Revised Article 9, The Proposed Bankruptcy Code Amendments and Securitizing Debtors and Their Creditors

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REVISED ARTICLE 9, THE PROPOSED BANKRUPTCY CODE AMENDMENTS AND SECURITIZING DEBTORS AND THEIR CREDITORS

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I. INTRODUCTION

This Article is a result of a Conference, appropriately titled Two Shocks to the Bankruptcy System. The Conference title recognizes that the revisions made to Article 9, and the proposed

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1. This paper is a result of the remarks made by the author at the Symposium entitled Two Shocks to the Bankruptcy System: Revised UCC Article 9 and the Pending Bankruptcy Reform Act of 2001, Where Do We Go From Here? held at Fordham University School of Law on November 15, 2001.

2. U.C.C. §§ 9-101- 9-709 (revised 1999). Article 9 of the Uniform Commercial Code ("UCC") deals with debt collateral and secured transactions. See Lawrence R. Ahern, III, "Workouts" Under Revised Article 9: A Review of Changes and Proposal for Study, 9 AM. BANKR. INST. L. REV. 115, 116 (2001) ("Article 9 of the Uniform Commercial Code governs the creation, perfection, priority and enforcement of consensual security interests in personal property and fixtures, as well as most consignments of personal property and sales of certain types of intangible personal property."). Article 9 was revised in 1999 ("Revised Article 9" or "Article 9"), and has been adopted uniformly by all U.S. states. NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS, States Uniformly Enact Article 9 Revisions, July 2001, at http://www.nccusl.org/nccusl/pressreleases/prl-07-01.asp (last visited Mar. 13, 2002). See generally Ingrid Michelson Hillinger & Michael G. Hillinger, 2001: A Code Odyssey (New Dawn for the Article 9 Creditor), 106 COM. L.J. 105 (2001) (discussing the key changes; "[m]any trees have died and many CLE credits have already been earned in the name of understanding Revised Article 9"). Article 9's recent revision have major implications for the financial world. See id. at 105-
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changes to the Bankruptcy Code,\textsuperscript{3} if enacted, will have a significant impact on firms and their creditors in bankruptcy. The Panel I participated in further recognized the impact these revisions and proposed changes will have on securitization originators in bankruptcy, as well as on their creditors.\textsuperscript{4} Indeed, many of these statutory changes are specifically designed to enhance the rights of secured creditors, as well as the rights of securitization transaction participants, once a debtor files for bankruptcy.\textsuperscript{5}

The central theme that runs through Revised Article 9 is the facilitation of secured credit. It is now easier for creditors to encumber a greater number and variety of types of assets.\textsuperscript{6}

\begin{enumerate}
\item Securitization, also known as structured financing, is the method of finance whereby a debtor transfers certain assets with a cash flow to a special purpose corporation ("SPC"); the SPC in turn transforms the cash flows into securities. See generally Glenn B. McClelland, Jr. & James W. McDonald, Jr., Securitizing Trade and Lease Receivables, in THE ASSET SECURITIZATION HANDBOOK 123, 130 (Phillip L. Zweig ed., 1989). These securities, known as asset-backed securities ("ABS"), are then sold to private or public investors. See id. Securitization remains the fastest growing sector in the capital markets, and there are currently about $185 billion ABS outstanding. Id. Commonly, originators securitize their assets to obtain certain advantages over alternative financing methods. See id. These advantages include improved liquidity, improved risk management, accounting-related benefits, and the ability to raise funds at a lower effective interest rate.
\item See G. Ray Warner, The Anti-Bankruptcy Act: Revised Article 9 and Bankruptcy, 9 AM. BANKR. INST. L. REV. 3 (2001) (discussing those changes in Article 9 that will significantly strengthen the rights of secured creditors in bankruptcy cases).
\item As noted in the PEB Commentary:
\[\text{[One could ask]} \ldots \text{whether Article 9 should limit the types of property that can be subjected to a security interest or the extent to which a debtor's property can be so encumbered or one might question whether any perfection step should be necessary to obtain priority over judicial lien creditors or other competing claimants. Or one might question whether security interests ought to be enforceable at all. Although it is well aware of challenges to the validity of some basic principles underlying Article 9, the Committee chose not to undertake a thorough reexamination of those principles. Nor did the Committee's deliberations reflect strong support for making major adjustments in the balance that Article}\]
Correspondingly, the revisions to Article 9 do much to enhance the certainty with which originators are able to securitize a greater number of types of assets.\(^7\) The ongoing debate in the academic literature, concerning both the economic efficiency of secured credit and the normative implications of secured creditors' priority over unsecured creditors,\(^8\) has spilled over to a debate about the efficiency and normative effects of securitization.\(^9\)

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7. See, e.g., Hillinger & Hillinger, supra note 2, at 105-06 ("The revisions significantly expand Article 9's scope . . . "); Terry M. Anderson et al., Attachment and Perfection of Security Interests Under Revised Article 9: A "Nuts and Bolts" Primer, 9 AM. BANKR. INST. L. REV. 179, 181 (2001) (writing that "[t]he Revision will expand the scope of Article 9 to include transactions and types of personal property previously not covered").


9. See David Gray Carlson, The Rotten Foundations of Securitization, 39 WM. & MARY L. REV. 1055, 1064 (1998) (arguing that because debtor retains some residual interest in assets sold in connection with a securitization, such assets should properly be returned to debtor's estate upon a bankruptcy filing); see also Christopher W. Frost, Asset Securitization and Corporate Risk Allocation, 72 TUL. L. REV. 101, 128-29 (1997) (describing the costs and benefits of securitization); Lynn M. LoPucki, The Death of Liability, 106 YALE L.J. 1, 23-
Notwithstanding this debate, Revised Article 9 not only reflects the drafters’ affirmative decision to further enhance secured creditors’ rights, it also includes myriad provisions designed to facilitate securitization transactions. Because bankruptcy law looks to Article 9 to determine the rights of creditors and transferees with respect to personal property, the changes to Article 9 enhancing the rights and interests of creditors as well as asset-backed security transferees are, in effect, changes in bankruptcy law. The question raised by these Article 9 revisions as well as by the proposed change in the Bankruptcy Code, is

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10. For the drafters’ intent, see Ahern, supra note 2, at 116, 118-21 (noting that the “fundamental ways [in which] the drafters have recalibrated the parties’ rights” promise to “increase secured creditors’ leverage substantially, both before and after the filing of a petition in bankruptcy”). Professor Barry Zaretzky referred to the Article 9 revision as a “love feast for secured creditors.” JULIAN B. MCDONNELL, UNIFORM COMMERCIAL CODE ANALYSIS OF REVISED ARTICLE 9 2 (1999).

11. See generally Lupica, Revised Article 9, Securitization Transactions and the Bankruptcy Dynamic, supra note 9.

whether these changes are consistent with our historical understanding of bankruptcy policy.

There are (at least) two views of bankruptcy. One view sees asset value maximization and asset distribution as the twin goals of the bankruptcy process. This vision of bankruptcy recognizes the value of bankruptcy outcomes tracking non-bankruptcy outcomes, and concedes that a property right redistribution in bankruptcy should be had only when a divergence from non-bankruptcy rules would result in an enhancement of estate value. An alternative vision of bankruptcy attaches importance to not only economic efficiency, but normative concerns such as distributional fairness among creditors and other stakeholders. Under this view, bankruptcy should have the effect of altering non-bankruptcy rights when such alterations further these normative goals. Moreover, the reorganization of viable businesses ought to be encouraged by the bankruptcy process, for the benefit of the debtor as well as the full array of stakeholders with an interest in the debtor’s continued viability.

