's financial position in the sense of his possibility of continuing his business activities. In this context the assessment of the size of the amount will automatically relate to the date on which payment was made, and in that case the requirement that the amount must have appreciably worsened the debtor's financial position will function as a reinforced prerequisite of prejudice.

4.3. *Ordinary payments*

As was stated in the introduction, a common exception has been made for payments which, even though as such they fall within one of the three typical situations, may nonetheless be considered *ordinary*.[18] This exception is quite in keeping with the legislator's aim of seeking to determine the conditions for avoidance so that they will apply to transactions which in themselves appear to depart from what is normal.[19] As expected, the objection that the payment was ordinary has proved popular among those creditors who have been exposed to claims for avoidance.

The Act merely states that the payment must be ordinary. There are,

[15] 1981 NJA 759.
[16] 1982 NJA 135.
[17] *Betænkning* no. 606/1971, p. 151, and *NOU* 1972: 20, p. 291.
[18] Cf. the exception under the *American* Bankruptcy Act, sec. 547(c)(2) for payments made "in the ordinary course of business or financial affairs of the debtor and the transferee".
[19] Cf. *SOU* 1970: 75, p. 129.

therefore, no special definitions along the lines that the payment must have been made within a certain time from the date the debt was incurred, etc.

The determination of what may be regarded as an "ordinary" payment is one of the most difficult problems posed by the new legislation. There are, in the first place, two questions that arise. The first is, what does the concept ordinary generally mean. The other is how the concept ordinary is related to the basic concepts payment by other than the usual means, payment in advance and payment in amounts of a size that appreciably worsens the debtor's financial position.

It is not easy to give a brief definition of the concept ordinary, nor is any such definition given in the legislative material. In my opinion, what was said above about the function of the rules regarding avoidance favours defining an ordinary payment as one which, objectively speaking, is not connected with the debtor's financial problems and possibly imminent bankruptcy. In other words, the payment must be one that, objectively speaking, has been affected, not by the debtor's insolvency, but by other factors. The decision must be made with reference to external factors and all the external circumstances must be taken into account. In general, the external situation must be such that there can, again objectively speaking, be no grounds for suspecting that the creditor knew of the debtor's payment problems and for this reason was anxious to be paid before the other creditors. On the other hand—and this is pointed out in the *travaux préparatoires*[20]—it does not in principle matter if in the specific case the creditor had or did not have reasonable cause to believe that the debtor was insolvent. Whether the creditor really knew or at least ought to have known of the debtor's insolvency is instead a question that is important when it comes to applying the general rule. If it can be established that in a special case the creditor acted in bad faith (and that the other conditions for avoidance have been present) avoidance can be effected according to the general rule, even if the payment as such has been found to be ordinary.

The starting point, then, is the question of whether the payment would have been made in the same way if the debtor had not had any financial problems. Circumstances to be noted when judging this are, for example, the following. When payment is made in advance the fact that the debtor formerly also used to pay in this way, or that the payment afforded him obvious practical benefits, could be of importance. If the payment involved an amount that appreciably worsened his financial position what could be important, for example, is that it related to a usual current expense, such as the rent, that it was made not all that long after the date of maturity and that he also paid other creditors. On

[20] *SOU* 1970: 75, p. 150, where examples of ordinary payments are also given.

the other hand, paying a debt that has been due for a long time is not an ordinary payment.[21] Another example of an ordinary payment is one that has been made in accordance with a previously agreed time payment plan.[22]

As regards the second question it is to be noted that the specially mentioned cases of payment where avoidance is possible that are stated in the Act are characterized by the fact that the payment itself is extraordinary: It has been made by other than the usual means of payment, on a day other than the normal date of maturity or relates to a conspicuously large amount. One could then ask oneself how much room the exception for ordinary payments could have by the side of the determination of whether the payment does belong to one of the cases mentioned at all.

The answer must be that the judgments relate to different circumstances. Thus, for example, the question of whether a payment has been made in an amount that appreciably worsens the debtor's financial position must be decided by reference to the size of the amount and the debtor's financial position, while the question of whether the payment can nonetheless be regarded as ordinary must be decided by taking into account other circumstances, such as the purpose of the payment, whether it was made in accordance with a previously agreed payments plan, and so on.

