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THE ANTI−BANKRUPTCY ACT: REVISED ARTICLE 9 AND BANKRUPTCY

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Introduction

The articles in this symposium issue of the American Bankruptcy Institute Law Review attempt to analyze some of the major effects that the 1999 revision of Article 9 of the Uniform Commercial Code [2] will have on bankruptcy law and bankruptcy practice. It is a hazardous activity to attempt to predict in advance the impact of new legislation. That problem is exacerbated when the new law is as extensive and complicated as the revised Article 9. [3] At this early pre−effective date stage, only the more obvious intersections between Article 9 and the bankruptcy laws are easy to anticipate and examine. No doubt, many other important effects will become apparent as the Act becomes effective [4] and other areas of intersection become the focus of litigation and of academic inquiry.

Since the federal bankruptcy law generally defers to non−bankruptcy law to define the legal rights of the parties in interest in a bankruptcy proceeding, [5] any significant change in an important area of substantive state law is likely to have bankruptcy implications. However, the bankruptcy implications of the current revision of Article 9 are particularly significant because Article 9 defines the relative rights in the estate's personal property of the most significant players in many bankruptcy cases − the secured and unsecured creditors. Thus, changes in Article 9 can go to the heart of the bankruptcy and reorganization process.

The question examined in this piece and the corresponding article by Professors Steven L. Harris and Charles W. Mooney, Jr. [6] is whether the changes incorporated in the Article 9 revisions are contrary to bankruptcy law and policy. It is the thesis of this article that they are.

As discussed below and in other articles appearing in this symposium, the Article 9 revisions will result in significant changes in bankruptcy law. These changes are neither accidental nor the unintended consequences of modifications that were designed to alter non−bankruptcy outcomes. Rather, many of the most important bankruptcy−related changes to Article 9 were designed primarily to alter bankruptcy results, and not to further non−bankruptcy state law policies. While it is fairly easy to see from even a cursory review of the Article 9 revision that many of the changes were designed to alter bankruptcy outcomes and will likely have that effect, it is harder to establish that those changes are contrary to bankruptcy policy.

There is little consensus among academics as to what are the proper policies of bankruptcy law. One view is that bankruptcy policy is limited to solving problems of asset deployment and value maximization. Under this view, bankruptcy law is not redistributional. Bankruptcy law properly should defer to the underlying non−bankruptcy rights of the parties and should alter those rights only where necessary to maximize the overall value of the estate.

Arguably, under this view there is no conflict between revised Article 9 and bankruptcy policy. Bankruptcy policy incorporates by reference whatever state law policy is reflected in revised Article 9. Thus, Article 9 policy is bankruptcy policy. The revision's approach to bankruptcy law is based largely on this theory of bankruptcy −− bankruptcy outcomes can and should be altered by changes in the underlying state law of secured transactions.

However, even if one adopts the view that it is consistent with bankruptcy policy to defer to and recognize state law rights, the Article 9 revision crosses the line. The rationale for respecting state law rights in bankruptcy is that bankruptcy outcomes should reflect non−bankruptcy outcomes as nearly as possible. Bankruptcy policy should not be concerned with distributional issues, unless a change in the distributional rule would maximize the estate's value.

This bankruptcy policy is violated if the underlying "state law" rule is itself designed to operate as a bankruptcy−only redistributional rule. Thus, to the extent that the revisions to Article 9 are designed primarily to alter the otherwise applicable bankruptcy distributional rules, they violate this view of bankruptcy policy. The major bankruptcy−related changes in revised Article 9 have little significance outside of bankruptcy. These changes are not driven by important non−bankruptcy state policies. Rather they are pure and simple bankruptcy distribution choices masquerading as non−bankruptcy law.

A very different view of bankruptcy policy recognizes normative values. Under this view, efficiency concerns are relevant, but bankruptcy law also involves other policies. Bankruptcy is redistributional and both can and should alter non−bankruptcy rights where necessary to achieve policies such as distributional fairness. In addition, bankruptcy law embodies a policy favoring the reorganization of financially troubled enterprises. Further, although United States bankruptcy law does not give formal standing to employees and communities as such, it does incorporate employment and community preservation goals by encouraging reorganization, even over the objection of and at the cost of modifying the non−bankruptcy rights of secured creditors.

The Article 9 revision is contrary to these normative bankruptcy policies in several ways. First, the revision greatly enhances the rights of secured creditors and transfers to them assets that currently would be available for distribution to unsecured creditors or to finance the reorganization effort. In addition, it attempts to capture for the secured creditors a major part of the extra value that may be created or preserved by the reorganization process. Finally, revised Article 9 will frustrate the reorganization policy by making it more difficult to reorganize without the secured creditor's co−operation.

Finally, without articulating specific principles, the current Bankruptcy Code can be viewed as reflecting this country's bankruptcy policies − or, rather, as reflecting federal political choices regarding the relative weight to be given conflicting bankruptcy policies. The current Bankruptcy Code was drafted against the backdrop of the then existing Article 9 rules. As a result, the Code reflects federal bankruptcy policy choices of the appropriate allocation of bankruptcy values between secured creditors and other parties in interest. The Article 9 revision fundamentally changes those allocations, contrary to the policy choices made by Congress.

It is possible to use the uniform laws drafting process to subvert federal bankruptcy policy choices only because of the long−standing bankruptcy law principle of deferring where possible to important non−bankruptcy state law policies. That deference principle, however, is grounded on the proposition that state law reflects important non−bankruptcy policy choices that are well within the proper realm of state power in a system of federalism. Thus, deference is proper only where the state law reflects bankruptcy−neutral principles of general application. Use of the uniform laws process for the purpose of altering the federal bankruptcy law greatly exceeds the proper role of that quasi−private legislative process.

Revised Article 9 is an anti−bankruptcy act. It will have the effect of changing the bankruptcy law. It is designed to change the bankruptcy law. And, the bankruptcy law changes resulting from the revision are contrary to bankruptcy policy.

I.Secured Credit, Wealth and Distributional Fairness

It is difficult, if not impossible, to separate the question of whether secured creditors should have greater rights in bankruptcy from the broader question of whether they should have greater rights at all. Although secured credit has become a common feature of our economy, there is much scholarly debate about whether it is beneficial and should be supported by the law.

A. Secured Credit's Checkered Past

The common law traditionally exhibited hostility toward the recognition of priority for personal property security interests. Something about the debtor's agreement to give one creditor priority over others seemed to be unfair −− a variant of fraud. The very early Star Chamber decision in *Twyne's Case* [7] sowed the seeds for centuries of hostile rulings based on its formulation of the badges of fraud. [8] The separation of title from possession was viewed as a fraud upon creditors, making it difficult to construct non−possessory security interests that could survive attack from other creditors. [9]

As *Twyne's Case* states, "[A] secret transfer is always a badge of fraud . . . The donor continued in possession [of the goods] and used them as his own; and by reason thereof he traded and trafficked with others, and defrauded and deceived them." [10] The nature of this "fraud" on creditors is that the secured creditor's non−possesory title or lien interest is secret. Thus, others might be deceived into extending unsecured credit based on the debtor's apparent ownership of property in its possession. [11]

The eventual legislative "solution" to this "ostensible ownership" problem was to enact recording statutes and to condition the secured creditor's right to priority on giving notice of its lien to the world. In theory, this solved the fraud problem because the other creditors now had notice of the lien and would not be deceived by the debtor's apparent ownership of property in its possession.

In practice, that notice is mostly a legal fiction. Although the act of filing gives "legal" or constructive notice, unsecured creditors seldom have actual notice of the liens at the time they deal with the debtor. Few unsecured creditors search the public records for lien filings. [12] Further, creditors who deal with the debtor prior to the recordation of the lien have no notice, but are nevertheless subject to the secured creditor's priority.

Nonetheless, the evolution of the filing system should have put an end to the *Twyne's*−based fraud issue. This was not the case. At some point "there was engrafted on the root idea of *Twyne's Case* the offshoot that the mortgagor's power of sale over goods remaining in his possession was, in some never precisely defined sense, fraudulent." [13]

Arguably some principle deeper than notice was the root of the common law courts' enmity to secured credit. Possibly it was discomfort with idea of allowing the debtor to reallocate the insolvency shares of various creditors without their consent. While the focus on notice might solve this problem to the extent that later voluntary creditors with notice could be deemed to have consented, that rationale fails if the notice is not actual, or if it comes after the creditor has already dealt with the debtor. These concerns may explain the continued judicial resistance to the priority of secured credit, as exhibited in the many opinions that penalize secured creditors for technical notice failures. [14]

Hostility toward the concept of allowing the debtor to reallocate the insolvency shares of creditors without their consent may also drive cases such as *Benedict v. Ratner*. [15] *Ratner* involved a floating lien on the debtor's accounts receivable. Prior to default, the debtor was permitted to collect the accounts and use their proceeds as it saw fit. It was not required to account to the secured party and the account debtors were not notified of the assignment of their accounts.

Although there was no finding of actual fraud in fact, Justice Brandeis, writing for the Supreme Court refused to recognize the priority of the lien. Basing his reasoning on a fraud analysis, Brandeis stated, "Under the law of New York a transfer of property which reserves to the transferor the right to dispose of the same, or to apply the proceeds thereof, for his own uses is, as to creditors, fraudulent in law and void." [16]

The Court made clear that the problem was not the ostensible ownership issue. Explaining the nature of the fraud, the Court stated, "It rests not upon seeming ownership because of possession retained, but upon lack of ownership because of dominion reserved. It does not raise a presumption of fraud. It imputes fraud conclusively because of the reservation of dominion inconsistent with the effective disposition of title and creation of a lien." [17] Since the rights retained by the debtor were inconsistent with a true transfer of property rights, there was no valid transfer of a lien to the secured creditor and the secured creditor was not entitled to assert priority over the other creditors.

While the *Ratner* opinion speaks in formalistic legal terms and on its face merely defines what formal legal steps are required for a valid transfer of a property interest, its meaning arguably goes much deeper. While basic property concepts allow a debtor to engage a non−fraudulent transfer of its property without creditor consent, what was at issue in *Ratner* was a purported transfer of property that was not a transfer at all. [18] When all the formalities were swept away, the only real interest that the *Ratner* debtor was trying to transfer was the insolvency share of the other creditors. When viewed in this fashion, *Ratner* stands for the proposition that a debtor commits a fraud upon creditors when it attempts to reallocate their insolvency shares without their consent. [19]

Ratner also anticipates one of the currently popular economic justifications for the priority of secured credit − the monitoring rationale. [20] The *Ratner* rule did not invalidate all security interests in accounts receivable as fraudulent. Instead *Ratner* required the secured creditor to monitor the debtor as a condition to the recognition of its lien. This rule benefited the unsecured creditors because the secured creditor, acting in its own interest, would recognize the signs of financial distress early and prevent the debtor from increasing its unsecured debt. [21]

The *Ratner* rule was firmly rejected by Article 9. [22] As the comments to section 9−205 of the 1972 version of Article 9 state, "It repeals the rule of *Benedict v. Ratner* (citation omitted) and other cases which held such arrangements void as a matter of law because the debtor was given unfettered dominion or control over the collateral." [23]

The legal world has since become very comfortable with the idea that a debtor may contractually reallocate the insolvency shares of its unsecured creditors by granting Article 9 security interests. The secured creditor obtains priority without the need for a "property transfer" like title. [24] Further, the debtor may retain all of the indicia of ownership without destroying the security interest, giving the secured creditor nothing more than a contingent foreclosure right and an enhanced insolvency share.

B. The Theoretical Case for Secured Credit

Although the common law courts' efforts to limit secured credit under a fraud rubric were beaten back by legislative attacks and the adoption of Article 9, the idea that secured credit can be a species of "wrong" committed against other creditors recently has enjoyed a resurgence in the academic literature.

The development of the law and economics movement led scholars to reevaluate many settled and accepted legal doctrines through the gray−tinted lenses of the "dismal science" of economics. Far from being immune to economic analysis, the law of secured transactions seemed to invite its review. The basic problem for supporters of secured credit comes from the Modigliani and Miller indifference proposition. [25] That widely accepted proposition asserts that, in a perfect market, a firm's capital structure does not affect its value. [26] Thus, the reasoning goes, the firm should be neutral to the choice between a capital structure with or without secured debt. If correct, this makes it very difficult to justify the asset distributional priority given to secured credit. [27]

The first real shot across the bow of Article 9 came in the seminal 1981 article by Professor Alan Schwartz that used economic analysis to challenge the very foundation of secured creditor priority. [28] That article took issue with the premise that secured credit reduces interest costs and thereby increases societal wealth. Essentially the traditional economic justification for secured credit was that: (1) granting priority to a secured creditor increases its share of the debtor's assets in the event of default; (2) this reduces the amount of the loss that the secured creditor will suffer upon default; (3) this allows the secured creditor to charge a lower interest rate; and (4) the debtor can use the interest savings in a more productive fashion.

Professor Schwartz took the analysis a few steps further to refute the claim that interest costs were necessarily reduced. Assuming that the debtor had both secured and unsecured creditors, the argument proceeded as follows: (1) the grant of priority to the secured creditor reduces the unsecured creditors' share of the debtor's assets upon default; (2) this increases the amount of the loss that the unsecured creditors will suffer upon default; (3) this forces the unsecured creditors to charge higher interest rates; and (4) the debtor's extra interest expense on its unsecured credit exactly equals the interest savings on its secured credit. [29] Thus, in a perfect market, the debtor has no incentive to issue secured debt. If there is no net interest savings, then security interests may increase transaction costs without increasing societal wealth.

While the Schwartz analysis focuses on efficiency rather than considerations like distributional fairness, it is only a short jump from a debtor−focused view of efficiency to a creditor−focused view of fairness. A restatement of the argument in creditor−focused terms might be "the gain to the secured creditor from obtaining a security interest is equally offset by losses to unsecured creditors." If there is no net gain from a secured transaction, then Article 9 is little more than a vehicle for transferring insolvency value from unsecured creditors to secured creditors. [30] Natural normative questions that follow are "Why are secured creditors more deserving of the debtor's insolvency value?" and "Why should the debtor have the power to decide which of its creditors is preferred?"

These ideas find expression in the current spate of articles [31] suggesting that secured transactions law should "carve out" a residual class of assets that would remain available to the unsecured creditors or grant secured creditors only partial priority. The proposals take various forms. Some, like Professor Warren's proposal, are based on normative distributional justice considerations. [32] Others are based on further refinements of the economic analysis and are designed to discourage those secured transactions that are not efficient. [33] Some carve out a cushion of unencumberable assets, [34] while others would require that part of the secured creditor's claim be treated as unsecured. [35] Some proposals would apply only in bankruptcy, [36] whereas others would apply generally. [37] Some would benefit all unsecured creditors, [38] while others would protect only favored classes of unsecured creditors such as non−adjusting creditors [39] or tort victims. [40]

Most of these analyses assume that there are at least some situations in which secured credit is efficient. [41] However, even a secured credit arrangement that is efficient may raise normative concerns. Economists distinguish between two different types of efficiency. A transaction is Pareto superior if the transaction increases overall wealth, but does not decrease the wealth of any party. A transaction that increases overall wealth, but that results in a decrease in the wealth of at least one party is Kaldor−Hicks efficient. [42]

The problem for proponents of secured credit, exacerbated by the Modigliani and Miller indifference proposition, is to identify sufficient benefits that flow from secured lending to justify its costs. Further, in order to show that secured lending is not merely efficient but Pareto−superior, sufficient benefits must flow to the unsecured creditors to offset their loss of insolvency shares. The challenge is identifying and quantifying those benefits.

This is an important aspect of the theoretical defense of secured credit. [43] The apparent significant and regressive distributional effect that the priority of secured credit produces raises normative distributional fairness concerns. [44] Further, although the economic analysis is useful in analyzing questions of allocative efficiency, it does not provide much insight into questions of distributive efficiency. [45]

Thus, even if secured credit does produce a net benefit and thus is wealth maximizing, it raises the normative question of why the wealth of the debtor and secured party should be increased at the expense of the unsecured creditors. However, if it can be shown that granting a security interest to one creditor also results in an incidental benefit to the unsecured creditors that offsets their loss of insolvency share, then the transaction would be Pareto−superior. If the unsecured creditors are not harmed, then the law should encourage such transactions. However, since the issue will arise in litigation only after the fact, it becomes critical whether the benefit to the unsecured creditors is measured at the time the security interest is created or at the time it is enforced.

Some scholars attempt to address this problem by hypothesizing unsecured creditor consent to the secured transaction. Although there is no actual consent, scholars approach the problem of justifying secured credit by asking whether a hypothetical rational unsecured creditor would have agreed to the secured creditor's priority if it had been asked to consent at the outset of the transaction. [46] Presumably any rational unsecured creditor would agree to a transaction with a risk−adjusted potential benefit in excess of the risk−adjusted potential cost. [47] Thus, any Pareto−superior secured transaction automatically becomes a transaction to which the unsecured creditors have constructively consented. [48] Under this view, the priority granted by secured transactions law should be limited to those secured transactions that are efficient in the Pareto−superior sense. The problem then becomes identifying the transaction's *ex ante* benefits to unsecured creditors that at least equal the loss of their insolvency share.

One suggestion is that the secured creditor may use its security interest to perform a monitoring function that benefits all creditors by reducing the debtor's ability to engage in activities that involve excessive risks. [49] If so, then the unsecured creditors' risk of loss may not be increased by giving the security interest priority. Of course, this rationale is weakened by current Article 9's rejection of *Benedict v. Ratner*. [50] While the secured creditor may monitor the debtor, that is not a pre−requisite to its obtaining priority. Thus, a secured creditor retains its priority under Article 9 even if it gives the debtor absolute discretion to do as it pleases with the collateral −− including betting it on a coin flip.

Another rationale advanced to support the argument that secured transactions may benefit unsecured creditors is that the ability to grant security interests increases the debtor's liquidity. [51] This benefits the unsecured creditors because it reduces the chance that the debtor will fail in the short term, and thereby increases the likelihood that the debtor will pay the then−existing unsecured creditors. [52] However, here again the rationale is weakened by the design of current Article 9. Just as Article 9 does not require monitoring as a condition of its grant of priority to security interests, it also does not require that the secured creditor make any additional advances as a condition to receiving priority. For example, it is not necessary that the secured creditor give new value to the debtor in order to obtain an enforceable security interest. [53] Further, Article 9 broadly validates after−acquired property clauses that can give the secured creditor additional collateral after the credit has already been extended. [54]

Another response to the argument that unsecured creditors are harmed by secured credit focuses on the unsecured creditors' ability to adjust their prices to reflect the increased risk. If the market works according to the economic model, unsecured creditors would increase their interest rates to adjust for the extra risk, if any, that a secured transaction imposed on them. [55] This would force the debtor to internalize the costs of the grant of a security interest and would insure that the debtor would have no incentive to grant a security interest in those situations where a security interest was inefficient. [56] Further, the unsecured creditors are not harmed by the transaction because the interest rates they charge fully compensate them for the additional risk.

However, if the unsecured creditors either do not or cannot adjust their interest rates, then the debtor can gain the benefit of lower interest rates on its secured credit without bearing the cost of an offsetting increase in the interest charges on its unsecured credit. [57] The result of this is that the unsecured creditors who cannot or do not adjust their rates bear additional risk without being compensated for that risk. The non−adjusting unsecured creditors are in essence "subsidizing" the secured credit transaction. While this subsidy can be analyzed on normative grounds such as fairness, [58] from a purely economic perspective, the existence of a subsidy will cause secured credit to be overused −− i.e. used in situations where its use does not result in a net increase in wealth. [59]

The arguments and counter−arguments result in an extremely complex web of theories, counter−theories, and variations on theories and counter−theories. These arguments continue to evolve and there is not yet any true consensus among scholars as to the validity of the arguments supporting the priority currently enjoyed by secured creditors. [60]

While there is little consensus on the theoretical side either as to the justifications for secured credit or the proper design of a secured credit law, there is even less empirical evidence to support either the current theories or the assumptions upon which they are based. [61] Against this backdrop of conflicting theory and a dearth of empirical evidence, [62] it is difficult to support legal reforms that enhance the priority rights of secured creditors or that encourage further expansion of the institution of secured credit. [63] However, revised Article 9 does exactly that. [64]

C. The Uniform Laws Process

Why does the Article 9 revision adopt such a pro−secured credit approach? In part, this is a natural result of the uniform laws drafting process. In recent years the uniform laws drafting process has become increasingly politicized. [65] Special interest groups have learned to exert their influence at the drafting stage, rather than actually putting their political muscle to the test in the usual political arena of 50 different state legislatures. [66] The need to draft an "enactable" uniform law opens the process up to threats of political blackmail that undermine the theoretical purity of the end product. [67]

One need look no further than revised Article 9 to find proof of this point. Although Article 9 does reflect a complete revision of the rules governing commercial secured transactions, it largely fails as a revision of the rules governing consumer transactions. The reason for this is mostly political. [68] The political battles fought in the drafting process between consumer groups and industry groups resulted in a compromise that produced a bland set of consumer protection rules that may be enactable, but that lack a strong theoretical or empirical foundation. [69]

A good example of the lack of a coherent consumer theory is the compromise reached on the "absolute bar" rule for deficiencies in cases where the Article 9 foreclosure provisions are not followed. While section 9−262(a) rejects the "absolute bar" rule for deficiencies in non−consumer transactions, new section 9−262(b) leaves it to the courts to determine the proper rule in consumer transactions and, in a truly unusual statutory directive, states, "The court may not infer from [the rejection of the "absolute bar" rule for non−consumer cases] the nature of the proper rule in consumer transactions and may continue to apply established approaches." [70]

While consumer groups are well organized and were at the drafting table presenting a counter−balance to the influence of the consumer credit industry, the world's general unsecured creditors and potential bankruptcy debtors are not so well organized. [71] Banks and other institutions that benefit most from the priority granted by Article 9 have well organized industry associations and have substantial political clout in many key states. The unsecured creditors who may be harmed by the Article 9 changes may not have a comparable degree of political power. Even if they had sufficient political power to influence the drafting process, they would be unlikely to recognize their shared interest in the Article 9 revisions and present as organized a force as the secured lending lobby. Thus, the enactability concerns do not merely interfere with the development of an appropriate secured credit policy, but they tilt the process in favor of enhancing the rights [72] of secured creditors. [73]

That is not to suggest that the Drafting Committee was captured by the credit industry lobbyist. The Reporters, Professors Harris and Mooney, are first rate scholars of high integrity who happen to accept the theory that secured credit maximizes wealth. [74] It is quite natural that they would be drawn to the Article 9 revision process and that their work product would reflect the theory that they think constitutes the best thought on the subject.

The nature of the Article 9 reform process may dictate such a result. The "neutral" principle that drives the process is the logic of secured credit, and that is the benchmark by which reform proposals are measured. [75] The goal of the process becomes making secured credit as "sleek and usable" as possible. [76] However, because of this approach, the participants in the reform process define efficiency within the system of secured credit and do not seriously consider the externalities imposed by that system or the distributional fairness questions raised by it. [77]

The natural outcome of such a process is a law that makes it easier to create and perfect liens, reduces the obligations imposed on secured creditors, and enhances the priority rights of secured creditors. While revised Article 9 succeeds in making secured credit more attractive, and thus will encourage the growth of secured credit as an institution, ironically those very reforms weaken the arguments that might justify the imposition of secured credit's costs on unsecured creditors.

The relaxed perfection requirements of revised Article 9 make the filing system virtually useless as a means of providing actual notice of security interests. Not only are there more situations where security interests are perfected without filing, but the relaxed description requirements coupled with the new place of filing rules mean that a search of the filing system will provide little in the way of precise information about the extent of secured credit outstanding against a debtor's assets. [78] This undermines the argument that unsecured creditors have consented to the secured creditor's priority, [79] unless one is willing to take the position that the *Twyne's Case* presumption has now been reversed −− i.e. unsecured creditors should assume that all of a debtor's apparent assets are encumbered and therefore be deemed to have consented to any security interest that may be granted by the debtor.

The relaxation of the Article 9 notice provisions also undermines the assumption that is critical to most economic models − i.e. that the unsecured creditors have perfect information. [80] Without such information, unsecured creditors cannot adjust their charges appropriately to compensate for the change in risk. If this prevents unsecured creditors from charging enough to compensate for their increased risks, it works as a subsidy for secured credit and adds supports to the carve out proposals. [81]

In addition, revised Article 9 continues the trend away from *Benedict v. Ratner* and further reduces the need for the secured creditor to monitor the debtor. [82] The expanded proceeds rule automatically extends the security interest to broad new classes of assets generated by the original collateral without requiring any monitoring by the secured creditor. [83] The new deposit account rules permit secured creditors to obtain enforceable liens on deposit accounts without restricting the debtor's pre−default use of those accounts in any way. [84] And, the new filing rules eliminate the need for the secured creditor to monitor changes in the location of the collateral or the debtor's place of business. [85] Since monitoring occurs at the whim of the secured creditor and is not mandated by revised Article 9, the monitoring argument cannot support the expanded priority of secured credit under revised Article 9.

The argument that the secured creditor's priority benefits unsecured creditors by increasing the debtor's liquidity is weakened by several features of revised Article 9. The revision allows the secured creditor's priority to extend to assets such as deposit accounts and non−assignable rights that in most situations are too uncertain to form the basis for additional financing. [86] Further, the expanded definition of "proceeds" causes the security interest to automatically extend to new classes of future assets that may be generated by the original collateral, although they are not replacements for it. [87] If those future assets were an important factor in the lender's decision to extend additional credit, it would be easy enough under current law for the security interest to extend to those assets through the use of an after−acquired property clause. The automatic nature of the proceeds security interest means that it will come into play only in those cases where the future assets were not deemed to be sufficiently important to mention in the security agreement. Thus, it seems highly unlikely that the extension of the priority in proceeds will result in any additional financing.

I.The Article 9 Revision and Bankruptcy Policy

While the revisions of Article 9 may weaken the already questionable foundation for granting full priority to secured credit, how does that become a bankruptcy policy issue? Article 9 is state law and presumably reflects non−bankruptcy state law policies about the benefits of secured credit and the appropriate hierarchy of claims against a debtor's assets. Further, under *Butner v. United States*, bankruptcy law generally respects state law property rights. [88] Thus, since bankruptcy policy incorporates the generally applicable state law property concepts, how could the Article 9 revision be contrary to bankruptcy policy?

For Professors Harris and Mooney the answer is simple. "Revised Article 9 and other nonbankruptcy law allocating property rights (such as priorities) *cannot* conflict with bankruptcy policies." [89] Under this view, there is no bankruptcy policy. Bankruptcy policy does not merely respect state law policies to some degree. Instead, state law policy is bankruptcy policy by definition. Bankruptcy law is merely procedural, with its substantive content supplied by state and other nonbankruptcy law.

There are two responses to this argument.

A. A Collective Remedy for a Collective Wrong

The first is that bankruptcy policy [90] is the central issue involved in determining whether and to what extent secured credit should be granted priority. Bankruptcy is a collective remedy for unsecured creditors and it is the forum where their rights as a group can be vindicated. While there may be valid non−bankruptcy−related reasons to permit or even encourage secured credit, at its core, secured credit involves the reallocation of a debtor's insolvency shares. Thus, any change in the Article 9 priority rights of secured creditors necessarily implicates the distributional fairness policies of bankruptcy law.

