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THE IMPACT OF THE NEW BANKRUPTCY CODE ON THE "BANKRUPTCY OUT" IN LEGAL OPINIONS*

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A legal opinion¹ is often an essential part of an agreement for the sale of property or the creation of an obligation.² One party to a transaction will customarily demand an opinion from the other party's lawyer stating that the agreement is "valid, binding, and enforceable in accordance with its terms"—an enforceability opinion.³ But while an obligation may remain "valid" and "binding," a party may be released from performance, or may otherwise have the enforceability of the obligation drastically limited, by its subsequent bankruptcy and by the actions of the trustee in bankruptcy. As a result, an enforceability opinion is usually qualified by the proviso "except as enforceability may be limited by bankruptcy, insolvency, reorganization or similar laws affecting the rights of creditors generally"—the "bankruptcy out."⁴ This limitation on the scope of the enforceability opinion is particularly important if the language "enforceable in accordance with its terms" is taken to mean that the agreement is specifically enforceable by the party to whom the opinion is addressed.⁵

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1. The kind of legal opinions discussed in this article have been described as "opinions of counsel rendered as the result of contractual obligations of the client to provide a favorable opinion as a condition to the obligation of the other party to the contract, or as is sometimes the case to opinions rendered to the client (in almost all cases the upperdog—underwriter, lender, buyer; the one with the money) which is still a condition of the client to proceed with the deal." Bermant, *The Role of the Opinion of Counsel: A Tentative Reevaluation*, 49 Cal. St. B.J. 132, 137 n.5 (1974).

2. "[L]egal opinions are almost always required as a condition precedent to the closing of the transaction." Fuld, *Legal Opinions in Business Transactions—An Attempt to Bring Some Order out of Some Chaos*, 28 Bus. Law. 915, 915 (1973).

3. For examples of legal opinions and discussions of the considerations involved in drafting them, see Special Committee on Legal Opinions in Commercial Transactions, *Legal Opinions to Third Parties: An Easier Path*, 34 Bus. Law. 1891 (1979) [hereinafter cited as *Legal Opinions to Third Parties*], and two model opinions prepared by the Subcommittee on Opinion Writing of the Massachusetts Bar Association Committee on Corporate, Banking and Business Law, *Omnibus Opinion for Use in Loan Transactions*, 60 Mass. L.Q. 193 (1975) [hereinafter cited as *Loan Transactions Opinion*], and *Omnibus Opinion for Use by Seller's Counsel in the Sale of a Closely-Held Business*, 61 Mass. L.Q. 108 (1976) [hereinafter cited as *Closely-Held Business Opinion*].

4. See *Legal Opinions to Third Parties*, *supra* note 3, at 1917, 1926; *Loan Transactions Opinion*, *supra* note 3, at 199-200; *Closely-Held Business Opinion*, *supra* note 3, at 116.

5. There is some controversy over the necessity for the bankruptcy out in legal opinions. One

The traditional understanding of the bankruptcy out as a qualification which "relates to the availability of remedies and the collectibility of debt"⁶ clearly limits the enforceability opinion by excluding from its scope a wide range of the effects of bankruptcy under the new Bankruptcy Code (the Code).⁷ For example, the filing of a petition in bankruptcy acts as an automatic stay preventing the commencement or continuation of lien enforcement proceedings, as well as other lawsuits, against the debtor and his property.⁸ Executory contracts, including unexpired leases of real property, may be rejected by the trustee in bankruptcy, leaving the unsecured creditor or lessor with a claim for

view is that the bankruptcy out is unnecessary because the scope of the enforceability opinion is not broad enough to include advice as to the impact of bankruptcy. Proponents of this position point out that the enforceability opinion is not an "extended opinion [containing] words such as 'in bankruptcy', 'against third parties' or 'specifically enforceable.'" Babb, Barnes, Gordon & Kjellenberg, *Legal Opinions to Third Parties in Corporate Transactions*, 32 Bus. Law. 553, 564 (1977). Accordingly, the enforceability opinion "does not predict the outcome of future litigation arising out of the [a]greement [and] does not mean that it will be enforced under all circumstances or against third parties or that any particular remedy (e.g. specific performance) will be available." *Id.* From this perspective, the bankruptcy out is obviously not necessary because it is "(i) not properly an exception to an opinion that an agreement is valid or enforceable or enforceable in accordance with its terms, or (ii) implied as a matter of custom, to the extent it is deemed an exception to any such opinion." *Id.* at 564-65. At the same time, adherents to this view recommend that the phrase "enforceable in accordance with its terms" not be included in a legal opinion. Yet the use of such language is customary. See, e.g., *Legal Opinions to Third Parties*, *supra* note 3, at 1926; *Loan Transactions Opinion*, *supra* note 3, at 202; *Closely-Held Business Opinion*, *supra* note 3, at 111. "The use of a general qualification as to insolvency laws and specific performance . . . are thought, by careful counsel, to be necessary general modifications of the opinion that the various agreements . . . involved . . . are 'enforceable in accordance with their terms.'" *Loan Transactions Opinion*, *supra* note 3, at 200 n.16; *Closely-Held Business Opinion*, *supra* note 3, at 116 n.53. As a result, the leading commentator on legal opinions has espoused a better view of the bankruptcy out which recognizes that the enforceability opinion may well convey advice which should be qualified. Fuld, *supra* note 2, at 930. Characterizing "enforceable in accordance with its terms" as "probably the most controversial phrase in legal opinions," *id.*, Fuld suggests, three possible meanings for the language. First, "specifically enforceable" is proposed as a fair meaning. For example, a client who contracts to purchase a business in reliance on an enforceability opinion could reasonably expect to receive the actual business and not simply a claim for damages. Second, the phrase may mean simply that some, unspecified, remedy will be available in the event of a breach. Third, it may mean that each term of the agreement is susceptible or capable of specific enforcement, but that no prediction is made as to whether a court would actually so enforce it. "Because of the basic uncertain meaning of the phrase . . . it is usually unwise to give an unqualified opinion that the agreement is 'enforceable in accordance with its terms,' unless the only obligation under the agreement is to pay money." *Id.* at 931.

