American Bankruptcy Institute Law Review

Volume 9 Number 1 Spring 2001

THE LIMITED SECURITY INTEREST IN NON−ASSIGNABLE COLLATERAL UNDER REVISED ARTICLE 9

Thomas E. Plank [1]

Revised Article 9 [2] expands the ability of secured parties to take security interests in debtors' assets. Section 9−408 is one instance of this expansion. [3] Section 9−408 allows a secured party to take a limited security interest in certain non−assignable intangible assets, such as franchise agreements, licenses, and permits. These intangible assets, which I call "Limited Intangibles," consist of contract or other rights granted to the debtor by a third party, whom I call the "Related Party." Either the underlying agreements or state or federal law may prohibit or condition the assignability of the Limited Intangibles to protect the interests of the Related Party in controlling the particular identity of the debtor as a party to the Limited Intangible. Under prior law, obtaining an enforceable, perfected security interest in a Limited Intangible was uncertain, difficult, and costly. [4]

Section 9−408 remedies this shortcoming in the law by allowing a debtor to grant a security interest in its Limited Intangibles to obtain lower cost secured financing while protecting the interests of the Related Party. Specifically, section 9−408 provides that restrictions on the assignment of a Limited Intangible (1) do not prevent the attachment of a security interest to the Limited Intangible but (2) remain effective to prevent the secured party from enforcing its security interest directly against the Limited Intangible by compelling its sale in the event of default or adversely affecting the Related Party. The effect of this section is to permit at minimum the creation of (a) a present security interest in the proceeds of a future permitted sale of the Limited Intangible and (b) a present security interest in the value of the Limited Intangible, if not the Limited Intangible itself. [5]

In many circumstances, section 9−408 only makes explicit a result that is implicit in prior Article 9. [6] Under prior Article 9, courts had begun to recognize a presently existing security interest in the proceeds of the sale of a property item that was not otherwise assignable without the consent of a third party. [7] Section 9−408, however, also sanctions a limited security interest that was not possible under prior Article 9. Revised Article 9 now applies to the sale of promissory notes and payment intangibles [8] and now explicitly applies to the sale of health−care− insurance receivables. [9] Consistent with this expansion of Article 9, section 9−408 now explicitly allows a buyer to obtain a limited ownership interest in certain non−assignable Limited Intangibles.

The drafters recognized that this section may have a substantial effect upon the debtor and its other creditors if the debtor became a "debtor" under the Bankruptcy Code. [10] One effect is to preserve a security interest in the proceeds from a post−petition sale of the Limited Intangible in the bankruptcy case. The second effect is to require that the secured party's security interest in the non−assignable Limited Intangible be valued in the bankruptcy proceeding at its going concern value.

The expansion of Revised Article 9 to allow the creation of a limited security interest in non−assignable Limited Intangibles raises two questions. One is whether this expansion is desirable. [11] Although this article does not address this question, it is worth noting that section 9−408 reflects the continuing development of commercial law since the nineteenth century to produce new legal devices to meet the needs of new kinds of businesses and to allow those new businesses to obtain the capital necessary for their operation and growth. [12] One of these developments has been the gradual removal of the old common law barriers to the assignment of choses in action [13] and the gradual limitation on

enforcing anti−assignment clauses by courts [14] and legislatures. [15] Section 9−408 continues this trend by making financing more readily available to those businesses today whose value depends not just on owning traditional assets but also on using a particular Limited Intangible. [16]

This Article analyzes whether section 9−408 will be successful and, most importantly, successful when a debtor enters bankruptcy. I conclude that section 9−408 should be successful. The analysis also shows that section 9−408 is not a radical extension of Article 9 but instead represents a specific application of basic principles underlying Article 9 as well as basic concepts of property law.

The Operation of Section 9−408

Introduction

The Limited Intangibles to which Section 9−408 applies consist of a promissory note, [17] a health−care−insurance receivable, [18] a payment intangible, [19] and a general intangible [20] other than a payment intangible, "whether a contract, permit, license, or franchise." [21] Each of these Limited Intangibles involves a Related Party: either an obligor on the promissory note or an account debtor who owes any duties to the debtor. [22] Because agreements or applicable law may prohibit or restrict the assignment of Limited Intangibles, subsection (a) of section 9−408 invalidates agreements, [23] and subsection (c) invalidate laws and regulations, [24] that would impair the creation, attachment, or perfection of a security interest in most Limited Intangibles or that would make such creation, attachment, or perfection a default or a termination under most Limited Intangibles. [25]

The blanket invalidation of anti−assignment restrictions in subsections (a) and (c) could adversely affect the interests of the Related Party, such as a governmental body that grants a liquor license or other license, an insurance company obligated to pay a health−care−insurance receivable, the licensor of software, or the franchisor under a franchise agreement. [26] To protect the Related Party, subsection (d) of 9−408 takes away some, but not all, of what subsections (a) and (c) give. Subsection (d) provides that, to the extent that the agreements or laws described in subsections (a) and (c) would otherwise prohibit the creation of a security interest in the Limited Intangibles, the security interest permitted by those subsections:

(i) is not enforceable against the Related Party, does not impose a duty on the Related Party, and does not require the Related Party to recognize the security interest, to render payment or performance to the secured party, or to accept payment or performance from the secured party; and

(ii) does not entitle the secured party to use or assign the debtor's rights under the Limited Intangible, to use any confidential information of the Related Party, or to enforce the limited security interest. [27]

The operative subsections of section 9−408 contain an additional complexity. By its express terms, section 9−408 permits a limited "security interest" in the Limited Intangibles. By definition, a "security interest" is more than a true security interest, as commonly understood. [28] A "security interest" includes the ownership interest of the buyer of accounts, chattel paper, payment intangibles, and promissory notes. [29] Accordingly, section 9−408 authorizes the creation of a limited "ownership interest" in those Limited Intangibles whose sale is governed by Article 9: a promissory note, a health−care−insurance receivable (included in the definition of an "account"), and a payment intangible. Accordingly, to have a complete understanding of how section 9−408 operates, I distinguish true security interests in Limited Intangibles and true sales of Limited Receivables.

Assignments of Limited Intangibles for Security

Section 9−408 allows an assignment of a Limited Intangible for security but limits the secured party's direct remedies against the Limited Intangible to the extent provided by an anti−assignment provision applicable to the Limited Intangible. The primary effect of Section 9−408 is to preserve the secured party's interests in the proceeds of any sale by the debtor of the Limited Intangibles and also to prevent a sale or assignment of the Limited Intangibles by the debtor that is not unauthorized by the secured party but that is authorized by the Related Party. It also preserves the secured party's priority over other secured parties or lien creditors.

Section 9−408, however, does not apply equally to all Limited Intangibles to abrogate anti−assignment provisions imposed by law and those imposed by agreement. Subsection (a) of section 9−408 invalidates anti−assignment provisions imposed by law for all Limited Intangibles. It also preserves the secured party's priority over other secured parties or lien creditors. In this regard, section 9−408(c) mirrors section 9−406(f), which invalidates any law that restricts the assignment of chattel paper and accounts, other than health−care−insurance receivables. [30] Section 9−406(f) is an expansion of section 9−318(4) of prior Article 9, which only invalidated provisions in an agreement that prevented the assignment of accounts and the assignment for security of general intangibles for the payment of money due or to become due. [31]

Subsection (a) of section 9−408, which abrogates contractual anti−assignment provisions, applies to a smaller set of Limited Intangibles. Preliminarily, subsection (a) does not apply to an assignment for security of a payment intangible or a promissory note; it only applies to a sale of a payment intangible or a promissory note. [32] Instead, section 9−406(d), which is an expanded successor to section 9−318(4) of the prior Article 9, invalidates contractual anti−assignment provisions in an assignment of a payment intangible or promissory note for security. [33]

Section 9−408(a) does invalidate contractual anti−assignment provisions in the case of the assignment for security of a non−payment intangible, that is, a general intangible other than a payment intangible. Furthermore, section 9−408(a) invalidates any contractual anti−assignment provision for a health−care−insurance receivable. [34] Although a health−care−insurance receivable is an account, [35] section 9−406(d) excludes all assignments of health−care−insurance receivables. [36] The inclusion of health−care−insurance receivables in section 9−408 reflects both (a) the expanded definition of "account" in Revised Article 9 to include a health−care−insurance receivable and other obligations for the payment of money that were general intangibles under prior Article 9 [37] and (b) a decision to respect the contractual limitations on the assignment of a health−care−insurance receivable to protect the interest of a Related Party.

To summarize, in the case of an assignment for security, section 9−408(c) invalidates anti−assignment provisions imposed by law for all Limited Intangibles, and section 9−408(a) invalidates contractual anti−assignment provisions for non−payment intangibles and health−care−insurance receivables. At the same time, section 9−408(d) limits the secured party's remedies against these Limited Intangibles to the extent provided by the applicable anti−assignment provision. The following hypothetical illustrates how section 9−408 would apply to a true security interest in a Limited Intangible.

Assume the following facts: Company D has obtained a franchise from municipality R to operate the local television cable system. Either the agreement or applicable state law prohibits assignment of D's rights under the agreement without R's consent. Lender SP1 has made a loan to D to fund its activities, including start−up costs, and takes a first priority, properly perfected security interest in all of D's goods, accounts, and general intangibles to secure the loan, including its rights under the franchise agreement. [38] R has not consented to this security agreement. The value of D's assets, including the value of the rights under the franchise agreement, is at all times $100, the value of the rights under the franchise agreement is at all times $50, the value of the remaining assets is at all times $50, and SP1's loan is at all times $70. The $50 value of the franchise represents the difference between the value of company D, measured as the present value of D's projected future earnings under the franchise agreement, less the value of the goods, accounts, and other general intangibles owned by D. [39] If the grant of the security interest in the franchise agreement were valid, SP1 would be an oversecured creditor, having a secured debt of $70 secured by D's $100 in assets. If the grant of the security interest in the franchise agreement were not valid, SP1 would be an undersecured creditor, having a total debt of $70 consisting of a secured debt of only $50 secured by the value of D's goods, accounts, and general intangibles other than the franchise agreement and having an unsecured debt of $20. [40]

D later borrowed $20 from another lender, SP2, and granted to SP2 a properly perfected, second priority security interest in all of D's property, including the rights under the franchise agreement. [41] If the grant of the security interest in the franchise agreement were valid, SP2 would have a secured debt of $20 secured by D's $30 equity interest in its assets. If the grant of the security interest in the franchise agreement were not valid, SP2 would have only an unsecured debt of $20.