If secured credit constitutes a "wrong" to unsecured creditors because it reallocates the group's insolvency share without its consent, then a non−bankruptcy remedy that can be exercised by individual unsecured creditors is not an adequate remedy, because it merely shifts the secured creditor's ill−gotten gain to the particular unsecured creditor who happens to levy first. However, in bankruptcy the benefit can be redistributed among all unsecured creditors, thereby restoring the insolvency shares that were wrongfully taken. Bankruptcy is the most appropriate forum to remedy an injury to the unsecured creditors as a group.

To the extent that a debtor's grant of security involves a transfer of insolvency shares, recognition of the secured creditor's priority in a bankruptcy proceeding involves bankruptcy policy. Indeed, the proper allocation of a debtor's insolvency shares is the core bankruptcy policy issue. Thus, the question of where to draw the line between the rights of secured creditors and unsecured creditors in an insolvency proceeding is a federal law bankruptcy policy question, not a question for state non−bankruptcy lawmakers.

B. The Deference Principle as Trojan Horse

The second response focuses on the nature of bankruptcy law's deference to state law. That principle is set forth in *Butner* as follows:

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. [91]

The *Butner* formulation of the deference principle sets forth two significant limitations to the concept of deference to state law. First, deference applies to state based property rights and, second, it applies only in the absence of some federal policy requiring a different result.

While Article 9 appears to be creating property rights, is it possible that some of the rights labeled as "security interests" under revised Article 9 do not constitute "property," but rather mere contract rights? The emphasis that Professors Harris and Mooney place on their "property−based" theory of security interests suggests that they recognize the risk that *Butner* may not apply if the security interest concept is pushed too far. [92]

The distinction between property and contract is not that clear. [93] What exactly is the *property* interest that a secured creditor receives when it takes a security interest in a non−assignable contract right under an Article 9 regime that gives it no right to enforce its lien? [94] Merely calling a right a "security interest" does not make it property. Even if the right has some limited attributes of property, the question then becomes whether sufficient life remains in *Benedict v. Ratner* [95] to override the *Butner* presumption of deference.

Further, if the only real interest that has been transferred to the secured creditor is part of the unsecured creditors' bankruptcy share, then that is property that the debtor did not own because the bankruptcy law considers it to belong to the borrower's creditors as a group. [96] "Bankruptcy law takes precedence over contractual arrangements, in part because the rights of third parties to pro rata distribution at liquidation cannot be negotiated away without consent." [97]

In addition, deference to state law is proper only when deference will not frustrate bankruptcy policy. [98] Thus, the deference principle is limited to state laws that reflect the state's non−bankruptcy policy choices and that do not interfere with bankruptcy policies. If the state law is instead designed to further a state−based insolvency policy, it is not entitled to deference.

This exception to the deference policy covers both state rules that are explicitly directed at bankruptcy and those that produce results contrary to bankruptcy policy. This principle is now embodied in numerous Code sections that either limit deference to "generally applicable" non−bankruptcy law or expressly override state law that is either designed to alter bankruptcy priorities or has a primary effect of altering those priorities.

State law insolvency rules come in a variety of forms, ranging from rules that explicitly attempt to alter bankruptcy priorities, to rules that are disguised bankruptcy rules, to rules that reflect non−bankruptcy state policies but that have the effect of undermining bankruptcy policy.

In general, the Bankruptcy Code overrides all three types of rules. State law statutory lien provisions that are triggered by the filing of a bankruptcy petition are not honored in bankruptcy and may be avoided by the trustee. [99] However, the bankruptcy override is not limited to such blatant attempts to subvert federal bankruptcy policy. Most state law insolvency rules, even if not specifically targeted at bankruptcy proceedings, are invalidated. For example, section 545 permits the trustee to invalidate state law statutory lien provisions that are triggered by the filing of a non−bankruptcy insolvency proceeding or by the debtor's insolvency. [100] In addition, the section 546(b) limitation on various bankruptcy avoiding powers applies only to "generally applicable law," [101] a term that has been interpreted to exclude state insolvency rules. [102]

Further, even state laws that incorporate non−insolvency state policies are overridden where they might significantly distort the bankruptcy distributional scheme or otherwise undermine bankruptcy policy. Thus, section 545 also invalidates state law statutory lien provisions that are triggered by the appointment of a custodian, a levy pursuant to an execution, or the debtor's financial condition short of insolvency. [103] Such liens would distort the bankruptcy distributional scheme even though they further state policies that are not bankruptcy−specific.

This exception to deference goes further and applies even to some generally applicable state rules that might impede the bankruptcy or reorganization process. For example, statutory liens for rent are invalidated even though generally applicable and not triggered by the debtor's insolvency. [104] Similarly, the Bankruptcy Code overrides generally applicable state law regarding the calculation of claims for breach of a real estate lease [105] or an employment contract [106] because of effect that those rules would have on the distribution of the estate. And, the Bankruptcy Code overrides generally applicable state law regarding the assignment of contracts and leases because such rules might interfere with the Code's reorganization policy. [107] In the area of secured credit, it overrides applicable state law that permits a lien to attach to after−acquired property. [108]

Thus, although the *Butner* policy of deference is a strong one, it does not require deference to state law rules that are either designed to alter bankruptcy outcomes or that have that effect. The revisions to Article 9 stretch the *Butner* deference principle beyond its breaking point.

While many of the changes to Article 9 reflect important non−bankruptcy policy choices, most of the changes that will have a significant impact in bankruptcy cases do not. Those changes have little or no importance in a non−bankruptcy context and thus reflect no strong non−bankruptcy state law policies. Instead, they reflect a pro−secured creditor revision of bankruptcy policy that will significantly enhance the rights of secured creditors in bankruptcy cases, hamper the debtor's ability to reorganize, and divert much of the reorganization value to secured creditors.

In this regard, the bankruptcy−related changes in revised Article 9 are more properly seen as amendments to the federal Bankruptcy Code than as amendments to generally applicable state commercial law. Professors Harris and Mooney reject this assessment of the revision. [109] While they do support their case with examples of how some non−bankruptcy outcomes will be changed by the revisions at issue, those points at most establish a mixed motive. Neither the bankruptcy implications of the proposed changes nor the possibility of employing the deference principle to change the substance of bankruptcy law without altering its form escaped their notice.

Their earlier writings have examined this use of the deference principle, [110] and they make no attempt to retreat from that position in this Symposium. As they state:

Subject to extremely limited exceptions, the Bankruptcy Code offers a blank check to the makers of nonbankruptcy law to define and delineate property law principles that will prevail in bankruptcy. [111]

If the bankruptcy courts myopically accord revised Article 9 the deference that has traditionally been given to the UCC, the secured credit industry will have obtained through *Butner* and the un−elected private legislature that promulgates uniform laws what it has been unable to persuade the courts or Congress to give it.

I.Article 9 Meets the Bankruptcy Code − And Wins

A review of a few of the most significant bankruptcy−related changes made by revised Article 9 illustrates this point. Several general themes emerge. First, revised Article 9 rejects the notion that any assets should be "carved out" of the reach of secured credit in order to preserve some free assets to either fund a reorganization effort or to insure some minimum recovery for unsecured creditors. Second, the revision drastically curtails the trustee's ability to use the bankruptcy strong arm power to avoid security interests. Third, with respect to income producing assets, the revision provides a mechanism for opting out of the bankruptcy regime entirely. Fourth, the revision diverts the enterprise's reorganization value to the secured creditor. Finally, the revision hampers the debtor's ability to reorganize by giving greater control over that process to the secured creditor.

As noted at the outset, it is hazardous to predict in advance the bankruptcy impact of revised Article 9. The discussion that follows analyzes some of the changes that could have substantial bankruptcy implications. The extent to which the changes in revised Article 9 will have these effects turns on a number of factors, not the least of which are the interpretations given to the new provisions and the extent to which bankruptcy courts defer to the new rules. This interpretive venture is made more difficult by the failure of the Official Comments to discuss fully the bankruptcy implications of the changes.

A. Grab the Crumbs

1. Weakening the Strong Arm Power

What is the balance that bankruptcy policy strikes between secured and unsecured creditors? Traditionally bankruptcy law has deferred to the state law rights of secured creditors. While on its face this might suggest that bankruptcy law merely reflects whatever rights the parties may have outside of bankruptcy, that analysis fails upon closer inspection.

The very first United States bankruptcy act reflected a strong policy of equal distribution and hostility towards attempts to assert priority status. Although non−possessory personal property security interests of the type now covered by Article 9 were non−existent at the time, the Bankruptcy Act of 1800 did not fully recognize a creditor's otherwise valid non−bankruptcy entitlement to security. [112] Under section 31 of the Bankruptcy Act of 1800, a creditor having security for its debt was not entitled to "more than a rateable part of his debt, with the other creditors of the bankrupt." [113] The only exception was where an execution had actually been executed upon the debtor's property prior to bankruptcy. [114] Thus, rather than reflecting non−bankruptcy law, the bankruptcy law required something more than a mere non−bankruptcy entitlement before a right to security would be recognized in bankruptcy.

Does bankruptcy law or policy require that a core of free assets be preserved in order to ensure a minimum recovery for unsecured creditors or to finance the reorganization effort? This question had little importance until modern times because it was difficult in times past to obtain a valid lien on all assets of a debtor. Thus, there usually would be some free assets to administer. [115]

However, even before it was possible for secured creditors to gain priority on all of the debtor's assets, bankruptcy law operated as a partial counterweight to the increasing priority rights of secured creditors. Thus, the history of American bankruptcy law has been marked by a tug of war between the bankruptcy estate and its secured creditors. As the non−bankruptcy rights of secured creditors and the reach of their liens increased, the bankruptcy law developed new powers to limit those rights. The Article 9 revision is but the latest secured creditor counter−attack.

In the early days of American bankruptcy law, it was not possible for a creditor to obtain a valid non−possessory security interest in the debtor's assets. As Professor Gilmore observed, "Until early in the nineteenth century the only security devices which were known in our legal system were the mortgage of real property and the pledge of chattels. Security interests in personal property which remained in the borrower's possession during the loan period were unknown." [116]

Consequently, the early view of the bankruptcy trustee's status did not include any power to avoid unperfected security interests. Instead, under the bankruptcy acts of 1841 and 1867 the rights and powers of the assignee in bankruptcy were seen as derivative of the rights of the debtor. [117] Although some lower courts took the view under the 1867 act that the assignee, as a representative of creditors, had their rights as well as those of the debtor, [118] the Supreme Court rejected that view in *Stewart v. Platt*. [119] Thus, the assignee was a mere successor to the debtor and stood in its shoes.

This changed with the Bankruptcy Act of 1898, where Congress overruled *Stewart* and gave the trustee the powers of existing unsecured creditors. [120] This reflected a view that the trustee was the representative of the unsecured creditors and not merely an assignee of the debtor. [121] Arguably, Congress intended to go further in the 1898 act and grant the trustee the power to avoid unrecorded liens. [122] However, in *York v. Cassel*, [123] the Supreme Court rejected the argument that Congress had given the trustee any greater powers than those held by actual unsecured creditors. [124] Thus, the trustee was viewed as a mere representative of unsecured creditors and could avoid only transactions that unsecured creditors could avoid. The trustee was not given the greater powers of a lien creditor.

Congress responded four years later, in 1910, by enacting section 47a(2), [125] which clearly gave the trustee the powers of a creditor with a judicial lien. [126] Thus, the "strong arm" or hypothetical lien creditor power was born. This represented a significant change in the focus of bankruptcy law because it gave the trustee the power to free up assets that could not be reached by the unsecured creditors outside of bankruptcy. [127]

The development of the strong arm lien avoidance power from the 1840's to the 1910's paralleled the growth of personal property secured transactions law. The legal impediment to the creation of non−possessory security interests in personal property comes from *Twyne's Case* and its view that the transfer of an interest in personal property without delivery of possession is fraudulent. [128] That rule was gradually abandoned during the nineteenth century with the creation of a variety of "independent security devices." [129]

The first erosion of this regime occurred with the enactment of the chattel mortgage acts. [130] These acts first began to appear in the eastern seaboard states in about the1820's. [131] However, rather than being phrased in a positive fashion that affirmed the validity of chattel mortgages, the typical act began by declaring such mortgages "absolutely void." While this language seemed to reaffirm the *Twyne's Case* view of non−possessory personal property security interests, the typical act then created an exception to the voidness rule in cases where notice of the chattel mortgage was properly given. [132]

As a result of this wording, most courts concluded that chattel mortgages continued to be fraudulent conveyances. [133] Thus, the express statutory validation of chattel mortgages generally was construed as narrowly as possible. [134] Under this view, the acts did not protect properly recorded chattel mortgages from fraudulent conveyance attack; they mere converted the presumption of fraud from an irrebuttable one to a rebuttable one.

For example, as late as 1851, the New York Court of Appeals held that a properly recorded chattel mortgage was "presumptively fraudulent" notwithstanding the chattel mortgage act. [135] Thus, although the chattel mortgage was not fraudulent in law, it was a jury question whether the presumption of fraud had been properly rebutted.

This view made it difficult to use the chattel mortgage acts to create valid security interests, and it was particularly difficult to use these statutes to create valid security interests in inventory. By the mid−1890's the states were fairly evenly split on the question of whether a mortgage on a merchant's stock in trade was absolutely void as being "fraudulent in law," or merely subject to scrutiny under a "fraud in fact" analysis. [136]

Only in the waning years of the century did other personal property security devices begin to gain acceptance. The theoretical basis for trust receipts financing was established by a series of New York cases decided in 1878 and 1879. [137] The use of trust receipts as a security device came into general use over the following decade. The use of field warehousing as a method of obtaining a personal property security interest in inventory began to develop in the 1890's, but did not receive general legal acceptance until after the turn of the century. [138]

In the consumer goods and equipment finance areas, creditors tried to borrow the conditional sale doctrine from the law of contracts and use it as a personal property security device shortly before the turn of the century. [139] Although the judicial response was a hostile one, statutes authorizing conditional sales and requiring filing were passed in most jurisdictions. [140] The first factor's lien act appeared in 1911, but such acts did not become widely enacted until after 1940. [141]

In 1938, the role of bankruptcy law evolved in a radical new direction with the passage of the Chandler Act. [142] The Chandler Act introduced the reorganization and arrangement chapters to the bankruptcy law. [143] Thus, rather than being merely a process whereby the debtor could be liquidated for the benefit of its creditors, bankruptcy became a vehicle for reorganizing troubled enterprises.

This new role required that the non−bankruptcy rights of secured creditors be modified where necessary to serve bankruptcy law's new reorganization policy. However, the expansion of the non−bankruptcy rights of secured creditors and the scope of their liens also continued.

The secured creditor's ability to obtain a valid lien on the debtor's inventory became clear. As Gilmore states:

By 1940 or thereabouts it was true in most states that a merchant or manufacturer could encumber his inventory, reserving the power to sell in the ordinary course of his business . . . In many states it was still doubtful whether he could do this by way of mortgage . . ., but that he could do it, in one way or another, was no longer doubtful. [144]

The use of intangible assets (other than negotiable instruments) developed more slowly. Such financing could not be accomplished under the chattel mortgage acts because virtually all courts limited those acts to tangible goods and chattels. [145] The institutionalized financing of accounts receivable did not begin until the 1920's and only after 1930 did a sensible pattern appear in the judicial decisions interpreting receivable's financing. [146] The use of other contractual rights as a source of financing did not begin until after World War II. [147] As late as 1965, Gilmore commented that "security transfers of other types of contractual rights proceed in as hesitant and experimental fashion." [148]

In the 1940's and 1950's work progressed on Article 9 of the Uniform Commercial Code. This culminated in the 1962 version of Article 9, which subsequently was replaced by the current 1972 version. The earlier and current versions of Article 9 not only made it easier to obtain valid liens in personal property, [149] but they also made secured credit more attractive and encouraged its growth.

These reforms in commercial law continued the tug of war between secured credit and bankruptcy. As Professor Gilmore, one of the Article 9 drafters stated:

Pre−Code personal property security law may be described as closely resembling that obscure wood in which Dante discovered the gates of hell. We [the drafters] thought that, with a little pruning and clearing, we could turn the obscure wood into a peoples park where widows and orphans and country bankers could enjoy their innocent pleasures, safe from the attack of ravening wild beasts and trustees in bankruptcy. [150]

The bankruptcy law's response came in the form of the Bankruptcy Reform Act of 1978, which continued the trend of limiting the power of secured creditors. It is clear that the 1978 Code was drafted in response to the growth of secured credit. [151] Using the warfare analogy, Gilmore states, "With respect to some of the article 9 excesses, relief is already at hand. Just as, in nineteenth century melodramas, the United States Cavalry always arrived just in the nick of time, so the new [1978] Bankruptcy Code has come galloping to the rescue." [152]

The 1978 Code's expansion of the strong arm power cannot easily be explained by the "trustee as representative" rationale. Not only did the 1978 Code retain the basic lien creditor power with respect to secured claims against personal property, but it expanded the power in ways that did not reflect any rights or powers that unsecured creditors had or could have obtained through non−bankruptcy judicial process. The best example of this is the newly introduced power to avoid unrecorded real estate mortgages. Under section 544(a)(3), the trustee was given the status of a hypothetical bona fide purchaser of real property. [153] Similarly, the trustee was given bona fide purchaser status against statutory liens. [154] A bona fide purchaser is a favorite of the law and the Code's grant of bona fide purchaser status to the trustee embodies a policy of avoiding some otherwise valid lien claims in order to further distributional or reorganization goals. It does not merely reflect the non−bankruptcy rights of unsecured creditors.

Traditional scholarly approaches have attempted to support, or have criticized the strong arm power from the perspective of the trustee as a representative of unsecured creditors. [155] However, when viewed against the backdrop of the expansion of secured credit under state law, the strong arm power can be seen as a response to the growing power of secured creditors. Increases in the power of secured creditors under state law have been partially countered by reductions in the rights that secured creditors can assert in bankruptcy proceedings. [156]

Thus, rather than recognizing the full panoply of rights granted to secured creditors under non−bankruptcy law, the strong arm power reflects a degree of dubiety toward the priority granted to secured credit under state law. The strong arm power represents a modest attempt to rebalance the allocation of insolvency shares once the debtor enters a collective insolvency proceeding. [157]

Properly viewed, the strong arm power is a bankruptcy distribution rule that defines the line between the rights of secured creditors and unsecured creditors. It sets a *federal* minimum standard that must be met before a secured claim can be given priority in bankruptcy. Although it adopts as its benchmark existing standards from non−bankruptcy law, it does not mere defer to and replicate the state law rights of unsecured creditors.

This view is supported by oft stated "anti−secret lien" policy that the strong arm power is said to reflect. [158] Some scholars have questioned why this policy should be reflected in a bankruptcy−specific rule that visits upon an innocent, but negligent, secured party a penalty far more severe than would result under non−bankruptcy law. [159] However, a bankruptcy−specific rule makes sense if the rationale for honoring the priority of secured credit in bankruptcy is that unsecured creditors are deemed to have consented to, or adjusted for, liens that are properly noticed. [160]

The state law rules that govern one−on−one priority disputes between a secured party and a single lien creditor might legitimately award the secured party priority on the basis of very weak notice or no notice (as is the case for real property mortgage priority in some states). However, bankruptcy is a collective insolvency proceeding where the trustee represents the unsecured creditors as a group. Any insolvency shares recovered by the trustee will be redistributed to the group. Under this analysis, the priority of secured credit should not be recognized in bankruptcy unless the notice of the lien was meaningful notice.

The question then becomes what is meaningful notice. Federal bankruptcy law could establish its own definition or it could borrow an appropriate standard from generally applicable non−bankruptcy law. Such standards existed in both real estate and personal property security law in 1978.

In the real estate realm, many state law regimes extant in the 1970's required no notice in order for a mortgage to prevail over lien creditors. [161] However, since the bona fide purchaser is a favorite of the law, it would be reasonable to assume that state law rules governing priority over bona fide purchasers truly reflect the state's view of what is required in order to give meaningful notice of a lien. Thus, although the Code's use of bona fide purchaser status under sections 544 and 545 will result in different bankruptcy and non−bankruptcy outcomes, it is essential if the bankruptcy policy it reflects is one that requires meaningful notice of liens to unsecured creditors.

Thus, the modern strong arm power reflects a bankruptcy anti−secret lien policy that recognizes the basic state law rights of secured creditors, but only if the lien meets the minimum *federal* standard of notice based on whether the secured creditor has taken all steps necessary to give it as nearly perfect a lien as is possible under state law.

a.Bifurcation of perfection

Because of the structure of the then−current version of Article 9, the hypothetical lien creditor power was sufficient to accomplish this goal in 1978. With a few exceptions, [162] the 1972 version of Article 9 did not distinguish between lien creditors and secured creditors with respect to its concept of perfection. A security interest was either perfected or it was not. There was no bifurcation of the perfection concept −− with minimal steps necessary to obtain priority over lien creditors and some greater steps required to obtain priority over purchasers and other secured creditors.

Indeed, contrary to the idea that bankruptcy law defers to the state law rights of unsecured creditors, the earlier versions of Article 9 actually deferred to the bankruptcy law standard of notice. Prior to the 1962 version of Article 9, the term "perfection" was unknown to the state law of personal property security. [163] The 1962 version of Article 9 introduced the concept of "perfection" and used it as the standard for determining whether a security interest was entitled to priority over competing claimants. [164] The perfection concept was borrowed from the bankruptcy law and was based on the bankruptcy trustee's avoiding powers. [165] The UCC and bankruptcy law standards of notice were harmonious. Notice was notice, and the lien creditor provided the standard for adequate notice, both as to lien creditors and as to competing purchasers and secured creditors.

Revised Article 9 takes a very different approach. Different levels of perfection are required in order to obtain priority over lien creditors and competing security interests. Do the new lien creditor priority rules reflect a considered judgment based on important non−insolvency state policies about the relative equities of lien creditors and secured creditors? If so, then granting deference in bankruptcy to those important state policies might be appropriate.

While the decision of where to draw the priority line between secured creditors and lien creditors clearly reflected important non−bankruptcy state law policies in the past, [166] no student of modern secured transactions law can ignore the fact that the primary use of the rule nowadays is to allocate bankruptcy value between secured and unsecured creditors. [167] The Article 9 lien creditor priority rule has little impact and is of little importance outside of bankruptcy. The Article 9 drafters were not unaware of this. [168] There is little justification for revised Article 9's perfection hierarchy other than to provide a simple means of defeating the bankruptcy strong arm power. [169] The revision's changes in the Article 9 lien creditor rule are designed to change a fundamental bankruptcy distributional rule, contrary to bankruptcy policy.

The revision picks up the concept of bifurcated perfection from the 1994 amendments dealing with investment property. [170] Carrying those provisions forward, revised Article 9 permits security interests in investment property to be perfected by either filing or "control." [171] In theory, the concept behind the rule allowing perfection by filing must be that filing gives adequate notice of the lien. However, the limited nature of the protection provided by filing makes clear that the drafters did not consider that notice to be meaningful.

Indeed, perfection by filing gives the security interest very little protection from competing claims. Essentially, perfection by filing gives priority only over lien creditors, and thus trustees in bankruptcy. [172] While a security interest perfected only by filing also has priority over other secured creditors who are foolish enough to perfect only by filing, the competing secured creditor can easily trump the filed security interest by taking control of the investment property. [173] Thus, true protection of the security interest from competing security interests requires perfection by control. [174] Indeed, contrary to the idea that filing provides meaningful notice to the world, section 9−331(c) expressly provides that, "Filing under this article does not constitute notice of a claim or defense to . . . purchasers . . ."

The revised Act extends the bifurcated perfection concept to security interests in instruments. Under current law, the secured party generally must take possession of an instrument in order to gain priority over either a lien creditor or a competing secured creditor. [175] However, under the revision, the security interest can be perfected by either possession or filing. [176] As is the case with investment property, the "perfection" achieved by filing is not complete. [177] Perfection by possession is necessary in order to obtain true protection of the security interest. [178]

The revision goes even further with respect to asset securitization transactions in instruments and in payment intangibles. [179] These transactions are structured as sales and the purchaser's interest is perfected automatically under revised Article 9, without the need for filing or possession. [180] This automatic perfection is sufficient to defeat a lien creditor, and thus neutralize the bankruptcy strong arm power. However, here again with respect to instruments, perfection by possession is necessary to prevent a competing purchaser or secured party from obtaining priority. [181] Thus, weak notice defeats lien creditors, but meaningful notice is required in order to obtain priority over secured creditors and purchasers.

This weak notice concept also undermines the modern justifications for secured credit's priority in bankruptcy. If the notice given to unsecured creditors is not meaningful, then the consent rationale fails. Similarly, if the notice is not meaningful, then the normative arguments against the priority of secured credit become stronger, because unsecured creditors cannot adjust their interest rates to reflect unknown security interests. Indeed, the weak notice concept undermines a fundamental assumption of the economic models that might justify secured credit. An efficient market requires perfect information and the reduction of the information available to unsecured creditors may cause the credit market to become less efficient.

b.Bifurcation of financing statement contents

The revision also undermines the strong arm power by relaxing the Article 9 filing requirements. These changes are not so blatantly targeted at the bankruptcy trustee, since many apply both to secured creditors and to lien creditors. However, even the facially neutral changes will dramatically curtail the trustee's ability to use the strong arm power to avoid security interests. [182] Thus, they do represent a significant shift in the allocation of insolvency values between the secured and unsecured creditors.

The revision's treatment of the required contents of a financing statement, [183] however, do appear to be targeted at the bankruptcy strong arm power. The revision adopts a bifurcated system that distinguishes between the information entitlement of lien creditors and that of secured creditors and purchasers. The revision sets up two classes of required information. A very limited list of information is essential in order for the financing statement to be effective to perfect a security interest. [184] Errors in this information could be used by a lien creditor to defeat the security interest. The remaining information is also required, [185] but errors or omissions do not affect the validity of the financing statement *vis a vis* lien creditors. [186] Instead, the filing officer is supposed to reject the filing if any of the required information is missing. [187] In addition, errors or omissions in this information could render the financing statement ineffective against a competing secured party or purchaser. [188] These rules are unnaturally complex. There is little need for such a level of complexity except to limit the trustee' strong arm power without reducing the value of the financing statement to other secured creditors.

The revision reduces to two the types of content errors in a financing statement that could be used to avoid a security interest under the strong arm power. Although, as noted above, the financing statement should still contain such additional information as the debtor's address, the debtor's organizational identification number, the secured party's address, etc, [189] the only information required in order for it to be effective to perfect a security interest are: (1) the debtor's name; (2) the name of the secured party or its representative; and (3) an indication of the collateral. [190]

However, when the "seriously misleading" error rule [191] is considered, only an error in the debtor's name or the collateral indication will provide grounds for avoidance. Although not explicit in the statutory language, official comment number 2 to section 9−506 appears to foreclose the possibility that an error in the secured party's name could render a financing statement ineffective. That comment states, "Inasmuch as searches are not conducted under the secured party's name, and no filing is needed to continue the perfected status of a security interest after it is assigned, an error in the name of the secured party or its representative will not be seriously misleading." [192]

Revised Article 9 also changes the strong arm analysis for the remaining required contents of the financing statement −− the debtor's name and the indication of the collateral.