6. Fuld, *supra* note 2, at 931.

7. The new Bankruptcy Code was enacted as title 11 of the United States Code. Act of Nov. 6, 1978, Pub. L. No. 95-598, 92 Stat. 2549 (effective Oct. 1, 1979).

8. 11 U.S.C. § 362(a) (Supp. II app. 1978). This section enjoins any act or the commencement or continuation of any court proceeding to enforce a lien against property of the estate. The stay against lien enforcement also applies to attempts to enforce a lien obtained before bankruptcy by attachment, judgment, levy, or other legal or equitable means. Enforcement of any judgment against the debtor is also enjoined.

damages⁹ or, in some instances, special remedies.¹⁰ There is an ever-present possibility that indebtedness incurred after the filing of a petition will be granted security and priority ahead of prefiling obligations.¹¹ Some prefiling obligations may be equitably subordinated to other similar claims¹² or disallowed entirely.¹³ Further, a secured party may be compelled to turn over collateral to the estate,¹⁴ and such collateral may be used, sold or leased¹⁵ notwithstanding a provision to the contrary contained in the security agreement.¹⁶ A creditor's right of setoff may also be limited in bankruptcy.¹⁷ Finally, the claims of general creditors to dividends, for example, will be subordinated to priority claims¹⁸ and the debtor will usually be released from liability on all its dischargeable debts.¹⁹ In each of these instances, the Bankruptcy Code has a direct effect on the enforceability of the original agreement, and the insertion of the bankruptcy out in the enforceability opinion apprises the client of the limitation on its scope and

9. *Id.* § 365. Under this section, the trustee is given the right to assume or reject executory contracts. The definition of an executory contract for the purpose of the section is not found in the Code, but the term generally includes all contracts under which acts remain to be performed by both parties. *See generally* Countryman, *Executory Contracts in Bankruptcy* (pt. 1), 57 Minn. L. Rev. 439 (1973). A claim arising from such a rejection may be filed, usually as a general claim. 11 U.S.C. § 365(g) (Supp. II app. 1978). Of course, executory contracts may sometimes be assumed by the trustee notwithstanding a termination clause based on the financial condition of the debtor or designed to take effect on bankruptcy or insolvency. *Id.* § 365(b)(2).

10. If the debtor is a landlord under a rejected lease of real property the lessee may remain in possession of the premises in lieu of a claim for damages. 11 U.S.C. § 365(h) (Supp. II app. 1978). If the debtor is a vendor under a rejected land sale contract and the vendee is in possession, the vendee may remain in possession in lieu of damages. *Id.* § 365(h)(2).

11. *Id.* § 364.

12. *Id.* § 510(c).

13. *Id.* § 502(j).

14. *Id.* § 542(a), (b).

15. *Id.* § 363.

16. *Id.* § 363(f), (l).

17. *Id.* §§ 362(a)(7), 553.

18. Before any dividends are payable to general unsecured creditors, *id.* § 726, certain debts are entitled to full payment out of the estate in the order specified in § 507(a) of the Bankruptcy Code. *Id.* § 507(a). The priority items are, for the most part, expenses incurred by the debtor and others as a consequence of the bankruptcy proceeding. *Id.* § 503. The first priority consists of all the costs and expenses of recovering property for, and preserving, the estate, fees for the debtor's lawyer, and fees for the lawyers, accountants, and appraisers retained by the petitioning creditors in involuntary proceedings. The reasonable costs and expenses incurred by creditors in successfully opposing the debtor's discharge are also covered. The remaining priority items pertain to favored creditors, including wage claimants, consumer creditors, and tax claimants.

