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Asset Securitization: A Discussion of the Traditional Bankruptcy Attacks and an Analysis of the Next Potential Attack, Substantive Consolidation

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This paper will begin with a description of the typical securitization transaction. It will then discuss the traditional bankruptcy attacks on an asset securitization transaction. This paper then suggests that the equitable remedy of substantive consolidation of an originator and special purpose vehicle ("SPV") in an asset securitization transaction will not be escaped by structuring the transaction to avoid the individual factors of the "identity of interests" factor analysis. The structure of the transaction necessarily creates an "identity of interests" between the originator and SPV. However, even though the structure of these transactions will allow a court to proceed to the balancing of the equities part of the substantive consolidation analysis, this does not mean that the court will substantively consolidate. This paper also suggests that "non−consolidation" opinions of counsel that claim that avoidance of the individual factors of the *Vecco Construction* or some other factor analysis will help avoid the remedy of substantive consolidation between originator and SPV may be incorrect in their recitation of the law in this area.

I.Introduction

Asset securitization has become a very popular method of corporate financing. [2] Also referred to as structured finance, ABS or simply securitization, this technique has grown to a multi−billion dollar industry in a relatively short period of time. [3] Securitization allows a corporation to convert a predictable future payment stream into current cash. [4] This technique can benefit a company in several ways which will be discussed later in the paper. [5]

The structured financing transaction begins with a corporation, referred to as the "originator," identifying and isolating a pool of assets, from those which it has originated or acquired in the ordinary course of business with a predictable future payment stream. [6] The originator then forms a wholly owned subsidiary corporation, the special purpose vehicle or "SPV." [7] Certain precautions are taken during the formation stage to ensure that the SPV is as "bankruptcy remote" as possible from the insolvency of the originator. [8] Next, the assets are transferred to the SPV. [9] The transfer will take the form of a "true sale," again a precaution to keep the assets of the SPV out of any bankruptcy filing of the originator. [10] The SPV will sell asset−backed securities or issue debt instruments in the bond market to pay the originator for the purchase of the assets with cash. [11] Finally, the incoming payment streams, plus credit enhancements, will be used by the SPV to complete payment to the investors in the asset pool over a predetermined payment period. [12]

The securitization industry is driven by the originator's ability to find investors willing to invest in the assets held by the SPV. [13] The investors are willing to place their money into securities of the SPV if these securities are highly rated by the rating agencies. [14] The rating agencies continue to grant these high ratings because many precautions are taken to make the SPV and the transferred assets "bankruptcy remote" [15] from any bankruptcy filing of the originator. [16]

Should the SPV or its assets be drawn into bankruptcy proceedings of the originator, it would hinder the investor's ability to collect on their investments as those payments came due, and hinder their ability to foreclose on the collateral should those payments no longer be made. [17] These are criteria the rating agencies look to in rating the asset−backed securities. [18] There are other problems that can arise for investors should the assets be drawn into the originator's bankruptcy. [19] Aside from the section 362 automatic stay [20] preventing the investors from collecting or

foreclosing on their investments, problems can arise under section 363 dealing with sales of assets, section 364 dealing with obtaining financing and section 365 dealing with executory contracts and unexpired leases. [21]

Under section 363 of the Bankruptcy Code, the trustee may use, sell or lease property of the estate. [22] This section allows the debtor to use or sell pledged assets necessary to its reorganization efforts, over the objections of creditors after notice and a hearing. [23] Section 364(d)(1), allows a debtor−in−possession lender to prime the existing lien of a creditor against assets, provided that is the only way for the debtor to obtain post−petition financing [24] and adequate protection under section 361 [25] is provided.

Section 365 [26] grants the bankruptcy trustee the power to assume or reject any executory contract that it deems beneficial or burdensome in its best business judgment. [27] Examples of potential executory contracts in the securitization transaction would include agreements of the SPV with servicers or liquidity facilities. [28]

Regardless of any direct effects of bankruptcy on the transferred assets, if the investor's ability to collect on its investment or foreclose on the collateral is otherwise hampered, this will cause asset−backed securities in the future to receive lower ratings. [29] If ratings generally fall below an acceptable level, it could destroy the viability of this type of financing altogether. [30]

Over the years, bankruptcy trustees and judges have developed several ways to attack the transfer of assets to the SPV and draw the assets back into the originator's bankruptcy estate. [31] These traditional bankruptcy attacks fall into two categories: 1) attacks on the asset transfer; [32] and 2) attacks on the "bankruptcy remoteness" of the SPV. [33]

There are three traditional attacks on the asset transfer. [34] First, is the "true sale" versus disguised secured loan analysis. [35] The transaction must be structured as a "true sale" [36] because if a court should find that the transaction was a disguised secured loan, the assets will be drawn back into the originator's bankruptcy estate. [37] Second, a problem was created by the court in *Octagon Gas Systems.* [38] That court set forth the proposition that any sale of accounts or chattel paper would result in a continuing ownership interest of the seller in the accounts or chattel paper which would be treated as collateral. [39] This interest would draw the accounts or chattel paper into the originator's bankruptcy estate. [40] The commentators on this case have stated simply that this case is wrong and the drafters of Revised Article 9 of the Uniform Commercial Code have taken that position as well. [41] Lastly, the fraudulent transfer laws can be used to draw the transferred assets back into the bankruptcy estate. [42] If the originator has initiated a voluntary bankruptcy proceeding, this transfer would be a transfer of "an interest of the debtor in property" and will therefore be subject to fraudulent transfer scrutiny. [43] However, provided that the attorneys are mindful of this problem it can easily be avoided. [44]

The traditional attack on the "bankruptcy remoteness" of the SPV was set out by the *Kingston Square Associates* court. [45] That decision allowed an originator to orchestrate the filings of involuntary bankruptcy petitions against its SPVs to circumvent the "bankruptcy proofing" provisions placed in the bylaws of each corporation. [46] This technique again placed the SPV under the jurisdiction of the Bankruptcy Court and gave control of the assets to the bankruptcy trustee. [47] This attack can be dealt with at the formation stage of the SPV, by providing for a specific business structure to avoid the possibility of an involuntary filing. [48]

The next potential bankruptcy attack that may be faced by the securitization industry is substantive consolidation. [49] Substantive consolidation is an equitable remedy that allows the bankruptcy court to pool the assets and liabilities of two separate but affiliated entities and treat them as though they were the assets of a single bankruptcy debtor. [50] The rating agencies, as part of their analysis when determining ratings for the SPVs, will require a non−consolidation opinion of counsel. [51] This is a statement of counsel, that in their professional opinion, if certain procedures are followed concerning the originator and SPV, then the two entities will not be consolidated upon the bankruptcy filing of the originator. [52] The commentators in this area have indicated that the test for whether substantive consolidation is warranted can be framed as: 1) whether there is a substantial identity between the entities to be consolidated; and 2) whether consolidation is necessary to avoid some harm or realize some benefit. [53] To determine a substantial identity between the parties, many courts and many drafters of non−consolidation opinions have looked to the multi−factor analysis laid out in *In re Vecco Construction Industries*. [54] That analysis, although both practical and necessary when looking at two related business entities, is neither practical nor necessary in the securitization context. [55] The SPV, by

design is a "mere instrumentality" of the originator. [56] The necessary structure of the transaction creates a substantial identity between the entities. [57] Therefore, regardless of whether the SPV and originator avoid all of the *Vecco Construction* factors, the SPV may still be consolidated into the bankruptcy estate of the originator if consolidation is necessary to avoid some harm or realize some benefit. [58]

II.The Securitization Transaction

Securitization has been defined in many ways by different commentators. [59] Ronald S. Borod simply defines securitization as, "the aggregation and pooling of assets with similar characteristics in such a way that investors may purchase interests or securities backed by those assets." [60] While Joseph Shenker and Anthony Colletta, in their article provided a more in depth definition:

the sale of equity or debt instruments, representing ownership interests in, or secured by, a segregated, income producing asset or pool of assets, in a transaction structured to reduce or reallocate certain risks inherent in owning or lending against the underlying assets and to ensure that such interests are more readily marketable and, thus, more liquid than ownership interests in and loans against the underlying assets. [61]

This section will discuss the reasons why securitization has become such a popular method of corporate financing and then will set out the prototypical securitization transaction.

A. Asset Securitization − Why Has It Become So Popular?

The asset securitization industry has grown to a multi−billion dollar industry in a relatively short period of time. [62] The question then becomes, why has this become such a popular method of corporate financing? Lois R. Lupica, in her article, provided an excellent analysis of why firms securitize assets, beginning with,

Firms securitize their assets for the same reason firms borrow money: to raise money for either special projects or working capital. Rational firms choosing to securitize their assets rather than use them for collateral for a secured loan conclude, on balance, that securitization's net benefits exceed the benefits of the possible financing alternatives. [63]

There are several reasons a corporation might want to choose this particular financing technique: it provides an alternative financing source for the originator; it improves the originator's overall liquidity; it provides the originator with access to lower cost debt; and this can be off−balance sheet financing which will make the originator's financial statements much more attractive. [64] Each of these reasons will be discussed in turn.

The securitization transaction itself provides the originator with access to alternative financing sources. [65] This transaction attracts new investors in the asset−backed securities that would not have invested in the originator. [66] The transaction is structured to allow the rating agencies to give the asset−backed securities high to investment grade rating based on the quality of the assets and the value of any enhancements incorporated into the structure. [67] The transaction removes the assets to an SPV so that the investors will not be taking into account the creditworthiness of the originator, they will only look to the creditworthiness of the SPV. [68] This diversification of the originator's funding sources may also improve the originator's overall credit rating, [69] improving the originator's ability to obtain financing in the future. [70]

The transaction will improve the originator's overall liquidity. [71] The transaction, by design, transforms predictable future payment streams into current cash. [72] This allows the originator to pursue attractive outside projects immediately or meet current obligations as they become due. [73] The ability to pursue outside projects can increase a firm's profitability and should increase its overall creditworthiness. [74]

Securitization will also grant the originator access to lower cost debt. [75] The rating agencies will grant the SPVs higher ratings, and this will lead to lower cost debt for the originator. [76] In these transactions, the SPV can be highly rated even if the originator is not. [77] The rating agencies have developed some specific criteria for the ratings granted to the SPVs. [78] These criteria include: the creditworthiness of the transferred assets; the sufficiency of the separation of the assets from the insolvency of the originator; the sufficiency of the steps taken to prevent a voluntary bankruptcy filing

of the SPV; the probability of default on the payments of the securities; the value of any credit enhancements; and the ultimate recovery of the assets pledged as collateral, including some assessment of the timing of recovery. [79] The SPVs can easily meet these criteria because the transferred assets can be investment grade, but even if they are not, the transaction can be structured to achieve the desired rating by adding whatever enhancements are deemed necessary. [80] The structure of the transaction will always attempt to make the assets as "bankruptcy remote" from the bankruptcy filing of the originator, as possible. [81] Additionally, the entire purpose for creating the SPV was to complete the transaction and reduce the probability of default on the payment of the securities. [82] Therefore, the SPV will meet these ratings criteria and provide the originator will access to lower cost debt.

Lastly, this can be off−balance sheet financing. [83] Using this technique, the originator is replacing one asset, the future stream of income, with another asset, cash. [84] Unlike a secured loan, the securitization transaction involves the sale of an asset and does not require the adding of debt to the liability side of the originator's balance sheet. [85] This allows the originator to "raise capital without increasing the originator's leverage or debt−to−equity ratio." [86] This makes the originator's financial statements much more attractive and enhances the originator's ability to seek financing in the future. [87]

B. The Prototypical Securitization Transaction.

There are many variations to the structure of one of these transactions. [88] However, for the purposes of this analysis, the prototypical securitization transaction will consist of five basic individual steps to be taken by the originator and SPV. [89] The transaction begins with the originator identifying a pool of assets to be securitized. [90] The originator then creates a wholly owned subsidiary corporation, the SPV. [91] Next, during the creation process, the originator attempts to make the SPV as "bankruptcy remote" as possible using several techniques discussed below. [92] The assets are then transferred to the SPV. [93] Finally, the SPV will pay for purchase of the assets by selling asset−backed securities in the financial markets, and paying the net cash proceeds to the originator as purchase price for the receivables. [94] Each of these steps will be discussed in detail below.

1. Identifying a pool of assets with a predictable stream of income

The originator begins by identifying a pool of assets with a predictable stream of income. [95] A typical example would include a pool of accounts receivable or real estate mortgages. [96] It is important that the income stream be relatively predictable. [97] A large pool of assets is preferable due to the increased predictability of default, but this technique has been employed in very small pools as well. [98] The originator, during its initial cost benefit analysis, as well as the rating agencies, will require a reasonable prediction of the rate of default on the payment stream. [99] This will affect the costs of the transaction and any potential return to the originator from the transaction. [100] Once an acceptable pool of assets has been identified, they will be isolated and prepared for the transfer. [101] This technique has been employed with nearly any financial asset. [102]

2. Create a wholly owned subsidiary corporation

The originator will then create the vehicle through which it will complete this transaction. [103] This vehicle can be a variety of legal entities. [104] For the purposes of this paper, the SPV created will be assumed to be a wholly owned subsidiary corporation. During the creation stage, there are several factors which must be addressed in the incorporation documentation to make the SPV as "bankruptcy remote" from the originator's insolvency proceeding as possible. [105] These factors will help prevent an involuntary petition from being filed against the SPV, keeping the two entities from being substantively consolidated, and ensuring that the SPV will not file a voluntary bankruptcy petition, to the extent possible under current law. [106] The "bankruptcy remote" provisions will be discussed in the next section, the other factors will be discussed later in the paper. [107]

There are two alternate formulations for the SPV structure to further protect investors from the risks of the originator's bankruptcy. [108] The first is the multi−tier structure. [109] In the multi−tier structure the originator will conduct a "true sale" of the assets to the first−tier SPV. [110] The first−tier SPV will then transfer the assets to the second−tier SPV. [111] The second−tier SPV will then issue the asset−backed securities or debt instruments. [112] Both transfers can be structured as "true sales" to further avoid any risk of the originator's insolvency. [113] However, there may be no need to

conduct the second transfer as a "true sale," it may be more prudent to conduct the second sale as a sale for accounting purposes but not for bankruptcy purposes. [114] Here, the initial "true sale" transfer will insulate the assets from the originator's bankruptcy, while the second transfer, "a secured transaction for commercial law purposes," allows the first−tier SPV to "provide internal credit enhancement to the investors at the second−tier SPV level." [115] Also, "this structure …allows the originator to realize the value of any excess receivables and collections created by the original overcollateralization." [116]

The second structure is the "multiseller securitization conduit." [117] This structure allows different originators to reduce their transaction costs by selling receivables to a single pre−existing SPV. [118] The "multiseller securitization conduit" is in the business of completing these securitization transactions, and can therefore reduce the cost to the participating originators. [119] However, the rating agencies will require the use of both credit enhancement and liquidity facilities in determining the ratings of the commercial paper issued by such a conduit, thereby somewhat increasing the transaction costs and reduce the profitability of this structure. [120]

This structure can be very effective in reducing the potential for substantive consolidation of the originator and SPV. [121] However, this structure runs contrary to the procedures taken to make the SPV "bankruptcy remote" and will increase the risk of an involuntary petition being filed against the SPV. [122] The "multiseller securitization conduit" is dealing with multiple originators and, therefore, will be dealing with more outside parties who could potentially become the creditors necessary to bring an involuntary bankruptcy petition against the SPV. The potential problem of involuntary filings against the SPVs will be discussed later in this paper.

3. Making the SPV "Bankruptcy Remote."

The next step is to make the SPV "bankruptcy remote" from the bankruptcy of the originator. [123] An entity can never be truly "bankruptcy proofed," [124] because provisions allowing for the inability of an entity to voluntarily file for bankruptcy relief when it is in the best interests of the entity and its creditors are against public policy. [125] When attempting to make an entity bankruptcy remote, five factors must be considered and each will now be addressed in turn. [126]

First, the activities of the SPV must be restricted. [127] Restrictions are placed in the charter and by−laws of the SPV to restrict the activities to those necessary or incidental to the financing. [128] Keeping the activities of the SPV limited to those involved with the financing limits the potential for involuntary petitions to be filed against the SPV in the future. [129]

Second, the debt incurred by the SPV must be limited. [130] By limiting SPV debt to that necessary or incidental to the financing, the originator again reduces the risk of a future involuntary petition. [131] Also, the originator should properly fund the SPV to allow it to pay foreseeable creditors as the obligations become due. [132]

Third, the originator should place restrictions on the SPV's ability to subject the securitized assets to voluntary liens. [133] This can be accomplished by adding language to that effect to the incorporation documentation. [134] Any additional liens can lead to future involuntary petitions. [135]

Fourth, the originator should restrict the SPV's ability to file a voluntary bankruptcy petition. [136] An absolute bar to the SPV's ability to file a voluntary petition is impermissible. [137] However, there is a technique that has been accepted by the rating agencies as sufficient for their rating purposes. [138] The originator begins by adding a provision in the articles of incorporation of the SPV requiring a unanimous vote of the board of directors to file a voluntary bankruptcy petition. [139] The originator will then place at least one independent director on the board of the SPV in an attempt to minimize the possibility that the originator could influence the directors to authorize the filing of a voluntary petition. [140] Unfortunately, this technique cannot guarantee that the SPV will never file a voluntary petition now that it is well established that the fiduciary duties of directors of a corporation approaching insolvency will shift to the outside creditors. [141] However, this technique does guarantee that the originator will not be able to cause the SPV to file a voluntary petition for its own purposes. [142]

Finally, the originator must be concerned with the ability of a creditor of the SPV to file an involuntary bankruptcy petition against the SPV. [143] The requirements for filing of an involuntary petition are contained in section 303 of the Bankruptcy Code [144] which permits the creditors to force the entity into bankruptcy against its will. The parties may be able to reduce the risk of an involuntary petition by contractual agreement. [145] However, this technique has not been tested before judicial scrutiny and may be an impermissible restriction on the SPV's ability to file a voluntary bankruptcy petition. [146] Also, the originator should be sure that the SPV is properly funded to eliminate foreseeable obligations as they come due for payment. [147] If the obligations of the SPV never exceed $10,775, no creditors can ever bring an involuntary petition. [148]

4. Transfer the assets to the SPV.

The originator must now transfer the assets to the SPV. [149] The transfer is intended to separate the financial assets from the insolvency risks associated with the originator. [150] The transfer must be structured as a "true sale." [151] To achieve "true sale" status the originator must have no interest in the financial assets, such that the financial assets will not be part of the originator's bankruptcy estate under section 541 of the Bankruptcy Code. [152] Section 541(a)(1) [153] defines the bankruptcy estate as, "all legal or equitable interests of the debtor in property as of the commencement of the case." [154] The problem facing an originator during the transfer is that it may not have transferred its interest in the assets properly, and the bankruptcy court may find that the transfer was not a "true sale" but merely a disguised secured loan. [155] Should this occur, the assets will be deemed part of the originator's bankruptcy estate, and be drawn into the originator's bankruptcy case. [156] The asset transfer is a part of this transaction that has traditionally been an area of bankruptcy attack. [157]

5. The SPV pays for the purchase of the assets.

The final step requires the SPV to pay for the purchase of the financial assets. [158] The SPV will use the favorable rating to issue asset−backed securities or sell debt instruments in the bond markets. [159] The SPV will then use the proceeds to pay the originator for the purchase of the assets, thereby converting the future stream of payments into current cash for the originator. [160] The SPV will then use collections from the stream of payments on the financial assets to pay off the asset−backed securities over a specified period of time. [161]

III.Traditional Bankruptcy Attacks on the Securitization Transaction

The securitization transaction will continue to be an excellent financing technique for the originators, only so long as the rating agencies continue to grant asset−backed securities issued by SPVs high to investment grade ratings. [162] The agencies will continue to do this if the transactions continue to be structured to keep the assets effectively separated from any bankruptcy filing of the originator. [163] The bankruptcy trustees have already effectively attacked the securitization transaction with several legal theories. [164] This section addresses the traditional bankruptcy attacks on both the asset transfer and on the attempts to make the SPV "bankruptcy remote." [165]

The first question that should be addressed is one of policy, is the asset securitization transaction contrary to the basic policies involved in bankruptcy reorganization? The two basic policies are, first, to promote the restructuring of going concerns rather than their liquidation and second, to maximize assets of the debtor's estate for the benefit of creditors. These transactions are designed to keep the transferred assets out of the bankruptcy estate of the originator. Should this be permitted, when it can be shown that those assets were undervalued at the time of the transaction, and there is some equity in the assets that would be necessary for the effective reorganization of the originator? Even if the assets would not be necessary for the effective reorganization of the debtor, shouldn't any excess equity in those assets be earmarked for the creditors of the originator rather than the investors in the SPV? [166]

As a rebuttal to these policy attacks, it must be recognized that the market forces surrounding the securitization transaction will ensure that the originator will have received fair value for the transfer. [167] "Indeed, due to the scrutiny imposed by rating agencies, credit enhancers, and the various other market participants, securitization may present fewer opportunities for self−dealing than alternative financing methods." [168] Also, the Bankruptcy Code already has safeguards in place to avoid fraudulent conduct by an originator or the receipt of less than a reasonably equivalent value for the transferred assets. [169]

A. Traditional Bankruptcy Attacks on the Asset Transfer.

There are three common traditional bankruptcy attacks on the asset transfer. [170] First, the transfer must be structured as a "true sale." [171] If the transfer is deemed to be a disguised secured loan rather than a true sale, Article 9 of the Uniform Commercial Code applies, and the assets will become part of the originator's bankruptcy estate. [172] Secondly, if the financial assets being transferred are accounts or chattel paper, the Tenth Circuit opinion in *Octagon Gas Systems Inc. v. Rimmer,* [173] stands for the proposition that because Article 9 treats the sale of accounts or chattel paper as resulting in a continuing ownership interest of the seller, the effect is that "Article 9's treatment of accounts sold as collateral would place [the] account within the property of [the] bankruptcy estate." [174] This would indicate that even if the sale were structured as a "true sale," the accounts or chattel paper would continue to be part of the originator's bankruptcy estate. [175] The final traditional attack on the asset transfer is the fraudulent transfer law. [176]

1. "True Sale" vs. Disguised Secured Loan

The asset−backed securities in these transactions will continue to receive high to investment grade ratings from the rating agencies only if the transferred assets do not become part of the originator's bankruptcy estate upon the bankruptcy filing of the originator. [177] Thus, the initial transfer must be structured as a "true sale." [178] A "true sale" can be defined as a transfer of all of a person's right, title and interest in an asset to another person. In the securitization context, a true sale has also been defined as, "a transfer of financial assets in which the parties state that they intend a sale, and in which all of the benefits and risks commonly associated with ownership are transferred for fair value in an arm's length transaction." [179] Ronald S. Borod enunciated the test for a "true sale" by stating:

While there is no universally accepted set of factors for determining whether a transfer is a "true sale," courts have looked to two or three principal factors:

1. Did the parties intend for the transaction to be a sale or to create only a security interest in favor of the transferor?

2. Regardless of intent, have the risks and benefits of ownership truly been transferred? Does the transferor or the transferee bear the risk of loss to the assets being transferred? The greater the recourse to the transferor, the more likely the transfer will not be upheld as a true sale.

3. Did the transferee acquire an interest in identifiable assets? [180]

The paradigm conflict between when the transactions will be viewed by the court as a secured loan, rather than a true sale, occurs when the SPV retains some recourse to the originator such that all of the risks of ownership have not been transferred. [181] It has been stated that, if there is recourse against the originator, the nature of the recourse is the important factor in the analysis of the court. [182] If the recourse is the equivalent of "warranting that the asset will perform in accordance with its terms," [183] then the transaction remains a true sale. [184] However, if the recourse is "the equivalent of warranting a return to the buyer of its investment plus an agreed upon yield unrelated to the asset payment terms," [185] then the commentators argue that the courts should find this transaction a secured loan. [186]

The securitization transaction must be structured as a true sale because if the transaction is deemed a secured loan to the originator, then the originator is deemed to continue to have an interest in the property. [187] Any property in which the debtor has an interest will become part of the debtor's bankruptcy estate under section 541 of the Bankruptcy Code. [188]

To avoid this problem in the securitization transaction, the transfer should be structured to avoid the originator retaining any interest in the assets. [189] However, sometimes recourse will be necessary due to the nature of the assets or the transaction. [190] If recourse to the originator is necessary, then the terms of the transaction should allow for no more recourse than the "warranting that the asset will perform in accordance with its terms;" anything further would jeopardize "true sale" status of the transfer. [191] Ideally, if recourse of some kind is necessary to the transaction, a credit enhancement other than recourse to the originator should be employed, thereby reducing the likelihood that the originator will have any further interest in the transferred assets. [192]

2. *Octagon Gas Systems* − case comment

In May of 1993, the securitization industry was dealt what was potentially a devastating blow by the Tenth Circuit Court of Appeals. [193] Judge Baldock's statements in *Octagon Gas Systems, Inc. v. Rimmer*, [194] caused anxiety among structured finance attorneys all over the country. His interpretation of Article 9's treatment of accounts sold as collateral indicated that the effect of U.C.C. section 9−102 was that the accounts or chattel paper sold to the SPV would continue to be part of the originator's bankruptcy estate. [195]

This case dealt with a business operating a natural gas gathering system. [196] The gas gathering business transferred to Mr. Rimmer an "overriding royalty interest" in gross proceeds received from the gas sold. [197] The court found that Rimmer's interest in the proceeds of the natural gas was an "account" for Article 9 purposes. [198] The Court, applying Article 9, found that under section 9−102(1)(b) [199] Article 9 applies to "any sale of accounts or chattel paper." [200] After an analysis of Uniform Commercial Code sections 1−201(37), [201] 9−105(1)(m), [202] 9−105(1)(d) [203] and 9−105(1)(c), [204] the court concluded that, "these provisions clearly indicate that the buyer of an account is treated as a secured party, his interest in the account is treated as a security interest, the seller of the account is a debtor, and the account sold is treated as collateral." [205] The court went on to state, "the impact of applying Article 9 to Rimmer's account is that Article 9's treatment of accounts sold as collateral would place Rimmer's account within the property of [the seller's] bankruptcy estate." [206] Therefore, this court found that any seller of an account or chattel paper retains an interest in the account or chattel paper under Article 9 for bankruptcy purposes. [207]

The impact of this decision, if adopted nationwide, would place securitized accounts or chattel paper within the bankruptcy estate of the originator under section 541 of the Code, regardless of whether the transfer was structured as a "true sale." [208] Most of the commentators addressing this case, as well as the Permanent Editorial Board of the Uniform Commercial Code, have criticized the court, stating it was wrong in its assertion regarding any retained interest by a seller of accounts or chattel paper. [209]

This is also the position taken by the drafters of the Revised Article 9. [210] Revised Article 9 section 9−318(a) states: "(a) [Seller retains no interest.] 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." [211] This specifically rejects Judge Baldock's assertions in Octagon Gas Systems. [212] Revised Article 9 also makes several other changes to current Article 9 that are beneficial to the securitization industry. [213]

However, a very recent Bankruptcy Court decision has been handed down involving a steel company as originator and its SPV suggesting that the issue raised by Judge Baldock is not dead. In *In re LTV Steel Company, Inc.*, Judge William T. Bodoh, United States Bankruptcy Judge for the Northern District of Ohio, in an unpublished opinion stated, "[t]o suggest that Debtor lacks some ownership interest in products that it creates with its own labor, as well as the proceeds 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." [214] Again, apparently stating that there can never be a "true sale" of accounts receivable.

3. Fraudulent Transfer law

Another method of attacking the asset transfer is the fraudulent transfer law under state law [215] and the Bankruptcy Code. [216] Assuming the originator files for bankruptcy relief, this would be a "transfer of an interest of the debtor in property," and it will be subject to fraudulent transfer scrutiny. [217]

Section 548 is the fraudulent transfer provision of the Bankruptcy Code. [218] The statute begins by enumerating the standard for an actual fraudulent transfer. [219] The statute requires an actual intent to hinder, delay or defraud creditors. [220] Actual fraud will clearly fall within these statutes, but there, the harm is attributable to the originator's fraudulent behavior and not the structure of the securitization transaction itself. [221] This problem can be avoided by the attorney's being cognizant of this potential problem and carefully structuring the transaction to avoid any fraudulent intent of the originator. [222]

More pertinent to this discussion are the constructive fraudulent transfer rules enumerated in section 548(a)(1)(B). [223] The requirements for a constructive fraudulent transfer include that the debtor received less than a reasonably equivalent value for the transfer, and either the debtor was insolvent at the time or was rendered insolvent by the transaction; or was left with an unreasonably small capital after the transaction; or incurred debts that would be beyond the debtor's ability to pay. [224] The market forces will usually prevent a constructive fraudulent transfer from taking place because this transaction is in the form of a financing transaction. [225] Cash will always be received for the transfer, and the rating agencies, credit enhancers and other market participants will ensure that the exchange is for a reasonably equivalent value. [226] Lastly, "because courts have applied the fraudulent conveyance doctrine to challenge transfers made in connection with leverage buy−outs, there is a precedent for expansion of this doctrine." [227]

B. The Traditional Attack on the "Bankruptcy Remoteness" of the SPV

The other traditional bankruptcy attack on the securitization transaction is an attack on the "bankruptcy remoteness" of the SPV. [228] An entity can never truly be "bankruptcy proof," because it is against public policy to have an absolute bar on an entity's ability to file for bankruptcy relief. [229] The sharpest blow dealt to the securitization industry in attacking the "remoteness" of the SPV was delivered by Chief Judge Tina Brozman, in the Southern District of New York. [230] In her decision in *In re Kingston Square Associates*, [231] Judge Brozman determined that it is permissible for the principal of the originator, now a debtor in bankruptcy, to orchestrate the filing of an involuntary petition against the "bankruptcy remote" SPV. [232] The effect of this decision is to call into question the effectiveness of all of the procedures currently employed to ensure that the SPV and the transferred assets are "remote" from the insolvency of the originator. [233]

1. *Kingston Square Associates* − case comment

This case dealt with eleven corporations set up as special purpose vehicles formed for the purposes of securitizing mortgages on the 11 properties all owned by Mr. Ginsberg. [234] The bylaws of all eleven corporations contained a provision requiring a unanimous vote of the board of directors to file a voluntary petition. [235] An independent director [236] was placed on the board of all eleven corporations by the underwriter of the transaction, DLJ. [237] The case contained a long discussion of the independent director's loyalties and elaborated on the fact that, in this case the independent director's loyalties were with the underwriter of the transaction and not the corporation upon whose board he was sitting. [238] There were defaults on all of the mortgages and DLJ began foreclosure proceedings on all of the properties. [239] Mr. Ginsberg, owner of the properties, hired independent counsel to find and recruit creditors to petition for involuntary bankruptcy relief against the eleven SPVs. [240] He went as far as giving those attorneys a list of potential creditors and paying the attorneys fees himself. [241] Only one trade creditor joined the involuntary petitions, the rest were professionals, the lawyers and consultants hired by the SPVs. [242] DLJ moved for dismissal of the involuntary petitions as bad faith filings due to debtor collusion with creditors under section 1112(b) of the Bankruptcy Code, [243] which permits dismissal for "cause." [244]

The court, in reaching its decision, used a two part test from *In re Winn*, [245] to determine if there had been collusion between the debtor and creditors in filing the involuntary petition. [246] The first part of the test requires that there must appear a concerted action between the debtor and the petitioning creditors. [247] The second part of the test requires that the parties must fraudulently invoke the jurisdiction of the Court. [248] The court found that even with these facts evincing a very clear orchestration of the involuntary petition by the principal of the originator, the second part of this test was not satisfied. [249] The court held, "that although the movants have successfully demonstrated that the debtors and petitioning creditors did orchestrate the filings of the 11 involuntary petitions commencing these cases, their behavior is not consonant with what is required by law for collusion. As a result, the orchestration is not sufficient to warrant the dismissal of the cases without evidence that the debtors have no chance at rehabilitation." [250]

Clearly there is a problem with the court's reasoning in this decision. The court acknowledged its "wide discretion to determine if cause exists and how ultimately to dispose of the case" [251] under section 1112(b), and then proceeded to employ a mechanical two part test to analyze the facts of this case. [252] Clearly, it was well within the court's equitable power to determine, under these obviously very collusive facts, that there was collusion and dismiss the petitions as bad faith filings without ever resorting to this two− part test.