Revised Article 9 is not consistent with bankruptcy policy under either view. The Bankruptcy Code, with its deference to non-bankruptcy-created property rights, was drafted at a time

13. See generally, Lupica, Asset Securitization, supra note 9 (detailing the equitable powers of courts under the Bankruptcy Code).
14. Id. at 656.
16. Id. at 785-94. The author lists five main rationales that bankruptcy law takes into account when deciding how to distribute the loss, most of which reflect fairness (rather than efficiency) values; e.g., the first rationale is “[r]elative ability to bear the costs of default.” Id. at 790-94.
18. See Steven L. Harris & Charles W. Mooney, Jr., Revised Article 9 Meets the Bankruptcy Code: Policy and Impact, 9 AM. BANKR. INST. L. REV. 85, 87 (2001) (referring to “the Bankruptcy Code’s overarching respect for nonbankruptcy law’s allocation of rights with respect to particular assets in which
when old Article 9 was the law governing security interests.\textsuperscript{19} While many have taken issue with the distributive scheme in bankruptcy under old Article 9,\textsuperscript{20} it was that system that was considered by Congress in its drafting of the substance and contours of bankruptcy law.\textsuperscript{21} Revised Article 9, however, is a significant departure from old Article 9.\textsuperscript{22} Bankruptcy outcomes are altered to the extent that non-bankruptcy-law-created property rights are changed,\textsuperscript{23} thereby upsetting the expectations in place at the time the Bankruptcy Code was drafted. Moreover, the change proposed to the definition of "estate" in the Bankruptcy Code,\textsuperscript{24} if enacted, will in many cases result in a substantial divergence in creditors' rights and the value of their interests, depending upon whether the creditor's debtor is or is not in bankruptcy.

Concerns regarding distributional fairness in bankruptcy are sharpened when what is being examined is the impact of a securitization transaction on a debtor-in-bankruptcy's unsecured creditors. Unlike in a secured lending context, when interests in the bankruptcy debtor has an interest... Indeed, nonbankruptcy law's allocation of property interests lies at the core of the Bankruptcy Code's provisions for allocating value between the debtor and its creditors\textsuperscript{\textsuperscript{19}}).
collateral are still included in a debtor's bankruptcy estate, the goal of the securitization transaction parties is to remove the securitized assets from the bankruptcy estate. Following a securitization and upon a subsequent liquidation, fewer unencumbered assets may remain in the debtor's bankruptcy estate for the benefit of the debtor's residual creditors.

Moreover, a bankruptcy debtor who has securitized its assets may have a diminished ability to reorganize due to the dearth of cash collateral. Experience has shown that a firm with a higher "going concern" value than its liquidation value is worth preserving for the benefit of the debtor, as well as for all of the debtor's creditors, employees, suppliers, and customers. If such a securitizing debtor finds itself without the cash necessary to sustain itself while it is formulating a reorganization plan, then a reorganization may not be tenable — leaving liquidation as the debtor's only alternative. This frustrates the long-standing bankruptcy policy of promoting the reorganization of viable businesses.

Whether an increase in the proliferation of securitization as a financing method is a good thing among both large and small firms, remains unproven. What is clear, however, is that the revisions made to Article 9 impacting securitization will alter bankruptcy outcomes, arguably in ways that are inconsistent with bankruptcy

25. See, e.g., Carlson, supra note 9, at 1056 ("The form of the transfer ... is supposed to ... [ensure] that no bankruptcy court can ever claim jurisdiction over the assets again.").

26. See Lupica, Revised Article 9, Securitization Transactions and the Bankruptcy Dynamic, supra note 9, at 314.

27. See KAREN GROSS, FAILURE AND FORGIVENESS 101 (1997) (discussing how viewing the bankruptcy process from the "strongest and most powerful" creditors' perspective "addresses only a limited number of those affected by a bankruptcy filing. It fails to take into account the myriad parties touched by a bankruptcy case and the economic consequences of their situations").

28. See Lupica, Revised Article 9, Securitization Transactions and the Bankruptcy Dynamic, supra note 9, at 291.

29. See In re Gathering Rest., Inc., 79 B.R. 992, 999 (Bankr. N.D. Ind. 1986) ("In the context of a bankruptcy case ... the public interest ... means the promoting of a successful reorganization which should be one of the paramount concerns of a bankruptcy court" (quoting In re Otero Mills, Inc., 25 B.R. 1018, 1021 (D.N.M. 1982))).
Moreover, Section 912 of the bankruptcy reform legislation provides an inordinate degree of protection and immunity from the normal operation of the bankruptcy system for participants in the structured finance market. This favored treatment appears to come at the expense of other creditors and debtors who seek to reorganize under the shelter of the bankruptcy laws.

II. CONCERNS OF SECURITIZATION ORIGINATORS AND OTHER PARTIES TO ABS TRANSACTIONS THAT LED TO CHANGES TO ARTICLE 9 AND THE BANKRUPTCY CODE

When old Article 9 was first enacted, the securitization market as currently constituted did not exist. Many assets
commonly securitized today were not included within old Article 9's definition of "account." Arguably many such assets, i.e., licensing receivables and credit card receivables, could be properly classified as either "accounts," "general intangibles" or, in some cases, "instruments." This uncertainty posed a problem for securitizers and their transferees because only sales of accounts and chattel paper fell within old Article 9's reach. As such, the securitization of general intangibles and instruments relegated these transferees to non-Article 9 law (state common law or remnants of pre-UCC accounts receivable statutes) to determine their rights and responsibilities.

Moreover, predicting the judicial characterization of the asset securitizations beyond the reach of old Article 9.

35. Old Article 9 defined accounts as "any right to payment for goods sold or leased or for services rendered, which is not evidenced by an instrument or chattel paper, whether or not it has been earned by performance." U.C.C. § 9-106 (1995). Old Article 9 recognizes that the distinction between asset sales and assets transferred as collateral was often blurred in practice, and as such, a distinction between the two was not made in the statute for purposes of the notice requirement. Id. § 9-102(1)(b).


37. See generally id.

38. Chattel paper is defined as "a writing or writings which evidence both a monetary obligation and a security interest in or a lease of specific goods." U.C.C. § 9-105 (1)(b) (1995).

39. Securitization of general intangibles and instruments relegated transferees to non-Article 9 law (namely, state common law or remnants of pre-U.C.C accounts receivable statutes) to determine their rights and responsibilities. (Notably, if proper non-Article 9 steps to perfect under the properly applicable non-Article 9 law, if any, are taken, the transferor's trustee in bankruptcy will not be able to defeat the transferee's interest. Discovery of and compliance with the appropriate governing law, however, may not be a simple matter. 11 U.S.C. § 544 (2000) (describing scope of the trustee in bankruptcy's powers)). See Jeffrey E. Bjork, Seeking Predictability in Bankruptcy: An Alternative to Judicial Recharacterization in Structured Financing, 14 BANKR. DEV. J. 119, 122 (1997) (pointing out that "[a] lack of certainty with respect to how the transaction may be characterized will almost assuredly reduce, if not destroy, the market for such securities").
transfer has been a further concern of parties to securitization transactions. Courts decide whether a particular transfer is a collateral transfer or a true sale based upon the presence or absence of a number of factors. These factors include: (i) residual interests retained by the transferor, (ii) transfer price set at fair market value by independent appraisers, (iii) recourse to the asset transferor, (iv) the acquisition of dominion and control over the assets by the transferee, (v) the transfer of the benefits and burdens of ownership by the transferee, and (vi) the intent of the parties as expressed in their writings. Many securitization transactions, however, include a mix of factors, some suggesting a

40. See Bjork, supra note 39, at 122 (noting that "[t]he potential problems associated with securitization in the bankruptcy context are properly attributable to inconsistent judicial evaluation of these transactions").

41. See generally Robert D. Aicher & William J. Fellerhof, Characterization of a Transfer of Receivables as a Sale or Secured Loan Upon the Bankruptcy of the Transferor, 65 AM. BANKR. L.J. 181, 186-206 (1991) (noting that bankruptcy courts look at the context of the asset transfer, taking into consideration a variety of factors).