For registered organizations, the name requirement has been tightened up to require use of the official name as listed in the public records of the debtor's jurisdiction of organization. [193] In addition, the test for determining whether a name error is seriously misleading is an objective test that focuses on whether a search under the correct name would produce the financing statement listing the erroneous name. [194] Thus, financing statements incorrectly filed under a debtor's trade name generally will not be effective. [195] Contrary to the general trend of the revision, these changes will make it easier for the trustee to attack financing statements with errors in the debtor's name. [196] Also, contrary to the general trend, these changes will improve the quality of the information contained in the filing system.

However, the changes in the collateral description requirement will have the opposite effect. Although the revision generally continues the current law's reasonable identification standard for measuring the sufficiency of a collateral description, it rejects the more restrictive case law by validating descriptions by category, UCC type (e.g. "general intangibles"), quantity, and by a computational or allocational formula or procedure. [197]

While these changes slightly relax the description requirement, the more significant change is that the revision expressly validates the use of a supergeneric "all assets" or "all personal property" indication of the collateral in the financing statement. [198] Since there is no prohibition against including an over−broad collateral indication in the financing statement, [199] and since an "all assets" indication will insulate the financing statement from a description−based strong arm attack, it is likely that lenders will file "all assets" financing statements even when the transaction is more limited in scope. If this practice develops, then the trustee's ability to challenge the contents of a financing statement will be limited to errors in the debtor's name.

However, the same is not true for competing secured creditors and purchasers. While they can attack a financing statement on any of the grounds that are available to lien creditors or trustees in bankruptcy, [200] they are also permitted to defeat an earlier filer's priority based on errors in the additional information required by section 9−516(b).

This power to subordinate a defective financing statement is not extended to all competing secured creditors, but purports to be limited to those who give value in reasonable reliance on the incorrect information. [201] However, when the UCC definition of "value" is factored in, it becomes clear that the value requirement will never deprive a secured creditor of this provision's protection. Under section 1−201(44) a party gives value for rights when, "he acquires them (a) in return for a binding commitment to extend credit or for the extension of immediately available credit . . . or (b) as security for . . . a pre−existing claim." [202] Thus, by definition the very act of obtaining a security interest constitutes the giving of value. [203] There is no requirement that the secured creditor give any new value [204] in order to subordinate the improperly perfected lien.

The only requirement imposed upon a secured creditor is that it reasonably rely upon the incorrect information. For example, if the organizational identification number is incorrect and the later secured party either searches by organizational identification number or eliminates the filing based on the incorrect identification number, the first financing statement may be rendered ineffective against it. As a practical matter, this preserves the value of the additional information requirement for secured creditors who search the filing system before taking their security interests.

Lien creditors, however, are given no such protection. Although the legal fiction that is indulged in to support perfection by filing is that such filing gives notice of the lien to unsecured creditors, the revision takes the view that they are not entitled to the additional information required by section 9−516(b). Thus, if some unsecured creditor actually took the steps that the law imputes to it and searched the filing system prior to making its unsecured loan, it would be held to a higher standard of care than is imposed on secured creditors. For example, a financing statement filed with an incorrect organizational identification number would be effective against a lien creditor even if the lien creditor had extended credit in reliance upon its reasonable conclusion that there were no liens against the debtor's assets.

If the real focus of the changes to these rules is to protect only those who give value in reliance upon what is disclosed in the public record, then it is both too broad and too narrow. It is too broad because it allows both lien creditors and secured creditors to take advantage of innocent errors in the debtor's name or the description of collateral without any proof of reliance or prejudice. It is also too broad because it protects secured creditors without requiring that they give any new value in reliance on the filed record. On the other hand, it is too narrow because it does not protect all parties who can demonstrate that they were prejudiced by an error in the section 9−516(b) information. Lien creditors are denied the opportunity to make such a showing. [205] That protection is extended only to secured creditors and purchasers.

This complex web of rules makes some sense if viewed as an attempt to limit the bankruptcy strong arm power. However, it does so at some cost both to the secured creditors and to the theories that might support their priority. The reasonable reliance requirement may prove to be a poor choice from the later secured creditor's perspective, because the proof and interpretive problems it presents will likely result in costly and uncertain litigation. [206] The drafters appear to have forgotten the lessons learned in the 1972 revision, when the "knowledge" element of the lien creditor priority rule was eliminated to avoid such wasteful litigation. [207] If so, the attempt to steer between the Scylla of bankruptcy avoidance and the Charybdis of unreliable filings will have failed.

The dysfunctional nature of the bifurcated approach to the financing statement contents requirements is highlighted by the revision's treatment of federal taxpayer identification numbers (i.e. social security numbers and employer identification numbers). Note that these are not the numbers required by section 9−516(b). [208] Although nothing in the revision requires that they be included on the financing statement, the section 9−521(a) "uniform form" of the financing statement includes a box for the social security number or taxpayer identification number. [209] Unsophisticated searchers are likely to search by that number alone. Yet, if they purchase collateral or extend credit and take a security interest in reliance on an incorrect taxpayer identification number, they are not protected by section 9−338 because the taxpayer identification number is not information that is required by section 9−516(b).

A much simpler and more sensible approach would have been to decide which items of information are important enough to be essential, and to provide that seriously misleading errors in those items render the filing ineffective. Of course, that is the general approach of current law, [210] which allows the trustee in bankruptcy to avoid many improperly perfected security interests. The revision's bifurcation of perfection, coupled with its bifurcation of the financing statement contents requirements, makes a mockery of the concept of providing any meaningful notice of liens to unsecured creditors.

c.More records but less information

Although apparently not targeted at the trustee in bankruptcy, the new place of filing rules will reduce the likelihood that the strong arm power can be used to avoid security interests. Under current law, financing statements for tangible collateral generally must be filed in the state where the collateral is located and, for intangible collateral, the financing statement must be filed in the state where the debtor is located. [211] For business entities, the debtor is deemed to be located at its place of business if it has one, or at its chief executive office if it has more than one place of business. [212]

In addition, in those states adopting the "Third Alternative Subsection (1)" of current section 9−401, financing statements must be filed both at the county level and the state−wide level in those cases where the debtor's business locations are located in a single county in the state. [213] The combined effect of these rules is to favor local creditors by ensuring that financing statements are located in the state where the debtor's business operations are centered or where the relevant assets are located. In addition, for local businesses that operate in a single county, the Third Alternative ensures that a second financing statement will be available at the local level for creditors interested in searching. [214] Thus, although filing may not provide actual notice to unsecured creditors, at least the current law's system appears designed to make the filing system more, rather than less, effective in conveying meaningful notice.

At the same time, these rules increase chance of error by the secured party. It is often difficult to determine where the debtor's chief executive office is located. In addition, it is difficult to monitor changes in the location of that office or of the collateral that might trigger a duty to re−file in a new state. [215] In states adopting the Third Alternative, a failure to file at both the county and state levels renders the security interest unperfected. Any of these errors might cause the security interest to be avoided under the strong arm power in a subsequent bankruptcy.

The revised Act greatly simplifies the filing rules. [216] With the exception of real estate related collateral, the revision requires that all financing statements be filed in the state where the debtor is located. [217] Further, if the debtor is a registered organization like a corporation, it is deemed to be located in its jurisdiction of organization. [218] Thus, the uncertainty involved in determining the location of the debtor is largely eliminated. [219] In addition, the Act eliminates the local filing option for non−real estate related collateral. [220]

Thus, virtually all financing statements relating to a particular debtor will be filed in the same state, and in a single office within that state. For a corporation, this means that all financing statements covering its non−real estate related assets will be filed in its state of incorporation. This is true even though the corporation has no business operations in that state and even though none of its assets are located there. Obviously, this will make it much easier and cheaper for a secured creditor to perfect its lien, because a single filing in the state of incorporation can perfect a security interest in virtually all of the corporation's assets, wherever located. This greatly reduces the chance of error.

When the relaxed content rules are combined with the centralized filing rules, the chance of error is reduced even further. [221] Thus, for a debtor incorporated in Delaware, a single filing in Delaware that correctly names the debtor and that identifies the collateral as "all assets" will perfect a security interest nationwide in virtually any or all of the assets of the debtor that can be perfected by filing. Such a filing would defeat the bankruptcy strong arm power even if all of the other information in the financing statement was in error.

The new rules clearly are designed to reduce the secured creditor's burden of giving notice. They also reduce the risk of errors that might result in the security interest being subordinated, thereby reducing the assets available for distribution to unsecured creditors. [222] However, do the new rules serve the goal of providing meaningful public notice of the lien?

Arguably, the move to centralized filing in a single jurisdiction and the elimination of the local filing option reduces the effectiveness of the notice. This change does not greatly inconvenience other secured creditors, and may even reduce their search burden. However, since the relevant jurisdiction for registered organizations need not be one where the corporation has assets or business operations, [223] notice filed there may not be easily accessible to the organization's creditors. [224] The difficulties in determining where to search and in mastering the distant offices search protocols may present additional barriers to effective notice. This depends in part on the extent to which telecommunication advances, third party information vendors, and the policies adopted by the distant filing offices compensate for these difficulties.

The much larger threat is that the centralized filing rule, when coupled with the relaxed description requirement, could render the filing system virtually worthless as a meaningful mechanism for giving notice of the existence or extent of liens. [225] Under the revision, a financing statement filed to perfect a very small transaction involving a security interest in a single tangible asset in a particular state must be filed in the corporation's state of incorporation. Similarly, every other financing statement, whether relating to a significant transaction or a trivial one, will be filed in that same office. Since all of the financing statements relating to a debtor will be concentrated in a single office in the state of incorporation, a search may produce an overwhelming number of financing statements.

If protective [226] "all assets" filings become common, the collateral description requirement will also become meaningless, because each financing statement will suggest that all assets are covered when that is not the case. Thus, the filing system may become cluttered with so many records, and those records may contain so little real information, that the system provides no notice to unsecured creditors other than a mere warning that there may be liens.

d.Legal fiction vs.reality

Revised Article 9 makes only a token effort to give notice to unsecured creditors. The "less signal − more static" approach to notice does not address the concerns that motivated *Twyne's Case* nor is it sufficient to support modern theories that might justify the priority of secured credit. [227] Such notice cannot support a presumption that unsecured creditors are sufficiently aware of the increased risk to have compensated by adjusting their charges. [228] If they are unable to compensate, the reallocation of their insolvency shares produces an unfair distributional result that should be readjusted in bankruptcy. [229] Further, this creates a subsidy for secured credit that may cause it to be used in situations where it does not increase efficiency.

While the act of filing is meaningless from the perspective of unsecured creditors, it is in fact very meaningful from the perspective of other secured creditors. The filing system's original function of providing public notice to unsecured creditors has been replaced by the dual function of providing inquiry notice to other secured creditors and of providing a simple means of determining the relative priority of competing security interests. [230]

Revised Article 9 takes this evolution one step further and does not even attempt to address the concerns that drive the anti−secret lien policies of the common law and American bankruptcy law. Instead, the new lien creditor notice provisions represent an attempt to push the legal fiction of notice to unsecured creditors as close to its breaking point as possible. [231] The revision triggers the question, at what point must the legal fiction of constructive notice to unsecured creditors be rejected and the legal reality of no notice be recognized and dealt with? [232] Will the revision's meaningless act of filing a meaningless notice be enough to allow the courts and scholars to continue to pretend that Article 9 security interests are not secret liens?

The lien creditor rules of revised Article 9 are not designed to provide notice to unsecured creditors. Instead, they are more properly seen as an attempt to reallocate the balance between secured and unsecured creditors in bankruptcy.

1. Leave Nothing on the Table

Not only does revised Article 9 reduce the unsecured creditors' share of the debtor's insolvency value by limiting the effect of the strong arm power, it also expands the permissible reach of the secured creditors' liens. Revised Article 9 now allows secured creditors to easily obtain liens in assets that previously were not available as collateral or in situations where it was difficult to obtain valid liens. This continues and will accelerate the trend toward the full priority of secured credit. [233] It also means that little or nothing may be available for unsecured creditors in bankruptcy. [234]

The two main areas where the revision will reduce the share of unsecured creditors by increasing the reach of the secured creditors' liens are the new provisions dealing with security interests in deposit accounts and in non−assignable rights. [235] In addition, the expanded proceeds rule [236] will automatically extend the reach of a security interest and reduce the unencumbered assets. [237]

a.Bank accounts as collateral

The revision makes it easy for a secured creditor to take a security interest in all of the debtor's deposit accounts, including checking accounts and other operating accounts. [238]

The uniform version of current Article 9 does not apply to most security interests in bank accounts. [239] Current section 9−104 expressly excludes from Article 9's scope "a transfer of an interest in any deposit account," except to the extent that the funds in the account represent identifiable proceeds of some other collateral. [240] The "deposit account" definition includes virtually all bank accounts, except certificates of deposit. [241] Thus, current Article 9 does not apply to a transaction that creates a security interest in a typical bank account as original collateral. It would, however, apply to a security interest in a certificate of deposit as original collateral and would apply to the extent that the proceeds of some other collateral are deposited into a deposit account.

The exclusion of deposit accounts from current Article 9 does not prohibit security interests in deposit accounts. It merely leaves such transactions subject to a state's non−UCC common law. However, the practical effect of the exclusion has been to make it extremely difficult or impractical to use such accounts as original collateral in most states. [242]

The revised Act extends the coverage of Article 9 to include security interests taken in non−consumer [243] deposit accounts as original collateral. [244] Thus, under the revision, a creditor can take a security interest in the funds on deposit in the debtor's bank accounts even if those funds do not represent the proceeds of some other collateral.

The perfection rules for deposit accounts are significantly different from the normal perfection rules under current law. Filing a financing statement will not perfect a security interest in a deposit account as original collateral. [245] Instead the revision relies on the concept of "control." In order to perfect a security interest in a deposit account as original collateral the secured party must have "control" of the account. [246]

There are three different ways to obtain "control" over a deposit account. First, if the secured party is the bank that maintains the deposit account, then control, and hence perfection, is automatic. [247] Other secured creditors can obtain control in either of two ways.

The method likely to be used in most cases is a "control agreement." A secured party has control if the debtor, the secured party, and the bank have agreed in an authenticated record that the bank will comply with the secured party's instructions to pay out the funds in the deposit account without further consent by the debtor. [248] The alternative method by which a secured party can obtain control is to become the bank's customer with respect to the account. [249] However, this method may be impractical for checking accounts and other types of accounts to which the debtor needs regular access.

Although control is the only method of perfecting a security interest in a deposit account as original collateral, a security interest might arise in a deposit account because the funds in the account are identifiable proceeds of some other collateral. Such a security interest in identifiable proceeds is automatically perfected if the security interest in the original collateral was perfected. [250]

While use of the term "control" creates an impression that perfection may require the secured creditor to restrict the debtor's use of the account in order to obtain priority, that is not the case. Although the control agreement could be drafted to restrict the debtor's use of the account, the debtor may retain full rights right to use the account without destroying the secured party's control. Section 9−104(b) provides that a secured party that has satisfied the minimum requirements for control (e.g. obtained a control agreement) is perfected by control "even if the debtor retains the right to direct the disposition of funds from the deposit account." [251]

By providing clear and simple rules for taking and perfecting deposit account security interests, the revision will likely result in lenders routinely obtaining security interests in debtor's bank accounts. The control requirement should not present any real barrier to taking these interests. [252] All the creditor must do is require the debtor to maintain its accounts at a bank that routinely consents to control agreements. [253] Once these practices develop, it will be a simple matter to obtain and perfect a security interest in the debtor's bank accounts as a matter of course in any substantial lending transaction.

Obviously this will result in a reduction of the amount of free assets available in bankruptcy and will shift the allocation of the debtor's insolvency shares accordingly. Do any of the justifications for secured credit priority support this extension of secured creditor rights?

The liquidity rationale for secured credit priority fails to support the revision for several reasons. First, since deposit accounts are already fairly liquid assets, it is not clear how making them available as collateral will significantly increase the debtor's liquidity. To the extent that funds on deposit are not needed for day−to−day operations, debtors can already use them as collateral under current law merely by opening a certificate of deposit account and converting the asset into an "instrument." [254] This extra step also helps ensure that obtaining a security interest in the funds on deposit actually is important to the credit extension, rather than merely a fortuitous windfall for the secured creditor. Thus, the liquidity rationale for the revision must be analyzed from the basis of the additional liquidity that can be gained from using operational accounts as collateral.

However, the liquid nature of an operational deposit account makes it a very uncertain class of collateral. For example, the Bankruptcy Code's special "cash collateral" rules recognize the ephemeral nature of collateral that can be depleted so easily and quickly by a debtor. [255] This uncertainty makes it unlikely that a lender would consider the funds in such an account as part of the lending base and increase the amount of credit it extends accordingly. [256] Similarly, the evanescent nature of this type of collateral makes it unlikely that lenders will factor it into their interest charges. [257]

The monitoring rationale also fails to support the revision's treatment of deposit accounts. Although the steps currently required under Article 9 or the relevant common law in order to obtain a valid lien in the debtor's funds do serve a monitoring function by restricting the debtor's use of the funds, the revision dispenses with those requirements. The control concepts represents nothing more than the briefest of nods to *Benedict v. Ratner*. [258] The secured creditor merely needs to have the power to obtain the funds upon default. The debtor's use of the account need not be restricted in any way. Thus the debtor gives up nothing, other than the insolvency shares of its unsecured creditors.

b.Non−assignable rights as collateral

The second major change that will extend the reach of security interests is revised Article 9's treatment of non−assignable contracts, leases, franchises, software licenses, and other rights. [259] The revision incorporates a strong policy in favor of free assignability and overrides most restrictions on the assignment of intangible property interests. [260] The elimination of anti−assignment rules will have the practical effect of making these classes of assets available as collateral.

Under current law, there is some dispute whether a security interest can be created in a non−assignable intangible asset. Since current section 9−203(1)(c) requires that the debtor have "rights in the collateral," the existence of an anti−assignment provision in the contract or under applicable law might prevent the creation of a valid security interest. [261]

Numerous cases have arisen in the context of FCC broadcast licenses. Early cases took the view that in light of the FCC's anti−assignment policy, no security interest could be created in such a license. As a result, even if the license were assigned to a new owner with the FCC's permission, the lender would have no security interest in the proceeds generated by the assignment. In 1994, the FCC modified its position to clarify that no security interest could be created in a license because that might interfere with the FCC's ability to regulate the licensee. However, a security interest could be created in the proceeds of the assignment of a license to an FCC−approved third party because the security interest in the proceeds did not interfere with FCC regulation of the licensee. [262]

The revised Act's treatment of security interests in non−assignable intangibles is similar to the current treatment of FCC licenses. The revision distinguishes between non−economic rights and the payment rights and proceeds that might be generated by the intangible asset. The basic policy of free assignability is tempered to the extent necessary to protect the other party to the contract, franchise, license, etc., from most adverse effects arising from the granting of a security interest.

With respect to payment obligations, the revision expands the more limited free assignability provisions of current law. Current Article 9 renders "ineffective" contractual anti−assignment clauses in accounts and in general intangibles for money due or to become due. [263] Revised Article 9 expands this provision in several significant respects. [264]

First, and perhaps most significantly, the broader definition of accounts under the revision brings a wider array of payment obligations within the scope of the provision. Under revised Article 9, the definition of accounts has been expanded beyond merely rights to payment arising from the provision of goods or services, and now includes such rights as franchise fees and intellectual property license fees. [265] In addition to the expansion of the accounts category, the free assignability provisions of the new section now expressly applies to payment intangibles, chattel paper and promissory notes. Thus, the new provision applies to virtually all types of payment obligations and prevents anti−assignment provisions from interfering with their use as collateral. [266]

Further, although current law only overrides contractual anti−assignment provisions, the revision goes further and renders ineffective both contractual anti−assignment provisions and any "rule of law, statute, or regulation" that restricts assignment of such payment rights. [267] In addition, the language of the new provision clarifies: (1) that it applies to assignments and transfers as well as security interests; (2) that it renders ineffective terms that merely restrict, rather than prohibit, assignment; and (3) that it renders ineffective terms that trigger a default, termination, or other penalty based on an assignment.

Although section 9−406 represents a modest expansion of the current law's free assignability policy, the more significant expansion is found in section 9−408. [268] While section 9−406 makes non−assignable rights to payment available as collateral, section 9−408 makes other non−assignable rights lienable.

Using language similar to section 9−406, section 9−408 broadly invalidates anti−assignment contractual provisions and legal rules relating to promissory notes and payment intangibles, to health−care−insurance receivables, and to other general intangibles, including contracts, permits, licenses, and franchises. [269]

Under this provision, it will be easy to create a valid, enforceable and perfected Article 9 security interest in a debtor's non−assignable rights under its contracts, permits, licenses, and franchise agreements. [270] Such a perfected security interest in the intangible right would also give the secured creditor a perfected security interest in any "proceeds" of the intangible. [271] Since the revised Act adopts a broader "proceeds" definition than current law, such proceeds would include, *inter alia*, any sale proceeds in the event that the debtor disposes of the intangible collateral, any license fees if the debtor is the licensor of an intellectual property right, and any property collected on, or distributed on account of, the collateral. [272]

However, the revision's invalidation of anti−assignment provisions is a limited one. Section 9−408 only renders such terms ineffective to the extent that they "would impair the creation, attachment, or perfection" of a security interest. [273] The secured party's right to "enforce" its security interest is noticeably absent from this list. [274]

Thus, other than obtaining a bare "security interest" in the non−assignable intangible right and a right to proceeds, the secured creditor receives few of the rights one normally associates with a security interest. The specific limitations on the secured party's enforcement rights are spelled out in section 9−408(d). [275]

An example illustrates these limitations. Assume that the security agreement grants a security interest in "general intangibles and equipment" and that the debtor has a license from Microsoft to use its "Word" computer software word processing program, which has been installed on the debtor's computers. The debtor's license from Microsoft prohibits the assignment of the license. Under sections 9−408 (a & c), the security interest would attach to the software license notwithstanding the contractual anti−assignment provisions or similar restrictions under applicable law.

However, the secured party's rights outside of bankruptcy are virtually non−existent. Under the limitations of section 9−408(d), the security agreement: (1) is not enforceable against Microsoft; (2) it imposes no duties or obligations on Microsoft; (3) it does not require Microsoft to recognize the security interest, pay or render performance to the secured party, or accept payment or performance from the secured party; (4) it does not entitle the secured party to use the Word software or to assign the debtor's rights in the software; and, (5) it does not entitle the secured party to have access to any trade secrets or confidential information of Microsoft.

Finally, and perhaps most significantly, section 9−408(d) explicitly states that the creation of a security interest in such a non−assignable right "does not entitle the secured party to enforce the security interest in the … general intangible." [276] As the Official Comment makes clear, using the example of a non−assignable software license, "Even if the secured party takes possession of the computers on the debtor's default, the debtor would remain free to remove the software from the computer, load it on another computer, and continue to use it, if the license so permits." [277]

What is the value of such a security interest outside of bankruptcy? Generally, such collateral is of value only where the non−debtor party to the non−assignable right is willing to recognize the security interest and consent to the secured party's enforcement of it. Thus, it is not clear why this reform is needed because, in those cases where the interest actually has some value as collateral, the secured party could presumably obtain a waiver of the anti−assignment provision or obtain a conditional assignment of the rights from the consenting non−debtor party. To the extent that the section covers these cases it adds nothing to the liquidity of the debtor.

If, on the other hand, the non−debtor party to the non−assignable right is unwilling to consent to enforcement of the security interest, the right has little value as collateral. The Official Comments provide the very weak response that in such cases a secured creditor may ascribe value to the collateral because of the possibility that the non−debtor party may consent to an assignment in the future. [278]

The comment refers to two possibilities: (1) that the non−debtor party may consent to the secured party's enforcement of the security interest; or (2) that the non−debtor party may consent to an assignment of the right by the debtor and that assignment may generate proceeds [279] to which the security interest would automatically attach. [280] Since both require a consent to assignment that the non−debtor party apparently is unwilling to give at the inception of the credit transaction, the value of the collateral is highly dubious. It seems unlikely that a reform making such unreliable collateral available to the creditor will increase the debtor's liquidity.

Further, the provision is not limited to rights, such as a franchise, that may be valuable enough to support an extension of credit. [281] Rather, it permits a secured creditor to lien up rights, such as the debtor's license to use Microsoft Word, that have no value as collateral outside of bankruptcy.

The new rules overriding anti−assignment provisions do allow secured creditors to obtain priority with respect to assets that previously would have been unavailable as collateral, and thereby extend the concept of full priority of secured debt. However, because of the non−assignable nature of the debtor's rights, the unsecured creditors could not have looked to those assets for satisfaction of their claims. Thus, the new rules do not significantly reduce [282] the assets available to unsecured creditors outside of bankruptcy.

As discussed below, [283] and made clear by Official Comment 7 to section 9−408, [284] the primary purpose of this reform is to enhance the secured creditor's recovery in bankruptcy. [285] It does this by making use of the Bankruptcy Code's rules that allow the estate to use and to assign non−assignable rights. Thus the revision truly is targeted at the bankruptcy process. It does not reflect a state law policy of preferring the rights of secured creditors over the rights of non−debtor parties to non−assignable contracts.

Since neither the secured nor unsecured creditors are given any rights against the non−debtor party to a non−assignable general intangible, these rules similarly do not reflect any non−insolvency state policy of the relative rights of secured and unsecured creditors. The Bankruptcy Code overrides such clauses in order to create value for unsecured creditors and to further a reorganization process that may also create value for them. This value, that is created only in a bankruptcy proceeding, truly is the unsecured creditors' insolvency share.

The new Article 9 rules do not make available as collateral valuable assets that will enhance the debtor's ability to obtain credit. They are instead bankruptcy−targeted insolvency value reallocation rules masquerading as neutral principles of state commercial law.

c.Expanded reach of proceeds

A final area where the revision extends the reach of security interests and thereby reduces the free assets available to unsecured creditors is its treatment of "proceeds." Current law generally limits the scope of the proceeds rule to assets that the debtor receives as replacements for the original collateral. While the revision retains this concept, it adds to the class of proceeds future property that is generated by or related to the original collateral.

As a result, the new rules will extend the reach of a secured creditor's lien outside of bankruptcy and thus result in fewer free assets for distribution to unsecured creditors in bankruptcy. However, like the rules overriding anti−assignment provisions, the main focus of the changes in the proceeds rule is not to define the permissible reach of security interests outside of bankruptcy. Instead, the primary impact of the changes will be to increase the secured creditor's share of the assets created by the bankruptcy reorganization process.