This decision has had two different effects on the securitization industry. First, the court stated, "it is universally agreed that when a corporation approaches insolvency or actually becomes insolvent, directors' fiduciary duties expand to include general creditors." [253] This holding eliminates the independent director's ability to block the voluntary petition filing when the SPV is nearing insolvency, if the petition would be in the best interest of all parties to the transaction, without breaching their fiduciary duties. [254] This will benefit the securitization industry, because the largest creditor of the SPV will be the holders of the asset−backed securities, and the filing of a voluntary petition will almost never be in their best interests.

However, this may create difficulty in finding people willing to become independent directors, knowing that the parties hiring them will be expecting the independent director's loyalties will lie with them. [255] Refusing to file the voluntary petition, when it is in the best interests of the parties to the transaction, is a breach of the independent director's fiduciary duties. [256] This type of breach of fiduciary duty may have harsh consequences for the independent director. [257] This breach could also result in the equitable subordination of the creditor's claim that hired the independent director, for aiding and abetting in the breach of a director's fiduciary duties. [258]

Second, according to the holding of this court, it is acceptable for the principal of the originator to orchestrate the filings of involuntary petitions against the SPVs. [259] It allows the principal of the originator to go as far as paying the creditor's attorney himself, and identifying who the creditors are to help the firm solicit their signatures on the involuntary petitions. [260] It allows the principal of the originator to go as far as paying the creditor's attorney himself, and identifying who the creditors are to help the firm solicit their signatures on the involuntary petitions. This allows for collusion between the originator and the creditors of the SPV to defeat the "bankruptcy proofing" provisions within the corporate bylaws of the SPVs. [261] It also calls into question the effectiveness of the procedures currently employed to ensure that the SPV and the transferred assets are "remote" from the insolvency of the originator. [262] "At a minimum, [this case] should prompt a second look by those involved in structured financings to ensure that the independent director is truly independent and that the director is, in fact, complying with his fiduciary obligations." [263]

There is a fiduciary duty imposed upon the board of directors of a company approaching or actually insolvent to the creditors of that corporation. [264] This may create difficulty in finding people willing to become independent directors knowing that the parties hiring them will be expecting the independent director's loyalties will lie with them. [265] However, this technique does have some merits, because the presence of this independent director will prevent the principals of the originator from causing the SPV to file a voluntary petition for their own purposes. [266]

There are two potential solutions to the problem of allowing collusion between the originator and the creditors of the SPV in filing involuntary petitions. [267] One solution is a contractual agreement with the principals of the originator at the time of the formation of the SPV that they will not aid or in any way orchestrate the involuntary filings of the creditors against the SPV. [268] This technique has not been reviewed by any court and may be an impermissible restriction on an entity's ability to seek bankruptcy relief. [269]

The second solution is to structure the business dealings of the SPV to avoid the potential for the filing of a section 303 involuntary bankruptcy petition. [270] Section 303(b) provides:

(b) An involuntary case against a person is commenced by the filing with the bankruptcy court of a petition under chapter 7 or 11 of this title

(1) by three or more entities, each of which is either a holder of a claim against such person that is not contingent as to liability or the subject of a bona fide dispute, or an indenture trustee representing such a holder, if such claims aggregate at least $10,775 more than the value of any lien on property of the debtor securing such claims held by the holders of such claims;

(2) if there are fewer than 12 such holders, excluding any employees or insider of such person and any transferee of a transfer that is voidable under section 544, 545, 547, 548, 549, or 724(a) of this title, by one or more of such holders of such claims; [271]

To avoid allowing creditors the ability to file under this section, the SPV must be adequately capitalized to pay its foreseeable debts as they become due. [272] The charter bylaws should also provide that the SPV will not engage in any business not related to the securitization transaction. [273] The incorporation documentation of the SPV should provide that the SPV will not incur any additional debt not related to the securitization transaction. [274] The aggregate debt, other than that incurred in the securitization transaction, of the SPV should not be permitted to exceed $10,774.00. [275] If the aggregate debt of the SPV never exceeds this amount, no involuntary petition can be filed against it. [276]

IV.Substantive Consolidation, the Next Potential Threat To Securitization

Substantive consolidation is an equitable remedy of the court that could have dramatic effects if applied to the typical securitization transaction. [277] Under this remedy, the court treats the assets and liabilities of at least two separate, but affiliated entities as if they were the assets and liabilities of a single bankruptcy debtor. [278] Creditors of the separate entities become the creditors of the consolidated entity, and the assets are pooled into a single bankruptcy estate. [279] It is widely accepted that substantive consolidation may occur between a debtor corporation and a solvent non−debtor affiliate. [280] The securitization transaction involves the originator removing its assets to a wholly owned subsidiary corporation, in order to convert future payment streams into current cash. In most instances, the SPV will have no other business operations other than completing this financing transaction. This type of relationship between parent and subsidiary clearly could give rise to substantive consolidation of the originator and SPV.

Although mentioned nowhere in the Bankruptcy Code, the court's power to substantively consolidate is implemented by the bankruptcy court's section 105 [281] equitable powers. [282] Substantive consolidation, therefore, is "entirely a creature of court made law." [283]

In the typical securitization transaction, the rating agencies will require the attorneys to supply a "non−consolidation opinion" letter at the onset of the transaction. [284] This letter states that in the professional's opinion, the SPV will not be substantively consolidated with the originator in the event of the originator's bankruptcy filing, assuming certain steps and procedures are followed in the formation and operation of the SPV. [285] These steps and procedures are usually designed to avoid creating an "identity of interest" between the originator and SPV as defined by either the *Vecco Construction* or some other factor analysis. Of course such opinion letters assume that the typical procedures respecting "separateness" of the two entities will be observed. The attorneys can not and do not opine that such procedures will be followed. These attorneys believe that, ultimately, compliance by the originator is the essential factor to avoid consolidation. This paper attempts to show that taking all of the recommended steps to maintain corporate separateness will not eliminate the identity of interest created by the necessary structure of the securitization transaction.

Also, should substantive consolidation of originator and SPV become an accepted remedy, this will have a dramatic effect on the securitization industry as a whole. If the rating agencies are unable to depend upon "non−consolidation opinions," the asset−backed securities may no longer receive high to investment grade ratings. [286] This may result in the elimination of the economic viability of this type of financing altogether.

This section of the paper addresses this potential problem. It will begin with a brief history of the equitable remedy of substantive consolidation. Next, it will address the modern legal standard used in determining if substantive consolidation is warranted. It will then analyze the potential problems that this modern legal standard poses to the prototypical securitization transaction set out above. This paper then takes the position that complying with all of the factors involved in the "identity of interests" test, set out in the modern standard, may not be enough to avoid the equitable remedy of substantive consolidation due to the very nature and structure of the prototypical securitization transaction. Lastly, this section addresses the consequences associated with substantive consolidation to the investors in the SPV and the securitization industry as a whole.

A. A Brief History of Substantive Consolidation.

The court in *In re Snider Bros.* explained:

The power to consolidate the estates of separate debtors is one arising out of equity, enabling the bankruptcy court to disregard corporate entities in order to reach assets for the satisfaction of a related corporation. *In re* Continental Vending Machine Corporation, 517 F.2d 997, 1000 (2d Cir. 1975). It is a power which should be used sparingly, for while the term has a disarmingly innocent sound, consolidation in bankruptcy is no mere instrument of procedural convenience, but a measure vitally affecting substantive rights. Matter of Flora Mir Candy Corporation, 432 F.2d 1060, 1062 (2d Cir. 1970); Chemical Bank New York Trust Company v. Kheel, 369 F.2d 845, 847 (2d. Cir. 1966). [287]

The Second Circuit, defining substantive consolidation, stated, "[s]ubstantive consolidation usually results in, *inter alia*, pooling the assets of, and claims against, the two entities; satisfying liabilities from the resultant common fund; eliminating inter−company claims; and combining the creditors of the two companies for the purposes of voting on reorganization plans." [288]

The power to substantively consolidate arises from the Bankruptcy Court's equitable powers under section 105 of the Bankruptcy Code. [289] The court in the *Vecco Construction* [290] case stated, "[i]t is well established that 'courts of bankruptcy are essentially courts in equity, and their proceedings are inherently proceedings in equity.'" [291] Section 105(a) permits the use of the court's equitable powers "where 'necessary' or 'appropriate'−− to facilitate the implementation of other Bankruptcy Code provisions." [292] However, this granting of equitable power is not "a roving commission to do equity," [293] rather, "the equitable discretion conferred upon the Bankruptcy Court by section 105(a) 'is limited and cannot be used in a manner inconsistent with the commands of the Bankruptcy Code.'" [294] The *Munford* Court addressed this mandate, stating, "the right to property in the hands of someone else is created by Bankruptcy Code section 541, [295] … which provides that property of the estate includes all legal and equitable interests of the estate,… and section 542, [296] which requires that all property must be turned over to the trustee." [297] Therefore, the use of the doctrine of substantive consolidation is consistent with the commands of the Bankruptcy Code under sections 541 and 542. Also, as stated by the Supreme Court in *Sampsell*, "[t]he power of the Bankruptcy Court to subordinate claims or to adjudicate equities arising out of the relationship between several creditors is complete." [298]

Mary Elizabeth Kors, in her article, identified four rationales that have developed over time supporting a court's decision to consolidate. [299] She stated,

four rationales for courts' decisions to consolidate emerge: (i) avoiding the extremely high costs of disentangling the related entities' financial affairs (as well as other pragmatic benefits of consolidation); (ii) protecting the expectations of creditors who relied on the collective credit of the entities; (iii) redressing the misappropriation of one entity's assets for the benefit of another entity; and (iv) recognizing the control, operational interdependence or lack of corporate formalities that has made the entities "alter egos" of one another. [300]

When looking to consolidate the typical securitization transaction, the courts will look to a subset of the fourth factor, labeled, whether there is an "identity of interests" between the parties or whether the subsidiary is a "mere instrumentality" of the parent. [301]

The doctrine of substantive consolidation evolved from the earlier common law doctrines of turnover, equitable subordination and piercing the corporate veil. [302] The turnover proceeding is the ancestor of substantive consolidation. [303] In those cases, the assets of one entity were turned over to the bankruptcy trustee of a related entity because he subsidiary was found to be a "mere instrumentality" of the parent. [304] Often, not all of the assets of the subsidiary would be turned over to the trustee of the parent. [305] However, in those turnover cases, the subsidiary's creditors would be given a first priority interest in those assets. [306] The seminal case in this area is *Fish v. East*, enunciating a ten factor test to determine if turnover was justified. [307] The court in *In re Munford* stated "substantive consolidation is essentially a complex turnover proceeding because the debtor is asking the nondebtor affiliate entity to bring into the estate assets in which the debtor asserts an unseparable interest." [308] However, unlike the turnover proceeding, substantive consolidation involves pooling the two corporation's assets and liabilities, rather than merely turning over the assets of one entity to the trustee of the debtor entity. [309]

Piercing the corporate veil is a remedy that is invoked when the subsidiary corporation is acting as an "alter ego" of the parent. [310] The classic factors to determine "alter ego" status were developed by Frederick Powell. The eleven factors include:

(1) The parent corporation owns all or most of the capital stock of the subsidiary.

(2) The parent and subsidiary corporations have common directors and officers.

(3) The parent corporation finances the subsidiary.

(4) The parent corporation subscribes to all of the capital stock of the subsidiary or otherwise causes its incorporation.

(5) The subsidiary has grossly inadequate capital.

(6) The parent corporation pays the salaries and other expenses or losses of the subsidiary.

(7) The subsidiary has substantially no business except with the parent corporation or no assets except those conveyed to it by the parent corporation.

(8) In the papers of the parent corporation or in the statements of its officers, the subsidiary is described as a department or division of the parent corporation, or its business or financial responsibility is referred to as the parent corporation's own.

(9) The parent corporation uses the property of the subsidiary as its own.

(10)The directors or executives of the subsidiary do not act independently in the interest of the subsidiary but take their orders from the parent corporation in the latter's interest.

(11)The formal legal requirements of the subsidiary are not observed. [311]

If these factors are shown to exist, the subsidiary company will be held liable to the creditors of the parent. [312] The fourth rationale set out for substantive consolidation in the Kors article, the "alter ego" rationale, was clearly influenced by the analysis for piercing the corporate veil and some courts have stated that piercing and substantive consolidation law overlap. [313]

The doctrine of substantive consolidation has evolved into its own separate and distinct corporate disregard doctrine. [314] Here, the Bankruptcy Court, under its equitable powers, treats the assets of two separate but affiliated entities as if they were the assets and liabilities of a single bankruptcy debtor. [315] The seminal case in this area is *Sampsell v. Imperial Paper & Color Corp*. [316] The modern legal standard for substantive consolidation will be discussed in the next section.

B. The Modern Legal Standard for Substantive Consolidation.

Several commentators have recognized that "the courts must examine the facts and circumstances of each case to determine if substantive consolidation is warranted." [317] The modern legal standard that will be applied to the typical securitization transaction was set out by the *Auto−Train* court. [318] The *Auto−Train* Court used a two part balancing test: "under this test, the proponent of substantive consolidation must show that (1) there is a substantial identity between the entities to be consolidated; and (2) that substantive consolidation is necessary to avoid some harm or to realize some benefit." [319]

The first prong, the existence of a substantial identity between the parties, has typically been determined by using a factor analysis. [320] Over the years, several factor analysis have been developed by the courts. [321] Today, the most commonly accepted factor analysis is that of the *Vecco Construction* case and that is the analysis pointed to by the commentators on asset securitization. [322] This is a seven factor test, and the courts have stressed that no one factor is determinative. [323] The seven factors are:

1. The degree of difficulty in segregating or ascertaining individual assets and liabilities;

2. The presence or absence of consolidated financial statements;

3. The profitability of consolidation at a single physical location;

4. The commingling of assets and business functions;

5. The unity of interests and ownership between the various corporate entities;

6. The existence of parent and intercorporate guarantees on loans; and

7. The transfer of assets without observance of corporate formalities. [324]

The court must determine that there is a sufficient identity of interests between the parties before the court will continue with the second part of the test. [325]

The second part of the test is an equitable determination to be made by the court. [326] The proponent of substantive consolidation must show that substantive consolidation is necessary to avoid some harm or to realize some benefit. [327] To use a well known maxim in bankruptcy law, the court should "look at the facts and do equity." [328] However, should the equities support consolidation, there is a defense available to the creditor. [329]

The potential defense to consolidation takes the form of a presumption that arises, "that the creditors have not relied solely on the credit of one of the entities involved." [330] The *Snider Bros*. court described the defense by stating, "a creditor who has looked solely to the credit of its debtor and who is certain to suffer more than minimal harm as a result of consolidation may be entitled to a denial of a request for consolidation." [331] Therefore, under the modern standard, if the creditor can show that it relied solely on the credit of the entity it dealt with, and that it will suffer some harm, it will have a defense to the consolidation. [332]

However, even if the creditor is able to make this showing, "it may be estopped from asserting this defense to consolidation where a reasonable creditor in a similar situation would not have relied on the separate credit of one of the entities to be consolidated." [333]

This is the basic analysis that commentators addressing this issue in the securitization context anticipate the courts will apply. [334] The next section will analyze the prototypical securitization transaction against the *Vecco Construction* factors and offer some steps that can be taken to avoid a finding that the securitization transaction is susceptible to consolidation.

C. Analysis of Potential Problems this Modern Legal Standard for Substantive

Consolidation poses to the Prototypical Asset Securitization Transaction.

This analysis will focus on the first part of the test, as discussed above, the factor analysis to determine if an identity of interests exists. [335] The courts have been very clear that no one factor is determinative in the analysis. [336] The parties involved in the transaction should attempt to eliminate all of the factors, if possible, to ensure that the SPV will not be substantively consolidated into the originator's bankruptcy estate. [337] There are several factor analysis that have developed over time, but for the purposes of this discussion, the Vecco Construction factors will be used. [338] The suggested steps to avoid these factors will overlap, and each factor will be addressed in turn.

(1) The degree of difficulty in segregating or ascertaining individual assets and liabilities. [339]

This first factor is triggered when assets and liabilities of the originator and the SPV become entangled. This factor can create problems in several areas of the transaction. First, the initial transfer of assets must be structured as a "true sale." [340] As discussed above, if "true sale" status is not achieved, then the assets of the SPV will be viewed by the court as merely collateral of the originator securing a loan made by the SPV. [341]

This factor may also be triggered if the originator acts as the collection agent for the assets transferred to the SPV. [342] The originator must be very careful to avoid commingling of collections with its own funds. [343] One way to avoid this problem is to hire an independent collection agent or servicer. [344] However, the use of an independent collection agent or servicer will increase the costs of the transaction. [345] Securitization transactions have become so widespread that many small businesses are securitizing assets and might not want to incur those added costs. [346] In that case, the originator should employ a "lock box" structure to its collections. [347] That structure will avoid any commingling of the funds. [348]

Lastly, the SPV should always be properly funded to pay its day−to−day expenses. [349] The originator should never pay the operating expenses of the SPV, and the incorporation documents of the SPV should provide that it will maintain it own books, records and bank accounts, and pay its own obligations as they become due. [350]

(2) The presence or absence of consolidated financial statements. [351]

A potential problem is created any time an originator maintains the SPV's liabilities, books and records. This can result in consolidated financial statements between the two entities due to laziness or inefficient bookkeeping. The SPV must prepare and maintain its own separate, full and complete books, records and financial statements. [352] The SPV also must maintain its own separate offices from those of the originator, although the space allocated on the originator's premises need not be substantial. [353]

(3) The profitability of consolidation at a single physical location. [354]

In today's world of computer documentation, this factor may not be as important as it once had been. However, the SPV should always maintain an independent office away from the originator, and be sure that it and not the originator is paying the expenses of that office. [355] This could involve merely allocating a percentage of the rental cost of the office space to the SPV, but it is important that the SPV pay its own office space expenses.

(4) The commingling of assets and business functions. [356]

The originator and SPV must avoid the commingling of assets and business functions. [357] A problem can be created when the originator acts as collection agent for the transferred financial assets. [358] There, the originator may find itself holding the funds collected on behalf of the SPV for some period of time. During this period, the originator runs the risk of developing enough of an interest in the funds to allow a court to find that it has effectively commingled the accounts. [359]

Ideally, an independent collection agent or servicer should be appointed. [360] An independent collection agent or servicer would monitor and collect the assets and administer the cash flow from the asset pool and remove those funds from the hands of the originator. [361] However, if the originator chooses to act as collection agent, a "lock box" format should be employed in collecting and administering the funds. [362] Management of the SPV must implement a written policy of not commingling money or assets with originator. [363] Also, the SPV must maintain its own separate books, financial records and bank accounts. [364]

(5) The unity of interests and ownership between the various corporate entities. [365]

Here, the SPV is a wholly owned subsidiary, created specifically to complete this financing transaction. [366] However, a finding of unity of interests and ownership of the transferred assets can be avoided by properly structuring the initial transfer as a "true sale." [367] The bylaws of the SPV should indicate that the originator and SPV will each be responsible for payment of their own operating expenses as they become due, and the SPV should be properly funded to pay those debts as they become due. [368]

(6) The existence of parent and intercorporate guarantees on loans. [369]

Any intercorporate guarantee can bring the parties within this factor. [370] However, in many securitization transactions the originator will partially guarantee bad accounts or bad collection on the assets to improve the creditworthiness of

the SPV in the eyes of the rating agencies. The existence of these guarantees can place this transaction within the scope of this factor. [371]

To avoid this factor, it has been suggested that a statement should be added to the bylaws indicating that neither parent nor subsidiary will guarantee debts of the other. [372] To improve the creditworthiness of the SPV, the originator should arrange for an independent credit enhancer or liquidity facility. [373] Credit enhancement will reduce the risks to the holders of the asset−backed securities that the SPV will have insufficient funds to pay back those securities. [374] A liquidity facility will advance funds against cash flow to ensure that the securities are paid timely, notwithstanding temporary delinquencies on the securitized assets. [375]

(7) The transfer of assets without observance of corporate formalities. [376]

The SPV must be treated as a truly separate entity. [377] The decisions involved in the SPV's business must be made independently by the SPV and not be dictated by the originator. [378] There are several steps that must be taken to observe corporate formalities: independent directors should be appointed to the board; [379] the board of directors of the SPV must hold regular meetings; [380] a quorum of the board of directors must be present in person at all of the scheduled meetings; [381] complete minutes of all meetings must be kept by the SPV; [382] the SPV must have sufficient officers and personnel to run daily operations; [383] and, the SPV must act solely through its own corporate name. [384] All of these provisions should be included in the SPV's incorporation documentation. [385] The accepted belief in the securitization industry today is that, if the originator and SPV are able to avoid these factors, the court's analysis under the doctrine of substantive consolidation will end there. [386] Therefore, the court would not reach the second part of the test, wherein the proponent of substantive consolidation must show that consolidation is necessary to avoid some harm or to realize some benefit. [387]

The next section will explore the possibility that even avoiding all of these factors will not be enough to stop the court from using its equitable powers under section 105 of the Bankruptcy Code to avoid some harm to the creditors of the originator.

D. Complying with all of the factors of the identity of interests test still may not be enough − Analysis of a court using its equitable powers under Section 105 to

correct some harm.

This section of the paper will show that the development of the case law in this area indicates that due to the structure of the securitization transaction, avoiding all of the factors of the identity of interests test may not deter a court's finding that an identity of interests exists between the originator and SPV. The *Augie/Restivo* court stated, "The sole purpose of substantive consolidation is to ensure the equitable treatment of all creditors." [388] The court in *In re Snider Bros.* stated, "While several courts have recently attempted to delineate what might be called 'the elements of consolidation' … the only real criterion is … the economic prejudice of continued debtor separateness versus the economic prejudice of consolidation. There is no one set of elements which, if established, will mandate consolidation in every instance." [389] The court is required to perform a balancing of the equities test when applying its equitable powers. [390] The court is not, however, bound or required to employ any factor analysis applied by earlier courts. [391] One commentator has stated, "courts may ignore the presence or absence of certain factors in order to fashion relief equitably under consolidation." [392]

The court in *In re Munford* reduced the analysis necessary for substantive consolidation down to two factors. [393] This court, in applying the two factors enunciated as the basis for consolidation by the *Augie/Restivo* court, stated, "the Circuit Court considered the long list of factors justifying consolidation which were enumerated by the various courts that have adjudicated the issue and boiled its analysis down to two apparently alternate factors…" [394] The court in *EastGroup Properties* stated, "[w]e stress, however, that we mention the specific factors set out in *Vecco, Ouimet* and elsewhere only as examples of information that may be useful to courts charged with deciding whether there is a substantial identity between the entities to be consolidated and whether consolidation is necessary to avoid some harm or realize some benefit." [395] These factor analysis can be employed by the court but are not required.

It can be argued that, in and of itself, a securitization transaction creates an identity of interests between the originator and the SPV by its very structure:

1. The SPV is created and incorporated by the originator, specifically to complete the financing transaction; [396]

2. The SPV is a wholly owned subsidiary of the originator; [397]

3. The SPV will have no creditors other than those necessary to the financing; [398]

4. The SPV will only engage in business necessary to complete the financing transaction; [399]

5. The SPV will not incur any debt unrelated to the transaction; [400]

6. Very often, the originator will continue to act as collection agent for the incoming stream of payments on the assets transferred to the SPV; [401] and

7. The SPV will typically be liquidated when the transaction is complete. [402]

Many of these factors are precautions taken to make the SPV "bankruptcy remote." [403] No one of these factors in and of itself is determinative, but nearly all of these factors will always be present in any securitization transaction that follows the prototypical structure. The SPV is created specifically to help the originator complete a financing transaction, to convert future receivables into current cash. [404] This is merely a structured financing technique and the SPV is clearly a "mere instrumentality" of the originator created to complete this technique. These are not two separate entities operating two separate businesses. Therefore, a court could find an identity of interests between the originator and SPV without ever employing an antiquated factor analysis.

The court in *Vecco Construction* quoted the court in *Soviero* stating, "the subsidiaries were but instrumentalities of the bankrupt with no separate existence of their own. Consequently, there existed a unity of interest and ownership common to all corporations, and that to adhere to the separate corporate entities theory would result in an injustice to the bankrupt's creditors." [405] The court went on to state, "where a corporation is a mere instrumentality … of the bankrupt corporation, with no independent existence of its own, equity would favor disregarding the separate corporate entities." [406]

However, if as discussed above, the SPV were formed to service more than one originator, a "multiseller securitization conduit," it would be in the "business" of completing asset securitization transactions, and would not be a "mere instrumentality" of any one originator. [407] The SPV would then have a separate existence of its own. [408] This would decrease the likelihood of substantive consolidation, but would undermine some of the steps taken to make the SPV "bankruptcy remote." This structure increases the number of potential creditors of the SPV and, therefore, increases the potential for the filing of an involuntary petition against the SPV. [409]

If a bankruptcy court were to take the position that a substantial identity of interests is created by the asset securitization transaction in and of itself, substantive consolidation could occur in these cases any time the consolidation is necessary to avoid some harm or realize some benefit. [410] In this context, when balancing the equities, the court must weigh the benefit to the creditors of the originator, with the harm to the investors in the SPV. [411]

When balancing the equities in the securitization context, the creditors of the originator and the investors in the SPV are not the only parties whose interests must be weighed. Securitization has grown into a multibillion dollar industry. Statutes have been amended to accommodate this type of financing because it is good for so many segments of society. The use of securitization in the mortgage industry has made it much easier for individuals to obtain funds to purchase homes. This technique allows companies to pursue new income producing projects that they could not have pursued without the ability to convert those future payment streams into cash. A court will always find it difficult to allow substantive consolidation between an originator and SPV because it could potentially destroy this industry that is so good for the economy. Also, a court allowing consolidation in this context would undermine the use of the corporation as an independent business entity. Therefore, any balancing will always lean against consolidation. Of

course, in a case with particularly bad facts, a court will always have the ability to consolidate but limit its decision to those particular bad facts and not affect the industry as a whole.

There is an additional factor to be considered in this analysis. [412] Once the two factors discussed above have been established, "a presumption arises 'that creditors have not relied solely on the credit of one of the entities involved.'" [413] Judge Edmondson went on to state, "once the proponent has made this prima facie case for consolidation, the burden shifts to an objecting creditor to show that (1) it has relied on the separate credit of one of the entities to be consolidated; and (2) it will be prejudiced by substantive consolidation." [414]

In the typical asset−backed securitization transaction, the investors always will have looked to the independent credit of the SPV, that is the purpose of separating the assets from the originator. [415] A bankruptcy judge may decide under its equitable powers that due to the structure of this type of financing transaction, this defense should not be available to the creditor in the typical securitization transaction. Independent evaluation of the SPV's credit and separate identity is the entire motivation for separating the assets from the originator. [416] By separating the assets, the SPV is able to achieve lower cost financing, for the benefit of its parent, by obtaining high to investment grade ratings on the securities collateralized by the transferred assets. [417] However, even if the bankruptcy judge decides to allow the creditor to rebut this presumption, the creditor might be estopped from asserting this defense. [418] Judge Edmondson stated in a footnote,

Even if an objecting creditor establishes reliance in fact, it may be estopped from asserting this defense to consolidation where a reasonable creditor in a similar situation would not have relied on the separate credit of one of the entities to be consolidated−−that is, "where such a claim would be unreasonable in light of all the facts." See *In re Snider Bros.*, 18 B.R. at 237, 235, 238 (estoppel applies where creditors "knew or should have known of the close association between affiliate and bankrupt," or where creditors "could be deemed to have dealt with the debtors with full knowledge of their 'consolidated operation'") [419]

In the typical securitization transaction, the investors in the securities of the SPV are sophisticated parties. Although the investors are relying on the SPV's separate credit, they are aware that they are dealing with a corporation created specifically for the purpose of completing this transaction. The investors are aware of the nature of this financing technique from the beginning. It is well within the reasonable expectations of those investors that this type of transaction might be substantively consolidated, and that is the reason for always requiring a non−consolidation opinion of counsel. Therefore, compliance with all of the *Vecco Construction* factors can potentially have no bearing on the Bankruptcy Judge's decision to substantively consolidate the originator and SPV in a modern securitization transaction.

E. Effects of a substantive consolidation in the securitization context

Should the bankruptcy judge choose to substantively consolidate the originator and SPV into the originator's bankruptcy filing, the SPV's investors will continue to have priority in the assets. However, they will be subject to the section 362 automatic stay and that will prohibit the collection on securities or foreclosure on the collateral. [420] These are two results the investors expected to avoid by the structure of the transaction. [421] There is also the possibility of a potential section 363 use, sale or lease of the property by the trustee, [422] or section 364(d)(1) priming lien. [423] However, in both of those circumstances the estate will be forced to provide the investors with adequate protection for the value of the assets as defined by section 361 of the Bankruptcy Code. [424] This result will, at the very least, make these investors very unlikely to invest in asset−backed securities in the future.

Should the courts, under their equitable powers follow this course, it would have a chilling effect on the securitization industry as a whole, due to the uncertainty an affirmative substantive consolidation decision would create. This would adversely affect any rating given to future asset−backed securities since the "non−consolidation opinion" would no longer be issued or accepted. There was no chilling in the industry after the *Kingston Square Assocs.* decision was issued, but that problem, as discussed above, could be corrected by a mechanical change in the initial structuring of the SPV. [425] A decision under this analysis would not be susceptible to such a correction. This might very well eliminate the viability of this type of financing altogether.

V. Conclusion

The structure of the typical securitization transaction creates a relationship where the SPV clearly will be a "mere instrumentality" of the originator, created solely for the purpose of completing a financing transaction. Although the courts have typically employed one of several factor analysis in determining whether an identity of interests exists between a parent and related corporation, the court is not required to use any specific factor analysis when employing its equitable powers. Therefore, a court can find that the first part of a substantive consolidation analysis is satisfied by the very structure of the typical securitization transaction. However, this does not mean that the typical securitization transaction will be consolidated.