42. See, e.g., In re Comer Capital Corp., 142 B.R. 78 (Bankr. S.D.N.Y. 1992) (explaining that a transfer was a loan due to transferee's payment of interest to purchasers of interests, notwithstanding transferor's default); In re Evergreen Valley Resort, Inc., 23 B.R. 659 (Bankr. D. Maine 1982) (explaining that a transfer was a security interest due to debtor's retained interest); In re Hurricane Elkhorn Coal Corp., 19 B.R. 609 (Bankr. W.D. Ky. 1982) (explaining that a transfer was a security interest because of debtor's retained interest); Federated Dept. Stores, Inc. v. Comm'r, 51 T.C. 500, 511 (1968), aff'd, 426 F.2d 417 (6th Cir. 1970) (explaining that because transferor retained some risk, transfer was deemed to be a loan); see also Fireman's Fund Ins. Cos. v. Grover (In re Woodson Co.), 813 F.2d 266, 272 (9th Cir. 1987) (explaining that a transferor retention of risk, coupled with lending interest rate, suggested a loan rather than a sale); Bear v. Coben (In re Golden Plan of Cal., Inc.), 829 F.2d 705, 707, 710 (9th Cir. 1986). See generally Aicher & Fellerhof, supra note 41, at 182-84; Peter L. Mancini, Bankruptcy and the U.C.C. as Applied to Securitization: Characterizing a Mortgage Loan Transfer as a Sale or Secured Loan, 73 B.U. L. REV. 873, 877-82 (1992) (noting that the U.C.C. provides no rules for resolving the sale/loan issue); Thomas E. Plank, The True Sale of Loans and the Role of Recourse, 14 GEO. MASON L. REV. 287, 290 (1991) (relating the absence of universal criteria for the determination of the sale versus loan issue); see also Major's Furniture Mart, Inc. v. Castle Credit Corp., 602 F.2d 538, 542-44 (3d Cir. 1979) (describing the factors relevant to the determination of the existence of a true sale).
true sale and others suggesting a collateral transfer. While parties may intend one characterization, the facts and circumstances of the transfer may suggest another. Because definitively concluding a particular asset transfer is a true sale is so difficult, lawyers have historically been reluctant, and in some instances unwilling, to offer unqualified legal opinions to that effect.

Even if the parties’ characterization of both the assets

43. See, e.g., Castle Rock Indus. Bank v. S.O.A.W. Enters., Inc. (In re S.O.A.W. Enters., Inc.), 32 B.R. 279, 283 (Bankr. W.D. Tex. 1983) (determining, notwithstanding the parties’ characterization as a sale, that a participation agreement was determined to be a loan transaction); Boerner v. Colwell Co., 577 P.2d 200, 204-05 (Cal. 1978) (deeming a transfer of construction contracts to be a sale and not a loan).


In order to obtain sales treatment under the relevant accounting standards, participants in mortgage-backed and asset-backed securitization transactions must obtain assurances from counsel that the sale of assets will be final under applicable bankruptcy law. Such legal advice is referred to as a “true sale opinion.” Unfortunately, there is a lack of guiding judicial precedent regarding what constitutes such a true sale of assets. The considerations in the analysis are highly subjective and depend upon a qualitative assessment of a wide variety of facts and circumstances. For these and other reasons, any true sale opinion will generally be a reasoned one, with various assumptions as to factual matters and conclusions that introduce an unnecessary degree of legal uncertainty in the asset-backed market. As a result, for some types of transactions, true sale opinions can be extremely difficult, costly, and in a few cases, impossible to render.

Id. at 10.
transferred and the nature of the transfer is deemed by a court to be correct, the transferor's bankruptcy may still pose a threat to the interests of the transferee. While it is commonly understood that the sale of an asset, if perfected, removes it from the transferor's bankruptcy estate, this understanding is not universal. In the now notorious case of *Octagon Gas Systems v. Rimmer*, the United States Court of Appeals for the Tenth Circuit held that property sold by the debtor prior to its bankruptcy was part of debtor's bankruptcy estate. The Tenth Circuit relied on the Supreme Court's expansive interpretation of "estate" in *United States v. Whiting Pools, Inc.*, in concluding that because property of the estate includes property subject to a security interest, and because the sales of accounts are governed by the law governing

45. Recently, the bankruptcy court in *In re LTV Steel, Inc.*, held that Debtor retained "at least some equitable interest" in its securitized receivables, "sufficient to support the entry of the interim cash collateral order." *In re LTV Steel, Inc.*, No. 00-43866, 2001 Bankr. LEXIS 131 (Bankr. N.D. Ohio Feb. 5, 2001).


47. *Octagon Gas Sys., Inc. v. Rimmer (In re Meridian Reserve, Inc.)*, 995 F.2d 948 (10th Cir. 1993). In *Octagon*, the transferee did not file a financing statement to perfect its interest, leaving it vulnerable to avoidance by the bankruptcy trustee, pursuant to its § 544(a) lien avoidance powers. *Id.* It is possible, however, that the transferee was automatically perfected under § 9-302(1)(e), providing for the automatic perfection of certain isolated and small transfers of accounts. *Id.* at 958.

48. *Octagon* did not present the issue of what is included in a transferor's bankruptcy estate in the context of a prototypical securitization. Instead, the transferor was transferring interests in the proceeds of certain sales of natural gas. *Id.* at 951, 954. The Court initially observed that the transferred interest was an account, as defined by Section 9-106, and sales of accounts are governed by Article 9. *Id.* The Court continued by observing that, notwithstanding the fact that the "transactions giving rise to the account were not intended to secure a debt," asset sales are covered by Article 9, "whether intended for security or not." *Id.* at 955. The underlying asset, natural gas, once extracted and sold, is a "good," and the payment stream arising from the sale of that good is an "account." *Id.* Article 9 defines an "account" as "any right to payment for goods sold ... which is not evidenced by an instrument of chattel paper." OKLA. STAT. ANN. tit. 12A § 9-106 (West Supp. 1993).

transfers of security interests, accounts sold remain property of the
debtor's bankruptcy estate.\textsuperscript{50}

Indeed, the Octagon decision, coupled with the uncertainty
surrounding both the issue of asset classification and the scope of
Article 9, led the PEB Drafting Committee to make a series of
substantive changes to Article 9, designed to minimize the risk to
originators and investors engaging in securitization transactions.\textsuperscript{51}

III. REVISED ARTICLE 9'S CHANGES IMPACTING SECURITIZING
ORIGINATORS AND THEIR CREDITORS

A. Issues of Asset Classification and Article 9's Governance of Sale

Revised Article 9 makes it easier to securitize a greater
number of types of assets.\textsuperscript{52} Revised Section 9-102(a)(2) has
redefined “account” to include “right[s] to payment of a monetary
obligation . . . for property that has been or is to be sold, leased,
licensed, assigned, or otherwise disposed of.”\textsuperscript{53} Many categories of
“rights to payment,” that were formerly classified as general
intangibles or instruments under old Article 9,\textsuperscript{54} now fall within
Revised Article 9's definition of “accounts.”\textsuperscript{55} Now, intellectual
property licensing receivables as well as credit card receivables are
explicitly classified as accounts and may be sold – and thus
securitized – under Article 9. This change in the definition of
“account” addresses the securitization market’s concerns about
ambiguity both in asset classification and in the applicable law
governing transfer.

Moreover, Article 9's sales coverage is further expanded to

\textsuperscript{50} Octagon, 995 F.2d at 957.
\textsuperscript{51} PEB STUDY, supra note 6, at 181-84.
\textsuperscript{52} See supra note 7 and accompanying text.
\textsuperscript{55} U.C.C. § 9-102(a)(2) (2000). Now, intellectual licensing receivables as
well as credit card receivables are explicitly classified as accounts and may be sold
- and thus securitized - under Article 9. See id.; see also THOMAS M. WARD,
INTELLECTUAL PROPERTY IN COMMERCE § 2:11 (2000).
include "payment intangibles" and "promissory notes."56 "Payment intangibles," a new category of collateral, are defined as "general intangible[s] under which the account debtor's principal obligation is a monetary obligation."57 Receivables that are not "chattel paper," "instruments" or "accounts"58 (because they are not "property that has been or is to be sold, leased, licensed, assigned or otherwise disposed of") are "general intangibles" for the payment of money – meaning, "payment intangibles."59 The

56. Revised § 9-109(a)(3) states that "this article applies to . . . a sale of accounts, chattel paper, payment intangibles, or promissory notes." U.C.C. § 9-109(a)(3) (2001). The definition of "promissory note" is similarly new, and according to the Official Comment, was "necessitated by the inclusion of sales of promissory notes within the scope of Article 9." U.C.C. § 9-102(a)(65). The definition reads:

'Promissory note' means an instrument that evidences a promise to pay a monetary obligation, does not evidence an order to pay, and does not contain an acknowledgment by a bank that the bank has received for deposit a sum of money or funds.