19. The ultimate impact of a bankruptcy proceeding, of course, is the discharge which is granted the debtor in an order declaring that any judgment theretofore or thereafter obtained in any court is null and void as a determination of the personal liability of the debtor with respect to debts discharged under §§ 727, 944, 1141, or 1328(b) of the Code. *Id.* § 523(a). Certain debts of individual debtors are nondischargeable under the section, including debts incurred by fraudulent means, and support and alimony debts. *Id.*

insulates the lawyer from liability if the agreement should eventually prove unenforceable.²⁰

It is less clear, however, whether the bankruptcy out also excludes from the scope of the enforceability opinion the potential impact of the rights and avoiding powers of the trustee in bankruptcy. On the one hand, the bankruptcy out would seem to have precisely this effect, because the trustee derives his rights and powers from the Bankruptcy Code, and the bankruptcy out excludes from the enforceability opinion all cases in which enforceability is "limited by bankruptcy." On the other hand, the bankruptcy out may not always accomplish this result because the trustee's rights and powers under the Code are often identical to, or substantially the same as, the prebankruptcy rights of the debtor or his creditors under state or federal nonbankruptcy law. When the trustee successfully attacks an agreement in reliance on one of these rights and powers, a court might decide that it was nonbankruptcy law that limited enforceability. In such a case the bank-

20. There is some uncertainty as to the scope of an attorney's liability in connection with a legal opinion. "It is frequently said that an opinion is only an opinion, not an insurance policy, and it is true that a lawyer is generally liable only for negligence." Fuld, *supra* note 2, at 918 (footnote omitted). For example, attorneys have frequently been held liable to clients on opinions as to the marketability of title based upon a faulty title search. *See, e.g.,* Gleason v. Title Guarantee Co., 300 F.2d 813 (5th Cir. 1962); Bayerl v. Smith, 117 N.J.L. 412, 189 A. 93 (1937); Byrnes v. Palmer, 18 A.D. 1, 45 N.Y.S. 479 (1897), *aff'd*, 160 N.Y. 699, 55 N.E. 1093 (1899). Traditionally, however, a lawyer's liability for such negligence has not extended to third parties who, unlike the client, are not in privity. *See* Savings Bank v. Ward, 100 U.S. 195 (1897); *cf.* Ultramares Corp. v. Touche, 255 N.Y. 170, 174 N.E. 441 (1931) (parties not in privity cannot recover for the negligence of a public accountant). Nevertheless, the typical third party legal opinion, which is delivered to the third party at the request of the client, is more analogous to *Glanzer v. Shepard*, 233 N.Y. 236, 135 N.E. 275 (1922), in which a public weigher, who delivered a weight certificate to a buyer at the request of the seller, was held liable to the buyer for its inaccuracy, notwithstanding the lack of privity. One lawyer has described the situation as follows: "You are counsel for the company and you are going to give the opinion at the company's request to the lender. In my definition, your client has become the third party. I think it is pretty clear that your obligations to your client are at least as great as your obligations to the lender to whom you are rendering the opinion. . . ." Panel Discussion, *Legal Opinions Given in Corporate Transactions*, 33 Bus. Law. 2389, 2422 (1978) (Remarks of John Burlingame). Accordingly, it has been argued that the liability of attorneys for their opinions should be extended, Note, *Public Accountants and Attorneys: Negligence and the Third Party*, 47 Notre Dame Law. 588 (1972), particularly in connection with securities transactions, Freeman, *Opinion Letters and Professionalism*, 1973 Duke L.J. 371. Commentators have noted the possibly enlarged scope of a lawyer's liability in connection with a legal opinion. *See* Fuld, *Lawyers' Standards and Responsibilities in Rendering Opinions*, 33 Bus. Law. 1295, 1309-10 (1978) ("In the hope of avoiding liability to a class of persons, a lawyer may state that he is limiting his opinion to the addressee and that only the addressee may rely on the opinion. . . . I suspect that, as the law develops in the future, a limitation which is contrary to realistic expectations would not be upheld."). A recent California decision refused to dismiss the complaint of a third party who sought damages from a law firm, alleging that the firm had negligently delivered an erroneous opinion to its client with the knowledge that it would be used to solicit loans from the plaintiff and other investors. *Roberts v. Ball, Hunt, Hart, Brown & Baerwitz*, 57 Cal. App. 3d 104, 128 Cal. Rptr. 901 (1976).

ruptcy out, by its terms, would not protect the lawyer who rendered the enforceability opinion.

The following analysis examines the trustee's panoply of rights and powers under the new Bankruptcy Code, ranging from those generally available to the debtor under nonbankruptcy law to those unique to the bankruptcy context. The impact of each right and power of the trustee is considered in order to determine whether the bankruptcy out should exclude that impact from the scope of the enforceability opinion, and language is recommended which may accommodate the suggested interpretation.

