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# THE ROTTEN FOUNDATIONS OF SECURITIZATION

DAVID GRAY CARLSON\*

## I. INTRODUCTION

A bankruptcy trustee is supposed to maximize debtor assets for the benefit of unsecured creditors. Often this task is achieved at the expense of the secured creditors. If a bankruptcy trustee can obtain control over collateral, the trustee might be able to use it without paying rent or interest to the lender. According to the U.S. Supreme Court, only oversecured creditors are worthy of postpetition interest.<sup>1</sup> Undersecured creditors are not.<sup>2</sup> To be sure, the lender is entitled to adequate protection for the collateral contributed to debtor rehabilitation,<sup>3</sup> but lenders are skeptical of this right and certainly hostile to the idea that, for the duration of the bankruptcy proceeding, the lender, if undersecured, is unable to earn income on its investment.<sup>4</sup>

In the 1980s, disdain of bankruptcy jurisdiction led financial markets to generate a multibillion dollar practice neologized as "securitization."<sup>5</sup> The goal of securitization is for a debtor, called an "originator," to sell accounts, chattel paper, general intangi-

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1. See 11 U.S.C. § 506(b) (1994); *Rake v. Wade*, 508 U.S. 464, 475 (1993).

2. See *United Sav. Ass'n v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 372 (1988).

3. See 11 U.S.C. § 363(e).

4. See STANDARD & POOR'S CORP., S&P'S STRUCTURED FINANCE CRITERIA 68-69 (1988).

5. The name "securitization" undoubtedly refers to the act of rendering fit for the securities market short-term collateral that otherwise would be viewed as inadequate. For an attempt at a definition of securitization, see Joseph C. Shenker & Anthony J. Colletta, *Asset Securitization: Evolution, Current Issues and New Frontiers*, 69 TEX. L. REV. 1369, 1374-75 (1991). Shenker and Colletta present a treasure trove of information on securitization, including its venerable history. See *id.* at 1369-429. What occurred in the 1980s was merely a revitalization of techniques that have long been known, understood, and used. See *id.* at 1372-73.

bles, or instruments to a bankruptcy-remote corporation (sometimes called a "special purpose vehicle" or SPV) set up for the sole purpose of buying this property.<sup>6</sup> The SPV raises funds by selling debt or perhaps equity participations in the financial markets.<sup>7</sup> The only obligation of the SPV is the debt or equity obligations the SPV issued to raise funds.<sup>8</sup> The assets are precisely what the SPV has bought from the originator—usually heavily guaranteed by the originator's promise to buy back or replace bad accounts.<sup>9</sup> The form of the transfer from the originator to the SPV—a sale—is supposed to prove that no bankruptcy court can ever claim jurisdiction over the assets again.<sup>10</sup>

To be more precise, section 541(a)(1) of the Bankruptcy Code indicates that the bankruptcy estate includes "all legal or equitable interests of the debtor in property as of the commencement of the case."<sup>11</sup> If a debtor were to convey to the SPV a mere lien on accounts<sup>12</sup> or chattel paper,<sup>13</sup> the assets would not have escaped bankruptcy jurisdiction.<sup>14</sup> In such a case, the debtor retains an equity interest in the collateral—enough to justify bankruptcy jurisdiction.<sup>15</sup> But since the debtor *sells the accounts*, the debtor supposedly retains nothing.<sup>16</sup>

This alleged nonrelationship between debtor and thing sold is sometimes said to be the very key to securitization.<sup>17</sup> If the rat-

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6. See Steven L. Schwarcz, *The Alchemy of Asset Securitization*, 1 STAN. J.L. BUS. & FIN. 133, 135 (1994).

7. See *id.* at 135.

8. See *id.* at 135-36.

9. To add to the security of the deal, this guarantee is sometimes enhanced with a bank letter of credit or the like. See Shenker & Colletta, *supra* note 5, at 1376.

10. See Lynn M. LoPucki, *The Death of Liability*, 106 YALE L.J. 1, 24-25 (1996) (discussing asset securitization as a method for judgment-proofing).

11. 11 U.S.C. § 541(a)(1) (1994).

12. See U.C.C. § 9-106 (1995) ("‘Account’ means any right to payment for goods sold or leased or for services rendered which is not evidenced by an instrument or chattel paper, whether or not it has been earned by performance.").

13. See *id.* § 9-105(1)(b) ("‘Chattel paper’ means a writing or writings which evidence both a monetary obligation and a security interest in or a lease of specific goods.").

14. See Stephen I. Glover, *Structured Finance Goes Chapter 11: Asset Securitization by Reorganizing Companies*, 47 BUS. LAW. 611, 621 (1992).

15. See *id.* at 621 & n.29.

16. See *id.* at 619, 621.

17. See Peter F. Culver, *The Dawning of Securitization*, PROB. & PROP.,

ing agencies were to perceive a mere hypothetical legal risk of bankruptcy jurisdiction, then the transaction would supposedly become more expensive or, it is sometimes alleged, impossible.<sup>18</sup> These are empirical predictions, of course. One is skeptical that mere hypothetical risks should be worth so much in the market. Nevertheless, securitization theorists have assumed that the cost of funds depends on the purely hypothetical question of bankruptcy jurisdiction.<sup>19</sup>

The burden of foreclosing any possibility of bankruptcy jurisdiction devolves into some very technical concepts of commercial law. First, lawyers must distinguish between (a) liens upon and (b) sales of intangible personal property.<sup>20</sup> Clearly, the lien is governed by Article 9 of the Uniform Commercial Code (UCC).<sup>21</sup> The commercial world agrees—without careful attention to the text of the Bankruptcy Code—that property encumbered by mere liens is subject fully to bankruptcy jurisdiction. It is assumed that the spirit—if not the language—of the Bankruptcy Code requires the modern secured lender to contribute the use of collateral to the rehabilitation of debtors.<sup>22</sup> It is for this very reason that securitization abandons secured *lending* and takes up the *sale* of intangible property as its mode of operation.<sup>23</sup>

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Mar./Apr. 1994, at 34, 34.

18. See Thomas E. Plank, *Sacred Cows and Workhorses: The Sale of Accounts and Chattel Paper Under the U.C.C. and the Effects of Violating a Fundamental Drafting Principle*, 26 CONN. L. REV. 397, 457 (1994); Steven L. Schwarcz, *The Parts Are Greater Than the Whole: How Securitization of Divisible Interests Can Revolutionize Structured Finance and Open the Capital Markets to Middle-Market Companies*, 1993 COLUM. BUS. L. REV. 139, 143-45. See generally Steven L. Schwarcz, *Structured Finance: The New Way to Securitize Assets*, 11 CARDOZO L. REV. 607 (1990) [hereinafter Schwarcz, *Structured Finance*] (arguing that removing assets from the originator's bankruptcy estate to an SPV reduces the cost and risk of fund raising).

19. See LoPucki, *supra* note 10, at 29.

20. See Glover, *supra* note 14, at 621.

21. See U.C.C. § 9-102(2) (1995). Certain security interests in personal property are omitted for political reasons from UCC coverage. See, e.g., *id.* § 9-104 (excluding liens arising from landlord-tenant relations, mechanics liens, and employee liens). In addition, federal law sometimes governs, as in the case of ship mortgages. See *id.* at cmt. 1.

22. See generally Elliott D. Levin & Phyllis McGurk, *Who Gets the Goodies: What Happens to the Enhancement of the Secured Parties' Collateral Post-Petition*, 102 COM. L.J. 55 (1997) (discussing distribution of collateral in bankruptcies).

23. See Glover, *supra* note 14, at 621.

Second, lawyers must distinguish between the sale of accounts and chattel paper and the sale of other intangible property. Article 9 of the UCC governs the sale of accounts and chattel paper in addition to governing the security interests on all personal property.<sup>24</sup> The sale of general intangibles<sup>25</sup> or instruments<sup>26</sup> is not governed by Article 9 but by the common law of assignment.<sup>27</sup>

A huge portion of the securitization trade involves the sale of accounts and chattel paper. It is admitted that Article 9 governs the sale of this kind of personal property from the originator to the SPV.<sup>28</sup> Yet the securitizers allege that Article 9's jurisdiction over the sale of accounts and chattel paper does not imply that the sold accounts are subject to bankruptcy jurisdiction.<sup>29</sup> Even if personal property subject to security interests is subject to bankruptcy jurisdiction,<sup>30</sup> *sold* property supposedly is not.<sup>31</sup>

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24. See U.C.C. § 9-102. But see *id.* § 9-104 (noting minor exceptions to subject matter jurisdiction). In addition, a security interest in securities is governed by Article 8, not Article 9. See generally U.C.C. art. 8 (addressing investment securities). Article 8 has recently been redrafted to give Article 9 back its jurisdiction over pledges of securities that it lost in the regrettable 1978 amendments to the UCC. See generally Jeanne L. Schroeder, *Is Article 8 Finally Ready This Time? The Radical Reform of Secured Lending on Wall Street*, 1994 COLUM. BUS. L. REV. 291 (exploring changes to Articles 8 and 9 of the UCC proposed by the National Conference of Commissioners on Uniform State Laws, in 1994).

25. See U.C.C. § 9-106 ("General intangibles' means any personal property (including things in action) other than goods, accounts, chattel paper, documents, instruments, investment property . . . and money.").

26. See *id.* § 9-105(1)(i) ("Instrument' means a negotiable instrument . . . or any other writing which evidences a right to the payment of money and is not itself a security agreement or lease and is of a type which is in ordinary course of business transferred by delivery with any necessary indorsement or assignment.").

27. See *id.* § 9-102(1)(b) (applying Article 9 to the sale of accounts or chattel paper, but not including general intangibles or instruments within Article 9's jurisdiction).

28. See *id.*

29. See Steven O. Weise, *U.C.C. Article 9: Personal Property Secured Transactions*, 49 BUS. LAW. 1867, 1870 (1994).

30. See *Dewhirst v. Citibank (Ariz.) (In re Contractors Equip. Supply Co.)*, 861 F.2d 241, 245 (9th Cir. 1988) (holding that encumbered accounts are part of the bankruptcy estate).

31. See Robert D. Aicher & William J. Fellerhoff, *Characterization of a Transfer of Receivables As a Sale or a Secured Loan upon Bankruptcy of the Transferor*, 65 AM. BANKR. L.J. 181, 182-84 (1991); Peter V. Pantaleo et al., *Rethinking the Role of Recourse in the Sale of Financial Assets*, 52 BUS. LAW. 159, 161 (1996); Thomas E. Plank, *The True Sale of Loans and the Role of Recourse*, 14 GEO. MASON L. REV. 287, 307-08 (1991) (arguing that payment of the full value, not the existence of recourse, should constitute the border between sales of and security interests in ac-

In *Octagon Gas Systems, Inc. v. Rimmer (In re Meridian Reserve, Inc.)*,<sup>32</sup> Judge Bobby Baldock set off an international fire storm of rage and indignation with the following humble statement: "The impact of applying Article 9 to Rimmer's account is that Article 9's treatment of accounts sold as collateral would place Rimmer's account within the property of [the] bankruptcy estate."<sup>33</sup>

This statement—quite unnecessary to the holding of the case—has been denounced in the financial press and in the law reviews.<sup>34</sup> The Permanent Editorial Board of the UCC has issued a "commentary" purporting to advise the federal courts on their own jurisdiction, in the hope of providing ammunition to the friends of securitization against the mere idea that bankruptcy courts may exert control over securitized assets.<sup>35</sup> Meanwhile, the rating agencies have decided to ignore *Octagon Gas*, when the originator is outside the Tenth Circuit, on the theory that it is "bad" law.<sup>36</sup>

This Article will argue that, in spite of the hue and cry through the streets of corporate finance, the *Octagon Gas* case was decided rightly: on its facts, its dictum, and its policy implications.