FOOTNOTES:

[1] Mr. Lahny received his B.S. in business and management from the University of Maryland, College Park, and both his J.D. and LL.M. in Bankruptcy from St. John's University School of Law. Mr. Lahny practices with a law firm in New York City specializing in asset−based lending and insolvency law. This article was submitted in compliance with the writing requirement for Mr. Lahny's LL.M in Bankruptcy degree. Back To Text

[2] See The Committee on Bankruptcy and Corporate Reorganization of the Association of the Bar of the City of New York, Structured Financing Techniques, 50 Bus. Law. 527, 528 (1995) [hereinafter Committee] (explaining "[a]lthough relatively new, the use of structured financing techniques has grown rapidly and now accounts for $450 billion per year of financings in the United States alone.");Robert Dean Ellis, Securitization Vehicles, Fiduciary Duties, and Bondholder's Rights, 24 J. Corp. L. 295, 296 (1999) [hereinafter Ellis] (finding "asset securitization has quite rapidly become a popular form of financing"); see also Teresa N. Kerr, Bowie Bonding in the Music Biz: Will Music Royalty Securitization be the Key to the Gold for Music Industry Participants?, 7 UCLA Ent. L. Rev. 367, 369 (2000) [hereinafter Kerr] (stating "[a]s of 1999, the U.S. asset−backed securities market was worth over $200 billion and observers anticipate even greater growth for the millennium."); Joseph C. Shenker & Anthony J. Colletta, Asset Securitization: Evolution, Current Issues and New Frontiers, 69 Tex. L. Rev. 1369, 1371 (1991) [hereinafter Shenker] (asserting "[t]hese same forces have led to tremendous growth in asset securitization−−one of the most significant financial innovations of the last twenty years."). Back To Text

[3] See Committee, supra note 1, at 528 (explaining "[a]lthough relatively new, the use of structured financing techniques has grown rapidly and now accounts for $450 billion per year of financings in the United States alone."); Lois R. Lupica, Asset Securitization: The Unsecured Creditors Perspective, 76 Tex. L. Rev. 595, 602 (1998) [hereinafter Lupica] (explaining market expansion); see also Steven L. Schwarcz, The Alchemy of Asset Securitization, 1 Stan. J. L. Bus. & Fin. 133, 133 (1994) [hereinafter Schwarcz] (providing securitization rapidly expanding worldwide); Shenker, supra note 1, at 1371 (1991) (claiming tremendous growth). Back To Text

[4] See Ronald S. Borod, Securitization, Asset Backed and Mortgage Backed Securities, 1−7 (3d ed. 1991)[hereinafter Borod] (explaining securitization as tool creating cash from future payments); see also Committee, supra note 1, at 532 (discussing instant cash); Ellis, supra note 1, at 299 (monetizing firms financial assets through secured financing); Lupica, supra note 2, at 609 (stating "[b]y definition, the process of securitization transforms future payments into instant cash"). Back To Text

[5] See discussion infra Part II.A. Back To Text

[6] See Ellis, supra note 1, at 299 (calling for isolation of assets); see also Schwarcz, supra note 2, at 134 (stating large pool preferable); Shenker, supra note 1, at 1376−77 (stating "[m]ost transactions involve large numbers of homogeneous assets pooled together…[a]ssets most suitable for securitization are those with standardized terms, delinquency and loss experience that can support an actuarial analysis of expected losses, and uniform underwriting standards and servicing procedures satisfactory to ratings agencies and investors."). Back To Text

[7] See Ellis, supra note 1, at 300 (discussing necessity of a "financial intermediary" to complete prototypical securitization structure); see also Lupica, supra note 2, at 600 (discussing intermediary); Schwarcz, supra note 2, at 135 (stating necessity of intermediary). Back To Text

[8] See discussion infra Part II.B.3; see also Committee, supra note 1, at 554−58 (discussing bankruptcy remoteness); Ellis, supra note 1, at 303−09 (explaining two−fold nature of bankruptcy risk requires securitizations to rely on multiple legal protections to achieve bankruptcy remote status); Steven L. Schwarcz, Structured Finance: The New Way to Securitize Assets, 11 Cardozo L. Rev. 607, 614−18 (1990) [hereinafter Structured Finance] (noting bankruptcy remoteness involves attention to activities, debts, liens, voluntary bankruptcy and involuntary bankruptcy of SPV). Back To Text

[9] See Ellis, supra note 1, at 299 (providing must conclusively sever the originator from the assets); Steven L. Schwarcz, Structured Finance: A Guide to the Principles of Asset Securitization, 28 (2d ed. 1993) [hereinafter Structured Finance] (acknowledging ownership must be effectively transferred); see also Committee, supra note 1, at 541−47 (stating assets must be transferred on absolute basis). Back To Text

[10] See Peter V. Pantaleo et al., Rethinking the Role of Recourse in the Sale of Financial Assets, 52 Bus. Law. 159, 159 (1996) [hereinafter Pantaleo] (stating "[t]ransfers of financial assets in which the parties state that they intend a sale, and in which all the benefits and risks commonly associated with ownership are transferred for fair value in an arm's−length transaction, are easily identifiable as sales…[t]he issue becomes complicated if the buyer retains recourse to the seller such that less than all of the risks of ownership are transferred."); see also Committee, supra note 1, at 541−47 (stating assets must be transferred on absolute basis); Steven L. Schwarcz, The Parts are Greater Than the Whole: How Securitization of Divisible Interests Can Revolutionize Structured Finance and Open the Capital Markets to Middle Market Companies, 1993 Colum. Bus. L. Rev. 139, 141−42 (1993)[hereinafter Schwarcz, The Parts are Greater] (stating most essential element is "true sale" of financial assets). Back To Text

[11] See Mortensen v. AmeriCredit Corp., 123 F. Supp. 2d 1018, 1020 (N.D. Tex. 2000) (describing SPVs); see also Committee, supra note 1, at 534 (stating "[a] successful structured financing culminates in the issuance of asset−backed securities. Asset−backed securities have taken three principal forms−−debt (of varying classes), preferred stock and certificates of beneficial interest."); Ellis, supra note 1, at 300 (explaining SPV will sell instruments to pay originator for purchase with cash). Back To Text

[12] See Mortenson v. AmeriCredit Corp., 123 F. Supp. 1018, 1020 (N.D. Texas 2000) (explaining SPVs raise capital to purchase receivables); see also Patrina R. Dawson, Ratings Games with Contingent Transfer: A Structured Finance Illusion, 8 Duke J. Comp. & Int'l. L. 381, 382−83 (1998) [hereinafter Dawson] (asserting issuers probable default taken into account by ratings agencies); Ellis, supra note 1, at 300 (showing SPV will use incoming payment streams and credit enhancements to pay investors over payment period). Back To Text

[13] An investor will look to the rating of the SPV in determining whether to invest or not. See Borod, supra note 3, at 9−2 (stating "[a]lthough,…ratings do not represent a recommendation to buy, sell, or hold any particular security, they are extremely important in determining and, in some measure, generating, market acceptance of new products."); see also Michael J. Cohn, Note: Asset Securitization: How Remote is Bankruptcy Remote, 26 hofstra l. rev. 929, 934 (1998) (stating rating of SPV will effect interest paid); Thomas J. Gordon, Comment: Securitization of Executory Future Flows as Bankruptcy−Remote True Sales, 67 U. Chi. l. rev. 1317, 1322 (2000) [hereinafter Gordon] (stating SPV must obtain favorable credit rating to entice investors). Back To Text

[14] See Borod, supra note 3, at 9−3 (explaining "[b]ecause asset−backed transaction are, essentially, synthetic financings, the structure, quality of the underlying assets, and level of credit enhancement can be manipulated so as to achieve the desired rating."); see also Dawson, supra note 11, at 383−84 (allowing for higher ratings due to insulation of assets ratings of securities based on creditworthiness of isolated assets not creditworthiness of originator); Gordon supra note 12, at 1322 (discussing importance of SPV obtaining favorable credit rating). Back To Text

[15] For the purposes of this paper, the term "bankruptcy remote" will include the techniques commonly used in an attempt to "bankruptcy proof" the SPV that are discussed later in this paper. Back To Text

[16] See Dawson, supra note 11, at 383−84 (noting "a true structured finance (or securitization) legally isolates the assets from a transferors insolvency to enable a purchaser of securities backed by the assets to rely solely on the creditworthiness of those assets."); see also Committee, supra note 1, at 554−58 (discussing remoteness); Ellis, supra

note 1, at 303−04 (providing bankruptcy remoteness involves attention to activities, debts, liens, voluntary bankruptcy and involuntary bankruptcy of SPV). Back To Text

[17] See 11 U.S.C. § 362 (1994) (providing for automatic stay); see also Harden v. Gilbert (In re International Heritage, Inc.), 239 B.R. 306, 310 (Bankr. E.D.N.C. 1999) (stating stay begins when bankruptcy petition is filed); Dawson, supra note 11, at 386 (noting insolvency laws may cause delays in payment and no timely access to collateral). Back To Text

[18] See In re Towers Fin. Corp. Noteholders Litig., 1996 U.S. Dist. LEXIS 22674, *15 (S.D.N.Y. 1996) (applying rating criteria); Dawson, supra note 11, at 382−83 (explaining "[t]he degree of rating enhancement will depend generally on the probability of default by the issuer and the ultimate recovery on the assets pledged as collateral, including some assessment of the timing of recovery."); see also In re Towers Fin. Corp. Noteholders Litigation, 1996 U.S. Dist. LEXIS at *15 n.3 (laying out criteria for renting asset−backed securities). Back To Text

[19] See In re Mottola, No. 97−19361DWS, 1997 Bankr. LEXIS 2220, *1−*2 (Bankr. E.D.Pa. 1997) (depicting problem with executory contract); Summit Inv. & Dev. Corp. (In re Leroux), 167 B.R. 318, 320 (Bankr. Mass. 1994) (depicting problem with executory contract); Thomas J. Gordon, Securitization of Executory Future Flows as Bankruptcy−Remote True Sales, 67 U. Chi. L. Rev. 1317, 1318 (2000) [hereinafter Gordon] (outlining problems for investors). Back To Text

[20] 11 U.S.C. § 362(a)(3) & (6) providing in pertinent part:

(a) Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title, or an application filed under section 5(a)(3) of the Securities Investor Protection Act of 1970. . ., operates as a stay, applicable to all entities, of¾

…

(3) any act to obtain possession of property of the estate or of property from the estate or to exercise control over property or the estate;…

(6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title;….;

11 U.S.C. § 362 (a) (3) & (6) (1994); see also Dawson, supra note 11, at 386 (noting insolvency laws may cause delays in payment and no timely access to collateral); Pantaleo, supra note 9, at 161−62 (discussing delays). Back To Text

[21] See Dawson, supra note 11, at 386 (describing potential problems under Bankruptcy Code sections 362, 363, and 364); see also Pantaleo, supra note 9, at 161−62 (discussing problems). See generally Official Unsecured Creditors' Committee v, Northern Trust Co. (In re Ellington Maclean Oil Co.), 98 B.R. 284, 291 (Bankr. W.D.Mich. 1989) (depicting situation where it was difficult getting financing). Back To Text

[22] See 11 U.S.C. § 363(b)(1) (1994) (providing "[t]he trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate."); see also Dawson, supra note 11, at 386 (noting debtor can use pledged collateral in debtors reorganization); Pantaleo, supra note 9, at 161−62 (discussing delays creditor objection can cause). Back To Text

[23] See 11 U.S.C. § 363(b)(1) (1994); see also Dawson, supra note 11, at 386 (noting debtor can use pledged collateral in debtors reorganization); Pantaleo, supra note 9, at 161−62 (discussing delays creditor objection can cause). Back To Text

[24] See 11 U.S.C. § 364(d) providing:

(1) The court, after notice and a hearing, may authorize the obtaining of credit or the incurring of debt secured by a senior or equal lien on property of the estate that is subject to a lien only if¾

(A) the trustee is unable to obtain such credit otherwise; and

(B) there is adequate protection of the interest of the holder of the lien on the property of the estate on which such senior or equal lien is proposed to be granted.

(2) In any hearing under this subsection, the trustee has the burden of proof on the issue of adequate protection.);

11 U.S.C. § 364 (d) (1994); see also Dawson, supra note 11, at 386 (describing potential problems under Bankruptcy Code sections 362, 363, and 364 whereby creditor loses control of pledged assets); Pantaleo, supra note 9, at 161−62 (discussing problems of debtor using pledged assets). Back To Text

[25] See 11 U.S.C. § 361 (1994) providing:

When adequate protection is required under section 362, 363, or 364 of this title of an interest of an entity in property, such adequate protection may be provided by−−

(1) requiring the trustee to make a cash payment or periodic cash payments to such entity, to the extent that the stay under section 362 of this title, use, sale, or lease under section 363 of this title, or any grant of a lien under section 364 of this title results in a decrease in the value of such entity's interest in such property;

(2) providing to such entity an additional or replacement lien to the extent that such stay, use, sale, lease or grant results in a decrease in the value of such entity's interest in such property; or

(3) granting such other relief, other than entitling such entity to compensation allowable under section 503(b)(1) of this title as an administrative expense, as will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property.);

11 U.S.C. § 361 (1994); see also Greives v. Bank of W. Indiana (In re Greives), 81 B.R. 912, 916 (Bankr. N.D.Ind. 1987) (applying adequate protection under section 361); In re Becker, 38 B.R. 913, 916 (Bankr. Minn. 1984) (discussing financing protection). Back To Text

[26] See 11 U.S.C. § 365(a) (1994) (providing "(a) Except as provided in sections 765 and 766 of this title and in subsections (b), (c), and (d) of this section, the trustee, subject to the courts approval, may assume or reject any executory contract or unexpired lease of the debtor."); see also Coast Cities Truck Sales v. Navistar Int'l Transp. Co. (In re Coast Cities Truck Sales, Inc.), 147 B.R. 674, 677 (D. N.J. 1992) (allowing assumption of executory contract); Kendall Grove Joint Venture v. Martinez−Esteve (In re Kendall Grove), 59 B.R. 407, 408 (S.D.Fla. 1986) (applying statute). Back To Text

[27] See 11 U.S.C. § 365(a) (1994) (providing "[e]xcept as provided in sections 765 and 766 of this title and in subsections (b), (c), and (d) of this section, the trustee, subject to the courts approval, may assume or reject any executory contract or unexpired lease of the debtor."); see also In re F.W. Restaurant Assoc., Inc., 190 B.R. 143, 147 (Bankr. D. Conn. 1995) (recognizing controlling authority of section 365(a)); Harris Int'l Telecommunications, Inc. v. Three Star Telecast, Inc. (In re Three Star Telecast, Inc.), 73 B.R. 270, 274 (Bankr. D. P.R. 1987) (mentioning party rights under executory contracts are enforceable under section 365). Back To Text

[28] See Borod, supra note 3, at 7−13; see also Sir Speedy, Inc. v. Morse, 256 B.R. 657, 659 (Bankr. D. Mass. 2000) (using franchise agreement as example of contracts subject to assumption or rejection, although obligations under such agreements are still binding); In re Three Star Telecast, Inc., 73 B.R. at 274 (using lease as executory contract subject to assumption under section 365). Back To Text

[29] See Dawson, supra note 11, at 382−83 (indicating these are two of the criteria looked at by ratings agencies); see also Salomon B. Samson & Gail I. Hessol, Ultimate Recovery in Ratings: A Conceptual Framework, S&P CreditWeek, Nov. 6, 1996, at 25 (addressing criteria used in determining credit ratings); Standard & Poor's, Corporate Ratings Criteria 7 (1998) (explaining rating definitions and criteria). Back To Text

[30] See supra notes 12−20 and accompanying text. Back To Text

[31] See generally In re Kingston Square Assocs., 214 B.R. 713 (Bankr. S.D.N.Y. 1997) (allowing originator to orchestrate involuntary bankruptcy filings against SPVs); see also Borod, supra note 3 at 7−1−34 (remarking on ways to form bankruptcy attacks); Committee, supra note 1, at 541−68 (noting different characterizations of bankruptcy attacks). Back To Text

[32] See infra notes 169−175 and accompanying text. Back To Text

[33] See infra notes 227−232 and accompanying text. Back To Text

[34] See infra notes 169−226 and accompanying text. Back To Text

[35] See Pantaleo, supra note 9, at 161 (stating "[i]f the transfer of the future payment stream from the originator [seller] to the third party [purchaser] fails to constitute a true sale under § 541 of the Bankruptcy Code, the transfer would be deemed an advance of funds by the third party to the originator secured by the payment stream, i.e., a secured loan."); Schwarcz, Parts are Greater, supra note 9, at 143 (defining "true sale" and discussing importance thereof); see also Committee, supra, note 1, at 542 (addressing how courts determine whether or not transaction constitutes a true sale). Back To Text

[36] See Borod, supra note 3, at 7−23 (acknowledging "true sale" as absolute conveyance); Dawson, supra note 11, at 400 (finding "[a] true sale of an asset is a transfer that is effective against the transferor, its creditors, its regulator, its liquidator or receiver, and can be enforced against the borrower. Such a transfer legally separates the credit risk of the assets from that of the transferor."); Pantaleo, supra note 9, at 159 (noting "[t]ransfers of financial assets in which the parties state that they intend a sale, and in which all benefits and risks commonly associated with ownership are transferred for fair value in an arm's−length transaction, are easily identifiable as sales."). Back To Text

[37] See 11 U.S.C. § 541(a) (1994) (governing creation of bankruptcy estates); see also Borod, supra note 3, at 7−23; Dawson, supra note 11, at 400 (discussing effect of true sale by creating separate legal entity); Pantaleo, supra note 9, at 159 (recognizing transactions may sometimes yield controversy over whether it is in fact secured loan or sale). Back To Text

[38] 995 F.2d 948, 957 (10th Cir. 1993) (formulating new method by which to make SPVs vulnerable to attack). Back To Text

[39] See Octagon Gas Sys, Inc. v. Rimmer (In re Meridian Reserve, Inc.), 995 F.2d 948, 955 (10th Cir. 1993) (discussing how UCC Article 9 and Bankruptcy Code give rise to way in which SPVs can be brought into bankruptcy estate). See generally 68A Am. Jur. 2d Secured Transactions § 127 (1993) (noting sale of accounts and chattel paper, as security interests, are governed by UCC, Article 9); 3 Norton Banktcy Law & Practice 2d § 51:6, at 51−24 −25 (1997) (applying UCC, Article 9 to determine parties' interests in secured transactions). Back To Text

[40] See 11 U.S.C. § 541(a) (1994) (governing creation of bankruptcy estates); see also David Gray Carlson, The Rotten Foundations of Securitization, 39 Wm. & Mary L. Rev. 1055, 1059 (1998) [hereinafter Carlson] (characterizing Octagon Gas as decided correctly); Steven L. Schwarcz, The Impact on Securitization of Revised UCC Article 9, 74 Chi.−Kent L. Rev. 947, 952 (1999) [hereinafter Schwarcz, Impact on Securitization] (addressing arguments that "certain limited property interests may remain with the originator after the sale of financial assets."). Back To Text

[41] See Revised U.C.C. § 9−318(a) (2000) (stating "[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."); PEB Commentary

No. 14, Transfer of Accounts or Chattel Paper (1994) (stating Octagon Gas decision is "erroneous"); see also Borod, supra note 3, at 7−26 (explaining "[t]he Permanent Editorial Board of the Uniform Commercial Code has approved a new official comment to Article 9−102 of the Uniform Commercial Code and setting forth its belief that Octagon was wrongly decided."); Schwarcz, Impact on Securitization, supra note 39, at 952 (highlighting familiar criticism of Octagon Gas). Back To Text

[42] See 11 U.S.C. § 548 (1994) (defining what conduct constitutes fraudulent transfers and obligations); Lowe v. Brajkovic (In re Brajkovic), 151 B.R. 402, 405 (Bankr. W.D. Tx. 1993) (classifying execution of disclaimer of devise under will as fraudulent transfer); Barr v. Weber (In re Carousel Candy Co., Inc.) 38 B.R. 927, 936 (Bankr. E.D.N.Y. 1984) (describing how transaction to remove assets from reach of creditor falls within reach of section 548(b)). Back To Text

[43] See 11 U.S.C. § 548 (1994) (defining what conduct constitutes fraudulent transfers and obligations); see also infra notes 215−226 and accompanying text. Back To Text

[44] See 11 U.S.C. § 548 (1994) (defining what conduct constitutes fraudulent transfers and obligations); see also Wyle v. Rider & Family (In re United Energy Corp.), 944 F.2d 589, 593 (9th Cir. 1991) (explaining bankruptcy trustees have power to avoid fraudulent transfers pursuant to, inter alia, section 548); Borod, supra note 3, at 7−12 (maintaining "[r]atings agencies usually require a legal opinion that the transfer of the assets is not vulnerable to attack as a fraudulent conveyance under section 548 of the Bankruptcy Code…[h]owever, they generally permit opinion counsel to rely on certifications as to the solvency and good faith motivation of the transferor, and the fairness of consideration."). Back To Text

[45] See generally In re Kingston Square Assocs., 214 B.R. 713, 735 (Bankr. S.D.N.Y. 1997) (finding debtor who orchestrated with creditor to file involuntary petitions against debtor did not preclude debtor from relief); see also The Committee on Bankruptcy and Corporate Reorganization of the Association of the Bar of the City of New York, New Developments in Structured Finance, 56 Bus. Law. 95, 162 (2000) (discussing implications of Kingston decision); Sheryl A. Gussett, Not−So−Independent Director in a Bankruptcy Remote Structure, Am. Bankr. Inst. J., Mar. 17, 1998, at 24 (citing Kingston as establishing bankruptcy remote attack). Back To Text

[46] See In re Kingston Square Assocs., 214 B.R. at 738−39 (holding debtor may obtain relief even though debtor and creditor "did orchestrate the filing of eleven involuntary petitions commencing these cases…"); see also In re Valdez, 250 B.R. 386, 390 (D. Or. 1999) (asserting to dismiss involuntary bankruptcy as collusive, there must be fraudulent activity between debtor and creditor); In re Halpern, 229 B.R. 67, 71 (Bankr. E.D.N.Y. 1999) (arguing involuntary filing of petition does not constitute cause to dismiss − however, case was dismissed on other grounds); see also infra notes 258−264 and accompanying text. Back To Text

[47] See supra, text accompanying note 45. Back To Text

[48] See infra notes 123−147 and accompanying text; see also Committee, supra note 1, at 554−58 (discussing how to structure bankruptcy remote SPV's); Ellis, supra, note 1, at 323 (analyzing Kingston Square Assocs.). Back To Text

[49] See infra notes 277−315 and accompanying text. Back To Text

[50] See generally J. Stephen Gilbert, Substantive Consolidation in Bankruptcy: A Primer, 43 Vand. L. Rev. 207 (1990) (discussing effects of substantive consolidation in bankruptcy situations); Mary Elizabeth Kors, Altered Egos: Deciphering Substantive Consolidation, 59 U. Pitt. L. Rev. 381, 381 (1998) (noting difference between substantive consolidation as opposed to procedural consolidation); Patrick C. Sargent, Bankruptcy Remote Finance Subsidiaries: The Substantive Consolidation Issue, 44 Bus. Law. 1223 (1989) [hereinafter Sargent] (analyzing struggle faced by business entities seeking to avoid substantial consolidation in view of bankruptcy). Back To Text

[51] See, e.g., Committee, supra note 1, at Appendix C & D (providing form of non−consolidation opinion); Ellis, supra note 1, at 306 (explaining substantive consolidation usually requires separate reasoned opinion of law); Sargent, supra note 49, at 1225 (providing criteria by which to determine if non−consolidation opinion should be issued and other

suggestions to avoid substantive consolidation). Several other opinions of counsel are required in these transactions but are beyond the scope of this paper Back To Text

[52] See Committee, supra note 1, at Appendix C & D (providing form non−consolidation opinion); Sargent, supra note 49, at 1225 (providing criteria by which to determine if non−consolidation opinion should be issued and other suggestions to avoid substantive consolidation); see also Fish v. East, 114F.2d 177, 191 (10th Cir. 1940) (listing various criteria by which to determine whether or not two entities should be treated as one). Back To Text

[53] See Borod, supra note 3 at 7−18 (laying out two factors as test); see also Eastgroup Properties v. S. Motel Assoc., Ltd., 935 F.2d 245, 249 (11th Cir. 1991) (stating two−part test); Munford, Inc. v. TOC Retail, Inc. (In re Munford, Inc.), 115 B.R. 390, 395 (Bankr. N.D. Ga. 1990) (recognizing substantial identity and harm balancing as two parts of test). Back To Text

[54] 4 B.R. 407, 412 (Bankr. E.D. Va. 1980) (listing seven considerations laid out in Vecco); see also Borod, supra note 3, at 7−18 (listing Vecco Construction test); Sargent, supra note 49 at 1226 (reducing previous eleven factors to seven); Schwarcz, Structured Finance, supra note 7, at 616 (enumerating seven factors). Back To Text

[55] See infra, notes 394−409 and accompanying text. Back To Text

[56] See In re Vecco Constr. Indus., Inc., 4 B.R. 407, 411 (Bankr. E.D. Va. 1980) (determining four subsidiary companies acted as mere instrumentalities for Vecco); see also Soviero v. Franklin Nat'l Bank of Long Island, 328 F.2d 446, 448 (2d Cir. 1964) (concluding parent company used branches as instrumentalities); Calvert v. Huckins, 875 F. Supp. 674, 678 (E.D.C.A. 1995) (explaining test for determining presence of mere instrumentalities). Back To Text

[57] See infra notes 59−62 and accompanying text. Back To Text

[58] See Eastgroup Prop. v. Southern Motel Assoc. LTD, 935 F.2d 245, 251 (determining benefits of consolidation must outweighs harms); In re Auto−Train Corp., 810 F.2d 270, 276 (D.C. 1987) (requiring court to inquire as to harms created by consolidation); Snider Bros., 18 B.R. 230, 237 (Bankr. D.Ma. 1982) (holding benefits of consolidation can't outweigh harms). Back To Text

[59] See Borod, supra note 3, at 1−3 (defining securitization); Kerr, supra note 1, at 369−70 (providing definition with similar reservation); Shenker, supra note 1, at 1373−74 (noting lack of legal definition for securitization, but providing working definition). Back To Text

[60] Borod, supra note 3, at 1−3. Back To Text

[61] Shenker, supra note 1, at 1373−73. Back To Text

[62] See Committee, supra note 1, at 528 (recognizing "[a]lthough relatively new, the use of structured financing techniques has grown rapidly and now accounts for $450 billion per year of financings in the United States alone."); Ellis, supra note 1, at 296 (noting "asset securitization, has quite rapidly become a popular form of financing"); Shenker, supra note 1, at 1371 (realizing tremendous growth in asset securitization and noting it as one of the most significant financial innovations of the last twenty years). Back To Text

[63] Lupica, supra note 2, at 605. Back To Text

[64] See Committee, supra note 1, at 530−31 (highlighting flexibility of structured financings); Ellis, supra note 1 at 301−03 (focusing on ability to make inexpensive financing available); Lupica, supra note 2, at 605 (explaining "[t]hese benefits include improving liquidity, increasing diversification of funding sources, lowering the effective interest rate, improving risk management, and achieving accounting−related advantages."). Back To Text

[65] See Ellis, supra note 1, at 302 (recognizing "[a]ccess to public market and private institutional financing further reduces cost of funding…"); Lupica, supra note 2, at 610 (explaining "[e]ven firms ordinarily able to get financing

may be able to tap a new market of investors through securitization"); Schwarcz, supra note 2, at 143 (stating "[a]nother benefit of asset securitization is that it may represent additional and untapped source of financing for an originator."). Back To Text

[66] See Committee, supra note 1, at 530 (noting "an entity has assets that can be segregated as a legal matter, it may be able to use structured financing techniques to obtain financing it would not otherwise be able to obtain or at a cost that would not otherwise be available to it."); Thomas J. Gordon, Securitization of Executory Future Flows As Bankruptcy−Remote True, 67 U. Chi. L. Rev 1317, 1344 (2000) [hereinafter Gordon] (remarking on benefits of securitization transactions including increased access to credit.); Lupica, supra note 2, at 610 (stating "individuals and institutional investors who would not ordinarily invest in an originator directly may be willing to invest in that originator's asset−backed securities."). Back To Text

[67] See Dawson, supra note 11, at 383 (stating "[r]elying on the insulation of assets in structured financings, [the rating agency] is able to base its ratings of securities on the creditworthiness or the isolated assets without regard to the creditworthiness of the original owner of the assets."); Lupica, supra note 2, at 613 (noting "[a]n originator can obtain this lower effective rate because the capital markets do not consider its creditworthiness in pricing the rate of return for the securitization of a firm's receivables. Rather, the quality of the underlying assets determines the rate."); see also Andrew E. Katz, Due Diligence in Asset−Backed Securities Transactions, 1247 PLI/Corp 529, 547 (2001) (asserting "[a]sset securitization transactions are designed to be, by their nature, relatively low risk transactions for an investor"). Back To Text

[68] See Dawson, supra note 11, at 383 (basing ratings on insulated assets rather than originator's creditworthiness); Lupica, supra note 2, at 613 (discussing fact that originator's credit does not factor in valuation of receivables); Schwarcz , supra note 2, at 136 (explaining "[t]he investors…are concerned only with the cash flows coming due on these receivables, and care little about the originators financial condition."). Back To Text

[69] See Lupica, supra note 2, at 611 (stating "[d]iversification of funding sources may also improve the originator's overall credit rating; a firm with a diversity of funding options generally has somewhat higher credit quality than a firm that solely utilizes commercial lending financing sources."); see also Matthew K. Fong, California Debt Advisory Commission And State Treasurer Actions, 974 PLI/Corp 835, 861 (1997) (stating "[a]s development activity progresses and property ownership diversifies, debt service payments become less vulnerable to delinquencies of major property owners, improving credit quality."). Back To Text

[70] See Lupica, supra note 2, at 611 (stating "[i]n some cases, a firm may find it financially prudent to engage in a securitization in order to improve its credit rating and then to return to the traditional commercial finance markets as a better credit risk."); see also Gordon, supra note 18, at 1344 (including access to credit within benefits of securitization transactions); J. Rosenthal & J. Ocampo, Securitization of Credit: Inside the New Technology of Finance, 40 at 219 (1988) (explaining how securitization transactions serve as vehicles to improve credit.). Back To Text

[71] See Borod, supra note 3, at 1−7 (stating "[t]he improved liquidity facilitated by securitization, while significant with respect to risk−based capital, is also a substantial benefit to issuers in its own right."); Committee, supra note 1, at 531 (noting "[s]tructured financings of receivables also can accelerate the receipt of cash flows, allowing the quicker redeployment of the proceeds of those assets."); Lupica, supra note 2, at 609 (declaring "[a]ll originators who securitize their assets enjoy an improvement in asset liquidity management."). Back To Text

[72] See Borod, supra note 3 at 1−7; Committee, supra note 1, at 532 (stating "[i]n theory, any asset that provides a predictable stream of cash flow or that can be converted into a predictable amount of cash can be securitized."); Ellis, supra note 1, at 299 (monetizing firms financial assets through a secured financing); Lupica, supra note 2, at 600 (positing "[b]y definition, the process of securitization transforms future payments into instant cash."). Back To Text

[73] See Lupica, supra note 2, at 610 (noting "[t]he transformation of a future payment stream into immediate cash may further enable an originator to pursue a potentially profitable project or merely meet its regular obligations."); Diane M. Sullivan, Why Does Tax Law Restrict Short−Term Trading Activity for Asset Securitization? 17 Va. Tax Rev. 609, 610 (1998) (explaining "[t]he issued securities are often more liquid than the underlying assets."); see also James

F. Penrose, Ratings Criteria For Project Finance Transactions, 1170 PLI/Corp 155, 159 (contrasting securitization in providing cashflow with project financing as alternate means). Back To Text

[74] See Lupica, supra note 2, at 610 (stating "[c]ash represents generalized purchasing power and is needed by businesses to invest in research and development, to pay dividends to shareholders, and to engage in other long−term investments, a need not always satisfied by a firm's erratic payment stream of receivables…[t]hese investments, in turn, may enable a firm to grow in profitability…"); see also George W. Gallinger & P. Basil Healy, Liquidity Analysis and Management 41−42 (2d ed. 1991); William L. Megginson, Corporate Finance Theory, 29 (1997). Back To Text

[75] See Committee, supra note 1 at 530 (declaring "[o]ne of the principal benefits from structured financings is a reduction in the cost of financing."); Ellis, supra note 1, at 301 (opining "[o]riginators enter into securitizations primarily to obtain low−cost financing."); Lupica, supra note 2, at 613 (explaining "[b]ecause securitizing originators can better manage event risks, securitization enables most firms to fund their operations at a lower effective interest rate than through a secured borrowing arrangement."); Schwarcz, supra note 2, at 143 (explaining how structured financings reduce risk of investment). Back To Text