Two sets of UCC rules must be considered when dealing with after−acquired property. First, both current law and revised Article 9 broadly validate "after−acquired property" clauses. [286] Thus, if proper language is included in the security agreement, the security interest will extend to property acquired by the debtor in the future, even if that future property is not derived from or in any way related to the creditor's original collateral. In addition, under the new filing rules, it will be easy to perfect such a security interest in after−acquired property. If, however, the future property qualifies as "proceeds," then the security interest automatically attaches to the future property without the need for any language in the security agreement. [287] In addition, the proceeds security interest generally will be perfected automatically by whatever step was required to perfect the security interest in the original collateral.

Thus, any future property that will now qualify as proceeds under the revised Act's expanded definition could easily be used as collateral merely by including a properly drafted after−acquired property clause in the security agreement. What the expanded proceeds rule does is to give the secured creditor a security interest in such assets automatically. Sophisticated lenders probably already obtain security interests in most types of after−acquired property that are now included in the expanded "proceeds" definition if they are considering those assets as part of the lending base. Outside of bankruptcy the proceeds rule will be important only in those cases where the secured creditor did not deem the proceeds assets to be valuable enough to mention them in the security agreement. As a result, the rule cannot be justified on a liquidity rationale.

As noted above, the revised Act carries forward the current rule that a security interest automatically extends to any "identifiable proceeds" of the original collateral. [288] The attachment of the security interest to the proceeds is automatic. [289] There is no need to include language in the security agreement granting a security interest in proceeds, nor is it necessary that the proceeds satisfy the description of collateral that is contained in the security agreement. [290]

The requirement that the proceeds be "identifiable" has also been clarified. Most courts interpreting current law allow the secured party to use equitable tracing devices such as the "lowest intermediate balance rule" to establish the identity of commingled proceeds [291] and the revised Act expressly authorizes that practice. [292] Thus, for cash proceeds and other non−goods proceeds, the proceeds are "identifiable," and thus subject to the security interest, "to the extent that the secured party identifies the proceeds by a method of tracing, including application of equitable principles, that is permitted under" non−Article 9 law for commingled property of that type. [293]

A different rule applies if the proceeds are goods that become commingled with other goods such that their identity is lost in the product or mass. In such a case, the "proceeds" security interest attaches to the entire product or mass. [294]

Under current law, a special rule applies to commingled cash proceeds when the debtor becomes involved in an insolvency proceeding. Current law limits the creditor's proceeds security interest in funds that have been deposited into a commingled bank account to the amount of any cash proceeds received by the debtor within ten days before the institution of the insolvency proceeding. [295] This provision has generated conflicting case law, [296] and could have the drastic effect of cutting off the proceeds claim if no funds were received during the ten day period. [297]

The revised Act eliminates the special insolvency proceeds rule. As a result, the proceeds claim will no longer be artificially limited by the ten−day rule. The combined effect of this change and the explicit validation of equitable tracing principles will be to enhance the secured creditor's ability to assert cash collateral claims against funds in the debtor's bank accounts.

However, the most significant change in the proceeds rule is the expansion of the definition of proceeds. Current law generally requires a "disposition" and limits proceeds to property that replaces the original collateral. In contrast, the revised Act enlarges the proceeds concept to include most property that is derived from the original collateral. [298]

The revised Act greatly expands the types of transactions that will be treated as "dispositions" that generate proceeds. Under current law it is unclear whether a lease or license involves a "disposition" and whether rental and license fees qualify as proceeds. While the case law suggests that such "use" payments are not proceeds, [299] the Permanent Editorial Board took the view that a lease does generate proceeds because it involves the disposition of a partial interest in the collateral. [300]

The revised Act resolves this question by expressly including leases and licenses in the list of dispositions that generate proceeds. [301] It is not clear how extensive these revisions are. Note that the *Value−Added* case involved funds generated by the use of pay telephones. The UCC definition of "lease" or the non−defined term "license" seems broad enough to cover such a short term use. [302] If so, then this provision may extend the reach of the proceeds rule to funds generated by coin−operated devices.

Like current law, insurance payable by reason of loss or damage to the collateral is also proceeds. [303] However, the revised Act expands the insurance provision to include as proceeds insurance payable by reason of nonconformity of the collateral, defects in the collateral, or the infringement of rights in the collateral. Although in most cases the secured party's right to proceeds is limited only by the amount of its claim, the revised Act limits the secured party's proceeds claim in insurance payments to the extent of the value of the collateral. [304]

Collections on the collateral are included as proceeds under both the current law and the revised Act. [305] However, the revised Act expands the proceeds definition to also include "whatever … is distributed on account of" the collateral. [306] Thus, both dividends payable on investment property collateral and collections or distributions on credit−support arrangements ("supporting obligations") are proceeds. [307] This change is designed to reject the reasoning of *FDIC v. Hastie* (*In re Hastie*), [308] which held that ordinary stock dividends were not proceeds of the stock since there was no disposition of the stock. [309]

The shift away from a disposition requirement is most apparent in section 9−102(64)(C), which expands the definition of proceeds to include "rights arising out of collateral." It is not at all clear how extensively the "rights" clause will expand the proceeds concept. Curiously, although the concept is completely new to the proceeds analysis, the Official Comments do not discuss its meaning. The Code's definition of "rights" offers little help since it merely affirms that "'rights' includes remedies." [310] Nonetheless, the Code's concept of "rights" is an extremely broad one and this clause, at a minimum, must push the proceeds definition beyond the already expansive reach of the other clauses of the definition.

Finally, the revised Act extends the definition of proceeds to include various claims relating to the collateral. [311] Thus, claims for nonconformity, defects in, damage to, or the loss of the collateral are proceeds. [312] In addition, claims for interference with the use of the collateral or for infringement of rights in the collateral are also proceeds. [313] However, like the insurance provision, the "claims" provision limits the secured party's proceeds security interest to the extent of the value of the original collateral. [314]

Outside of bankruptcy, the expanded proceeds definition will mean that a greater class of derivative assets will be subject to the security interest in the original collateral. Thus, the lien may extend to more assets at the time a bankruptcy is filed. Since, the bankruptcy strong arm power gives the trustee or debtor−in−possession the capacity to avoid unperfected security interests, the secured creditor's ability to assert priority over the proceeds assets in bankruptcy will depend on whether the proceeds security interest is perfected. Here, changes in Article 9 will make it virtually impossible for a trustee in bankruptcy to avoid the proceeds security interest.

Since the proceeds collateral may be of a type different from the original collateral, the steps taken to perfect a security interest in the original collateral may not be the appropriate steps to take in order to perfect a security interest in collateral of the new type. With some revisions, the new Act carries forward the current rules that specify the extent to which new steps must be taken in order to maintain perfection in proceeds.

Like current law, if the security interest in the original collateral was perfected, then the proceeds security interest is automatically perfected for a short period of time, giving the creditor an opportunity to take the steps necessary in order to maintain perfection. [315] If the security interest in the original collateral was not properly perfected, then the security interest in proceeds will not be perfected automatically.

The revised Act extends the period of automatic perfection from 10 to 20 days. On the 21st day after the security interest attaches to the proceeds, it will become unperfected unless one of three conditions is satisfied. [316] The three conditions for maintaining perfection are phrased in terms similar to current law. However, other changes in the revision likely will have the effect of preventing lapse in almost all cases where the original security interest was perfected by filing a financing statement.

The first of the three conditions for continuing perfection after the 20th day is the simplest. If the proper steps for perfecting a security interest in the type of collateral that constitutes proceeds are taken before the 21st day after attachment, then perfection is maintained. [317] These steps could be taken during the 20−day grace period or they could have been taken long before the proceeds were generated.

For example, if the creditor has perfected a security interest in the debtor's checking account by "control" and the debtor uses funds from that account to acquire a piece of equipment, the creditor's proceeds security interest in the equipment would be perfected automatically for the first 20 days. If the creditor filed a financing statement listing "equipment" during the 20−day period, [318] its security interest in the equipment would remain perfected after the 20th day. Similarly, if the creditor had previously filed a financing statement listing "all assets," then that earlier filed financing statement would perfect the proceeds security interest in the new equipment immediately upon its acquisition.

If it becomes a common practice to file "all assets" financing statements, then there will be few situations where proceeds perfection might lapse in favor of a bankruptcy trustee. This is because of the combination of various features of the revised Act. First, an "all assets" financing statement filed to perfect the security interest in the original collateral will be sufficient to perfect the proceeds security interest even though the proceeds constitute a different type of collateral. [319] Second, except for certain real estate related collateral, all financing statements relating to a particular debtor will be filed in a single office in the debtor's state of incorporation or state of residence. [320] Finally, the filing of a financing statement will perfect a security interest against a lien creditor or trustee in bankruptcy with respect to several new types of assets that previously had to be perfected by either possession or control. [321] For example, if a negotiable promissory note is received as proceeds, an "all assets" filing will perfect against a trustee in bankruptcy, although it will not provide perfection against a competing purchaser or a secured creditor who takes possession of the note. [322]

The combined result of these three new rules will be that an "all assets" financing statement filed at the outset of the transaction will be sufficient to perfect a security interest in most types of proceeds against a trustee in bankruptcy.

One class of proceeds that generally cannot be perfected by filing is "cash proceeds." This group includes money, which must be perfected by possession, and deposit accounts, which must be perfected by control. [323] However, here the second condition allows perfection to be maintained for as long as the cash proceeds are "identifiable." [324] Since the cash proceeds likely will have been commingled with other funds, the critical issue under this provision will be whether commingled cash proceeds remain "identifiable." As noted above, the revision solves this problem by eliminating the current 10−day insolvency limitation on commingled cash proceeds and by expressly providing that cash proceeds are identifiable "to the extent that the secured party identifies the proceeds by a method of tracing, including application of equitable principles . . ." [325]

The third condition is the "same office" rule. This rule applies to maintain perfection if: (1) a filed financing statement covers the original collateral; (2) the proceeds are collateral that could be perfected by filing a financing statement in the same filing office as the original statement; and (3) the proceeds were not acquired with cash proceeds. [326]

For example, if the original financing statement described the collateral as "inventory," the proceeds security interest in the accounts generated when inventory is sold would be perfected as long as the proper office for filing an "accounts" financing statement is the same office where the "inventory" financing statement is on file. Thus, a financing statement listing only "inventory" can perfect a proceeds security interest in "accounts," and the secured creditor has no duty to amend its filing to reflect that accounts are also covered. [327]

While collateral descriptions are critically important under current law, extensive use of "all assets" financing statements under the revised Act should limit the need to rely on the "same office" rule. However, in those cases where a narrowly worded collateral description is used in the original financing statement, the "same office" rule will provide far greater protection than it does under current law.

The revised Act expands the reach of the "same office" rule in two ways. First, under current law, financing statements for tangible collateral are filed in the state where the collateral is located, while those covering intangible collateral are filed in the state where the debtor's chief executive office is located. [328] Thus, if the inventory and the chief executive office are located in different states, the "same office" rule does not maintain perfection of the proceeds security interest in the accounts. Since the revised Act centralizes filing and requires that almost all financing statements relating to a debtor be filed in the debtor's state of incorporation or residence, there will rarely be a case where the proceeds filing would need to be in a different office. [329] Second, since filing can now be used to perfect security interests in instruments and investment property against a trustee in bankruptcy, the rule will apply in situations where it previously did not apply. For example, the "same office" rule will now cause the "inventory" financing statement to perfect a security interest in a negotiable promissory note received as proceeds.

The net effect of the new proceeds rules will be to enhance the secured creditor's position in bankruptcy. The expanded proceeds definition will significantly extend the reach of a secured creditor's proceeds claim, while the new perfection rules will reduce the opportunities for a bankruptcy trustee or debtor−in−possession to avoid a proceeds security interest claim under the strong arm power.

These effects are small, however, when compared to the true anti−bankruptcy impact of the proceeds rule. Together with the new rules overriding anti−assignment provisions, the expanded proceeds rule will divert much of the reorganization value of the estate from the unsecured creditors to the secured creditors. Thus, these rules are bankruptcy−only redistributional rules that violate the deference principle.

A. Capture the Reorganization Value

1. Reorganization Value and the Unsecured Creditors

For whose benefit does the Bankruptcy Code allow a debtor to reorganize and what is the proper allocation of any extra value that may be created by the reorganization process? Are unsecured creditors the intended beneficiaries of the bankruptcy reorganization process, or is it designed to enrich the secured creditors?

It seems clear that the current federal bankruptcy law is designed to advance the interests of unsecured creditors. Many features of current law suggest that bankruptcy is a collective remedy for the unsecured creditors. [330] Much decisional and scholarly authority also supports this view. [331]

Secured creditors, on the other hand, are required to forego some of their non−bankruptcy rights in order to create or preserve the reorganization value for the benefit of the unsecured creditors. For example, the automatic stay forces secured creditors to delay the exercise of their non−bankruptcy rights to enforce their liens and to foreclose on their collateral. [332] In addition, the estate is permitted to use the collateral in the reorganization effort without secured party consent. [333]

Only the core of the secured creditor's state law rights are recognized −− the right to realize the value of its pre−petition collateral. This concept is embodied in the section 506(a) provision limiting the allowed amount of the secured creditor's claim to the value of its collateral. [334] It is also reflected in the Code provisions granting secured creditors a right to adequate protection. [335] As made clear in *Timbers* [336] the secured creditor is not entitled to protection of all of its contractual rights. Instead, it is entitled only to protection of the value of its lien on the collateral. [337]

The plan confirmation provisions also reflect the bankruptcy policy of giving the reorganization value to the unsecured creditors, [338] while merely preserving the value of the secured creditor's lien. Under those rules, a chapter 11 plan can be confirmed over the objection of a secured creditor only if the property to be distributed to the secured creditor on account of the secured portion of its claim has a present value at least as great as the value of its collateral. [339] The cram down provisions applicable to unsecured creditors makes clear that the secured creditor is entitled to no more. [340]

Thus, secured creditors, in their capacity as secured creditors, [341] are entitled only to the preservation of the value of their pre−petition liens. [342] The extra reorganization value that is created by the estate's post−petition use of the secured creditor's collateral belongs to the unsecured creditors.

The Code's treatment of after−acquired property clauses also demonstrates that value created post−petition properly belongs to the unsecured creditors. [343] The general rule under the Code is that a pre−petition security interest cannot reach property that comes into the estate post−petition. Section 552(a) provides that "property acquired by the estate or by the debtor after the commencement of the case is not subject to any lien resulting from any security agreement entered into by the debtor before the commencement of the case." [344] Thus, bankruptcy generally cuts off the secured creditor's right to reach after−acquired property.

The secured creditor's right to the proceeds of its original collateral is an exception to the rule that a secured creditor is entitled merely to the preservation of its pre−petition lien. [345] Under section 552(b)(1), a pre−petition security agreement will extend the security interest to property acquired by the debtor or the estate post−petition if the post−petition property constitutes "proceeds, products, offspring, or profits" of the pre−petition collateral. [346]

At the time the Bankruptcy Code was enacted, the Article 9 concept of "proceeds" was limited to replacements for collateral that had been disposed of. [347] Thus, the Bankruptcy Code's proceeds exception could be seen as incorporating the lien preservation idea. Concededly, however, the proceeds exception goes further and could allow an under−secured creditor to capture some of the reorganization value.

Even if the concept of proceeds is limited to replacement collateral, the proceeds rule could allow the secured creditor to enhance its position post−petition. For example, if the pre−petition security interest covered the debtor's inventory, the post−petition sale of inventory might generate accounts proceeds that would enhance the secured creditor's position to the extent of the debtor's mark−up on the inventory.

In addition, the section is not limited to proceeds, but also extends to "products, offspring, or profits." [348] These terms would allow the pre−petition security interest to reach newly acquired post−petition property even though the value of the original collateral was not reduced. [349]

However, the section hardly reflects a policy of transferring the reorganization value to secured creditors, even when the post−petition property does constitute "proceeds, products, offspring, or profits" of their collateral. This is because the Bankruptcy Court is authorized to limit the reach of the proceeds security interest "based on the equities of the case." [350]

a.It's all proceeds

Revised Article 9 attempts to use the proceeds exception to divert much of the bankruptcy reorganization value to secured creditors. As discussed above, the revision greatly expands the Article 9 definition of proceeds. [351] However, outside of bankruptcy that change will have relatively little impact. Under current law, a secured creditor could easily replicate the non−bankruptcy effects of the new proceeds rule merely by incorporating a properly drafted after−acquired property clause in the security agreement and filing an "all assets" financing statement. [352]

The most significant effect of the new proceeds rule is its interaction with section 552(b) of the Bankruptcy Code. Outside of bankruptcy, it does not really matter whether the secured creditor obtains its security interest in after−acquired property by virtue of an after−acquired property clause or as the result of the Article 9 proceeds rule. However, in bankruptcy, that distinction is critical. Mere contractual after−acquired property clauses are rendered ineffective with respect to post−petition assets. In contrast, if the security interest is asserted in the post−petition assets as a proceeds claim, it will be recognized. The revision exploits this bankruptcy law distinction to alter the bankruptcy law balance between secured and unsecured creditors.

First, the Bankruptcy Code's proceeds rule applies only where the security interest created by the pre−petition "security agreement extends to property of the debtor acquired before the commencement of the case and to proceeds, product, offspring, or profits of such property." [353] Since an Article 9 security interest automatically extends to proceeds, the expanded proceeds definition will cause a security agreement that lacks an after−acquired property clause to create a more extensive security interest in after−acquired property than is the case under current law. [354] As a result, the requirement that the pre−petition security agreement extend to the post−petition assets will be more easily satisfied in cases of poorly drafted security agreements.

The most important bankruptcy issue presented by the revised proceeds rules is whether the expansion of the Article 9 definition of "proceeds" will automatically expand the meaning of the term "proceeds" under section 552(b)(1). Currently, the courts are split as to the proper interpretation of the term "proceeds" as used in section 552(b)(1). Some courts use a restrictive federal bankruptcy law definition that emphasizes the rehabilitative purpose of bankruptcy law, others apply the current Article 9 definition, and some rely upon the legislative history of section 552 to create a definition that is more liberal than the current Article 9 definition. [355]

If courts defer to the Article 9 definition, [356] the expanded proceeds definition will enhance the secured creditor's ability to reach post−petition assets. For example, *Hastie v. FDIC* [357] relied upon the then−current Article 9 definition of proceeds to hold that ordinary cash dividends were not proceeds of stock because they did not result from a disposition of the stock. Since the revised Act includes dividends in the definition of proceeds, deference to the Article 9 definition would reverse the *Hastie* result. [358]

Depending on how extensively the new "lease" and "license" clauses are interpreted, section 552(b)(1) may extend the reach of a secured creditor's post−petition security interest to most revenues generated by the debtor post−petition. For example, if the debtor is a rental car company, a secured creditor with a lien on its fleet of rental cars currently is entitled to adequate protection of its lien on the cars under section 363. [359] However, it has no claim to the post−petition revenue generated by the debtor's rental of those cars. [360] Under the new proceeds definition, the secured creditor would be entitled to assert its security interest in the post−petition rental fees. [361] Similarly, secured creditors may now be able to assert section 552(b)(1) secured claims to other types of post−petition rental fees and license fees. [362]

However, even if the Article 9 change does expand the reach of the secured creditor's claim on post−petition assets, the bankruptcy courts have the power to prevent secured creditors from diverting the reorganization value away from unsecured creditors. Although 552(b)(1) recognizes the secured creditor's lien on post−petition assets as an initial matter, it also provides the bankruptcy court with wide discretion to limit the lien "based on the equities of the case." [363] Thus, even if revised Article 9 extends the reach of the proceeds security interest to new classes of post−petition property, the equities should not support recognizing such security interests.

b.Hijacking section 365

The second way in which the Article 9 revision diverts the reorganization value away from the unsecured creditors is through the new rules overriding anti−assignment provision with respect to general intangibles. These provisions work in concert with the section 365 executory contract power to capture for the secured creditor any value created by that power.

The first way in which the new rules nullifying anti−assignment provisions channel the estate's reorganization value to secured creditors arises from their interaction with the Article 9 and bankruptcy proceeds rules. As noted in the discussion of the new section 9−408 free assignability rules, those changes to Article 9 will have little impact outside of bankruptcy. [364] The impact in bankruptcy, however, is likely to be significant.

As a result of the new free assignability rules, the debtor's interest in a non−assignable general intangible could be subject to a pre−petition security interest that secures a pre−petition claim. Although that security interest may have little or no value pre−petition, the security interest may become very valuable post−petition as the result of the proceeds rule.

The simplest example of this involves a bankruptcy sale or assignment of the non−assignable right. Since the security interest was attached and perfected pre−petition and since the Article 9 proceeds rule automatically causes the security interest to extend to any proceeds of the non−assignable right, the Bankruptcy Code's proceeds rule would give the secured creditor a security interest in whatever the estate receives in exchange for sale of its rights.

Comment 7 to section 9−408 makes clear that this was the intent of the change. As the comment states:

This section could have a substantial effect if the assignor enters bankruptcy. Roughly speaking, Bankruptcy Code Section 552 invalidates security interests in property acquired after a bankruptcy petition is filed, except to the extent that the postpetition property constitutes proceeds of prepetition collateral. [365]

The Comment goes on to describe an example of a debtor who is the owner of a franchise that represents the principal value of the business. [366] The lender is willing to extend credit only if the credit is secured by the debtor's going concern value −− the franchise. However, the franchisor refuses to consent to an assignment of the franchise rights for collateral purposes. The Comment then explains how under current law, if the debtor files bankruptcy and sells its franchise rights in bankruptcy, the secured party would receive only a fraction of the business's value. Under the revision, however, the security interest would attach to the franchise and "to the proceeds of any sale of the franchise while a bankruptcy is pending." [367] The example concludes, by stating that "this section would protect the interests of the [franchisor] by preventing the secured party from enforcing its security interest to the detriment of the municipality." [368]

The next Official Comment begins by asserting that, "The principal effects of this section will take place outside of bankruptcy." [369] That is similar to the position taken by Professors Harris and Mooney in this Symposium. [370] Is that assertion correct?

Official Comment 8 proceeds to use the non−bankruptcy analogy to the example discussed in Official Comment 7. However, Official Comment 8 acknowledges that the franchisor's unwillingness to consent to an assignment may deprive the security interest of any value except to the extent of the possibility that the franchisor may have a future change of heart.

Is the bankruptcy outcome merely a replication in bankruptcy of what could occur outside of bankruptcy? If so, then the section is not bankruptcy targeted because it merely gives the secured party in a bankruptcy proceeding what it would have received in the absence of a bankruptcy filing.

What is left un−addressed in the comments is the question of how the debtor was able to sell its non−assignable franchise rights in the bankruptcy proceeding. If the only way that a debtor in bankruptcy could sell such rights was to obtain franchisor consent, then the section would do little more than reduce the assets available to unsecured creditors −− both in and out of bankruptcy.

Except, if that is what the drafters of the comment had in mind, then it is unclear why the hypothetical lender, who was unwilling to extend credit without a security interest on the business' going concern value, would make a loan where the value of the collateral turned on the whim of the franchisor. Something else must be involved. That something is the Bankruptcy Code's executory contract powers.

Under section 365 of the Bankruptcy Code, the trustee is given the power to assume and assign executory contracts and unexpired leases. [371] More importantly, section 365 overrides "a provision in an excutory contract or unexpired lease of the debtor, or in applicable law, that prohibits, restricts, or conditions the assignment of such contract or lease." [372] Thus, the trustee or debtor−in−possession has the power in bankruptcy to invalidate certain otherwise valid and enforceable anti−assignment provisions. This allows the estate to assign the debtor's non−assignable contracts and leases in order to preserve the value of those rights for the unsecured creditors.

This is the unspoken reason why the debtor was able to sell its non−assignable rights in bankruptcy. The franchisor did not consent to the sale. Its consent was not required and its non−bankruptcy rights under the anti−assignment clause were not honored. Instead, its rights were modified in bankruptcy to further a bankruptcy reorganization policy.

This power is a bankruptcy−specific power that is given to the estate in order to create value for the unsecured creditors. [373] Revised Article 9 perverts it into a tool to capture the reorganization value of the enterprise for the secured creditor −− to the detriment both of the unsecured creditors and the non−debtor party to the non−assignable right.

The "general intangibles" to which section 9−408 applies are precisely the types of executory contracts and leases to which section 365 might be applied. [374] In addition, the types of clauses that section 9−408 nullifies bear a striking similarity to those nullified by Bankruptcy Code section 365(f). [375] Section 9−408 is designed to dovetail with section 365 and its principal effects will take place in bankruptcy, not outside of bankruptcy.

Outside of bankruptcy, the secured creditor with a security interest in a non−assignable general intangible recovers little or nothing absent a waiver of the restriction. Only in bankruptcy does the collateral have value. Section 9−408 allows the secured creditor to divert this value to the payment of its own secured claim.

In addition, application of the expanded proceeds rule to general intangibles, including the non−assignable general intangibles covered by section 9−408, could result in a significant reallocation of reorganization value. The bankruptcy sale of the non−assignable franchise discussed above provided a simple example of the interplay between these UCC provisions and the Bankruptcy Code. However, there may be other bankruptcy implications to the Article 9 revision. This depends on how extensively the new proceeds definition is interpreted. It is easy to see that a sale generates proceeds that trigger both the UCC and bankruptcy proceeds rules. However, if the broadest interpretation of the "rights arising out of collateral" clause is applied to a general intangible, the reach of the secured creditor's section 552(b)(1) proceeds claim may capture all of the reorganization value generated by the general intangible, even if the assets is merely used by the debtor but not sold. [376]

Finally, the Article 9 free assignability provisions may produce a similar result in bankruptcy cases even without considering the proceeds rule. Since section 9−408 will now permit a secured creditor to obtain a security interest in a non−assignable general intangible, it will be necessary to determine the value of that collateral in order to determine the allowed amount of the secured creditor's claim. [377]

Because the general intangible is subject to an anti−assignment provision, the collateral has virtually no market value outside of bankruptcy. Further, since section 9−408(d) provides that the secured party is not entitled to enforce the security interest, the "foreclosure" value of the collateral is zero. [378] Thus, from the perspective of the secured creditor, the collateral has no value.

However, from the estate's perspective the value may be far higher. If the estate is able to use its section 365(f) power to assign the contract to a third party in exchange for some payment, then the contract's value to the estate is the amount of that payment. If, on the other hand, the debtor is reorganizing and intends to use the general intangible in its on−going business operations, the asset has a higher−than−liquidation "use" value to the debtor.