I. TRUSTEE'S POWERS DERIVED FROM NONBANKRUPTCY LAW

A. *Trustee Asserting Claims and Defenses Available to the Debtor*

The enforceability of an agreement may depend solely on the rights of the debtor as of the date the petition in bankruptcy is filed. Under section 541(a) of the Code, for example, the commencement of a bankruptcy case creates an estate consisting of all the debtor's legal and equitable interests in property.²¹ These interests include the legal rights of title and possession, as well as choses in action, and the equitable rights of redemption and specific performance.²² In addition, the trustee, as representative of the estate,²³ can commence any lawsuit that the debtor could have instituted prior to the filing of the petition.²⁴ Thus, if the debtor had the right to challenge the enforceability of an agreement prior to bankruptcy, the trustee will have the same right. The Code also affords the trustee the benefit of "any defense available to the debtor as against an entity other than the estate, including statutes of limitation, statutes of fraud, and other personal defenses."²⁵

As a result of section 541(a), the trustee in bankruptcy, rather than the debtor, can both initiate an action to rescind an agreement and defend an action to enforce an agreement: the trustee is simply substituted for the debtor.²⁶ In such situations, enforceability is not limited by bankruptcy but depends on the rights of the debtor which

21. 11 U.S.C. § 541(a)-(a)(1) (Supp. II app. 1978).

22. See H.R. Rep. No. 595, 95th Cong., 1st Sess. 367-68 (1977), reprinted in [1978] U.S. Code Cong. & Ad. News 5963, 6323-24; S. Rep. No. 989, 95th Cong., 2d Sess. 82-83 (1978), reprinted in [1978] U.S. Code Cong. & Ad. News 5787, 5868-69.

23. 11 U.S.C. § 323 (Supp. II app. 1978).

24. *Id.* § 541(a)(1). See generally 4 W. Collier, *Bankruptcy* ¶ 541.10 (15th ed. L. King, M. Cook, R. D'Agostino & K. Klee 1979).

25. 11 U.S.C. § 541(e) (Supp. II app. 1978). The waiver of any such defense by the debtor after the commencement of the case does not bind the estate. *Id.*

26. One slight difference exists when the trustee asserts the claim. The time during which the debtor must have asserted the claim may be tolled if the claim is brought by the trustee. *Id.* § 108.

existed prior to bankruptcy. The bankruptcy out, therefore, should not be interpreted as excluding these situations from the scope of the enforceability opinion. A cautious recipient of the opinion, however, may wish to make clear that the bankruptcy out does not extend to these situations by requiring that the opinion be modified as follows:

except as such enforceability may be limited by provisions of title 11 of the United States Code, insolvency laws, or similar laws affecting the rights of creditors generally, that are not expressly derived from rights that the seller (purchaser) was entitled to assert absent such title or laws.

This contraction of the bankruptcy exception expands the scope of the enforceability opinion, thereby giving greater assurance to the recipient. At the same time, the opining lawyer has expressly broadened the scope of matters which must be considered before rendering his opinion, exposing himself to a greater potential for liability.²⁷

B. *Trustee Asserting Rights and Powers of Creditors Under State and Federal Nonbankruptcy Law*

The enforceability of an agreement in a bankruptcy proceeding may depend on rights enjoyed under state or federal nonbankruptcy law by a creditor of a debtor. Under section 544(b) of the Code, a trustee is empowered to avoid any transfer of property or any obligation of the debtor that is voidable for any reason by an actual unsecured creditor under any applicable nonbankruptcy law.²⁸ The claim of the actual unsecured creditor must be one which is allowable under the Code.²⁹

As in the case of the prebankruptcy rights of the debtor, this section appears, at least initially, to create a situation which the bankruptcy out should not exclude from the scope of the enforceability opinion, because the powers conferred on the trustee by section 544(b) are derived from nonbankruptcy law rather than from the Code. The trustee assumes the role of an actual creditor of the debtor, instead of standing in the shoes of the debtor. The dependence of the trustee's rights on the existence of an actual unsecured creditor suggests that the bankruptcy out should not exclude the potential impact of the exercise of those rights on enforceability. The attorney drafting the enforceability opinion can reasonably be expected to have considered the rights of a party's creditors under the applicable state and federal nonbankruptcy law.

Nevertheless, the operation of the rule of *Moore v. Bay*³⁰ may have

27. "[T]he more the lawyer is willing to commit himself, the more he facilitates a transaction for his client, but of course the more the lawyer exposes himself." Fuld, *supra* note 2, at 918.

28. These powers "enable the trustee to marshal or increase the potential assets of the estate." 4 W. Collier, *supra* note 24, ¶ 544.01 at 544-2.

29. 11 U.S.C. § 544(b) (Supp. II app. 1978).

30. 284 U.S. 4 (1931).

devastating consequences if the bankruptcy out does not exclude the impact of an actual unsecured creditor's rights on enforceability. In *Moore v. Bay*, the Supreme Court construed section 70e of the Bankruptcy Act,³¹ from which section 544(b) of the new Code is derived, to permit the trustee to assert the rights of a single creditor on behalf of the entire estate.³² Section 544(b) continues this principle to the extent of allowing the trustee to assert one unsecured creditor's rights on behalf of the entire estate. In addition, the rule has the effect of allowing the trustee to stand in the shoes of a creditor who has a relatively small claim and to exercise his power to avoid the transfer in its entirety, not merely to the extent of the creditor's claim.