Id.

57. U.C.C. § 9-102(a)(61). Comment 5d notes that "payment intangibles" are a subset of "general intangibles." U.C.C. § 9-102(a)(61) cmt. 5d. "Virtually any intangible right could give rise to a right to payment of money once one hypothesizes, for example, that the account debtor is in breach of its obligation." Id. The term "payment intangible," however, embraces only those general intangibles "under which the account debtor's principal obligation is a monetary obligation." Id. (emphasis in original). General intangibles are a "residual category of personal property" under Revised Article 9. Comment 5d to Revised § 9-102(42) states that "any personal property, including things in action, other than accounts, chattel paper, commercial tort claims, deposit accounts, documents, goods, instruments, investment property, letter-of-credit rights, letters of credit, money, and oil, gas or other minerals before extraction" are general intangibles. U.C.C. § 9-102(a)(42). Examples cited in the Official Comment include intellectual property and the right to payment of a loan of funds that is not evidenced by chattel paper or an instrument. U.C.C. § 9-102(a)(42) cmt. 5d.


59. U.C.C. § 9-102(a)(42) ("'General intangible' means any personal property, including things in action, other than accounts, chattel paper, commercial tort claims, deposit accounts, documents, goods, instruments, investment property, letter-of-credit rights, letters of credit, money, and oil, gas, or other minerals before extraction.'"). "'Payment intangible' means a general intangible under which the account debtor's principal obligation is a monetary obligation." U.C.C. § 9-102(a)(61).
B. Removal of Restrictions on the Transfer of Certain Assets

UCC Section 9-406(d) & (f), building upon old Section 9-318(4), renders ineffective both contractual anti-assignment provisions and any "rule of law, statute, or regulation" that restricts assignment of payment rights. These provisions make explicit that they (i) apply to assignments and transfers as well as security interests, (ii) render ineffective terms that merely restrict, rather than prohibit assignment, and (iii) render ineffective terms that trigger a default, termination or other penalty based on assignment. Moreover, revised Section 9-408 makes many

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60. Transfers of interests of loan participations are perfected automatically. U.C.C. § 9-309(3) ("The following security interests are perfected when they attach: ... (3) a sale of a payment intangible."). The danger with such automatic perfection of a transfer of payment intangibles and promissory notes is that searchers of the public records will not discover another party's prior interest in these assets.

61. Former U.C.C. § 9-318(4) reads:

A term in any contract between an account debtor and an assignor is ineffective if it prohibits assignment of an account or prohibits creation of a security interest in a general intangible for money due or to become due or requires the account debtor's consent to such assignment or security interest.


63. See id. Specifically, new U.C.C. § 9-406(d) reads:

d) [Term restricting assignment generally ineffective.] Except as otherwise provided in subsection (e) and Sections 2A-303 and 9-407, and subject to subsection (h), a term in an agreement between an account debtor and an assignor in a promissory note is ineffective to the extent that it:

(1) prohibits, restricts, or requires the consent of the account debtor or person obligated on the promissory note to the assignment or transfer of, or the creation, attachment, perfection, or enforcement of a security interest in, the account, chattel paper, payment intangible, or promissory note; or

(2) provides that the assignment or transfer or the creation, attachment, perfection, or enforcement of the security interest may give rise to a default, breach, right of recoupment, claim, defense, termination, right of termination, or remedy under the account, chattel paper, payment intangible, or promissory note.

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otherwise non-assignable rights lienable, provided that the rights of the account debtor are not adversely affected. These Article 9 revisions are designed to aid the securitization of assets by removing or reducing restrictions on such assets’ transfer while protecting account debtors’ interests.

C. Debtors Retain No Interest in Sold Assets

The issue that was clouded by the Octagon decision – whether a debtor retains an interest in sold assets – is squarely addressed in UCC’s Revised Section 9-318(a). This section states that “[a] debtor that has sold an account, chattel paper, payment intangible, or promissory note does not retain a legal or equitable interest in the collateral sold.”

Revised Section 9-318(b) further makes explicit that “a debtor

U.C.C. § 9-406(d).
64. Comment 5 to Revised § 9-408 further makes clear that the term “account debtor,” defined in Revised § 9-102 (3), refers to:
the party, other than the debtor, to a general intangible, including a permit, license, franchise, or the like, and the person obligated on a health-care-insurance receivable, which is a type of account. The definition of ‘account debtor’ does not limit the term to persons who are obligated to pay under a general intangible. Rather, the term includes all persons who are obligated on a general intangible, including those who are obligated to render performance in exchange for payment.

U.C.C. § 9-408 cmt. 5 (emphasis in original). The licensor of intellectual property is obligated to perform on “general intangibles” and is therefore an “account debtor.” See WARD, supra note 55, at § 2:13.

65. U.C.C. §§ 9-408(a) & (c). Consent of the account debtor, however, is required to enforce such security interest. See U.C.C. § 9-408(d).

66. Thus, “[a]ccount debtor’ means a person obligated on an account, chattel paper, or general intangible. The term does not include persons obligated to pay a negotiable instrument, even if the instrument constitutes part of chattel paper.”

U.C.C. § 9-102(a)(3).

67. See supra, notes 46-48 and accompanying text.

68. U.C.C. § 9-318(a).

69. See id. Comment 2 observes that this provision:
makes explicit what was implicit, but perfectly obvious, under former Article 9:
The fact that an account or chattel paper gives rise to a “security interest” does not imply that the seller retains an interest in the property that has been sold. To the contrary, a seller of an account or chattel paper retains no interest whatsover in the property to the extent it has been sold.

U.C.C. § 9-318 cmt. 2.
that has sold an account or chattel paper, while the buyer's security interest is unperfected, . . . [has] rights and title to the account or chattel paper identical to those the debtor sold." Comment 3 to the section observes: "if the buyer’s security interest is unperfected, the seller can transfer, and the creditors of the seller can reach, the account or chattel paper as if it had not been sold." Accordingly, upon the transferor's bankruptcy, the trustee can recover the unperfected transfer under Bankruptcy Code Section 544(a), and such transferred assets are included in the bankruptcy estate.

Section 9-318, however, does not address the equitable determination of whether a particular asset transfer is properly characterized as a sale of assets or a transfer of collateral in connection with a loan (the collateral transfer versus true sale dilemma). Comment 2 makes this clear in noting that, "[n]either this Article nor the definition of ‘security interest’ in Section 1-201 provides rules for distinguishing sales transactions from those that create a security interest securing an obligation." Thus, this remains a determination to be made by courts on a case-by-case basis.

**D. Express Validation of After-Acquired Receivables to Be Securitized**

Revised Sections 9-204(a) & (c) expressly validates "after-acquired property" and "future advance" clauses when the transaction involves the sale of "accounts," "chattel paper," "payment intangibles" and "promissory notes." The comment to

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70. *Id.* § 9-318(b).
71. *Id.* § 9-318 cmt. 3.
72. *Id.* §§ 541(a)(3), 544 (Section 544(a) provides that "[t]he trustee . . . may avoid any transfer of property of the debtor . . . that is voidable by . . . a bona fide purchaser . . . against whom applicable law permits such a transfer to be perfected . . .").
73. *See infra* notes 87-91 and accompanying text (describing the proposed amendment to the Bankruptcy Code designed to federalize the true sale versus collateral transfer determination, based upon the parties to the transaction's characterization of the transfer).
74. U.C.C § 9-318 cmt. 2.
75. Revised Section 9-204 (a) & (c) read:
   (a) a security agreement may create or provide for a security interest in after-
the section observes that these provisions make explicit what was implicit under old Article 9. While not changing the law, this revision will increase ABS investors' confidence that their initially perfected interests in asset-backed securities, backed by after-acquired payment streams, will remain perfected.