Now many reading this Article will protest that, since the market supposedly reacts to merely hypothetical risks, the bare suggestion that securitization's premises are false will cause an originator's cost of funds to increase. Hence, mere investigation of law is a mistake, on wealth maximization principles. To such claims, the author is obviously insouciant. First, whether prices rise is an empirical prediction. If the rating agencies determine that the actual risk of an originator's bankruptcy is small, the rating agencies, bound in by competitive pressure, will eventu-

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counts and chattel paper); Schwarcz, *Structured Finance*, *supra* note 18, at 621-27; Peter L. Mancini, Note, *Bankruptcy and the U.C.C. as Applied to Securitization: Characterizing a Mortgage Loan Transfer As a Sale or a Secured Loan*, 73 B.U. L. REV. 873, 876-77 (1993).

32. 995 F.2d 948 (10th Cir. 1993).

33. *Id.* at 955.

34. See, e.g., Thomas E. Plank, *When A Sale of Accounts Is Not A Sale: A Critique of Octagon Gas*, 48 CONSUMER FIN. L.Q. REP. 45 (1994).

35. See PERMANENT EDITORIAL BOARD FOR THE U.C.C., AMERICAN L. INST., COMMENTARY NO. 14 (SECTION 9-102(1)(B) (1994)) [hereinafter P.E.B. COMMENTARY].

36. See Plank, *supra* note 18, at 459 n.278.

ally issue a fair rating at or near the current risk, so that, in the long run, the price of funds will not rise. As securitization usually involves highly solvent originators, an increase in price is by no means a foregone conclusion. Second, if truly risky originators find their cost of funds rising, this may in fact have *desirable* social consequences. Risk of bankruptcy constitutes what economists style an externality. A higher interest rate for future funds may discourage a firm from exposing the public to further externalities. As such, higher interest rates are a social good, even if privately regrettable. It is the surest sign of bad economic theory to equate higher private costs with social inefficiency. Though the law reviews are full to overflowing with suggestions for reducing transaction costs in the name of the public good, sophisticated economists know better.<sup>37</sup>

The critique that follows will strike many as rarified indeed. The critique points out that, when we adhere to the words of the Bankruptcy Code and not to what people say about those words or what they wish the Code said, bankruptcy jurisdiction turns on whether *any* debtor interest in a thing exists—no matter how remote or improbable. In short, the distinction between bank-

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37. See R.G. Lipsey & Kelvin Lancaster, *The General Theory of the Second Best*, 24 REV. ECON. STUD. 11 (1956). A recent study of securitization suggests that, like secured lending in general, securitization is inefficient. Securitization, in this account, serves only to export uncompensated risk to unsecured creditors, thereby enriching debtors. See Christopher W. Frost, *Asset Securitization and Corporate Risk Allocation*, 72 TUL. L. REV. 101 (1997). It is useless to speculate on the efficiency of law for the reasons demonstrated by Lipsey and Lancaster, *supra*. But Professor Frost makes a particularly disastrous choice in invoking the Modigliani-Miller irrelevance hypothesis with regard to the cross-elasticity between secured and unsecured credit. See Frost, *supra*, at 105. To be sure, this is a time-honored move. See Thomas H. Jackson & Anthony T. Kronman, *Secured Financing and Priorities Among Creditors*, 88 YALE L.J. 1143, 1154-55 (1979) (invoking, for the first time, Modigliani-Miller in such a context); see also Alan Schwartz, *Security Interests and Bankruptcy Priorities: A Review of Current Theories*, 10 J. LEGAL STUD. 1 (1981) (developing this idea). In fact, Modigliani-Miller assumptions, transposed to the cross-elasticity between secured and unsecured credit, strictly imply Ponzi schemes—unproductive enterprises that borrow themselves into insolvency. It is the height of irony that, for almost twenty years, law and economics has assessed the efficiency of secured lending by unwittingly studying the dynamics of Ponzi schemes. This amazing fact is quite sufficient to undermine confidence in economic science as it has been applied in the law schools, and yet is fully proved in David Gray Carlson, *Secured Lending as a Zero Sum Game*, 19 CARDOZO L. REV. (forthcoming 1998).

ruptcy jurisdiction does not turn on the lien-sale distinction, as is usually supposed. Rather, even sold accounts are subject to bankruptcy jurisdiction, provided some "legal or equitable" debt- or property interest in the thing sold can be located. If some hypothetical connection between debtor and thing can be located, then bankruptcy jurisdiction is justified.

Because we traffic in the hypothetical, whatever is possible is real. The exercise we are about to undertake will resemble the fantastic excesses of the Rule Against Perpetuities with which all first-year law students are familiar. Just as contingent future interests in property are tested according to whether octogenarian women can have children or great-grandfathers can have unborn widows, so we will test sales of accounts and chattel paper according to the most astonishing hypotheticals, in order to discover whether debtors have retained some property connection with the accounts and chattel paper they have sold. If so, then bankruptcy jurisdiction plausibly exists.

At least three property interests in the debtor exist after the sale of accounts or chattel paper. First, the debtor retains a power to convey chattel paper to subsequent purchasers who take possession in the ordinary course of their business free and clear of the SPV buyer's rights.<sup>38</sup> This is so even after the SPV perfects its purchase by filing a financing statement as required by Article 9.<sup>39</sup>

The second power is the power to collect. Ordinarily, the SPV appoints the originator as collecting agent for accounts.<sup>40</sup> The mere existence of this collecting power constitutes a power to "use" the accounts—though this power is fiduciary in nature. Nevertheless, I will show that the Bankruptcy Code can plausibly be read to make legal title—held for the benefit of another—the foundation of bankruptcy jurisdiction.

The third power belongs to the bankruptcy trustee, who is a hypothetical judicial lien creditor in bankruptcy.<sup>41</sup> This strong-arm power establishes an interest in sold accounts and chattel

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38. See U.C.C. § 9-308 (1995).

39. See *id.* § 9-308(a).

40. This may occur because originators are "loathe to part with control over ongoing relationships with their customers." Aicher & Fellerhoff, *supra* note 31, at 182.

41. See 11 U.S.C. § 544(a)(1) (1994).



paper even after the buyer perfects.<sup>42</sup> That the trustee has power over sold accounts or chattel paper by means of the strong-arm power is obvious enough when the buyer has not perfected.<sup>43</sup> It is equally true that, even after perfection, a future interest belongs to the trustee.<sup>44</sup> A close study of Article 9 will reveal that perfection is never final but always contingent. Every financing statement lapses—either at the end of five years<sup>45</sup> or at the end of four months, if the debtor changes location.<sup>46</sup> As a result, creditors retain a “future interest” in the sold accounts. This future interest represents the inherent possibility that, in the future, the creditors will regain the present power to sell the accounts again to a subsequent bona fide purchaser for value.<sup>47</sup>

These property rights may seem slight or insubstantial. If the Bankruptcy Code clearly made *substantiality* a test of bankruptcy jurisdiction, then courts could make prudential judgments as to whether debtor interests in things have sufficient “weight” to sustain bankruptcy jurisdiction. Yet the Bankruptcy Code does not make substantiality the test—only mere possibility.<sup>48</sup> This was underscored by the Supreme Court itself in an opinion that securitization lawyers have studied like Roman augurs riveted to the entrails of slaughtered chickens, hoping to find there a harbinger preceding still the fates and a prologue to the omens coming on.

In *United States v. Whiting Pools, Inc.*,<sup>49</sup> the Internal Revenue Service (IRS) claimed about \$92,000 in back taxes.<sup>50</sup> Pursuant to its tax lien, the IRS seized inventory, equipment, vehicles, and office supplies with a liquidation value of “at most, \$35,000.”<sup>51</sup> Even though the value of the debtor’s equity interest in the inventory was remote, the debtor-in-possession in *Whiting Pools* nevertheless succeeded in asserting bankruptcy

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42. See *id.* § 544(a)(3).

43. See *id.* § 544; U.C.C. § 9-301.

44. See 11 U.S.C. § 541(a)(5).

45. See U.C.C. § 9-403(2).

46. See *id.* § 9-103(3)(e).

47. See *id.* § 9-403(2).

48. See 11 U.S.C. § 541 (requiring only “any” interest to assert jurisdiction).

49. 462 U.S. 198 (1983).

50. See *id.* at 199.

51. *Id.* at 200.

jurisdiction over the collateral.<sup>52</sup> According to Justice Harry Blackmun, the debtor had a purely hypothetical right to a surplus.<sup>53</sup> In addition, the IRS had the duty to send a notice to the debtor that it had levied the inventory.<sup>54</sup> The right of a thing's owner to receive this fallow notice proved connection enough between debtor and thing.<sup>55</sup> On these thin and wanton reeds were founded the massy edifice of bankruptcy jurisdiction.

Still, Justice Blackmun, in a footnote to *Whiting Pools*, did suggest that some debtor property interests were too tenuous and giddy a ground for bankruptcy jurisdiction.<sup>56</sup> Trying to explain why a trustee might be able to use the whole of collateral, not just the part the debtor owns,<sup>57</sup> Justice Blackmun had to maintain that section 541(a)(1) was very expansive, but nevertheless some debtor rights were excluded.<sup>58</sup> The excluded rights were said to be "minor interest[s] such as a lien or bare legal title."<sup>59</sup> In its dicta, *Whiting Pools* invites courts to figure out what is major and what is minor. This is precisely the prudential invitation that securitization needs to survive—if bankruptcy courts will only privilege the footnoted dicta over the fantastic blackletter holding of the case.

Securitization, therefore, exists uneasily with *Whiting Pools*. The holding of *Whiting Pools* suggests that extremely unimportant debtor interests—the mere theoretic right to be notified when radically overencumbered property is taken—sustain bankruptcy jurisdiction.<sup>60</sup> The dictum in a footnote suggests that bankruptcy jurisdiction requires "major" debtor interests.<sup>61</sup> With regard to the dictum, the Court gave mere examples of minor interests, without attempting to explain why these inter-

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52. See *id.* at 209-11.

53. See *id.* at 209.

54. See *id.* at 201 n.4.

55. See *infra* text accompanying notes 143-44.

56. See *Whiting Pools*, 462 U.S. at 204 n.4.

57. Section 541(a)(1) includes only debtor equity in the estate, but Justice Blackmun was trying to explain why the trustee might use all the collateral—the encumbered part and the equity as well. See *infra* text accompanying notes 142-50.