Still later, D encounters financial difficulty. With R's consent but without SP1's or SP2's consent or knowledge, D sells its entire business, including its rights under the franchise agreement, to another established cable company B for $100. D receives a check for the purchase price, and the check is now D's only asset. Just before the sale of its business, D suffered a judgment for $45. Immediately after the sale, the judgment creditor levies on the check.

The following legal conclusions follow from the assumed facts. If SP1's security interest in the franchise agreement is recognized, SP1 will be paid its entire debt–$70–out of the check from B, which is proceeds of the property sold to B. [42] SP2 will also be paid its debt of $20 out of the check as proceeds of SP2's collateral. The judgment creditor will be paid $10 of its $45 judgment. [43] On the other hand, if neither SP1's nor SP2's security interest in the franchise agreement is recognized, out of the $100 check from B, SP1 will be paid $50 of its secured debt first, the judgment creditor will then be paid $45 out of the check, [44] and SP1 and SP2 as unsecured creditors will seek to be paid first out of the remaining $5. D could chose whom to prefer and pay either SP1 or SP2. Accordingly, the effectiveness of the limited security interest in the franchise agreement has a substantial effect on SP1, SP2, and the judgment creditor.

SP1 could in fact be worse off if its security interest in the franchise agreement is not valid and SP2 had received the consent of municipality R to its security interest. Such consent would presumably make SP2's security interest in the franchise agreement effective. In this way, SP2–the later lender and the later filer–could achieve priority over SP1 for its $20 and the judgment creditor for $30 of its $45 claim, and leave SP1 with an unsecured and uncollectible debt of $20. In sum, SP1 would collect $50 of its secured debt, SP2 would collect its $20 secured debt, the judgment creditor would collect $30 of its $45 judgment, SP1 would lose $20, and the judgment creditor would lose $15.

If SP1's security interest in the franchise agreement were not effective, SP1 could still try to protect itself by taking a security interest in any receipts from a permitted assignment of the franchise agreement. If the security interest in the franchise is not effective, the security interest in the receipts would be after acquired property and not proceeds. The practical effectiveness of a security interest in the receipts as after acquired property is limited. If the receipts were in the form of money, SP1 can only perfect a security interest by possession. [45] The receipts will more likely be in the form of collateral in which a security interest could be perfected by filing, such as an account, a payment intangible, investment property, or an instrument, [46] or by control, as in the case of a deposit account. [47] If so, SP1 could obtain a perfected security interest in those receipts, and as the first to file would achieve priority over SP2 and the judgment creditor. [48] However, most of those receipts will be very liquid–investment securities, a deposit account, and instruments in the form of either checks or promissory notes–and therefore, even if SP1 were to obtain a perfected security interest in such receipts, its security would be more ephemeral. A bona fide purchaser of an instrument or security may easily take priority over SP1, [49] and a recipient of amounts drawn from a deposit account will take free of SP1's security interest in any deposit account. [50] SP2 has the same problem.

In either event, if the security interest in the franchise agreement were not effective, the secured party would be deprived of the most practical value of the security interest. Because SP1 has properly perfected its security interest by filing a financing statement, buyer B can (and presumably will) search the appropriate filing offices and learn of SP1's interests. If SP1's secured debt is not paid in full, SP1's security interest continues in any collateral transferred to B. [51] To ensure that it receives the collateral free of any claims of a prior secured party or other purchaser, [52] B will insist that it pay SP1 directly. Similarly, because it will learn of SP2's security interest, it will insist on paying SP2 directly.

D and the judgment creditor will insist, however, that B only pay SP1 and SP2 the amount of each's secured debt. If the security interests in the franchise agreement are valid, then B must pay SP1 $70 and SP2 $20 to protect its own interests. If SP1's and SP2's security interests in the franchise agreement are not valid, those security interests will not continue in the rights under the transferred franchise agreement. B need only pay SP1 $50, and need not pay SP2 anything. Accordingly, the effectiveness of SP1's and SP2's security interest against future purchasers, including future secured lenders, provides considerable practical protection to SP1's and SP2's ability to receive payment of each's secured debt. This protection is not available even if SP1 and SP2 can obtain a perfected security interest in the receipts from the sale of the franchise agreement.

The effectiveness of SP1's and SP2's security interests in the franchise agreement will also determine how much SP1 and SP2 get paid if D files for bankruptcy. Assume that, instead of D selling its assets to a buyer, D files a chapter 11 petition in bankruptcy after the judgment creditor's judgment but before the judgment creditor can levy on any of D's

property. If SP1's security interest is effective under non−bankruptcy law, SP1 will have a secured claim of $70 in the bankruptcy case. [53] SP1 is entitled to adequate protection of its claims. [54] Because the value of the collateral–the franchise agreement and the other assets–is $100, SP1 will be entitled to interest on its $70 claim until it has accrued $30 in interest. [55] If D as debtor in possession is able to assume the franchise agreement and reorganize, [56] any confirmed reorganization plan must provide SP1 with the present value or the "indubitable equivalent" of $70 plus accrued interest. [57] Moreover, if the debtor as a debtor in possession or a bankruptcy trustee (if the chapter 11 were converted to a chapter 7 or the initial filing were a chapter 7) were to sell its interests in the franchise agreement, SP1 would also be entitled to receive the full amount of its claim, including interest accrued. [58] SP2 would also have a secured claim for $20 and would be entitled to similar protection of its interests, unless the interest that accrues on SP1's claim causes its claim to exceed $80, in which case, SP2's claim would become undersecured. Of course, the declining value of D's equity–$10 less the interest that accrues on SP1'secured claim and SP2's secured claim–will be insufficient to pay the costs of administering the bankruptcy case and repaying in full the unsecured creditors. [59]

If the security interest in the franchise agreement were not effective under non−bankruptcy law, then SP1 would have a secured claim for only $50 and an unsecured claim for $20, would be entitled to protection of its secured claim only to the extent of the value of the other property of the debtor–$50–and as an undersecured creditor would not be entitled to interest on its claim. [60] SP2's claim would be completely unsecured. The value of the unencumbered franchise agreement–$50–would be used to pay the costs of administering the bankruptcy case [61] and the remainder would be divided pro−rata among all of the unsecured creditors: SP1's claim for $20, SP2's claim for $20, the judgment creditor's claim for $45, and all other unsecured creditors for their claims.

If SP1's and SP2's security interest in the franchise agreement were not effective under non−bankruptcy law, but SP1 and SP2 had a security interest in receipts from a permitted assignment of the franchise agreement, their security interest would not be effective in bankruptcy. Under section 552(a) of the Bankruptcy Code, property acquired by the estate after the commencement of the case is not subject to any security interest resulting from a security agreement entered into by the debtor before the commencement of the case. [62] There is one exception. If the pre−petition security agreement extends to proceeds of collateral subject to a pre−petition security interest, the secured party's security interest will extend to proceeds received by the bankruptcy estate after the commencement of the case. [63]

If SP1's and SP2's security interest in the franchise agreement were effective under non−bankruptcy law, the receipts from a permitted assignment of the franchise agreement would be proceeds subject to a pre−petition security interest. If SP1's and SP2's security interest in the franchise agreement were not effective under non−bankruptcy law, however, the receipts from a permitted assignment of the franchise agreement would not be proceeds subject to a pre−petition security interest but would be property received by the bankruptcy estate after the commencement of the case. Accordingly, SP1's and SP2's security interest in the receipts as after acquired property and not as proceeds would be disallowed by the general rule of section 552(a), and not be saved by the exception for proceeds of pre−petition collateral.

Further, even if SP1 and SP2 could obtain a security interest in any receipts from a permitted assignment of the franchise agreement or could obtain payment of their debts before D files for bankruptcy, the security interest or the payment would be subject to avoidance as a preference. Any security interest in the receipts would be a security interest in after acquired property and not proceeds of the underlying franchise agreement. Therefore, SP1 and SP2 would receive a perfected security interest in the receipts when D has rights in the receipts. [64] If D files for bankruptcy within 90 days of the date on which SP1 and SP2 receive a perfected security interest in the receipts or receive payment of their debts, the trustee in bankruptcy (including D as the debtor in possession) could avoid the security interest in the receipts or the payment of the debts as a preferential transfer to SP1 and SP2 on account of an antecedent debt. [65]

The preceding discussion has contemplated an assignment of a Limited Intangible as security for a payment of a debt or performance of another obligation. That Article 9 also applies to sales of most Limited Intangibles adds another level of complexity to understanding the operation of section 9−408.

Sale of Limited Intangibles

Section 9−408 permits a limited "security interest" in the Limited Intangibles. This "security interest" includes the ownership interest of the buyer of accounts, chattel paper, payment intangibles, and promissory notes. [66] By definition, section 9−408 authorizes the creation of a limited "ownership interest" (a "Limited Ownership Interest") in those Limited Intangibles that can be sold under Article 9: a promissory note, a health−care−insurance receivable (included in the definition of an "account"), and a payment intangible. I call these Limited Intangibles that can be sold Limited Receivables. Limited Receivables do not include general intangibles other than a payment intangible. Subsection (a), which abrogates contractual anti−assignment provisions, and subsection (c), which abrogates anti−assignment provisions imposed by law, apply equally to the sale of all Limited Receivables. [67]

In the case of a sale of a Limited Receivable, as in the case of an assignment of Limited Intangibles for security, section 9−408(d) limits the buyer's ownership interest in the Limited Intangible to the extent provided by the applicable anti−assignment provision to protect the interests of the Related Party. In the case of Limited Receivables, the Related Party is an obligor or account debtor who owes money, and I refer to the Related Party of a Limited Receivable as a "Related Obligor." By the terms of section 9−408(d), recast to reflect a sale instead of an assignment for security, the buyer's ownership interest in the Limited Receivable:

(i) is not enforceable against the Related Obligor, does not impose a duty on the Related Obligor, and does not require the Related Obligor to recognize the buyer's ownership interest, to render payment or performance to the buyer, or to accept payment or performance from the buyer, and

(ii) does not entitle the buyer to use or assign the seller's rights under the Limited Intangible, to use any confidential information of the Related Obligor, or to enforce the buyer's ownership interest in the Limited Intangible. [68]

Why would a buyer buy such a Limited Ownership Interest in a Limited Receivable? This answer: The value of the Limited Receivable derives primarily from the payments due under it and not from having a present right to control the Limited Receivable. [69] Allowing a buyer to perfect a Limited Ownership Interest in a Limited Receivable ensures that the buyer's ownership of the payments due under the Limited Receivable–the real value–is perfected and cannot be defeated by a permitted sale to another buyer, a pledge to a lender, the levy and execution by a lien creditor, or the filing of a bankruptcy petition. Hence, section 9−408 allows the owner of a Limited Receivable who is the obligee of the Related Obligor to unlock the value of that Limited Receivable by selling that value without disturbing the interests, deemed to be significant, of the Related Obligor.