[76] See Dawson, supra note 11, at 382 (noting "a given security may be 'enhanced,' that is given a rating above the issuer credit rating"); Lupica, supra note 2, at 613 (stating "[i]n cases where the originator's credit rating is deficient, the capital markets (meaning the rating agencies) may give a higher credit rating to the asset−backed securities issued by the SPC than to the securities issued by the originator directly. This translates into a lower effective interest rate."). See generally Overview of Structured Financings, CreditReview, Oct. 25, 1993, at 3, 3. Back To Text

[77] See Dawson, supra note 11, at 383 (noting "relying on the insulation of assets in structured financings, [the rating agency] is able to base its ratings of securities on the creditworthiness of the isolated assets, without regard to the creditworthiness of the original owner of the assets."); Lupica, supra note 2, at 613 (explaining "an originator can obtain this lower effective rate because the capital markets do not consider its creditworthiness in pricing the rate of return for securitization of a firm's receivables. Rather, the quality of the underlying assets determines the rate."). See generally Overview of Structured Financings, CreditReview, Oct. 25, 1993, at 3, 3. Back To Text

[78] See Dawson, supra note 11, at 382−83 (declaring "[t]he rating of a security, then, is based on the general creditworthiness of the issuer, the probability of the issuers default, and the value of any assets or other credit enhancement that support the rated issue…[t]he degree of rating enhancement will depend generally on the probability of default by the issuer and the ultimate recovery on the assets pledged as collateral, including some assessment of the timing of recovery."); see also Standard & Poor's, Corporate Ratings Criteria, 7 (1998) (detailing ratings and criteria); Standard & Poor's, Structured Finance Ratings Asset Backed Securities: Trade Receivable Criteria, 21−30 (1996) (detailing receivable criteria). Back To Text

[79] See Dawson, supra note 11, at 382−83 (noting factors to consider in rating of security). See generally Standard & Poor's, Corporate Ratings Criteria, 7 (1998) (detailing rating definitions); 1 Securitization of Financial Assets 7−63 to 7−82 (Jason H. P. Kravitt ed., 1991). Back To Text

[80] See Borod, supra note 3, at 9−3 (explaining "[b]ecause asset−backed transaction are, essentially, synthetic financings, the structure, quality of the underlying assets, and level of credit enhancement can be manipulated so as to achieve the desired rating."); Schwarcz, supra note 2, at 137 (stating "[a] securitization transaction can provide obvious cost savings by permitting an originator whose debt securities are rated less than investment grade or whose securities are unrated to obtain funds through an SPV whose debt securities have an investment grade rating."). See generally Gerard Uzzi, A Conceptual Framework for Imposing Statutory Underwrited Duties on Rating Agencies Involved in the Structuring of Private Label Mortgage−Backed Securities, 70 St. John's L. Rev. 779, 785 (1996) (discussing how issuers structure securities to meet rating requirements). Back To Text

[81] See Committee, supra note 3, at 533 (explaining "the assets that are to be the basis of the structured financing−− the assets to be securitized−−are transferred out of the entity receiving the benefits of the financing and into a special purpose vehicle…The objective is to remove the assets from the bankruptcy estate of the transferor and isolate them in

a special purpose vehicle."); Schwarcz, Structured Finance, supra note 7, at 613 (explaining "[t]he SPV itself must be insulated, to the extent practicable, from the possible bankruptcy of the originator."); G. Ray Warner, Lien on Me: Asset Securitization Under Revised Article 9, 2000 ABI Jnl. LEXIS 73, 2−3 (Sept 2000) (discussing securitization as alternative that reduces credit and bank risk). Back To Text

[82] See Ellis, supra note 1, at 299 (discussing necessity of a "financial intermediary" to complete the prototypical securitization structure); Schwarcz, supra note 2, at 135 (stating goal is to prevent creditors from having claims against SPV); see also Lupica, supra note 2 at 600 (discussing SPCs as servicers that pay on debtors' accounts). Back To Text

[83] See Committee, supra note 3 at 531 (discussing tremendous flexibility of structured financing); Ellis, supra note 1, at 302−03 (noting this is considered off balance sheet financing); Lupica, supra note 2, at 615−16 (recognizing accounting−related advantages of securitization); Schwarcz, supra note 2, at 142 (noting important indirect benefits are sources of off balance sheet funding). Back To Text

[84] See Committee, supra note 3, at 531−32 (discussing monetization of assets); Ellis, supra note 1, at 303 (discussing benefits of off balance sheet treatment); see also Borod, supra note 3, at 1−7 (noting replacement off assets with cash); Lupica, supra note 2, at 600 (noting sale of receivables replaced with cash). Back To Text

[85] See Ellis, supra note 1, at 302 (stating "unlike secured loans, securitizations permit the originator to raise funds without concomitantly reporting a liability on its balance sheet."); Lupica, supra note 2, at 615−16 (declaring "[p]ursuant to the Statement of Financial Accounting Standards (SFAS) No. 77, a transfer of assets in connection with a structured finance transaction will be treated as a sale for accounting purposes if the transfer is made without "recourse"…[t]his type of transfer is known as an off−balance sheet sale and offers a firm enormous flexibility in raising capital"). See generally Committee, supra note 1, at 531−32 (noting benefits of structured financings). Back To Text

[86] See Schwarcz [Alchemy], supra note 2, at 143 (discussing benefits of asset securitization as source of off balance sheet spending); see also Steven L. Schwarcz, Structured Finance: A Guide to the Principles of Asset Securitization 2−3 (Practicing Law Inst. 2d ed. 1993) (discussing balance sheet implications of securitization); Securitization of Financial Assets § 3.02 (Jason H.P. Kravitt ed., 1988). Back To Text

[87] See Ellis, supra note 1, at 302−03 (stating "[t]his off−balance sheet treatment enhances the originator's ability to seek financing when existing debt might prohibit borrowing additional funds or impose arduous financial triggers that would adversely affect traditional financing alternatives."); Lupica, supra note 2, at 615 (noting "[t]his type of transfer is known as an off−balance sheet sale and offers a firm enormous flexibility in raising capital…"). See generally Committee, supra note 3, at 531−32 (discussing flexibility permitted by structured financings). Back To Text

[88] See Committee, supra note 3, at 568 (stating "[t]he first fundamental structural variation occurs in the legal form of the special purpose vehicle or special purpose vehicles used to effectuate a structured financing…[c]ommonly used forms include the corporation, grantor trust and owner trust. Less commonly used are business cooperatives, limited partnerships and limited liability companies."); see also Dawson, supra note 11, at 391−92 (discussing bankruptcy−remote entities); Ellis, supra note 1, at 299 (discussing various forms of SPCs). Back To Text

[89] See infra notes 89−93 and accompanying text. Back To Text

[90] See Shenker, supra note 1, at 1376−77 (stating "[m]ost transactions involve large numbers of homogeneous assets pooled together. Assets most suitable for securitization are those with standardized terms, delinquency and loss experience that can support an actuarial analysis of expected losses, and uniform underwriting standards and servicing procedures satisfactory to ratings agencies and investors."); see also Ellis, supra note 1, at 299 (calling for isolation of assets); Schwarcz, supra note 2, at 135 (stating statistically large pool of receivables preferable). Back To Text

[91] See Ellis, supra note 1, at 299 (discussing formation of SPV); see also Committee, supra note 3, at 553−54 (structuring SPV); Lupica, supra note 2, at 600 (defining structured finance terms and formation of SPC); Schwarcz, supra note 2, at 135 (noting how securitization works generally). Back To Text

[92] See infra notes 122−47 and accompanying text; see also Committee, supra note 3, at 554−58 (providing bankruptcy remoteness involves attention to activities, debts, liens, voluntary bankruptcy and involuntary bankruptcy of SPV); Ellis, supra note 1, at 303−09 (explaining two−fold nature of bankruptcy risk requires securitizations rely on multiple legal protections to achieve bankruptcy remote status); Schwarcz, Structured Finance, supra note 7, at 613−18 (discussing separation of source of payment from originator for bankruptcy purposes). Back To Text

[93] See supra notes 89−92 and accompanying text; see also Committee, supra note 3, at 541−47 (discussing how assets must be transferred on absolute basis); Ellis, supra note 1, at 299 (providing must conclusively sever originator from assets); Steven L. Schwarcz, Structured Finance: A Guide to the Principles of Asset Securitization, 28 (2d ed. 1993) (acknowledging ownership must be effectively transferred). Back To Text

[94] See Committee, supra note 3, at 534 (stating "[a] successful structured financing culminates in the issuance of asset−backed securities…[a]sset−backed securities have taken three principal forms−−debt (of varying classes), preferred stock and certificates of beneficial interest."); see also Ellis, supra note 1, at 300 (discussing prototypical securitization structures); Lois R. Lupica, Revised Article 9 Securitization Transactions and the Bankruptcy Dynamic, 9 Am. Bankr. Inst. L. Rev. 287, 288 n.11 (2001) [hereinafter Lupica, Revised Article 9] (putting article in context of prototypical originator corporation). Back To Text

[95] See Committee, supra note 3, at 532 (stating "the cash flow or liquidation value of the assets must be predictable. Unless cash flow or liquidation value can be predicted reliably, the securities that can be supported by the assets cannot be determined. As discussed below, this predictability is at the heart of the evaluation by the rating agencies."); Kerr, supra note 1, at 371 (stating "[a]n asset is ideal for securitization if it generates a steady stream of income in the form of a payment obligation from a third party that is sufficient enough to cover the distribution of income to the asset−backed securities, all administrative expenses associated with structuring the deal, as well as the default risk for the entire portfolio of secured assets."); Schwarcz, supra note 2, at 135 (discussing preliminary stages of securitization); see also Shenker, supra note 1, at 1376 (discussing cash flow produced by income−producing asset). Back To Text

[96] These assets can be very large pools and have a very predictable stream of income. See supra, note 94; see also Amy C. Bushaw, Small Business Loan Pools: Testing the Waters, 2 J. Small & Emerging Bus. L. 197, 202 (1998) (discussing securitization of residential mortgage loans); Yuliya A. Dvorak, Transplanting Asset Securitization: Is the Grass Green Enough on the Other Side?, 38 Hous. L. Rev. 541, 546 (2001) (identifying "accounts receivables" as assets). Back To Text

[97] See Committee, supra note 3, at 532 (stating "the cash flow or liquidation value of the assets must be predictable. Unless cash flow or liquidation value can be predicted reliably, the securities that can be supported by the assets cannot be determined. As discussed below, this predictability is at the heart of the evaluation by the rating agencies."); Kerr, supra note 1, at 371 (declaring "[a]n asset is ideal for securitization if it generates a steady stream of income in the form of a payment obligation from a third party that is sufficient enough to cover the distribution of income to the asset−backed securities, all administrative expenses associated with structuring the deal, as well as the default risk for the entire portfolio of secured assets."); see also Schwarcz, supra note 2, at 135 (discussing preference to large pool of receivables); Shenker, supra note 1, at 1377 (noting qualities of predictability of income stream). Back To Text

[98] See Kerr, supra note 1, at 372 (asserting "[a] diversified pool of obligors minimizes the risks associated with asset−backed securitization and is therefore preferable for an asset−backed securitization transaction."); Schwarcz, supra note 2, at 135 (explaining "a statistically large pool of receivables due from many obligors, for which payment is reasonably predictable, is generally preferable to a pool of a smaller number of receivables due from a few obligors."); Shenker, supra note 1, at 1376−77 (declaring "[m]ost transactions involve large numbers of homogeneous assets pooled together…[a]ssets that do not satisfy these criteria, however, such as individual commercial real property, may also be securitized."). Back To Text

[99] See Committee, supra note 3, at 532 (discussing importance of predictability in evaluation by rating agencies); Kerr, supra note 1, at 372 (explaining "[i]f the payments on the assets are predictable, the assets will receive a higher valuation from the 'rating agencies.'"); see also Jeffrey E. Bjork, Seeking Predictability in Bankruptcy: An Alternative

to Judicial Recharacterization in Structured Financing, 14 Bank. Dev. J. 119, 120 (1997) (giving example of importance of predictable income stream). Back To Text

[100] See supra notes 94−98, and accompanying text. Back To Text

[101] See Schwarcz, supra note 2, at 135 (explaining once originator identifies assets to be used in securitization he will then transfer receivables to a newly formed SPV); see also Committee, supra note 3, at 533 (noting different structuring techniques); Shenker, supra note 1, at 1377 (discussing segregation of assets to insulate from risk). Back To Text

[102] See Committee, supra note 3, at 532 (noting "the assets that can be securitized through structured financings are virtually limitless."); Kerr, supra note 1, at 371 (listing "credit card receivables, lease receivables (including automobile, equipment, and aircraft leases), commercial loans, insurance premiums, mortgages, and loans to small businesses" as examples of permissible legal entities utilized); Lupica, supra note 93, at 292 (recognizing range of types of assets that can be securitized). Back To Text

[103] See Ellis, supra note 1, at 299 (discussing formation of SPV); see also Committee, supra note 3, at 553−54 (discussing structuring SPVs); Lupica, supra note 2, at 600 (discussing organization of SPCs); Schwarcz, supra note 2, at 135 (discussing newly formed special purpose vehicle). Back To Text

[104] For the purposes of this paper, the SPV created is assumed to be a wholly owned subsidiary corporation. See Committee, supra note 3, at 568 (asserting "[t]he first fundamental structural variation occurs in the legal form of the special purpose vehicle or special purpose vehicles used to effectuate a structured financing…[c]ommonly used forms include the corporation, grantor trust and owner trust. Less commonly used are business cooperatives, limited partnerships and limited liability companies."); see also Dawson, supra note 11, at 391−92 (discussing bankruptcy−remote entities and commonly used securitization entities); Lupica, Revised Article 9, supra note 93, at 320 n.183 (defining "eligible entity" as certain trusts, corporations, partnerships, and limited liability companies). Back To Text

[105] See Committee, supra note 1, at 536 (stating structured financing market understands "bankruptcy remote" does not mean "bankruptcy proof"); Frederick Dannen, The Failed Promise of Asset−Backed Securities, Institutional Investor, Oct. 1989, at 260 (recognizing distinction between "bankruptcy remote" and invulnerable to possibility of bankruptcy); Lupica, supra note 2, at 618 (stating in bankruptcy remote structure assets are removed from purview of originator's trustee in bankruptcy). Back To Text

[106] See In re Cont'l Vending Mach. Corp. v. James Talcott, Inc., 517 F.2d 997, 1001 (2d Cir. 1975) (observing consolidation affects substantive rights therefore to avoid inequity it must heavily outweigh other practical considerations); In re Kingston Square Assocs., 214 B.R. 713, 738 (Bankr. S.D.N.Y. 1997) (observing while voluntary insolvency would not generally be in interests of securitization investors, in some circumstances, investors might actually benefit from filing petition); Ellis, supra note 1 at 307 (explaining likelihood of involuntary petitions is minimized through contractual covenants and prohibiting creation of unsecured creditors). Back To Text

[107] See infra notes 122−147 and accompanying text. Back To Text

[108] See Committee, supra note 1, at 573 (stating"[a] widely used method of providing investor protection in a structured financing while retaining structural integrity involves the use of two or more special purpose entities in a 'multi−tier' structure."); Dawson, supra note 11 at 387−88 (stating desired structure is achieved by having pool of assets held by transferor transferred to bankruptcy−remote, special−purpose entity (SPE)); Schwarcz, supra note 2, at 140 (observing "[a] 'multiseller securitization conduit' offers originators the opportunity to minimize their transaction costs by utilizing a common SPV."). Back To Text

[109] See Committee, supra note 1, at 573 (maintaining "[a] widely used method of providing investor protection in a structured financing while retaining structural integrity involves the use of two or more special purpose entities in a 'multi−tier' structure."); Dawson, supra note 11, at 387−88 (explaining intermediate SPE may transfer rated securities

directly or to issuing SPE in two−tier transaction); Schwarcz, supra note 2, at 142 (claiming bankruptcy risk can be avoided by structuring securitization transaction in two tier structure). Back To Text

[110] See Committee, supra note 1, at 573 (noting t in multi−tier structure, originator effects true sale of assets to be securitized to first−tier SPV); Dawson, supra note 11, at 388 (discussing fact that each transferor holding assets either sells assets to intermediate SPE or makes capital contribution of assets to intermediate SPE); Schwarcz, supra note 2 at 142 (stating bankruptcy protection is achieved by selling receivables to wholly owned SPV in transaction constituting true sale). Back To Text

[111] See Dawson, supra note 11, at 388 (noting transferor has either originated assets or purchased assets in chain of transfers from originator); see also Committee, supra note 1, at 573 (stating second−tier SPV assets are transferred to is either trust or corporation not owned by originator); Schwarcz, supra note 2, at 142 (explaining transfers of receivables to independent SPV constitutes sale for accounting purposes but not necessarily for bankruptcy purposes). Back To Text

[112] See Committee, supra note 1, at 573 (noting assets will be removed from books of transferor if "(a) transferor surrenders control of future economic benefits, (b) transferor's recourse can be reasonably estimated and (c) transferor does not have repurchase obligations other than pursuant to the recourse provisions"); Dawson, supra note 11, at 388 (explaining intermediate SPE deposits or sells assets to issuing SPE, or borrows from issuing SPE and pledges assets to issuing SPE to secure loan); Schwarcz, supra note 2, at 142 (discussing fact independent SPV will issue securities in capital markets to fund transfer). Back To Text

[113] See Committee, supra note 1, at 533 (noting transfer of assets to special purpose vehicle is typically structured as "true sale" as distinguished from transfer that serves merely as collateral security); Dawson, supra note 11, at 388 (asserting "[t]o avoid the risk that bankruptcy may cause a court to deem some or all of the assets transferred to the intermediate SPV to be part of the transferor's bankruptcy estate,…each transfer should be structured as a 'true sale.'"); see also In re Woodson Co., 813 F.2d 266, 272 (9th Cir. 1987) (holding simply calling transactions "sales" does not make them so). Back To Text

[114] See Committee, supra note 1, at 573 (stating "the transfer of those assets from SPV1 to SPV2 will be an accounting sale, but not a true sale, and forms the basis for a financing with a commercially acceptable level of credit enhancement."); Schenker supra note 2, at 1416 (observing depository institutions securitizing assets will almost always desire that the securitization be treated as a sale for accounting purposes). Schwarcz, supra note 2, at 142 (noting overpayment represents indirect cost to originator). Back To Text

[115] See Committee, supra note 1, at 573 (maintaining if transfers are properly constructed financing with commercially acceptable level of credit enhancement will be formed); Ellis, supra note 1, at 305 (noting sale characterization requires seller and purchaser to abide by strict set of criteria); Schwarcz, Structured Finance, supra note 7, at 611 (maintaining credit enhancement can take various forms, such as guaranty, letter of credit, irrevocable credit line, or third party purchasing subordinated securities from SPV). Back To Text

[116] See Schwarcz, supra note 2, at 142 (stating "[a]fter the independent SPV pays off the securities, it can reconvey the remaining receivables and collections to the wholly owned SPV without impairing the accounting characterization as a sale…[t]he wholly owned SPV is then merged into the originator, or alternatively, the remaining receivables and collections are transferred back to the originator, as dividends."); Id. at 139 (stating "binary recourse" may permit a bankruptcy true sale directly from the originator to the SPV while permitting the SPV to reconvey a significant portion of excess collections back to the originator"). See generally Howard M. Felson, Closing the Book on Jusen: An Account of the Bad Loan Crisis and a New Chapter for Securitization in Japan, 47 Duke L.J. 567, 600 (1997) (stating overcollateralization is needed to assure investors and providers of liquidity and credit enhancement they will not suffer losses from delayed collection or defaults). Back To Text

[117] See Schwarcz, supra note 2, at 140 (stating multi−seller securitization conduits offer originators opportunity to minimize their transaction costs by utilizing common SPV); see also Thomas J. Gordon, Securitization of executory Future Floews as Bankruptcy−Remote True Sales, 67 U Chi. L Rev. 1317, 1325 (2000) (stating multi−seller

securitization conduits are more attractive to investors since they are basically mutual funds which diversify investors portfolios); Adam Grant, Ziggy Stardust Reborn: A Proposed Modification of the Bowie Bond, 22 Cardozo L. Rev. 1291, 1310 (2001) (stating "[t]he Primary benefit of the multi−seller securitization conduit is that it allows originators who would not traditionally be able to afford the transaction costs of one−off securitizations to engage in securitization."). Back To Text

[118] See Schwarcz, supra note 2, at 140 (stating "these conduits are typically administered by commercial or investment banks and are able to achieve a transaction cost economy of scale by allowing multiple originators to sell receivables to a single pre−existing SPV."); see also Pantaleo, supra note 9 at 159 (recognizing trade receivables as rights to payment for goods sold or services rendered); Schwarcz, supra note 2, at 140 n. 26 (stating by limiting conduit to investment grade originators, transaction costs may be reduced). Back To Text

[119] See id. at 140 (reasoning to minimize risk multiseller securitization conduits accommodate only investment grade originators); Schwarcz, The Parts Are Greater, supra note 2, at 140 (stating originator will typically be commercial or investments bank). Back To Text

[120] See Joan Barmat, Securitization: An Overview, in The Handbook of Asset−Backed Securities 10 (Jess Lederman ed., 1990) (stating over−collateralization offers credit enhancement of securitization program, creating reserve against potential credit losses from any excess yield on the assets); Schwarcz, supra note 2, at 141 (noting liquidity facilities and credit enhancement significantly reduce risk on securities issued by multiseller conduits). See generally Gregory R. Salathe, Reducing Health Care Costs Through Hospital Accounts Receivable Securitization, 80 Va. L. Rev. 549, 552 (1994) (discussing types of liquidity facilities and credit enhancement). Back To Text

[121] If the SPV is in the business of completing these securitization transactions, there is less likelihood of a court finding an "identity of interests" between one particular originator and this "multiseller securitization conduit." Back To Text

[122] One of the procedures taken to make the SPV "bankruptcy remote" is limiting the number of creditors of the SPV to those necessary to complete that particular financing transaction. This limits the potential for the filing of involuntary petitions against the SPV. The "multiseller securitization conduit" will have other creditors in addition to each individual transaction. See Schwarcz, supra note 2, at 135 (stating "the goal is to prevent creditors (other than holders of SPV's securities) from having claims against SPV); see also Carl S. Bjerre, International Project Finance Transactions: Selected Issues Under Revised Article, 73 Am. Bankr. L.J. 261, 265 n.18 (1999) (stating structuring entities to be bankruptcy remote involves drafting the entities organizational documents to restrict management's ability to file a voluntary bankruptcy petition, limiting its debt and its number of creditors in order to minimize the risk of an involuntary bankruptcy petition); Henry Hansmann, Section II: Trust Law in the United States. A Basic Study of Special Contribution, 46 Am. J. Comp. L 133, 149 (1998) (stating entity which is bankruptcy remote will be unaffected by bankruptcy of corporation, and will maintain secured title to assets it holds). Back To Text

[123] See Committee, supra note 1, at 554−58 (noting purpose of structuring SPV as "bankruptcy remote" is so it is unlikely to be affected by bankruptcy of transferor or any of its affiliates); Dawson, supra note 11, at 391−94 (expanding on how to make SPV bankruptcy remote); Schwarcz, Structured Finance, supra note 7, at 613−18 (maintaining SPV must be insulated from possible bankruptcy of originator). Back To Text

[124] Government agencies such as state funded housing agencies or military agencies and Banks are not eligible to become debtors under the Bankruptcy Code so they are bankruptcy proof. See Dawson, supra note 11 at 389−90 (stating "special nature of the originator has made it acceptable to use a secured loan rather than an SPV as a means of separating the creditworthiness of the assets from that of the originator."); see also 11 U.S.C. § 109(b)(2) (1994) (providing bank originators are not eligible to become debtors under Bankruptcy Code). See generally Eric S. Pommer & Marc M. Friedman, Municipal Bankruptcy and its Effect on Government Contractors, 25 Pub. Cont. L. J. 249, 264 (1996) (asserting since municipalities may be able to find protection under chapter 9 of Bankruptcy Code creditworthiness of governmental entity should be evaluated). Back To Text

[125] See Committee, supra note 1 at 556 (maintaining "[a]dvance restrictions against filing a voluntary bankruptcy case pursuant to an agreement between a debtor and a creditor have been held to be void against public policy."); Ellis, supra note 3, at 307 (asserting "the issuer cannot be prohibited from filing a bankruptcy petition…[a]s a general principal, waivers or prohibitions on bankruptcy petitions are void as matter of public policy."); Marshall E. Tracht, Contractual Bankruptcy Waivers: Reconciling Theory, Practice, and Law, 82 Cornell L. Rev. 301, 305−08 (1997) (stating firm cannot waive its bankruptcy eligibility entirely because creditors have right to file involuntary petition and to extinguish this right is against public policy). Back To Text

[126] See Committee, supra note 1, at 554 (stating "[s]tructuring a bankruptcy remote SPV generally involves attention to at least five areas: activities, debts, liens, voluntary bankruptcy, and involuntary bankruptcy."); Dawson, supra note 11, at 392 (noting bankruptcy−remote special−purpose entity (SPE) is generally defined in accordance with six factors); Schwarcz, Structured Finance, supra note 7, at 614 (stating limitations are accomplished by drafting SPV's charter or articles of incorporation or other organizational documents to restrict voluntary bankruptcy). Back To Text

[127] See Committee, supra note 1, at 554 (stating "[t]he activities of an SPV are restricted to those necessary or incidental to the filing."); Dawson, supra note 11, at 393 (stating "the entity should not engage in any other business or activity."); see also Kristin Brooks et al., A Structured Finance Alternative to Reinsurance, S&P Creditweek, Nov. 13, 1996, at 28−29 (stating bankruptcy−remote entity's activities should be limited to those necessary to fulfill its role in transaction). Back To Text

[128] See Committee, supra note 1, at 554 (stating that "[t]his is accomplished by restrictions placed in the charter and bylaws of corporate SPVs…"); Dawson, supra note 13, at 393 (explaining that to restrict SPV it should agree to "separateness covenants"); Schwarcz, Structured Finance, supra note 7, at 614 (noting that "[t]his limitation normally is accomplished by drafting the SPVs charter or articles of incorporation or other organizational documents…"). Back To Text

[129] This restriction will limit the number of creditors and amounts of claims against the SPV. See 11 U.S.C § 303 (1994) (stating an involuntary case may be commenced only against a person who may be a debtor under the chapter which such case is commenced upon);Committee, supra note 1, at 554 (noting that in some structured financings profits from securitized assets are permitted to be used to acquire new assets). See generally In re Fox, 171 B.R. 31, 34 (Bankr. E.D.Va. 1994) (finding that creditor continued to pursue petition to cause debtor to incur substantial additional fees). Back To Text

[130] See Committee, supra note 1, at 554 (noting that debt of SPV is limited to asset−backed securities, obligations to credit enhancers and liquidity providers); Dawson, supra note 11,at 392 (stating that "the entity should be restricted from incurring additional debt"); see also 11 U.S.C. § 510(a) (1988) (providing subordinated debt obtained from third−party may be form of external credit enhancement which is enforceable in bankruptcy to extent that they are enforceable under applicable nonbankruptcy law); Steven L. Schwarcz, The Alchemy of Asset Securitization, 1 Stan. J. L. Bus & Fin. 133, 135 (1994) [hereinafter Schwarcz, The Alchemy of Asset Securitization] (reasoning by limiting SPV's business activities prevent creditors from having claims against SPV). Back To Text

[131] This restriction will limit the number of creditors and amounts of claims against the SPV. See 11 U.S.C. § 303 (1994) (allowing for an involuntary bankruptcy); Schwarcz, supra note 129, at 135−136 (asserting goal is prevent creditors from claims against debtor enabling them to file claims against SPV); see also Robert Dean Ellis, Securitization Vehicles, Fiduciary Duties, and Bondholder's Rights, 24 J. Corp. L. 295, 307 (1999) [hereinafter Ellis, Securitization Vehicles] (finding likelihood of involuntary petitions limited by contractual covenants and provisions prohibiting conduct which could create unsecured creditors). Back To Text

[132] See Ellis, Securitization Vehicles, supra note 130, at 309 (requiring vote of independent director in filing insolvency proceeding); Dawson, supra note 11, at 392−393 (requiring vote of independent director to file bankruptcy proceeding); see also Committee, supra note 1, at 556 (stating a super−majority vote is required for board of directors to approve voluntary bankruptcy). Back To Text

[133] Committee, supra note 1, at 555 (explaining that "[i]t is also important that the securitized assets be free of liens in favor of parties external to the structured financing."); see also Kerr, supra note 1, 375 (noting the importance of perfecting security interest in the securitized asset in order to avoid exposing SPV to bankruptcy in event originator faces bankruptcy). Back To Text

[134] See Committee, supra note 1, at 555 (noting that "the constituent documents typically provide that the securitized assets cannot be subject to a voluntary lien or security interest in favor of anyone other than the holders of the asset−backed securities, except to the extent those assets are permitted to be pledged to a provider of credit enhancement or liquidity support."); Kerr, supra note 1, at 373 (advising that SPV's charter should contain provisions that limit SPV's ability to become bankrupt) Back To Text

[135] This restriction will limit the number of creditors and amounts of claims against the SPV. See 11 U.S.C. § 303 (1994) (placing restrictions on creditors who want to file involuntary bankruptcy); see also Kerr, supra note 1, at 373−74 (advising SPV's ability to engage in activities allowing involuntary bankruptcy be limited); In re Faberge Restaurant of Florida, Inc., 222 B.R. 385, 387 (Bankr. S.D.Fla. 1997) (stating section 303 of Bankruptcy Code governs filing involuntary petitions and sets stringent tests which must be satisfied before debtor may be adjudicated). Back To Text

[136] See Ellis, supra note 130, at 309 (stating "[t]he charter restrictions in a typical securitization expressly negate the boards discretion to file a bankruptcy petition."); see also Committee, supra note 1, at 556 (explaining structuring is important to avoid bankruptcy); Dawson, supra note 11, at 393 (explaining "the entity should have at least one 'independent director' on the board of directors, and the consent of that director should be required to institute insolvency proceedings."); Schwarcz,, The Alchemy of Asset Securitization, supra note 129, at 135 (stating importance of making SPVs bankruptcy remote). Back To Text

[137] See Committee, supra note 1, at 556 (noting "[a]dvance restrictions against filing a voluntary bankruptcy case pursuant to an agreement between a debtor and a creditor have been held to be void against public policy."); Ellis, supra note 130, at 307 (explaining "the issuer cannot be prohibited from filing a bankruptcy petition…[a]s a general principal, waivers or prohibitions on bankruptcy petitions are void as matter of public policy."); see also In re Weitzen 3 F. Supp. 698−99 (S.D.N.Y. 1933) (stating "[t]he agreement to waive the benefit of bankruptcy is unenforceable"). Back To Text

[138] See infra, notes 267−271and accompanying text. Back To Text

[139] See Committee, supra note 1, at 556 (requiring "a super−majority vote, necessarily including all or at least one of the independent directors, is required in order for the board of directors to approve a voluntary bankruptcy."); Derrick A. Dyer, The Impact of dilution in asset Securitization: Commercial Separation Anxiety, 66 Miss. L.J. 407, 417 (1996) (suggesting in order to seek bankruptcy protection SPVs if corporations should require super−majority votes); see also Dawson, supra note 11, at 392−93 (requiring vote of independent director to file bankruptcy). Back To Text

[140] See Ellis, Securitization Vehicles, supra note 130, at 309 (requiring vote of independent director to file insolvency proceedings); Dawson, supra note 11, at 392−93 (requiring vote of independent director to file bankruptcy); see also Committee, supra note 1, at 556 (stating super−majority votes necessarily include all or at least one of the independent directors to approve voluntary bankruptcy). Back To Text