That different circumstances are taken account of when an assessment is made is the only thing—apart from the general guidelines—that unites the application of the exception for ordinary payments in the three typical situations. Detailed analysis, in fact, shows that the exception serves quite different purposes in the three cases.

In the first place, it may be observed that the exception is of no particular importance when it is a matter of payments made by *unusual means of payment.* The concepts usual and ordinary cover on the whole the same set of circumstances. In the Swedish legislative material no concrete example is in fact given of an ordinary payment made by unusual means of payment. All that is stated is that a payment made by a means of payment that is in general unusual in a certain trade may "on occasion in a special case" be quite correct.[23] On the other hand, the exception is more important in respect of payments in advance and in amounts that appreciably worsen the debtor's financial position.

Judging whether a payment made by an unusual means of payment or in advance may be regarded as ordinary takes into account circumstances of the kind that could in fact already have been noted when making the initial appraisal, that is to say, when judging whether the payment had been made by

[21] 1982 NJA 224, 1981 NJA 534.
[22] 1982 NJA 135.
[23] *Prop.* 1975:6, p. 224.

an unusual means of payment or in advance. Where payments made by an unusual means of payment are concerned account is also taken of most of the circumstances in the initial assessment. It would hardly simplify matters to refer certain of these circumstances to the exception for ordinary payments. As regards payments *in advance,* however, a special exception for ordinary payments offers certain advantages, thereby making it easier to deal with the application of the concept "in advance". The fact is that the normal date of payment can in this way be determined according to more rigorous criteria, following which modifications may be made with the aid of the exception for ordinary payments. The effect of this is that payments made at a time that should normally not be accepted may, in individual cases, be approved and conversely that payments made at a time that normally—though not always—ought to be accepted can despite this be avoided. By way of illustration of the final statement let us assume that the point at issue is whether the day on which the debtor acquires the right to pay or the day on which he becomes liable to pay is to be regarded as the normal maturity day. Even if one were to hold the opinion that payments made after the debtor has acquired the right to pay ought in most cases to be accepted, it could be an advantage to choose the day on which his liability begins, since the court is not obliged to accept *all* payments made after the former day.[24] The acceptable payments are regarded as ordinary, the others are not.

The line of demarcation between the initial judgment and the consideration of the exception for ordinary payments is the easiest one to draw when the payment has been made in an amount that *appreciably worsens* the debtor's financial position. Here, too, the assessments relate to different types of circumstances, though in this case these are clearly distinguishable. In contrast to the two previous cases it is not a question here of exercising a certain freedom of choice as to the respect in which a circumstance must be regarded as important. Whether the payment was of a "considerable size" is decided by reference to its size and to the debtor's financial position, whether it has been ordinary in view of the other circumstances surrounding the payment.

It appears therefore that the exception for ordinary payments has different functions in the three basic cases. It has a minor correctional function where payments are made by unusual means of payment. Where payments in advance are concerned it simplifies the determination of the normal maturity day. In the case of payments of a size that appreciably worsen the debtor's financial position it enables account to be taken of circumstances quite different from those that could be allowed for in the initial judgment.

[24] Cf. Krag Jespersen, in *Juristen & Økonomen* 1975, p. 480.

5. THE SPECIAL RULE RELATING TO AVOIDANCE OF TRANSFERS OF SECURITY INTERESTS ON ACCOUNT OF ANTECEDENT DEBTS

According to the earliest Swedish rules on avoidance (from 1862) avoidance could be effected of transfers of security interests made within the period of vulnerability if no security agreement was made when the debt was incurred. Bad faith was not a requirement. In a later reform (1921) a rule was added to cover the case where the transfer of a security interest certainly had been agreed on when the debt was incurred but where the security interest was not perfected, i.e. made effective against third parties, until later. Here, too, avoidance was possible, though the critical period was shorter than when no agreement at all had been made. According to the 1921 rules the creditor must have acted in bad faith. The present rule requires *both* that there is a security agreement at the time the debt is incurred *and* that the security interest is perfected without delay thereafter. The transfer of the security interest is avoidable if any of these conditions is not complied with. Thus, the practical emphasis has been transferred from the question of whether a security agreement existed at the time the debt was incurred to that of whether the security interest was thereafter perfected without delay. (If there is no security agreement at the time the debt is incurred it can rarely be expected that the security interest will thereafter be perfected without delay.) The prerequisite "without delay" is new and amounts to a certain, though slight, easing of the rule.