58. See *Whiting Pools*, 462 U.S. at 204 n.8.

59. *Id.*

60. See *id.* at 211-12.

61. See *id.* at 204 n.8.

ests are so thin of substance.<sup>62</sup>

Regardless of whether we follow the holding of or the footnotes in *Whiting Pools*, we cannot say that the words of the Bankruptcy Code snatch securitized collateral from the ponderous and marble jaws of bankruptcy jurisdiction.<sup>63</sup> If we examine only the Bankruptcy Code itself, we find that bankruptcy jurisdiction is founded on *any* debtor interest in a thing.<sup>64</sup> This is plenty broad enough to sweep in sold accounts and chattel paper—thanks to Article 9.<sup>65</sup> Only the good will of procreeitor judges—that is to say, judicial legislators—can save securitization from the plain meaning of the Bankruptcy Code.

But does securitization deserve the good will of bankruptcy judges? This may be severely questioned. In 1979, Congress radically extended bankruptcy jurisdiction over secured creditors, with the idea of forcing them to contribute to the rehabilitation of debtors.<sup>66</sup> Though made to surrender this collateral to bankruptcy trustees, secured parties were given no entitlement to postpetition interest.<sup>67</sup> This uncompensated use of capital can be viewed as a wealth transfer or *tax* on secured creditors (the "Bankruptcy Tax"). Securitization, in contrast, is therefore best viewed as *tax avoidance*. In response to securitization, financial markets have reacted as they always do, by awarding a premium for tax avoidance. The theory of tax avoidance is that the *sale* of intangible property leaves *no connection* between the debtor and thing. To be sure, the policy winds have turned angrily from the dew-dropping prodebtor south to the frozen bosom of the procreeitor north. Many of the amendments to the Bankruptcy Code since 1979 have been designed to level out the Bankruptcy Code's radical prodebtor bias.<sup>68</sup> Perhaps today's Con-

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62. See *id.*

63. See 11 U.S.C. § 541 (1994).

64. See *id.* § 541(a)(3)-(5).

65. See U.C.C. § 9-102(1)(a) (1995).

66. See discussion *infra* Part II.

67. See *United Sav. Ass'n v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 379 (1988) (denying postpetition interest to an undersecured creditor relying on the plain meaning of section 506 and section 362(d)(2) of the Bankruptcy Code).

68. For example, the addition of the new subsection 522(f)(3) in 1994 was extremely procreeitor. See David Gray Carlson, *Security Interests on Exempt Property After the 1994 Amendments to the Bankruptcy Code*, 4 AM. BANKR. INST. L. REV. 57, 59 (1996).

gress in its surly mood would not choose to empower unsecured creditors and debtors at the expense of secured creditors. Yet it still remains true that the Bankruptcy Reform Act of 1978 remains largely intact. The legislation favors the Bankruptcy Tax on secured lending that financial markets wish to avoid. At least the judicial conservatives will agree that, until Congress affirmatively changes the relevant provisions of the Bankruptcy Code, the creditors *ought* to subvent debtor rehabilitation by submitting to the Bankruptcy Tax imposed on them by the Bankruptcy Code. This applies as much to securitization as to other forms of secured credit.

This Article will therefore explore the premise that bankruptcy courts have no jurisdiction over property involved in securitization. First, it will be argued that the Bankruptcy Code itself compels no such conclusion.<sup>69</sup> Second, it will be argued that the Bankruptcy Code's policy favors the participation of the securitization industry in the rehabilitation of debtors.<sup>70</sup> On both formal and policy grounds, therefore, securitization's right to exist may be sharply questioned.<sup>71</sup>

In pursuit of these twin goals, Part I of this Article commences with the statutory foundations of bankruptcy jurisdiction over the property of third persons. Part II discusses the absolutist holding and the relativist dictum of the Supreme Court's decision in *Whiting Pools*. Part III examines the ability of securitization to survive an absolutist reading of the Bankruptcy Code and concludes that it cannot. Part IV addresses the policy of the Bankruptcy Code and concludes that securitization *should* not survive, if we take for granted the correctness of the Bankruptcy Code's spirit of rehabilitating debtors. Part V examines the infamous *Octagon Gas* case and concludes that it was correctly decided on both its facts as well as on its dictum.

## II. BANKRUPTCY JURISDICTION

Prior to the enactment of the Bankruptcy Code in 1978, secured creditors ruled the sea like so many pirates, boarding distressed

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69. See discussion *infra* Part IV.A-C.

70. See discussion *infra* Part IV.D-VI.

71. See discussion *infra* p. 1119.

debtor vessels to expropriate cargo, forcing these debtors to scuttle themselves. But those happy days, when debtors were made a toast to Neptune, are over. Instead, under the modern Bankruptcy Code, secured creditors find themselves deeply entangled with their victims in the maelstrom of bankruptcy jurisdiction.<sup>72</sup>

In the high and palmy days of the Bankruptcy Act of 1898 (the "1898 Act"), jurisdiction over collateral was limited. In liquidation cases, the trustee had power over collateral if the debtor still possessed it, but had none if the collateral had already been repossessed by a secured party. Even if the trustee began the liquidation case with possession of the collateral, she could retain and sell the collateral only if some debtor equity existed. If no debtor equity existed, the secured party could claim that retention of the collateral would cause irreparable harm by denying interest compensation during the bankruptcy proceeding. Such irreparable harm was grounds enough to lift the stay that a court would have instituted in a reorganization case. In reorganization cases, the trustee could, via court order, recapture collateral already repossessed by a secured creditor, but, as a practical matter, the trustee could retain collateral only if debtor equity existed.<sup>73</sup>

From this procreeitor situation under the 1898 Act, bankruptcy jurisdiction underwent "a sea change / Into something rich and strange."<sup>74</sup> Today, section 363 of the Bankruptcy Code empowers the bankruptcy trustee to retain all the collateral she can use.<sup>75</sup> Section 363 is a long, rambling provision, replete with opportunities for the trustee to use and abuse the property of another on behalf of the unsecured creditors.<sup>76</sup>

The literal words of the Bankruptcy Code differ in their treat-

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72. Ironically, the legislative history states that the Bankruptcy Code was written "as a significant boon to secured lenders." H.R. REP. NO. 95-595, at 183 (1978) (reprinted in 1978 U.S.C.A.N. 5963, 6143).

73. See generally David Gray Carlson, *Postpetition Interest Under the Bankruptcy Code*, 43 U. MIAMI L. REV. 577, 590-96 (1989) (discussing pre-1978 Act law); Mary Josephine Newborn, *Undersecured Creditors in Bankruptcy: Dewsnup, Nobelman, and the Decline of Priority*, 25 ARIZ. ST. L.J. 547 (1993) (comparing lien enforcement rights of undersecured creditors under the 1898 Act and the Bankruptcy Code).

74. WILLIAM SHAKESPEARE, *THE TEMPEST*, act 1, sc. 2.

75. See 11 U.S.C. § 363 (1994).

76. See *id.*

ment of illiquid and liquid collateral—something not often appreciated by lawyers or scholars. According to these literal words, illiquid collateral is not so clearly within the province of bankruptcy jurisdiction. The Bankruptcy Code is clear only with regard to *cash collateral*. Cash collateral is beyond question within the jurisdiction of the bankruptcy courts, according to the literal words of the Bankruptcy Code.<sup>77</sup> The following sections explore these distinctions.

### A. *Illiquid Collateral*

It is universally assumed that, so long as adequate protection has been supplied,<sup>78</sup> the trustee, in aid of debtor rehabilitation, can use, sell, or lease any collateral claimed by a secured party under section 363.<sup>79</sup> Oddly, section 363 makes this explicit only with regard to cash collateral.<sup>80</sup> When it comes to illiquid collateral, section 363(b)(1) says only that the trustee “may use, sell, or lease, other than in the ordinary course of business, *property of the estate*.”<sup>81</sup>

But is collateral property of the estate? Section 541(a)(1) defines property of the estate as “all legal or equitable interests of *the debtor* in property as of the commencement of the case.”<sup>82</sup> When it comes to collateral, the debtor only owns that part of the collateral that is not the security interest.<sup>83</sup> Taken literally, the Bankruptcy Code provides that part of the thing is in the estate and part of it is out of the estate.<sup>84</sup> Is it possible to argue that the security interest is never property of the estate, and, therefore, the trustee may never interfere with the operation of the security interest?<sup>85</sup> Such an argument overturns the fondest beliefs of the

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77. *See id.* § 363(a).

78. *See id.* § 363(e).

79. *See id.* § 363(b)(1).

80. *See id.* § 363(a).

81. *Id.* § 363(b)(1) (emphasis added).

82. *Id.* § 541(a) (emphasis added).

83. *See id.* § 541(b), (d).

84. *See id.* § 541.

85. This argument was used to explain, however imperfectly, why the state of California was entitled to a preference for unpaid taxes when a state law prohibited the transfer of any liquor license unless the taxes were paid. *See California v. Farmers Mkts., Inc. (In re Farmers Mkts., Inc.)*, 792 F.2d 1400, 1403 (9th Cir. 1986). In this

debtors' bar and twenty years of everyday experience.

This statutory problem seems to have drawn the attention of Justice Blackmun in *United States v. Whiting Pools, Inc.*<sup>86</sup> In dictum, Justice Blackmun remarked: "Although these statutes could be read to limit the estate to those 'interests of the debtor in property' at the time of the filing of the petition, we view them as a definition of what is included in the estate, rather than as a limitation."<sup>87</sup> He further stated:

Section 541(a)(1) speaks in terms of the debtor's "interests . . . in property," rather than property in which the debtor has an interest, but this choice of language was not meant to limit the expansive scope of the section. The legislative history indicates that Congress intended to exclude from the estate property of others in which the debtor had some minor interest such as a lien or bare legal title.<sup>88</sup>

These remarks establish that the bankruptcy estate exceeds the words of section 541(a). Thus, the estate includes not only the debtor's interest but also the security interest part of an encumbered thing. Under this dictum, since the trustee can use "property of the estate,"<sup>89</sup> the trustee can use the whole of a secured party's collateral.

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case, Judge Alfred Goodwin ruled that the bankruptcy court could sell the license over the opposition of the State, but that the State had some sort of charge against the proceeds—though state law did not appear to say so. *See id.* at 1404. Relying upon ROBERT NOZICK'S ANARCHY, STATE AND UTOPIA (1974), Judge Goodwin held, "Because the estate may take no greater interest than that held by the debtor . . . the estate takes the license subject to the restrictions imposed on the debtor by its transferor." *Id.* at 1403 (citation omitted). That is to say, the debtor's interest in the license was *in* the estate, but the State's interest in the license was *out* of the estate. That a restraint on alienation should equate with a lien on proceeds was a great leap Judge Goodwin chose to leave unexplained. *See id.* at 1402-03. The court, however, did not really decide whether the debtor's limited ownership of the fund precluded use under section 363(a) or not. *See id.* at 1404; *see also* SouthTrust Bank v. Thomas (*In re* Thomas), 883 F.2d 991 (11th Cir. 1989) (holding that only the debtor's bare right of possession becomes property of the estate in a conditional sale, where the seller retains title).

86. 462 U.S. 198 (1983).

87. *Id.* at 203.

88. *Id.* at 204 n.8.

89. 11 U.S.C. § 363(b)(1).