[141] See Ellis, supra note 130, at 316 (explaining "[t]his shift figured prominently in Credit Lyonnais Bank Nederland, N.V. v. Pathe Communication Co., which explicitly endorsed overall firm maximization as the controlling norm for board decision making: [I]n the vicinity of insolvency, a board of directors is not merely an agent of the residue risk bearers, but owes its duty to the corporate enterprise…[Management has] an obligation to the community of interests that sustain the corporation, to exercise judgement in an informed, good faith effort to maximize the corporation's long term wealth creating capacity."); Credit Lyonnais Bank Nederland N.V. v. Pathe Communications Co., No. CIV. A. 12130, 1991 Del. Ch. LEXIX * 215 (Dec. 30, 1991) (endorsing overall firm maximization as the controlling norm); see also In re Kingston Square Assocs., 214 B.R. 713, 735 (Bankr. S.D.N.Y. 1997) (asserting "it is universally agreed that when a corporation approaches insolvency or actually becomes insolvent, directors fiduciary duties expand to

include general creditors."). Back To Text

[142] See Ellis, Securitization Vehicles, supra note 130, at 308 (declaring "[t]he real issues that then need to be addressed are opportunistic insolvency petitions that come about when the issuer's management seeks to benefit itself, or some other interest group, through the reorganization process…[t]o deal with this problem, securitizations rely on the form of the issuer to reduce the likelihood of a voluntary petition."); see also 11 U.S.C. § 303(i) (1994) (granting attorney fees, costs, and occasional punitive damages against unsuccessful involuntary petitioners); In re Silverman, 230 B.R. 46, 51 (Bankr. D.N.J. 1998) (stating punitive damages awarded only on showing of bad faith). Back To Text

[143] See Committee, supra note 1, at 557 (explaining "structuring can be done to reduce the likelihood of involuntary bankruptcy."); Dawson, supra note 11, at 393 (stating "the transaction documents should contain a covenant preventing the parties from filing, instigating or joining in any involuntary bankruptcy proceeding against the entity so long as the rated securities are outstanding."); Schwarcz, Structured Finance, supra note 7, at 615 (planning to reduce the likelihood of bankruptcy). Back To Text

[144] Section 303(b) provides:

(b) An involuntary case against a person is commenced by the filing with the bankruptcy court of a petition under chapter 7 or 11 of this title¾

(1) by three or more entities, each of which is either a holder of a claim against such person that is not contingent as to liability or the subject of a bona fide dispute, or an indenture trustee representing such a holder, if such claims aggregate at least $10,775 more than the value of any lien on property of the debtor securing such claims held by the holders of such claims;

(2) if there are fewer than 12 such holders, excluding any employees or insider of such person and any transferee of a transfer that is voidable under section 544, 545, 547, 548, 549, or 724(a) of this title, by one or more of such holders of such claims;

11 U.S.C. § 303(b) (1994). Back To Text

[145] See Committee, supra note 1, at 558 (stating "[i]n order to substantially reduce the risk of an involuntary filing, all or most of the consensual creditors of the SPV may be required to sign an agreement not to file an involuntary bankruptcy case against the SPV until at least 366 days after the asset−backed securities have been paid."); Dawson, supra note 11, at 393 (explaining "the transaction documents should contain a covenant preventing the parties from filing, instigating or joining in any involuntary bankruptcy proceeding against the entity so long as the rated securities are outstanding."). See generally 11 U.S.C. § 303(b) (1994) allowing for an involuntary bankruptcy petition). Back To Text

[146] Cf. Committee, supra note 1, at 556 (stating "[a]dvance restrictions against filing a voluntary bankruptcy case pursuant to an agreement between a debtor and a creditor have been held to be void against public policy."); Ellis, supra note 130, at 307 (explaining "the issuer cannot be prohibited from filing a bankruptcy petition…[a]s a general principal, waivers or prohibitions on bankruptcy petitions are void as matter of public policy."); see also Marshall E. Tracht, Contractual Bankruptcy Waivers: Reconciling Theory, Practice and Law, 82 Cornell L. Rev. 301, 305−08 (1997) (discussing public policy of waiving bankruptcy protection). Back To Text

[147] This restriction will limit the number of creditors and amounts of claims against the SPV. See 11 U.S.C. § 303 (1994) (dictating creditors aggregate claims against debtor must amount to $11, 625 to file involuntary bankruptcy). Back To Text

[148] See 11 U.S.C. § 303(b)(1) (1994) (allowing claims against a debtor only if claims aggregate more than $11,625); In re Silverman, 230 B.R. 46 (Bankr. D.N.J. 1998) (noting amount of claim requirement); see also In re Sago Palms Joint Venture, 27 B.R. 33 (Bankr. S.D.Fla. 1982) (stating when statutory requirements of section 303 are met courts have no discretion to deny relief). Back To Text

[149] See Committee, supra note 1, at 541 (directing assets be transferred on an absolute basis); Kerr, supra note 1, at 374 (stating "[a]fter the SPV is created, the originator's isolated and valued assets are sold to the SPV."); see also Joseph C. Shenker & Anthony J. Colletta, Asset Securitization: Evolution, Current Issues and New Frontiers, 69 Tex L. Rev. 1369, 1377 (1991) [hereinafter Shenker & Colletta] (revealing securitized assets must be segregated from sponsors other assets in order to insulate them from risks associated with sponsors other assets). Back To Text

[150] See id. at 1377 (stating segregation of assets to be securitized insulates them from risks associated with originators other assets); Schwarcz, The Alchemy of Asset Securitization, supra note 129, at 135 (explaining "[b]ankruptcy remote in this context means the SPV is unlikely to be affected by a bankruptcy of the originator"); see also Dawson, supra note 11, at 400 (finding true sale of assets a transfer which is effective against the transferor, its creditors, and which legally separates credit risks of assets from those of transferor). Back To Text

[151] See Borod, supra note 3, at 7−23 (acknowledging "true sale" as absolute conveyance); Committee, supra note 1, at 542 (laying out issues to be analyzed in "true sale" determination); Dawson, supra, note 11 at 400 (explaining "[a] true sale of an asset is a transfer that is effective against the transferor, its creditors, its regulator, its liquidator or receiver, and can be enforced against the borrower. Such a transfer legally separates the credit risk of the assets from that of the transferor."); Pantaleo, supra, note 9 at 159 (noting "[t]ransfers of financial assets in which the parties state that they intend a sale, and in which all benefits and risks commonly associated with ownership are transferred for fair value in an arm's−length transaction, are easily identifiable as sales."). Back To Text

[152] See Borod, supra note 3, at 7−23 (acknowledging "true sale" as absolute conveyance); Dawson, supra note 11, at 400 (stating "a true sale of an asset is a transfer that is effective against the transferor…[s]uch transfer legally separates the credit risk of the assets from that of the transferor."); see also Schwarcz, The alchemy of Asset securitization, supra note 129, at 135 (finding bankruptcy remote entails the SPV's insulation from the bankruptcy of the originator). Back To Text

[153] Section 541(a)(1) provides:

(a) The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all of 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(a)(1) (1994). Back To Text

[154] Id. (defining "estate" in bankruptcy); see Vogel v. Palmer (In re Palmer), 57 B.R. 332, 333 (Bankr. W.D.Va. 1986) (finding scope of property in estate under section 541 broader than under Bankruptcy Act, intending to be all embracing); In re Burgess, 234 B.R. 793, 796 (Bankr. D.Nev. 1999) (holding "property of estate" should be broadly interpreted). Back To Text

[155] See infra notes 176−191 and accompanying text. Back To Text

[156] See 11 U.S.C. § 541 (1994) (listing property includable in the estate for purposes of action brought under sections 301−303 of Bankruptcy Code); see also infra notes 186−187 and accompanying text. Back To Text

[157] See infra notes 169−226 and accompanying text. Back To Text

[158] See American Bar Association Section of Taxation Committee on Financial Transactions Subcommittee on Asset Securitization, Legislative Proposal to Expand the REMIC Provisions of the Code to Include Nonmortgage Assets, 46 Tax. L. Rev. 299, 311−12 (1991) (describing variety of legal structures asset−backed securities are issued with); Committee, supra note 1, at 534 (stating "[a] successful structured financing culminates in the issuance of asset−backed securities. Asset−backed securities have taken three principal forms−−debt (of varying classes), preferred stock and certificates of beneficial interest); see also Ellis, supra note 3, at 300 (stating: "[a] rudimentary or

prototypical securitization structure, then, might require an originator to convey (for value) certain financial assets to a financial intermediary, which, in turn, would sell or issue "interests" backed by the value of the conveyed assets, and paid through their liquidation."). Back To Text

[159] See Kerr, supra note 1, at 379 (stating "[i]n order to attract investors, these securities must be rated by a rating agency, such as Standards and Poor's Rating Group, Duff and Phelps, or Moody's Investors Services."); see also Dawson, supra note 11, at 383 (describing manner in which Standard & Poor's is able to base its ratings of securities). But cf. Francis A. Bottini, Jr., An Examination of the Current Status of Rating Agencies and Proposals for Limited Oversight of Such Agencies, 30 San Diego L. Rev. 576, 584 (1993) (discussing financial securities market and its problems dealing with lethargy in changing ratings by ratings agencies such as Standard & Poor's and Moody's). Back To Text

[160] See Ellis, supra note 3, at 299 (monetizing firm's financial assets through secured financing); see also Borod, supra note 3, at 1−7; Committee, supra note 1, at 532 (stating "[i]n theory, any asset that provides a predictable stream of cash flow or that can be converted into a predictable amount of cash can be securitized."); Lupica, supra note 2, at 609 (noting "[b]y definition, the process of securitization transforms future payments into instant cash."). Back To Text

[161] See Kerr, supra note 1, at 380−81 (stating "[a]fter the securities are issued, a servicer is arranged to ensure that the assets are monitored and collected and the receivables plus interest are paid to the SPV, who then repay the bondholders."); see also Alan Kronovet, Comment, Securities: An Overview of Commercial Mortgage Backed Securitization: The Devil Is in the Details, 1 N.C. Banking Inst. 288, 296−97 (1997) (discussing relative benefits for lender who securitizes commercial real estate loans); Jennifer B. Sylva, Bowie Bonds Sold for Far More Than a Song: the Securitization of Intellectual Property as a Super−Charged Vehicle for High Technology Financing, 15 Computer & High Tech. L.J. 195, 197 (1999) (discussing significance of securitization of music sound recording and publishing royalties). Back To Text

[162] See Dawson, supra note 11, at 383−84 (allowing for higher ratings due to insulation of assets ratings of securities based on creditworthiness of isolated assets not creditworthiness of originator); see also Borod, supra note 3 at 9−3 (stating "[b]ecause asset−backed transaction are, essentially, synthetic financings, the structure, quality of the underlying assets, and level of credit enhancement can be manipulated so as to achieve the desired rating."); Lisa M. Fairfax, When You Wish Upon a Star: Explaining the Cautious Growth of Royalty−Backed Securitization, 1999 Colum. Bus. L. Rev. 441, 455 (1999) (stating "[s]ecuritization enables a company to transfer its valuable receivables to an SPV so that a rating agency focuses on the quality of the asset being securitized as opposed to the credit worthiness of the company itself."). Back To Text

[163] See Ellis supra note 3, at 303−04 (recognizing bankruptcy remoteness involves attention to activities, debts, liens, voluntary bankruptcy and involuntary bankruptcy of SPV); see also Committee, supra note 1, at 554−58 (discussing areas that must be examined to structure bankruptcy remote SPV); Dawson, supra note 11, at 383 (stating "[a] true structured finance (or securitization) legally isolates assets from a transferor's insolvency to enable a purchaser of securities backed by the assets to rely solely on the creditworthiness of those assets."). Back To Text

[164] See infra notes 170−226, 227−275 and accompanying text. Back To Text

[165] See infra notes 170−226 and accompanying text. Back To Text

[166] See Lupica, supra note 2, at 597 (stating "[i]n the event of bankruptcy, the originator's residual estate, available for pro rata distribution to unsecured creditors, likely will not include the securitized assets."); see also In re Kingston Square Assocs., 214 B.R. 713, 716 (Bankr. S.D.N.Y. 1997) (referring to securitization transaction as "bankruptcy proof"). Cf. Lois R. Lupica, Circumvention of the Bankruptcy Process: The Statutory Institutionalization of Securitization, 33 Conn. L. Rev. 199, 200−01 (2000) [hereinafter Lupica, Circumvention of the Bankruptcy Process] (discussing recent revisions to Article 9 and result that, if party becomes unsecured creditor following securitization, it may find itself creditor to debtor that is judgment proof). Back To Text

[167] See Lupica, supra note 2, at 648 (stating "[m]arket forces provide a check, however, on whether the securitized assets transferred to the SPC are in exchange for 'reasonably equivalent value'"); see also Christopher W. Frost, Asset Securitization and Corporate Risk Allocation, 72 Tul. L. Rev. 101, 114−15 (1997) (explaining in normal securitization transaction, originator will receive market value for assets); Amy K. Rhodes, The Role of the SEC in the Regulation of the Rating Agencies: Well−Placed Reliance or Free−Market Interference?, 20 Seton Hall Legis. J. 293, 316 (1996) (stating "rating agencies are not apt to overrate or underrate issuers due to strong market forces."). Back To Text

[168] See Lupica, supra note 2, at 648; see also supra note 157. Back To Text

[169] See 11 U.S.C. § 548 (1994) (allowing trustee to avoid transfers of debtors interest if less than reasonable value was exchanged or if such transfer was made with actual intent to hinder, delay, or defraud any entity debtor was indebted to); see also BFP v. Resolution Trust Corp., 511 U.S. 531, 532 (1994) (holding fair and proper price or "reasonably equivalent value" for foreclosed property is price in fact received at foreclosure sale so long as all requirements of state's foreclosure law have been complied with); In re Donovan, 183 B.R. 700, 701 (Bankr. W.D. Pa. 1995) (citing holding in BFP). Back To Text

[170] See infra notes 170−226 and accompanying text. Back To Text

[171] See Borod, supra note, 3, at 7−23 (acknowledging "true sale" as absolute conveyance); Dawson, supra, note 11, at 400 (stating "[a] true sale of an asset is a transfer that is effective against the transferor, its creditors, its regulator, its liquidator or receiver, and can be enforced against the borrower. Such a transfer legally separates the credit risk of the assets from that of the transferor."); Pantaleo, supra note 9, at 159 (stating "[t]ransfers of financial assets in which the parties state that they intend a sale, and in which all benefits and risks commonly associated with ownership are transferred for fair value in an arm's−length transaction, are easily identifiable as sales."). Back To Text

[172] See 11 U.S.C. § 541(a) (1994) (listing broad categories of property included in the bankruptcy estate in actions brought under sections 301−303 of Bankruptcy Code); Borod, supra note 3, at 7−23 (acknowledging "true sale" as absolute conveyance); Dawson, supra note 11, at 388−89 (stating "[t]o avoid the risk that bankruptcy may cause a court to deem some or all of the assets transferred to the intermediate SPE [special purpose entity] to be part of the transferor's bankruptcy estate (and thus subject to the automatic stay or distribution to other creditors of the transferor), each transfer should be structured as a "true sale."); Pantaleo, supra note 9, at 159 (stating complications arise when buyer retains recourse to seller such that less than all risks of ownership are transferred); see also infra notes 177−192 and accompanying text. Back To Text

[173] 995 F.2d 948 (10th Cir. 1993). Back To Text

[174] See Octagon Gas Systems, Inc. v. Rimmer (In re Meridian Reserve, Inc.), 995 F.2d 948, 955 (10th Cir. 1993) (reversing appelees motion because his interest was security interest in account subject to Article 9 and such accounts remain property of debtor's bankruptcy estate); see also Motor Freight v. Schwartz (In re De−Pen Line Inc.), 215 B.R. 947, 950 (Bankr. E.D.Pa. 1997) (applying Article 9 to sales of accounts and chattel paper). But see Lupica, supra note 2, at 655 (stating "It was error for the Octagon Court conclude, in reliance on what it perceived to be the holding of Whiting Pools, that the sold assets were property of the bankruptcy estate."). Back To Text

[175] See Octagon Gas Systems, Inc. v. Rimmer (In re Meridian Reserve Inc.), 995 F.2d.at 957 (holding because Article 9 treats sale of accounts as creating security interest in accounts, accounts sold by debtor prior to filing bankruptcy petition remain part of debtors bankruptcy estate); see also 11 U.S.C. § 541(a) (1994) (defining bankruptcy estate as all legal or equitable interests of debtor in property as of commencement of case); David Gray Carlson, The Rotten Foundations of Securitization, 39 Wm. & Mary L. Rev. 1055, 1061 (1998) (stating "[t]he debtor retains a power to convey chattel paper to subsequent purchasers who take possession in the ordinary course of business free and clear of the SPV buyer's rights…[t]his is so even after the SPV perfects its purchase by filing a financial statement as required by Article 9."). Back To Text

[176] See 11 U.S.C. § 548 (1994). Section 548(a) provides:

(a) 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−−

(1) 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; or

(2)(A) received less than a reasonably equivalent value in exchange for such transfer or obligation; and

(B)(i) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;
(ii) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital; or
(iii) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured.

11 U.S.C. § 548(a); see infra notes 214−226 and accompanying text. Back To Text

[177] See Committee, supra note 1, at 554−58 (providing bankruptcy remoteness involves attention to activities, debts, liens, voluntary bankruptcy and involuntary bankruptcy of SPV); Dawson, supra note 11, at 383−84 (stating "[a] true structured finance (or securitization) legally isolates the assets from a transferors insolvency to enable a purchaser of securities backed by the assets to rely solely on the creditworthiness of those assets."); Ellis, supra note 3, at 303−04 (discussing goal of bankruptcy remoteness). Back To Text

[178] See Dawson, supra note 11, at 400 (stating "[a] true sale of an asset is a transfer that is effective against the transferor, its creditors, its regulator, its liquidator or receiver, and can be enforced against the borrower…[s]uch a transfer legally separates the credit risk of the assets from that of the transferor."); Pantaleo, supra note 9, at 159 (stating "[t]ransfers of financial assets in which the parties state that they intend a sale, and in which all benefits and risks commonly associated with ownership are transferred for fair value in an arm's−length transaction, are easily identifiable as sales."); see also Borod, supra note 3, at 7−23 (acknowledging "true sale" as absolute conveyance). Back To Text

[179] See Pantaleo, supra note 9, at 159; see also supra note 177. Back To Text

[180] See Borod, supra note 3, at 7−24; Committee, supra note 1, at 542−47 (describing issues to analyze in structuring "true sales" include degree to which risk of loss is transferred to SPV, degree of retention of benefits of ownership by transferor, degree of post−transfer control over transferred assets retained by transferor, accounting treatment of transfer on transferor's books, and expressed consent of parties); see also Pantaleo, supra note 9, at 161 (stating "in structuring true sale transaction, tension often arises between the desire for a certain amount of recourse and the belief that 'too much' recourse will prevent true sale treatment."). Back To Text

[181] See Pantaleo, supra note 9, at 159 (stating "[t]he issue becomes complicated if the buyer retains some recourse to the seller such that less than all of the risks of ownership are transferred. In that case, an issue can arise over whether to view the transaction as a sale or a secured loan."); see also Committee, supra note 1, at 543 (stating "[i]f there is excessive recourse, direct or indirect, against the transferor covering credit losses, an issue may exist as to whether the risk of loss has been sufficiently transferred for there to be a 'true sale.'"); Schwarcz, supra note 9, at 145 (stating "[t]he most significant factor in determining whether a transaction is a true sale or a secured loan appears to be the extent and nature of the recourse that the transferee of the payment stream has against the transferor."). Back To Text

[182] See Major's Furniture Mart v. Castle Credit Corp., 602 F.2d 538, 544 (3d Cir. 1979) (holding "[i]f recourse is present, the issue is, 'whether the nature of the recourse, and the true nature of the transaction, are such that the legal rights and economic consequences of the agreement bear a greater similarity to a financing transaction [a secured loan] or to a sale.'"); see also Pantaleo, supra note 9, at 162−63 (concluding there is legal distinction between recourse

for collectibility and economic recourse); Schwarcz, The Parts are Greater, supra note 9, at 145−46 (stating "[t]he most significant factor in determining whether a transaction is a true sale or a secured loan appears to be the extent and nature of the recourse that the transferee of the payment stream has against the transferor."). Back To Text

[183] See Pantaleo, supra note 9, at 163 (defining recourse for collectibility); see also Eugene F. Cowell III, Texas Article 9 Amendments Provide "True Sale" Safe Harbor, 115 Banking L.J. 699, 703 n.6 (1998) [hereinafter Cowell, Texas Article 9] (providing "recourse ensuring the 'quality' of the financial asset" as example of recourse for collectibility); Christopher W. Frost, Healthcare Financing in Bankruptcy: Where You Stand Depends on Where You Sit, 24 Cal. Bankr. J. 185, 196 (1998) [hereinafter Frost, Healthcare Financing] (commenting on Pantaleo's definition of recourse for collectibility). Back To Text

[184] See Pantaleo, supra note 9, at 163 (describing circumstances causing transaction to be sale); see also U.C.C. § 9−502 cmt. 4 (1995) (stating there may be true sale although recourse exists); Major's Furniture Mart, Inc. v. Castle Credit Corp., 449 F.Supp. 538, 542 (1978) (rejecting argument that recourse transforms sale of account to transfer of security interest). Back To Text

[185] Pantaleo, supra note 9, at 163 n.167 (defining economic recourse); see also Amy C. Bushaw, Small Business Loan Pools: Testing the Waters, 2 J. Small & Emerging Bus. L. 197, 236 n.167 (1998) (noting Pantaleo's distinction between recourse for collectibility and economic recourse); Cowell, Texas Article 9, supra note 182, at 703 n.6 (providing "recourse ensuring an economic rate of return unrelated to the payment terms of the underlying assets" as example of economic recourse). Back To Text

[186] See Pantaleo, supra note 9, at 163 (stating if buyer retains economic recourse transaction is susceptible to recharacterization as loan); see also Frost, Healthcare Financing, supra note 182, at 196 (stating transactions with economic recourse "smell and look like loans"). Cf. Thomas E. Plank, The True Sale of Loans and the Role of Recourse, 14 Geo. Mason L. Rev. 287, 291 (1991) (noting credit recourse increases possibility that court will recharacterize sale of loan as secured loan transaction). Back To Text

[187] See Dawson, supra note 11, at 400 (finding true sales to separate credit risk of asset from risk of transferor); see also Borod, supra note 3 at 7−23 (considering risks of failing to properly perfect and structure loan so it qualifies as true sale); Pantaleo, supra note 9, at 159 (discussing effects of true sales). Back To Text

[188] See 11 U.S.C. § 541(a)(1) (1994) (providing bankruptcy estate includes "all legal or equitable interests of the debtor in property as of the commencement of the case."); Pauley & McDonald v. Brown (In re Pauley & McDonald, Inc.), 215 B.R. 37, 41−42 (Bankr. D. Ariz. 1996) (giving examples of property and claims that are part of bankruptcy estate under 11 U.S.C. § 541(a)); David Gray Carlson, Bankruptcy's Organizing Principle, 26 Fla. St. U. L. Rev. 549, 567−68 (1999) (interpreting intention of section 541(a)) . Back To Text

[189] See Pantaleo, supra note 9, at 159 (explaining "[t]he issue becomes complicated if the buyer retains some recourse to the seller such that less than all of the risks of ownership are transferred. In that case, an issue can arise over whether to view the transaction as a sale or a secured loan."); see also Committee, supra note 1, at 543 (asserting "[i]f there is excessive recourse, direct or indirect, against the transferor covering credit losses, an issue may exist as to whether the risk of loss has been sufficiently transferred for there to be a 'true sale.'"); Schwarcz, Parts are Greater, supra note 9, at 145 (declaring "[t]he most significant factor in determining whether a transaction is a true sale or a secured loan appears to be the extent and nature of the recourse that the transferee of the payment stream has against the transferor."). Back To Text

[190] See Pantaleo, supra note 9, at 164 (discussing nature of transactions); see also Committee, supra note 1, at 545 (distinguishing direct and indirect recourse used for different arrangements); Schwarcz, Parts are Greater, supra note 9, at 145−47 (reviewing factors used to determine if transaction is true sale or secured transaction). Back To Text

[191] See Pantaleo, supra note 9, at 163 (defining recourse for collectibility); see also Committee, supra note 1, at 545 (noting "[t]erms by which a transferor retains credit loss recourse are only problematic if they result in recourse against the transferor in excess of the reasonably anticipated credit losses."); Ellis, supra note 1, at 304−05 (discussing

originator insolvency and risk of recharacterization of assets). Back To Text

[192] Employing a credit enhancement will increase the transaction costs of this securitization transaction. See Committee, supra note 1, at 549−50 (describing credit enhancements); see also Lupica, Circumvention of the Bankruptcy Process, supra note 165, at 236 n.204 (stating transaction costs include costs of credit enhancement); Schwarcz, supra note 2, at 139−40 (observing although credit enhancements add to transaction costs total cost may be reduced because securities with credit enhancement have higher ratings). Back To Text

[193] See Octagon Gas Sys., Inc. v. Rimmer (In re Meridian Reserve, Inc.), 995 F.2d 948 (10th Cir. 1993) (holding account is part of bankruptcy estate); Thomas E. Plank, The Outer Boundaries of the Bankruptcy Estate, 47 Emory L.J.1193, 1285 (1998) (explaining interruption caused by Octagon Gas holding in securitization industry); David Gray Carlson, The Rotten Foundations of Securitization, 39 Wm. & Mary L. Rev. 1055, 1059 (1998) (recognizing impact and reaction caused by Octagon Gas System's holding). Back To Text

[194] 995 F.2d 948 (10th Cir. 1993). Back To Text

[195] See id. at 955 (finding account to be within bankruptcy estate). But see Douglas G. Baird, Security Interests Reconsidered, 80 Va. L. Rev. 2249, 2267 n.42 (criticizing Octagon Gas Systems decision); Lynn M. Lopucki, The Death of Liability, 106 Yale L.J. 1, 30 n.127 (1996) (criticizing holding in Octagon Gas Systems because it would render securitized accounts property of bankruptcy estate causing asset securitization to fail its essential purpose). Back To Text

[196] See Octagon Gas Sys. Inc ., 995 F.2d at 951 (describing bankrupt party to be in business of selling natural gas). Back To Text

[197] See id. Back To Text

[198] See id. at 955 (defining interest acquired to be account); see also U.C.C. 9−106 (1995) (amended 2001) (defining account as "any right to payment for goods sold or leased or for services rendered which is not evidenced by an instrument or chattel paper); Petron Trading Co. v. Hydorcarbon Trading & Transp. Co., 663 F.Supp. 1153, 1158 (1986) (finding right to payment qualifies as account under Article 9). Back To Text

[199] Section 9−102(1)(b) provides:

(1) Except as otherwise provided in section 9−104 on excluded transactions, this article applies

(b) to any sale of accounts or chattel paper.

U.C.C. § 9−102(1)(b) (1995) (amended 2001). Back To Text

[200] Octagon Gas Sys. Inc., 995 F.2d at 955; see also U.C.C.§ 1−201(37) (1995) (defining security interest as including interest of a buyer of accounts…subject to article 9); Lois R. Lupica, Circumvention of the Bankruptcy Process: The Statutory Institutionalization of Securitization, 33 Conn. L. Rev. 199, 206 (2000) (stating article 9 applies to "any sale of accounts or chattel paper"). Back To Text

[201] Section 1−201(37) provides in pertinent part:

(37) "Security interest" means an interest in personal property or fixtures which secures payment or performance of an obligation. The retention or reservation of title by a seller of goods notwithstanding shipment or delivery to the buyer (Section 2−401) is limited in effect to a reservation of a "security interest." The term also includes any interest of a buyer of accounts or chattel paper which is subject to Article 9…

U.C.C. § 1−201(37) (1995). Back To Text

[202] Section 9−105(1)(m) provides:

(1) In this Article unless the context otherwise requires:

(m) "Secured party" means a lender, seller or other person in whose favor there is a security interest, including a person to whom accounts or chattel paper have been sold. When the holders of obligations issued under an indenture of trust, equipment trust agreement or the like are represented by a trustee or other person, the representative is the secured party;

U.C.C. § 9−105(1)(m) (1995). Back To Text

[203] Section 9−105(1)(d) provides:

(1) In this Article unless the context otherwise requires:

(d) "Debtor" means the person who owes payment or other performance of the obligation secured, whether or not he owns or has rights in the collateral, and includes the seller of accounts and chattel paper. Where the debtor and the owner of the collateral are not the same person, the term "debtor" means the owner of the collateral in any provision of the Article dealing with the collateral, the obligor in any provision dealing with the obligation, and may include both where the context so requires;

U.C.C. § 9−105(1)(d) (1995). Back To Text

[204] Section 9−105(1)(c) provides:

(1) In this Article unless the context otherwise requires:

(c) "Collateral" means the property subject to a security interest, and includes accounts and chattel paper which have been sold;

U.C.C. § 9−105(1)(c) (1995). Back To Text

[205] Octagon Gas Sys., Inc. v. Rimmer (In re Meridian Reserve, Inc.), 995 F.2d 948 (10th Cir. 1993). Back To Text

[206] See id. at 955 Back To Text

[207] See id; see also CF Motor Freight v. Schwartz (In re De−Pen Line Inc.), 215 B.R. 947, 950 (Bankr. E.D.Pa. 1997) (finding Article 9 applying to sales of accounts and chattel paper primarily because of their financing character); Majors Furniture Mart, Inc. v. Castle Credit Corp., 602 F.2d 538, 542−546 (3d Cir. 1979) (stating Article 9 applies to transactions involving sales of accounts and chattel paper). Back To Text

[208] See id. But see Lupica, supra note 2, at 658 (stating Octagon courts decision was so wrong it prompted "the UCC Article 9 Drafting Committee to propose an amendment to the UCC specifically addressing the issue of whether or not accounts sold to a third party remain subject to the seller's bankruptcy proceeding."). See generally, David Gray Carlson, The Rotten Foundations of Securitization, 39 Wm. & Mary L. Rev. 1055 (1998) (discussing effect of Octagon on bankruptcy and Article 9). Back To Text

[209] See Permanent Editorial Board of the Uniform Commercial Code, Commentary No. 14, Transfer of Accounts or Chattel Paper (1994) (asserting Octagon Gas decision was "erroneous"); see also Borod, supra note 3, at 7−26 (stating "[t]he Permanent Editorial Board of the Uniform Commercial Code has approved a new official comment to Article 9−102 of the Uniform Commercial Code setting forth its belief that Octagon was wrongly decided."); Impact, supra note 39, at 952 (noting Permanent Editorial Board of Uniform Commercial Code criticized Octagon). Back To Text

[210] Revised U.C.C. § 9−318(a) (1999); accord id. cmt. 2 (observing section 9−318 (a) simply makes explicit what should been obvious in original Article 9); see Committee, supra note 3, at n.42 (observing "the Tenth Circuit ignored portions of the UCC and the Official Comments thereto,"); see also U.C.C. § 9−502(2) (1972) (distinguishing between sales of accounts and granting of security interests, and providing "if the security agreement secures an indebtedness, the secured party must account to the debtor for any surplus. . . . [b]ut, if the underlying transaction was a sale of accounts or chattel paper, the debtor is entitled to any surplus or is liable for any deficiency only if the security agreement so provides."). Back To Text

[211] Revised U.C.C. § 9−318(a) (1999). But c.f. Impact, supra note 39, at 952 (predicting language of statue may lead courts to misinterpret it and hold that sale did not occur simply because originator retained certain limited interests, and suggesting that comment to section be amended so as to eliminate this possibility). Back To Text