The consequences of this power become apparent in a transaction involving the transfer of substantially all the assets of a retail or wholesale merchant. Assume, for example, that the buyer of the assets waives compliance with the bulk sales article of the Uniform Commercial Code,³³ which might not seem unreasonable if arrangements had been made to assure that the seller's creditors are paid. If all but one of the seller's creditors are paid and, following the transaction, the seller invests the proceeds of the sale in a new business which fails, leaving new creditors and forcing the seller into bankruptcy, a trustee who is able to locate the lone unpaid creditor may set aside the entire bulk sale for the benefit of the estate. This would be true even if the claim of the original unpaid creditor were miniscule in amount, and even though all the other claims were subsequent to the bulk sale, having arisen upon the failure of the second business.³⁴

Absent bankruptcy, the lawyer who rendered an enforceability opinion which neglected to consider the bulk sales requirements would be liable only to the extent of the claim of the single creditor who was overlooked and not paid. Under *Moore v. Bay*, however, the impact of the lawyer's negligence is compounded by the party's bankruptcy, resulting in the avoidance of the entire transaction. This drastic result ought to be excluded from the scope of the enforceability opinion by the bankruptcy out. To accomplish this result, the bankruptcy out might be modified in the following way:

31. Act of July 1, 1898, ch. 541, § 70, 30 Stat. 544 (repealed 1979).

32. 284 U.S. at 5.

33. U.C.C. art. 6. Sections 6-104, 6-105, and 6-107 of the U.C.C. generally provide that unless the transferor gives notice to his creditors in the required manner, and submits a list of those creditors to the transferee, a bulk transfer is ineffective against the transferor's creditors.

34. A second example of the trustee's power under § 544(b) involves the sale of personal property which requires a change of possession to complete the transfer. Under Cal. Civ. Code § 3440 (West 1970), if such a sale is not accompanied by a change of possession, the property remains subject to the claims of the creditors of the transferor. Accordingly, the trustee would have the power to invalidate the prior transfer of any such personal property which remains in the possession of the debtor on the date of bankruptcy. The intended transferee would have no recourse other than to file a claim as a general unsecured creditor for consideration which had been transferred to the debtor in exchange for such property.

except as such enforceability may be limited by provisions of title 11 of the United States Code, insolvency laws, or similar laws affecting the rights of creditors generally that (i) are not expressly derived from and (ii) do not have substantially the same effect as, the rights that the seller (purchaser) or any creditor of the seller (purchaser) was entitled to assert absent such title or laws.

Such a provision would insulate the opining lawyer from the untoward effects of section 544(b) and *Moore v. Bay* by excluding from the scope of the opinion any limitation on enforceability that has an effect which is not substantially the same as the effect of rights that any unsecured creditor was entitled to assert absent bankruptcy. The "magnifying" effect of *Moore v. Bay*, therefore, is specifically excluded by the narrowed enforceability opinion.

II. TRUSTEE'S POWERS WHICH ARE SUBSTANTIALLY THE SAME AS RIGHTS UNDER THE NONBANKRUPTCY LAW

A. *The Trustee's Right to Avoid Fraudulent Transfers*

The enforceability of an agreement may depend on rights which are substantially the same as those vested in creditors under the state fraudulent conveyance statute. Under section 548(a) of the Code, every transfer made³⁵ within one year immediately prior to bankruptcy is fraudulent as to creditors if made or incurred: (1) with actual intent³⁶ to hinder, delay, or defraud a creditor; or (2) without receipt of a reasonably equivalent value in exchange for such transfer or obligation³⁷ if the debtor (a) is, or will thereby be rendered, insolvent,³⁸ or (b) is engaged or is about to engage in a business or transaction for which the remaining capital is unreasonably small,³⁹ or (c) intended to, or believed that he would, incur debts beyond his ability to pay as they mature.⁴⁰

The trustee may avoid a transfer made or an obligation incurred

35. "[A] transfer is made when such transfer becomes so far perfected that a bona fide purchaser from the debtor against whom such transfer could have been perfected cannot acquire an interest in the property transferred that is superior to the interest in such property of the transferee, but if such transfer is not so perfected before the commencement of the case, such transfer occurs immediately before the date of the filing of the petition." 11 U.S.C. § 548(d)(1) (Supp. II app. 1978).

36. Section 548(a)(1) requires "actual intent" to defraud, as distinguished from intent presumed in law.

37. 11 U.S.C. § 548(a)(2)(A) (Supp. II app. 1978).

38. Section 548(a)(2)(B)(i) applies without regard to the debtor's actual intent to hinder, delay, or defraud creditors. "Insolvent" is generally defined as the "financial condition such that the sum of such entity's debts is greater than all of such entity's property, at a fair valuation. . . ." *Id.* § 101(26).