In this regard, the buyer's motivations are similar to those who buy either interest bearing bonds or zero coupon bonds on which interest is not paid currently but added to the principal balance and paid at maturity. The value of these future rights to payment derives from expected future payments. These bonds, issued by the United States, state and local governments, and private enterprises and individuals, represent substantial assets in our economy. [70] The property interests of the buyer of a Limited Receivable are also very much like the property interest of a lessor of a property item who retains a reversion in a property item that she has leased to a tenant for a specified term. [71] The property interests of such a buyer of Limited Receivables are also similar to the property interests of a holder of a reversion or a vested remainder in a property item subject to a life estate who will not receive a present possessory interest until the death of a life tenant [72] In either case, the holders of these future interests–the reversion and the remainder–do not have possession or control over the property item but do retain the future value of the property item. At the specified point in the future, these holders will obtain possession of the property item. These future interests have long been recognized as present property interests that can be sold, devised, or inherited and that can be subjected to the claims of creditors. [73]

Survival of Limited Security Interests in Bankruptcy

The study group established by the Permanent Editorial Board of the Uniform Commercial Code to consider revision of prior Article 9 (which eventually led to the drafting and adoption of Revised Article 9) recommended that a provision like 9−408 be added to Article 9. [74] Some committee members expressed a concern that bankruptcy courts would disregard the limited security interests permitted by a provision like section 9−408 as an impermissible attempt to create a state law priority that conflicts with those established by the Bankruptcy Code. [75] This concern falls within an important principle of bankruptcy law: Bankruptcy law and bankruptcy courts will not respect special rules

designed to be effective only in the case of bankruptcy or to defeat the provisions of the Bankruptcy Code. Accordingly, a bankruptcy trustee (including a debtor in possession) could argue that a bankruptcy court should disregard the limited security interest in a Limited Intangible as an impermissible attempt to avoid the dictates of the Bankruptcy Code. In addition, a bankruptcy trustee may also argue that a limited security interest is not a true property interest and that therefore the holder of a limited security interest should be treated as an unsecured creditor. In my view, neither of these arguments provide sufficient grounds to cause a bankruptcy court to disregard a limited security interest created under section 9−408. To put these arguments in their appropriate context, I first discuss the important principle of bankruptcy law that bankruptcy courts should respect state law unless a specific provision or policy of the Bankruptcy Code requires different treatment.

The Paramount Role of State Law in Bankruptcy

Bankruptcy law provides a procedure for adjusting the relationship between an insolvent debtor and its creditors. Non−bankruptcy law, which is primarily state law, creates the debtor−creditor relationship, not bankruptcy law. In establishing an orderly procedure for liquidating or reorganizing the debtor's assets to repay its creditors, the Bankruptcy Code depends, both implicitly and explicitly, on non−bankruptcy law. For example, the principal components of property of the estate to be distributed to creditors are "all legal or equitable interests of the debtor in property" as of the filing. [76] The creditors who may participate in the bankruptcy case are entities that have a "claim," which is a "right to payment," that "arose" pre−petition. [77] The Bankruptcy Code does not define "interests of the debtor in property," "right to payment" or "arose." Non−bankruptcy law is the only source for determining these essential elements in any bankruptcy case.

Accordingly, bankruptcy law respects the property rights of the players in a bankruptcy case, including the property rights of secured creditors, [78] except for specific instances when the Code expressly overrules the property rights of creditor. [79] For example, in its 1979 decision of *Butner v. United States*, [80] the Supreme Court held that federal courts in bankruptcy should apply state law instead of a federal rule of equity in deciding whether a mortgagee has a perfected security interest in rents. [81] In this decision, the Supreme Court articulated a principle long recognized in bankruptcy law: "Property interests are created and defined by state law. Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding." [82]

Recently, the Supreme Court in *Raleigh v. Illinois Department Of Revenue* [83] quoted the *Butner* statement [84] in holding that a bankruptcy court was not free to alter the burden of proof established by a state's tax code for a tax claim against the debtor−taxpayer. The Court stated that "[b]ankruptcy courts are not authorized in the name of equity to make wholesale substitution of underlying law controlling the validity of creditors' entitlements, but are limited to what the Bankruptcy Code itself provides." [85] Therefore, a limited security interest created pursuant to section 9−408 starts with a strong presumption of validity.

The Limited Security Interest Does Not Violate Bankruptcy Policy

A bankruptcy trustee seeking to abrogate a limited security interest under section 9−408 may invoke an important principle of bankruptcy law, which I call the Non−Interference Principle, [86] that does overrule non−bankruptcy law. The Non−Interference Principle provides that neither creditors nor other parties in interest may (a) defeat the rights of a debtor or of the creditors as a collective group solely because a debtor seeks relief under the Bankruptcy Code or (b) otherwise interfere with the application of bankruptcy law. First, bankruptcy courts will generally not enforce an agreement of a debtor not to seek relief under the Code or an agreement to waive certain provisions of the Bankruptcy Code. [87]

Second, the Code overrules "ipso−facto" provisions found in non−bankruptcy law [88] and in agreements that allow the discretionary or automatic termination of the debtor's rights upon the filing of a bankruptcy petition or the occurrence of other insolvency conditions. [89] Under the Bankruptcy Code, these "ipso facto"−insolvency conditions [90] may not prevent a property interest of the debtor from becoming property of the estate [91] and may not effect a forfeiture, termination, or modification of the debtor's interests in executory contracts or leases. [92] The "ipso facto"−insolvency conditions may not prevent the trustee from using, selling, or leasing property of the estate. [93] In sum, the Bankruptcy

Code appropriately prevents a third party from using an ipso facto−insolvency clause to recapture a net benefit that it had contracted away to the debtor. [94]

Third, the Code overrules anti−assignment provisions contained in agreements or non−bankruptcy law. These anti−assignment provisions may not prevent property interests of the debtor from becoming property of the estate. [95] They may not prevent the trustee in bankruptcy from assuming and assigning executory contracts or unexpired leases between the debtor and a third party, [96] so long as the particular identity of the debtor was not an material element of the contract. [97] In addition, they may not cause the termination of the executory contract or unexpired lease. [98]

Fourth, the trustee may avoid a statutory lien on property of the debtor to the extent that such lien first becomes effective against the debtor when a case under the Bankruptcy Code or other insolvency proceeding is commenced or certain other insolvency conditions occur. [99]

Finally, federal courts in bankruptcy, like all courts, may look beyond the formalities of any legal relationship and analyze the substance of that relationship to determine if the substance violates the Non−Interference Principle. [100] Thus, federal courts will not enforce an otherwise legitimate provision in an agreement, such as a discretionary power to terminate a contract upon notice, if the other party invokes the provision solely because the debtor filed for bankruptcy. [101] Bankruptcy courts will also overrule state law attempts to alter the priorities set forth in the Bankruptcy Code. [102]

Congress has not, however, expressly abrogated the rights of the holders of a limited security interest in Limited Intangibles. Because Congress has not expressly altered those rights, bankruptcy courts must follow non−bankruptcy law unless that non−bankruptcy law violates the Non−Interference Principle. Under these constraints, the creation of limited security interests under section 9−408, whether a true security interest in a Limited Intangible or a sale of a Limited Receivable, should survive in bankruptcy.

First, by its very terms, neither section 9−408 nor any limited security interest created under section 9−408 takes effect solely because a debtor has filed for bankruptcy or is otherwise conditioned on a debtor's insolvency condition. [103] Second, there is no provision of the Bankruptcy Code that would authorize a bankruptcy court to disregard the limited security interest authorized by section 9−408.

Furthermore, a limited security interest under section 9−408 has substantial effect outside of a bankruptcy case. That section 9−408 may have a substantial effect in bankruptcy proves nothing. All security interests have substantial effect in bankruptcy. As discussed above, [104] the limited security interest (including the Limited Ownership Interest in a Limited Receivable), like all true security interests and ownership interests, protects a secured lender or a buyer against the claims of later purchasers of the collateral, other secured parties, lien creditors, and unsecured creditors outside of bankruptcy at least as much as it protects the secured party in bankruptcy. [105]

Because the creation of limited security interests under section 9−408 does not violate the Non−Interference Principle, bankruptcy courts must follow non−bankruptcy law unless the Code specifically alters the applicable non−bankruptcy rights. Congress has not expressly abrogated the rights of the holders of a limited security interest in Limited Intangibles. Therefore, the creation of limited security interests under section 9−408, whether a true security interest or a sale, should survive in bankruptcy.

The Limited Security Interest is a Substantial Property Interest

Another argument that a trustee in bankruptcy could use to disregard a limited security interest is that the limited security interest is so limited that it is not an property interest that a bankruptcy court must respect. First, to the extent provided by the anti−assignment provisions in a Limited Intangible, the limited security interest is not enforceable against the Related Party, does not impose a duty on the Related Party, and does not require the Related Party to recognize the security interest or deal with the secured party. [106] Second, the limited security interest does not entitle the secured party to use or assign the debtor's rights under the Limited Intangible or to enforce the limited security interest. [107]

These limitations, however, do not transform a limited security interest into a non−security interest. As a preliminary matter, the security interest authorized by section 9−408 is limited only to the extent of the anti−assignment provision. For example, if the only limitation is prior notice to consent of the Related Party, the secured party's enforcement will not be limited if the Related Party receives notice of and gives consent.

Even if the applicable anti−assignment provisions invoked the full limitations of section 9−408(d), the limited security interest would still be a "security interest" under the Code. The Code defines a "security interest" as a lien created by agreement. [108] A "lien" is a "charge against or interest in property to secure payment of a debt or performance of an obligation." [109] Because a security interest continues notwithstanding any sale or other disposition, [110] a limited security interest in a Limited Intangible is an interest in property. The limited security interest has all the attributes of a property interest. It has value. It can be tranferred. [111] It gives the secured party control over the Limited Intangible that excludes all the world other than the Related Party. It prevents the debtor from selling or pledging the Limited Intangible free of the secured party's interest. It also entitles the secured party to have a security interest in the proceeds of any sale. [112]

The debtor's interests in the Limited Intangible include the right to use the Limited Intangible and the right to realize the benefit from a future sale of the Limited Intangible. Any owner of a property item can separate the right to use the property item and the right to receive the future value of the property item. If the owner does so, the latter right to realize the benefit from a future sale of the property item remains a significant property interest in the hands of the owner. In the case of an owner of a Limited Intangible, the right to future sale proceeds is a presently existing future interest very much like a landlord's reversionary interest in real or personal property items leased to a tenant for a specified term. The landlord owns the property item but parts with the ability to use the property item. [113] The landlord is entitled to rent and to the return of the property item in the future. [114] Similarly, the holders of other reversions or remainders have a present property interest even though their ability to obtain any benefit from the property is postponed to a future date. [115]

The owners of these presently existing future interests should as a matter of basic property law be able to create a security interest in this right. That a debtor may have only limited rights in a property item does not defeat the grant of a security in those limited rights. Similarly, the owner of a Limited Intangible should be able to pledge or sell its right to receive proceeds from a future sale of the Limited Intangible.