[212] Revised U.C.C. § 9−318(a) (1999); see supra note 198 (quoting text of U.C.C. § 9−102(1)(b)); see also U.C.C. § 9−102(1)(b) cmt. 2 (1972) (observing "[c]ommercial financing on the basis of accounts and chattel paper is often so conducted that the distinction between a security transfer and a sale is blurred, and a sale of such property is therefore covered ... whether intended for security or not."); Octagon Gas Systems, 995 F.2d at 955 (quoting U.C.C. § 9−102(1)(b) cmt. 2, and interpreting it to require that sales of accounts be treated as security transfers). But see Impact, supra note 39, at 952 note 31 (quoting U.C.C.§ 9−102(1)(b) cmt. 2, and interpreting it as simply putting sales of accounts under U.C.C's purview, not as requiring that sales of accounts be treated as security transfers). Back To Text

[213] See generally Impact, supra note 39 (discussing Revised Article 9's impact on securitization). Compare, e.g., U.C.C. § 9−306 (4) (d) (ii) (1994) (prescribing formula for identifying SPVs' interests in cash proceeds commingled with originators' funds, whereby all such funds not so identified will be lost in bankruptcy proceedings), with, e.g., Revised U.C.C. § 9−315 (1999) (allowing SPVs to identify proceeds "by a method of tracing, including application of equitable principles, that is permitted under law other than this article,"); compare, e.g, U.C.C. § 9−103 (3) (1995) (providing that registered organizations are deemed to be located in state of their principal place of business), with, e.g., Revised U.C.C. § 9−307(1999) (providing registered organizations are deemed to be located in state in which they were organized). Back To Text

[214] In re LTV Steel Company, Inc., Memorandum Opinion Bankr. case no. 00−43866 (Bankr. N.D. Ohio 2001); contra DeWhirst v. Citibank (In re Contractor's Equip. Supply Co.), 861 F.2d 241, 245 (9th Cir. 1988) (holding transaction was secured loan, but recognizing that "if the transaction involve[s] a sale, the debtor is entitled to any surplus or is liable for any deficiency only if it is provided for in the parties' agreement,… [but,] [i]f the transaction involves only a security interest, the debtor is entitled to any surplus and liable for any deficiency."); Major's Furniture Mart, Inc. v. Castle Credit Corp., 602 F.2d 538, 544 (3d Cir. 1979) (concluding transaction was secured loan but recognizing that different legal consequences would follow from sale). Back To Text

[215] See 11 U.S.C. § 544 (1994) (permitting trustees to use longer reach−back periods provided by state law fraudulent transfer statutes under Uniform Fraudulent Transfer Act or Uniform Fraudulent Conveyance Act); see also Michael L. Cook & Richard E. Mendales, The Uniform Fraudulent Transfer Act: An Introductory Critique, 62 Am. Bankr. L.J. 87, 95 (1987) (describing Uniform Fraudulent Transfer Act's extension of Bankruptcy Code's reach back period); Lupica, supra note 2, at 647, nn. 265−66 (discussing Bankruptcy Code's incorporation of state fraudulent transfer law); c.f. Borock v. Telesz (In re Ventimiglia), 198 B.R. 205, 210 (Bankr. E.D. Mich. 1996) (allowing creditor, under section 544, to use state law to avoid fraudulent conveyance one and a half years after transaction, in spite of limitation that section 548 applies only to transactions made within one year of bankruptcy). See generally Lupica, supra note 2, at 647, nn. 265−66 (explaining English history of Uniform Fraudulent Transfer Act and its predecessor, Uniform Fraudulent Conveyance Act). Back To Text

[216] See Lupica, supra note 2, at 647 (analyzing securitization through fraudulent conveyance); Committee, supra note 3, at 548 (noting if originator receives fair value for assets conveyed, transaction should not run afoul of fraudulent transfer laws); see also Borod, supra note 3, at 7−12 (analyzing securitization using fraudulent conveyance framework). Back To Text

[217] See 11 U.S.C. § 548 (1994) (stating "the trustee may avoid any transfer of an interest of the debtor in property, or any obligation incurred by the debtor…subject to various conditions."). But see Christopher W. Frost, Asset Securitization and Corporate Risk Allocation, 72 Tul. L. Rev. 101, 115 (1997) [hereinafter Asset Securitization] (stating while fraudulent transfer law provides conceptually useful mode of analyzing securitization transactions, it is rarely actually applied); see also Douglas G. Baird & Thomas H. Jackson, Fraudulent Conveyance Law and Its Proper Domain, 38 Vand. l. rev. 829, 838 (1985) (cautioning "[f]raudulent conveyance law should never apply to arms−length transactions, even if it appears after the fact that the debtor's actions injured the creditors."). Back To Text

[218] See 11 U.S.C. § 548 (1994); see also Christopher W. Frost, Organizational Form, Misappropriation Risk, and the Substantive Consolidation of Corporate Groups, 44 Hastings L.J. 449, 486−87 (1993) [hereinafter Organizational Form] (explaining scope of scope of 548); Schwarcz, supra note 2, at 147 (suggesting fraudulent transfer laws are appropriate means of dealing with questionable asset securitization transactions). Back To Text

[219] 11 U.S.C. § 548(a)(1)(A) (1994) provides:

(a)(1) 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−

(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… Id. Back To Text

[220] Id.; see Asset Securitization, supra note 216, at 114 (explaining requirement of actual intent, and adding that because determining value of exchanges ex post facto would be unduly burdensome, application of fraudulent transfer laws is limited to transactions that either leave debtor insolvent or take place after debtor is insolvent); see also Organizational Form, supra note 217, at 487 (describing manner in which fraudulent transfer law is applied to transfers of assets from parent corporation to subsidiary). Back To Text

[221] See Lupica, supra note 2, at 648 (noting "the harm faced by the originator's unsecured creditors as a result of the fraud is not necessarily attributable to securitization as a method of financing, but to the originator's fraudulent behavior."); Paul M. Shupack, On Boundaries and Definitions: A Commentary on Dean Baird, 80 Va. L. Rev. 2273, 2293 (1994) (asserting "[t]he risk to creditors of the debtor resulting from any sale is not the sale transaction itself, but the subsequent dissipation by the debtor of the cash realized" and remarking "[a]ll sales and security interests in the debtor's assets carry with them the same risk of removing an asset from the debtor's estate and the attendant risk of dissipation."). Back To Text

[222] See Lupica, supra note 2, at 648 (arguing "due to the scrutiny imposed by rating agencies, credit enhancers, and the various other market participants, securitization may present fewer opportunities for self−dealing than alternative financing methods."); Schwarcz supra note 2, at 147 (stating same); see also Asset Securitization, supra note 216, at 114 (noting asset securitization transactions do not typically carry earmarks of fraudulent transfers). Back To Text

[223] 11 U.S.C. § 548(a)(1)(B) (1994) provides:

(a)(1) 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−

(B)(i) received less than a reasonably equivalent value in exchange for such transfer or obligation; and

(ii)(I) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;

(II) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital; or

(III) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured. Back To Text

[224] Id.; see Asset Securitization, supra note 216, at 114−15 (stating because originators in asset securitization transactions typically receive fair market value for their assets, and because such transactions generally do not leave originators insolvent, such transfers are not likely to be deemed constructively fraudulent); see also Organizational Form, supra note 217, at 487−90 (describing manner in which law of constructive fraudulent transfer is applied to transfers of assets from parent corporation to subsidiary). Back To Text

[225] Lupica, supra note 2, at 648 (opining due to the scrutiny imposed by rating agencies, credit enhancers, and the various other market participants, securitization may present fewer opportunities for self−dealing than alternative financing methods."). Back To Text

[226] Id. Back To Text

[227] Id. at 648−49. Back To Text

[228] See Ellis, supra note 1, at 323 (discussing Kingston Square's role in establishing bankruptcy remoteness as a means to attack securitization transactions); In re Kingston Square Assoc's., 214 B.R. 713, 738−39 (Bankr. S.D.N.Y. 1997) (finding debtor who orchestrated with creditor to file involuntary petitions against debtor did not preclude debtor from relief). Back To Text

[229] Ellis, supra note 1, at 307 (arguing "the issuer cannot be prohibited from filing a bankruptcy petition" and noting "[a]s a general principal, waivers or prohibitions on bankruptcy petitions are void as matter of public policy."); Committee, supra note 1, at 556 (observing "[a]dvance restrictions against filing a voluntary bankruptcy case pursuant to an agreement between a debtor and a creditor have been held to be void against public policy."). Back To Text

[230] In re Kingston Square Assoc's, 214 B.R. 713 (Bankr. S.D.N.Y. 1997) (creating new method by which SPVs are vulnerable to attack). Back To Text

[231] Id. Back To Text

[232] Id. Back To Text

[233] Ellis, supra note 1, at 323; Sheryl A. Gusset, A Not−So−Independent Independent Director in a Bankruptcy Remote Structure, 1998 ABI Jnl. Lexis 64 at 6 (noting after ruling in Kingston Square, those involved in structured financings should make sure independent directors are truly independent and fulfilling their fiduciary duties); Gregory A. Tselikis, "Bankruptcy Proofing" Your Commercial Transaction: Reality or Myth?, 13 Me. B. J. 234, 235 (1998) (cautioning implications of Kingston Square case are significant and should give secured creditors pause in their attempts to use bankruptcy−proofing by way of appointing supposedly independent directors). Back To Text

[234] See In re Kingston Square Assoc's, 214 B.R. at 715. Back To Text

[235] Id. at 716 (finding each corporation's charter contained "bankruptcy proof" provision preventing debtors from seeking voluntary bankruptcy); see also Gussett, supra note 232, at 4−5 (discussing strategy employed in Kingston Square Associates of avoiding bankruptcy−proofing clause by hiring counsel to solicit creditors to file involuntary bankruptcy); Tselikis, supra note 232, at 234−35 (describing basic bankruptcy−proofing theory). Back To Text

[236] In re Kingston Square Assoc's., 214 B.R. at 717, 735−37 (discussing independent director's loyalties to involved mortgage underwriter who had employed him); see also Gussett, supra note 232, at 2 n.1 (defining "independent director" as anyone without direct or indirect interest in outcome); Tselikis, supra note 232, at 234−35 (suggesting

ways in which "independent directors" may minimize risk of voluntary bankruptcy). Back To Text

[237] In re Kingston Square Assoc's., 214 B.R. at 717, 735−37 (discussing nature of independent director's loyalties to involved mortgage underwriter who had employed him). See, e.g., Nordhoff Inv., Inc. v. Zenith Elec's. Corp. (In re Zenith Elec's. Corp.), 250 B.R. 207, 220 (Bankr. D. Del. 2000) (holding Special Committee would be necessary if independent directors did not obtain fair opinion regarding proposed reorganization plan); In re Greate Bay Hotel & Casino, Inc., 251 B.R. 213, 248 (Bankr. D. N.J. 2000) (placing two independent directors on board of directors to represent reorganized debtors' interests). Back To Text

[238] See supra note 236. Back To Text

[239] See In re Kingston Square Assocs., 214 B.R. at 717 (discussing foreclosure actions commenced against each property, debtor and non−debtor, and installing receivers at all thirty−eight properties). See e.g., Johnson v. Home State Bank, 501 U.S. 78, 80 (1991) (allowing bank to commence foreclosure proceedings against mortgagors' farm property after debtor's chapter 7 bankruptcy filing); Commercial Fed. Mortgage Corp. v. Smith (In re Smith), 85 F.3d 1555, 1557 (11th Cir. 1996) (allowing debtor to reclaim property by curing default via chapter 13 plan). Back To Text

[240] In re Kingston Square Assoc's., 214 B.R. at 720; see also Gussett, supra note 232, at 4−5 (observing debtors in Kingston Square Associates attempted to circumvent board of directors' unanimous vote requirement by hiring attorney to convince creditors to file involuntary bankruptcy against debtor); Tselikis, supra note 232, at 235 (asserting debtors in Kingston Square Associates worked with unsecured creditors to arrange involuntary bankruptcy). Back To Text

[241] See In re Kingston Square Assoc's., 214 B.R. at 726−27 (noting debtor provided attorney with creditor names and paid attorney's fees for solicitation of creditors); see also Gussett, supra note 232, at 4−5 (observing debtors in Kingston Square Associates paid attorney to solicit creditors); Tselikis, supra note 232, at 235 (stating debtors in Kingston Square Associates hired and paid attorney to file involuntary bankruptcy action). Back To Text

[242] In re Kingston Square Assoc's., 214 B.R. at 726 (noting those creditors recruited into involuntary bankruptcy action had done little to recover amount claimed with exception of one debtor who claimed debt as business loss); see also Tselikis, supra note 232, at 235 (listing trade creditors, attorneys and other consultants among creditors joining involuntary bankruptcy action in Kingston Square Associates). Back To Text

[243] 11 U.S.C. § 1112(b) (1994):

(b) Except as provided in subsection (c) of this section, on request of a party in interest or the United States trustee or bankruptcy administrator, and after notice and a hearing, the court may convert a case under this chapter to a case under chapter 7 of this title or may dismiss a case under this chapter, whichever is in the best interest of creditors and the estate, for cause, including −− (1) continuing loss to or diminution of the estate and absence of a reasonable likelihood of rehabilitation; (2) inability to effectuate a plan; (3) unreasonable delay by the debtor that is prejudicial to creditors; (4) failure to propose a plan under section 1121 of this title within any time fixed by the court; (5) denial of confirmation of every proposed plan and denial of a request made for additional time for filing another plan or a modification of a plan; (6) revocation of an order of confirmation under section 1144 of this title, and denial of confirmation of another plan or a modified plan under section 1129 of this title; (7) inability to effectuate substantial consummation of a confirmed plan; (8) material default by the debtor with respect to a confirmed plan; (9) termination of a plan by reason of the occurrence of a condition specified in the plan; or (10) nonpayment of any fees or charges required under chapter 123 of title 28.

Id.; see also Kestell v. Kestell (In re Kestell), 99 F.3d 146, 148 (4th Cir. 1996) (finding bad faith filing or conduct would be sufficient grounds for dismissal under Bankruptcy Code section 1112(b)); Dunes Hotel Assoc's. v. Hyatt Corp. (In re Dunes Hotel Assoc's.), 245 B.R. 492, 511 (Bankr. S.C. 2000) (noting evidence of bad faith within meaning of section 1112(b) can lead to dismissal three years into chapter 11 plan). Back To Text

[244] See In re Kingston Square Assoc's., 214 B.R. at 724 (declaring movants must establish cause to receive relief under section 1112(b)). Back To Text

[245] In re Winn, 49 B.R. 237, 239 (Bankr. M.D. Fla. 1985); see also Jauregui v. San Antonio Fed. Credit Union (In re Jauregui), 185 B.R. 34, 37 (Bankr. W.D. Tex. 1995) (explaining goal of good faith rule is to discourage bad faith filing of petitions merely to invoke jurisdiction); In re Petralex Stainless, Ltd., 78 B.R. 738, 744 n.16 (Bankr. E.D. Penn. 1987) (emphasizing impact petitioning creditors' lack of legitimate concern for debtors' financial situation had on finding of bad faith in In re Winn). Back To Text

[246] In re Kingston Square Assoc's., 214 B.R. at 725 (applying two−part test for collusion established by In re Winn Court). Back To Text

[247] See Generally Corto v. Nat'l Scenery Studios, 112 F.3d 503 (2d Cir. 1997) (satisfying Winn test for collusion by petition being filed by debtors friend who did not investigate filing and who had little reason for bringing petition); In re Kingston Square Asso's., 214 B.R. 713, 725−26 (Bankr. S.D.N.Y. 1997) (applying two part test in Winn to find collusion in filing of eleven involuntary cases). Back To Text

[248] See F.D.I.C. v. Cortez, 96 F. 3d 50, 51 (2d Cir. 1996) (discussing need for court to inquire into all of surrounding circumstances to determine if jurisdiction of court has been fraudulently invoked); In re Kingston Square Assoc's., 96 F.3d at 725−26 (finding coordination of efforts to file cases does not demonstrate fraudulent or deceitful purposes). Back To Text

[249] In re Kingston Square Assoc's., 214 B.R. at 735 (holding debtors did not meet second prong of In re Winn test because it was unclear whether reorganization was not possible); see also In re Jauregui, 185 B.R. at 37 (observing goal of good faith rule is to discourage bad faith filing of petitions merely to invoke jurisdiction); In re Caucus Dist., Inc., 106 B.R. 890, 925 (Bankr. E.D. Va. 1989) (asserting court has authority to find bad faith where jurisdiction has been improperly invoked). Back To Text

[250] In re Kingston Square Assoc's., 214 B.R. at 738−39 (holding collusion requirements were not met, and ordering movants to obtain new hearing date if they desired to continue their motion); see also In re Valdez, 250 B.R. 386, 390 (Bankr. D. Or. 1999) (requiring concerted action between debtors and creditors to establish collusion); Tselikis, supra note 232, at 235 (explaining Kingston Square Associates court found cooperation, but not collusion, between principal and petitioning creditors). Back To Text

[251] In re Kingston Square Assoc's., 214 B.R. at 724; see also Toibb v. Radloff, 501 U.S. 157, 165 (1991) (noting Bankruptcy Code gives court substantial discretion to dismiss case for variety of reasons); Tamecki v. Frank (In re Tamecki), 229 F.3d 205, 207 (3d Cir, 2000) (finding decision to dismiss rests within sound discretion of bankruptcy court). Back To Text

[252] In re Kingston Square Assoc's., 214 B.R. at 725 (holding "there are two components of collusion: (i) the secret acts of at least two people and (ii) the wrongful purpose); see also In re New York Trap Rock Corp., 42 F.3d 747, 752 (2d Cir. 1994) (defining "collusion" as "secret cooperation for a fraudulent or deceitful purpose." (quoting Webster's Third International Dictionary 446 (G. & C. Merriam Co. 1976 ed.))); In re Winn, 49 B.R. at 239 (adopting two−part test for collusion). Back To Text

[253] In re Kingston Square Assoc's., 214 B.R. at 735 (stating independent director's fiduciary duty expands to include general creditors when corporation approaches insolvency); see also Ellis, supra note 3, at 316:

"This shift figured prominently in Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Co., which explicitly endorsed overall firm maximization as the controlling norm for board decision making: [I]n the vicinity of insolvency, a board of directors is not merely an agent of the residue risk bearers, but owes its duty to the corporate enterprise…[Management has] an obligation to the community of interests that sustain the corporation, to exercise judgement in an informed, good faith effort to maximize the corporation's long term wealth creating capacity."

Id. (discussing Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Co., No. CIV.A. 12130, 1991 Del. Ch. Lexis 215 (Del. Ch. Dec. 30, 1991)); see also Laura Lin, Shift of Fiduciary Duty Upon Corporate Insolvency: Proper Scope of Directors' Duty to Creditors, 46 Vand. L. Rev. 1485, 1512 (1993) (asserting fiduciary duty of director expands to include general creditors once corporation has become insolvent). Back To Text

[254] If the independent director's loyalty already lies outside of the corporation on whose board he sits, a breach of his fiduciary duties is almost inevitable. See generally Andrew W. Shaffer, Corporate Fiduciary − Insolvent: The Fiduciary Relationship Your Corporate Law Professor (Should Have) Warned You About, 8 Am Bankr. Inst. L. Rev. 479 (2000) (providing excellent discussion of fiduciary duties). Back To Text

[255] See Tselikis, supra note 232, at 235:

Equally important, persons who had previously been willing, for compensation, to become the 'independent' designee of a secured creditor must now think twice. The prospect of significant liability, including punitive damages, against both the secured creditor and the independent designee loom large…A designated representative who takes the assignment of protecting the interests of a secured creditor by breaching his fiduciary duty for a fee, will probably require a well−crafted indemnification agreement that the lender may be unwilling to give. Back To Text

[256] See id. (stating "[t]he bar rules of most states pose a serious ethical dilemma for the attorney who agrees in advance to disregard the instructions of those parties with whom he may have an attorney client relationship" and that "[m]ost major accounting firms are likely to remove themselves for much the same reasons."). See, e.g., In re Kingston Square Assoc's., 214 B.R. at 717, 735−37 (discussing independent director's loyalties to mortgage underwriter who had employed him); In re Greate Bay Hotel & Casino, Inc., 251 B.R. 213, 248 (Bankr. D. N.J. 2000) (placing two independent directors on board of directors to represent reorganized debtors' interests). Back To Text

[257] See Tselikis, supra note 232, at 235 (describing as unlikely ability of prospective independent directors to protect themselves through contract provisions). See, e.g., Thomas v. Fales, 577 A.2d 1181, 1182 (Me. 1990) (holding fiduciary obligations cannot be contracted away); Casco Northern Bank, N.A. v. Pearl, 584 A.2d 643, 645 (Me. 1990) (stating trustee must take affirmative steps to protect its beneficiaries). Back To Text

[258] See Tselikis, supra note 232, at 235 (cautioning "[s]ecured creditors who rely upon bankruptcy−remote provisions may find their claims subordinated to all other claims based upon their having aided and abetted a breach of fiduciary duty."). See, e.g., Brandt v. Wand Partners, 242 F.3d 6, 15 (1st Cir. 2001) (dismissing motion to subordinate preferred shareholders' claims because no proof existed that they were involved in fraudulent activity); In re Ashford Hotels, Ltd., 235 B.R. 743, 737 (Bankr. S.D.N.Y. 1999) (subordinating claims of guilty party to those of unsecured debtors). Back To Text

[259] In re Kingston Square Assoc's., 214 B.R. at 735 (allowing "orchestration" to occur because it could not be established that reorganization was not possible); see also Tselikis, supra note 232, at 235 (speculating court's ruling will encourage orchestration because unanimity restrictions are unenforceable). Back To Text

[260] See In re Kingston Square Assoc's., 214 B.R. at 726−27 (observing debtor provided attorney with creditor names and paid attorney's fees for solicitation of creditors); see also Gussett, supra note 232, at 4−5 (1998) (noting debtors in Kingston Square Associates paid attorney to solicit creditors); Tselikis, supra note 232, at 235 (recounting debtor in Kingston Square Assocs. hired and paid attorney to file involuntary bankruptcy action). Back To Text

[261] See id. at 734−35 (finding "[t]he worst that the Movants have established is that the Respondents coordinated their efforts to perform an end run around the bylaw provision that restricted the Debtors from filing voluntary petitions" and that these actions in and of themselves were not enough to "constitute a fraudulent intent vis−à−vis the court's process."); Ellis, supra, note 1, at 324 (determining "[t]he vehicle's corporate governance mechanism simply did not work −− partly because of inaction and partly because of the multiplicity of interests held by parties in this transaction."); see also In re Valdez, 250 B.R. 386, 390 (Bankr. D. Or. 1999) (noting in order "[t]o dismiss an involuntary bankruptcy as collusive, there must appear to be concerted action between the debtors and the petitioning creditor and these parties must fraudulently invoke the jurisdiction of the bankruptcy court", and, alternatively, that

"the two parties must act for a wrongful purpose."). Back To Text

[262] See Gussett, supra note 232, at 24 (observing "[d]espite the obvious orchestration of the involuntary filings on the eve of foreclosure, the court refused to dismiss the filings pursuant to § 1112(b) and found there was no fraudulent or deceitful purpose in the coordination efforts primarily because of the possibility of reorganization."); id. (noting court's holding in In re Kingston "can be read in a much broader context−−that corporate formalities can be overlooked if there is a legitimate ability or reason to reorganize the debtor."); see also Sheryl A. Gussett, Bankruptcy Remote Entities In Structured Financings, 1996 ABI Jnl. Lexis 499, at 14 [hereinafter Remote Entities] (opining with limited exceptions "it is probably impossible to create an entity that is entirely bankruptcy proof" but with proper precautions entity can be created that "is unlikely to become insolvent as a result of its own activities and that is adequately insulated from the consequences of another party's bankruptcy."). Back To Text

[263] See Gussett, supra note 232, at 1; see also Remote Entities, supra note 261, at 25−26 (recommending reduction of risk that SPV be subject of either voluntary or involuntary bankruptcy can be accomplished by appointment of independent director with consent of said director being "necessary to commence a voluntary bankruptcy proceeding and to make other fundamental changes in the SPV's structure."). Back To Text

[264] See Ellis, supra note 1, at 316 (noting "[t]his shift figured prominently in Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Co., which explicitly endorsed overall firm maximization as the controlling norm for board decision making…."):

[I]n the vicinity of insolvency, a board of directors is not merely an agent of the residue risk bearers, but owes its duty to the corporate enterprise…[Management has] an obligation to the community of interests that sustained the corporation, to exercise judgment in an informed, good faith effort to maximize the corporation's long term wealth creating capacity.

Id. (quoting Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Co., No. CIV.A. 12130 (1991)); see also In re Kingston Square Assoc's, 214 B.R.713, 735 (Bankr. S.D. N.Y. 1997) (stating "it is universally agreed that when a corporation approaches insolvency or actually becomes insolvent, directors fiduciary duties expand to include general creditors."). Back To Text

[265] See Tselikis, supra note 232, at 235 (suggesting it is "[e]qually important…[that] persons who had previously been willing, for compensation, to become the 'independent' designee of a secured creditor must now think twice. The prospect of significant liability, including punitive damages, against both the secured creditor and the independent designee loom large."). Back To Text

[266] See Ellis, supra note 1, at 308:

The real issues then that need to be addressed are opportunistic insolvency petitions that come about when the issuer's management seeks to benefit itself, or some other interest group, through the reorganization process. To deal with this problem, securitizations rely on the form of the issuer to reduce the likelihood of a voluntary petition.

Id. Back To Text

[267] See infra, notes 267−75 and accompanying text (discussing issues relating to filing of involuntary bankruptcy); Gussett, supra note 232 at 24 (opining "pitfalls" of court's broader holding in In re Kingston Square Associates "may be avoided by either: (i) an agreement by all other creditors not to file an involuntary petition against the debtor; or, if this is not feasible, (ii) an agreement by the principal(s) of the debtor not to solicit creditors to file involuntary petitions."). See, e.g., In re Nazarian Bankr., 5 B.R. 279, 281 (Bankr. D. Md. 1980) (holding prayer for relief could not be granted as there were not at least three creditors petitioning for relief as required by Code). See generally 11 U.S.C. § 303(b) (1994) (describing requirements for filing of involuntary bankruptcy petition under this section). Back To Text

[268] See Gussett, supra note 232, at 25 (concluding "it would appear that the pitfall of the broader interpretation of this case may be avoided by either: (i) an agreement by all other creditors not to file an involuntary petition against the debtor; or if this is not feasible, (ii) an agreement by the principal(s) of the debtor not to solicit creditors to file involuntary petitions."). Back To Text

[269] See Ellis, supra note 1, at 307 (noting "the issuer cannot be prohibited from filing a bankruptcy petition. As a general principal, waivers or prohibitions on bankruptcy petitions are void as matter of public policy."); id. (commenting "[w]hile great care is taken in crafting [contractual covenants and provisions aimed at…prohibiting activities that might "create" unsecured creditors],…they are not self−enforcing, and problems of non−compliance occasionally arise."); Committee, supra note 2, at 556 (stating "[a]dvance restrictions against filing a voluntary bankruptcy case pursuant to an agreement between a debtor and a creditor have been held to be void as against public policy."). Back To Text

[270] See Dawson, supra note 11, at 393 (suggesting "the transaction documents should contain a covenant preventing the parties from filing, instigating or joining in any involuntary bankruptcy proceeding against the entity so long as the rated securities are outstanding."); Committee, supra note 2, at 557 (opining "structuring can be done to reduce the likelihood of involuntary bankruptcy."); Structured Finance, supra note 8, at 11 (suggesting "by design, the ability of the originator to cause the SPV to file a voluntary bankruptcy can be limited" as, for example, when"[c]harters of SPVs sometimes provide that the SPV may not place itself into bankruptcy unless the SPV is insolvent and a requisite percentage of independent board members votes for bankruptcy."). But see id. at 11−12 (cautioning that methods discussed to limit originator's ability to place itself in voluntary bankruptcy "are not infallible" and whether they can be enforced "will depend upon the law of the particular jurisdiction of the SPV's formation."). Back To Text

[271] See 11 U.S.C. § 303(b) (1994); see also In re Gill Enterprises Inc., 15 B.R. 328, 331 (Bankr. D. N.J. 1981) (holding "[t]he purpose of § 303(b)(1) is to allow more flexibility on considering involuntary actions and not to restrict or limit the involuntary process" and that "[m]echanical, inflexible tests should not be applied…"). See, e.g., In re Hill, 5 B.R. 79, 83 (Bankr. D. Minn. 1980) (holding, notwithstanding debtor's payment of all but three debts, debtor was "generally not paying" within meaning of section 303(h), as these three debts "constituted such an overwhelming portion of the total…."). Back To Text

[272] See 11 U.S.C. § 303(b) (1994) (discussing manner in which involuntary petition may be commenced). Back To Text

[273] See Committee, supra note 2, at 554 (commenting "[t]he activities of an SPV are restricted to those necessary or incidental to the financing."); Dawson, supra note 11, at 393 (recommending entity should not engage in any other business or activity). This restriction will limit the number of creditors and amounts of claims against the SPV. See generally 11 U.S.C. § 303(1994) (permitting filing of involuntary bankruptcy petition). Back To Text

[274] See Dawson, supra note 11, at 393 (recommending entity should be restricted from incurring additional debt); see also Committee, supra note 2, at 554 (noting "[t]he activities of an SPV are restricted to those necessary or incidental to the filing."). This restriction will limit the number of creditors and amounts of claims against the SPV. See generally 11 U.S.C. § 303(1994) (permitting filing of involuntary bankruptcy petition). Back To Text

[275] See 11 U.S.C. § 303(b) (1994) (providing in pertinent part that "[a]n involuntary case… is commenced by the filing with the bankruptcy court of a petition… (1) by three or more entities…if such claims aggregate at least $11,625 more than the value of any lien on property of the debtor securing such claims held by the holders of such claims."); see also 11 U.S.C. § 104(b) (1994) (providing in pertinent part that "each dollar amount in effect under section…303(b)…shall be adjusted…to reflect the change in the Consumer Price Index for All Urban Consumers, published by the Department of Labor, for the most recent 3−year period ending immediately before January 1 preceding such April 1…"). As per provisions of section 104, effective April 1, 2001, and applicable to cases commenced on or after such date, dollar amounts in section 303(b) were automatically adjusted by substituting $11,625 for $10,775. Back To Text

[276] See 11 U.S.C. § 303(b) (1994) (providing manner in which involuntary petition may be commenced). See, e.g., In re Tsunis 29 B.R. 527, 531 (Bankr. E.D. N.Y. 1983) (holding since four petitioning creditors established "[they] have non−contingent claims of an aggregate value at least [then statutory amount of] $5,000 more than the value of any lien on property of the debtor securing such claims and that the debtor is generally not paying his debts as they become due," alleged debtor is adjudicated as such under chapter 7); In re Chas, B's, Inc., 51 B.R. 21, 22 (Bankr. S.D. Ohio 1985) (holding claimed "[creditor] is…a creditor only to the extent of approximately $1,000.00, which is insufficient to comply with the requirement of [section 303(b)(1)]."). Back To Text

[277] See generally J. Stephen Gilbert, Substantive Consolidation in Bankruptcy: A Primer, 43 Vand. L. Rev. 207, 210 (1990) [hereinafter Gilbert] (discussing judicial doctrine of substantive consolidation); Mary Elisabeth Kors, Altered Egos: Deciphering Substantive Consolidation, 59 U. Pitt. L. Rev. 381, 384−85 (1998) [hereinafter Kors] (discussing judicial doctrine of substantive consolidation); Patrick C. Sargent, Bankruptcy Remote Finance Subsidiaries: The Substantive Consolidation Issue, 44 Bus. Law. 1223 (1989)[hereinafter Sargent] (discussing judicial doctrine of substantive consolidation). Back To Text