39. *Id.* § 548(a)(2)(B)(ii).

40. *Id.* § 548(a)(2)(B)(iii).

that is fraudulent under section 548(a).⁴¹ This power is similar to that available to creditors under the Uniform Fraudulent Conveyance Act (UFCA),⁴² adopted in many states.⁴³ In fact, pursuant to section 544(b) of the Code, the trustee may elect to proceed under the state's fraudulent conveyance law if it affords a longer statute of limitations or if the transfer was not in good faith.⁴⁴

The Code does not substantially alter nonbankruptcy law in this situation. Whether the trustee relies on section 548(a) of the Code, or, alternatively, on section 544(b) and the state fraudulent conveyance statute, the effect is the same. *Moore v. Bay* allows the trustee to avoid the transfer for the benefit of both creditors who exist at the time of the transfer and future creditors. Under nonbankruptcy law, the UFCA generally allows the transfer to be avoided for the benefit of then-existing and future creditors.⁴⁵

In one instance, however, the UFCA standard varies from that of the Bankruptcy Code. A conveyance by an insolvent is deemed fraudulent under the UFCA only as to then-existing creditors.⁴⁶ In practical terms, this means that such a fraudulent conveyance could only be set aside for the benefit of creditors who had extended credit at the time of the conveyance. Under the Code, however, the trustee may rely either on section 548(a)(2) or the combination of section 544(b) and *Moore v. Bay* in order to set aside the conveyance for the benefit of all creditors, even those "future" creditors who extended credit after the fraudulent transfer.⁴⁷ Effectively, the trustee is able to set aside the conveyance of an insolvent even if no creditors existed at the time of the transfer, as long as a future creditor exists. A future creditor relying solely on the state fraudulent conveyance statute would have no such power.

Accordingly, the bankruptcy out should exclude from the scope of the enforceability opinion situations in which a transaction is avoided because of the debtor's insolvency, under either section 548(a)(2) or section 544(b) and state law. At the same time, the previous analysis

41. A transferee who takes for value and in good faith has a lien to the extent of value given in exchange for the transfer. *Id.* § 548(c).

42. See Uniform Fraudulent Conveyance Act §§ 4-8. The provisions of the UFCA generally correspond to the provisions of § 548(a). Thus, Uniform Fraudulent Conveyance Act § 4 deals with conveyances by an insolvent, § 5 with conveyances by those in business, § 6 with conveyances of those about to incur debts, and § 8 with conveyances made with actual intent to defraud.

43. Twenty-three states have adopted the Uniform Fraudulent Conveyance Act. See 7A Uniform Laws Annotated 161 (1978), Uniform Fraudulent Conveyance Act, Table of Jurisdictions Wherein Act Has Been Adopted.

44. 11 U.S.C. § 544(b) (Supp. II app. 1978).

45. See Uniform Fraudulent Conveyance Act §§ 5-8.

46. Uniform Fraudulent Conveyance Act § 4.

47. See 4 W. Collier, *supra* note 24, ¶ 548.03 at 548-44.

suggests that if a transaction is set aside under any of the other provisions of section 548 or of the UFCA—those not involving the debtor's insolvency—the bankruptcy out should not be interpreted to exclude from the opinion the potential effect of avoidance. Under these latter provisions, the trustee's powers, and the amount which he is able to recover for the estate, will be substantially the same as that of creditors who could bring actions under state law in the absence of bankruptcy.

If the recipient of the enforceability opinion desires to modify the bankruptcy out so as to conform to this interpretation, the following language is suggested:

except as such enforceability may be limited by provisions of title 11 of the United States Code, insolvency laws, or similar laws affecting the rights of creditors generally, that (i) are neither expressly derived from *nor substantially identical to*, and (ii) do not have substantially the same effect as, the rights that the seller (purchaser) or any creditor of the seller (purchaser) was entitled to assert absent such title or laws.

B. The Trustee as a Hypothetical Lien Creditor and Purchaser

The enforceability of an agreement may turn on rights which a hypothetical lien creditor or bona fide purchaser could have asserted on the date of bankruptcy. Under section 544(a)(1), the trustee has the status of a hypothetical lien creditor who, on the date of bankruptcy, extends credit and obtains a judicial lien on all property of the debtor on which a creditor on a simple contract could have obtained a lien.⁴⁸ Section 544(a)(1) probably has its greatest impact in the situation where a security interest in personal property remains unperfected as of the date of bankruptcy. Under section 9-301 of the Uniform Commercial Code, an unperfected security interest is subordinate to the rights of a person who becomes a lien creditor before the security interest is perfected.⁴⁹ Because the trustee is granted the status of a "lien creditor" by section 544(a)(1) of the Bankruptcy Code, the trustee is given the power to invalidate security interests in personal property which remain unperfected as of the date of bankruptcy. In such a case, the affected secured creditor would be relegated to the status of a general unsecured creditor.