That the secured party with a limited security interest in a Limited Intangible may not acquire or foreclose on the debtor's right to use the Limited Intangible should not defeat the limited security interest. [116] A secured party with a security interest in a lessor's reversionary interest in property items leased to a tenant may not acquire or foreclose on the tenant's right to use or possess the leased property. [117] This limitation does not defeat the security interest in the lessor's reversion. The secured party with a limited security interest in a Limited Intangible does effectively encumber the debtor's right to realize the benefits from the sale of the Limited Intangible just as a secured party with a security interest in the lessor's reversionary interest in property items leased to a tenant effectively encumbers the lessor's right to realize the future benefits from the sale of the leased property item.

Indeed, there are good grounds for validating a limited security interest in a Limited Intangible without section 9−408. The right of an owner of a Limited Intangible to realize the benefit from a future sale of the Limited Intangible is a sufficient right in the collateral for attachment of a security interest. [118] These rights would either be an account–"a right to payment of a monetary obligation, whether or not earned by performance, (i) for property that has been or is to be sold" [119] –or it would be a general intangible. [120] A security interest would generally be perfected in such an account or general intangible by filing.

In 1998, the Court of Appeals for the Ninth Circuit held in *MLQ Investors, L.P v. Pacific Quadracasting, Inc.* [121] held that a "creditor may obtain a security interest in the proceeds of the sale of an FCC license, and such an interest constitutes a 'general intangible' that may be perfected prior to the sale of the licence." [122] In this case, the lender perfected a security interest in the debtor's general intangibles, including a security interest in the FCC broadcasting licenses to the extent permitted by applicable law. [123] When the debtor defaulted, the lender obtained a court order appointing a receiver for the debtor, who arranged a sale of all of the assets of the debtor and obtained approval of the FCC for a transfer of the related broadcasting licences. Over the objection of the IRS, who had filed tax liens against

the debtor for unpaid taxes, the receiver paid the proceeds of the sale (which was less than the amount of debt owed) to the lender. The court of appeals upheld the priority of the secured lender's security interest over the later filed tax liens of the IRS. In doing so, it specifically stated that the proceeds of the sale were not after acquired property of the debtor and that the lender's "interest was 'in existence' and 'attached' at the time of the filing of the financing statement." [124] Other courts have also recognized that the proceeds from the sale of licenses constitute general intangibles in their own right [125] or proceeds of general intangible notwithstanding contractual or regulatory anti−assignment provisions. [126]

Most earlier cases had held that the anti−assignment policy of the FCC under the Federal Communications Act prevented a lender from taking a security interest in an FCC license. [127] A typical statement of the FCC policy was that "a broadcast license . . . is not an owned asset or vested property interest so as to be subject to a mortgage, lien, pledge, attachment, seizure, or similar property right." [128] The FCC was implementing its policy that only it, and not a secured lender, could control the licensee of an FCC license or determine who could acquire the license. In 1994, however, the FCC explicitly recognized that its responsibility for controlling the licensee did not extend to controlling the proceeds from a sale approved by the FCC. [129] The FCC decision followed a few federal court decisions that had upheld a security interest in the proceeds of an approved sale of an FCC license. [130] These cases, the FCC change in policy, and later federal cases provide solid support for the validity of a limited security interest created under section 9−408, both in and out of bankruptcy.

A true sale of a Limited Receivable should be on even stronger legal grounds. As discussed above, [131] the right to receive money in the future is a substantial property interest. The sale of a Limited Receivable conveys to the buyer a substantial property interest. Following the *Butner* principle, [132] bankruptcy courts should respect the limited ownership interest of a buyer of a Limited Receivable. Further, in my view, neither the Bankruptcy Code nor bankruptcy courts may alter the property rights of those who are not debtors or their creditors in a bankruptcy case. [133] Therefore, bankruptcy courts must respect a Limited Ownership Interest in a Limited Receivable.

Conclusion

Section 9−408 allows a secured party to take a limited security interest in a Limited Intangible, including a Limited Ownership Interest in a Limited Receivable. This limited security interest accommodates the needs of owners of a Limited Intangible to obtain lower−cost secured financing or to sell the economic value of the Limited Receivable and at the same time protect the interests of the Related Party who has an interest in controlling the identity of those with whom its deals. The limited security interest authorized by section 9−408 creates at the very least a present security interest in the proceeds of a future permitted sale of the Limited Intangible and in the value of the Limited Intangible. Section 9−408 represents, clarifies, and implements basic principles underlying both Article 9 and the more general body of property law. The limited security interest is a substantial property interest that has substantial effect both inside and outside of the debtor's bankruptcy. Bankruptcy courts should respect the limited security interest in a Limited Intangible.

FOOTNOTES:

[1] Associate Professor of Law, University of Tennessee College of Law. A.B. 1968, Princeton University; J.D. 1974, University of Maryland. I thank George Kuney and Bob Lloyd for their helpful comments on drafts of this Article. Back To Text

[2] See U.C.C. Article 9 (1999) (current official text, effective July 1, 2001). Back To Text

[3] See U.C.C. § 9−408 (1999). Back To Text

[4] See, e.g., Timothy J. Boyce, Collateralizing Nonassignable Contracts, Licenses, and Permits: Half a Loaf Is Better than No Loaf, 52 Bus. Law. 559 (1997) (discussing regulatory and other practical obstacles to perfecting security interests in contracts, licenses and permits subject to anti−assignment restrictions); Edwin E. Smith, Article 9 in Revision: A Proposal for Permitting Security Interests in Nonassignable Contracts and Permits, 28 Loy. L.A. L. Rev. 335 (1994) (describing precarious position of lender with security interest in non−assignable contracts or permits

when debtor seeks relief under Bankruptcy Code). Back To Text

[5] See Robert M. Lloyd, The New Article 9: Its Impact on Tennessee Law (Part I), 67 Tenn. L. Rev. 125, 155−56 (1999) (noting use of § 9−408 to obtain effective security interest in proceeds of sale of Limited Intangible); Ronald J. Mann, Secured Credit and Software Financing, 85 Cornell L. Rev. 134, 181 (1999) (discussing desire of lenders to obtain security interest in software to preserve claim to enterprise value that software generates). Back To Text

[6] See U.C.C. Article 9 (1995) [hereinafter U.C.C. § 9−XXX (1995)] (prior official text previously adopted in all 50 states). Back To Text

[7] See infra notes 120−125 and accompanying text (discussing several cases in which proceeds from sale of general intangibles were deemed to be either general intangibles in their own right or proceeds of general intangibles available to secured lender despite existence of any anti−assignment provisions). Back To Text

[8] See U.C.C. § 9−109(a)(3)(1999) (providing that Revised Article 9 applies to sales of accounts, chattel paper, payment intangibles and promissory notes). Back To Text

[9] Revised Article 9 has added "health−care−insurance receivable" as a new category of collateral. See U.C.C. § 9−102(a)(46) (1999) (defining "health−care−insurance receivable" to mean "an interest in or claim under a policy of insurance which is a right to payment of a monetary obligation for health−care goods or services provided"). Prior Article 9 excluded any "transfer of an interest in or claim in or under any policy of insurance" other than certain proceeds of insurance. See U.C.C. § 9−104(g) (1995). Accordingly, there was great uncertainty about whether security interest in health−care−insurance receivable could be created under prior Article 9. See, e.g., Charles E. Harrell & Mark D. Folk, Financing American Health Security: The Securitization of Healthcare Receivables, 50 Bus. Law. 47, 92−96 (1994) (observing that myriad of interpretations given to § 9−104(g) by various courts has led to uncertainty about intended scope of its exception). Revised Article 9 continues the exclusion for transfer of rights under an insurance policy other than health−care−insurance receivable. See U.C.C. § 9−109(d)(8) (1999) (providing that exclusion for insurance policies does not apply to "an assignment by or to a health−care provider of a health−care−insurance receivable and any subsequent assignment of the right to payment"). In addition, health−care−insurance receivable is now included in definition of an "account." See infra note 36 (quoting definition of "account" in U.C.C. § 9−102(a)(2) (1999)). Revised Article 9 continues to apply to the sale of accounts, see U.C.C. § 9−109(a)(3), as it has always done. See U.C.C. § 9−102(1)(b)(1995); Thomas E. Plank, Sacred Cows and Workhorses: The Sale of Accounts and Chattel Paper Under Article 9 of the U.C.C. and the Effects of Violating a Fundamental Drafting Principle, 26 Conn. L. Rev. 397, 400, 402−06 (1994) [hereinafter Plank, Sale of Accounts] (describing and criticizing how prior Article 9 incorporated "sales transaction" through use of abnormal definitions of defined terms that connote true security interests). Accordingly, Revised Article 9 now applies unambiguously to true security interest in and sale of a health−care−insurance receivable. Back To Text

[10] See U.C.C. § 9−408 cmt. 7 (1999) (stating that "Bankruptcy Code § 552 invalidates security interests in property acquired after a bankruptcy petition is filed, except to the extent that the post−petition property constitutes proceeds of pre−petition collateral"). Back To Text

[11] Some believe that security interests disadvantage unsecured creditors and some favor making bankruptcy reorganization easier for debtors, even at the expense of secured creditors. These will disapprove of this section. Others believe that allowing borrowers to choose how to use their assets, including using those assets as collateral for borrowing, maximizes social welfare, including interests of borrowers and unsecured creditors. These will approve of this section. Back To Text

[12] Particular examples include the growth of accounts receivable financing and factoring at the beginning of the twentieth century, the growth of chattle paper financing to meet the growing demands for automobiles, and the various responses, culminating in the development of the original Article 9. See 1 Grant Gilmore, Security Interests in Personal Property § 4.3, at 95−99 (1965) (discussing development of trust receipt to finance purchase of automobiles); Plank, Sale of Accounts, supra note 8, at 406−16 (describing development of factoring and accounts receivable financing under common law and accounts receivables statutes of 1940's and 1950's and identifying lack of

consistency among accounts receivable statutes as major impetus for inclusion of sales of accounts and chattel paper in Article 9); see also Daniel J. Boorstin, The Americans: The Democratic Experience, 422−27 (1974) (discussing development of installment credit first to finance purchase of automobiles and later to finance wide variety of consumer goods). Back To Text