Although the limited nature of section 541(a) has been explained away by the Supreme Court,<sup>90</sup> this precise argument is routinely used and easily accepted in other contexts. Specifically, this very same argument—only part of the thing is in the estate—is used to explain why a bankruptcy trustee must surrender the res of a constructive trust, or, indeed, any kind of trust.<sup>91</sup> Section 541(d) states:

Property in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest . . . becomes property of the estate . . . only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold.<sup>92</sup>

This provision is usually cited to mean that constructive trust property is not part of the estate,<sup>93</sup> and therefore cannot be used under section 363(b),<sup>94</sup> yet the provision says no such thing. It says that the debtor's *legal* title is property of the estate.<sup>95</sup> Now, if the debtor and the beneficiary of a trust are, roughly speaking, cotenants of the res of the trust, why can the debtor's bankruptcy trustee not use this trust property in speculative ventures for the benefit of the general creditors of the debtor?

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90. See *Whiting Pools*, 462 U.S. at 204 & n.8, 205.

91. See *Begier v. IRS*, 496 U.S. 53, 59 (1990) ("Because the debtor does not own an equitable interest in property he holds in trust for another, that interest is not 'property of the estate.'").

92. 11 U.S.C. § 541(d).

93. See, e.g., *Owen v. Owen*, 500 U.S. 305, 308 (1991); *Begier*, 496 U.S. at 59; *Whiting Pools*, 462 U.S. at 205 n.10 (contrasting section 541(d), which excludes trust property, with section 541(a), which, though identically worded, does not exclude collateral); *Southmark Corp. v. Grosz (In re Southmark Corp.)*, 49 F.3d 1111, 1117 (5th Cir. 1995); cf. *City of Farrell v. Sharon Steel Corp.*, 41 F.3d 92, 101-03 (3d Cir. 1994) (holding open the possibility that trust funds could have been transferred to secured parties free and clear of trust, in which case the trust funds would be cash collateral). For cases expelling trust property from the bankrupt estate, see *Empire Fin. Servs., Inc. v. Gingold (In re Real Estate W. Ventures, L.P.)*, 170 B.R. 736, 744 (Bankr. N.D. Ga. 1993) (holding that security deposits from tenants are required to be segregated from debtor property); *In re All-Way Servs., Inc.*, 73 B.R. 556, 564 (Bankr. E.D. Wis. 1987) (holding that a withholding tax is not subject to turnover).

94. See 11 U.S.C. § 363(b).

95. See *id.* § 541(a)(1).



Such a thought is monstrous, and so, in default of a good answer, it is usually asserted that the equitable part of the res is simply *dehors* the estate and cannot be used beneficially for the unsecured creditors. Thus, in *XL/Datacomp, Inc. v. Wilson (In re Omegas Group, Inc.)*,<sup>96</sup> Judge Alice Batchelder wrote: "A debtor that served prior to bankruptcy as trustee of an express trust generally has no right to the assets kept in trust,<sup>97</sup> and the trustee in bankruptcy must fork them over to the beneficiary."<sup>98</sup> This is what she writes of *express* trusts.<sup>99</sup> Where the trust is implied in law—i.e., a constructive trust—Judge Batchelder writes: "Nowhere in the Bankruptcy Code does it say, 'property held by the debtor subject to a constructive trust is excluded from the debtor's estate.'"<sup>100</sup> Judge Batchelder then provides a radical theory of constructive trusts—they do not arise until a judicial decree declaring the trust arises.<sup>101</sup>

We think that § 541(d) simply does not permit a claimant in the position of Datacomp to persuade the bankruptcy court to impose the remedy of constructive trust for alleged fraud committed against it by the debtor in the course of their business dealings, and thus to take ahead of all creditors, and indeed, ahead of the trustee. Because a constructive trust, unlike an express trust, is a remedy, it does not exist until a plaintiff obtains a judicial decision finding him to be entitled to a judgment "impressing" defendant's property or assets with a constructive trust. Therefore, a creditor's claim of entitlement to a constructive trust is not an "equitable interest" in the debtor's estate existing prepetition, excluded from the estate under § 541(d).<sup>102</sup>

This holding, which seems to be asserted as a matter of federal

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96. 16 F.3d 1443 (6th Cir. 1994).

97. Notice the imprecision of this claim. Of course, trustees have legal title—and the power to convey good title to bona fide purchasers.

98. *Omegas*, 16 F.3d at 1449.

99. *See id.* (discussing the limited analogy between constructive and express trusts).

100. *Id.* at 1448.

101. *See id.* at 1449 (contending that a constructive trust is a legal fiction that requires judicial action to exist).

102. *Id.* at 1451.

bankruptcy law,<sup>103</sup> spells the end of *any* constructive trust in bankruptcy, if it is followed.<sup>104</sup> Interestingly, at least part of Judge Batchelder's theory is that section 541(d) fails to expel constructive trust property from the estate.<sup>105</sup> Hence, the necessity of a federal override of state law.

At least the express trust was expelled from the bankruptcy estate, according to Judge Batchelder, because section 541(d) brings only the legal title to the property into the bankruptcy estate under section 541(a).<sup>106</sup> Since the trustee can only use property of the estate under section 363(b), the trustee cannot use the beneficial interest of a trust.<sup>107</sup> Yet this same argument applies just as well to illiquid collateral encumbered by security interests. If the beneficial interest of a trust is beyond the estate, then so is the security interest. But, in spite of the common position of trust beneficiaries and secured creditors, it is universally assumed, with no grounding in the Bankruptcy Code, that bankruptcy trustees can use collateral for the benefit of unsecured creditors, although the *corpus* of a trust cannot be so used.<sup>108</sup>

Clearly, there exists some extra statutory principle that distinguishes beneficiaries of trusts from secured creditors. What might this principle be? Judge Stephen Gerling usefully suggested that the distinction has to do with appreciation value.<sup>109</sup> When a creditor claims any sort of lien on property that goes up in value, the creditor's immediate liquidation of such property

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103. Judge Batchelder is not perfectly clear about this, but she did write: "The equities of bankruptcy are not the equities of the common law. Constructive trusts are anathema to the equities of bankruptcy since they take from the estate, and thus directly from competing creditors, not from the offending debtor." *Id.* at 1452 (footnote omitted); see *In re Dow Corning Corp.*, 192 B.R. 428, 435-41 (Bankr. E.D. Mich. 1996) (reading *Omegas* as adopting a new federal rule against constructive trusts).

104. See *Omegas*, 16 F.3d at 1452-53; *Dow Corning Corp.*, 192 B.R. at 441.

105. See *Omegas*, 16 F.3d at 1451.

106. See *id.* at 1448-49.

107. See 11 U.S.C. § 541(c)(2) (1994).

108. See Wayne Rodney, Note, *The Non-Traceable 7501 Tax Trust and Bankruptcy Superpriority*, 14 CARDOZO L. REV. 449, 453-54 (1992).

109. Cf. *In re Amodio*, 155 B.R. 622, 625 (Bankr. N.D.N.Y. 1993) (distinguishing between the trustee's ability to recapture tangible property seized prepetition and intangible property, concluding that the trustee's ability to recapture intangible property rests in its value to the estate).

effectively deprives the debtor, and her unsecured creditors, of any potential upside.<sup>110</sup> The secured creditor must therefore suffer the law's delay and the insolence of office because bankruptcy jurisdiction hopes to nurture appreciation value in favor of unsecured creditors. In comparison, the beneficial owners of trust property are not subject to bankruptcy jurisdiction because they, not the debtor, own the cozening hope of appreciation value.<sup>111</sup> If trust property goes up in value, the fiduciary does not keep the surplus but rather the beneficiary enjoys the increase.<sup>112</sup> This aspect of equitable property interests keeps it outside of bankruptcy jurisdiction.

This distinction captures the spirit of the Bankruptcy Code's legislative history, even though that spirit is articulated poorly in the language of the statute itself. Indeed, read literally, nothing in the Bankruptcy Code subjects *any* third parties claiming illiquid property to bankruptcy jurisdiction.

### *B. Cash Collateral*

The above suggestion—that nothing in the Bankruptcy Code clearly subjects secured creditors to bankruptcy jurisdiction—is not valid with regard to cash collateral. The statutory language governing cash collateral differs from that which governs illiquid collateral. According to section 363(a), “cash collateral” means cash and the like “in which the estate and an entity other than the estate have an interest.”<sup>113</sup> The trustee may use “cash collateral”—defined as *both* the debtor equity *and* the security interest<sup>114</sup>—if the secured party consents or if the court so orders.<sup>115</sup> Section 363(a) expressly states that the trustee may use the whole of the collateral—the secured party's portion and

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110. Cf. 11 U.S.C. §§ 365, 541 (allowing the trustee to assume executory contracts, the benefit of which flows to the estate).

111. See *id.* §§ 363, 726 (stating that the trustee may use, sell, or lease property of the estate for distribution to creditors, paying secured creditors with any remainder divided *pro rata* among unsecured creditors).

112. See *id.*

113. *Id.* § 363(a).

114. See *id.*

115. See *id.* § 363(c)(2).

the debtor's portion.<sup>116</sup> Ironically, when collateral is illiquid, there is no such explicit assurance. Instead, section 363(b)(1) indicates that the trustee can use only the debtor's portion.<sup>117</sup>

Those hoping to rationalize the Bankruptcy Code's disparate treatment of liquid and illiquid collateral might wish to make these additional points. First, if the trustee has the power to sell illiquid collateral free and clear of liens under section 363(f)(3),<sup>118</sup> the trustee can freely change illiquid collateral into cash collateral, thereby taking advantage of the broader "use" power over cash.<sup>119</sup> The ability to render illiquid property into cash renders the distinction between liquid and illiquid collateral irrelevant; as in chemistry, the distinction between liquids and solids is overrated.<sup>120</sup> In addition, it also might be ventured that the automatic stay prevents a secured party from repossessing collateral.<sup>121</sup> Pending repossession, the debtor can lawfully "use" and even depreciate it.<sup>122</sup> The automatic stay effectively prevents a secured party from exploiting her right to repossess, even if the security interest is conceived as being outside the bankruptcy estate.<sup>123</sup>

The problem with such points is that they apply equally to beneficiaries of trusts as to secured creditors. The trustee has the power to sell free and clear of equitable interests,<sup>124</sup> and the automatic stay applies just as much to trust beneficiaries as it does to secured creditors.<sup>125</sup> One must conclude that the Bankruptcy

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116. See *id.* § 363(a).

117. See *id.* § 363(b)(1).

118. See *id.* § 363(f)(3).

119. See *id.* § 363(a), (f).

120. Section 363(f)(3), however, probably only permits sales free and clear when the price received is greater than the aggregate amounts of all claims of the affected secured parties. See David Gray Carlson, *Undersecured Claims Under Bankruptcy Code Sections 506(a) and 1111(b): Second Looks at Judicial Valuations of Collateral*, 6 BANKR. DEV. J. 253, 260-63 (1989).

121. See 11 U.S.C. § 362.

122. See *id.* § 363; Carlson, *supra* note 120, at 260-63.

123. See 11 U.S.C. § 363.

124. See *id.* § 363(f)(1) (allowing a trustee to sell free and clear if "applicable nonbankruptcy law permits sale of such property free and clear").