The starting point, therefore, is that the transaction is protected from avoidance if the security interest is perfected at the time debt is incurred, that is to say, at the same time as the money is transferred to the debtor. If the basic idea is that avoidance can be made only of transactions that have prejudiced the creditors at the time they are undertaken, there is nothing to object to about such a reciprocal transaction. It only means that the parties have exchanged services and the transfer of the security interest has not led to any prejudice to the creditors.

A different situation arises where the transfer of the security interest is made on account of an antecedent debt, that is to say, when the transfer is made later than when the debtor gets the money. In such cases the creditor does not receive any valuable consideration that could benefit the other creditors. The consideration could, for example, consist of the creditor's refraining from collecting his claim on the appointed maturity day. The transfer is in practice equivalent to a payment or at least to an agreement that the creditor will have a preferential right in the event of the debtor's bankruptcy. The reasons in favour of a payment in a corresponding situation being avoidable also suggest that the transfer of the security interest ought to be avoidable. If in some cases the creditor's consideration consists in a lowering of the interest rate or the loan is written off to a certain extent, then—to the extent that the considerations cover each other—a situation exists that more specifically ought to be regarded as a payment and where avoidance ought therefore to be made by means of at least an analogous application of the rules relating to payment. This could be of advantage to the creditor since exceptions can then be made for ordinary transactions.

As we have seen, the security agreement and the perfection are two relevant elements of a secured transaction. But why must both these elements be regarded as important in connection with avoidance? Would it not suffice if there was a security agreement when the debt was incurred?[25] This question ought, however, to be divided into two parts. The first is concerned with deciding which transactions the rule should on the whole aim to cover, while the second is concerned with deciding whether it is the security agreement or the perfection that should be made during the critical period.

In my opinion, the transactions which there is reason to discourage are in the first place those where there was no security agreement at the time the debt was incurred. It is, in the first place, here that one can suspect an unfair purpose on the part of the creditor. (Cf. what is said in section 4.1 above about "congruous" payments, that is to say, payments of debts due by ordinary means of payment.)

What, then, can be the reasons for regarding the perfection as so important? One reason that is advanced is the difficulty of proof, that is to say, it is more difficult to produce evidence concerning the security agreement than is the case where the observance of the perfection is concerned. Another reason is that it is desirable for the perfection to take place as quickly as possible; in this way the security interest is made known to the other creditors, who will then have an opportunity of considering whether they wish to institute bankruptcy proceedings against the debtor. The arguments have been criticized,[26] the former on the ground that it would not be in conformity with what has been observed in case law and the latter on the ground that in practice the transfer of a security interest is not as a rule discovered until bankruptcy proceedings have already been instituted for some other reason. As against this, though, it must be admitted that if avoidance can be made of "congruous" payments then it ought also to be possible where such transfers of security interests are concerned. However, as we have seen in the foregoing, there is no *general* possibil-

[25] According to the French Bankruptcy Act, art. 29, para. 2 no. 6, avoidance cannot be made of a transfer of a security interest, if the security agreement is made outside the period of vulnerability, regardless of when the perfection takes place.

[26] Berning, "Omstødelse i konkurs og den sikrede kreditor", *TfR* 1975, pp. 21 ff., on pp. 57 ff.

ity of avoiding congruous payments under Swedish law; furthermore, exceptions are made for ordinary payments.

The second question was whether the requirement should be that the security agreement or the perfection is made during the period of vulnerability. Even if the security agreement as such is the most interesting point of time according to the argument outlined above it is not to be taken for granted that the period of vulnerability really ought to be linked with it. The fact is that there is a different reason altogether that, on balance, argues in favour of linking the critical period to the time of the perfection. This is that prior to this time the right does not prejudice the other creditors; the security interest is not effective against third parties and does not amount to a preferential right in the bankruptcy. Why should the respite run for such a "harmless" matter? From the point of view of the bankrupt's creditors the really interesting point of time is the perfection and as we have seen it is also this point of time that has to fall within the critical period.