E. Expanded Concept of “Proceeds”

The definition of collateral “proceeds” has been modified under Revised Article 9. Revised Section 9-102(a)(64) defines “proceeds” as “whatever is acquired upon the sale, lease, license, exchange, or other disposition of collateral,” and “rights arising out of collateral.” This definition, in eliminating the requirement that to constitute proceeds, the original collateral must be “disposed” of, expands the type of collateral that may be claimed by a perfected transferee of securitized assets. The impact of this expanded definition is most fully realized upon the securitization of originator’s bankruptcy.

acquired collateral...

(c) [a] security agreement may provide that collateral secures, or that accounts, chattel paper, payment intangibles, or promissory notes are sold in connection with, future advances or other value, whether or not the advances or value or given pursuant to commitment.

Id. at §§ 9-204(a) & (c).

76. Id. §§ 9-204(a) & (c) cmt. 6. But see Carlson, supra note 9, at 1111-12 (“Article 9 does not expressly authorize after acquired property clauses when accounts are sold. Rather, it authorizes after-acquired property clauses only when a lender advances a loan and takes after-acquired accounts as collateral.”).

77. PEB Study, supra note 6, at 185.

78. Old Article 9 defines “proceeds” as what is “received upon the sale, exchange, collection or other disposition of collateral or proceeds.” U.C.C. § 9-306(1) (1995).

79. U.C.C. § 9-102(a)(64) (2001). “Proceeds” now specifically includes “cash or stock dividends distributed on account of securities or other investment property that is original collateral,” rejecting the holding of Hastie. See Hastie v. FDIC, 2 F.3d 1042 (10th Cir. 1993). U.C.C. § 9-102 cmt. 13a.

80. See Lupica, Revised Article 9, Securitization Transactions and the Bankruptcy Dynamic, supra note 9, at 309 (discussing the significance of the expanded definition of “proceeds” of collateral in terms of the securitization originator’s bankruptcy).
Bankruptcy law makes a clear distinction between proceeds of collateral and property that arises after the initial secured transaction that does not fall within the definition of "proceeds," namely "after-acquired collateral."\(^{81}\) Assets that are acquired by a bankruptcy debtor following the filing of a petition are either deemed to be "proceeds" or "after acquired property."\(^{82}\) Section 552 of the Bankruptcy Code cuts off secured parties' interests in "after acquired collateral," unless the post-petition collateral is proceeds of the original collateral.\(^{83}\) Section 552, in limiting its recognition of post-petition security interests, furthers the bankruptcy policy of preserving the value of the bankruptcy estate for the benefit of the bankruptcy debtor's unsecured creditors.\(^{84}\)

81. See id. at 306, 309 (detailing how Article 9 distinguishes between "proceeds" of collateral and "after-acquired collateral"). After-acquired collateral is "[t]hat property that arises after the initial secured transaction that does not fall within the definition of 'proceeds.'" Id. at 309 (emphasis in original).


83. Section 552(a) of the Bankruptcy Code states that "[e]xcept as provided in subsection (b), property acquired by the estate or by the debtor after the commencement of the case is not subject to any lien resulting from any security agreement entered into by the debtor before the commencement of the case." 11 U.S.C. § 552(a). Section 552(b) states:

(b)(1) if the debtor and an entity entered into a security agreement before the commencement of the case and if the security interest created by such security agreement extends to property of the debtor acquired before the commencement of the case and to proceeds, product, offspring, or profits of such property, then such security interest extends to such proceeds, product, offspring, or profits acquired by the estate after the commencement of the case to the extent provided in such security agreement and by applicable nonbankruptcy law, except to any extent that the court, after notice and a hearing and based on the equities of the case, orders otherwise.


84. "The scope of . . . [§ 541(a)(1)] is broad. It includes all kinds of property, including tangible or intangible property causes of action . . . and all other forms of property currently specified in section 70a of the Bankruptcy Act." H.R. Rep. No. 95-595, p. 367 (1977); S. Rep. No. 95-989, p. 82 (1978). Numerous bankruptcy precedents confirm the debtor's need for post-petition cash flow in order to reorganize and pay unsecured creditors. See In re Dynaco Corp., 162 B.R. 389, 393 (Bankr. D.N.H. 1993) ("Debtors seeking to reorganize under Chapter 11 of the Bankruptcy Code frequently need to use their cash and proceeds therefrom in order to continue with their business operations."); see also In re Rancourt, 123 B.R. 143 (Bankr. D.N.H. 1991) (recognizing the necessity of debtor's using cash collateral rents in the first months following a
Because the Bankruptcy Code does not explicitly define "proceeds," the Article 9 definition of "proceeds" becomes key to the determination of what estate property remains unencumbered. Because ABS purchasers can reach proceeds, but not after acquired property, the expanded definition of "proceeds" in Revised Article 9 will result in less unencumbered "after-acquired property" and a greater number and type of assets deemed to be the "proceeds" of asset-backed security-holder's interests.

bankruptcy in order to conduct its business during the reorganization effort); In re Earth Lite, Inc., 9 B.R. 440, 443 (Bankr. M.D. Fla. 1981) ("[I]t is evident that if a Debtor who seeks relief under Chapter 11 is deprived of the use of cash, its chances to secure rehabilitation are immediately destroyed and very few, if any, entities could survive and effectuate a reorganization without cash."); In re Greenwood Bldg. Supply, Inc., 23 B.R. 720, 721 (W.D. Mo. 1982) ("The evidence shows that debtor could not reorganize without the use of cash collateral."); see also United States Senate Committee on the Judiciary Subcommittee on Administrative Oversight and The Courts: Hearings Regarding the Business Bankruptcy Act, 106th Cong. (Mar. 17, 1999) (testimony of Professor Kenneth N. Klee, on behalf of the National Bankruptcy Conference), available at http://www.house.gov/judiciary/106-klee.htm (last visited on Feb. 20, 2002) [hereinafter Klee Testimony].

85. Courts have not been consistent in their interpretation of what is meant by "proceeds, product, offspring, or profits" in Section 552(b). See In re Hastie, 2 F.3d 1042 (10th Cir. 1993) The exception "except to any extent that the court . . . based on the equities of other case, orders otherwise" has only added to the inconsistency of court opinions with respect to this issue. See id. (relying upon state law definition of proceeds in holding that a security interest in stock dividends was not perfected because it was not a substitute for disposed of stock (the collateral), pursuant to section 9-306(4)); In re Bumper Sales, 907 F.2d 1430, 1437 (4th Cir. 1990) (holding that Article 9's definition of "proceeds" was the definition to be applied in determining the scope of Bankruptcy Code § 552(b)); J. Catton Farms, Inc. v. First Nat'l Bank of Chi., 779 F.2d 1242 (7th Cir. 1985) (holding that a party with a security interest in receivables and accounts had a perfected interest, as proceeds, in a payment received post-petition pursuant to a pre-petition account). Revised Article 9 brings licensing income within the definition of "proceeds" whether or not any portion of the underlying intellectual property was "disposed of" under the license. U.C.C. § 9-102(a)(64) (2001); WARD, supra note 55, §§ 2:29, 2:86-91.

86. See WARD, supra note 55, at § 2 (explaining that Revised Article 9's expansion of the definition of proceeds has resulted in a substantial benefit to leveraged secured creditors).
IV. PROPOSED CHANGES TO THE BANKRUPTCY CODE AFFECTING SECURITIZATION

Among the many proposed changes in the pending bankruptcy reform legislation is a redefinition of the term "estate." The proposed amendment to Section 541 of the Bankruptcy Code excludes from the debtor's "estate" assets transferred in a securitization transaction.

87. Section 541 of the Bankruptcy Code reads in part:
(a) The commencement of a case under section 301, 302 or 303 of this title creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:
(1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case. 11 U.S.C. § 541 (2000).