125. See *First Nat'l Bank v. Hurricane Elkhorn Coal Corp. II* (*In re Hurricane Elkhorn Coal Corp. II*), 32 B.R. 737, 741 (W.D. Ky. 1983), *aff'd*, 763 F.2d 188 (6th Cir. 1985). The trustee of an express or constructive trust cannot lawfully use property except for the benefit of the *cestui que trust*. The automatic stay, standing

Code, in its current state, is not very coherent in its theory of bankruptcy jurisdiction over the property of others.<sup>126</sup> It requires judicial supersession to meet the goal of taxing secured creditors while leaving beneficial owners of fiduciary property alone.

### III. WHITING POOLS

#### A. *Its Absolutism*

If the trustee can use, sell, or lease collateral under section 363, then the trustee can wrest custody of it from secured creditors who have repossessed it—a vast increase in the power that bankruptcy trustees have over secured parties. The operative statute that allows the trustee to obtain repossessed collateral is section 542(a), which provides:

Except as provided in subsection (c) or (d) of this section, an entity, other than a custodian, in possession, custody, or control, during the case, of property that the trustee may use, sell, or lease under section 363 of this title . . . shall deliver to the trustee, and account for, such property or the value of such property, unless such property is of inconsequential value or benefit to the estate.<sup>127</sup>

Although broadly written, the section does sometimes let secured parties escape jurisdiction of the bankruptcy trustee if they have already repossessed the collateral.<sup>128</sup> For example, in a liquidation case in which there is no debtor equity, the trustee probably cannot “use, sell, or lease” the property under section 363, and so section 542(a) does not authorize a turnover.<sup>129</sup>

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alone, cannot justify use of trust property under section 363, although section 363(a)'s definition of cash collateral, if read literally, does indeed justify use of trust funds.

126. See *supra* Part II.

127. 11 U.S.C. § 542(a). The exceptions in subsections (c) and (d) defend good faith transfers by the possessor of debtor property without knowledge of the bankruptcy petition and premium payments to life insurance companies. See *id.* § 542(c)-(d).

128. See, e.g., *In re Amodio*, 155 B.R. 622, 624 (Bankr. N.D.N.Y. 1993) (noting cases in which prepetition seizures by the IRS were not returned to the bankruptcy estate).

129. See 11 U.S.C. § 542(a) (discussing property that the trustee may use, sell, or lease under section 363); see also Craig S. Provorny, Note, *The Outer Limits of Sec-*

Analogously, where the chapter 7 trustee possesses collateral, the same secured party could have the automatic stay lifted because no equity exists.<sup>130</sup>

The definitive interpretation of section 542(a)'s reach is the fantastic case of *United States v. Whiting Pools, Inc.*<sup>131</sup> This case is fantastic because it rests bankruptcy jurisdiction on the giddy footing of hypothetical speculation.<sup>132</sup> To the extent it empowers a speculative—not a prudential—logic, *Whiting Pools* is deeply disturbing to the practice of securitization.

In *Whiting Pools*, the IRS claimed approximately \$92,000 in back taxes.<sup>133</sup> Pursuant to its tax lien, the IRS seized inventory, equipment, vehicles, and office supplies with a liquidation value of "at most, \$35,000."<sup>134</sup>

Having filed for bankruptcy, the debtor-in-possession sought a turnover of the collateral under section 542(a) and section 543.<sup>135</sup> After some fallow maneuvering over which section properly governed the action, the bankruptcy court ordered a turn-

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tion 542 of the Bankruptcy Code: *United States v. Whiting Pools, Inc., Revisited*, 7 CARDOZO L. REV. 935, 937-40 (1986) (discussing turnover under section 542(a)).

130. See 11 U.S.C. § 362(d)(2)(A).

131. 462 U.S. 198 (1983).

132. According to Hegel, "the relation of the hypothetical judgement is necessity or inner substantial identity associated with external diversity of Existence, or mutual indifference of being in the sphere of Appearance." GEORG WILHELM FRIEDRICH HEGEL, *HEGEL'S SCIENCE OF LOGIC* 699 (A.V. Miller trans., Humanities Press 1969) (1812).

133. See *Whiting Pools*, 462 U.S. at 199.

134. *Id.* at 200. The going concern value of the inventory, it appeared, was precisely \$162,876. See *id.*; *United States v. Whiting Pools, Inc. (In re Whiting Pools, Inc.)*, 10 B.R. 755, 757 (Bankr. W.D.N.Y.), *rev'd*, 15 B.R. 270 (W.D.N.Y. 1981), *rev'd*, 674 F.2d 144 (2d Cir. 1982), *aff'd*, 462 U.S. 198 (1983). Most court valuations are unable to obtain this level of precision. See generally David Gray Carlson, *Secured Creditors and the Eely Character of Bankruptcy Valuations*, 41 AM. U. L. REV. 63 (1991) (discussing theories of valuation in bankruptcy). A debtor surplus existed on the basis of this going concern valuation, and one suspects that the valuation was colored by the bankruptcy court's desire to assure the existence of bankruptcy jurisdiction. In any case, this implication of debtor surplus was irrelevant to the analysis. Justice Blackmun wrote his opinion as if the collateral were valued at the low liquidation value of \$35,000. But see *Brown v. Evanston Bank (In re Brown)*, 126 B.R. 767, 772 (N.D. Ill. 1991) (hinting that *Whiting Pools* hinged on a large going concern value of collateral).

135. See *Whiting Pools*, 462 U.S. at 201.

over under section 543.<sup>136</sup> The court of appeals, however, preferred that the turnover be baked in the oven of section 542(a).<sup>137</sup>

On further appeal, Justice Blackmun ruled that the debtor-in-possession had turnover rights under section 542(a).<sup>138</sup> The debtor's rights in the inventory were not extinguished just be-

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136. *See id.*

137. *See id.* at 202. The standards for these two sections seem to be largely identical.

Section 543 is appropriate when a "custodian" is in possession of the collateral. A "custodian" is a receiver, trustee, or agent under state law who is authorized to enforce a lien. The exact definition appears in the Bankruptcy Code § 101(11), which states that a "custodian" means:

(A) receiver or trustee of any of the property of the debtor, appointed in a case or proceeding not under this title;

(B) assignee under a general assignment for the benefit of the debtor's creditors; or

(C) trustee, receiver, or agent under applicable law, or under a contract, that is appointed or authorized to take charge of property of the debtor for the purpose of enforcing a lien against such property, or for the purpose of general administration of such property for the benefit of the debtor's creditors.

11 U.S.C. § 101(11) (1994). A custodian with knowledge of the bankruptcy must stop all disbursements, *see id.* § 543(a), and must hand over the collateral to the bankruptcy trustee. *See id.* § 543(b)(1). But a court may also excuse compliance with a turnover action "if the interests of creditors and, if the debtor is not insolvent, of equity security holders would be better served by permitting a custodian to continue in possession, custody, or control of such property." *Id.* § 543(d)(1).

About the only substantive difference between section 542(a) and section 543 is that, if the custodian is an assignee for the benefit of creditors under a state law whose jurisdiction is over 120 days old by the time of the petition, no turnover can be ordered. *See id.* § 543(d)(2).

Although it would appear to make no substantive difference, courts have ruled that a secured party who repossessed under Article 9 is not a "custodian" because the secured party is no longer working on behalf of another. *See Flourney v. City Fin. of Columbus, Inc.*, 679 F.2d 821, 824 (11th Cir. 1982) (following the pre-Code rule); *Whiting Pools*, 674 F.2d at 148-49, *aff'd*, 462 U.S. 198 (1983); *Debmar Corp. v. United States (In re Debmar Corp.)*, 21 B.R. 858, 859 (Bankr. S.D. Fla. 1982). Therefore, the secured creditor could not be deemed a "trustee, receiver, or agent under applicable law, or under a contract, that [was] appointed or authorized to take charge of property of the debtor for the purpose of enforcing a lien." 11 U.S.C. § 101(11)(C). This holding overlooked the fact that the secured party was a trustee or agent of the debtor or junior secured parties, in case there was a surplus. *See Luize E. Zubrow, Rethinking Article 9 Remedies: Economic and Fiduciary Perspectives*, 42 UCLA L. REV. 445, 448 (1994). Therefore, it was possible to call a repossessing secured party a custodian, but, as it seems to make little difference, the courts were guilty of harmless error at best in their steadfast denial of the proposition.

138. *See Whiting Pools*, 462 U.S. at 211.

cause the IRS seized it.<sup>139</sup> The final alienation of debtor and thing would occur only when the inventory was sold in a foreclosure sale.<sup>140</sup>

What were the debtor's connections to the repossessed inventory that justified bankruptcy jurisdiction? Justice Blackmun mentioned two things. First, the debtor had a hypothetical right to a surplus, in case a buyer at a foreclosure sale might bid more than the amount of the secured claim.<sup>141</sup> Justice Blackmun as-

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139. See *id.* at 211-12.

140. See *id.* at 211 ("Until such a sale takes place, the property remains the debtor's and thus is subject to the turnover requirement of § 542(a)."). Justice Blackmun also noted that the Internal Revenue Code itself refers to the debtor as the "owner" of the collateral prior to the foreclosure sale. See *id.*

A turnover of this sort would not mean that ordinary secured creditors must forfeit their collateral. Once collateral is returned, an ordinary secured creditor would still have a lien on it, for which a bankruptcy trustee must supply adequate protection. See 11 U.S.C. § 363(e); *Whiting Pools*, 462 U.S. at 211-12. Failure to provide adequate protection permits the secured party to have the automatic stay dissolved "for cause." See 11 U.S.C. § 362(d)(1). The issue, then, was not ownership of the thing, but control and use over time.

Tax lien creditors, however, are worse off than other secured creditors, because their liens are deeply subordinated to the administrative expenses of the bankruptcy proceeding. According to section 724(b), "[p]roperty in which the estate has an interest and that is subject to a lien that . . . secures an allowed claim for a tax" must be distributed to any creditor with a priority under section 507(a)—most notoriously the lawyers for the debtor-in-possession. See *id.* § 724(b). If it had prevailed in proving the debtor had "no interest" in the repossessed inventory, then the IRS could have escaped this subordination. But because the inventory fell within section 542(a)'s reach, it might have been subjected to subordination under section 724(b) and so had to subsidize the expensive maneuvers and scholarly ruminations of the debtor's bankruptcy lawyers.

Based on the *Whiting Pools* decision, however, it appears the bankruptcy court sculpted highly preferential treatment for the IRS. See *Whiting Pools*, 462 U.S. at 201 n.6; *United States v. Whiting Pools, Inc. (In re Whiting Pools, Inc.)*, 10 B.R. 755, 761 (Bankr. W.D.N.Y.), *rev'd* 15 B.R. 270 (W.D.N.Y. 1981), *rev'd*, 674 F.2d 144 (2d Cir. 1982), *aff'd*, 462 U.S. 198 (1983). This treatment overlooks the deeply subordinated position the IRS should have had in the chapter 11 proceeding. Nor is there any justification for payments to the IRS in advance of plan confirmation. Such right to payment is restricted to special situations identified in the statute. See 11 U.S.C. §§ 331 (lawyers), 365(d)(3) (commercial landlords), 1114 (medical insurance for workers). See generally Russell A. Eisenberg & Frances F. Gecker, *The Doctrine of Necessity and Its Parameters*, 73 MARQ. L. REV. 1, 11-17 (1989) (arguing that interim payments are always justified by nonstatutory emergencies). But see Craig B. Cooper, Note, *The Priority of Postpetition Retainers, Carve-Outs, and Interim Compensation Under the Bankruptcy Code*, 15 CARDOZO L. REV. 2337 (1994).