The fact that the perfection is of decisive importance in both the respects mentioned, and that Swedish law makes no mention of any exceptions from the possibility of avoidance, does, however, lead to a number of transactions that in themselves do not seem all that unfair being adversely affected by the rule. In all these cases a security agreement has been made at the time the debt was incurred. One group comprises transfers of security interests in after-acquired property. Here the security interest does not attach until the debtor acquires rights in the collateral and this leads to it becoming automatically a question of securing antecedent debts. The problem could easily be solved if an exception were to be made for ordinary transactions relating to secured transactions as well. Otherwise, all that remains is to try other legal constructions, such as exchanging pledges or the like, to the extent this would be generally accepted by the courts. It ought, however, to be pointed out that there is in Swedish law a special legal form that is reminiscent of the American concept of the "floating lien on inventory" and which is so constructed that in this present respect it is not affected by the avoidance rules.[27] Another group comprises cases where the parties have made some minor error, for example, where the creditor by mistake sends his application for filing his security interest to the wrong address. The error does not make the transaction normal, though it can be brought in as a mitigating circumstance that could possibly result in some modification of the effects of avoidance. However, stringent requirements are laid down in this respect (see next section).

[27] It is to be regretted that there is no equivalent of the *American* "improvement of position test".

6. MODIFICATION OF THE LEGAL EFFECTS OF AVOIDANCE

Generally speaking, avoidance means that the avoided transaction is void, that is to say, any considerations exchanged have to be returned.[28] The 1975 legislation introduced the possibility of modification, in full or in part, of the duty of the transferee—but not the estate in bankruptcy—to make restitution. As is suggested above, this new rule is connected with the removal of the prerequisite of bad faith. This means that there is nonetheless a possibility of taking account of the fact that the individual transferee has in reality acted in good faith. The disadvantage, of course, is that the possibility of modification introduces an uncertain element that can be unlawful in view of the way the rules are used as a guiding principle in voluntary agreements and in negotiations outside bankruptcy.

However, modification presupposes "special reasons" and it is clear that this applies only in exceptional cases. As yet, the Supreme Court has not granted it in any case in which it has been requested.

When judging whether modification ought to take place all the existing circumstances have to be taken into account, and the following are specifically mentioned in the legislative material.[29] One important guideline is whether what the transferee has to return exceeds what he gained through the transaction. It is not, however, the intention that modification should as a rule be made when the recovery would involve the transferee in a clear loss. Great importance is also attached to the transferee's having acted in good faith, as well as to the nature of the transaction and the relationship between the transferee and the debtor in bankruptcy. In the cases referred to above, where the Supreme Court did not grant a request for modification, the principal reason was that the transaction benefitted an insider or that the creditor (transferee) acted in bad faith.

7. CONCLUSION

This paper has attempted to demonstrate that the basic ideas behind the avoidance system are international. The present rules regarding avoidance in Swedish law, which date from 1975, are above all intended to lead to enhancing the possibilities of avoidance, at the same time as the demands of business life are, even so, taken into account. The method adopted by the legislator in

[28] The rule that the transferee must have returned to him the consideration he gave does not, however, apply to a consideration that has not been of benefit to the estate if the transferee was aware or ought to have been aware that it was the debtor's intention to make this inaccessible to the creditors.

[29] *Prop.* 1975:6, pp. 140 f., 249 ff.

order to achieve this objective may be said to constitute part of the international trend in this field. The move towards improving avoidance prospects is also affected by the repudiation of the prerequisite of bad faith and the stricter view taken of insiders. The rules have also led to an increase in the number of avoidance cases. The express exception made for ordinary payments occasioned by the realities of business life does have a restrictive effect. One critical view is that this exception could have been made somewhat more comprehensive; no exceptions have, for example, been laid down for secured transactions. There are a number of practical situations for which the rules are not suited, for example concerning check account overdrafts, transfers of security interests in after-acquired property and various transactions within a group of companies. It must also be pointed out that certain of the rules include concepts that have proved difficult to apply, though it is hoped that these problems can be overcome.