Under section 544(a)(3), the trustee enjoys the status of a hypothetical bona fide purchaser of real property from the debtor on the date of bankruptcy.⁵⁰ This section is most significant where a deed on real property remains unrecorded as of the date of bankruptcy. Under the

48. 11 U.S.C. § 544(a)(1) (Supp. II app. 1978). The trustee also enjoys the status of a hypothetical creditor who obtains an execution which is unsatisfied. *Id.* § 544(a)(2).

49. U.C.C. 9-301.

50. 11 U.S.C. § 544(a)(3) (Supp. II app. 1978).

law of many states, a bona fide purchaser of real property prevails over a grantee holding an unrecorded deed on such property.⁵¹

How should the bankruptcy out be interpreted if the trustee invalidates a security interest by reason of the hypothetical lien creditor or the bona fide purchaser status? First, the situation is once removed from reality since no *actual* creditor need exist. Second, a *Moore v. Bay* problem is once again presented because the trustee may rely on section 544(a) to set aside a transfer for the benefit of all creditors. Both factors suggest that the bankruptcy out ought to exclude the impact of section 544(a) from the scope of the enforceability opinion.

Nevertheless, since the trustee's rights depend on whether a security interest has been properly perfected under state law, the relevant issue is to determine who was responsible for the task. If the enforceability opinion specifically advised that the security interest had been perfected, counsel might reasonably be held accountable for the foreseeable consequences of the erroneous opinion—including loss of the security interest in bankruptcy—and the bankruptcy out should not be interpreted to exclude such an impact. On the other hand, if the enforceability opinion identified the appropriate steps required to perfect the security interest and stated that perfection was the responsibility of the recipient of the opinion, the opposite conclusion should follow. If the perfection problem were simply overlooked, counsel should not be permitted to rely on the bankruptcy out in any case in which counsel could have prevented the result and the perfection of the security interest was central to the transaction.

Absent a situation in which responsibility for the error on which the trustee relied rests with counsel, the bankruptcy out should be adjusted to clearly exclude the impact of section 544(a) from the scope of the enforceability opinion. This exclusion may be accomplished by the addition of the word "actual" to modify "creditor," as in the following example:

except as such enforceability may be limited by provisions of title 11 of the United States Code, insolvency laws, and similar laws affecting the rights of creditors generally, that (i) are neither expressly derived from *nor* substantially identical to, and (ii) do not have substantially the same effect as, the rights that the seller (purchaser) or any *actual* creditor of the seller (purchaser) was entitled to assert absent such title or laws.

III. TRUSTEE'S POWERS UNIQUE TO BANKRUPTCY

A. *The Trustee's Right to Ignore Forfeiture Clauses*

The Bankruptcy Code limits the enforceability of a forfeiture clause: that is, a provision in an agreement which would modify or terminate

51. See 6 R. Powell, *Real Property* ¶ 913 (P. Rohan ed. 1979).

the agreement upon insolvency or a change in the financial condition of a party, the commencement of a case under the Code, or the appointment of a receiver, trustee, or custodian. Section 541(c) requires that the property of the debtor pass to the estate notwithstanding a forfeiture clause or other provision that restricts the transfer of property.⁵² Once the debtor's property becomes property of the estate, section 363(l) permits the trustee to use, sell, or lease the property notwithstanding a forfeiture clause to the contrary.⁵³ Under section 365(e) a forfeiture clause cannot be used to terminate or modify an executory contract or unexpired lease of the debtor, with certain exceptions.⁵⁴ Further, a forfeiture clause cannot prevent the trustee from assuming⁵⁵ or assigning⁵⁶ most kinds of executory contracts and unexpired leases.⁵⁷ The bankruptcy out should be interpreted to exclude the application of these sections from the scope of the opinion, because these sections restrict forfeiture clauses only during bankruptcy.⁵⁸

B. *The Trustee's Right to Avoid Preferential Transfers*

The enforceability of an agreement in bankruptcy may depend on whether the transaction involved a preferential transfer.

A preference is defined in part as a transfer of property of the debtor, to or for the benefit of a creditor, for or on account of an antecedent debt of the debtor, made while the debtor was insolvent and within ninety days of bankruptcy, that enables such creditor to receive more than the creditor would receive in a liquidation case had the transfer not been made.⁵⁹ In addition, if the creditor is an "insider" and has reasonable cause to believe the debtor was insolvent, the ninety-day period is extended to one year prior to bankruptcy.⁶⁰ The trustee may avoid preferential transfers, subject to certain exceptions.⁶¹

52. 11 U.S.C. § 541(c) (Supp. II app. 1978).

53. *Id.* § 363(l).

54. *Id.* § 365(e). The section states that the limitation on forfeiture clauses does not apply to contracts to make loans or extend other debt financial accommodations to or for the benefit of the debtor, or a contract to issue a security of the debtor. In addition, forfeiture clauses remain effective with respect to contracts where applicable law excuses the nonbankrupt party from rendering performance to or accepting performance from the trustee. This would probably include some kinds of personal service contracts. *Id.* § 365(e)(2).