141. See *Whiting Pools*, 462 U.S. at 211.



serted this debtor interest even though its "value" was nonexistent and very speculative.<sup>142</sup> Second, the debtor had a right to be notified of the impending sale.<sup>143</sup> Although the value of this notice is likely to be nil, its mere existence was enough to ground bankruptcy jurisdiction over the inventory.<sup>144</sup>

### B. *Its Relativism*

*Whiting Pools*, then, grounds bankruptcy jurisdiction on valueless, or mere hypothetical, property interests.<sup>145</sup> If a bankruptcy trustee can fathom any legal connection between the debtor and a thing, the thing may be expropriated for the benefit of the unsecured creditors—though, to be sure, in exchange for adequate protection.<sup>146</sup>

Nevertheless, a counternote is also sounded by Justice Blackmun, who noticed the very same textual defect emphasized here. Worrying that section 541(a) admits only the *debtor's interest in collateral*—for example, it excludes the security interest and so puts secured parties beyond the scope of bankruptcy jurisdiction—Blackmun wished to show that, where a debtor owned even a valueless equity, the bankruptcy trustee could use the entire piece of collateral, not just the debtor equity: "Section 541(a)(1) speaks in terms of the debtor's 'interests . . . in property,' rather than property in which the debtor has an interest, but this choice of language was not meant to limit the expansive scope of the section."<sup>147</sup> Here, Justice Blackmun noted that section 541(a)(1) seems to include debtor equity but not the security interest itself.<sup>148</sup> Taken in isolation, such a principle would ex-

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142. See *id.* at 207 n.16, 210-11.

143. See *id.* at 201 n.4.

144. See *id.*

145. See *In re Alcom Am. Corp.*, 154 B.R. 97, 103 (Bankr. D.D.C.) ("Any interest the debtor has in property, no matter how insignificant, constitutes property of the estate . . ."), *vacated in part*, 156 B.R. 873 (Bankr. D.D.C. 1993), *aff'd*, 48 F.3d 539 (D.C. Cir. 1995).

146. See *Whiting Pools*, 462 U.S. at 204 ("Both the congressional goal of encouraging reorganizations and Congress' choice of methods to protect secured creditors suggest that Congress intended a broad range of property to be included in the estate.").

147. *Id.* at 204 n.8 (citations omitted).

148. See *id.*

clude secured creditors from bankruptcy jurisdiction altogether.<sup>149</sup> But Justice Blackmun rejected this utter failure of the Bankruptcy Code to expand jurisdiction on the basis of legislative history:

The legislative history indicates that Congress intended to exclude from the estate property of others in which the debtor had some minor interest such as a lien or bare legal title. Similar statements to the effect that § 541(a)(1) does not expand the rights of the debtor in the hands of the estate were made in the context of describing the principle that the estate succeeds to no more or greater causes of action against third parties than those held by the debtor. These statements do not limit the ability of a trustee to regain possession of property in which the debtor had equitable as well as legal title.<sup>150</sup>

Carefully read, this footnote indicates that section 541(a)(1) is very expansive, insofar as the debtor's *equitable* property interests are concerned, but restrictive, insofar as the debtor's *legal* interests are concerned. A debtor's lien is therefore in the estate, but the account debtor's equity is outside of it. Such an exclusion prevents a secured creditor from filing for bankruptcy and then using the account debtor's equity interest in property to rehabilitate the secured creditor. Nor does a debtor's "legal" title over fiduciary property suggest that the beneficiaries of wills or pension funds must contribute to the rehabilitation of their bankrupt fiduciary. Being monstrous, the proposal will simply not be entertained; therefore, a debtor's "minor interests" are to be excluded from the estate.

Once again, these statements, based on legislative history, cannot be justified by the text of the Bankruptcy Code. Section 541(a)(1) includes both legal *and* equitable property interests on the same basis.<sup>151</sup> Section 541(d) excludes the equitable interests of others,<sup>152</sup> but section 541(a)(1) equally expels the legal

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149. See 11 U.S.C. § 541(a)(1) (1994) (stating that the "estate is comprised of all the following property, wherever located: . . . all legal or equitable interests of the debtor in property as of the commencement of the case").

150. *Whiting Pools*, 462 U.S. at 204 n.8 (citations omitted).

151. See 11 U.S.C. § 541(a)(1).

152. See *id.* § 541(d).

interests of nondebtors.<sup>153</sup> Nothing in the Bankruptcy Code quite says that a trustee can use the collateral but not the beneficial side of a trust relationship. On the contrary, section 363(a) suggests that the trustee may use *any* cash in which a debtor and some third party share a property interest.<sup>154</sup>

Finally, it may be noted that Justice Blackmun's distinction between legal title and equitable title can be made to cohere with Judge Gerling's suggestion that bankruptcy jurisdiction turns on ownership of appreciation value.<sup>155</sup> When the debtor is the equitable owner, the debtor enjoys all appreciation value, and the bankruptcy courts may take jurisdiction over the whole of the encumbered thing in the hope of nurturing the appreciation value for the benefit of the unsecured creditors.<sup>156</sup> When the debtor is the legal owner, growth in value belongs to a third party, not to the debtor.<sup>157</sup> The legal interest is therefore "minor" and cannot be used to justify seizure of the whole thing for the benefit of the unsecured creditors.<sup>158</sup>

Thus, Justice Blackmun may have correctly identified the spirit of the Bankruptcy Code, but the *words* of the Bankruptcy Code do not yield forth any such prodigy.

#### IV. THE PREMISES OF SECURITIZATION

The preceding discussion demonstrates that the *holding* of *Whiting Pools* supports the foundation of bankruptcy jurisdiction on extremely tenuous debtor property interests in property jointly owned by others. *Whiting Pools*'s dictum, however, honors the legislative history that purports to subject secured creditors to bankruptcy jurisdiction while excusing other property claimants.

How does this legal background affect securitization's sacred premises?

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153. See *id.* § 541(a)(1).

154. See *id.* § 363(a).

155. See *supra* text accompanying notes 109-12.

156. See *id.*; Carlson, *supra* note 120, at 258-63.

157. See *supra* notes 110-12 and accompanying text.

158. See *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 204 n.8 (1983).

### A. *The Traditional Test*

Currently, the defenders of securitization assume that bankruptcy jurisdiction turns on whether a debtor sells property or whether it merely grants a security interest on it.<sup>159</sup> The distinction between sales and liens is no doubt important for other reasons. Most significantly, a sale of a general intangible may have no perfection requirement because such sales are not subject to Article 9's governance.<sup>160</sup> A lien on the same property, though, falls under Article 9's jurisdiction.<sup>161</sup> Whether a general intangible had been sold or merely encumbered with a lien determines whether a transferee of the intangible must perfect her interest under Article 9 to survive bankruptcy avoidance.<sup>162</sup> The inquiry into the sale-lien distinction will be relevant when general intangibles have been transferred. The distinction is also important to determine whether a secured party must account for any surplus to the originator<sup>163</sup> or whether the usury laws apply.<sup>164</sup>

In drawing this distinction, courts have grown suspicious of any self-serving declaration in the contract itself.<sup>165</sup> Instead, courts penetrate the form to discover the essence of the deal.<sup>166</sup> Very roughly speaking, the characterization of the transfer as a lien or as a sale turns on who bears the risk of market fluctua-

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159. See Pantaleo et al., *supra* note 31, at 161 ("Defining true sale is the holy grail of the securitization market . . ."). At least one case has denied bankruptcy jurisdiction on the basis of this test. See *Harris v. Farmers Home Admin. (In re Bargstedt)*, 7 B.R. 556, 557 (Bankr. M.D. Ga. 1980).

160. See U.C.C. § 9-102(1) (1995); Debora L. Threedy, *Loan Participations—Sales or Loans? Or Is That the Question?*, 68 ORE. L. REV. 649, 654 (1989).

161. See U.C.C. § 9-102(2).

162. See Threedy, *supra* note 160, at 653-54.

163. See U.C.C. § 9-502(2); *Major's Furniture Mart, Inc. v. Castle Credit Corp.*, 602 F.2d 538, 542-44 (3d Cir. 1979).

164. See Aicher & Fellerhoff, *supra* note 31, at 182.

165. See, e.g., *Major's Furniture Mart*, 602 F.2d at 543 (finding a lien, despite contrary contract language, so that the debtor owned a surplus); *First Nat'l Bank v. Hurricane Elkhorn Coal Corp. II (In re Hurricane Elkhorn Coal Corp. II)*, 19 B.R. 609, 614 (Bankr. W.D. Ky. 1982), *rev'd on other grounds*, 32 B.R. 737 (W.D. Ky. 1983), *aff'd*, 763 F.2d 188 (6th Cir. 1985). Courts are nevertheless willing to give contractual language some weight in close cases. See, e.g., *TKO Equip. Co. v. C & G Coal Co.*, 863 F.2d 541, 545-46 (7th Cir. 1988) (holding that a lessor who drew up a "lease" could not claim that the transfer was a sale).

166. See *supra* note 162 and accompanying text.

tion.<sup>167</sup> Who suffers when prices fall and who benefits when prices rise will be relevant, but not sufficient, to determine the characterization. Unfortunately, transferees have insisted on all sorts of devices that blur the line. For instance, a lien might be nonrecourse, thereby posing all risk of decline on the transferee. Or a sale might be subjected to recourse, so that the seller has an unsecured obligation to repurchase defective collateral.<sup>168</sup> The former does not necessarily destroy lien status, and the latter does not necessarily destroy sale status.<sup>169</sup> The tests are much more complicated than that.<sup>170</sup>

It is an error to assume, however, that the sale-lien distinction is also the test for bankruptcy jurisdiction. Instead, the only proper test is: whether state law connects or disconnects the debtor to or from the thing transferred. If alienation is less than

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167. See *Fireman's Fund Ins. Cos. v. Grover (In re Woodson Co.)*, 813 F.2d 266, 271-72 (9th Cir. 1987) (finding that the buyers' absolute right to payment and the seller's purchase of insurance proved the transfer was a lien); *Castle Rock Indus. Bank v. S.O.A.W. Enters., Inc., (In re S.O.A.W. Enters.)*, 32 B.R. 279, 282-83 (Bankr. W.D. Tex. 1983) (holding that guaranties proved the transfer was a lien, not a sale).

168. See Pantaleo et al., *supra* note 31, at 160.

169. See *Bear v. Coben (In re Golden Plan of Cal., Inc.)*, 829 F.2d 705, 710 (9th Cir. 1986) (holding that a buyer's option to obtain payment from seller in lieu of waiting for collection did not preclude a sale); *Major's Furniture Mart*, 602 F.2d at 544-46 (finding a lien, not a sale, existed). In *Major's Furniture Mart*, Judge Leonard Garth thought that a hold-back of a portion of the sale price created a security interest in the sale of accounts. See *id.* at 546. But this does not necessarily follow. The premise that recourse is not fatal to the characterization of sale is that the seller's warranty is a separate transaction from the sale of the account. If the purchase price is held back, then the buyer reserves a right of setoff to secure the warranty claim. In short, the separate recourse is a secured claim of the buyer, but it is still separate from the sale of the account. See Pantaleo et al., *supra* note 31, at 161.