[13] See 1 Gilmore, supra note 11, §§ 7.3−7.5, at 200−10 (describing presumed resistance to assignability of choses in action by common law courts, and developments, including abolition of separate law and equity courts, which led to erosion of this attitude). Back To Text

[14] See 1 Gilmore, supra note 11, §§ 7.6−7.9, at 210−28 (explaining that modern courts have grown increasingly reluctant to uphold validity of anti−assignment clauses, particularly where dispute is between obligor and assignee); see also Restatement (Second) of Contracts § 317 cmt. c (1981) (noting that historic common−law rule that chose in action cannot be assigned has largely disappeared). Back To Text

[15] See, e.g., U.C.C. § 2−210 (1995) (permitting assignment of contract rights for sale of goods); U.C.C. § 2A−303(3) (1995) (overriding anti−assignment provisions in case of grant by lessee or lessor of security interest in its interests under lease); U.C.C. § 9−406 (1999) (overriding anti−assignment provisions in case of assignment of accounts or chattel paper); see also infra notes 29, 32 and accompanying text (comparing § 9−406 to its predecessor section in prior Article 9 and discussing expansion of limitations on effectiveness of anti−assignment provisions in § 9−406). Back To Text

[16] See U.C.C. § 9−408 cmt. 8 (1999) (observing that § 9−408 will have greater effect outside of bankruptcy than in bankruptcy because it will enable debtors to obtain additional credit); Boyce, supra note 3, at 560 (asserting that growth of service sector and demands of information age produce greater capital needs for businesses that use Limited Intangibles, but have few traditional hard assets to collateralize); Smith, supra note 3, at 336−43 (noting increasing importance of cash flow lending for businesses whose value depends on their use of Limited Intangibles, and necessity for lenders to be able also to rely on such value). Back To Text

[17] See U.C.C. § 9−102(a)(65) (1999) (defining "promissory note" as "an instrument that evidences a promise to pay a monetary obligation, does not evidence an order to pay, and does not contain an acknowledgment by a bank that the bank has received for deposit a sum of money or funds."); id. § 9−102(a)(47) (defining "instrument" as "a negotiable instrument or any other writing that evidences a right to the payment of a monetary obligation, is not itself a security agreement or lease, and is of a type that in ordinary course of business is transferred by delivery with any necessary indorsement or assignment"). Because a promissory note must be a writing, in one sense it is not intangible. However, the promissory note simply reifies the intangible obligation of the maker, and in this sense it is an intangible. Back To Text

[18] See supra note 8 (explaining how Revised Article 9 added "health−care−insurance receivable" to types of collateral in which secured parties may take security interest). Back To Text

[19] See U.C.C. § 9−102(a)(61) (1999) (defining "payment intangible" as "a general intangible under which the account debtor's principal obligation is a monetary obligation."). Back To Text

[20] See id. § 9−102 (a)(42) (defining "general intangible" as "any personal property, including things in action, other than accounts, chattel paper, commercial tort claims, deposit accounts, documents, goods, instruments, investment property, letter−of−credit rights, letters of credit, money, and oil, gas, or other minerals before extraction. The term includes payment intangibles and software."). Id. § 9−102(a)(42). Back To Text

[21] Id. § 9−408(a), (c). Back To Text

[22] See id. § 9−102(a)(3) (defining "account debtor" as "a person obligated on an account, chattel paper, or general intangible. The term does not include persons obligated to pay a negotiable instrument, even if the instrument constitutes part of chattel paper."). Back To Text

[23] See U.C.C. § 9−408(a) (1999). Except as otherwise provided in subsection (b), U.C.C. § 9−408(a) applies to:

a term in a promissory note or in an agreement between an account debtor and a debtor which relates to a health−care−insurance receivable or a general intangible, including a contract, permit, license, or franchise, and which term prohibits, restricts, or requires the consent of the person obligated on the promissory note or the account debtor to, the assignment or transfer of, or creation, attachment, or perfection of a security interest in, the promissory note, health−care−insurance receivable, or general intangible . . . .

Id. Back To Text

[24] Section 9−408(c) applies to:

A rule of law, statute, or regulation that prohibits, restricts, or requires the consent of a government, governmental body or official, person obligated on a promissory note, or account debtor to the assignment or transfer of, or creation of a security interest in, a promissory note, health−care−insurance receivable, or general intangible, including a contract, permit, license, or franchise between an account debtor and a debtor . . . .

Id. Back To Text

[25] 4 See U.C.C. § 9−408(a), (c) (1999) stating that the agreement or law is ineffective to the extent that it:

(1) would impair the creation, attachment, or perfection of a security interest; or

(2) provides that the assignment or transfer or the creation, attachment, or perfection of the security interest may give rise to a default, breach, right of recoupment, claim, defense, termination, right of termination, or remedy under the promissory note, health−care−insurance receivable, or general intangible.

Id. Back To Text

[26] One must use care in deciding who is a Related Party for a Limited Intangible. To the extent that the debtor is a licensor or franchisor entitled to the receipt of money for goods licensed or services provided, the right to receive money is an "account," and the sale or assignment for security of an account other than a health−care−insurance receivables is governed by § 9−406, and not § 9−408. See infra note 36 (quoting the definition of "account" in U.C.C. § 9−102(a)(2) (1999)); infra note 32 (discussing § 9−406 and its applicability to sales and assignments). Back To Text

[27] U.C.C. § 9−408(d) (1999). Section 9−408(d) provides:

To the extent that a term in a promissory note or in an agreement between an account debtor and a debtor which relates to a health−care−insurance receivable or general intangible or a rule of law, statute, or regulation described in subsection (c) would be effective under law other than this Article but is ineffective under subsection (a) or (c), the creation, attachment, or perfection of a security interest in the promissory note, health−care−insurance receivable, or general intangible:

(1) is not enforceable against the person obligated on the promissory note or the account debtor;

(2) does not impose a duty or obligation on the person obligated on the promissory note or the account debtor;

(3) does not require the person obligated on the promissory note or the account debtor to recognize the security interest, pay or render performance to the secured party, or accept payment or performance from the secured party;

(4) does not entitle the secured party to use or assign the debtor's rights under the promissory note, health−care−insurance receivable, or general intangible, including any related information or materials furnished to the debtor in the transaction giving rise to the promissory note, health−care− insurance receivable, or general intangible;

(5) does not entitle the secured party to use, assign, possess, or have access to any trade secrets or confidential information of the person obligated on the promissory note or the account debtor; and

(6) does not entitle the secured party to enforce the security interest in the promissory note, health−care−insurance receivable, or general intangible.

Id. Back To Text

[28] In addition to governing true security interests, Revised Article 9 applies to the sale of accounts, chattel paper, promissory notes, and payment intangibles, which I refer to as "Article 9 Receivables." See id. § 9−109(a)(3). Revised Article 9 does this by incorporating sale concepts into important defined terms. See id. § 1−201(37) (defining "security interest" to include ownership interest in Article 9 Receivables); id. § 9−102(a)(12) (defining "collateral" to include Article 9 Receivables that have been sold); id. § 9−102(a)(28) (defining "debtor" to include seller of Article 9 Receivables); id. § 9−102(a)(72) (defining "secured party" to include buyer of Article 9 Receivables); id. § 9−102(a)(73) (defining "security agreement" as agreement that creates or provides for security interest, which includes ownership interest in Article 9 Receivables). The use of abnormal definitions and misleading defined terms to incorporate the sale of Article 9 Receivables is a violation of an important drafting principle. See Plank, Sale of Accounts, supra note 8. The defined terms "security interest," "collateral," "debtor," "secured party," and "security agreement" do not conjure up in the minds of the readers or the drafter "ownership interest," "property sold," "seller," "buyer," and "sale agreement." Accordingly, drafters of the statute will make drafting errors. See id. at 482−92 (describing drafting errors that prior Article 9 contained and that Revised Article 9 has fixed). See, e.g., U.C.C. § 9−102(28)(A) (1999) (providing that "debtor," which includes seller of Article 9 Receivables, is no longer defined as owner of Article 9 Receivables); id. § 9−202 (excepting Article 9 Receivables from provision that title is irrelevant in applying rights and obligations under Revised Article 9); id. § 9−203(b)(2) (requiring as one element of attachment that debtor has rights in collateral or power to transfer rights to secured party; latter provision necessary for sale of Article 9 Receivables); id. § 9−204(c) (extending provision for future advances and other value to sale of Article 9 Receivables); id. § 9−207(d) (distinguishing duties and rights of buyer of Article 9 Receivables from those of secured party with true security interest in collateral); see id. § 9−209(c) (1999) (noting inapplicability to buyers of accounts, chattel paper or payment intangibles of requirement to release account debtor from obligation to secured party); id. § 9−210(b) (excepting buyers of Article 9 Receivables from duty to respond to requests for accounting); id. § 9−318(b) (providing that seller of Article 9 Receivables is deemed to have rights in Article 9 Receivables if buyer's security interest is unperfected); id. § 9−323(c) (provision delaying priority of certain perfected future advances not apply to buyer of Article 9 Receivables); id. § 9−513(c)(1) (excepting buyer of accounts and chattel paper from requirement for filing termination statement); id. § 9−601(g) (providing that part 6 of Revised Article 9 governing the secured party's rights and duties upon default not apply to buyer without credit recourse of Article 9 Receivables). Nevertheless, those who rely on Article 9 have failed and will likely continue to fail to learn of or to comply with its requirements for sale of Article 9 Receivables. See Plank, Sale of Accounts, supra note 8, at 450−75. Back To Text

[29] See U.C.C. § 1−201(37) (1999) ("'Security interest' . . . also includes any interest of a consignor and buyer of accounts, chattel paper, a payment intangible, or a promissory note in a transaction that is subject to Article 9"). Back To Text

[30] See id. § 9−406(f), (i) & cmt. 6 (stating new subsection codifies principle of free assignability for accounts (other than health−care−insurance receivables) and chattel paper). Back To Text

[31] See infra note 32 (comparing § 9−406 to its predecessor section in prior Article 9 and discussing expansion of limitations on anti−assignment provisions in § 9−406). Back To Text

[32] Although section 9−408(a) invalidates contractual anti−assignment provisions that would interfere with the creation of a "security interest" in a general intangible or a promissory note, subsection (b) provides that, in the case of a payment intangible and a promissory note, subsection (a) only applies to a sale of the payment intangible or promissory note and does not apply to an assignment of a payment intangible or promissory note for security. See id. § 9−408(b) (providing that subsection (a) "applies to a security interest in a payment intangible or promissory note only if the security interest arises out of a sale of the payment intangible or promissory note"). Back To Text