The Supreme Court addressed the question of the appropriate measure of value for secured claims in *Associates Commercial Corp. v. Rash.* [379] There the Court rejected the argument that value should be limited to the value that the creditor could receive by exercising its foreclosure rights. [380] Instead, under section 506(a), "the 'proposed disposition or use' of the collateral is of paramount importance to the valuation question." [381] Thus, since the chapter 13 debtor in *Rash* proposed to retain the collateral and use it in his business, the Court held that the "replacement value" was the proper standard. The Court stated:

Of prime significance, the replacement−value standard accurately gauges the debtor's "use" of the property. It values "the creditor's interest in the collateral in light of the proposed [repayment plan] reality: no foreclosure sale and economic benefit for the debtor derived from the collateral equal to . . . its [replacement] value." In re Winthrop Old Farm Nurseries, 50 F.3d, at 75 . The debtor in this case elected to use the collateral to generate an income stream. That actual use, rather than a foreclosure sale that will not take place, is the proper guide under a prescription hinged to the property's "disposition or use." [382]

If, as *Rash* suggests, the value of the secured creditor's collateral turns on its use or disposition value to the estate, rather than its value to the secured creditor, the section 9−408 rules will provide a bankruptcy windfall to secured creditors. If a chapter 7 trustee seeks to assign a non−assignable contract that is subject to a security interest, the value of the collateral under the *Rash* analysis may be the amount realized by the trustee since that is the proposed disposition. Similarly, since the use value of the debtor's contract or lease rights may be high in a reorganization context, the secured claim arising from a security interest in a non−assignable intangible right may be very large, even though the collateral would be of no value to the creditor outside of bankruptcy.

Returning to the earlier example of the debtor's Microsoft Word software program, that asset has absolutely no value as collateral outside of bankruptcy. Nevertheless, under *Rash* the secured creditor may be entitled to a secured claim equal to the "replacement value" of the program if the debtor wishes to retain and use it in the reorganization. *Rash* defines the replacement value as "the price a willing buyer in the debtor's trade, business, or situation would pay to obtain like property from a willing seller." [383] Since there is no legitimate market for purchasing used Word programs, the price that the debtor would have to pay to replace the software license may well be the full retail price retail price. If so, then the secured creditor's allowed secured claim will equal the retail price of the program. That is also the minimum amount that the plan must pay to the secured creditor. [384]

If the secured creditor has obtained a blanket lien on all of the debtor's general intangibles and other assets, the creditor could make similar claims with respect to all of the debtor's contract and lease rights. Since the use value of those rights might be equivalent to the value of the business, the *Rash* analysis may well transfer most of the reorganization value to the secured creditor. [385]

A.

A. Impede the Reorganization

A final anti−bankruptcy feature of the Article 9 revision is that it will give secured creditors far greater control over the reorganization process than they have currently. Not only will this make it more difficult to reorganize without secured creditor consent, but it will give secured creditors greater leverage to demand a larger share of the debtor's reorganization value.

One of the responses of Professors Harris and Mooney to this point is to question the theoretical foundations of chapter 11. [386] They do not appear to be embracing the school of thought that views chapter 11 as wasteful and advocates its repeal. [387] Rather, they appear to raise the issue to show that, at least in some cases, the reorganization process may harm unsecured creditors by dissipating assets that might otherwise have been distributed to them. [388]

Starting from that assumption, they posit that the expansion of the secured creditor's power under revised Article 9 "could work to the substantial benefit of unsecured creditors" because the secured creditor would force "an earlier, rather than later, liquidation." [389]

While it is true that an early liquidation would benefit unsecured creditors in the hypothetical posed, it is not clear that the secured creditor's self−interest would parallel the interests of the unsecured creditors. The only situation in which an early liquidation would result in a significant benefit to the unsecured creditors is where (1) the liquidation value of the enterprise is greater than its reorganization value [390] and (2) the liquidation value is significantly [391] higher than the secured creditor's claim.

First, a hypothetical that posits significant unencumbered assets available at liquidation values does not seem to be the proper hypothetical to test the expanded reach of Article 9. The more realistic situation, and one where the secured creditor's expanded rights will matter, is the case where the liquidation values do not produce a meaningful surplus for unsecured creditors. In such a case, a protracted and wasteful reorganization attempt does no harm to the unsecured creditors.

Even in the original hypothetical, it is not clear that the secured creditor has any incentive to force a liquidation early enough to benefit the unsecured creditors. Apart from the natural desire to recover its collateral as quickly as possible, [392] it will have no special incentive to force a liquidation until the surplus values have been exhausted and continuation of the reorganization begins to erode its collateral base.

In fact, the real efficiency problem arises in cases where the liquidation values do not produce a surplus for unsecured creditors, but a reorganization would produce a significant surplus. What are the secured creditor's incentives in such a case and will they cause it to make an efficient asset deployment choice? First, if it is fully secured or has a relatively small deficiency claim at liquidation values, it has no incentive to permit a reorganization no matter how great the reorganization value. If it has a sizable deficiency claim, it still may not have sufficient incentive to permit a reorganization *unless it is permitted to capture the extra value*. [393] Of course, if the secured creditor gets the extra reorganization value, its self−serving actions do not result in an incidental benefit to the unsecured creditors.

The extensive reach of the secured creditor's lien may further distort its incentives. Assume that the debtor's liquidation value is $100 and its reorganization has a 60% chance of success. If the reorganization succeeds, the reorganization value will be $140. However, if the reorganization effort fails, it will have used up $10 of the liquidation value, leaving only $90. The most efficient asset deployment decision is to attempt the reorganization (40% chance of losing $10 = − $4, 60% chance of gaining $40 = + $24, net risk adjusted gain = + $20).

Now add in the secured creditor's lien. Assume that the secured creditor is owed $110 and there are $90 in other unsecured claims. If under current law the secured creditor can encumber only $90 of assets, there will be a $10 cushion of unencumbered assets − enough to allow the reorganization and provide adequate protection to the secured creditor. However, if the revision allows the secured creditor to obtain a lien on all assets, then the reorganization attempt will put the value of the secured creditor's new $100 lien at risk and there will be no free assets that could be used to provide adequate protection. The secured creditor will not consent to the reorganization attempt because it now faces a 40% chance of losing $10 (value − $4). That risk is not offset by its 60% chance of receiving its pro rata 10% share of $40 (60% of 10% of $40 = + $2.4).

1. Increase the Secured Creditor's Leverage

This shift in the balance of power represents a sharp reversal of the bankruptcy reorganization policies embodied in the 1978 Bankruptcy Code. Current chapter 11 was designed to reduce the control that secured creditors had exercised over the reorganization process under the prior law. [394]

The chapter 11 process relies upon negotiation. [395] The cram down rules not only ensure an equitable distribution between various classes of creditors when the negotiation process fails, but they also represent a careful balancing of the leverage that various classes have in the negotiation process. [396] The Article 9 revision upsets this balance and violates bankruptcy policy by giving back to secured creditors power that Congress took away from them in 1978.

Article 9 alters the bankruptcy balance of power in a number of ways. At the most basic level, any enhancement in the rights of secured creditors or the reach of their liens will improve their leverage in bankruptcy. [397] Thus, since the Article 9 revision generally enhances the rights of secured creditors outside of bankruptcy, it also enhances their rights in bankruptcy. Beyond this truism, there are a number of specific changes that will hamper the debtor's reorganization or increase the leverage of secured creditors. Several of these have been analyzed earlier in this article.

Obviously, the changes that limit the strong arm power will make security interests less susceptible to avoidance in bankruptcy. As discussed earlier, one bankruptcy implication of this change is that secured creditors will more often be able to assert valid lien claims and thus capture a larger share of the available assets. [398]

This change also has practical implications for the reorganization policy. By reducing the risk of lien avoidance, Article 9 deprives the estate of a powerful negotiating tool. [399] In many cases, the threat of lien avoidance gives the estate and its unsecured creditors the leverage needed to bring the secured creditor to the bargaining table. The Article 9 revision nullifies this leverage by slipping the secured creditor a few extra aces under the table.

The revision's new proceeds and free assignability rules also thwart the reorganization goal of bankruptcy by giving the secured creditor control over the value that might be created or preserved by a reorganization. If the courts recognize the secured creditor's priority claim to the new value that is created post−petition, the secured creditor's negotiating position will be enhanced immensely.

For example, under current law an under−secured creditor, whose security interest cannot reach the extra value created by the reorganization, might consent to a plan that creates reorganization value and shares it among all unsecured creditors. This is because the unsecured portion of its claim will share in that distribution, and the creditor has no other realistic prospect of recovering its unsecured deficiency claim. If the revision allows the creditor's pre−petition security interest to automatically capture the extra value created by the reorganization, then that extra value will go towards satisfying the secured creditor's unsecured deficiency claim. There will be little incentive to agree to a plan that shares the reorganization value with the other unsecured creditors.

The only leverage the unsecured creditors can use to extract concessions from the secured creditor is to threaten a "scorched earth" response. Since the creation or preservation of the extra reorganization value requires use of the special estate−enhancing powers available only under bankruptcy law, [400] the secured creditor would need to give up enough of the reorganization value to persuade the unsecured creditors to allow the reorganization to proceed.

This is the opposite of the situation now. In most cases, the debtor need not even negotiate with the secured creditor for its consent to the reorganization. If the unsecured deficiency claim is small in relation to the total unsecured debt, the cram down rules may give the secured creditor no leverage. [401] Even where the creditor's unsecured claim is large enough to veto a class' acceptance of the plan, the expected pro−rata distribution on the deficiency claim may be sufficient inducement for it to permit the reorganization.

2. Expand the Scope of Cash Collateral

In addition to changing the dynamic of the chapter 11 negotiation process, the new proceeds and free assignment rules will give the secured creditor greater control over the debtor's post−petition operations. These Article 9 changes are likely to have a significant impact on cash collateral issues.

Under current law, it is difficult to obtain a security interest in the funds in a deposit account as "original collateral." [402] However, where proceeds of some other item of collateral are deposited into a deposit account, current Article 9 automatically gives the secured creditor a perfected security interest in those funds as long as they are identifiable. [403] As a result, most cases where the secured creditor can assert a security interest in "cash collateral" [404] under section 363 of the Bankruptcy Code [405] involve primarily proceeds collateral.

Since the revised Act permits creditors to take security interests in deposit accounts as original collateral, [406] such accounts will likely be subject to liens even when the funds in the accounts are not proceeds of some other collateral. This may make it difficult for the debtor to provide adequate protection, which is required as a pre−condition to the use of cash collateral under section 363 of the Bankruptcy Code.

Currently, if the cash collateral is the proceeds of some other item of the same creditor's collateral, it may be possible to provide adequate protection by agreeing to use the cash collateral to enhance or maintain the value of the non−cash collateral. For example, rents can be used to operate and maintain the real estate collateral, or the cash proceeds of inventory can be used to purchase new inventory. [407] However, if the first priority lien on the deposit account is held by a creditor who does not have other collateral, the debtor may be not be able to use the funds in the account to operate the business unless it can provide some other form of adequate protection.

This problem will be exacerbated by the new priority rules for deposit accounts. These rules increase the likelihood that the creditor with the first priority lien in the deposit account will not be the creditor who also holds a lien on the debtor's inventory or other productive assets.

Under current law, when proceeds are deposited into a bank account, the perfected proceeds lender has priority over the depositary bank's right of setoff. [408] Further, since deposit accounts cannot be original collateral under current law, there will rarely be a competing non−proceeds creditor with a valid lien on the account.

The revision changes these rules. Under revised Article 9, the depositary bank's rights of set off and recoupment generally will have priority over the proceeds security interest. [409] Further, if a competing creditor has obtained a security interest in the bank account as original collateral and has perfected by control, its security interest will also be superior to the proceeds security interest. [410] Finally, even if the proceeds creditor foresees the problem and obtains and perfects an Article 9 security interest in the account as original collateral, its perfected security interest generally will be subordinate to an Article 9 security interest held by the depositary bank. [411]

The alternative to providing adequate protection is to obtain the consent of the secured creditor. [412] If the new Article 9 rules make it more difficult for debtors to provide adequate protection, then consent will be needed in more cases. In cases where the debtor must use the cash collateral in order to continue its business operations, this greatly increases the secured creditor's leverage by giving it effective veto power over the reorganization effort.

In addition to the new deposit account rules, the changes in the proceeds rule will have two significant effects in the cash collateral area. First, since the proceeds rule now extends to a wider range of income generated by the original collateral, the likelihood that the funds in the debtor's bank account constitute cash collateral will be much greater. For example, if rental fees, license fees, or stock dividends have been deposited into the debtor's bank account pre−petition, the funds in the account will now be the cash collateral of the creditor holding a security interest in the asset that generated those fees. This is a change from current law since those items would not be cash collateral under current Article 9. [413] In addition, all such revenue generated by the debtor's post−petition operations will also be cash collateral to the extent that the section 552(b) proceeds rule applies.

As a result, the debtor−in−possession will be required to obtain the secured creditor's consent or to provide it with adequate protection before using those funds in its business operations. Here again the debtor may have difficulty providing adequate protection. For example, if the secured creditor has a security interest only in a patent held by the debtor, the post−petition license revenues would now be proceeds subject to both section 552(b) and the cash collateral rules. Unless the court chooses to cut off the post−petition security interest under the "equities of the case" doctrine, that security interest would extend to all revenues received post−petition. [414] Since this cash collateral evaporates as soon as the debtor uses it to fund post−petition business operations, the debtor must provide adequate protection for the used up cash. Unless the debtor has significant continuing obligations under the patent license, its continued business operations would not be likely to enhance the value of the secured creditor's original collateral −− the patent. Thus, the debtor would need to provide some other means of adequate protection such as a replacement lien on some unencumbered asset. If this is not possible, then the secured creditor has veto power over the reorganization.

3. Opt Out of the Reorganization Through Securitization

Finally, the revision makes it easier for the "secured creditor" to opt out of the bankruptcy process entirely. It does this by encouraging asset securitization transactions as an alternative to secured credit where the debtor wishes to use income producing assets as a source of financing. [415]

Over the past decade, securitization transactions have become an increasing popular form of obtaining financing. [416] From a bankruptcy and credit perspective the major advantage of securitization is that it allows income producing assets to be isolated from the credit of the business that originated those assets. [417] For example, if a business generates valuable accounts, one way to structure the business' financing would be to loan against the accounts and obtain a traditional Article 9 security interest in those accounts. However, the lender would have to be concerned that many of its rights altered if the business filed bankruptcy.

Securitization is an alternative that reduces the bankruptcy risk. In a securitization transaction, a new "bankruptcy remote" entity called a "special purpose vehicle" ("SPV") is created. [418] The business (the "originator") transfers the accounts to the SPV in a "true sale" transaction. The SPV issues securities backed by the value of the transferred accounts. The funds generated from the sale of those securities is used by the SPV to pay the originator for the purchased accounts. Finally, the investors in the SPV are paid from the income generated by the collection of the transferred accounts.

By separating the assets from the originator, securitization allows the financing to be based on the quality of the assets and not on the originator's credit. [419] Further, since the accounts were sold by the originator, they are no longer property of the originator and the originator's bankruptcy has little or not impact on the financing transaction. [420] Finally, if the SPV is properly constituted, it has no reason, and possibly no ability, to file bankruptcy itself. [421]

The problem under current law is that the legal framework for securitization is based primarily on common law principles that frequently are uncertain and that may impose cumbersome and impractical requirements. By bringing most securitization transactions within Article 9, these common law rules are replaced by a clear set of legal standards that are designed to encourage and protect securitization transactions. [422]

Although the scope of current Article 9 generally is limited to security interests, two classes of sales are covered by current law. Certain true sales of "accounts" and "chattel paper" are governed by Article 9. [423] The reason for this is that account and chattel paper financing was often accomplished by selling the accounts at a discount and it was difficult to distinguish between sales and financing transactions. [424] Thus, all such transactions were brought within Article 9 to avoid the difficulty of drawing such distinctions. In addition, subjecting sales of such assets to the Article 9 filing rules made the filing system more useful as a method for lenders to determine the existence and priority of competing interests in these intangibles. [425]

These provisions were not designed to facilitate asset securitization transactions. Those transactions did not become common until much later. [426] Ironically, while the initial reason for including sales of accounts in Article 9 was the difficulty of distinguishing between financing transactions and true sales, asset securitization turns this idea on its head. Asset securitization is an elaborate process that allows a true sale to be a financing transaction. Thus, the decision in the 1960's to include true sales of accounts and chattel paper, because they could not easily be distinguished from financing transactions, caused Article 9 to apply to the financing transactions of the 1990's, because they were true sales. However, the growth of asset securitization was both assisted and hindered by the Article 9 provisions.

While this provision would appear to bring account and chattel paper securitization transactions within the current Article 9 framework, it had the opposite effect in the Tenth Circuit. In the much criticized case of *Octagon Gas Systems v. Rimmer*, [427] the Court reasoned that Article 9's treatment of such sales as "secured transactions" meant that the buyer obtained only a security interest. Under this view, accounts and chattel paper could not be "sold," making securitization of such assets difficult or impossible. Revised section 9−318(a) is designed to overrule *Octagon* by providing that a debtor who has sold an income producing asset does not retain a legal or equitable interest in the collateral sold. [428]

With the *Octagon* problem solved, revised Article 9 provides the legal framework for securitization merely by expanding the classes of sales covered by the Act. This expansion is accomplished in two ways. First, the definitions of "accounts" and "chattel paper" are expanded to include a broader array of assets. [429] Second, the revision adds sales of "payment intangibles" and "promissory notes" to the scope of Article 9. [430]

Although the definition of "accounts" under current law is limited to certain payment rights for goods sold or leased or for services rendered, the revised Act greatly expands the accounts definition to include, *inter alia*, rights to payment for providing energy, lease payments for property other than goods, license fees, health−care−insurance receivables, credit or charge card receivables, and lottery winnings. [431] This is a major expansion of the types of income producing assets that can be subject to an Article 9 securitization transaction. In addition, the "chattel paper" definition has been expanded to include a new non−tangible category of chattel paper called "electronic chattel paper." [432]

Two new classes of assets have been added to the types of sales that are subject to Article 9. They are "promissory notes" and "payment intangibles." [433] The term "payment intangible" is broadly defined as a "general intangible under which the account debtor's principal obligation is a monetary obligation." [434] This term would cover loan participations and may be broad enough to cover virtually any financial asset not already covered by the terms account, chattel paper, and promissory note. [435] Thus, the expansion of Article 9 to cover sales of accounts, chattel paper, promissory notes, and payment intangibles will bring most financial asset securitization transactions within Article 9. [436]

The principal effect of bringing securitization transactions within the scope of Article 9 is that the Article 9 perfection and priority rules will determine whether the SPV has priority over other creditors of the originator, other transferees of the assets, and the originator's trustee in bankruptcy. As discussed earlier in this article, the new rules for filing financing statements should make it simple to properly perfect a securitization transaction by filing. [437] While perfection by filing will be the primary means of perfection in securitization transactions, special rules will apply to certain types of transactions.

With two exceptions, the rules for perfecting an Article 9 covered sale are the same as those for a traditional security interest. [438] The exceptions are that both a sale of a payment intangible and a sale of a promissory note are perfected automatically, [439] without the need for filing a financing statement or taking possession of the instrument. [440] These exceptions will protect securitizations in those assets from bankruptcy attack even if the SPV fails to take any action to perfect its interest. [441]

If the revisions to Article 9 make asset securitization the preferred method of using income producing assets to obtain financing, it will become impossible to reorganize many debtors. Asset securitization removes the income producing assets from the estate pre−petition. Thus, the debtor has no property interest in the assets at the time of filing and they do not become property of the estate. [442] Neither is the asset, nor the income produced by it, available to finance post−petition operations or to fund the reorganization effort. Thus, instead of facing the difficulty of providing adequate protection in order to use cash collateral, the debtor will instead face the far more difficult problem of having no cash collateral at all.

Further, the structure of the asset securitization transaction may make it impossible to obtain consent to use the revenues generated by the income producing assets. First, the structure of the asset securitization transaction − selling the assets to an entity created for the sole purpose of holding it, and then issuing public securities backed by the income stream −− may mean that there is no party who could consent. However, even if there was a party in a position to consent, there would be no incentive to do so. Asset securitization is based on the concept of separating the intrinsic value of the income−producing asset from the financial fortunes of its originator. Thus, the success or failure of the originator is likely to be of no consequence to the parties who financed the securitization transaction.

The devastating impact asset securitization could have upon the ability of debtors to reorganize may alone be sufficient to label it an anti−bankruptcy practice. The Bankruptcy Code embodies a federal policy of encouraging reorganization for the benefit of the debtor, its creditors, its employees, and the broader community. State law rules that make reorganization impossible should not be entitled to deference in bankruptcy proceedings. [443]

However, the anti−bankruptcy nature of asset securitization is more significant than its effects alone. Asset securitization at its core is an anti−bankruptcy practice. From the financing perspective, [444] it is a device which is designed for, and has as its principal feature, the nullification of bankruptcy. As Schwarcz states, "Securitization, thus, creates genuine costs reductions. By eliminating the risk of bankruptcy to investors, many different types of companies can better utilize their most valuable asset, their receivables, by accessing low cost capital market funding." [445] The extreme efforts engaged in to insure that the special purpose vehicle is bankruptcy remote demonstrate that. [446]

Asset securitization is a bankruptcy opt out strategy designed to allow the financier to avoid the effects of the originator's bankruptcy. [447] Opt out strategies are fundamentally inconsistent with the collective nature of the bankruptcy process. The Bankruptcy Code nullifies other opt out strategies through rules such as the preference power [448] and its override of ipso facto clauses in executory contracts and leases. [449] The asset securitization provisions of revised Article 9 are inconsistent with bankruptcy policy.

While the asset securitization process also helps protect against other credit risks associated with the originator, those could be addressed just as easily outside of bankruptcy with a properly structured security interest. Outside of bankruptcy, the secured creditor's legal right [450] to enforce its security interest in an income producing assets is not impaired by the credit risks associated with the originator. It is only when the originator files bankruptcy that the secured creditors rights are modified. They are modified by the automatic stay and the cash collateral rules because bankruptcy policy requires that the rights of secured creditors modified for the greater good of all the debtor's constituents.

Asset securitization results in lower financing costs for debtors. [451] It does so because the structure of asset securitization eliminates the bankruptcy risk. [452] It insulates the financier from the possibility that it may be forced to defer the enforcement of its rights so that the originator's reorganization value can be preserved for the benefit of the unsecured creditors. Thus, the financing cost savings the debtor realizes from asset securitization represents more than the mere involuntary transfer of the insolvency shares of its unsecured creditors, it represents a waiver of their bankruptcy reorganization rights. [453]

Conclusion

The bankruptcy−related revisions to Article 9 have both the purpose and effect of changing bankruptcy outcomes. They will neutralize important bankruptcy avoiding powers and will convert other estate−enhancing powers into tools to increase the recovery of secured creditors. The revision reallocates reorganization value from unsecured creditors to secured creditors and gives secured creditors greater control over the reorganization process. It does all of this without a firm basis of theoretical or empirical support.

The Article 9 revisions are bankruptcy amendments disguised as state law reforms. They exceed the proper scope of a state uniform law revision and violate bankruptcy policy. Revised Article 9 is an anti−bankruptcy act.

FOOTNOTES:

[1] © G. Ray Warner 2001. Professor of Law, School of Law, University of Missouri − Kansas City, Visiting Professor of Law, LL.M. in Bankruptcy Program, St. John's University School of Law. Professor Warner thanks the UMKC School of Law and the UMKC Law Foundation for their support of his on−going research on revised Article 9. The opinions expressed herein are the author's and do not necessarily reflect the views of the University of Missouri or St. John's University. Back To Text

[2] The 1999 revision to Article 9 is cited herein as "UCC § 9−XXX." The currently applicable pre−revision version of Article 9 is cited as "former UCC § 9−XXX." Back To Text

[3] A good indication of the increased complexity of the revised Act comes from a simple numerical comparison of the two versions of Article 9. The current version of Article 9 contains only 55 substantive sections. In contrast, the revised Article 9 contains 126 substantive sections (not counting the transitional rules and conforming amendments). Back To Text

[4] Revised Article 9 is designed to become effective simultaneously in all United States jurisdictions on July 1, 2001. See UCC § 9−701. However, as of this writing, a substantial minority of the states have not yet adopted the revision. Although there appears to be little organized opposition to the revision, it is highly unlikely that the revision will become effective in all states on the target date. Back To Text

[5] See generally Butner v. United States, 40 U.S. 48 (1971). Back To Text

[6] Professors Harris and Mooney served as Reporters for the Drafting Committee to Revise Uniform Commercial Code Article 9. Back To Text

[7] 76 Eng. Rep. 809 (1601). Back To Text

[8] See 1 Grant Gilmore, Security Interests in Personal Property § 2.1, at 24−25 (1965). Back To Text

[9] See id. Back To Text

[10] Twyne's Case, 76 Eng. Rep. at 812−13. Back To Text

[11] 1 Gilmore, supra note 7, § 2.5, at 40−41. Back To Text

[12] See id. § 15.1, at 463−65. Back To Text

[13] Id. § 2.5, at 41. Support for this extension might be found in the Twyne's Case reference to the debtor's continued unfettered use of the supposedly transferred goods. Back To Text

[14] See William J. Woodward, Jr., The Realist and Secured Credit: Grant Gilmore, Common−Law Courts, and the Article 9 Reform Process, 82 Cornell L. Rev. 1511, 1519 (1997). Back To Text

[15] 268 U.S. 353 (1925). Back To Text

[16] Id. at 360. Back To Text

[17] Id. at 362−63. Back To Text

[18] When viewed from this perspective, both Ratner and Twyne's Case involve judicial attacks on sham transactions. See Steven L. Harris & Charles W. Mooney, Jr., A Property−Based Theory of Security Interests: Taking Debtor's Choices Seriously, 80 Va. L. Rev. 2021, 2063−64 (1994) [hereinafter Harris & Mooney, A Property−Based Theory of Security Interests]. Back To Text

[19] Dean Baird cites Ratner as an example of the principle that some free assets should be preserved for the unsecured creditors of an insolvent debtor. Douglas G. Baird, The Importance of Priority, 82 Cornell L. Rev. 1420, 1420 n.1 (1997) [hereinafter Baird, The Importance of Priority]. Back To Text

[20] See infra text accompanying notes 48−49. Back To Text

[21] Gilmore states, "It is clear that a lender who [followed Ratner] could not help but keep a close watch over his debtor's affairs . . . [and] would intervene in his own interest when the business began to fail." 1 Gilmore, supra note 7, § 8.3, at 261. This would prevent the debtor from incurring more unsecured debt during its spiral into bankruptcy. See id. Back To Text

[22] See Grant Gilmore, The Good Faith Purchase Idea and the Uniform Commercial Code: Confessions of a Repentant Draftsman, 15 Ga. L. Rev. 605, 625 (1981) [hereinafter Gilmore, The Good Faith Purchase Idea]. Section 9−205 of the 1972 version of Article 9 provides, in relevant part:

A security interest is not invalid or fraudulent by reason of the liberty of the debtor to use, commingle or dispose of all or part of the collateral (including returned or repossessed goods) or to collect or compromise accounts or chattel paper, or to accept the return of goods or make repossessions, or to use, commingle, or dispose of proceeds, or by reason of the failure of the secured party to require the debtor to account for proceeds or replace collateral . . . .