Grant Gilmore took a different position, suggesting that any kind of recourse proved that the transfer was a lien. 2 GRANT GILMORE, *SECURITY INTERESTS IN PERSONAL PROPERTY* § 44.4, at 1230 (1965). This reasoning would turn any Article 2 transaction into a lien, when the seller offers any warranties, implied or express.

170. See generally Pantaleo et al., *supra* note 31, 163-79 (discussing the complex case law regarding when a sale of financial assets with recourse is a true sale). Some arguments that have proved persuasive are that a fixed return unconnected with the interest rate in the sold account suggests a lien, not a sale. See *Ables v. Major Funding Corp. (In re Major Funding Corp.)*, 82 B.R. 443, 448-49 (Bankr. S.D. Tex. 1987). Reduction of an antecedent debt upon the assignment proves that an account was sold, i.e., an "asset payment," not a lien. See *Dewhirst v. Citibank (Ariz.) (In re Contractors Equip. Supply Co.)*, 861 F.2d 241, 245 (9th Cir. 1988) (finding a lien because antecedent debt was not reduced).

complete, then the debtor's share of the thing is in the bankruptcy estate.<sup>171</sup> This, at least, is what the plain words of the Bankruptcy Code require.<sup>172</sup>

The next few sections set forth the reasons why it might be said that a debtor's connection to an account or chattel paper does not end, even if it is "sold." First, Article 9 reserves in sellers of accounts and chattel paper the power to convey better title to some subsequent transferee.<sup>173</sup> Because this is so, the broad statement from *Octagon Gas Systems* that so disturbs the securitization industry was formulated correctly.<sup>174</sup> Second, to the extent that securitization permits the originator to remain the collecting agent, the originator has a property interest directly in the thing sold, even though this property interest is held in trust for the buyers of the accounts. Because section 363(a) and section 363(c)(2) permit the use of cash in which the debtor is a cotenant, this power to collect is an adequate basis on which to found bankruptcy jurisdiction.<sup>175</sup>

### B. Power to Convey Senior Rights

It can be shown that Article 9 does not terminate the connection of the debtor to a sold account or chattel paper, even if the buyer perfects the sale by filing a financing statement. To see

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171. See *First Nat'l Bank v. Hurricane Elkhorn Coal Corp. II* (*In re Hurricane Elkhorn Coal Corp. II*), 19 B.R. 609, 614 (Bankr. W.D. Ky. 1982) ("Whether the assignment of accounts is characterized as an absolute and irrevocable assignment, much in the nature of a sale, or as a security device, the ultimate question is whether the estate has any interest in the proceeds from the assigned accounts."), *rev'd on other grounds*, 32 B.R. 737 (W.D. Ky. 1983), *aff'd*, 763 F.2d 188 (6th Cir. 1985).

172. According to Professor David Frisch:

The Code defines a security interest as "an interest in personal property or fixtures which secures payment or performance of an obligation." Although this language is strongly suggestive of a property interest, it must be understood that definitions do not create property interests. Whatever terminology is employed, the key point is that a true property interest cannot be defined independently of the remedies that are available to the secured party.

David Frisch, *The Implicit "Takings" Jurisprudence of Article 9 of the Uniform Commercial Code*, 64 FORDHAM L. REV. 11, 18 (1995) (quoting U.C.C. § 1-201(37) (1995)).

173. See *infra* text accompanying notes 176-200.

174. See *infra* text accompanying notes 314-81.

175. See 11 U.S.C. § 363(a), (c)(2) (1994).

why this is so, we start with a proposition that no one really doubts: if the buyer does *not* perfect, then the sold account is part of the bankruptcy estate.<sup>176</sup>

First, we could do with a definition of "property," something the Bankruptcy Code does not supply.<sup>177</sup> Instead, nonbankruptcy law must supply the definition. Let us, for the purpose of our demonstration, define property the Hohfeldian way—as an agglutination of rights, powers, privileges, and immunities.<sup>178</sup>

If a buyer of accounts or chattel paper never takes a perfecting step,<sup>179</sup> then the debtor has a "power" to convey it free and clear of the buyer's rights.<sup>180</sup> This proposition is established in section 9-301(1)(c) for chattel paper<sup>181</sup> and section 9-301(1)(d) for accounts.<sup>182</sup> According to section 9-301:

Except as otherwise provided in subsection (2),<sup>183</sup> an unper-

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176. See *id.* § 547(c)(5) (excluding perfected interests from the bankruptcy estate); U.C.C. § 9-301(1).

177. See *Harris v. Petri (In re Petri)* 59 B.R. 58, 70 (Bankr. M.D. La. 1986).

178. See Wesley Newcomb Hohfeld, *Some Fundamental Legal Conceptions As Applied in Judicial Reasoning*, 23 YALE L.J. 16, 30 (1913). Hohfeld has recently come under attack for doing away with the concept of property, reducing the legal universe to one without "things" at all—only disembodied human subjects interacting with each other at a level of utterly useless abstraction. See Jeanne L. Schroeder, *Chix Nix Bundle-O-Stix: A Feminist Critique of the Disaggregation of Property*, 93 MICH. L. REV. 239, 290-95 (1994). This critique undoubtedly has merit. I wish here only to expropriate Hohfeld's distinction between rights and powers, or no-rights and disabilities—useful vocabulary for what follows.

179. A buyer of accounts must file a financing statement, unless the sale "does not alone or in conjunction with other assignments to the same assignee transfer a significant part of the outstanding accounts of the assignor." U.C.C. § 9-302(1)(e). A large originator of sold accounts may be tempted to argue that a single securitization deal does not constitute a significant part of the originator's total portfolio of accounts. See Dan T. Coenen, *Priorities in Accounts: The Crazy Quilt of Current Law and a Proposal for Reform*, 45 VAND. L. REV. 1061, 1085-103 (1992). At this point of the analysis, we are assuming that a financing statement would be required.

As to chattel paper, a secured party may perfect either by filing or by possessing the relevant documents that constitute the chattel paper. See U.C.C. §§ 9-304(1), -305.

180. See U.C.C. § 9-301(1)(c) to (d).

181. See *id.* § 9-301(1)(c).

182. See *id.* § 9-301(1)(d).

183. Subsection (2) governs purchase money security interests. It provides a means for purchase money secured parties to take back priority after a debtor conveys title to a subsequent lien creditor or a buyer out of the ordinary course of business or to a buyer of farm products. See *id.* § 9-301(2).

fectured security interest is subordinate to the rights of

(a) persons entitled to priority under Section 9-312;<sup>184</sup>

(b) a person who becomes a lien creditor before the security interest is perfected;

(c) in the case of . . . chattel paper, a person who is not a secured party and who is a transferee in bulk or other buyer not in ordinary course of business or is a buyer of farm products in ordinary course of business, to the extent that he gives value and receives delivery of the collateral without knowledge of the security interest and before it is perfected;

(d) in the case of accounts . . . a person who is not a secured party and who is a transferee to the extent that he gives value without knowledge of the security interest and before it is perfected.<sup>185</sup>

Under this provision, if the buyer forgets to perfect, then the seller retains a power to convey these accounts and chattel paper free and clear to a second secured creditor who is the first to perfect,<sup>186</sup> or to a second buyer without knowledge.<sup>187</sup> This power means that the debtor owns a property interest in the sold accounts, so long as the buyer does not perfect.<sup>188</sup>

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184. These persons are subsequent secured parties who are the first to perfect their own security interest or who are the first to file a financing statement. See *id.* § 9-312(5)(a).

185. *Id.* § 9-301(1). This provision is not without its ambiguities. First, although the provision applies only to "security interests," the UCC's definition of "security interest" is careful to include the rights of buyers of accounts and chattel paper. See *id.* § 1-201(37). Hence, a buyer "who is not a secured party" is an impossibility. Second, the provision merely "subordinates" the rights of buyers. Properly understood, the power to "subordinate" is coterminous with the power to convey free and clear of the right altogether. See generally David Gray Carlson, *Death and Subordination Under Article 9 of the Uniform Commercial Code: Senior Buyers and Senior Lien Creditors*, 5 CARDOZO L. REV. 547, 547-63 (1984) (discussing section 9-301, the powers of a seller to transfer property and its effect on security interests); David Gray Carlson, *Simultaneous Attachment of Liens on After-Acquired Property*, 6 CARDOZO L. REV. 505, 512-13 & n.38 (1985) (discussing connection of priorities to the termination of liens).

186. See U.C.C. §§ 9-301(1)(a), -312(5)(a).

187. See *id.* § 9-301(1)(d).

188. Even this truth has been disputed by Professor Dan Coenen, who gives this following example: Suppose *D* "sells" accounts to *A*, who does not perfect. *D* then sells the same accounts to *B*, who is the first to perfect. Professor Coenen suggests that *A* might win because, when *D* "sold" to *A*, *D* successfully alienated the ac-



The UCC also creates power in creditors. The power is contained in section 9-301(1)(b), which provides that "an unperfected security interest is subordinate to the rights of . . . (b) a person who becomes a lien creditor before the security interest is perfected."<sup>189</sup> This power, implicit in any unsecured creditor, or, for that matter, in any human being or other legally recognized entity who may become a creditor, permits a creditor to attach a judicial lien to the property a debtor has already conveyed to her secured party.<sup>190</sup> In this respect, Article 9 expresses a fraudulent conveyance idea. We may say that an unsecured creditor of *D* has no *in rem* rights in *D*'s assets—only an *in personam* right that implies access to a judicial lien, if the right

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counts in a very complete and thorough way. After the sale to *A*, *D* had no rights in the collateral, and therefore *B*'s second-in-time interest cannot attach. See Coenen, *supra* note 179, at 1076-80; see also *Bergquist v. Anderson-Greenwood Aviation Corp. (In re Bellanca Aircraft Corp.)*, 850 F.2d 1275, 1278-79 (8th Cir. 1988) (making this error with regard to an airplane sale not perfected in Federal Aviation Administration records).

This is a metaphorical error. The logic Professor Coenen follows is that a sale is a complete alienation of seller from thing, from which it follows that buyers from or judicial lien creditors of a debtor cannot possibly obtain property free and clear of *A*'s unperfected security interest. See Coenen, *supra* note 179, at 1077-78. But it is precisely the point of Article 9 to overcome this assumption. It is by virtue of Article 9 that sales of accounts are not the complete alienation of debtor from thing.

Professor Coenen suggests that courts should reject this faulty conclusion, but only on consequentialist grounds. That is, if we admit that *D* has no rights in the thing, then Article 9's perfection regime simply fails to punish *A* for not perfecting. This consequence would appear to contradict the intent of the drafters and therefore it is to be rejected.