88. Section 912 of The Bankruptcy Abuse Prevention and Consumer Protection Act of 2001 (Introduced in the House on Jan. 30, 2001) reads:
SEC. 912. ASSET-BACKED SECURITIZATIONS.
Section 541 of title 11, United States Code, is amended
(i) in subsection (b) by inserting after paragraph (7), as added by this Act, the following:
(8) any eligible asset (or proceeds thereof), to the extent that such eligible asset was transferred by the debtor, before the date of commencement of the case, to an eligible entity in connection with an asset-backed securitization, except to the extent such assets (or proceeds or value thereof) may be recovered by the trustee under section 550 by virtue of avoidance under section 548(a); and
(ii) by adding at the end the following new subsection
(f) For purposes of this section—
(1) The term 'asset-backed securitization' means a transaction in which eligible assets transferred to an eligible entity are used as the source of payment on securities, including, without limitation, all securities issued by governmental units, at least one class or tranche of which was rated investment grade by one or more nationally recognized securities rating organizations, when the securities were initially issued by an issuer;
(2) The term 'eligible asset' means—
(A) financial assets (including interests therein and proceeds thereof), either fixed or revolving, whether or not the same are in existence as of the date of the transfer, including residential and commercial mortgage loans, consumer receivables, trade receivables, assets of governmental units, including payment obligations relating to taxes, receipts, fines, tickets, and other sources of revenue, and lease receivables, that, by their terms, convert into cash within a finite period, plus any residual interest in property subject to receivables included in such financing assets plus any rights or other assets designed to assure the servicing or timely distribution of proceeds to security holders;
(B) cash; and
The redefinition of "estate" will remove from the jurisdiction of the bankruptcy court, "eligible assets" "transferred" by the debtor to an "eligible entity in connection with an asset-backed securitization."89 "Eligible assets" are defined to include commonly securitized receivables.90 Receivables, including credit

(C) securities, including, without limitation, all securities issued by governmental units;
The term 'eligible entity' means-

(A) an issuer; or

(B) a trust, corporation, partnership, governmental unit. Limited liability company (including a single member limited liability company), or other entity engaged exclusively in the business of acquiring and transferring eligible assets directly or indirectly to an issuer and taking actions ancillary thereto;

The term 'issuer' means a trust, corporation, partnership, governmental unit, limited liability company (including a single member limited liability company), or other entity engaged exclusively in the business of acquiring and holding eligible assets, issuing securities backed by eligible assets, and taking actions ancillary thereto; and

The term 'transferred' means, the debtor, under a written agreement, represented and warranted that eligible assets were sold, contributed, or otherwise conveyed with the intention of removing them from the estate of the debtor pursuant to subsection (b)(8) (whether or not reference is made to this title or any section hereof), irrespective and without limitation of-

(A) whether the debtor directly or indirectly obtained or held an interest in the issuer or in any securities issued by the issuer;

(B) whether the debtor had an obligation to repurchase or to service or supervise the servicing of all or any portion of such eligible assets; or

(C) the characterization of such sale, contribution, or other conveyance for tax, accounting, regulatory reporting or other purposes.


89. Id.; cf. 11 U.S.C. § 541 (2000). Before and currently, no such asset would escape a bankruptcy court's jurisdiction unless it was definitively sold away to the debtor prior to bankruptcy. See Carlson, supra note 9, at 1056 (arguing against the very result that Revised Section 912 would institutionalize).

90. See 11 U.S.C. § 541. Furthermore, the definition of "asset securitization" in the amendment does not exclude all securitized assets form the originator's bankruptcy estate – simply those assets that are transferred and result in the issuance of securities rated investment grade or better by a nationally-recognized statistical rating organization. This limits the "carve out" from the definition of "estate" to public offering and rated private issuances. Unrated assets securitized in private issuances remain uncovered by this exception, however. See also Testimony of Ann Stern, CEO, Financial Guarantee Insurance Corporation, FED. DOCUMENT CLEARING HOUSE CONG. TESTIMONY, May 19, 1998 [hereinafter Stern Testimony] (claiming that the application of the proposed
card receivables, intellectual property licenses, cash and securities are all deemed to be “eligible” for purposes of this provision.\(^9\)

V. NORMATIVE ISSUES RAISED BY CHANGES TO ARTICLE 9 AND PROPOSED CHANGES TO THE BANKRUPTCY CODE – THE SYSTEM HAS BEEN SHOCKED!

The debate among legal scholars concerning whether secured creditors ought to have full priority in bankruptcy continued throughout Article 9’s revision process.\(^9\) Some academics posited that it is economically efficient and socially desirable for secured claims in bankruptcy to have full priority of repayment.\(^9\) Other scholars, citing efficiency and fairness concerns, challenged the absolute supremacy of secured claims, to the exclusion of unsecured claims and questioned whether secured financing’s continued dominance misallocates resources by forcing unsecured creditors into the role of recipient of limited residual interests, without their affirmative consent.\(^9\) The issues raised in this debate have spilled over and have application to the question of whether 

\(^9\) See sources cited supra note 8.
there are any harmful consequences to the unsecured creditors of securitizing debtors in bankruptcy and whether securitized asset transferees ought to be able to opt out, by contract, of participation in the bankruptcy process. 95

The most immediate and obvious effect of the Revised Article 9 provisions that streamline, facilitate and generally make securitization easier to effectuate will be a further expansion of the securitization market. 96 The revised definition of "account"97 and the extension of Article 9's sales coverage, 98 coupled with the relaxation of restrictions on asset transfers, 99 will make it easier to securitize more types of assets with greater certainty. 100 Moreover, if bankruptcy courts adopt Revised Article 9's definition of proceeds, more post-petition assets will be deemed to be securitized proceeds, rather than after-acquired unencumbered estate property. Accordingly, a consequence of this expansion will be that fewer assets available for residual claimants upon a securitizing originator's liquidation.

A less obvious, although not necessarily less immediate, effect of Article 9 changes will be that securitizing businesses, having transferred their cash flow will have less ability to, and thus will be less likely to, reorganize. 101 Since a debtor's bankruptcy estate does not generally include property transferred, the more after-acquired proceeds are deemed to have been securitized, the more assets that are outside of the reach of the automatic stay and the trustee's turnover powers. As such, a securitizing debtor-in-bankruptcy's cash flow from its securitized receivables will be unavailable to the

95. See supra note 9 and accompanying text. 96. See Lupica, Revised Article 9, Securitization Transactions and the Bankruptcy Dynamic, supra note 9, at 293 (pointing out that "the volume of ABS issuances has grown from $1 billion in 1985 to $185 billion in 1999"). 97. U.C.C. § 9-102(a)(2) (2001). 98. Id. § 9-102(a)(2) cmt. 5a. 99. Id. §§ 9-406(d) & (f). 100. See, e.g., Edward E. Gainor, Pending Legislation Would Change True Sale Analysis, ASSET SECURITIZATION REP., Mar. 12, 2001 (stating that "[t]he proposed legislative provisions should have the effect of simplifying some securitization structures and facilitating transactions that are difficult or impossible to execute under the constraints imposed by traditional true sale analysis;" see also supra notes 40-44 and accompanying text. 101. See supra notes 27-29 and accompanying text.
debtor for use in connection with its reorganization efforts. This cash flow may be necessary to pay employees, trade creditors, consumer claims, and to generally keep the debtor afloat during the pending reorganization.