[278] See Kors, supra note 276, at 381 (describing substantive consolidation as "the effective merger of two or more legally distinct (albeit affiliated) entities into a single debtor with a common pool of assets and a common body of liabilities."); Gilbert, supra note 276, at 208 (noting "[s]ubstantive consolidation is a powerful vehicle in bankruptcy by which the assets and liabilities of one or more entities are combined and treated for bankruptcy purposes as belonging to a single enterprise."); Sargent, supra note 276, at 1223 (explaining when substantive consolidation occurs in bankruptcy, "the assets and liabilities of different entities may be consolidated and dealt with as if the assets were held by, and the liabilities incurred by, a single entity."). Back To Text

[279] See Kors, supra note 276, at 381(discussing judicial doctrine of substantive consolidation); Gilbert, supra note 276, at 208 (stating same); Sargent, supra note 276, at 1223 (stating same). Back To Text

[280] See Sampsell v. Imperial Paper & Color Corp., 313 U.S. 215, 218 (1941) (finding "[debtor's] corporation was in no position to assert against [debtor's] trustee that it was so separate and insulated from [debtor's] other business affairs as to stand in an independent and adverse position."); see also Clyde Bergemann, Inc. v. Babcock & Wilcox Co. (In re Babcock), 250 F.3d 955, 958 n. 5 (5th Cir. 2001) (explaining substantive consolidation is judicial creation which "usually results in, inter alia, pooling the assets of, and claims against, the two entities; satisfying liabilities from the resultant common fund; eliminating inter−company claims; and combining the creditors of the two companies for purposes of voting on reorganization plans."); id.(noting "[f]undamentally, 'substantive consolidation' occurs when the assets and liabilities of separate and distinct legal entities are combined in a single pool and treated as if they belong to one entity."). Back To Text

[281] Section 105(a) provides:

(a)The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

11 U.S.C.§ 105(a) (1994); see Schlein v. Golub, 178 B.R. 82, 86 (Bankr. E.D.Pa. 1995) (noting jurisdictions may be taken and consolidation ordered since it is likely to reduce the parties overall costs and be the most efficient and expeditious manner of resolving the matter); see also Jones v. Bank of Santa Fe (In re Courtesy Inns), 40 F.3d 1084, 1089 (10th Cir. 1994) (holding attorneys' fees may be imposed by bankruptcy courts to prevent abuse of power). Back To Text

[282] See id.; see also In re An Unknown Group of Cases Seeking to Be Filed, 79 B.R. 651, 652 (Bankr. E.D. Va.1987) (declaring "[t]he bankruptcy court is a court of equity" and noting that "[I]t can do what needs to be done as long as there is not an abuse of that power."). But see In re Schewe 94 B.R. 938, 949−50 (Bankr. W.D. Mich. 1989) (stating "[a] bankruptcy court should not create additional property rights or remedies in favor of a debtor or any other party in interest where such rights do not exist outside of bankruptcy law unless such rights and remedies are statutorily

authorized under the Bankruptcy Code."). Back To Text

[283] See In re Parkway Calabrasas, Ltd., 89 B.R. 832, 837 (Bankr. C.D.Cal. 1988) (discussing judicial origins of substantive consolidation doctrine); see also Clyde Bergemann, Inc. v. Babcock and Wilcox Co. (In re Babcock), 250 F.3d 955, 958 n. 5 (5th Cir. 2001) (explaining t substantive consolidation is judicial creation); In re Baker & Getty Financial Services, Inc., 78 B.R. 139, 141 (Bankr. N.D. Ohio 1987) (observing court's authority to order substantive consolidation arises from its equity jurisdiction pursuant to section 105(a)). Back To Text

[284] See Committee, supra note 2, at 593−606 (providing "Issue List for Substantive Consolidation Analysis" [Appendix C] and "Form of Non−Consolidation Opinion" [Appendix D]); Ellis, supra note 1, at 306 (stating substantive consolidation usually requires separate reasoned opinion of law); Lupica, supra note 2, at 646 (explaining "[b]ecause of the substantial implications the risk or substantive consolidation has on the market for asset−backed securities, rating agencies…require that counsel for securitization originators represent that all steps have been taken to minimize the chance that a court will substantively consolidate the originator and its affiliated SPC."); Sargent, supra note 276, at 1225 (suggesting "[practitioner] giving a 'no−consolidation opinion' should research carefully the standards required to pierce the corporate veil in the jurisdictions whose laws might be applied to the finance subsidiary and its parent."). Back To Text

[285] See Committee, supra note 1, at 595−606 (providing "Form of Non−Consolidation Opinion" [Appendix D]); Richard W. Painter, Toward a Market for Lawyer Disclosure Services: In search of Optimal Whistleblowing Rules, 63 Goe. Wash. L. Rev. 221, 226 (1995) (stating formal opinion letters from lawyers and accountants are usually required to close corporate transactions). Back To Text

[286] The rating agencies will look at the insulation of the assets from the insolvency of the originator in determining the rating. See Dawson, supra note at 383−84 (allowing for higher ratings due to insulation of assets ratings of securities based on creditworthiness of isolated assets not creditworthiness of originator); Borod, supra note at 9−3 (stating "[b]ecause asset−backed transaction are, essentially, synthetic financings, the structure, quality of the underlying assets, and level of credit enhancement can be manipulated so as to achieve the desired rating."). Back To Text

[287] See In re Snider Bros., Inc., 18 B.R. 230, 234 (Bankr. D. Mass. 1982). Back To Text

[288] See In re Augie/Restivo Baking Co., Ltd., 860 F.2d 515, 518 (2d Cir. 1988) (describing consequences of substantive consolidation); see also In re Crown Machine & Welding, Inc., 100 B.R. 25, 26−27 (Bankr. D. Mont. 1989) (same); 2 Collier on Bankruptcy¶ 105.09 at 1 n. 3 (Lawrence P. King et al. eds., 15th ed. Rev. 1997) (stating "substantive consolidation merges the assets and liabilities of the debtor entities into a unitary debtor estate to which all holders of allowed claims are required to look for distribution."). Back To Text

[289] See 11 U.S.C. § 105 (1994) (providing authority for court to consolidate substantively two bankruptcy cases pursuant to its general equitable power). Back To Text

[290] See In re Vecco Constr. Indus., 4 B.R. 407 (Bankr. E.D. Va. 1980); see also 11 U.S.C. § 105(a) (1994) (defining scope of court's equitable power by providing "[t]he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title."); Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 206 (1988) (asserting equitable powers of court must be exercised within boundaries of Bankruptcy Code). Back To Text

[291] See In re Vecco Constr. Indus., 4 B.R. at 409 (Bankr. E.D. Va. 1980) (citing Pepper v. Litton, 308 U.S. 295, 304 (1939)); see also 11 U.S.C. § 105(a) (1994) (providing court with broad equitable power to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title."). See contra, Hon. Marcia S. Krieger, The Bankruptcy Court is a Court of Equity? What Does That Mean?, 50 S.C. L. Rev. 275, 275 (1999) (arguing bankruptcy courts are not courts of equity). Back To Text

[292] See Noonan v. Secretary of Health and Human Servs. (In re Ludlow Hospital Society, Inc.), 124 F.3d 22, 27 (1st Cir. 1997) (discussing scope of discretionary authority granted bankruptcy court under section 105 of Code); see also Norwest, 485 U.S. at 206 (stating that equitable powers of bankruptcy court under § 105 are to be exercised "to fulfill

some specific Code provision."); Donovan v. Reitmeyer, 183 B.R. 700, 702 (Bankr. W.D. Pa. 1995) (asserting section 105 gives court power to issue orders that are necessary to further other provisions of Bankruptcy Code). Back To Text

[293] See In re Oxford Management, Inc., 4 F.3d 1329, 1334 (5th Cir. 1993) (cautioning broad discretion granted court is not without limits). Back To Text

[294] See In re Ludlow Hospital Society, Inc., 124 F.3d at 27 (quoting In re Plaza de Diego Shopping Ctr., Inc., 911 F.2d 820, 824 (1st Cir. 1990); see also Norwest, 485 U.S. at 206 (defining scope of equitable powers of bankruptcy court). See generally 11 U.S.C. § 105(a) (1994) (granting bankruptcy court broad equitable powers). Back To Text

[295] Section 541(a)(1) provides:

(a) The commencement of a case under § 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. Back To Text

[296] Section 542(a) provides:

(a) Except as provided in subsection (c) or (d) of this section, an entity, other than a custodian, in possession, custody, or control, during the case, of property that the trustee may use, sell, or lease under section 363 of this title, or that the debtor may exempt under section 522 of this title, shall deliver to the trustee, and account for, such property or the value of such property, unless such property is of inconsequential value or benefit to the estate. Back To Text

[297] See In re Munford, Inc., 115 B.R. 390, 398 (Bankr. N.D. Ga. 1990) (discussing Code provisions which enable trustee to maximize value and size of estate); Chemical Bank New York Trust Co. V. Kheel, 369 F.2d 845, 847 (2d Cir. 1966) (stating consolidation treats assets of all debtors as common assets eliminating a large number of duplicative claims filed against several debtors). Back To Text

[298] See Sampsell v. Imperial Paper & Color Corporation, 313 U.S. 215, 219 (1941) (confirming considerable scope of bankruptcy court's authority to equitably reorder and redistribute assets of estate). Back To Text

[299] See Mary Elizabeth Kors, Altered Egos: Deciphering Substantive Consolidation, 59 U. Pitt. L. Rev. 381, 385 (1998) (assessing validity of several bases for court's authority to effect substantive consolidation). Back To Text

[300] Id. Back To Text

[301] See Borod, supra note 3, at 7−18 (employing "identity of interests" approach to "control" factor); Committee, supra note 2, at 559 (using "mere instrumentality" as subset of fourth factor); Sargent, supra note 49, at 1224 (using "mere instrumentality" approach in determining existence of fourth factor). Back To Text

[302] See Kors, supra note 298, at 386−87 (explaining "[s]ubstantive consolidation derives from an earlier body of 'corporate disregard' law common to the remedies of substantive consolidation, piercing the corporate veil, and equitable subordination and has slowly evolved into a distinct doctrine."). See generally In re Ionica, 241 B.R. 829 (Bankr. S.D. N.Y. 1999) (discussing British and American common law approaches to insolvency). Back To Text

[303] See Kors, supra note 298, at 389 (positing "turnover proceedings are the ancestor of substantive consolidation…."); see also In re Deltacorp, 179 B.R. 773, 777 (Bankr. S.D. N.Y. 1995) (observing "substantive consolidation merges the separate estates into one estate for distributive purposes."); In re Munford, 115 B.R. at 398 (Bankr. N.D. Ga. 1990) (stating "substantive consolidation is essentially a complex turnover proceeding because the debtor is asking the nondebtor affiliate to bring into the estate assets in which the debtor asserts an unseparable interest."). Back To Text

[304] See In re T.G. Morgan, Inc., 172 F.3d 607, 608 (8th Cir. 1999) (finding bankruptcy trustee required "the FTC receiver to turn over to him all of the assets in the 'Settlement Estate' on the ground that the assets were rightfully the property of the bankruptcy estate."); Kors, supra note 298, at 387 (discussing consequences of failing to observe certain corporate formalities); see also 11 U.S.C. § 521 (1994) (providing debtor is duty−bound to cooperate with bankruptcy trustee, including surrendering all property of estate.). Back To Text

[305] See Stone v. Eacho, 127 F.2d 384, 289 (4th Cir. 1942) (determining in fairness to all creditors "the corporate entity should be ignored and the bankruptcy proceedings consolidated with the proceedings relating to the parent corporation."); Kors, supra note 298, at 391 (concluding "[o]nly when the turnover order encompassed all of an affiliates assets and creditors of both entities shared pari passu, did turnover result in true consolidation."); see also Matter of Security Products Company, 310 F.Supp 110, 117 (E.D. Mo. 1969) (cautioning "the petition and the proof must show that the corporation whose property is sought to be brought into the bankruptcy proceeding was organized or used to hinder, delay or defraud the creditors of the bankrupt."). Back To Text

[306] See Kors, supra note 298, at 391 (reporting "[e]ven in those cases where the subsidiary had creditors, the courts often gave the subsidiary's creditors first priority in the subsidiary assets."). See contra Central Republic Bank and Trust Co. v. Caldwell, 58 F.2d 721, 735 (8th Cir. 1932) (ruling subsidiary and parent company were so intermingled, assets of two companies should be treated as one). Back To Text

[307] See Fish v. East, 114 F.2d 177, 191 (10th Cir. 1940) (listing ten factors to determine if affiliate corporation is "mere instrumentality"):

1. The parent owns all or a majority of the capital stock of the subsidiary;

2. There are common directors and officers;

3. The parent corporation finances the subsidiary;

4. The parent corporation is responsible for the incorporation of the subsidiary;

5. The subsidiary has grossly inadequate capital;

6. The parent company pays the salaries or expenses or losses of the subsidiary;

7. The subsidiary has no independent business from the parent;

8. The subsidiary is commonly referred to as a subsidiary or as a department or a division of the parent;

9. Directors and executive officers of the subsidiary do not act independently but take direction from the parent; and

10. The formal legal requirements of the subsidiary as a separate and independent corporation are not observed.)

Id. Back To Text

[308] See In re Munford, Inc., 115 B.R. 390, 398 (Bankr. N.D. Ga. 1990). Back To Text

[309] See Kors, supra note 298, at 391 (observing "[i]n the early turnover decisions, courts would typically require the subsidiary to turn over its assets to the parent corporations bankruptcy trustee (or appoint a receiver for the subsidiary) so that the assets could be administered for the benefit of the parent's creditors."); see also supra note 304 and accompanying text (discussing limitations on turnover of assets to bankrupt parent). Back To Text

[310] See Kors, supra note 298, at 390 (discussing possible rationales for determination of substantive consolidation); see also Schimmelpenninck v. Byrne (In re Schimmelpenninck), 183 F.3d 347, 355 (5th Cir. 1999) (stating "even though, under Texas law, claims based on alter ego and other piercing−the−corporate−veil theories are typically brought by a

creditor, nothing prevents a corporation from asserting such a claim against its own subsidiary or affiliated companies."); Culbreth v. Amosa, Ltd., 898 F.2d 13, 15 (3d Cir. 1990) (ruling in order to pierce the corporate veil, one must show "that the controlled corporation acted robot− or puppet−like in mechanical response to the controller's tugs on its strings or pressure on its buttons."). Back To Text

[311] Frederick Powell, Parent & Subsidiary Corporations: Liability of a Parent Corporation for the Obligations of its Subsidiary, at 9 (1931). Back To Text

[312] See Kors, supra note 49, at 393 n.64 (observing "[n]ot only is this [disregard of the corporate entity] done for the purpose of holding a stockholder or parent corporation for debts created by an insolvent corporate agent or subsidiary which is a mere instrumentality of the stockholder or parent, but also for the purpose of allowing the creditors of the stockholder or parent to reach assets held by such a subsidiary.") (quoting Stone v. Eacho, 127 F.2d 284, 288−89 (4th Cir. 1942)); see also Stone v. Eacho, 127 F.2d 284, 288 (4th Cir. 1942) (stating where subsidiary has no real existence and should be ignored as separate entity, creditors of parent and subsidiary corporations should share equally in their pooled assets); In re Drexel Burnham Lambert Group, 138 B.R. 723, 763−764 (Bankr. S.D.N.Y. 1992) (describing corporate veil piercing factors as those factors used in ascertaining whether interrelationship between parent and subsidiary warrants creation of single estate for the benefit of all creditors under doctrine of substantive consolidation). Back To Text

[313] Kors, supra note 49, at 398−99. See In re Cooper, 147 B.R. 678, 683 (Bankr. D.N.J. 1992) (finding "a substantial overlap between the grounds for and remedies of piercing the corporate veil and substantive consolidation."); see also In re Bonham, 226 B.R. 56, 77 (Bankr. D. Alaska 1998) (observing factors evaluated on motion for substantive consolidation appear similar to those evaluated in corporate veil piercing analysis); In re Stop & Go of America, Inc. 49 B.R. 743, 747 (Bankr. D. Mass. 1985) (noting "[t]he gravaman of any consolidation complaint is the traditional but elusive concept known as piercing the corporate veil."); In re Lewellyn, 26 B.R. 246, 252 (Bankr. S.D. Iowa 1982) (applying corporate veil piercing factors to substantive consolidation analysis). Back To Text

[314] Kors, supra note 49, at 386−87. See also id. at 387 n.24 (asserting "[a]uthorities often speak of the substantive consolidation doctrine as inherently distinct from 'piercing the corporate veil' and other corporate disregard law , and trace the history of substantive consolidation back to [Sampsell] and no further" and that "[s]ubstantive consolidation law did not spring up fully formed in 1941."); In re Bonham, 226 B.R. at 89 (opining "[w]hile the remedy of substantive consolidation is similar to piercing the corporate veil, it is not the same."); In re Cooper, 147 B.R. at 683 (contrasting substantive consolidation with piercing the corporate veil theory by noting that latter is remedy employed by bankruptcy courts to correct prior harm and prevent future injury to creditors, while former is employed in nonbankruptcy law to remedy fraud or injustice). Back To Text

[315] See In re Cooper, 147 B.R. at 678 (asserting "[s]ubstantive consolidation is the merger of the assets and liabilities of two or more estates, creating a common fund of assets and a single body of creditors."); Gilbert, supra note 49, at 208 (noting "[s]ubstantive consolidation is a powerful vehicle in bankruptcy by which the assets and liabilities of one or more entities are combined and treated for bankruptcy purposes as belonging to a single enterprise"); Kors, supra note 49, at 381 (stating substantive consolidation is "the effective merger of two or more legally distinct (albeit affiliated) entities into a single debtor with a common pool of assets and a common body of liabilities."). Back To Text

[316] 313 U.S. 215 (1941). Back To Text

[317] Gilbert, supra note 49 at 215; see Committee, supra note 1 at 597 (observing "[g]iven that the power to order substantive consolidation derives from the equity jurisdiction of the bankruptcy courts, the issue is determined on a case−by−case basis..."); Kors, supra note 49, at 397 (reporting "[s]ubstantive consolidation cases repeatedly stress that each case is sui generis."); Sargent, supra note 49, at 1227 (remarking "there is no clear litmus test for determining substantive consolidation, and cases are to a great degree sui generis.") (citing 5 Collier on bankruptcy ¶ 1100.06[1] at 1100−33 (Lawrence P. King et al. eds., 15th ed. 1985)); see also In re Augie/Restivo Baking Co., Ltd., 84 B.R. 315, 321 (Bankr. E.D.N.Y. 1988) (stating substantive consolidation cases "are to a great degree sui generis") (citing 5 Collier on bankruptcy ¶ 1100.06[1] at 1100−33), rev'd on other grounds, 860 F.2d 515 (2d Cir. 1988). Back To Text

[318] In re Auto−Train Corp., Inc., 810 F.2d 270 (D.C. Cir. 1987). Back To Text

[319] Id. at 276; see Eastgroup Props. v. Southern Motel Assoc., Ltd., 935 F.2d 245, 249 (11th Cir. 1991) (adopting standard for determining whether to grant motion for substantive consolidation as set forth in In re Auto−Train, 810 F.2d at 276); see also In re Reider, 31 F.3d 1102, 1108 (11th Cir. 1994) (explaining "Eastgroup analysis" of substantive consolidation); In re F.W.D.C., Inc., 158 B.R. 523, 525 (Bankr. S.D. Fla. 1993) (citing Eastgroup Properties v. Southern Motel Assoc., Ltd., 935 F.2d at 249). Back To Text

[320] See Kors, supra note 49 at 400 (stating courts use "checklist" approach to determine if substantive consolidation is appropriate); Sargent, supra note 49, at 1226 (noting "[w]hile earlier decisions frequently cited the ten factors enunciated by the Fish v. East court, courts in later decisions devised a list of seven elements relevant to determining the appropriateness of consolidation."); see also In re Vecco Constr. Indus., Inc., 4 B.R. 407, 410 (Bankr. E.D. Va. 1980) (proposing seven criteria to determine whether substantive consolidation is appropriate). Back To Text

[321] See Kors, supra note 49 at 400−01 (observing "[t]he Vecco factors have enjoyed enormous popularity and have been cited in over twenty substantive consolidation decisions" while "other courts have cited similar five−factor, six−factor, eight−factor and ten−factor tests."); see also Pension Ben. Guar. Corp. v. Quimet Corp., 711 F.2d 1085, 1093 (1st Cir. 1983) (stating various factors used in deciding whether to grant substantive consolidation); In re Gainesville P−H Props., Inc., 106 B.R. 304, 305−06 (Bankr. M.D. Fla. 1989) (incorporating ten factor analysis based on seven Vecco factors and three additional factors from Pension Ben. Gaur. Corp.). Back To Text

[322] See Kors, supra note 49, at 400 (noting "[t]he Vecco factors have enjoyed enormous popularity and have been cited in over twenty substantive consolidation decisions."); id. at 400 n.111 (citing, inter alia, Eastgroup Props., 935 F.2d at 249); In re Creditor's Serv. Corp., 195 B.R. 680, 689 (Bankr. S.D. Ohio 1996); In re New Ctr. Hosp., 179 B.R. 848, 856 (Bankr. E.D. Mich. 1994); In re Stevenson, 153 B.R. 52, 53 (Bankr. D. Idaho 1993); In re Lease−a−Fleet, Inc., 141 B.R. 869, 871−72 (Bankr. E.D. Pa. 1992); In re Orfa Corp. of Phila., 129 B.R. 404, 414−15 (Bankr. E.D. Pa. 1991); Holywell Corp. v. Bank of New York, 59 B.R. 340, 347 (Bankr. S.D. Fla. 1986); Structured Finance, supra note 7 at 616 (discussing In re Vecco factors); Borod, supra note 3 at 7−18 (same). Back To Text

[323] See Eastgroup Props., 935 F.2d at 250 (concluding "[n]o single factor is likely to be determinative in the court's inquiry."); Holywell Corp. v. Bank of New York, 59 BR 340, 347 (Bankr. S.D. Fla. 1986) (stating not all seven factors must be present to support substantive consolidation); In re Donut Queen, Ltd., 41 B.R. 706, 709 (Bankr. E.D.N.Y. 1984) (cautioning "[t]he case law reveals that the objective criteria set forth in Vecco should not be mechanically applied in reaching an ultimate finding on the issue of consolidation: There is no one set of elements which, if established, will mandate consolidation in every instance."). Back To Text

[324] In re Vecco Constr. Indus., Inc., 4 B.R. 407, 410 (Bankr. E.D. Va. 1980); see Holywell Corp., 59 B.R. at 347 (detailing seven substantive consolidation factors) (citing In re Donut Queen, Ltd., 41 B.R. at 709); In re Donut Queen, Ltd., 41 B.R. at 709 (listing seven Vecco factors) (citing In re Vecco Constr. Indus., Inc., 4 B.R. at 407). Back To Text

[325] See Gilbert, supra note 49 at 216 (noting "[a]scertaining whether certain factors exist is merely an initial step in the courts' process of considering the propriety of substantive consolidation."); see also Eastgroup Properties, 935 F.2d at 251 (applying Auto−train analysis); In re Auto−Train Corp., 810 F.2d at 276 (holding "[t]he proponent must show not only a substantial identity between the entities to be consolidated, but also that consolidation is necessary to avoid some harm or realize some benefit."). Back To Text

[326] See Eastgroup Properties, 935 F.2d at 251 (determining cost−benefit analysis must be performed before finding of need for substantive consolidation); In re Auto−Train, 810 F.2d at 276 (finding "[b]efore ordering consolidation, a court must conduct a searching inquiry to ensure that consolidation yields benefits offsetting the harm it inflicts on objecting parties.") (citing In re Snider Bros., 18 B.R. 230, 237−38 (Bankr. D. Mass. 1982)). Back To Text

[327] See supra note 325 and accompanying text (discussing need for searching cost−benefit analysis before proceeding to substantive consolidation). Back To Text

[328] See Kors, supra note 49, at 397 (opining "[t]he command 'look at the facts and do equity' may provide as much guidance as the frequently confusing and inconsistent tests in modern substantive consolidation cases."); see also Hassett v. Bank Ohio Nat'l Bank 172 B.R. 748, 762 (S.D.N.Y. 1994) (citing In re Paula Saker & Co., 37 B.R. 802, 808); In re Paula Saker & Co., 37 B.R. 802, 808 (Bankr. S.D.N.Y. 1984) (warning "[i]n determining whether a claim is legal or equitable and hence whether there is a cognizable right to a jury trial, [courts are required] not to accept the theory pleaded but to look to the facts to determine if a decree in equity is required.") (emphasis added). Back To Text

[329] See Eastgroup Props., 935 F.2d at 249 (observing "[w]hen this showing is made [the balancing test], a presumption arises 'that creditors have not relied solely on the credit of one of the entities involved.'"); In re Auto−Train, 810 F.2d at 276 (finding "[a]t this point, a creditor may object on the grounds that it relied on the separate credit of one of the entities and that it will be prejudiced by consolidation."); In re Snider Bros., Inc., 18 B.R. 230, 238 (Bankr. D. Mass 1982) (remarking "[o]nce the applicant has established by affirmative proof the need for consolidation, there is still the matter of the defense that the benefits of consolidation do not outweigh the harm to be caused to the objector."). Back To Text

[330] In re Lewellyn, 26 B.R. 246, 251−52 (Bankr. S.D. Iowa 1982); see also supra note 328 and accompanying text (discussing procedural and other obstacles to consolidation); Alexander v. Compton (In re Bonham), 229F.3d 750, 766 (asserting once "a proponent of substantive consolidation" has been made a prima facie showing of identity between the two entities to be consolidated and consolidation is necessary either to avoid harm or to be beneficial, then such presumption arises). Back To Text

[331] In re Snider Bros., Inc., 18 B.R. at 238 (Bankr. D. Mass. 1982); see also supra note 328 and accompanying text (discussing procedural and other impediments to consolidation). Back To Text

[332] See supra text accompanying note 328 (discussing procedural and other impediments to substantive consolidation). Back To Text

[333] Eastgroup Props., 935 F.2d at 249 n.11; see also In re Snider Bros., Inc., 18 B.R. at 238 (noting "such a defense has been denied to creditors who could be deemed to have dealt with the debtors with full knowledge of their 'consolidated operation' and who therefore, could be estopped to assert corporate separateness."). Back To Text

[334] See Borod, supra note 3, at 7−18 (explaining analysis for substantive consolidation); Committee, supra note 1, at 598−99 (explaining analysis for substantive consolidation). Back To Text

[335] See supra Part IV.B. Back To Text

[336] See Eastgroup Properties, 935 F.2d at 250 (asserting "[n]o single factor is likely to be determinative in the court's inquiry."); see also Holywell Corp. v. Bank of New York, 59 B.R. 340, 347 (Bankr. S.D. Fla. 1986) (stating not all factors must be present to support consolidation); In re Donut Queen Ltd., 41 B.R. 706, 709 (Bankr. E.D.N.Y. 1984) (concluding no one set of elements will necessarily result in consolidation). Back To Text

[337] The courts have held that no one factor is determinative, but once a majority of the factors exist, a finding that there is an "identity of interests" becomes much more likely. See Eastgroup Properties, 935 F.2d at 250 (holding "[t]he Bankruptcy Court's findings on five of the seven…factors constitute a factual basis for its decision to order substantive consolidation in this case."); Holywell Corp., 59 B.R. at 348 (noting "[t]hese courts apply each factor to a case's facts, but the absence of one or more factors will not necessarily defeat a request for consolidation."); Gilbert, supra note 49, at 216−17. Back To Text

[338] See Kors, supra note 49, at 400−01 (explaining "[t]he Vecco factors have enjoyed enormous popularity and have been cited in over twenty substantive consolidation decisions…[s]till other courts have cited similar five−factor, six−factor, eight−factor and ten−factor tests."). See e.g. In re Stevenson, 153 B.R. 52, 52 (Bankr. D. Idaho 1993) (illustrating in order to establish substantive consolidation, court must follow formula of seven factors); In re Orfa Corp. of Philadelphia, 129 B.R. 404, 410 (Bankr. E.D. Pa. 1991) (determining case law permits bankruptcy to court utilize these factors). Back To Text

[339] See In re Vecco Constr. Indus., Inc., 4 B.R. 407, 410 (Bankr. E.D. Va. 1980) (listing this as factor appropriately considered in determining merits of consolidation); see also Eastgroup Properties, 935 F.2d at 249 (asserting when making prima facie case for consolidation "the proponent of consolidation may want to frame his argument" on the degree of difficulty in segregating or ascertaining individual assets and liabilities among other factors); In re Gainesville P−H Properties, Inc., 106 B.R. 304, 305 (Bankr. M.D. Fla. 1989) (listing seven factors upon which consolidation may be founded); In re Donut Queen, Ltd., 41 B.R. at 709 (noting upon consideration for motion to consolidate, degree of difficulty in segregating or ascertaining individual assets and liabilities, is one factor to be weighed). Back To Text

[340] See Dawson, supra note 11, at 400 (asserting "[a] true sale of an asset is a transfer that is effective against the transferor, its creditors, its regulator, its liquidator or receiver, and can be enforced against the borrower" and that "[s]uch a transfer legally separates the credit risk of the assets from that of the transferor."); Pantaleo, supra note 9, at 159 (opining "[t]ransfers of financial assets in which the parties state that they intend a sale, and in which all benefits and risks commonly associated with ownership are transferred for fair value in an arm's−length transaction, are easily identifiable as sales."). See generally Borod, supra note 3, at 7−23 (acknowledging "true sale" as absolute conveyance); Committee, supra note 1, at 542 (laying out issues to be analyzed in "true sale" determination). Back To Text

[341] See supra note 339 and accompanying text (providing definition of "true sale"). See generally Major's Furniture Mart, Inc. v. Castle Credit Corp., 602 F.2d 538, 544 (3d Cir. 1979) (stating "[t]he determination of whether a particular assignment constitutes a [true] sale or a transfer for security is left to the courts."). Back To Text

[342] See Committee, supra note 1, at 551−52:

Several bankruptcy issues may exist where the securitized assets are receivables and the payments on the receivables are made to a seller−servicer: the amounts collected and turned over to the special purpose vehicle prior to bankruptcy might constitute voidable preferences with respect to the seller−servicer's obligation to turn over; the special purpose vehicle's interest in amounts collected prior to bankruptcy held by the seller−servicer at the time of bankruptcy may be voidable under the Bankruptcy Code's 'strong−arm' power; or the amounts held by a seller−servicer at the time of bankruptcy could be immobilized by the automatic stay, even if the special purpose vehicle's interest in such amounts is not voidable.

Id. See generally 11 U.S.C. § 544(a)(1) (1994) (explaining under Code's "strong−arm" provision, trustee in bankruptcy "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…a judicial lien on all property…"); id. § 362(a)(3) (providing automatic stay functions to stay any act to obtain property of or from estate even if debtor has no interest therein). Back To Text

[343] See Committee, supra note 1, at 548 (stating "when the servicer is the transferor…, concerns are raised as to whether a true sale has been effected if the transferor has post transfer control over the assets or their proceeds."); see also infra notes 355−363 and accompanying text (examining factor four of Vecco Construction factors). See generally Major's Furniture Mart, Inc. v. Castle Credit Corp., Inc., 602 F.2d 538, 544 (3d Cir. 1979) (explaining contractual association as well as course of dealings between parties must be evaluated by court). Back To Text

[344] See Committee, supra note 1, at 552 (concluding bankruptcy issues would not exist if payments were made to servicer acting solely as SPV's agent). See e.g., In re Southern Equip. Sales Co., 24 B.R. 788, 794 (Bankr. D.N.J. 1982) (asserting "the problem of 'commingling' arises only when funds are to be traced in the debtor's hands and not the creditor's."). See generally Harris Diamond, Tracing Cash Proceeds in Insolvency Proceedings Under Revised Article 9, 9 Am. Bankr. Inst. L. Rev. 385, 393 (explaining problem of commingling). Back To Text

[345] Any hiring of third parties will increase transaction costs. See Committee, supra note 1, at 548 (explaining "[t]he role of the servicer is primarily to collect the assets and administer the cash flow of the asset pool" and that "[t]he servicer may be a third party or the transferor."). Back To Text

[346] See Ellis, supra note 1, at 296 (asserting asset securitization is quickly gaining favor with many small businesses); see also Committee, supra note 1, at 528 (noting although asset securitization is relatively new, it has become quite widespread); Shenker & Colletta, supra note 1, at 1371 (stating asset securitization has become quite expansively utilized). Back To Text

[347] See Committee, supra note 1, at 552:

One alternative is for payments on both the sold and non−sold receivables to be collected by a third party servicer, or sent to a 'lockbox' bank, acting for both the special purpose vehicle (with respect to the sold receivables) and the transferor (with respect to the non−sold receivables). The collections would be separated and placed in separate trust or lockbox accounts as they come in.