Former UCC § 9−205. Back To Text

[23] Former UCC § 9−205 cmt. 1. Back To Text

[24] See former UCC § 9−202 (title to collateral immaterial). Back To Text

[25] See Baird, The Importance of Priority, supra note 18, at 1422. Back To Text

[26] See id. Back To Text

[27] See id. Back To Text

[28] See Alan Schwartz, Security Interests and Bankruptcy Priorities: A Review of Current Theories, 10 J. Legal Stud. 1 (1981) [hereinafter Schwartz, Security Interests]. Back To Text

[29] Id. at 7−8. Back To Text

[30] Relaxing the perfect market assumption, Professor Schwartz suggests that secured debt can have the effect of redistributing wealth from uninformed small creditors. See id.at 30−33. Back To Text

[31] See, e.g., Symposium: The Priority of Secured Debt, 82 Cornell L. Rev. 1279, et seq. (1997). See also Lucian A. Bebchuk & Jesse M. Fried, The Uneasy Case for the Priority of Secured Claims in Bankruptcy, 105 Yale L.J. 857, 869 (1996) [hereinafter Bebchuk & Fried, The Uneasy Case]. Professor Schwartz explored the carve−out concept much earlier in his seminal article on the economic justifications for secured credit. See Schwartz, Security Interests, supra note 27, at 33−40. Back To Text

[32] See generally Elizabeth Warren, Making Policy with Imperfect Information: The Article 9 Full Priority Debates, 82 Cornell L. Rev. 1373, 1392 (1997). Back To Text

[33] See generally Lucian Arye Bebchuk & Jesse M. Fried, The Uneasy Case for the Priority of Secured Claims in Bankruptcy: Further Thoughts and a Reply to Critics, 82 Cornell L. Rev. 1279, 1293 (1997) [hereinafter Bebchuk & Fried, Further Thoughts]. Back To Text

[34] See Warren, supra note 31, at 1382−83. Back To Text

[35] See Bebchuk & Fried, Further Thoughts, supra note 32, at 1285. Back To Text

[36] See id. Back To Text

[37] See Warren, supra note 31, at 1388; see also, Lynn M. LoPucki, Should the Secured Credit Carve Out Apply Only in Bankruptcy? A Systems/Strategic Analysis, 82 Cornell L. Rev. 1483, 1489, 1509 (1997). Back To Text

[38] See Warren, supra note 31, at 1388; see also Bebchuk & Fried, Further Thoughts, supra note 32, at 1323−24. Back To Text

[39] See id. at 1325−27. Back To Text

[40] See Lynn M. LoPucki, The Unsecured Creditor's Bargain, 80 Va. L. Rev. 1887, 1910−14 (1994) [hereinafter LoPucki, The Unsecured Creditor's Bargain]; David W. Leebron, Limited Liability, Tort Victims, and Creditors, 91

Colum. L. Rev. 1565, 1646−50 (1991) (subordinating both secured and other unsecured claims to tort claims). Back To Text

[41] See Steven L. Harris & Charles W. Mooney, Jr., Measuring the Social Costs and Benefits and Identifying the Victims of Subordinating Security Interests in Bankruptcy, 82 Cornell L. Rev. 1349, 1349 (1997) [hereinafter Harris & Mooney, Measuring the Social Costs]. Back To Text

[42] See generally Richard A. Posner, Economic Analysis of the Law 13−14 (4th ed. 1992); see also Schwartz, Security Interests, supra note 27, at 2 n.7 (applying these concepts to secured credit). Back To Text

[43] Professors Harris and Mooney apparently do not agree. Although they argue that secured credit bestows some benefits to unsecured creditors, they support expansion of secured credit on Kaldor−Hicks efficiency grounds. See Harris & Mooney, A Property−Based Theory of Security Interests, supra note 17, at 2034. Back To Text

[44] See Robert E. Scott, The Truth About Secured Financing, 82 Cornell L. Rev. 1436, 1462 (1997); see also, Schwartz, Security Interests, supra note 27, at 30−36. Back To Text

[45] See Warren, supra note 31, at 1377. "[T]he ultimate normative question about preference for one group over another in the distribution of limited assets is beyond the expertise these tools provide." Id. Back To Text

[46] See, e.g., Bebchuk & Fried, Further Thoughts, supra note 32, at 1299. A variant of the consent argument is based on the Article 9 filing system. This argument implies consent because the unsecured creditors entered into their loans with (constructive) notice of the secured claim. See id. at 1287. Back To Text

[47] See id. at 1288. Back To Text

[48] Of course, an alternative would be to require actual consent. In theory, the two choices are the same, although in practice the transaction costs of obtaining consent might prove prohibitive. Back To Text

[49] See, e.g., Thomas H. Jackson & Anthony T. Kronman, Secured Financing and Priority Among Creditors, 88 Yale L. Rev. 1143, 1158 (1979) ("[T]he economic utility of secured credit rests upon the assumption that total monitoring costs can sometimes be reduced by giving certain creditors a priority over others."); see also Scott, supra note 43, at 1449 (secured credit helps reduce "agency costs"). For example, the equity holders in a debtor on the brink of insolvency would have little to lose and much to gain by betting the assets on a coin flip because they would capture most of the benefit of a win but bear almost none of the cost of a loss. As a result their incentives might cause them to make inefficient investment choices for the firm. The existence of a security interest in the assets might deprive them of the ability to make the bet. This problem is also addressed by the recent line of corporate law decisions imposing on corporate directors a fiduciary duty to creditors when the corporation is operating in the vicinity of insolvency. See, e.g., Credit Lyonnais Bank v. Pathe Communications, No. 12150, 1991 LEXIS 215 (Del. Ch. Dec. 30, 1991). See generally Andrew D. Shaffer, Corporate Fiduciary−−Insolvent: The Fiduciary Relationship Your Corporate Law Professor (Should Have) Warned You About, 8 Am. Bankr. Inst. L. Rev. 479 (2000). Back To Text

[50] See supra text accompanying notes 21−22. Back To Text

[51] Professors Harris and Mooney are strong advocates of this view. See Harris & Mooney, Measuring the Social Costs, supra note 40, at 1350, 1360−61; see also Steven L. Schwarcz, The Easy Case for the Priority of Secured Claims in Bankruptcy, 47 Duke L.J. 425, 426 (1997). But this rationale requires one to assume that some creditors will irrationally refuse to loan on an unsecured basis even with a higher interest rate that fully compensates them for the extra risk. See Kenneth N. Klee, Barbarians at the Trough: Riposte in Defense of the Warren Carve−Out Proposal, 82 Cornell L. Rev. 1466, 1329−30 (1997); see also Schwartz, Security Interests, supra note 27, at 7 n.23. Back To Text

[52] See Scott, supra note 43, at 1446. Back To Text

[53] See UCC § 1−201(44)(b) ("[A] person gives 'value' for rights if he acquires them . . . (b) as security for…a pre−existing claim."); UCC § 9−203(b)(1) (requiring that "value" be given in order for security interest to attach). Back To Text

[54] See former UCC § 9−204(1); UCC § 9−204(a). The effectiveness of such clauses is not limited to situations where the fluid nature of the collateral may make the clause essential to the utility of the security interest. For example, inventory presents a type of collateral where the security interest must apply to a constantly shifting mass of fungible items. The after−acquired property clause makes it possible to use inventory as collateral by taking a security interest in the shifting mass, without having to account for the fact that specific items of inventory are being sold and replaced by new items of inventory. Back To Text

[55] See Schwartz, Security Interests, supra note 27, at 31−33. Back To Text

[56] See generally Bebchuk & Fried, Further Thoughts, supra note 34. Back To Text

[57] See Schwartz, Security Interests, supra note 27, at 30−33. Back To Text

[58] Dean Scott states, "Thus, the normative bite of any claims grounded in distributional fairness turns largely on the perceived inadequacy of the Article 9 filing system to alert unsophisticated debtors [sic] to the risks of subordination." Scott, supra note 43, at 1439. Back To Text

[59] See Bebchuk & Fried, Further Thoughts, supra note 34, at 1294. Back To Text

[60] See Warren, supra note 31, at 1373, 1376, 1379. "The justifications for contractual priority remain, at best disputed, and at worst, thoroughly debunked." Id. at 1376. Back To Text

[61] Professor Warren stated, "[T]he lack of theoretical consensus for full priority has become prominently exposed, the absence of empirical data has obviated the ability to make any concrete evaluation of the costs and benefits of secured credit, and the headlong push to enlarge on every scintilla of priority for secured creditors has intensified." Warren, supra note 31, at 1374. Back To Text

[62] Dean Robert Scott described the current environment as follows:

Put simply, we still do not have a theory of finance that explains why firms sometimes (but not always) issue secured debt rather than unsecured debt or equity. Moreover (and perhaps because of the lack of any plausible general theory), we lack any persuasive empirical data to predict whether, in any particular case, a later security−financed project will generate sufficient return to offset any reduction in the value (i.e., the bankruptcy share) of prior unsecured claims.

Scott, supra note 43, at 1436. Back To Text

[63] Professors Harris and Mooney acknowledge the "indeterminacy of the social welfare claims made in the security interest debate," but argue both that the law reform process cannot await the development of a consensus and that the adoption of the revision shows that it has wide support. See Steven L. Harris & Charles W. Mooney, Jr., Revised Article 9 Meets the Bankruptcy Code: Policy and Impact, 9 Am. Bankr. Inst. L. Rev. 85, 111 (2001) [hereinafter Harris & Mooney, Policy & Impact]. Neither response is sufficient. They point to no crisis in the world of finance that makes an urgent reform more important than a correct reform. And, their support argument puts the cart before the horse. The somewhat lukewarm support of the state legislatures is not proof that the reforms are based on solid theoretical ground. Instead that support exists, at least in part, because the revision has the blessing of the uniform laws process and the legislators assume that it is theoretically sound. A final defense, implicit in their stated assumption that some form of Article 9 will continue to exist, may be an adequate reply to a call to eliminate secured credit, but it gives no support for a project that enhances the rights of secured creditors.

Professors Harris and Mooney state, "The train may have left the station, but we hope that scholars will keep it in their sights as it moves along on its journey." Id. Train tracks require a firm foundation. For an observer from the heights of the ivory tower, the question whether the engineer chose the right track is merely academic. The view is much different for the unsecured creditors riding inside. Back To Text

[64] "Article 9 embraces the goal of facilitating the extension of secured credit." Steven L. Harris & Charles W. Mooney, Jr., How Successful Was the Revision of UCC Article 9?: Reflections of the Reporters, 74 Chi.−Kent L. Rev. 1357, 1359 (1999); see also Harris & Mooney, Policy & Impact, supra note 62, at 108 (outlining ways in which the revision will facilitate the extension of secured credit). "[W]e take as our 'first principle' that Uniform Commercial Code Article 9 should facilitate the creation of security interests. Stated otherwise, we think the transfer of an effective security interest ought to be as easy, inexpensive, and reliable as possible." Harris & Mooney, A Property−Based Theory of Security Interests, supra note 17, at 2021. Back To Text

[65] See Corinne Cooper, The Madonnas Play Tug of War with the Whores or Who is Saving the UCC?, 26 Loy. L.A. L. Rev. 563 (1993). Back To Text

[66] Where only one interest group is represented, it is likely to have more influence in the private legislative arena than in a state legislature. See Alan Schwartz & Robert E. Scott, The Political Economy of Private Legislatures, 143 U. Pa. L. Rev. 595, 630−33 (1995) [hereinafter Schwartz & Scott, The Political Economy]. Back To Text

[67] As Professor Woodward states, "Even if there were compelling empirical data or an otherwise strong general consensus that limiting secured credit was sound policy, it seems that such a policy could not be implemented through the Article 9 reform process." Woodward, supra note 13, at 1514−15; see also, Kathleen Patchel, Interest Group Politics, Federalism, & the Uniform Law Process: Some Lessons from the Uniform Commercial Code, 78 Minn. L. Rev. 83, 98−101 (1993). Back To Text

[68] For a brief review of the politics behind the process, see Marion W. Benfield, Jr., Consumer Provisions in Revised Article 9, 74 Chi.−Kent L. Rev. 1255, 1255−59 (1999). Back To Text

[69] A candid acknowledgement of this limitation is contained in the Consumer Issues Subcommittee report:

[T]he drafting participants must recognize that the question of coverage of consumer issues in Article 9 involves not only a judgment as to the best substantive rule, but also a judgment regarding whether there is sufficient consensus on the appropriate substantive rule outside the Conference [the National Conference of Commissioners on Uniform State Laws] and the American Law Institute (ALI) that a decision made by the Conference and the ALI would be acceptable. Therefore, provisions which the sponsoring organizations believe substantively desirable might nevertheless not be included in Article 9 because of enactability concerns.

Report of the Consumer Issues Subcommittee of the UCC Article 9 Drafting Committee (issued May 29, 1996), reprinted in Benfield, supra note 67, at 1256. Back To Text

[70] UCC § 9−626(b). Back To Text

[71] Large groups with diverse interests are less likely to organize into effective interest groups than smaller groups with strong shared interests. See Patchel, supra note 66, at 127−32. Back To Text

[72] As is true with revised Article 9, the interest group dynamic causes new regulation to redistribute wealth from relatively diffuse groups with limited shared interests to more organized groups with strong shared interests. See Patchel, supra note 66, at 128. Back To Text

[73] Dean Scott asserts that "private legislatures" like ALI and NCCUSL are poorly suited for evaluating the efficiency arguments involving secured credit and may be more susceptible to interest group influence than ordinary legislatures. Scott, supra note 43, at 1463. "[T]here is strong evidence that a dominant group has influenced the [Article 9] process." Id.; see also, Schwartz & Scott, The Political Economy, supra note 65, at 397 (bright line rules indicate interest group dominance). Back To Text

[74] See generally Harris & Mooney, A Property−Based Theory of Security Interests, supra note 17. Back To Text

[75] Woodward, supra note 13, at 1515. The writings of Professors Harris and Mooney make clear that did occur in the Article 9 drafting process. See, e.g., Harris & Mooney, A Property−Based Theory of Security Interests, supra note 17, at 2097. Back To Text

[76] "The dominant enterprise is to make the system of secured credit as sleek and usable as the reformers can make it." Woodward, supra note 13, at 1525. As Professor Woodward states, "[O]ne senses in the current reform process a comparable enterprise aimed at overriding or rendering moot judicial decisions that have tended to limit secured credit." Id. at 1521. Back To Text

[77] See id. at 1528−29. Back To Text

[78] See infra text accompanying notes 182−225. Back To Text

[79] See Scott, supra note 43, at 1463 (concerns about the secured credit's regressive redistribution are influenced largely by the degree to which the Article 9 filing system informs unsophisticated creditors of these risk). Back To Text

[80] At least one theorist takes the view that information imperfections in the market for credit provide the most plausible explanation for a firm's use of secured credit. See George G. Triantis, Secured Debt Under Conditions of Imperfect Information, 21 J. Legal Stud. 225 (1992). Back To Text

[81] On the other hand, if revised Article 9 causes most unsecured creditors to react to the lack of information by assuming that all assets are encumbered and to raise their charges accordingly, the net effect of the revision may be to increase overall borrowing costs since debtors will be charged an extra risk premium whether or not they have any secured debt. See Alan Schwartz, Priority Contracts and Priority in Bankruptcy, 82 Cornell L. Rev. 1396, 1416−17 (1997) [hereinafter Schwartz, Priority Contracts] (uninformed creditors will charge every borrower the higher secured rate); see also Scott, supra note 43, at 1443 (suppliers and trade creditors may charge an average risk premium rather than adjust for each transaction). Since the debtor will be burdened with this extra interest cost in any event, revised Article 9 may force the debtor to seek secured financing in cases where it would not otherwise be efficient. See Schwartz, Security Interests, supra note 27, at 31−33. Back To Text

[82] Although involved in the decision to reject Ratner in the 1962 version of Article 9, Gilmore later argued that its substance should have been retained. See Gilmore, The Good Faith Purchase Idea, supra note 21, at 625. Back To Text

[83] See infra text accompanying notes 285−313. Back To Text

[84] See infra text accompanying notes 237−257. Back To Text

[85] See infra text accompanying notes 210−219. Back To Text

[86] In cases where these types of assets truly are important items of collateral that may induce additional lending (like a radio station license or a certificate of deposit), it generally is possible to obtain a lien on them under current law. Unlike the simple methods of creating and perfecting a security interest in these types of collateral under revised Article 9, the current methods are rather cumbersome. However, that may help insure that they are used as collateral only in those cases where their use adds to the debtor's liquidity. Back To Text

[87] See infra text accompanying notes 285−313. Back To Text

[88] See Butner v. United States, 40 U.S. 48, 55 (1971). Back To Text

[89] Harris & Mooney, Policy & Impact, supra note 62, at 87 (emphasis added). Back To Text

[90] Here the term bankruptcy policy is used in its broader sense to encompass the policy choices involved in deciding how to allocate insolvency shares. In this sense, I must plead guilty to the charge of considering not merely what is the bankruptcy law, but what it ought to be. See Harris & Mooney, Policy & Impact supra note 62, at 86−87. Back To Text

[91] Butner, 440 U.S. at 55. Back To Text

[92] See Harris & Mooney, A Property−Based Theory of Security Interests, supra note 17, at 2024. Back To Text

[93] See id. at 2048 n.68. They assert that, "It seems clear enough that security interests, under Article 9 and real estate law alike, are interest in property." Id. at 2051. Back To Text

[94] See UCC § 9−408(d). The rights listed by Professors Harris and Mooney as the "property" attributes of security interests either do not apply to a security interest in a non−assignable right, or could be waived without affecting the validity of the "security interest." See Harris & Mooney, A Property−Based Theory of Security Interests, supra note 17, at 2024. Back To Text

[95] Professor Harris and Mooney recognize the possibility that the Ratner security interest could be seen as an unenforceable contract to give priority rather than a property interest. See id. at 2063−64. Back To Text

[96] See Bebchuk & Fried, Further Thoughts, supra note 32, at 1290. Back To Text

[97] Warren, supra note 31, at 1388. Back To Text

[98] State laws are suspended to the extent they conflict with federal bankruptcy law. Butner, 440 U.S. at 54 n.9. Back To Text

[99] 11 U.S.C. § 545(1)(A) (1994). Back To Text

[100] 11 U.S.C. § 545(1)(B)−(F) (1994). Back To Text

[101] See 11 U.S.C. § 546(b)(1) (1994). Some state insolvency policies are honored in bankruptcy, but in those instances the Code expressly defers to the specific rule. For example, although the UCC Article 2 reclamation right applies only in cases of insolvency, the Bankruptcy Code expressly recognizes that right in bankruptcy proceedings. See 11 U.S.C. § 546(c). Back To Text

[102] The House Report for the 1978 Bankruptcy Code states that the term "is not designed to give States an opportunity to enact disguised priorities in the form of liens that apply only in bankruptcy cases." H.R. Rep. No. 95−595, at 371, reprinted in 1978 U.S.C.C.A.N. 5963, 6327. Back To Text

[103] See 11 U.S.C. § 545(1)(B), (E)−(F) (1994). Back To Text

[104] See 11 U.S.C. § 545(3)−(4) (1994). Back To Text

[105] See 11 U.S.C. § 502(b)(7) (1994). Back To Text

[106] See 11 U.S.C. § 502(b)(6) (1994). Back To Text

[107] See 11 U.S.C. § 365 (1994). Back To Text

[108] See 11 U.S.C. § 552(a) (1994). Back To Text

[109] See Harris & Mooney, Policy & Impact, supra note 62, at 93. Back To Text

[110] See Harris & Mooney, A Property−Based Theory of Security Interests, supra note 17, at 2068. Back To Text

[111] Harris & Mooney, Policy & Impact, supra note 62 at 88. Back To Text

[112] Section 31 states:

And be it further enacted, That in the distribution of the bankrupt's effects, there shall be paid to every of the creditors a proportion−rate, according to the amount of their respective debts, so that every creditor having security for his debt by judgment, statute, recognizance, or specialty, or having an attachment under any of the laws of the individual states, or of the United States, on the estate of such bankrupt, (Provided, there be no execution executed upon any of the real or personal estate of such bankrupt, before the time he or she became bankrupts) shall not be relieved upon such judgment, statute, recognizance, specialty, or attachment, for more than a rateable part of his debt, with the other creditors of the bankrupt.

Bankruptcy Act of 1800, § 31, 2 Stat. 19, 30 (1800). Back To Text

[113] Id. Back To Text

[114] See id. Back To Text

[115] Indeed, the concept of preserving some free assets runs deep in the legal culture. As Dean Baird states, "American judges have long asserted that a portion of the assets of an insolvent firm should always be made available for its general creditors." Baird, The Importance of Priority, supra note 18, at 1420. Although this principle initially found expression in the courts' concerns about the adequacy of notice, "[l]ater cases identified keeping some assets available for general creditors as a distinct issue. Id. at n. 1. Back To Text

[116] 1 Gilmore, supra note 7, § 2.1, at 24. Back To Text

[117] John C. McCoid, Bankruptcy, the Avoiding Powers, and Unperfected Security Interests, 59 Am. Bankr. L.J. 175, 177 (1985). Back To Text

[118] See id. at 178. Back To Text

[119] 101 U.S. 731 (1879); see also McCoid, supra note 116, at 180. Back To Text

[120] See McCoid, supra note 116, at 180. Back To Text

[121] See id. at 181. Back To Text

[122] See id. at 176. Back To Text

[123] 201 U.S. 344 (1906). Back To Text

[124] See McCoid, supra note 116, at 182. Back To Text

[125] Bankruptcy Act of June 25, 1910, 36 Stat. 838. Back To Text

[126] See McCoid, supra note 116, at 181. Back To Text

[127] The principle of deference to state law in the Bankruptcy Act of 1898 rested on the uncertain distinction between "property" law and "commercial" law, with deference being given to property rights established by state law. 2 Gilmore, supra note 7, § 45.2, at 1284. While this principle was never absolute, bankruptcy law has progressively increased the power of the bankruptcy trustee and the role of federal law. See id. at 1285. Back To Text

[128] Twyne's Case, 76 Eng. Rep. 809 (1601). See supra text accompanying notes 9−10. Back To Text

[129] 1 Gilmore, supra note 7, § 2.1, at 25. Back To Text

[130] See id. Back To Text

[131] See id. § 2.2, at 26. Back To Text

[132] See id. Back To Text

[133] See id. Back To Text

[134] See id. Back To Text

[135] See Griswold v. Sheldon, 4 N.Y. 581, 587−88 (1851); see also 1 Gilmore, supra note 7, § 2.3, at 27. Back To Text

[136] 1 Gilmore, supra note 7, § 2.5, at 45. Back To Text

[137] See id. § 4.1, at 86−91. Back To Text

[138] See id. § 6.3, at 154, 162−63. Back To Text

[139] See id. § 3.2, at 67. Back To Text

[140] See id. Back To Text

[141] See id. § 5.1, at 129. Back To Text

[142] Act of June 22, 1938, c. 575, 52 Stat. 840. Back To Text

[143] See 1 Collier on Bankruptcy ¶1.01[1][a][i] (15th ed. rev. 2000). Back To Text

[144] 1 Gilmore, supra note 7, § 2.6, at 47. Back To Text

[145] See id. § 2.8, at 55. Back To Text

[146] See id. § 2.8, at 61; id. § 8.1, at 250. Back To Text

[147] See 1 Gilmore, supra note 7, § 7.5, at 207; 2 Gilmore, supra note 7, § 41.1, at 1077. Back To Text

[148] Id. § 7.5, at 206. Back To Text

[149] It was not until the adoption of Article 9 in the 1960's that "parties could reliably and inexpensively negotiate for reduced collection rights of third parties in the event of financial collapse." Warren, supra note 31, at 1375. Back To Text

[150] Gilmore, The Good Faith Purchase Idea, supra note 21, at 620. Back To Text

[151] See Scott, supra note 43, at 1464−65 (many changes in the 1978 Code were in response to Article 9's concessions to secured creditors). Back To Text

[152] Gilmore, The Good Faith Purchase Idea, supra note 21, at 627−28. Gilmore referred to his work on the bankruptcy revisions as a "second chance to clean up the mistakes" made in the Article 9 drafting process. Id. at 628. Back To Text

[153] See 11 U.S.C. § 544(a)(3) (1994). Back To Text

[154] See 11 U.S.C. § 544(2) (1994). Back To Text

[155] See, e.g., Thomas H. Jackson, Avoiding Powers in Bankruptcy, 36 Stan. L. Rev. 725, 732−42 (1984); Thomas H. Jackson & Robert E. Scott, On the Nature of Bankruptcy: An Essay on Bankruptcy Sharing and the Creditor's Bargain, 75 Va. L. Rev. 155, 179−81 (1989); McCoid, supra note 116, at 186−92. Back To Text

[156] For example, Gilmore noted that the bankruptcy law's approach to delayed perfection reflects a "progressively harsher attitude." 1 Gilmore, supra note 7, § 1.1, at 9. Back To Text

[157] This view is reflected in Gilmore's 1965 treatise, "[The trustee] might have been designed as an official whose primary duty was to hold the scales in even balance between the creditors who claimed property interests and the creditors who had no such claim." 2 Gilmore, supra note 7, § 45.2, at 1287. Back To Text

[158] See McCoid, supra note 116, at 192. Back To Text

[159] See id. at 190−92. Back To Text

[160] See supra text accompanying notes 45−47. Back To Text

[161] The 1968 edition of Powell on Real Property indicates that the real estate recordation statutes of most states did not protect creditors. Richard R. Powell & Patrick J. Rohan, Powell on Real Property, § 615, at 1051−52 (abr. ed. 1968). However, the rule was not uniform. "A large fraction of the American jurisdictions protect creditors, either by express additional statutory language, or by construction of less clearly worded statutes." Id. at 1052. Back To Text

[162] For example, while a security interest in chattel paper could be perfected by filing or possession, see former UCC § 9−304 & § 9−305, under the 1972 version of Article 9, perfection by possession was necessary to perfect against certain subsequent purchasers, see UCC § 9−308, a term that could include a secured party, see UCC § 1−201(32), (33) (defining "purchase" and "purchaser"). Note, however, that unlike some of the revised Article 9 provisions, this type of bifurcated perfection was not applicable to all secured creditors, but was limited to a very special group −− those who both gave new value and who did so in the ordinary course of business. Similarly, the lapse of perfection rules for inter−state movement under current Article 9, UCC § 9−103(1)(d) & (3)(e) distinguish between lien creditors and secured parties, however, here again the distinction applies only to security interests that attach after the move. Back To Text

[163] See 1 Gilmore, supra note 7, § 13.7, at 435. Back To Text

[164] See id. Back To Text

[165] This lineage is explained by Gilmore in his landmark treatise on the 1962 version of Article 9:

The term "perfection" or "perfected" is derived from § 60 of the Federal Bankruptcy Act on voidable preferences. As used in the Bankruptcy Act the term, which is undefined, means in effect that a security interest which is perfected is good against the debtor's trustee in bankruptcy. With respect to personal property, the § 60 point of perfection is reached when no creditor of the debtor could thereafter acquire a judicial lien on the collateral which would be superior to the interest of the secured property.