The Article 9 revisions will have an even greater effect on bankruptcy outcomes when read in conjunction with proposed changes in the Bankruptcy Code designed to further benefit parties to securitization transactions. The bankruptcy reform legislation

102. See Lupica, Revised Article 9, Securitization Transactions and the Bankruptcy Dynamic, supra note 9, at 294-97, 301-02 (noting, however, that the opposite result is also possible, as evidenced by the Octagon Gas Systems v. Rimmer, 995 F.2d 948, 957 decision). In the recent case of In re LTV Steel, Inc., the Bankruptcy Court examined the issue of whether a reorganizing debtor retained any interest in its securitized receivables. See generally In re LTV Steel, Inc., No. 00-43866, 2001 Bankr. LEXIS 131 (Bankr. N.D. Ohio Feb. 5, 2001). In that case the Court observed that if debtor was unable to access its liquid receivables, it would have immediately ceased business operations. LTV Steel, Inc., 2001 Bankr. LEXIS 131 at *5. With respect to the issue of whether the securitized assets were property of the estate, the court said:

[T]here seems to be an element of sophistry to suggest that the Debtor does not retain at least an equitable interest in the property that is subject to the interim order. Debtor's business requires it to purchase, melt, mold and cast various metal products. To suggest that Debtor lacks some ownership interest in products that it creates with its own labor, as well as the proceeds to be derived from that labor, is difficult to accept. Accordingly, the court concludes that Debtor has at least some equitable interest in the inventory and receivables, and that this interest is property of the Debtor's estate. This equitable interest is sufficient to support the entry of the interim cash collateral order. Finally, it is readily apparent that granting Abbey National relief from the interim cash collateral order would be highly inequitable. The Court is satisfied that the entry of the interim order was necessary to enable Debtor to keep its doors open and continue to meet its obligations to its employees, retirees, customers and creditors. Allowing Abbey National to modify the order would allow Abbey National to enforce its state law rights as a secured lender to look to the collateral in satisfaction of this debt. This circumstance would put an end to Debtor's business, would put thousands of people out of work, would deprive 100,000 retirees of needed medical benefits, and would have more far reaching economic effects on the geographic areas where Debtor does business ...

Id. at 131.

103. Id. In addition, refer to cases listed supra note 84, evidencing the courts' recognition that the debtor must have access to a healthy cash flow in order to successfully meet the goals of bankruptcy. See also Klee Testimony, supra note 84.

104. See supra notes 87-91 and accompanying text; see also Klee Testimony,
includes a redefinition of the term “estate,”105 carving out of it certain assets that have been transferred in connection with a securitization. Notwithstanding the fact that it was referred to in the Congressional Record as a “clarification,”106 and Congressional testimony as “in the nature of [a] technical correction,”107 this provision, if enacted, will fundamentally alter the essence of

supra note 85 (explaining how the new changes will be a detriment both to debtors’ estates and to unsecured creditors).

105. See Lupica, Revised Article 9, Securitization Transactions and the Bankruptcy Dynamic, supra note 9, n.173 (noting that a debtor’s bankruptcy estate was originally defined under § 541(a) of the Bankruptcy Act as comprising of “interests of the debtor in property.”); see also 11 U.S.C. § 704(1) (2000) (stating that a trustee has the power to “collect and reduce to money the property of the estate”); Id. § 726 (outlining the scheme for the distribution of property of the estate); Id. § 1129 (describing how property of the estate used in connection with plan of reorganization); Id. §§ 363(b)(1), (c)(1) (noting that the property of the estate must be used, sold or leased); Id. §§ 364(c)(2), (c)(3), (d)(1) (debtor’s borrowing secured by property of the estate); Id. § 542(a) (authorizing the trustee to demand return of “property that the trustee may use, sell or lease under section 363); Id. §§ 362(a)(2) – (4); Id. § 364(d). Of course, a secured party whose collateral is being used by a reorganizing debtor must be offered “adequate protection” of its interest. Lupica, Revised Article 9, Securitization Transactions and the Bankruptcy Dynamic, supra note 9, at 298-99 (pointing out that adequate protection is usually the only consideration given to such a secured party). In addition, the Code’s automatic stay precludes actions taken with respect to property of the estate. In Chapter 11 cases, property of the estate necessary to the reorganization may be used by the debtor, notwithstanding a secured parties’ state law created interest. The corollary to this rule, designed to encourage the reorganization of viable businesses, is that debtor may not use non-estate property to reorganize.

106. Congressional Record, Bankruptcy Abuse Prevention and Consumer Protection Act of 2001, 107th Cong., Jan. 31, 2001, available at http://www.abiworld.org/hr333.html (last visited on Feb. 27, 2002) [hereinafter Proposed Bankruptcy Legislation] (noting that “the purpose of the special order to which I am attached today is to announce the introduction of the new bankruptcy reform act that we hope will be enacted into law during this current session and swiftly to arrive at the President’s desk for signature. . . . It also clarifies the treatment of certain financial contracts under the banking laws as well as under the Bankruptcy Code”).

107. Grosshandler Statement, supra note 44 (“These proposed changes should not raise sweeping new policy issues – they are entirely consistent with many statutory provision that have already been enacted, and are in the nature of technical corrections.”).
business bankruptcy.\textsuperscript{108}

Property that constitutes a debtor's bankruptcy estate is at the center of the bankruptcy process.\textsuperscript{109} Estate property is used to satisfy creditor claims, it may be used, sold, leased, or borrowed against, and it may be required to be returned to the estate if the property is currently in the hands of third parties.\textsuperscript{110} As noted above, the Bankruptcy Code has historically relied upon non-bankruptcy law to define the rights of parties to the bankruptcy under the Code.\textsuperscript{111} Ascertaining whether a transfer of Article 9 assets are properly included in the transferee's bankruptcy estate, the nature of the transfer, as well as the steps needed to establish the transferee's property rights have always been non-bankruptcy-law determinations.

Current law tries to balance the rights of transferees of securitized assets against the interests of the debtor's general creditors,\textsuperscript{112} who may not be aware, unless they check the public filing records, that the debtor no longer owns what appears to be its income stream. At present, in order for an asset transferee to

\begin{itemize}
\item \textsuperscript{108} This section would allow many transactions to be structured so that in the event of bankruptcy, no cash collateral would be available for funding a reorganization or repaying unsecured creditors. This is because of the overly broad definition which treats many secured loans as asset transfer, which in turn would remove those assets from property of the bankrupt's estate. Removal of such assets will virtually ensure a shortage of cash, and thereby create a crisis for many troubled businesses whose receivables represent the only source of liquidity. Because this provision represents a departure from the federal policy of favoring reorganizations over the liquidation of viable business enterprises, the League opposes this provision. \textit{United States Senate Committee on the Judiciary Subcommittee on Administrative Oversight and The Courts: Hearings Regarding the Business Bankruptcy Act, 106th Congress (Mar. 19, 1999) (Statement of the Commercial Law League of America and its Bankruptcy and Insolvency Section), available at http://www.house.gov/judiciary/106-gree.htm (last visited Feb. 27, 2002).}
\item \textsuperscript{109} The debtor's estate, as defined under section 541(a), is comprised of "interests of the debtor in property." 11 U.S.C. § 541(a) (1997).
\item \textsuperscript{110} \textit{Id.} § 704(1) (stating that trustee has the power to "collect and reduce to money the property of the estate").
\item \textsuperscript{111} \textit{See supra} note 18 and accompanying text.
\end{itemize}
effectively acquire the debtor's equity in these assets, and thus remove them from the reach of general creditors, the transfer of accounts must be deemed a “true sale.” Whether or not the transfer is a true sale, if the asset is governed by Article 9, the transferee must give notice of the transfer by filing a financing statement. As stated earlier, because a bulk “true sale” of a debtor's accounts can be structured in a way that takes on certain aspects of a secured loan to the debtor, state law allows the debtor's creditors to pierce the formal structure of a documented “sale” of accounts and treat the buyer's interest as a lien rather than an ownership right.

Section 912 of the bankruptcy reform legislation upsets the current balance and unduly favors the institutional investors at the expense of ordinary general creditors of the debtor, and the debtor itself, who will not be able to reorganize in bankruptcy without any access to cash flow. Two parts of Section 912 are particularly one-sided attempts to give federal protection to participants in the structured finance market.