[33] Section 9−406 is the successor to § 9−318(4) of prior Article 9. Section 9−406 continues, in a somewhat broader form, to invalidate any agreement that restricts the assignment–whether a sale or a true security interest–of accounts, other than health−care−insurance receivables. See U.C.C. § 9−406(d), (i) (1999). Prior section 9−318(4) only abrogated contractual provisions that prohibited assignment or required consent for assignment. Compare U.C.C. § 9−406(d) (1999) with U.C.C. § 9−318(4) (1995). In an expansion from prior Article 9, § 9−406 also abrogates contractual anti−assignment provisions for the assignment of chattel paper. See U.C.C. § 9−406(d) (1999). In addition, § 9−406(d) continues to abrogate the anti−assignment provisions in an agreement in the case of an assignment of a payment intangible for security, and extends this abrogation to an assignment of a promissory note for security. See id. Back To Text

[34] See supra note 22, quoting U.C.C. § 9−408(a) (1999) (stating terms restricting assignment are generally ineffective). Back To Text

[35] See supra note 8 (explaining how Revised Article 9 added health−care−insurance receivables to types of collateral in which secured parties may take security interest by adding term to definition of "account"). Back To Text

[36] See U.C.C. § 9−406(i) (1999). Back To Text

[37] Compare id. § 9−102(a)(2) (defining an account as "a right to payment of a monetary obligation, whether or not earned by performance, (i) for property that has been or is to be sold, leased, licensed, assigned, or otherwise disposed of, (ii) for services rendered or to be rendered, (iii) for a policy of insurance issued or to be issued, (iv) for a secondary obligation incurred or to be incurred, (v) for energy provided or to be provided, (vi) for the use or hire of a vessel under a charter or other contract, (vii) arising out of the use of a credit or charge card or information contained on or for use with the card, or (viii) as [certain lottery] winnings" and also including "health−care−insurance receivables") with U.C.C. § 9−106 (1995) (defining account as "any right to payment for goods sold or leased or for services rendered . . . whether or not earned by performance"). See also U.C.C. § 9−102 cmt. 5. (1999) ("The definition of 'account' has been expanded and reformulated. It is no longer limited to rights to payment relating to goods or services. Many categories of rights to payment that were classified as general intangibles under former Article 9 are accounts under this Article.") Back To Text

[38] D's rights under the franchise agreement would constitute a general intangible, and SP1 would perfect its security interest in D's goods, accounts, and general intangibles by filing a financing statement. See, e.g., U.C.C. §§ 9−308, 9−310(a) (1999). Back To Text

[39] See, e.g., In re Oklahoma City Broadcasting Co., 112 B.R. 425, 427 (Bankr. W.D. Okla. 1990) (finding for purposes of allocating proceeds from sale of debtor radio station's assets, value of debtor's assets other than FCC license was only $2 million, and creditor's claim was in excess of $2.7 million). Back To Text

[40] SP1's debt of $70 secured by a security interest in the assets other than the franchise agreement, valued at $50, would have priority over SP2's security interest in those assets. Back To Text

[41] SP2 would also perfect its security interest in D's goods, accounts, and general intangibles by filing a financing statement. See U.C.C. §§ 9−308, 9−310(a) (1999). As the later filer, SP2 is subordinate to SP1. See id. § 9−322(a)(1) (establishing priorities among conflicting security interests). Back To Text

[42] See id. § 9−102(a)(64) (defining "proceeds"); id. § 9−315(a)(2) (providing that a security interest attaches to proceeds of collateral). Back To Text

[43] The judgment creditor comes in third because SP1 and SP2 perfected before the judgment creditor became a lien creditor. See id. §9−201 (stating that except as otherwise provided in the UCC, a security agreement is effective against creditors); id. § 9−317(a)(2)(A) (mandating when an unperfected security interest is subordinate to lien creditor). Back To Text

[44] The judgment creditor as a lien creditor has priority over all other unsecured creditors. See, e.g., D.C. Code Ann. § 15−307 (1995) (providing that writ of fieri facias is lien from time of its delivery to marshal upon goods and chattel of judgment debtor); N.Y. C.P.L.R. § 5202(a) (McKinney 1997) (establishing priority of judgment creditor over rights of transferee); Va. Code Ann. § 8.01−478 (Michie 2000) (providing that writ of fieri facias binding against property of defendant capable of being levied upon from time it is actually levied by officer to whom delivered); see also Tenn. Code Ann. § 26−1−109 (2000) (providing that date of teste for priority of liens is date of issuance of execution); Smith v. United States Fire Ins. Co., 150 S.W. 97, 99 (Tenn. 1912) (holding execution from court of record is lien from day of its "teste"); Cecil v. Carson, 5 S.W. 532 (Tenn. 1887) (holding same); John Weiss, Inc. v. Reed, 118 S.W.2d 677, 683 (Tenn. Ct. App. 1938) (holding same). Back To Text

[45] See U.C.C. §§ 9−312(b)(3), 9−313(a) (1999). Back To Text

[46] See id. § 9−310 (requiring perfection by filing except as provided in other sections); id. § 9−312(a) (permitting perfection by filing in chattel paper, instruments, or investment property). Back To Text

[47] See id. §§ 9−312(b)(1), 9−314, 9−104 (providing that security interest in deposit account may be perfected only by control). Back To Text

[48] SP1's and SP2's security interest would attach the moment that D has rights in the collateral, the check, and would therefore achieve perfection at the same time. See id. § 9−203(a)–(b) (setting forth elements of attachment); id. § 9−308(a) (providing that security interest is perfected when it has attached and all the requirements for perfection have been satisfied). Accordingly, SP1 has priority as the first to file. See id. § 9−322(a)(1). In addition, SP1 has priority over the judgment creditor because the judgment creditor lien did not become a lien creditor before the security interest was perfected. See id. § 9−317(b)(1)(A). Back To Text

[49] See id. § 9−330(d) (giving priority to purchaser of instrument who gives value and takes possession of instrument in good faith and without knowledge that purchase violates rights of secured party); id. § 9−331(a) (providing that holder in due course of negotiable instrument and a protected purchaser of a security take priority over an earlier security interest, even if perfected, to extent provided in Articles 3 and 8). Back To Text

[50] See U.C.C. § 9−332(b) (1999) (providing that transferee of funds from deposit account takes funds free of security interest in deposit account unless transferee acts in collusion with debtor in violating rights of secured party). Back To Text

[51] See id. § 9−315(a)(1) (stating that security interest continues in collateral notwithstanding sale or other disposition unless secured party authorizes disposition free of security interest). Back To Text

[52] See id. § 1−201(33) (defining "purchaser" as "a person who takes by purchase"); see also id. (defining "purchase" to include "taking by sale, discount, negotiation, mortgage, pledge, lien, issue or re−issue, gift or any other voluntary transactions creating an interest in property"). Back To Text

[53] 11 U.S.C. § 506(a) (1994) states:

[an] allowed claim of a creditor secured by a lien on property in which the estate has an interest . . . is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property . . . and is an unsecured claim to the extent that the value of such creditor's interest . . . is less than the amount of such allowed claim.

Id. Back To Text

[54] Because the debtor D has filed for bankruptcy, the loan will be in default, but the automatic stay prevents SP1 from foreclosing on its collateral. See id. § 362(a). SP1, however, will be entitled to relief from the automatic stay if it does not receive adequate protection. See id. § 362(d)(1). Also, if the debtor D proposes to use the collateral, it must also provide adequate protection to SP1's interests. See id. § 363(e). Back To Text

[55] 11 U.S.C. § 506(b) (1994) states that to:

the extent that an allowed secured claim is secured by property the value of which . . . is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement under which such claim arose.

Id. Back To Text

[56] The franchise agreement is an executory agreement which, under § 365(a), the debtor in possession as trustee may assume. See id. §§ 365(a), 1108. Under the plain language of § 365(c)(1), if applicable non−bankruptcy law prohibits the assignment of the franchise agreement, the debtor in possession may not assume the franchise agreement unless the municipality R consents. See id. § 365(c) (providing that trustee may not assume or assign contract if applicable law excuses other party to contract from accepting performance from or rendering performance to entity other than debtor or debtor in possession unless that party consents). Courts have disregarded this language on policy grounds and held that the debtor in possession, as the same entity as the debtor, may assume if there is no actual prejudice to the other party. See generally Daniel J. Bussel & Edward A. Fiedler, The Limits on Assuming and Assigning Executory Contracts, 74 Am. Bankr. L. J. 321, 323−26 (2000) (providing excellent, short summary of controversy). Back To Text

[57] Under § 1129, a bankruptcy court may confirm a plan only if, among other requirements, each class of claims has accepted the plan or the class is not impaired under the plan. See 11 U.S.C. § 1129(a) (1994). However, the plan need not satisfy this requirement if the plan "is fair and equitable" with respect to each class of claims that is impaired under, and has not accepted, the plan. See id. § 1129(b)(1). To be fair and equitable, the plan must provide (i) that the holders of such claims retain the liens securing such claims to the extent of the allowed amount of such claims and receive deferred cash payments having a present value equal to the lesser of its claim or the value of the holder's interest in the collateral or (ii) that the holders of the claim realize "the indubitable equivalent of such claims." See id. § 1129(b)(2)(A)(i)−(iii). Back To Text

[58] See id. § 363(f)(3) (providing that trustee may sell property free and clear of any interest in that property of entity other than estate, if interest in lien and price at which property is to be sold is greater than aggregate value of all liens on property). Back To Text

[59] Some will consider this prospect unpalatable. Nevertheless, without the advantage of a lower cost secured financing, D would have had to pay higher financing costs–in the form of either higher interest rates to unsecured lenders or even higher returns to equity investors–from the very beginning, if such financing were available at all. The higher costs would have led D to fail earlier if it could have gotten off the ground to begin with. Back To Text

[60] See 11 U.S.C. § 506(a) (1994) (providing when a creditor with a security interest has a secured and unsecured claim), quoted supra note 52; id. § 502(b)(2) (disallowing unmatured interest on claims); United Sav. Ass'n v. Timbers of Inwood Forest Assoc., 484 U.S. 365, 370 (1988) (holding that right of under−secured creditor to adequate protection does not include interest payments to compensate creditor for delay of foreclosure caused by bankruptcy case). Back To Text

[61] See 11 U.S.C. § 507(a)(1) (1994) (giving administrative claims priority over general unsecured claims). Back To Text

[62] See id. § 552(a). Back To Text

[63] See id. § 552(b). Back To Text

[64] See supra note 47 and accompanying text (describing perfection of security interest in receipts from assignment of franchise agreement that are not "proceeds," when receipts consist of collateral in which security interest may be perfected by filing). Back To Text

[65] See 11 U.S.C. § 547(b) (1994). Section 547(b) permits the trustee to avoid:

any transfer of an interest of the debtor in property–

1. to or for the benefit of a creditor [eg. SP1 and SP2];
2. for or on account of an antecedent debt owed by debtor before such transfer was made [eg. the initial loans by SP1 and SP2];
3. made while the debtor was insolvent [presumed under § 547(f) for the ninety days preceding the filing];
4. made–

    A. on or within 90 days before the date of the filing of the petition; or
    B. between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and

        1. that enables such creditor to receive more than such creditor would receive if–

            A. the case were a case under chapter 7 of this title;
            B. the transfer had not been made; and
            C. such creditor received payment of such debt to the extent provided by the provisions of this title.