Id. See, e.g., Ronald J. Mann, Searching for Negotiability in Payment and Credit Systems, 44 Ucla L.Rev. 951, 992 (explaining "lockbox structure" is mechanism by which "the lender can limit the borrower's ability to misuse funds it receives from its business if the lender can cause the funds to be deposited directly into an account from which the borrower cannot readily obtain the funds."). See generally, U.C.C. § 4−205 and Comment (2001) (clarifying "lockbox structures" further). Back To Text

[348] See Committee, supra note 1, at 552 (asserting lockbox banks are alternative for companies that are securitizing assets). See e.g., Mann, supra note 346, at 992 (providing clear explanation of "lockbox" account). See generally U.C.C. § 4−205 and Comment (elucidating notion of "lockbox" mechanism by providing examples of such accounts). Back To Text

[349] See Committee, supra note 1, at 593 (identifying 14 factors which may militate against finding of need for substantive consolidation); see also Sarah Robinson Borders, Hot Topics with Respect to Real Estate Bankruptcy Issues, 457 PLI/Real 509, 541−43 (2000) (addressing these 14 factors); Portia Owen Morrison, Financial Covenants and Bankruptcy Remote Structures in Real Estate Loan Transactions, SE50 ALI−ABA 165, 173 (2000) (describing circumstances in which "[t]he SPV and, where applicable, parent or other affiliate, should provide [certain] 'separateness' undertakings."). Back To Text

[350] See Committee, supra note 1, at 594 (explaining SPV will prepare and maintain its own separate, full and complete books, records and financial statements."); see also Borders, supra note 348, at 541−543 (discussing factors which may militate against substantive consolidation determination); Morrison, supra note 348, at 173 (stating when "[t]he SPV and, where applicable, parent or other affiliate, should provide [certain] 'separateness' undertakings."). Back To Text

[351] See In re Vecco Constr. Indus., Inc., 4 B.R. 407, 410 (E.D.Va. 1980) (discussing "yardstick" criteria used by the courts to determine whether or not to allow consolidation); see also Eastgroup Properties v. Southern Motel Assoc., Ltd., 935 F.2d 245, 249 (11th Cir. 1991) (identifying criteria needed to be assessed when determining whether consolidation is warranted); In re Gainesville P−H Properties, Inc., 106 B.R. 304, 305−06 (Bankr. M.D. Fla. 1989) (asserting substantive consolidation may be founded upon the presence or absence of consolidated financial statements); In re Donut Queen, Ltd., 41 B.R. 706, 709 (Bankr. E.D.N.Y. 1984) (outlining factors relied upon when evaluating need for consolidation). Back To Text

[352] See Committee, supra note 1, at 594 (stating " SPV will prepare and maintain its own separate, full and complete books, records and financial statements."); see also, Borders, supra note 348, at 541−43 (identifying factors which may militate against substantive consolidation determination); Morrison, supra note 348, at 173 (describing circumstances in which "[t]he SPV and, where applicable, parent or other affiliate, should provide [certain] 'separateness' undertakings."). Back To Text

[353] See Committee, supra note 1, at 594 (asserting that "SPV will maintain a separate office (a) which if leased from its parent will be on terms no more or less favorable to the SPV than could be obtained elsewhere and (b) which will be conspicuously identified as the SPV's office so it can be easily located by outsiders."); see also Borders, supra note 348, at 541−43 (identifying factors which may militate against substantive consolidation determination); Morrison,

supra note 348, at 173 (indicating contexts within which "[t]he SPV and, where applicable, parent or other affiliate, should provide [certain] 'separateness' undertakings."). Back To Text

[354] See In Re Vecco Constr. Indus., Inc., 4 B.R. at 410 (laying out Yardstick for gauging appropriateness of consolidation); see also Eastgroup Properties, 935 F.2d at 249 (citing Vecco factors); In re Gainesville P−H Properties, Inc., 106 B.R. at 305−06 (listing seven factors upon which consolidation may be founded); In re Donut Queen, Ltd., 41 B.R. at 709 (stating decision of whether consolidation is necessary depends on balancing of equities). Back To Text

[355] See Committee, supra note 1, at 594 (stating that "the SPV will maintain a separate office (a) which if leased from its parent will be on terms no more or less favorable to the SPV than could be obtained elsewhere and (b) which will be conspicuously identified as the SPV's office so it can be easily located by outsiders."); see also Borders, supra note 348, at 541−43 (identifying factors which may militate against substantive consolidation determination); Morrison, supra note 348, at 173 (describing circumstances in which "[t]he SPV and, where applicable, parent or other affiliate, should provide [certain] 'separateness' undertakings."). Back To Text

[356] See In re Vecco Constr. Indus., Inc., 4 B.R. at 410 (stressing all seven factors need not be present); see also Eastgroup Properties, 935 F.2d at 249 (finding court inquiries necessary to determine whether consolidation yields benefits which offset the harm to objecting parties); In re Gainesville P−H Properties, Inc., 106 B.R. at 305−06; In re Donut Queen, Ltd., 41 B.R. at 709 (using Vecco factors to balance prejudice claimed by moving creditor with proposed order). Back To Text

[357] See supra note 355 and accompanying text (exemplifying factors for consideration); see also Committee, supra note 1, at 594 (asserting that "the SPV will not commingle any of its money or other assets with the money or assets of the parent or any affiliates thereof."); Borders, supra note 348, at 541−43 (identifying factors which may militate against finding of need for substantive consolidation); Morrison, supra note 348, at 173 (describing situations in which "[t]he SPV and, where applicable, parent or other affiliate, should provide [certain] 'separateness' undertakings."). Back To Text

[358] See supra note 338. Back To Text

[359] See Committee, supra note 1, at 548 (noting "when the servicer is the transferor…concerns are raised as to whether a true sale has been effected if the transferor has post transfer control over the assets or their proceeds."). See generally Major's Furniture Mart, Inc. v. Castle Credit Corp., Inc., 602 F.2d 538, 544 (3d Cir. 1979) (explaining contractual association as well as course of dealings between parties must be evaluated by court). Back To Text

[360] See Committee, supra note 1, at 552 (speculating bankruptcy issues would not exist if payments were made to servicer acting solely as SPV's agent). See e.g., In re Southern Equip. Sales Co., Inc., 24 B.R. 788, 794 (Bankr. D.N.J. 1982) (asserting "the problem of 'commingling' arises only when funds are to be traced in the debtor's hands and not the creditor's."). See generally Harris Diamond, Tracing Cash Proceeds in Insolvency Proceedings Under Revised Article 9, 9 Am. Bankr. Inst. L. Rev. 385, 393 (explaining problem of commingling). Back To Text

[361] See Schwarcz, supra note 2, at 135 (discussing necessity for independent collection agents); see also Committee, supra note 2, at 548 (noting importance of maintaining arm's length relationship between independent collection agent and servicer). Back To Text

[362] See Committee, supra note 2, at 552 (proposing "[o]ne alternative is for payments on both the sold and non−sold receivables to be collected by a third party servicer, or sent to a 'lockbox' bank, acting for both the special purpose vehicle (with respect to the sold receivables) and the transferor (with respect to the non−sold receivables)," and explaining that "[t]he collections would be separated and placed in separate trust or lockbox accounts as they come in."); see also G. Ray Warner, The Anti−Bankruptcy Act: Revised Article 9 and Bankruptcy, 9 Am. Bankr. Inst. L. Rev. 3, 84 n.449 (2001) (illustrating manner in which certain problems surrounding collection of revenue derived from income−producing device can be addressed by using lock−boxes). See generally Stephen W. Sather, Patricia L. Barsalou & Richard Litwin, Borrowing From the Taxpayer: State and Local Tax Claims in Bankruptcy, 4 Am. Bankr.

Inst. L. Rev. 201, 206 (1996) (explaining procedure for lock−box arrangement). Back To Text

[363] See Committee, supra note 1, at 594, 603 (listing 14 factors which may minimize risk of substantive consolidation determination with respect to SPV: "11. The SPV will not commingle any of its money or other assets with the money or assets of the parent or any affiliates thereof."); see also, Borders, supra note 348, at 543 (stating that "the SPV should be held out to the public as a separate and distinct entity and there should be no commingling of assets of funds with any other entity."); Morrison, supra note 348, at 173 (discussing several "undertakings" that must remain distinct between special purpose vehicle and parent or other "affiliate"). Back To Text

[364] See Committee, supra note 2, at 594, 602 (stating that financial statements must comply with "generally accepted accounting principles."); see also Borders, supra note 348, at 542 (asserting "SPV should maintain its books and records separate from the Originator or any affiliate and should prepare separate tax returns."); Morrison, supra note 348, at 173 (extending notion of distinct and separate financial records for each members of consolidated groups). Back To Text

[365] See In re Vecco Constr. Indus. Inc., 4 B.R.407, 410 (Bankr. E.D. Va. 1980) (discussing "yardstick" criteria used by courts to determine whether to allow consolidation); see also Eastgroup Properties v. Southern Motel Ass'n, Ltd., 935 F.2d 245, 249 (11th Cir. 1991) (identifying criteria needed to be assessed in determining whether consolidation is warranted); In re Gainesville P−H Properties, Inc., 106 B.R. 304, 305 (Bankr. M.D. Fla. 1989) (listing seven factors upon which consolidation may be "founded" when assessing relationships between corporations); In re Donut Queen, Ltd., 41 B.R. 706, 709−10 (Bankr. E.D. N.Y. 1984) (stating that factors relied upon in reviewing need for consolidation of corporate debtors should be evaluated within larger context of balancing "prejudice resulting from proposed order of consolidation with the prejudice the moving creditor alleges it suffers from debtor separateness."). Back To Text

[366] See Ellis, supra note 3, at 299 (discussing formation of SPV); see also Committee, supra note 2, at 27 (defining SPV as "a newly created entity with no prior business activities that could have given rise to preexisting creditors, or potential tort, environmental or other claims."); Lupica, supra note 3, at 600 (noting "SPC[']s are generally organized in one of two forms: either as a 'pay−through' entity or as a 'pass− through' entity."); Schwarcz, supra note 2 at 135 (describing procedure for identification and transfer of assets for securitization into special purpose vehicles). Back To Text

[367] See supra notes 176−91 and accompanying text; see also Dawson, supra note 11, at 400 (stating true sale transfer "legally separates the credit risk of the assets from that of the transferor."); Pantaleo, supra note 9, at 159 (defining true sale securitization as transfer of assets "in which the parties state that they intend a sale, and in which all the benefits and risks commonly associated with ownership are transferred for fair value in an arm's−length transaction…"). Back To Text

[368] See Committee, supra note 1, at 593, 602 (listing 14 factors which may minimize risk of determination of substantive consolidation of SPV; "6. The SPV will directly manage its own liabilities, including paying its own payroll and operating expenses."); see also, Borders, supra note 348, at 542 (stating "SPV should maintain its books and records separate from the Originator or any affiliate and should prepare separate tax returns."); Morrison, supra note 348, at 173 (reiterating notion of maintaining separate books and records for special purpose vehicles). Back To Text

[369] See In re Vecco Construction, 4 B.R. at 410 (describing existence of parent and intercorporate guarantees on loans as one "yardstick" used in consolidation analysis); see also Eastgroup Properties, 935 F.2d at 249 (identifying existence of parent and intercorporate guarantees of loans as factor required to establish prima facie case for consolidation); In re Gainesville P−H Properties, Inc., 106 B.R. 304, 305 (Bankr. M.D. Fla. 1989) (holding substantive consolidation may be "founded" upon, among other factors, existence of parent and intercorporate guarantees on loans); In re Donut Queen, Ltd., 41 B.R. 706, 709 (Bankr. E.D.N.Y. 1984) (same). Back To Text

[370] In most small closely held companies using a parent−subsidiary corporate structure, there will exist intercorporate guarantees on the indebtedness of the interrelated parties. Requiring these guarantees is a standard practice of

commercial finance lenders. Back To Text

[371] See Soviero v. Franklin Nat'l Bank of Long Island, 328 F.2d 446, 448 (2d Cir. 1964) (finding existence of inter−company and parent guarantees important elements in approving substantive consolidation); see also Leibowitz v. Parkway Bank & Trust Co. (In re Image Worldwide Ltd.), 139 F.3d 574, 577 (7th Cir. 1998) (discussing various types of intercorporate guarantees); In re Donut Queen, 41 B.R. at 710 (arguing guarantees given relative to one specific transaction are not evidence of commonality of business purpose between two entities). Back To Text

[372] See Committee, supra note 1, at 594, 603 (listing 14 factors which may reduce likelihood of finding of need for consolidation. "9. Neither the parent nor any affiliates thereof will guarantee debts of the SPV and the SPV will not guarantee debts of the parent or any affiliates thereof."); see also, Borders, supra note 348, at 542 (stating "SPV should not guarantee or pay the debts or obligations of the Originator or any other entity; the Originator should not guarantee or pay the debts or obligations of the SPV."); Morrison, supra note 348, at 173 (recommending parent "not guarantee obligations of the SPV, other than indemnification of certain limited obligations to underwriters."). Back To Text

[373] See Committee, supra note 1, at 549−51(discussing roles of credit enhancement and liquidity facility in transferring of assets); see also Mortensen v. AmeriCredit Corp., 123 F. Supp.2d 1018, 1021 (N.D.Tex. 2000) (explaining in order to "reduce further the risk of debt securities issued by the SPVs, AmeriCredit provides a credit enhancement either in the form of a cash reserve account or a subordinated interest."); Schwarcz, supra note 2, at 139 (asserting securities supported by credit enhancement attain higher credit ratings). Back To Text

[374] See Committee, supra note 1, at 549 (explaining "[a] necessary result of structuring a true sale is that the holders of the asset−backed securities have a risk that the special purpose vehicle will have insufficient funds to pay the asset−backed securities" and that "[t]his is dealt with by one or more forms of credit enhancement."); see also Mortensen, 123 F.2d at 1021 (illustrating reduction of risk through cash reserve accounts or subordinated interest); Teresa N. Kerr, Comment, Bowie Bonding in the Music Biz: Will Music Royalty Securitization be the Key to the Gold for Music Industry Participants?, 7 ucla ent. l. rev. 367, 380 (2000) (arguing "credit enhancement also protects the originator's assets from default in payment by creating alternate lines of credit."). Back To Text

[375] See Committee, supra note 1, at 551 (observing "[u]nlike credit enhancers, liquidity providers are not intended to take credit risk", but "[r]ather they are merely advancing funds against an assured, but not yet collected, cash flow."). But see Robert B. Miller, Future Shock: Mortgage Securitization in Bankruptcy, 2000 ABI Jnl. 105 (2000) (illustrating certain bankruptcy protections do not make sense for securitized interests). Back To Text

[376] See In re Gainesville P−H Properties, Inc., 106 B.R. 304, 305 (Bankr. M.D. Fla. 1989) (stating substantive consolidation may be founded upon transfer of assets without observance of corporate formalities among other factors); In re Donut Queen, Ltd., 41 B.R. 706, 709 (Bankr. E.D.N.Y. 1984) (noting upon consideration for motion to consolidate, transfer of assets without observance of corporate formalities is one factor that must be weighed); In re Vecco Constr. Indus. Inc., 4 B.R. 407, 410 (Bankr. E.D. Va. 1980) (finding transfer of assets without observance of corporate formalities proper foundation upon which to allow "proceedings to be consolidated.)." Back To Text

[377] See Committee, supra note 1, at 559 (discussing manner in which some courts compare "benefits of substantive consolidation . . . with the prejudice to any third−party that justifiably relied on the separateness of the entity with which it dealt."); Ellis, supra note 3, at 323 (stating "isolation" of certain assets enables SPVs to be treated more independently). Back To Text

[378] See Committee, supra note 1, at 593, 602 (listing 14 factors which may preclude determination of substantive consolidation of SPV. "4. Decisions with respect to the SPV's business and daily operations will be independently made by the SPV and will not be dictated by its parent or any affiliates thereof."); see also Borders, supra note 348, at 542 (stating SPV should operate as separate entity in eyes of public); Morrison, supra note 348, at 173 (asserting SPV should be viewed by public as separate entity from its parent corporation). Back To Text

[379] See Committee, supra note 1, at 593, 602 (listing 14 factors which may preclude finding of need for consolidation of SPV: "1. A specified percentage (at least one−fourth…) of the directors of the SPV will be independent directors.");

see also Borders, supra note 348, at 542 (stating independent director should be appointed, and should not be affiliated with the Originator); Morrison, supra note 348, at 173 (asserting necessity of an outside director "not affiliated with the parent or any of its affiliates."). Back To Text

[380] See Committee, supra note 1, at 593, 602 (listing 14 factors which may diminish risk of substantive consolidation analysis of SPV; "2. The Board of Directors and stockholders of the SPV will hold all regular meetings appropriate to authorize corporate action."); see also, Borders, supra note 348, at 541 (discussing role of independent director); Morrison, supra note 348, at 173 (observing regular board meetings must be held to approve SPV activities). Back To Text

[381] See Committee, supra note 1, at 593, 602 (listing 14 factors which may minimize risk of substantive consolidation of SPV; "2. A quorum of the board of directors will be present in person, and not by means of conference telephone or similar communications equipment, at least one meeting each year."). Back To Text

[382] See id. at 602 (listing 14 factors which may reduce risk of substantive consolidation of SPV; "2. Complete minutes of all Board of Director and stockholder meetings will be kept by the SPV."). Back To Text

[383] See id. (listing 14 factors which may preclude substantive consolidation of SPV; "3. The SPV will have sufficient officers and personnel to run its business operations."); see also, Borders, supra note 348, at 544 (discussing employee allocation); Morrison, supra note 348, at 173 (suggesting all employees shared with affiliates should be "allocated and charged."). Back To Text

[384] Committee, supra note 1, at 593, 602 (listing 14 factors to which may preclude substantive consolidation of SPV; "5. The SPV will act solely in its own corporate name and through its own authorized officers and agents."); see also, Borders, supra note 348, at 541−43 (stressing importance of presenting SPV to public as separate and distinct); Morrison, supra note 348, at 173 (suggesting SPV be held out to public as separate entity). Back To Text

[385] Committee, supra note 1, at 595 (stating limitations on activity of SPV should be in Articles of Incorporation). Back To Text

[386] See Committee, supra note 3, at 598−99 (explaining circumstances in which consolidation has been ordered by courts); Borod, supra note 3, at 7−18 (stating same). See generally Soviero v. Franklin Nat'l Bank of Long Island, 328 F.2d 446, 448 (2d Cir. 1964) (discussing assertion that affiliates are instrumentalities of bankrupt). Back To Text

[387] See Eastgroup Properties, 935 F.2d at 251 (finding cost−benefit analysis must be conducted to determine advisability of consolidation); In re Auto−Train Corp., Inc., 810 F.2d at 276 (cautioning "[b]efore ordering consolidation, a court must conduct a searching inquiry to ensure that consolidation yields benefits offsetting the harm it inflicts on objecting parties."); In re Snider Bros., 18 B.R. at 237 (observing consolidation involves showing of corporate interrelationship and also possibility of harm); In re Flora Mir Candy Corp., 432 F.2d at 1062 (suggesting limited use of consolidation because of possibility of unfair treatment of creditors). Back To Text

[388] See In re Augie/Restivo Baking Co., Ltd., 860 F.2d 515, 518 (2d Cir. 1988); see also Eastgroup Properties, 935 F.2d at 248 (stating purpose of consolidation is "to insure equitable treatment of all creditors."). See generally Gilbert, supra note 276, at 208 (describing substantive consolidation as bankruptcy's equitable remedy). Back To Text

[389] See In re Snider Bros., Inc., 18 B.R. 230, 234 (Bankr. D. Mass. 1982); In re RaeJean Bonham 226 B.R. 56, 81−82 (Bankr. D. Ala. 1998) (stating same); In re Worley Grain Co., 28 B.R. 564, 567 (Bankr. D. Idaho 1983) (stating same). Back To Text

[390] See Eastgroup Properties, 935 F.2d at 249 (finding before ordering substantive consolidation, "a court must conduct a searching inquiry to ensure that consolidation yields benefits offsetting the harm it inflicts on the parties.'"); In re Auto−Train, 810 F.2d at 276 (stating same); In re Snider Bros., 18 B.R. at 237 (stating same); In re Flora Mir Candy Corp., 432 F.2d at 1062 (stating same). Back To Text

[391] See Eastgroup Properties, 935 F.2d at 250 (stressing "the specific factors set out in Vecco, Ouimet and elsewhere [are only] examples of information that may be useful to courts charged with deciding whether there is a substantial identity between the entities to be consolidated and whether consolidation is necessary to avoid some harm or to realize some benefit."); In re Munford, 115 B.R. at 395 (noting "the Circuit Court considered the long list of factors justifying consolidation which were enumerated by the various courts that have adjudicated the issue and boiled its analysis down to two apparently alternate factors…"). See generally Union Savings Bank, 860 F.2d at 518 (determining examination of many factors from past cases has led to development of two particularly compelling factors). Back To Text

[392] See Gilbert, supra note 276, at 216 (stating courts may disregard some factors to furnish equitable relief through consolidation); Charles M. Tatelbaum, The Multi−Tiered Corporate Bankruptcy and Substantive Consolidation−−Do Creditors Lose Rights and Protection?, 89 Com. L.J. 285, 288 (1984) (noting although courts may disregard some factors, majority of factors are necessary to sustain burden of proof for consolidation); see also In re Augie/Restivo Baking Co., Inc., 84 B.R. 315, 321 (Bankr. E.D.N.Y. 1984) (stating "[c]ourt must determine what equity requires."). Back To Text

[393] See Munford, Inc. v. TOC Retail, Inc. (In re Munford, Inc.), 115 B.R. 390, 395 (Bankr. N.D. Ga. 1990); see also Union Savings Bank, 860 F.2d at 518 (noting two critical factors should be examined to determine whether equitable treatment will result from substantive consolidation). Back To Text

[394] See supra note 392 and accompanying text. See generally Chemical Bank New York Trust Co. v. Kheel, 369 F.2d 845, 847 (2d Cir. 1966) (demonstrating where interrelationships are "hopelessly obscured" consolidation should be used). Back To Text

[395] See Eastgroup Properties v. Southern Motel Assoc., Ltd., 935 F.2d 245, 250 (11th Cir. 1991); In re Auto−Train Corp., 810 F.2d at 276 (cautioning "[b]efore ordering consolidation, a court must conduct a searching inquiry to ensure that consolidation yields benefits offsetting the harm it inflicts on objecting parties."); In re Snider Bros., 18 B.R. at 237 (asserting consolidation involves showing of corporate interrelationship and also possibility of harm). Back To Text

[396] See supra notes 6, 55 and accompanying text (discussing manner in which securitization should be structured to accomplish "bankruptcy−proofing" objectives). Back To Text

[397] See supra notes 6, 90, 102 and accompanying text (describing precautionary steps which ought to be taken to maximize likelihood of creating "bankruptcy−proof" entity). Back To Text

[398] See supra note 127 and accompanying text (noting importance of minimizing number of creditors of SPV). Back To Text

[399] See supra note 131 and accompanying text (stressing importance of minimizing activities of SPV). Back To Text

[400] See supra notes 81, 129 and accompanying text (cautioning against allowing SPV to incur more than minimum of debt). Back To Text

[401] See supra note 11 and accompanying text (noting factors taken into account by creditors of and investors in SPV). Back To Text

[402] See generally Derrick Allen Dyer, The Impact of Dilution in Asset Securitization: Commercial Separation Anxiety, 66 Miss. L. J. 407, 416 (1996) (suggesting when SPV purchases income−generating assets, separation from originator should occur). Back To Text

[403] See supra notes 7, 14, 32, 44, 80 and accompanying text (describing as precautionary many of steps taken to create effective SPV). Back To Text

[404] See Ellis supra note 3, at 299 (discussing consequences of "monetizing" financial assets through secured financing); Lupica, supra note 3, at 609 (noting "[b]y definition, the process of securitization transforms future payments into instant cash."); see also Committee, supra note 3, at 532 (stating same); Borod, supra note 3, at 1−7 (stating same). Back To Text

[405] See In re Vecco Constr. Indus., Inc., 4 B.R. 407, 411 (Bankr. E.D. Va. 1980) (quoting Soviero v. Franklin National Bank of Long Island, 328 F.2d 446, 448 (2d Cir. 1964)). See generally Consol. Sun Ray, Inc. v. Oppenstein, 335 F.2d 801, 806 (11th Cir. 1964) (explaining when subsidiary is mere instrumentality and parent corporation uses it for an improper purpose, then no separate corporate entity exists). Back To Text

[406] See In re Vecco Constr. Indus., Inc., 4 B.R. 407, 411 (Bankr. E.D. Va. 1980) (citing In re Gulfco Inv. Corp., 593 F.2d 921, 928 (10th Cir. 1979)). Back To Text

[407] See supra, note 116 and accompanying text. Back To Text

[408] See In re Gulfco Inv. Corp., 593 F.2d 921, 928 (10th Cir. 1979); Soviero v. Franklin National Bank of Long Island, 328 F.2d 446, 448 (2d Cir. 1964). Back To Text

[409] See supra notes 105, 121 and accompanying text. Back To Text

[410] See Eastgroup Properties, 935 F.2d at 251 (holding court must conduct cost−benefit analysis before making finding that consolidation is mandated); In re Auto−Train, 810 F.2d at 276 (cautioning "[b]efore ordering consolidation, a court must conduct a searching inquiry to ensure that consolidation yields benefits offsetting the harm it inflicts on objecting parties."); see also In re Flora Mir Candy Corp., 432 F.2d at 1062 (stating same); In re Snider Bros., 18 B.R. at 237 (stating same). Back To Text

[411] See supra note 409 and accompanying text (advocating cost−benefit analysis by court before arriving at finding of need for substantive consolidation). Back To Text

[412] See Eastgroup Properties v. Southern Motel Assoc., Ltd., 935 F.2d 245, 249 (11th Cir. 1991) (citing In re Auto−Train, 810 F.2d 270, 276 (D.C. Cir. 1987)); In re Lewellyn, 26 B.R. 246, 252 (Bankr. S.D. Iowa 1982); In re Snider Bros., 18 B.R. 230, 238 (Bankr. D.Mass. 1982). Back To Text

[413] See Eastgroup Properties, 935 F.2d at 249 (quoting In re Lewellyn, 26 B.R. at 251−52 (Bankr. S.D. Iowa 1982)); see also 11 U.S.C. § 302(b) (1994) (requiring courts to combine assets and liabilities into one pool to pay creditors). Back To Text

[414] See Eastgroup Properties, 935 F.2d at 249 (citing In re Auto−Train, 810 F.2d at 276); In re Lewellyn, 26 B.R. at 252; In re Snider Bros., 18 B.R. at 238. Back To Text

[415] See Lupica, supra note 2, at 610 (observing "individuals and institutional investors who would not ordinarily invest in an originator directly may be willing to invest in that originator's asset−backed securities."); Committee, supra note 1, at 530 (noting "[i]f an entity has assets that can be segregated as a legal matter, it may be able to use structured financing techniques to obtain financing it would not otherwise be able to obtain or at a cost that would not otherwise be available to it."). Back To Text

[416] See Schwarcz, supra note 2, at 136 (asserting "investors…are concerned only with the cash flows coming due on these receivables, and care little about the originators financial condition."); see also Dawson, supra note 11, at 383 (same); Lupica, supra note 2, at 613 (same). Back To Text

[417] See id. (observing "an originator can obtain this lower effective rate because the capital markets do not consider its creditworthiness in pricing the rate of return for securitization of a firm's receivables", and that, instead, "the quality of the underlying assets determines the rate."); see also Dawson, supra note 11, at 383 (asserting "relying on the insulation of assets in structured financings, [the rating agency] is able to base its ratings of securities on the

creditworthiness of the isolated assets, without regard to the creditworthiness of the original owner of the assets."). Back To Text

[418] See infra note 418 and accompanying text (discussing importance of creditor reliance in substantive consolidation analysis). Back To Text

[419] See Eastgroup Properties, 935 F.2d at 249 n.11 (quoting In re Snider Bros., 18 B.R. at 235, 237−38(Bankr. D. Mass. 1982)); see also In re Auto−Train, 810 F.2d at 276 (D.C. Cir. 1987) (applying reasonableness doctrine into harm inquiry). Back To Text

[420] See 11 U.S.C. § 362 (1994) (providing automatic stay of all attempts to obtain or encumber assets and interests of estate as of petition date); see also id. § 1301 (listing requirements for stay of action against codebtor); Fed. R. Bankr. P. 4001 (explaining manner in which relief may be obtained from stay). Back To Text

[421] These are two of the factors considered by the rating agencies. See Dawson, supra note 11, at 382−83 (concluding "[t]he rating of a security, then, is based on the general creditworthiness of the issuer, the probability of the issuers default, and the value of any assets or other credit enhancement that support the rated issue…" and observing "[t]he degree of rating enhancement will depend generally on the probability of default by the issuer and the ultimate recovery on the assets pledged as collateral, including some assessment of the timing of recovery."). Back To Text

[422] 11 U.S.C. § 363 (1994); see also id. § 541 (providing broad definition of property of estate); Fed. R. Bankr. P. 6004 (prescribing rules governing use, sale, or lease of property of estate). Back To Text

[423] 11 U.S.C. § 364(1994); see also id. § 503 (b) (allowing administrative expense priority to those costs and expenses deemed actual and necessary in preserving assets of estate); id. § 1304 (providing authorization for trustee to operate business of individual debtor with regular income seeking adjustment to debt repayment schedule and balances). Back To Text

[424] 11 U.S.C. § 361 (1994) provides:

When adequate protection is required under section 362, 363, or 364 of this title of an interest of an entity in property, such adequate protection may be provided by−−

(1) requiring the trustee to make a cash payment or periodic cash payments to such entity, to the extent that the stay under section 362 of this title, use, sale, or lease under section 363 of this title, or any grant of a lien under section 364 of this title results in a decrease in value of such entities interest in such property;

(2) providing to such entity an additional or replacement lien to the extent that such stay, use, sale, or lease, or grant results in a decrease in the value of such entities interest in such property; or

(3) granting such other relief, other than entitling such entity to compensate allowable under section 503(b)(1) of this title as an administrative expense, as will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property.

Id.; see also id. §§ 362, 363, 364 (explaining, in greater detail, exceptions to section 361). Back To Text

[425] See generally Lawrence R. Ahren, "Workouts" Under revised Article 9: A Review of Changes and Proposals for Study, 9 Am. Bankr. Inst. L. Rev. 115 (2001) (proposing changes to be made in structuring of SPVs); Lois P. Lupica, Revised Article 9, Securitization Transactions and the Bankruptcy Dynamic, 9 Am. Bankr. Inst. L. Rev. 115 (2001) (same). Back To Text