First, the proposed amendment both “federalizes” and “formalizes” the issue of whether the underlying transfer of these account assets is a sale (as distinguished from a collateral transfer made in connection with a loan). Under the proposed language of Section 912, whenever the parties represent in writing that a sale was intended, that formal characterization controls, notwithstanding the way the transfer would be characterized under state law. The decided cases contain instances where transfers framed as “sales” by parties are determined to be the functional

113. See generally Charles Cheatham, Changes in Filing Procedures Under Revised Article 9, 25 OKLA. CITY U.L. REV. 235 (2000) (detailing the numerous filing requirements of parties to a secured transaction governed by Article 9, with the Article’s 1999 revision in mind).
114. See Plank, supra note 42, at 290; see also supra notes 40-44 and accompanying text.
115. See id. at 315-16.
116. See generally Lupica, Circumvention, supra note 9, at 226-31 (lamenting the “privatization” of the bankruptcy system, and arguing that thanks to Section 912, larger institutional investors will be able to “circumvent the bankruptcy process” through securitization).
117. For the text of the proposed Section 912, see supra note 88.
equivalent of a collateralized loan. For example, when the debtor retains some risk of ownership or when the buyer retains recourse rights against the debtor, courts, citing consideration of fairness, have overridden the parties' formal expression of intent and properly characterized the transaction as a collateralized loan.\(^9\)

Notwithstanding some of the testimony in hearings in support of proposed Section 912, there is not "a lack of guiding judicial precedent regarding what constitutes such a true sale of assets."\(^1\) Courts analyzing the circumstances of the transfer and the interests of all parties affected by the transaction regularly make this characterization.\(^2\)

Second, even if Congress decides that the special needs of the bond market override the balance struck among creditor interests under state law, the language of Section 912 goes too far in this regard. Subsection (1) of proposed Section 912 purports to create a single exception from the exclusion of these eligible assets from the bankruptcy estate.\(^3\) This exception allows the trustee to recover transferred assets for the estate under Section 550 "by virtue of avoidance under Section 548(a)."\(^4\) The negative

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18. See Plank, supra note 42, at 315-16 (discussing reasons why courts may find a purported "true sale" to constitute a secured loan, rather than a sale).

19. See id. (citing one such instance of a judicially-determined loan).

20. E.g., Grosshandler Statement, supra note 44 ("Unfortunately, there is a lack of guiding judicial precedent regarding what constitutes such a true sale of assets . . . . As a result, for some types of transactions, true sale opinions can be extremely difficult, costly, and in a few cases, impossible to render."). According to Mr. Grosshandler and some other commentators, the new bankruptcy law's empowerment of parties to decide for themselves whether the transaction is an asset sale or loan will resolve the uncertainty and significantly reduce transaction costs. Id.

21. Id. Indeed, the parties' own characterization of the transaction may conflict with the plain facts and circumstances of the exchange. See supra note 43 and accompanying text.

22. See supra notes 41-42 and accompanying text (listing the courts' usual criteria for determination, as well as multiple examples of court decisions that systematically applied those factors to make the sale/loan determination).


24. See Lupica, Revised Article 9, Securitization Transactions and the Bankruptcy Dynamic, supra note 9, at 320 n.185.
inference in this language seems to be that these excluded ‘eligible assets’ are beyond the reach of the trustee’s other powers to recover transferred assets – specifically, those provided for in sections of the law other than Section 548.\footnote{125}

Section 548(a) avoidance is limited to giving the bankruptcy trustee the right to recover for the estate transfers by the debtor that are deemed to be fraudulently made within one-year of bankruptcy filing.\footnote{126} The other important avoidance powers include Section 544(a)(1), which provides for the avoidance of unperfected security interests,\footnote{127} and Section 547, which provides for the avoidance of transfers that result in a preference for one creditor over all other creditors as a group.\footnote{128} In particular, Section 544(a)(1) allows the bankruptcy trustee to avoid unperfected transfers of accounts when the creditor has not “perfected” its transfer by a simple notice filing.\footnote{129}

As noted above, even in the case of a true sale of accounts, a judgment lien creditor would have state law priority in transferred account assets when the “buyer” fails to file a financing

\footnote{125} Id.; see also 11 U.S.C. §§ 544(a)(1) & 547(b)(5) (2000). Section 544(a)(1) provides:

(a) The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, any knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by—

a creditor that extends credit to the debtor at the time of the commencement of the case, and that obtains, at such time and with respect to such credit, a judicial lien on all property on which a creditor on a simple contract could have obtained such a judicial lien, whether or not such a creditor exists.

\footnote{Id. at § 544(a)(1).}

\footnote{126} Id. § 548(a)(1) (according to this Section,}

The trustee may avoid any transfer of an interest of the debtor in property, or any obligation incurred by the debtor, that was made or incurred on or within one year before the date of the filing of the petition, if the debtor voluntarily or involuntarily—

\footnote{Id. § 544(a)(1).}

\footnote{A} made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted).

\footnote{127} Id. § 544(a)(1).\footnote{128} Id. § 547(b)(5).\footnote{129} Id. § 544(a)(1).
It is not clear why that same unperfected buyer, assuming a true sale of accounts, should be safe from a challenge in bankruptcy. The proposed language that makes these federalized "true sales" immune from Section 544(a)(1) avoidance is a significant departure from bankruptcy law's historic deference to state law.  

VI. CONCLUSION

The issues raised by my Panel in the symposium, in many ways, track the issues raised in discussions of whether secured creditors ought to have full priority in bankruptcy. Unfortunately, as is the case with respect to the full priority issue, most of the assertions made regarding the wisdom of implemented and proposed securitization-related changes are unproven. It is not clear whether securitization is efficient or inefficient, nor is it proven that changes in the law designed to facilitate securitization will result, in the aggregate, in more credit availability. It is similarly unclear, even if securitization leads to a greater availability of credit, whether the result of the credit infusion will stave off bankruptcy or simply postpone it. Nor is it apparent whether a securitizing debtor's unsecured creditors, or unsecured creditors in the aggregate, will be benefited or injured as a consequence of a securitization. What is clear, however, is that Bankruptcy Code changes and changes to Article 9 will alter bankruptcy outcomes in ways inconsistent with many of bankruptcy's first principles, as well as with the bankruptcy system's normative goals distributional fairness.

There have not been any empirical studies demonstrating that the law ought to be changed to further facilitate and protect those parties to securitization transactions. Further, there is little case law addressing the legal issues raised by these changes and proposed changes in the law. Likely due to the market's relative

130. See supra note 113 and accompanying text.
131. See supra note 18 and accompanying text (discussing the historical goals of bankruptcy legislation).
132. See Proposed Bankruptcy Legislation, supra note 106.
133. See generally supra note 2 and accompanying text.
youth, there have not been many bankruptcies of securitizing originators. Therefore, courts have not had the opportunity to carefully scrutinize the structures of these transactions. As noted in Congressional testimony concerning proposed Bankruptcy Code revisions affecting securitization:

[The issues of] the possible harm to the bankruptcy estate and other creditors that may result from securitized financings... are unresolved, because there have been almost no cases addressing the consequences of securitization in bankruptcy. There are a handful of unreported opinions and almost no reported opinions. We are not learning, because we are not litigating. Usually, judicial development of an area gives us a full sense of the issues raised by any new practice. It is the interaction of case law and legislation that is the genius of the American system. . . .

134. United States Senate Committee on the Judiciary Subcommittee on Administrative Oversight and The Courts: Hearings Regarding the Business Bankruptcy Act, 105th Cong. (May 19, 1998) (testimony of Randal C. Picker). Professor Picker was referring in his testimony to a Senate subcommittee on behalf of the National Bankruptcy Conference, on the proposed modification of the definition of bankruptcy "estate" found in Section 541 of the Bankruptcy Code. Id. The proposed language addition to Section 541 states that "eligible assets" transferred by the debtor in a securitization are affirmatively deemed to be excluded from the debtor's bankruptcy estate. Professor Picker testified:

This provision is objectionable. The current existence of a robust asset securitization business, coupled with the existence of minimal case law in the area, strongly suggest that special Bankruptcy Code treatment is unnecessary. The broad definition of "transferred" is likely to cause certain financing arrangements to be treated as sales to prevent the debtor's assets from being considered property of the estate even through they are only pledged as collateral. The proposed provision makes no effort to distinguish those transactions properly characterized as "true sales" from those legitimately subject to characterization as security interests . . . .

Id.