Id. Here, SP2's security interest or payment would be avoided completely, and SP2 would retain its unsecured claim in the bankruptcy case. SP1's security interest or payment would be avoided only to the extent of the excess of its claim over its perfected security interest in D's other assets, and SP1 would retain its secured claim for $50 and an unsecured claim for $20. See supra note 59 and accompanying text (describing treatment of undersecured claims). Back To Text

[66] See supra note 27 and accompanying text (describing how Article 9 incorporates the sale of these Article 9 Receivables). Back To Text

[67] Recall that these two subsections, subsection (a) abrogating contractual anti−assignment provisions and subsection (c) abrogating anti−assignment provisions imposed by law, do not apply equally to an assignment for security of all Limited Intangibles. See U.C.C. § 9−408 (1999); supra notes 31−32 and accompanying text (describing difference between treatment of sale of payment intangible or promissory note under § 9−408 (a), (b) versus treatment of assignment of payment intangible or promissory note under § 9−406(d)). Back To Text

[68] U.C.C. § 9−408(d) (1999). Back To Text

[69] Cf. Boyce, supra note 3, at 575 (noting that primary value for lender taking true security interest in Limited Intangible is priority in proceeds of sale and not ability to seize Limited Intangible); Smith, supra note 3, at 336−37 (noting that cash flow lenders rely on ability of borrower to generate sufficient cash flow to repay debt and understand that liquidation of debtor's assets will not produce sufficient assets to repay debt). Back To Text

[70] For example, as of June of 2000, the total debt owed by the United States Government exceeded $3.4 trillion and that owed by nonfinancial, nonfederal borrowers in the United States exceeded $14 trillion dollars. See Board of Gov. of Fed. Res. System, Domestic Financial Statistics, 86 Fed. Res. Bull. No. 12, A40, tbl. 1.59, ll. 3, 5 (December 2000) [hereinafter, Financial Statistics]. For some of this debt, the payment date for the principal is certain. For other debt, however, the payment date is not certain. For example, treasury securities issued by the United States Government pay principal at a fixed maturity date. See Frank J. Fabozzi & Michael J. Fleming, U.S. Treasury and Agency Securities, in The Handbook of Fixed Income Securities 175, 176 (Frank J. Fabozzi, ed. 2001) [hereinafter Handbook]. On the other hand, the vast majority of the $2.1 trillion of corporate bonds and the $6.6 trillion of mortgage loans included in the $14 trillion of private debt outstanding as of the end of June 2000 are prepayable before their final maturity date. See Domestic Financial Statistics, supra at A40, tbl. 1.59, ll. 5, 11 (discussing ability to prepay corporate bonds); Frank J. Fabozzi, et al., Corporate Bonds, in Handbook at 253, 256, 266−71 (discussing redemption before maturity of

corporate bonds); Frank J. Fabozzi & Chuck Ramsey, Mortgages and Overview of Mortgage−Backed Securities, in Handbook at 549, 560−61, 563−65 (discussing prepayment risk for mortgages and mortgage backed securities). Although the uncertainty of when the principal of the corporate bond and mortgage loan will in fact be paid in full imposes additional costs on their holders, these corporate bonds and mortgage loans are still valuable investments. See Ravi E. Dattatreya & Frank J. Fabozzi, Risks Associated with Investing in Fixed Income Securities, in Handbook at 21 (discussing all risks of owning fixed income securities). Back To Text

[71] See William B. Stoebuck & Dale A. Whitman, Law of Property § 6.12, at 256−57 (3d ed. 2000) (describing nature of landlord's property interest). Back To Text

[72] See id. § 3.1, at 79−81 (describing future interests in realty and personalty); see id. § 3.6, at 83−85 (describing reversionary interests); see id. § 3.6, at 88−91 (describing remainders and executory interests). Back To Text

[73] See id. § 3.1, at 79−81; see id. §§ 3.23−3.25, at 138−45 (outlining inheritability and devisability of future interests and subjection of future interests to creditors' claims); see id. § 6.12, at 256−57. Back To Text

[74] Permanent Editorial Bd. for the Unif. Commercial Code, PEB Study Group Unif. Commercial Code Article 9 Report, Recommendation 23, at 178−80 (Dec. 1, 1992). Back To Text

[75] See id. at 180. Back To Text

[76] 11 U.S.C. § 541(a) (1994) provides:

The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:

(1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case.

Id. Back To Text

[77] See id. § 101(10) (defining creditor as entity that has claim against debtor that "arose at the time of or before the order for relief concerning the debtor"); id. § 101(5) (defining claim "as right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured"). Back To Text

[78] See, e.g., id. §§ 362(d)(1), 363(e), 364(d) (requiring adequate protection of interests of third party in property in which estate has interest); id. § 506(a) (defining secured claim), quoted supra note 52; id. § 725 (providing that chapter 7 trustee, before final distribution of property of estate, "shall dispose of any property in which an entity other than the estate has an interest, such as a lien, and that has not been disposed of under another section of this title"). Back To Text

[79] See, e.g., 11 U.S.C. § 362 (a)(3)−(6) (1994) (providing that automatic stay prevents enforcement of secured creditor's security interest against collateral that is owned by the debtor); id. § 1123(b) (providing that chapter 11 reorganization plan "may (1) impair or leave unimpaired any class of claims, secured or unsecured, . . . [or] (5) modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence . . ."); id. § 1222(b)(2) (providing that chapter 12 reorganization plan may "modify the rights of holders of secured claims"); id. § 1322(b)(2) (providing that chapter 13 reorganization plan may "modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence"). Back To Text

[80] 440 U.S. 48 (1979). Back To Text

[81] See id. at 53−54. Back To Text

[82] See id. at 55. Back To Text

[83] 530 U.S. 15 (2000). Back To Text

[84] See id. at 20, quoting language set forth supra in text accompanying note 81. Back To Text

[85] See id. at 24. Back To Text

[86] See Thomas E. Plank, Federalism and the Erie Doctrine in Bankruptcy: When State Law Rules (manuscript on file with the author) (arguing that, subject to the Non−Interference Principle, under the Bankruptcy Clause of the United States Constitution, U.S. Const. Art. I, § 8, cl. 4, Congress may not adversely affect interests of persons other than debtor or its creditors and further that federal courts in bankruptcy must follow Erie Ry. Co. v. Tompkins, 304 U.S. 64 (1938), and apply state law to resolve disputes involving such interests) [hereinafter Plank, Federalism and Erie in Bankruptcy]. Back To Text

[87] See, e.g., Hayhoe v. Cole (In re Cole), 226 B.R. 647, 651−52 nn.6−7, 654 (B.A.P. 9th Cir. 1998) (holding that pre−petition waiver of discharge was unenforceable against debtor in bankruptcy); In re Tru Block Concrete Products, Inc., 27 B.R. 486, 492 (Bankr. S.D. Cal. 1983) (holding void as against public policy covenant not to file bankruptcy petition in agreement among shareholders of debtor and creditors to liquidate debtor outside of bankruptcy). See also Marshall E. Tracht, Contractual Bankruptcy Waivers: Reconciling Theory, Practice, and Law, 82 Cornell L. Rev. 301,303−15 (1997) (describing and questioning conventional wisdom of unenforceability of bankruptcy waivers); David S. Kupetz, The Bankruptcy Code is Part of Every Contract: Minimizing the Impact of Chaptrer 11 on the Non−Debtor's Bargain, 54 Bus. Law. 55,67−69 (1998) (summarizing law on pre−bankruptcy waivers). Back To Text

[88] See, e.g., Revised Uniform Limited Partnership Act, § 402(4)–(5) (1976 with 1985 Amendments), 6A U.L.A. 172 (1995) (providing that, unless otherwise provided in partnership agreement, person ceases to be general partner if person: (i) files state court assignment for benefit of creditors; (ii) files voluntary petition in bankruptcy; (iii) is adjudicated bankrupt or insolvent; (iv) seeks other similar relief under any law; (v) seeks or acquiesces in appointment of trustee, receiver, or liquidator; (vi) if, after specified number of days, any proceeding is commenced against general partner seeking reorganization, liquidation, or similar relief; or (vii) if general partner consents to appointment of trustee, receiver, or liquidator of general partner or its property). Back To Text

[89] The ipso facto provisions are generally provisions in non−bankruptcy law or agreements conditioned on or relating to "the insolvency or financial condition of the debtor, . . . the commencement of a case under this title, or . . . the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement." Infra notes 90−92 and accompanying text (describing the different "ipso −facto" provisions abrogated by the Code). Back To Text

[90] The Code's description of these insolvency conditions is broad: they go beyond the commencement of a case under the Code to include is the insolvency or financial condition of the debtor. See supra note 88 and accompanying text. Nevertheless, the overruling of these ipso facto clauses based on a broadly defined insolvency condition occurs only in bankruptcy. Outside of bankruptcy, third parties are free to exercise these clauses based on the debtor's financial condition. Moreover, the Code provides that, to the extent that the non−creditor is forced to maintain an ongoing relationship with the debtor, the bankruptcy trustee, or an assignee, the debtor, trustee, or assignee must provided adequate assurance of due performance of its obligations under that relationship. Thus, the trustee need not cure a pre−petition default of a covenant by the debtor to maintain a certain positive net worth in assuming an executory contract or unexpired lease under 11 U.S.C. § 365(b)(2), but if the trustee wants to assign the contract or lease it must assure adequate performance by any assignee of such contract, including the net worth covenant. See 11 U.S.C. § 365(b)(2), (f)(2)(B) (1994). Back To Text