Id. Back To Text

[166] See supra text accompanying notes 111−151. The use of this as the measure for perfection against secured creditors and good faith purchasers under the prior version of Article 9 shows that it reflected the state's view of what notice was generally adequate. Back To Text

[167] Professors Harris and Mooney recognize that real lien creditors are very rare and that the unsecured creditors in bankruptcy are the real beneficiaries of the state law lien creditor rules. See Harris & Mooney, A Property−Based Theory of Security Interests, supra note 17, at 2061. Back To Text

[168] Acknowledging the obvious, Harris and Mooney state, "A principal motivation for taking security is the desire to increase the likelihood of payout in the event of bankruptcy." Harris & Mooney, A Property−Based Theory of Security Interests, supra note 17, at 2067. Even in 1965, Gilmore recognized that "the debtor's bankruptcy is the principal risk against which a creditor seeks to insure by taking a security interest in the debtor's property." 1 Gilmore, supra note 7, § 13.7, at 435. Back To Text

[169] Ironically, although the revision creates a bifurcated perfection system that allows lien creditors to be defeated under circumstances where the notice is deemed inadequate to establish priority over competing secured creditors, it reverts back to the unitary model of perfection when dealing with foreign secured credit regimes. Since the debtor's location determines which jurisdiction's laws govern perfection, see UCC § 9−301(1), it is possible that the relevant jurisdiction might be a non−United States jurisdiction. In such cases the question of whether the foreign law governs perfection turns on the nature of the foreign law. The test used by the revision defines perfection with reference to the rights of lien creditors. Section 9−307(c) provides that the local law of the jurisdiction where the debtor is located governs only if the debtor:

is located in a jurisdiction whose law generally requires information concerning the existence of a nonpossessory security interest to be made generally available in a filing, recording, or registration system as a condition or result of the security interest's obtaining priority over the rights of a lien creditor with respect to the collateral . . ."

UCC § 9−307(c). Thus, at some level the drafters of the revision, like § 544(a)(1) of the Bankruptcy Code and drafters of the earlier versions of Article 9, recognize that the lien creditor test should be synonymous with perfection. Back To Text

[170] See former UCC § 9−115(5). Back To Text

[171] See UCC §§ 9−312(a), 9−314(a). Back To Text

[172] See UCC § 9−328(7). Section 9−331 makes clear that filing does not give priority over protected purchasers of securities. Back To Text

[173] See UCC § 9−328(1). Back To Text

[174] See UCC § 9−238(1). Back To Text

[175] See former UCC § 9−304(1). Back To Text

[176] See UCC §§ 9−312(a), 9−313(a). Back To Text

[177] It does, however, provide some protection against parties other than trustees and lien creditors. See Harris & Mooney, Policy & Impact, supra note 62, at 95−96. Back To Text

[178] See UCC § 9−330(d). Note that although the section speaks of an instrument "purchaser's" priority, the term "purchaser" is broadly defined and would include a secured creditor, although it would not include a lien creditor or trustee in bankruptcy. See UCC § 1−201(32)−(33). Back To Text

[179] "Payment intangible" means a general intangible under which the account debtor's principal obligation is a monetary obligation. UCC § 9−102(61); see also G. Ray Warner, Asset Securitization Under Revised Art. 9, Am. Bankr. Inst. J., September 2000, at 16. See generally Lois R. Lupica, Revised Article 9, Securitization Transactions and the Bankruptcy Dynamic, 9 Am. Bankr. Inst. L. Rev. 287 (2001). Back To Text

[180] See §§ 9−309(3)−(4), 9−310(b)(2). Back To Text

[181] See UCC § 9−330(d). Back To Text

[182] See generally C. Scott Pryor, How Revised Article 9 Will Turn the Trustee's Strong−arm Into a Weak Finger: A Potpourri of Cases, 9 Am. Bankr. Inst. L. Rev. 229 (2001). Back To Text

[183] See G. Ray Warner, Documenting a Transaction under Revised Article 9, Am. Bankr. Inst. J., April 2000, at 20. See generally Terry M. Anderson, Marianne B. Culhane, Catherine Lee Wilson, Attachment and Perfection of Security Interests Under Revised Article 9: A "Nuts and Bolts" Primer, 9 Am. Bankr. Inst. L. Rev. 179 (2001). Back To Text

[184] See UCC § 9−502(a). Back To Text

[185] See UCC § 9−516(b). Back To Text

[186] See UCC § 9−520(c). Back To Text

[187] See UCC § 9−520(a). Back To Text

[188] See UCC §§ 9−520(c), 9−338. Back To Text

[189] See UCC § 9−516(b). Back To Text

[190] See UCC § 9−502(a). Back To Text

[191] See UCC § 9−506(a). Back To Text

[192] UCC § 9−506 cmt. 2. Note that the § 9−506(a) safe harbor appears to require both that the error or omission be "minor" and not "seriously misleading." Although the comment suggests that name errors or omissions will not be seriously misleading, if the use of the term "minor" error or omission has any significance independent of the seriously misleading test, then it is possible the failure to list a secured party or a major error in the name might render the financing statement ineffective. Back To Text

[193] See UCC § 9−503(a)(1). Back To Text

[194] See UCC § 9−506(c). Back To Text

[195] See UCC § 9−503(c). Back To Text

[196] See Harris & Mooney, Policy & Impact, supra note 62, at 105. That is not to say that the changes were designed to aid trustees or lien creditors. More likely, these changes were made so that a later secured creditor who searches the records can be confident that its priority will not be defeated by an earlier secured creditor who's financing statement was not disclosed by the search. Back To Text

[197] See UCC § 9−108(b). Back To Text

[198] See UCC § 9−504(2). The "all assets" description is not sufficient for the security agreement. UCC § 9−108(c). Back To Text

[199] The debtor must authorize the filing in an authenticated record. UCC § 9−509(a)(1). While the debtor's authentication of the security agreement ipso facto constitutes authorization to file a financing statement covering the collateral described in the security agreement, see UCC § 9−509(b)(1)−(2), a specific authorization would be required in order to file an "all assets" financing statement where the security interest was more limited. Back To Text

[200] See UCC § 9−502(a). Back To Text

[201] See UCC § 9−338(1)−(2). Back To Text

[202] UCC § 1−201(44)(a)−(b). Back To Text

[203] See also UCC § 9−203(b)(1) (security interest does not attach until "value" is given). Back To Text

[204] Contrast the UCC § 1−201(44) definition of "value" with the Bankruptcy Code's definition of "new value" in 11 U.S.C. § 547(a)(2). Back To Text

[205] Had this right been extended to lien creditors it may not have passed to the trustee in bankruptcy under § 544(a)(1). Although § 544(a)(1) does specify that the hypothetical lien creditor status includes lack of notice, it does not expressly include any reasonable reliance element. Back To Text

[206] For example, searching by, or eliminating "false positives" on the basis of, a unique state organizational identification number would appear to be an efficient method or checking the public record. However, is it reasonable to rely upon the organizational number alone to eliminate financing statements when a review of the actual financing statement would have disclosed the debtor's correct name, correct address, etc.? Leaving that question for case−by−case determination by a judge or jury hardly adds certainty to the filing system. Back To Text

[207] The 1962 version of Article 9 subordinated unperfected security interests to "a person who becomes a lien creditor without knowledge of the security interest and before it is perfected." UCC § 9−301(1)(b) (1962) (amended 1972) (emphasis added). That language was eliminated in the 1972 revision. Cf. former UCC § 9−301(1)(b). Back To Text

[208] Compare UCC § 9−521(a), box 2d with UCC § 9−521(a), box 2g; see UCC § 9−516, cmt 3. It is likely that some filers may not catch this distinction and will insert the taxpayer identification number in the organizational identification number box. Inexplicably, the revision does not permit the filing officer to reject a financing statement with an obviously incorrect identification number. As explained in official comments:

Neither this section nor Section 9−520 requires or authorizes the filing office to determine, or even consider, the accuracy of information provided in a record. For example, the State A filing office may not reject under subsection (b)(5)(C) an initial financing statement indicating that the debtor is a State A corporation and providing a three−digit organizational identification number, even if all State A organizational identification numbers contain at least five digits and two letters.

UCC § 9−516 cmt. 3. Thus, the rules virtually insure that erroneous financing statements will appear in the public records. Back To Text

[209] See UCC § 9−521(a), box 2d. This creates an extremely dangerous third class of information −− information that is called for on the form, but that is neither essential nor required and upon which no one can rely. Back To Text

[210] See former UCC § 9−402(1), (8). Back To Text

[211] See former UCC § 9−103(1), (3). Back To Text

[212] See former UCC § 9−103(3)(d). Back To Text

[213] See former UCC § 9−401(1). Back To Text

[214] See former UCC § 9−401 cmt. 1. Back To Text

[215] If the collateral or debtor changes its location to a new state, it is necessary to file a financing statement in the new state in order to maintain perfection. See former UCC § 9−103(1)(d), (3)(e). Back To Text

[216] See G. Ray Warner, New Filing Rules Follow the Debtor, Am. Bankr. Inst. J., March 2000, at 16. See generally Anderson et al., supra note 182, at 212. Back To Text

[217] See UCC § 9−301(1). Fixture filings, and filings for "as extracted" collateral and timber to be cut must be filed in the state where the related real estate is located. See §§ 9−301(3)(A)−(B), (4). In addition, special rules apply to agricultural liens. See § 9−302. Back To Text

[218] See § 9−307(e). Back To Text

[219] Problems may remain for individual debtors and debtors that are not registered organizations. The current law's "place of business/chief executive office" rule continues to apply to non−registered organizations, such as general partnerships. See § 9−307(b)(2)−(3). And, an individual is located as his or her principal residence. See § 9−307(b)(1). Back To Text

[220] See § 9−501(a)(2). Fixture filings, and filings for "as extracted" collateral and timber to be cut must be filed in the office where a mortgage on the related real estate would be filed. See § 9−501(a)(1). Special rules apply if the debtor is a transmitting utility. See § 9−501. Back To Text

[221] My quoted comments from a newspaper interview are not inconsistent with my view here. See Harris & Mooney, Policy & Impact, supra note 62, at 92 n.39, 102 n.94. I do believe that the complexity of the revision will make the code less user−friendly for the casual practitioner and thereby increase the possibility of error in general. However, the rules discussed here greatly reduce the possibility of one class of errors −− those that can be used by a bankruptcy trustee. Back To Text

[222] Generally, a change in the legal rules that reduces the risk of errors is a positive development. Professors Harris and Mooney make this point rather forcefully. See Harris & Mooney, Policy & Impact, supra note 62, at 99−101. However, if as Professors Bebchuk and Fried suggest, the strong arm power serves a useful carve out function by taking advantage of those errors, a reduction in the incidence of such errors may require adoption of a more formal bankruptcy carve out mechanism. See Bebchuk & Fried, Further Thoughts, supra note 32, at 1292. Back To Text

[223] The new rules might not prove substantially more inconvenient. Professor LoPucki's research indicates that most small business are incorporated in the state where their principal assets are located. Lynn M. LoPucki, The Article 9 Filing System: Why the Debtor's State of Incorporation Should be the Proper Place for Article 9 Filing: A Systems Analysis, 79 Minn. L. Rev. 577, 607−08 (1995). Back To Text

[224] This may be particularly true with respect to debtors organized under the laws of a non−United States jurisdiction. Under the revision, a filing in a foreign country may suffice to perfect a security interest in tangible collateral located in the United States. See UCC § 9−307(c). This turns on the nature of the foreign country's lien recordation laws. See id. Back To Text

[225] Some of these points could be made about the current system which gives in many cases gives only "inquiry notice." The revision, however, takes this concept to a new level. Back To Text

[226] Since the "all assets" designation will also be sufficient, even when the security interest is far more limited, creditors may routinely list "all assets" in order to avoid the risk of a defective financing statement. Will debtors permit this, since later secured creditors may be unwilling to extend credit to a debtor with such financing statements on file? That problem could be addressed by including a subordination provision in the security agreement. See UCC § 9−339. Back To Text

[227] The filing system should address the information needs of all parties who will be bound by the security interest. See LoPucki, The Unsecured Creditor's Bargain, supra note 39, at 1952−54, 1965. Back To Text

[228] This exacerbates the information deficiencies of current law. The current system does not permit an accurate determination of the extent of a firm's secured debt since the filing system provides little information. See Douglas G.

Baird, Notice Filing and the Problem of Ostensible Ownership, 12 J. Legal Stud. 53, 54−55 (1983) [hereinafter Baird, Notice Filing]. Back To Text

[229] In their discussion supporting the view that bankruptcy law should reflect non−bankruptcy entitlements, Professors Harris and Mooney concede that the trustee's status as a bona fide purchaser of real property and the power to avoid unperfected real estate interests "is best viewed as an anti−secret lien policy that is more exacting than state law." Harris & Mooney, Policy & Impact, supra note 62, at 94 n.48. They cite Professor Jackson's explanation that this aspect of the strong arm power "principally addressed the evil of property interests with ostensible ownership problems that remained despite available curative measures under nonbankruptcy law." Id. (quoting Thomas H. Jackson, The Logic and Limits of Bankruptcy Law, 76 & n.13 (1986)). The Article 9 revision's approach to the notice rights of unsecured creditors brings the revision within the bankruptcy policy that permits the override of state law entitlements. Back To Text

[230] The revision embodies the view that the filing system is for the benefit of secured creditors and buyers. See Harris & Mooney, A Property−Based Theory of Security Interests, supra note 17, at 2058. Back To Text

[231] Although the notice provided by the current filing system may not be meaningful, at least the rules were designed originally to provide notice. As Gilmore explains, although filing was introduced as a mere alternative − and a less desirable alternative − to the notice provided by possession, filing became viewed "as an effective method of giving a debtor's creditors notice of encumbrances." 1 Gilmore, supra note 7, § 15.1, at 462−63. The centralized filing adopted by Article 9 was viewed as increasing the likelihood that the unsecured creditors would search for liens and obtain actual notice. See id. at 465. Back To Text

[232] Why not drop the fiction and push the evolution of the filing system to its logical endpoint? Article 9 could provide for the automatic perfection of all security interests against lien creditors and leave them out of the filing system entirely. Accord James J. White, Revising Article 9 to Reduce Wasteful Litigation, 26 Loy. L.A. L. Rev. 823, 823−26 (1993). This would be a more theoretically pure approach that would obviate the need for the revision's Byzantine notice rules. However, such an approach would make the anti−bankruptcy nature of the Article 9 revision clear to all. It would also require that the priority of secured credit stand or fall on its own merits − and not hide behind the fiction of notice. Back To Text

[233] As Professor Warren observes:

What is remarkable about the Article 9 system is the consistent direction of the redistributive impulse. To the extent that the rules create any redistribution among creditors of a failing business, the system directs resources away from creditors who are involuntary, underrepresented, and least able to spread their losses. Instead, value is directed toward lenders who are entirely voluntary, best able to protect their rights, and best able to spread their risks among numerous projects.

Warren, supra note 31, at 1389. Back To Text

[234] Although Professors Harris and Mooney argue that this effect will be minimal, they do not take issue with the proposition that "secured creditors' claims may reach a greater proportion of a debtor's assets than would have been the case under Former Article 9." Harris & Mooney, Policy & Impact, supra note 62, at 98; see also Harris & Mooney, A Property−Based Theory of Security Interests, supra note 17, at 2065 (cushion of free assets may disappear if revision makes security interests easier to create). Back To Text

[235] See UCC §§ 9−109, 9−406, 9−407, 9−408, 9−409. Back To Text

[236] See UCC §§ 9−102(64), 9−203(f), 9−315. Back To Text

[237] See infra text accompanying notes 285−313. Back To Text

[238] See generally Bruce Markell, From Property to Contract and Back: An Examination of Deposit Accounts and Revised Article 9, 74 Chi.−Kent L. Rev. 963 (1999); see also G. Ray Warner, Deposit Accounts as Collateral under Revised Article 9, Am. Bankr. Inst. J., July−August 2000, at 18. Back To Text

[239] Non−uniform amendments do bring deposit account security interests within Article 9 in several states, including California, Illinois, Louisiana, Hawaii, and Idaho. See Barkley Clark, Revised Article 9 of the UCC: Scope, Perfection, Priorities, and Default, 4 N.C. Banking Inst. 129, 134 (2000). Back To Text

[240] See former UCC § 9−104(l). Back To Text

[241] See former UCC § 9−105(1)(e). Back To Text

[242] See UCC § 9−109 cmt. 16. Back To Text

[243] Although the revised act excludes from its scope security interests taken in deposit accounts as original collateral in "consumer transactions," see UCC § 9−109(d)(13), the definition of "consumer transaction" requires both that the obligation be incurred primarily for personal, family, or household purposes and that the collateral be held primarily for personal, family, or household purposes. See UCC § 9−102(a)(26). An individual who borrows money for business purposes or who uses a single account for both business and personal funds may find little protection in the consumer transaction exclusion. Back To Text

[244] See UCC § 9−109. Back To Text

[245] A certificate of deposit could be either a "deposit account" or an "instrument" depending on whether there is a certificate that in the ordinary course of business is "transferred by delivery with any necessary indorsement or assignment." See UCC § 9−102(a)(47). A security interest in an "instrument" can be perfected either by possession or filing. See UCC §§ 9−312(a), 9−313(a). Back To Text

[246] See UCC § 9−312(b)(1). Back To Text

[247] See UCC § 9−104(a)(1). Note that the bank's control of the deposit account gives it attachment even if the security agreement is not authenticated or does not adequately describe the collateral. See § 9−203(b)(3)(D). Thus, since a depository bank needs only the debtor's agreement in order to obtain a perfected security interest in a deposit account maintained at that bank, many banks will likely insert security agreement language into their standard account agreements. The effect of such a practice in bankruptcy may be limited because many debts owed to the depository bank might already be secured by the bank's common law right of setoff. However, by obtaining a security interest instead of relying merely on its set off rights, the depository bank may lose the protection of § 553 and become subject to § 547 preference liability for deposits made prior to bankruptcy. See Markell, supra note 237, at 973. Back To Text

[248] See UCC § 9−104(a)(2). The bank is not required to enter into a control agreement, even if its customer directs it to do so. See UCC § 9−342. Back To Text

[249] See UCC § 9−104(a)(3). The benefits of this method are that it does not require the bank to enter into a control agreement, it avoids the risk of some later creditor obtaining a competing control agreement, and it gives the secured party greater priority rights against the depository bank. Back To Text

[250] See UCC § 9−315(d)(2). Back To Text

[251] See UCC § 9−104(b). Back To Text

[252] Professors Harris and Mooney take a somewhat different view. They see the control requirement as a proxy for reliance and suggest that it will help ensure that a secured party who claims a perfected security interest in a deposit account is a "reliance party." See Harris & Mooney, Policy & Impact, supra note 62, at 102−03. Back To Text

[253] Competitive forces may give rise to a group of banks specializing in this niche. These banks may even be willing to routinely subordinate their own rights of set off. See UCC § 9−340 (giving priority to bank's set off rights). Back To Text

[254] See former UCC § 9−105(1)(e), (i). Back To Text

[255] See 11 U.S.C. § 363(c)(2) (1994). Back To Text

[256] In addition, Article 9 does not require that a creditor give new consideration in order to obtain a valid security interest. See UCC §§ 1−201(44)(a)−(b) (defining "value"), 9−203(b)(1). Back To Text

[257] An empirical study of lending practices in the non−uniform states might support or negate the liquidity argument. Do Illinois borrowers obtain more loans, larger loans, or better interest rates than similarly situated New York borrowers? Back To Text

[258] 268 U.S. 353 (1925). Back To Text

[259] See G. Ray Warner, Non−Assignable Rights, Contracts and Leases as Collateral under Revised Article 9, Am. Bankr. Inst. J., October 2000, at 18; see also Thomas E. Plank, The Limited Security Interest in Non−Assignable Collateral Under Revised Article 9, 9 Am. Bankr. Inst. L. Rev. 323 (2001). Back To Text

[260] Professor Gilmore cautions against this type of extension of the concept of "negotiability" to new classes of assets. See Gilmore, The Good Faith Purchase Idea, supra note 21, at 611, 621. Back To Text

[261] See, e.g., In re Delgado, 967 F.2d 1466 (10th Cir. 1992); In re Amereco, Envtl. Services, Inc., 129 B.R. 197 (Bankr. W.D. Mo. 1991) (involving hazardous waste operating permit). See generally 1 Barkley Clark, The Law of Secured Transactions Under the Uniform Commercial Code ¶ 2.04[3] (2000). Back To Text

[262] See Clark, at 2−71. Following the FCC's lead, the Ninth Circuit drew a distinction between the license and its proceeds and validated the lender's rights in the proceeds in MLQ Investors, L.P. v. Pacific Quadracasting, Inc., 146 F.3d 746 (9th Cir. 1998), cert. denied, 525 U.S. 1121 (1999). Back To Text

[263] See former UCC § 9−318(4). The category of covered general intangibles is similar to what the revision calls "payment intangibles." See UCC § 9−102(a)(61). Back To Text

[264] See UCC § 9−406. Back To Text

[265] See UCC § 9−102(a)(2). Back To Text

[266] Section 9−406 expressly excludes from its coverage assignments of health−care−insurance receivables, and outright sales of payment intangibles and promissory notes. Those are dealt with in § 9−408, discussed below. Note, however, that § 9−406 would apply to a security interest in a payment intangible or promissory note. Back To Text

[267] See UCC §§ 9−406(d), (f). Back To Text

[268] The revision provides similar free assignability rules for leases in § 9−407 and for letter of credit rights in § 9−409. Back To Text

[269] See UCC §§ 9−408(a), (c). Back To Text

[270] Note, that because of the supremacy of federal law, this change will not affect anti−assignment rules based on federal law, such as those involved in the FCC broadcast license cases. See UCC § 9−408 cmt. 9. However, to the extent that refusal to recognize the security interest is based on the UCC "rights in collateral" requirement, § 9−408 should change the result. Back To Text

[271] See UCC §§ 9−315(a)(2), (c). Back To Text

[272] See UCC § 9−102(a)(64). Back To Text

[273] See UCC §§ 9−408(a)(1), (c)(1). Back To Text

[274] This omission was intentional and was designed to strike a balance that permitted the assignment of the debtor's rights without adversely affecting the interests of the non−debtor party to the contract, permit, license, franchise, etc. See generally, Steven O. Weise, The Financing of Intellectual Property Under Revised UCC Article 9, 74 Chi.−Kent L. Rev. 1077 (1999). Back To Text

[275] UCC § 9−408(d) reads as follows:

(d) [Limitation on ineffectiveness under subsections (a) and (c).] 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

[276] See UCC § 9−408(d)(6). Back To Text

[277] UCC § 9−408 cmt. 2. Back To Text

[278] See UCC § 9−408 cmt. 8. Back To Text

[279] Note that the proceeds referred to here are the proceeds of a sale of the franchise right, not income generated by the franchisee's operations. The secured creditor can obtain a security interest in the accounts receivable or other revenue generated by business operations under current law without taking a security interest in the franchise. Back To Text

[280] See id. See UCC §§ 9−203(f), 9−515(a)(2) (right to proceeds). Back To Text

[281] It would have been easy enough to add such a safeguard by adopting the model that Article 9 uses for commercial tort claims. Although the revision extends the reach of Article 9 to commercial tort claims (compare former UCC § 9−104(k) with UCC § 9−109(d)(12)), the tort claim must already be in existence and must be described with some

specificity in the security agreement. See UCC §§ 9−108(e)(2), 9−204(b)(2). Although not fail−proof, these provisions help ensure that such claims actually are important to the credit extension and are used as collateral in situations where they may increase the debtor's liquidity. Back To Text

[282] As noted by the Official Comment, the Article 9 proceeds rule will cause these provisions to reduce available assets in a situation where the anti−assignment provision was waived and the debtor has been permitted to assign or sell the right. See UCC § 9−408 cmt. 8. The proceeds of that disposition will be subject to the security interest in the non−assignable right. See infra text accompanying notes 285−313. Back To Text

[283] See infra text accompanying notes 363−384. Back To Text

[284] UCC 9−408 cmt. 7 reads as follows:

7. Effect in Assignor's Bankruptcy. This section could have a substantial effect if the assignor enters bankruptcy. Roughly speaking, Bankruptcy Code Section 552 invalidates security interests in property acquired after a bankruptcy petition is filed, except to the extent that the postpetition property constitutes proceeds of prepetition collateral.

Example 4: A debtor is the owner of a cable television franchise that, under applicable law, cannot be assigned without the consent of the municipal franchisor. A lender wishes to extend credit to the debtor, provided that the credit is secured by the debtor's "going business" value. To secure the loan, the debtor grants a security interest in all its existing and after−acquired property. The franchise represents the principal value of the business. The municipality refuses to consent to any assignment for collateral purposes. If other law were given effect, the security interest in the franchise would not attach; and if the debtor were to enter bankruptcy and sell the business, the secured party would receive but a fraction of the business's value. Under this section, however, the security interest would attach to the franchise. As a result, the security interest would attach to the proceeds of any sale of the franchise while a bankruptcy is pending. However, this section would protect the interests of the municipality by preventing the secured party from enforcing its security interest to the detriment of the municipality.