55. *Id.* § 365(b)(2).

56. *Id.* § 365(f).

57. The trustee may not assume or assign the contracts discussed in note 54 *supra*. *Id.* § 365(c).

58. Since a forfeiture clause may be enforced only under extremely limited circumstances, the opining lawyer would be wise to consider such a clause carefully when passing on the "validity" of the agreement in his opinion. The considerations involved are, however, beyond the scope of this article.

59. 11 U.S.C. § 547(b) (Supp. II app. 1978).

60. *Id.* § 547(b)(4)(B)(i)-(ii).

61. *Id.* § 547(c).

In the typical transaction involving the transfer of property for a present consideration there will be no risk of a preferential transfer because no antecedent debt is involved. Consider, for example, the case in which real and personal property is sold pursuant to an agreement under which the seller receives a down payment and a secured promissory note representing the balance of the purchase price. In such a situation the cash down payment and promissory note are delivered at the closing in exchange for a deed to the real property and a bill of sale covering the personal property. In addition, the security interest of the seller is usually evidenced by a deed of trust as to the real property and a security agreement as to the personal property.

In this example, property of both the seller and the buyer is being transferred contemporaneously. The seller transfers the real and personal property, and the buyer transfers the cash down payment, the promissory note, and the security interest granted to the seller in the real and personal property.⁶² None of these transfers constitutes a preference because, even if consummated on the eve of the seller's or the buyer's bankruptcy, the transfers are for a new and contemporaneous consideration.

Thus, the typical sale does not involve a preferential transfer when all the appropriate procedures are followed in consummating the transaction. A misstep in this area, however, may be fatal because of the provisions of section 547(e) of the Code.⁶³

Section 547(e) defines when a transfer of property is perfected and deemed to have been made for the purposes of section 547 of the Code. In the case of real property other than fixtures, a transfer is deemed to be perfected when "a bona fide purchaser . . . from the debtor against whom applicable law permits such transfer to be perfected cannot acquire an interest [in such property] superior to the interest of the transferee."⁶⁴ In the case of fixtures or personal property, a transfer is deemed to be perfected when no creditor on a simple contract can acquire a judicial lien superior to the interest of the transferee.⁶⁵ These tests are applicable regardless of whether there actually are or were creditors who might have obtained liens or become bona fide purchasers. A transfer is made at the time it takes effect between the debtor and transferee if perfected at or within ten days after such time. Otherwise the transfer is made when perfected or at the commencement of the case, whichever is earlier. A transfer is never made, however, until the debtor has rights in the property transferred.

62. "Transfer" is defined to include the retention of title as a security interest. *Id.* § 101(40).

63. *Id.* § 547(e).

64. *Id.* § 547(e)(1)(A).

65. *Id.* § 547(e)(1)(B).

The impact of section 547(e) is aptly illustrated if it is assumed that, through an inadvertance such as the improper filing of a financing statement, a seller's security interest in personal property is not properly perfected at the time of closing. Assume also that a year passes before the error is rectified and that the buyer files a petition under the Code within the ninety-day period following perfection of the security interest. In this case, even though the buyer's bankruptcy occurs more than a year after the actual transaction, the transfer of the buyer's property (the granting of the security interest in favor of the seller) will be deemed to have been made within ninety days of bankruptcy. In addition, the transfer will be treated as if it were for an antecedent debt because of the substantial period of time between the creation of the original obligation and the subsequent perfection of the security interest. If the other elements of a preference are present, the trustee would be able to successfully avoid the security interest.

How should the bankruptcy out be interpreted where a preference results because of the failure to perfect a security interest? Two factors point toward interpreting the bankruptcy out as excluding the effect of a preference from the scope of the enforceability opinion. First, the preference section of the Code has no counterpart in the laws of most states. Second, a *Moore v. Bay* kind of problem is presented. Absent bankruptcy, the secured party would merely be subordinate to creditors who obtained their liens prior to perfection. In bankruptcy, the security interest is invalidated in its entirety as to all creditors.

Outweighing these considerations, however, is the fact that the critical issue is one which is determined by state nonbankruptcy law—did the seller perfect the security interest? Because the failure to comply with state law regarding perfection creates the preference, the crucial question is whether counsel rendering the enforceability opinion or its recipient had the responsibility for this failure. If the recipient had responsibility, the bankruptcy out should exclude the effect of section 547 from the scope of the enforceability opinion. If counsel had responsibility, the bankruptcy out, as formulated above, clearly does not exclude the impact of the section.

CONCLUSION

The formulation of an enforceability opinion ought to involve an analysis of all the elements of a transaction which could bring the fraudulent conveyance, the preference, or other sections of the Bankruptcy Code into play. In such opinions, the bankruptcy out should be drafted with care and with consideration of all the possible situations in which enforceability may be affected by bankruptcy and related law. Indeed, both the counsel rendering the opinion and the recipient thereof should make certain that their respective interests are protected by the bankruptcy out.