[91] See 11 U.S.C. § 541(c)(1) (1994). Back To Text

[92] See id.. § 365(e)(1); see also id. § 365(b)(2) (providing that trustee need not cure breach of "ipso−facto" insolvency condition that is default under executory contract or lease to be assumed). Back To Text

[93] See id.. § 363(l). Back To Text

[94] If continued performance of the contract by the other party or the existence of the other party's property interest is a net benefit for the debtor, it is also a net burden to the third party. For example, the other party may have agreed to deliver goods to a debtor or leased a property item to the debtor at a price that, because of changes in the market, has become less than the market value of the goods or the lease. If the third party may not avoid this burden under non−bankruptcy law, it may not use the filing of relief under bankruptcy law to avoid the burden. See generally 11 U.S.C. § 365 (1994) (describing trustee's power to reject, assume or assume and assign executory contracts and leases). Back To Text

[95] See id.. § 541(c)(1)(A). Back To Text

[96] See id.. § 365(f)(1). Back To Text

[97] See id.. § 365(c)(1) (providing that the trustee may not assume or assign executory contract or unexpired lease if applicable law excuses party, other than debtor, from accepting performance from or rendering performance to entity other than debtor or debtor in possession and such party does not consent to such assumption or assignment). There are other limitations to assumption or assignment pursuant to section 365. See id. § 365 (c)(2) (prohibiting assumption of contract to make loan, to extend financial accommodations, or to issue security); id. § 365 (c)(3) (prohibiting assumption of terminated lease of non−residential real property); id. § 365 (c)(4) (limiting assumption of aircraft terminal lease). Back To Text

[98] See id.. § 365(f)(3) (providing that, notwithstanding anti−assignment provision of non−bankruptcy law or agreement allowing modification or termination of executory contract or unexpired lease because of assignment of such contract or lease, such contract or lease may not be terminated or modified on account of such anti−assignment provision because trustee has assumed or assigned such contract or lease). Back To Text

[99] 11 U.S.C. § 545 (1994) provides:

The trustee may avoid the fixing of a statutory lien on property of the debtor to the extent that such lien (1) first becomes effective against the debtor−−

(A) when a case under this title concerning the debtor is commenced;

(B) when an insolvency proceeding other than under this title concerning the debtor is commenced;

(C) when a custodian is appointed or authorized to take or takes possession;

(D) when the debtor becomes insolvent;

(E) when the debtor's financial condition fails to meet a specified standard; or

(F) at the time of an execution against property of the debtor levied at the instance of an entity other than the holder of such statutory lien.

Id. Back To Text

[100] For example, bankruptcy may prevent third parties using terms in a contract or lease that nominally are not anti−assignment clauses, such as a "use" clause in a lease, as a disguised anti−assignment clause. See, e.g., In re U.L. Radio Corp., 19 B.R. 537, 544−45 (Bankr. S.D.N.Y. 1982) (holding that clause in lease prohibiting use of leased premises for any purpose other for television and radio sales and service was disguised anti−assignment clause, since landlord could offer no reason for objecting to assigning lease to assignee planning to operate premises as restaurant). Back To Text

[101] See, e.g., Holland America Ins. Co. v. Sportservice, Inc. (In re Cahokia Downs, Inc.), 5 B.R. 529, 530, 532 (Bankr. S.D. Ill. 1980) (holding that insurance company may not use its discretionary power to terminate insurance contract for any reason to terminate debtor's insurance policy shortly after filing of bankruptcy petition when only reason for termination was filing of petition). Back To Text

[102] See, e.g., In re Leslie, 520 F.2d 761 (9th Cir. 1975) (disregarding California statute that required that holder of liquor license pay debts of its liquor suppliers in full as condition to approval of transfer of license as impermissible statutory priorities and not neutral statutory liens). Back To Text

[103] See supra note 88 (discussing ipso facto provisions). Back To Text

[104] See supra notes 41−51 and accompanying text (discussing value of perfected security interest in proceeds of assignment of franchise agreement). Back To Text

[105] Security interests generally offer greater protection to secured parties outside of bankruptcy because the automatic stay interferes with the rights of secured parties in bankruptcy. See 11 U.S.C. § 362 (a)(6) (1994) (staying acts to collect a creditor's claim, including act to foreclose secured creditor's security interest); see also id. § 362 (a)(3) (staying acts to obtain possession of property from estate, which prevents repossession of, or foreclosure of security interest in, collateral in debtor's possession). In the case of a limited security interest, the secured party does not have the right to enforce the security interest against the debtor. Hence, the imposition of the automatic stay in bankruptcy does not affect the secured party of a limited security interest to the same extent as other secured parties. Back To Text

[106] See supra note 26 (quoting text of § 9−408(d)(1)−(3)). Back To Text

[107] See supra note 26 (quoting text of § 9−408(d)(4), (6)). Back To Text

[108] See 11 U.S.C. § 101(51) (1994). Back To Text

[109] See id. § 101(37). Back To Text

[110] See U.C.C. § 9−315(a)(1) (1999) (providing that security interest continues in collateral notwithstanding sale or other disposition unless secured party authorized disposition free of security interest). Back To Text

[111] See, e.g., id. § 9−310(c) (providing that "[i]f a secured party assigns a perfected security interest or agricultural lien, a filing under this article is not required to continue the perfected status of the security interest against creditors of and transferees from the original debtor"). Back To Text

[112] See id. § 9−315(a)(2) (providing that a security interest attaches to proceeds of collateral). Back To Text

[113] See Stoebuck & Whitman §§ 6.21−22, supra note 70, at 270−72; id. §§ 6.30−6.32, at 281−82 (describing landlord's obligation to transfer legal right to possession, to refrain from interfering with the tenant's possession, and, in most jurisdictions, to deliver actual possession of leased premises). Back To Text

[114] The interests are not identical. The landlord may retain the ability to regain possession if the lessee fails to pay rent. See id. Back To Text

[115] See id. § 3.1, at 79−81; id. § 3.3, at 83−85; id. § 3.6, at 88−91 (describing reversionary and remainder interests). Back To Text

[116] Ronald Mann has suggested that, in the context of software financing, a limited security interest authorized by § 9−408 is a "sham" and a "pseudo−secured transaction" because "a security interest that carries with it neither a right of liquidation nor a right to possess or use the collateral has little of state−law significance." See Mann, supra note 4, at 181−82. Although this may be true in the context of computer software financing, this statement, is not true as a general matter. There are many examples of how a limited security interest in a Limited Intangible retains significant

state law significance. See, e.g., MLQ Investors, L.P. v. Pacific Quadracasting, Inc., 146 F.3d 746 (9th Cir. 1998), discussed infra note 120 and accompanying text (giving secured creditor priority in proceeds of sale of FCC license over IRS lien); State Street Bank & Trust Co. v. Arrow Comm. Inc., 833 F. Supp. 41, 44, 48−49 (D. Mass. 1993) (giving priority in proceeds from approved sale of FCC license to secured creditor owed $9,000,000 over unsecured creditor); supra text accompanying notes 41−51 (discussing value of perfected security interest in proceeds of assignment of franchise agreement). Back To Text

[117] See 1 Milton R. Friedman, Friedman on Leases § 8.1, at 477 (4th ed. 1977) (noting that lease is not subordinate to subsequent mortgage on premises); cf. U.C.C. § 9−203 cmt. 6 (1999) (noting that debtor may only grant security interest in rights that debtor has). Back To Text

[118] See U.C.C. § 9−203(b)(2) (1999) (requiring rights in collateral as one element for attachment). Back To Text

[119] See supra note 36 (quoting definition of "account" in § 9−102(a)(2)). Back To Text

[120] See supra note 19 (quoting definition of "general intangible" in § 9−102(a)(42)). Back To Text

[121] 146 F.3d 746 (9th Cir. 1998). Back To Text

[122] Id. at 749. Back To Text

[123] See id. at 747 (apparently summarizing security agreement). Back To Text

[124] See id. at 749 n.1 (finding that debtor had limited right to pledge broadcasting licenses). Back To Text

[125] See, e.g., Beach Television Partners v. Mills, 38 F.3d 535, 536−537 (11th Cir. 1994) (holding that creditor may hold valid security interest in proceeds of sale of FCC broadcasting license sold by bankruptcy trustee with approval of FCC, and reversing district court and bankruptcy court invalidation of security interest). Back To Text

[126] See, e.g., State St. Bank & Trust Co. v. Arrow Communications, Inc., 833 F. Supp. 41, 48−49 (D. Mass. 1993) (holding that licensee can grant a creditor lien with no right except to be secured creditor against any proceeds from sale of license and finding FCC license is general intangible and proceeds from approved sale of license were proceeds of general intangible and therefore secured creditor who was owed $9,000,000 had priority in proceeds of sale over unsecured creditor). Back To Text

[127] See generally Boyce, supra note 3, at 563−66 (discussing evolution of FCC policy). Back To Text

[128] In re Merkley, 94 F.C.C.2d 829, 830 (1983), aff'd, 776 F.2d 365 (D.C. Cir. 1985). Back To Text

[129] See In re Cheskey, 9 F.C.C.R. 968, 987 (1994). Back To Text

[130] See, e.g., State St. Bank & Trust Co., 833 F. Supp. at 48−49 (stating bank has security interest in right to remuneration from transfer of broadcasting licenses); In re Ridgely Comm., Inc., 139 B.R. 374, 378−79 (Bankr. D. Md. 1992) (finding right to transfer license concerned F.C.C. and licensee but right to remuneration for transfer concerned only two private parties). Back To Text

[131] See supra note 69 and accompanying text (stating that although date of payment principle may be uncertain, corporate bonds and mortgage loans are valuable investments). Back To Text

[132] See supra note 81 and accompanying text (discussing Butner principle that property interests are created and defined by state law and absent some federal policy, should not be altered simply because one party is involved in bankruptcy proceedings). Back To Text

[133] See Thomas E. Plank, The Constitutional Limits of Bankruptcy, 63 Tenn. L. Rev. 487, 492−93, 559−64, 571−79 (1996) [hereinafter Plank, Constitutional Limits] (arguing that, under Bankruptcy Clause of the United States Constitution, U.S. Const. Art. I, § 8, cl.4, Congress may not create direct entitlement or liabilities for persons other than debtor or its creditors); Plank, Federalism and Erie in Bankruptcy, supra note 85 (arguing that, under the Bankruptcy Clause, U.S. Const. Art. I § 8 cl.4, Congress may not adversely affect interests of persons other than debtor or its creditors and further that federal courts in bankruptcy must follow Erie Ry. Co. v. Tompkins, 304 U.S. 64 (1938), and apply state law to resolve disputes involving such interests). Back To Text