UCC 9−408 cmt. 7. Back To Text

[285] Professors Harris and Mooney strongly disagree with this charge. Indeed, they assert that "the principal effect of the new rule will be the facilitation of credit and, at the margin, keeping debtors out of bankruptcy." Harris & Mooney, Policy & Impact, supra note 62, at 96. Back To Text

[286] See former UCC § 9−204(1); UCC § 9−204(a). Back To Text

[287] See former UCC § 9−203(3); UCC § 9−203(f). Back To Text

[288] See UCC §§ 9−203(f), 9−315(a)(2). Back To Text

[289] See UCC § 9−315(a)(2). Back To Text

[290] See UCC § 9−203(f). Note that, although the revised Act includes "agricultural liens" within its scope, the § 9−315 proceeds rules do not apply to agricultural liens. See UCC § 9−315 cmt. 9. Thus, the relevant state's non−UCC agricultural lien laws will determine whether the lien extends to proceeds. Back To Text

[291] Contra 2 Gilmore, supra note 7, § 27.4, at 736. Back To Text

[292] See UCC § 9−315 cmt. 3. Back To Text

[293] UCC § 9−315(b)(2). Back To Text

[294] See UCC §§ 9−315(b)(1), 9−336(c). If the security interest in the original collateral was perfected, the "proceeds" security interest in the product or mass will continue to be perfected. See UCC §§ 9−315(c)−(e), 9−336(d). However,

special complex priority rules apply if there is a competing perfected security interest in the product or mass. See § 9−336(e)−(f). Back To Text

295 See former UCC § 9−306(4)(d). Back To Text

296 Compare In re Gibson Products of Ariz., 543 F.2d 652, 656 (9th Cir. 1976), cert. denied, 430 U.S. 946 (1977) (giving creditor security interest in all funds in account even if only $10 are traceable) with Fitzpatrick v. Philco Fin. Corp., 491 F.2d 1288, 1291−92 (7th Cir. 1974) (limiting security interest to traceable proceeds received within ten days); see also Gerald Dunne, Commingled Proceeds − Clarification, Please!, 104 Banking L.J. 3 (1987). Back To Text

297 See Maxl Sales Co. v. Critiques, Inc., 796 F.2d 1293, 1301 (10th Cir. 1986). Back To Text

298 Compare former UCC § 9−306(1) with UCC § 9−102(a)(64). Back To Text

299 See, e.g., In re Value−Added Communications, Inc., 139 F.3d 543 (5th Cir. 1998) (stating that coins for use of pay telephones were not proceeds of telephone because use is not disposition). Back To Text

300 See PEB Commentary No. 9 § 9−306(1) (June 25, 1992). Back To Text

301 See UCC § 9−102(a)(64)(A). Back To Text

302 See UCC § 9−102(b); UCC § 2A−103(j). Under § 2A−103(j) a lease "means a transfer of the right to possession and use of goods for a term in return for consideration . . ." Id. While the coin−operated telephone may involve a service rather than a lease of the telephone, a coin−operated pinball machine presents a closer case. However, even if the "lease" clause does not capture such revenue (possible because there is merely a transfer of the right to use and not of the right to possession), the "license" clause may bring it within the scope of the expanded proceeds rule. Revised Article 9 does not appear to include a definition of license. See UCC §§ 9−102(a)−(b); UCC § 1−201. Back To Text

303 See UCC § 9−102(a)(64)(E). Back To Text

304 See id. Back To Text

305 See former UCC § 9−306(1); UCC § 9−102(a)(64)(B). Back To Text

306 UCC § 9−102(a)(64)(B). This provision expands upon the 1994 amendment to § 9−306(1) that included in proceeds "payments or distributions made with respect to investment property." However, the revised Act does not limit the "distribution" proceeds provision to investment property collateral. Back To Text

307 See UCC § 9−102 cmt. 13(a)−(b). Back To Text

308 2 F.3d 1042, 1045 (10th Cir. 1993). Back To Text

309 See UCC § 9−102 cmt. 13(a). Back To Text

310 See UCC § 1−201(36). In a truly circular fashion, the term "remedy" is then defined as "any remedial right." See UCC § 1−201(34). Back To Text

311 See UCC § 9−102(a)(64)(D). Back To Text

312 Some cases under current law adopt the view that claims for damage to collateral are proceeds. See, e.g., McConigle v. Combs, 968 F.2d 810, 828 (9th Cir.), cert. denied, 506 U.S. 948 (1992). Back To Text

313 See UCC § 9−102(a)(64)(D). Back To Text

[314] Id. Back To Text

[315] Compare former UCC § 9−306(3) with UCC § 9−315(c)−(d). Back To Text

[316] See UCC § 9−315(d). Unlike current law, this lapse in perfection is prospective only and apparently does not permit a competing interest that arose while the security interest was perfected to move ahead in priority. See UCC § 9−315 cmt. 4. Back To Text

[317] See UCC § 9−315(d)(3). Back To Text

[318] Note that the debtor's signature is no longer needed on a financing statement so the creditor would not need the assistance of the debtor in order to maintain perfection. See UCC § 9−502 cmt. 3. Back To Text

[319] See supra text accompanying notes 196−198. Back To Text

[320] See supra text accompanying notes 215−219. Back To Text

[321] See supra text accompanying notes 169−180; see also UCC § 9−312(a) (filing for chattel paper, instruments, negotiable documents, and investment property). Back To Text

[322] See UCC § 9−330(d). Back To Text

[323] See UCC §§ 9−102(a)(9), 9−312(b)(1)−(3). Back To Text

[324] See UCC § 9−315(d)(2). Back To Text

[325] See UCC § 9−315(b)(2). The comment to that provision specifically mentions the "lowest intermediate balance rule" as one such equitable tracing principle that may be applied. See UCC § 9−315 cmt. 3. Back To Text

[326] See UCC § 9−315(d)(1). Back To Text

[327] This rule does not apply if there are intervening cash proceeds. See UCC § 9−315(d)(1)(C). A two−part example illustrates this point. If the debtor trades some inventory for a piece of equipment, the "inventory" financing statement will perfect the proceeds security interest in the equipment (assuming that the equipment could have been perfected by filing an "equipment" financing statement in the same filing office). If, on the other hand, the debtor sells the inventory for cash and then uses the cash to purchase the equipment, the proceeds security interest in the equipment would not be perfected by the "inventory" financing statement. Back To Text

[328] See former UCC § 9−103. Back To Text

[329] See supra text accompanying notes 215−219. Back To Text

[330] For example, an involuntary case cannot be commenced unless the petitioning creditors hold at least $11,625 in unsecured claims. See 11 U.S.C. § 303(b) (1994). Back To Text

[331] See, e.g., David G. Carlson, Car Wars: Valuation Standards in Chapter 13 Bankruptcy Cases, 13 Bankr. Dev. J. 1, 17 (1996); Basil H. Mattingly, Sale of Property of the Estate Free and Clear of Restriction and Covenants in Bankruptcy, 4 Am. Bankr. Inst. L. Rev. 431 (1996); Max Radin, The Nature of Bankruptcy, 89 U. Pa. L. Rev. 1, 5 (1940). Back To Text

[332] See 11 U.S.C. § 362(a)(4)−(5) (1994). Back To Text

[333] See 11 U.S.C. § 363 (1994). In cases where the business of the debtor is authorized to be operated, like chapter 11 reorganization cases, see 11 U.S.C. § 1108 (1994), the debtor−in−possession may use non−cash collateral in the

ordinary course of business without first obtaining consent or a court order. See 11 U.S.C. § 363(c)(1) (1994). Back To Text

[334] See 11 U.S.C. § 506(a) (1994). In a chapter 11 case, an under−secured creditor might be able to elect to waive its unsecured claim and have the entire amount of its claim treated as a secured claim. See 11 U.S.C. § 1111(b) (1994). While such an election increases the allowed amount of the secured claim, it has no impact on the cram down requirement that the value of the distribution on the secured claim is limited to the value of the collateral. See 11 U.S.C. § 1129(b)(2)(A)(i)(II) (1994). Back To Text

[335] See 11 U.S.C. §§ 361, 362(d)(1), 363(e) (1994). Back To Text

[336] United Savings Ass'n v. Timbers of Inwood Forest Assoc., Ltd., 484 U.S. 365 (1988). Back To Text

[337] Id. at 372. As the Timbers Court states, "Section 506(b)'s denial of post−petition interest to undersecured creditors merely codified pre−Code bankruptcy law, in which that denial was part of a conscious allocation of reorganization benefits and losses between undersecured and unsecured creditors." Id. at 373. Back To Text

[338] In a non−consensual plan, interest holders (shareholders) are entitled to receive value only if the all claims have been paid in full, including any unsecured deficiency claim held by the holder of an under−secured claim. See 11 U.S.C. § 1129(b)(B)(ii) (1994); see also Bank of Am. Nat'l Trust and Sav. Ass'n v. 203 North LaSalle St. P'ship, 526 U.S. 434 (1999) Back To Text

[339] Section 1129(b)(2) requires that each holder of a secured claim "receive on account of such claim deferred cash payments . . . of a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property [the collateral]." 11 U.S.C. § 1129(b)(2)(A)(i)(II) (1994). Back To Text

[340] The § 1129(b)(1) "fair and equitable" requirement prohibits paying more than the collateral value on a secured claim over the objection of a class of unsecured creditors who have not been paid in full. H.R. Rep. No. 95−595, at 414, reprinted in 1978 U.S.C.C.A.N. 5963, 6370; see also Kenneth N. Klee, Cram Down II, 64 Am. Bankr. L.J. 229, 231−32 (1990). Back To Text

[341] Under 506(a), a partly secured creditor will hold both an allowed secured claim equal to the value of its collateral and an allowed unsecured claim for its deficiency. See 11 U.S.C. § 506(a) (1994). In its capacity as a holder of an allowed unsecured claim, the creditor will have the rights of a unsecured creditor. Back To Text

[342] Under § 506(b), if the collateral has a value that exceeds the debt amount, the over−secured creditor is entitled to continue to accrue post−petition interest and reasonable fees to the extent of the value of the collateral. See 11 U.S.C. § 506(b) (1994). While this right allows the creditor's secured claim to increase post−petition, it only recognizes the pre−petition lien rights that the creditor had in the collateral. Back To Text

[343] See 11 U.S.C. § 552(a) (1994). Back To Text

[344] Id. Back To Text

[345] See 11 U.S.C. § 552(b)(1) (1994). Back To Text

[346] Id. Back To Text

[347] Both the P.E.B. commentary regarding leases and the expanded definition of proceeds for investment property came after 1978. Back To Text

[348] See 11 U.S.C. § 552(b)(1) (1994). Note that the term "profits" is a real estate term of art that refers to pecuniary gain accruing to the owner or occupant of land from its actual use. Black's Law Dictionary (6th ed. 1990). This provision does not entitle the secured creditor to profits earned by the debtor's use of personal property collateral.

Back To Text

[349] The 1994 amendments to the comparable real estate section dealing with rents and hotel occupancy fees also pushes the provision beyond mere replacements of collateral. See The Bankruptcy Reform Act of 1994, Pub. L. No. 103−394, 108 Stat. 4106 (1994). Back To Text

[350] See 11 U.S.C. § 522(b)(1) (1994). Back To Text

[351] See supra text accompanying notes 297−313. Back To Text

[352] In addition, if the proceeds are cash proceeds deposited into a deposit account, the secured creditor could perfect a security interest in the deposit account by control. See UCC § 9−314(a). In fact, under the revised Act a secured creditor must perfect by control in order to insure its priority in such deposited funds. A secured creditor who relies upon the automatic perfection granted by the revision's proceeds rule will be subordinated to a competing secured creditor who perfects by control. See UCC § 9−327(1). Back To Text

[353] 11 U.S.C. § 552(b)(1) (1994). Back To Text

[354] Compare UCC § 9−204(a) (security agreement must provide for after−acquired property) with UCC § 9−203(f) (automatic attachment to proceeds). Back To Text

[355] See 5 Collier on Bankruptcy ¶ 552.02[2], at 552−7, 552−8 (Lawrence P. King et al., eds., 15th ed. rev. 2000). Back To Text

[356] Ironically, the very language in the legislative history that supports adopting a proceeds definition more expansive than current Article 9 may also support adopting one narrower than the revision's definition. The House Report states, "The term 'proceeds' is not limited to the technical definition of that term in the U.C.C., but covers any property into which property subject to the security interest is converted." H.R. Rep No. 95−595, at 377, reprinted in 1978 U.S.C.C.A.N. 5963, 6333. Not only does this language support divorcing the bankruptcy definition from the Article 9 definition, but it also supports the argument that the bankruptcy concept of proceeds is limited to replacement collateral (i.e. property into which the collateral is "converted"). Back To Text

[357] 2 F.3d 1042, 1045 (10th Cir. 1993). Back To Text

[358] See UCC § 9−102(a)(64)(B). Back To Text

[359] See 11 U.S.C. § 363(e) (1994). Thus, the secured creditor would be fully compensated for the depreciation of the cars. Back To Text

[360] See In re Cleary Bros. Constr. Co., 9 B.R. 40, 41 (Bankr. S.D. Fla. 1980) (rental of equipment does not produce proceeds). Back To Text

[361] See UCC § 9−102(a)(64)(A). Back To Text

[362] See UCC § 9−102(64)(A)−(C). Compare In re S&J Holding Corp., 42 B.R. 249, 250 (Bankr. S.D. Fla. 1984) (coins not proceeds of video games) with In re Value−Added Communications, Inc., 139 F.3d 543, 546 (5th Cir. 1998) (coins not proceeds of pay telephones). Back To Text

[363] See 11 U.S.C. § 552(b)(1) (1994). Back To Text

[364] See supra text accompanying notes 272−279. Back To Text

[365] UCC § 9−408 cmt. 7. Back To Text

[366] See id. Back To Text

[367] Id. Back To Text

[368] Id. Back To Text

[369] UCC § 9−408 cmt. 8. Back To Text

[370] They state:

Obviously, this change in law will permit the creation of perfected security interests that will be enforceable in bankruptcy. However, by making it possible for formerly nonassignable rights, such as those under liquor licenses and franchises, to be the subject of attached and perfected security interests, the principal effect of the new rule will be the facilitation of credit and, at the margin, keeping debtors out of bankruptcy.

Harris & Mooney, Policy & Impact, supra note 62, at 96. Back To Text

[371] See 11 U.S.C. § 365 (1994). Back To Text

[372] 11 U.S.C. § 365(f)(1) (1994). Back To Text

[373] See Daniel J. Bussel & Edward A. Friedler, The Limits on Assuming and Assigning Executory Contracts, 74 Am. Bankr. L. J. 321, 333−34 (Summer 2000) (noting that responding to needs of economic society, courts are now in favor of free assignability of contract rights). See generally Brett W. King, Assuming and Assigning Executory Contract: A History of Indeterminate "Applicable Law", 70 Am. Bankr. L. J. 95 (Spring, 1996). Back To Text

[374] Section 9−408(a) applies to "a general intangible, including a contract, permit, license, or franchise." In addition, § 9−407 applies a similar rule to leases. Back To Text

[375] The structure of the provisions are remarkably similar, as is language. Both statutes override provisions that prohibit, restrict, or condition assignment. Compare UCC §§ 9−408(a), (c) with 11 U.S.C. § 365(f)(1) (1994). Both statutes override provisions that cause assignment to trigger termination or modification. Compare UCC § 9−408(a)(2), (c)(2) with 11 U.S.C. § 365(f)(3) (1994). Back To Text

[376] For example, the current Article 9 definition of "account" includes a right to payment "whether or not it has been earned by performance." See former UCC § 9−106. Some courts have relied upon that definition and § 552(b)(1) of the Bankruptcy Code to hold that a creditor who obtained a security interest pre−petition in an unperformed contract of the debtor was entitled to assert its security interest against the revenue generated by the debtor's post−petition performance of the contract. See, e.g., In re Patio & Porch Sys., Inc., 194 B.R. 569, 574 (Bankr. D. Md. 1996). Back To Text

[377] See 11 U.S.C. § 506(a) (1994). Back To Text

[378] See UCC § 9−408(d) cmt. 2. Back To Text

[379] 520 U.S. 953 (1997). Back To Text

[380] See id. at 961. Back To Text

[381] Id. at 962. Back To Text

[382] Id. at 963. Back To Text

[383] Id. at 960. Back To Text

[384] See 11 U.S.C. § 1129(b)(2)(A)(i)(II) (1994). Back To Text

[385] Rash may be distinguishable on several grounds. First, Rash involved a chapter 13 case and a used motor vehicle for which there were market prices. In contrast, there is no market for "used" non−assignable general intangibles. Thus, a market−based approach may not make sense. Perhaps more importantly, § 365 may change the analysis. Since these non−assignable assets have no market value, one could argue that the value that is preserved or realized under § 365 is created by the Bankruptcy Code. The secured creditor has a security interest only in the non−assignable intangible. Article 9 cannot give it an enforceable security interest in the estate's § 365 rights. Thus, the secured creditor is entitled to assert its security interest only in that portion of the use value that represents the intrinsic value of the non−assignable rights, and not that portion attributable to § 365. Back To Text

[386] See Harris & Mooney, Policy & Impact, supra note 62, at 111−13. Back To Text

[387] See id. at 113. That debate is well beyond the scope of the present undertaking. But see Baird, The Importance of Priority, supra note 18, at 1432 (suggesting a linkage between the questions about chapter 11's efficiency and modification of secured creditor rights). Back To Text

[388] See Harris & Mooney, Policy & Impact, supra note 62, at 112−13. Back To Text

[389] Id. at 113. Back To Text

[390] Presumably this is the class of cases where reorganization might harm unsecured creditors. Back To Text

[391] One might quibble about the meaning of "significant," but it would seem that an argument supporting the secured creditor's right to additional assets and leverage in bankruptcy would need to produce a non−trivial benefit to unsecured creditors. Back To Text

[392] See Warren, supra note 31, at 1390 (Secured creditors want their collateral immediately, even it that would destroy the going concern value of the enterprise). Back To Text

[393] The problem is that the undersecured creditor's pro rata share of the additional value may be insufficient to offset its lost opportunity costs, even if the reorganization is the most efficient asset deployment decision. Under § 506, the undersecured creditor is not entitled to recover lost opportunity costs. See See United Sav. Assoc. of Texas v. Timbers of Inwood Forest Assoc. Ltd., 484 U.S. 365 (1988). Back To Text

[394] See H.R. Rep. No. 95−595, at 220−23, reprinted in 1978 U.S.C.C.A.N. 5963, 6179−83. Cf. Peter F. Coogan, The New Bankruptcy Code: The Death of Security Interest, 14 Ga. L. Rev. 153 (1980) (discussing changes that affect secured creditors). Back To Text

[395] See H.R. Rep. No. 95−595, at 224, reprinted in 1978 U.S.C.C.A.N. 5963, 6183−84; see also Lawrence P. King, Chapter 11 of the 1978 Bankruptcy Code, 53 Am. Bankr. L.J. 107, 107, 109, 130 (1979). Back To Text

[396] See H.R. Rep. No. 95−595, at 224, 413−18, reprinted in 1978 U.S.C.C.A.N. 5963, 6184. Back To Text

[397] See Warren, supra note 31, at 1390. For a discussion of this issue in the "workout" context see, Lawrence R. Ahern, III, "Workouts" Under Revised Article 9: A Review of Changes and Proposal for Study, 9 Am. Bankr. Inst. L. Rev. 115 (2001). Back To Text

[398] See supra text accompanying note 111. Back To Text

[399] See Warren, supra note 31, at 1390. Professor Gilmore recognized that the secured creditor's tactical situation in workout negotiations "is decisively affected" by the trustee's power to avoid or reduce the reach of its lien in bankruptcy. See 2 Gilmore, supra note 7, § 45.2, at 1287. Back To Text

[400] For example, outside of bankruptcy neither the debtor nor its secured creditor could override anti−assignment clauses in its executory contracts or unexpired leases. Compare 11 U.S.C. § 365(f) (1994). Back To Text

[401] Since acceptance is measured on a class basis, the deficiency claim must represent more than one−third of the total amount of unsecured claims in the class in order to have veto power over acceptance. See 11 U.S.C. § 1126(c) (1994). In addition, as long as the plan provides for full payment of the secured claim, it would be easy to cram down the secured portion of the claim even if the secured creditor objects to the plan. See 11 U.S.C. § 1129(b)(2)(A)(i) (1994). Back To Text

[402] See supra text accompanying note 241. Back To Text

[403] See former UCC §§ 9−306(2), (3)(b). Back To Text

[404] Cash collateral is defined by the Bankruptcy Code as follows:

[C]ash, negotiable instruments, documents of title, securities, deposit accounts, or other cash equivalents whenever acquired in which the estate and an entity other than the estate have an interest and includes the proceeds, products, offspring, rents, or profits of property and the fees, charges, accounts or other payments for the use or occupancy of rooms and other public facilities in hotels, motels, or other lodging properties subject to a security interest as provided in section 552(b) of this title, whether existing before or after the commencement of a case under this title.

11 U.S.C. § 363(a) (1994). Back To Text

[405] See 11 U.S.C. § 363(c)(2) (1994). Back To Text

[406] See supra text accompanying notes 237−257. Back To Text

[407] See In re Constable Plaza Assoc., L.P., 125 B.R. 98, 105 (Bankr. S.D.N.Y. 1991) (noting that debtor wants to collect rent to pay expenses on building); see also Hartigan v. Pine Lake Vill. Apartment Co. (In re Pine Lake Vill. Apartment Co.) 16 B.R. 750, 756 (Bankr. S.D.N.Y. 1982) (noting that applying rents to maintaining property, prevents deterioration and maintains value of collateral). Back To Text

[408] Clark, supra note 260, ¶ 3.11, at 3−190.2. Back To Text

[409] See UCC § 9−340(a). Back To Text

[410] See UCC § 9−327(1). Back To Text

[411] See UCC § 9−327(3)−(4). Back To Text

[412] See 11 U.S.C. § 363(c)(2)(A) (1994). Back To Text

[413] The stock dividends would be cash collateral in those jurisdictions adopting the 1994 amendment that added the special investment property rules of § 9−115. Back To Text

[414] See 11 U.S.C. § 552(b)(1) (1994). Back To Text

[415] See generally Steven Schwarcz, The Impact on Securitization of Revised UCC Article 9, 74 Chi.−Kent L. Rev. 947, 948 (1999) [hereinafter Schwarcz, Impact]; Warner, supra note 178, at 16. See also Lupica, supra note 178. Back To Text

[416] See Christopher W. Frost, Asset Securitization and Corporate Risk Allocation, 72 Tul. L. Rev. 101, 104 (1997). Back To Text

[417] See Steven L. Schwarcz, The Alchemy of Asset Securitization, 1 Stan. J.L. Bus. & Fin. 133, 134 (1994) [hereinafter Schwarcz, Alchemy]. Back To Text

[418] For a description of the structure of a typical transaction see id. at 135−36. Back To Text

[419] See id. at 134. Back To Text

[420] See id. at 135. Back To Text

[421] See Lupica, supra note 178. See also In re Kingston Square Assoc., 214 B.R. 713, 725 (Bankr. S.D.N.Y. 1997). Back To Text

[422] See Schwarcz, Impact, supra note 414, at 953. Back To Text

[423] See former UCC § 9−102(1)(b). Back To Text

[424] Official Comment 2 to the 1972 version of Article 9 states:

An assignment of accounts or chattel paper as security for an obligation is covered by subsection (1)(a). Commercial financing on the basis of accounts and chattel paper is often so conducted that the distinction between a security transfer and a sale is blurred, and a sale of such property is therefore covered by subsection (1)(b) whether intended for security or not, unless excluded by Section 9−104. The buyer then is treated as a secured party, and his interest as a security interest. See Sections 9−105(1)(m), 1−201(37). Certain sales which have nothing to do with commercial financing transactions are excluded by Section 9−104(f) . . .

Former UCC § 9−102 cmt. 2. Back To Text

[425] See 1 Gilmore, supra note 7, § 10.5, at 308−09 (discussing the similar provision of the 1962 version of Article 9). Back To Text

[426] See Schwarcz, Impact, supra note 414, at 949; see also Schwarcz, Alchemy, supra note 416, at 133 n.1 (noting that asset securitization had become "a dominant means of capital formation" by 1992). Back To Text

[427] 995 F. 2d 948 (10th Cir. 1993) Back To Text

[428] See also UCC 9−109 cmt. 5. "Subesction (a) makes explicit what was implicit, but perfectly obvious, under former Article 9: The fact that a sale of an account or chattel paper gives rise to a 'security interest' does not imply that the sellerretains an interest in the property that has been sold." UCC 9−318 cmt. 2. Back To Text

[429] See UCC § 9−102(a)(2). Back To Text

[430] See UCC § 9−109(a)(3). Back To Text

[431] Compare former UCC § 9−106 with UCC § 9−102(a)(2). Back To Text

[432] See UCC § 9−102(11), (31). Back To Text

[433] See UCC § 9−109(a)(3). Back To Text

[434] See UCC § 9−102(a)(61). Back To Text

[435] See Schwarcz, Impact, supra note 414, at 948. Back To Text

[436] However, Article 9 will not apply to all sales of these types of assets. Section 9−109(d) excludes most sales that do not involve financing. For example, Article 9 will not apply where the assignment is for the purposes of collection only or where it is a part of the sale of the business. See, e.g., UCC § 9−109(d)(4)−(5). Back To Text

[437] See supra text accompanying notes 181−225. Back To Text

[438] The term "security interest" would apply to a securitization transaction within the scope of Article 9. See UCC § 9−109 cmt. 5. Back To Text

[439] See UCC §§ 9−309(3)−(4), 9−310(b)(2). Back To Text

[440] While both automatic perfection and perfection by filing for promissory notes will give the SPV priority over lien creditors and the originator's bankruptcy trustee, the failure to take possession of the instrument can result in a subsequent purchaser or secured party gaining priority. See UCC § 9−330(d). Back To Text

[441] However, since these exceptions only apply to true sales, a financing statement should be filed in order to avoid the argument that the transaction was not a true sale. Note that under revised Article 9, a security interest in a promissory note can be perfected by filing. See UCC § 9−312(a). Back To Text

[442] See Schwarcz, Alchemy, supra note 416, at 136. Back To Text

[443] For example, these considerations led the Bankruptcy Court in the LTV Steel Co., Inc. case to issue an interim cash collateral order permitting the debtor to use receivables that were the subject of an asset securitization transaction. The Court stated:

Furthermore, there seems to be an element of sophistry to suggest the Debtor does not retain at least an equitable interest in the property that is subject to the interim order. Debtor's business requires it to purchase, melt, mold and cast various metal products. To suggest that Debtor lacks some ownership interest in products that it creates with its own labor, as well as the proceeds to be derived from that labor, is difficult to accept. Accordingly, the Court concludes that Debtor has at least some equitable interest is property of the Debtor's estate. This equitable interest is sufficient to support the entry of the interim cash collateral order.

Finally, it is readily apparent that granting Abbey National relief from the interim cash collateral order would be highly inequitable. The Court is satisfied that the entry of the interim order was necessary to enable Debtor to keep its doors open and continue to meet its obligations to its employees retirees, customers and creditors. Allowing Abbey National to modify the order would allow Abbey National to enforce its state law rights as a secured lender to look to the collateral in satisfaction of this debt. This circumstance would put an end to Debtor's business, would put thousands of people out of work, would deprive 100,000 retirees of needed medical benefits, and would have more far reaching economic effects on the geographic areas where Debtor does business…

In re LTV Steel Co., Inc., No. 00−43866, slip op. at 14−15 (Bankr. N.D. Ohio Feb. 5, 2001). Back To Text

[444] There may be reasons for financier to use the device that have nothing to do with the credit insulation feature. For example, since the transaction is structured as a sale rather than a loan, it has balance sheet and regulatory implications for both the financier and the debtor. See Schwarcz, Alchemy, supra note 417, at 142−43. Back To Text

[445] Id. at 151. Back To Text

[446] Cf. id. at 135 (maintaining that SPV must be bankruptcy remote). Back To Text

[447] See Bebchuk & Fried, Further Thoughts, supra note 32, at 1340−41; Warren, supra note 31, at 1393. Back To Text

[448] See 11 U.S.C. § 547(b) (1994). Back To Text

[449] See 11 U.S.C. §§ 365(b)(2), 365(e)(1), 541(c)(1) (1994). Back To Text

[450] Schwarz argues that asset securitization can reduce monitoring costs. See Schwarcz, Alchemy, supra note 416, at 150. However, the practical problems involved in collecting the revenue produced by an income−producing assets can be addressed by using devices such as a postal lock−box arrangement or notification financing. See former UCC §§ 9−502, 9−607(a) (collection rights of secured party). Moreover, monitoring problems can exist in asset securitization transactions as well − for example where the special purpose entity is a subsidiary of the debtor and the debtor handles all collections. Back To Text

[451] See Schwarcz, Alchemy, supra note 416, at 134. Back To Text

[452] See id. at 150−51. Back To Text

[453] Schwarcz acknowledges that it is not clear whether "securitization enables originators to realize a gain at the expense of others, such as the originator's unsecured general creditors." Id. at 146. Back To Text