Professor Coenen's consequentialist point is valid, but unnecessary. See Coenen, *supra* note 179, at 1078-80. Property in a thing is some right, privilege, power, or immunity, according to our Hohfeldian definition. If *D* has a power to alienate the thing free and clear of *A*, then *D* owns a part of the thing. That is to say, *D* and *A* are coowners. Or, if *D*'s creditors have the power to sell *A*'s thing in order to satisfy *D*'s debt, *A* and *D*'s creditors are coowners.

The debtor's power to convey free and clear is, by itself, "rights in the collateral." U.C.C. § 9-203(1)(c). When *D* conveys the same accounts to *B* as collateral for a loan, *B*'s security interest therefore attaches to the accounts by virtue of this power. Hence, the purely consequentialist reason of Professor Coenen, though well taken, is not the basis on which to argue that *B* is capable of taking priority over *A*.

189. U.C.C. § 9-301(1)(b).

190. See *id.*

procedures are followed.<sup>191</sup> Suppose, however, that *D* makes a fraudulent conveyance to *A*—a secret lien, for instance. The creditors of *D* now have a power over *A*'s property. According to this power, the creditors of *D* may affix judicial liens to *A*'s property and sell it in satisfaction of *D*'s debt.<sup>192</sup>

This is the very power on which a bankruptcy trustee's avoidance theories depend. As a matter of federal law, the trustee becomes a lien creditor.<sup>193</sup> Hence, when *D* conveys an unperfected security interest to *A*, *D*'s bankruptcy trustee expropriates this power from the creditors. Only the trustee may reach *A*'s property, which comes into the bankruptcy estate under section 541(a)(3).<sup>194</sup> Other creditors are stayed from pursuing this "property of the estate."<sup>195</sup> The securitization industry concurs with this, and so, lawyers are careful to assure that a proper financing statement is filed, even when accounts or chattel paper are "sold."<sup>196</sup>

By now, two points have been established that will be important in the discussion that follows. First, a debtor retains a pow-

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191. *See id.* § 9-301(1)(b), (3).

192. *See supra* notes 189-90 and accompanying text.

193. *See* 11 U.S.C. § 544(a)(1) (1994).

194. *See, e.g.,* *Concrete Equip. Co. v. Fox (In re Vigil Bros. Constr., Inc)*, 193 B.R. 513 (B.A.P. 9th Cir. 1996) (determining that sold accounts entered the bankruptcy estate because the buyer forgot to perfect). The bankruptcy estate includes "[a]ny interest in property that the trustee recovers under section . . . 550." 11 U.S.C. § 541(a)(3). The trustee may recover property under the strong-arm power of section 544. Section 541(a)(3), therefore, plays Chance to the Tinkers and Evers of section 550(a) and section 544(a).

195. 11 U.S.C. § 362(a)(2).

196. According to section 9-103(3)(b) of the UCC, the law of the debtor's location applies. *See* U.C.C. § 9-103(3)(b). If the debtor is located abroad in a jurisdiction that provides for recordation of a security interest, then the foreign law applies. *See id.* § 9-103(3)(c). If the jurisdiction has no recording system, then the law of the state in which the debtor has its most major executive office governs. *See id.* If the debtor has more than one place of business, then "location" means the place of the chief executive office. *See id.* § 9-103(3)(d). Once the choice of law is established, section 9-401(1) establishes the proper place of filing. *See id.* § 9-401(1). The drafters of the UCC have offered states three alternative versions of § 9-401. Most notoriously, the third alternative suggests that if the debtor has a place of business in only one county of a state, then the secured party must file both locally and with the secretary of state. *See id.* § 9-401(1)(c) (third alternative subsection (1)). These rules make perfection treacherous but well within the bounds of certainty needed for a law firm to issue an opinion letter.

er to convey accounts and chattel paper, even after they are sold.<sup>197</sup> This retained power is an ownership right in the thing transferred. Second, at least when the buyer of an account or of chattel paper does not perfect, the creditors of the debtor have the power to obtain a judicial lien on the property of the secured party.<sup>198</sup> This latter power is the foundation of the trustee's strong-arm power.<sup>199</sup>

The next three sections will show that, after a buyer of accounts or chattel paper files a financing statement under Article 9, the debtor continues to own interests in the sold accounts.<sup>200</sup> On the basis of these interests, bankruptcy courts may retain jurisdiction over the proceeds of sold accounts, even over the opposition of account buyers.

## V. RETAINED INTERESTS IN SOLD ACCOUNTS AND CHATTEL PAPER

### A. *Power to Convey Chattel Paper in the Ordinary Course*

The first point covers only chattel paper. Even though the point is of limited reach, it introduces some basic concepts that will be useful for later discussion and so is a convenient place to start.

Perfection does not end a debtor's power to alienate when the SPV purchases chattel paper, unless the SPV takes possession of it.<sup>201</sup> According to section 9-308(a):

A purchaser of chattel paper or an instrument who gives new value and takes possession of it in the ordinary course of his business has priority over a security interest in the chattel paper or instrument

(a) which is perfected under Section 9-304 (permissive filing and temporary perfection) or under Section 9-306 (perfection as to proceeds) if he acts without knowledge that the specific paper or instrument is subject to a security interest.<sup>202</sup>

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197. See *supra* notes 176-88 and accompanying text; see also § 9-301(1)(a) (granting power to debtors).

198. See *supra* notes 189-92 and accompanying text; see also § 9-301(1)(b) (creating powers in creditors).

199. See *supra* note 194 and accompanying text.

200. See *infra* notes 201-71 and accompanying text.

201. See U.C.C. § 9-308(a).

202. *Id.*

If SPVs perfect only by filing and if they appoint the originator as collecting agent, the originator will typically retain a connection with the thing sold. This connection is enough to establish bankruptcy jurisdiction over securitization, to the extent that the deal involves secured receivables.<sup>203</sup>

The capture of sold chattel paper by the bankruptcy estate, because the debtor retains a power to sell, must overcome the following objection: According to Bankruptcy Code section 541(b)(1), property of the estate does not include "any power that the debtor may exercise solely for the benefit of an entity other than the debtor."<sup>204</sup> It is clear that a debtor has a power to convey chattel paper free and clear of a buyer's interest, when the buyer has failed to take possession of the chattel paper,<sup>205</sup> but it is equally clear that the debtor ought not to use this power. If the debtor does so, then what is received in return is deemed to be proceeds owned by the secured party.<sup>206</sup> In short, *D* owns the power to convey *in* trust for *A*. If *D* uses the power for her own benefit, *D* is in breach of a fiduciary duty to *A*; therefore, *D*'s power to convey accounts free and clear of *A*'s ownership rights is not part of the bankruptcy estate.<sup>207</sup>

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203. Thomas Plank disputes this interpretation:

One can counter this argument by stating [*D*] still has "rights" in the collateral because she has the contingent power to defeat [*A*]'s interest by assigning the account to [*B*]. The power is contingent because it depends upon [*B*] filing before [*A*] files. It is a perversion of language to call this power, which is an illegitimate power, a "right."

Plank, *supra* note 18, at 489-90 (footnote omitted). Professor Plank also wishes to distinguish an "illegitimate power" from a Hohfeldian "legal power." See *id.* at 490. This misconceives Hohfeld's definition. According to Hohfeld, a "power" is the "ability" to change the present rights of other people. See Hohfeld, *supra* note 178, at 45. It is a "right" over the rights of others and therefore quite consistent with the UCC's phrase "rights in the collateral." Although it is true that *D* is *obligated* to use her power for the benefit of *A*, this does not change the fact that *D* is nevertheless an owner of the thing, just as any trustee has legal title to the *corpus* of a trust.

204. 11 U.S.C. § 541(b)(1) (1994); see *Sigmon v. Royal Cake Co. (In re Cybermech, Inc.)*, 13 F.3d 818, 820 (4th Cir. 1994) (interpreting section 541(b)(1) as saying that "property of the debtor does not include assets being held by the debtor in trust for another").

205. See *supra* notes 179-88 and accompanying text.

206. See U.C.C. § 9-306(2).

207. See *id.*

That section 541(b)(1) expels all powers from the bankruptcy estate cannot, by itself, explain why a debtor's power to sell chattel paper free and clear of the buyer's perfected interest is not within the jurisdiction of the bankruptcy trustee. Section 541(b)(1) cannot be taken literally. Rather, courts must expel some powers and retain others, contrary to the plain meaning of the statute.<sup>208</sup>

The reason why section 541(b)(1) must be applied selectively pertains to a debtor's power to sell inventory free and clear of security interests.<sup>209</sup> Such a power is not distinguishable from the power to sell chattel paper free and clear. Yet if the power to sell inventory is expelled by section 541(b)(1) from the bankruptcy estate, then it becomes impossible to explain why a debtor-in-possession may run a retail business under the aegis of chapter 11. The inventory could never be sold because the power to sell free and clear is not part of the bankruptcy estate.

As to this last point, it may be objected that section 363(f)(3) permits the sale of inventory, regardless of what section 541(b)(1) says.<sup>210</sup> In other words, section 541(b)(1) may expel debtor powers to sell free and clear,<sup>211</sup> but section 363(f)(3) reestablishes the power in the bankruptcy trustee as a matter of federal law.<sup>212</sup> Section 363(f)(3) provides:

The trustee may sell property under subsection (b) or (c) of this section free and clear of any interest in such property of an entity other than the estate, only if—

. . . .

(3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property.<sup>213</sup>

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208. See, e.g., *Amdura Nat'l Distrib. Co. v. Amdura Corp.* (*In re Amdura Corp.*), 75 F.3d 1447, 1451 (10th Cir. 1996) (determining a manager of funds had the power to abuse his fiduciary position making the funds part of bankruptcy estate).

209. See U.C.C. § 9-307(1).

210. See 11 U.S.C. § 363(f)(3) (1994).

211. See *id.* § 541(b)(1).

212. See *id.* § 363(f)(3).

213. *Id.*

Unfortunately for securitization, the invocation of section 363(f)(3) to save the power to sell inventory likewise saves the power to sell free and clear of a buyer's right in chattel paper.<sup>214</sup> The two powers are not analytically distinguishable.

Few readers will have failed to note a certain tension in the thesis of this argument. First, I have relied upon the literal words of section 541(a)(1) to bring SPV chattel paper into the bankruptcy estate.<sup>215</sup> Second, I have ignored the literal words of section 541(b)(1) because such a reading would contradict the existence of the strong-arm power.<sup>216</sup> I have also ignored the literal meaning of the Bankruptcy Code by suggesting that, once illiquid collateral is brought within the estate, the trustee can actually use it under section 363(b)(1) or section 363(c)(1)—a premise not borne out by the actual words of those provisions. Hence, I both emphasize and dismiss the literal meaning of the Bankruptcy Code.<sup>217</sup>

The reader has me dead to rights here. But this simply proves my point. The Bankruptcy Code is contradictory and requires the good will of judges to make it coherent. Because of this tension, securitization depends entirely upon the good will and legislative proclivities of individual bankruptcy judges. The real point of this Article is to emphasize how securitization depends entirely on the subjective will of human beings, not on the content of the Bankruptcy Code, which inadequately theorizes the nature of the bankruptcy estate. Yet securitization little deserves any such good will.

### *B. The Right to Collect Accounts After Sale*

There is a second reason why, in a great many cases, securitization might fail to remove assets from the hypothetical jurisdiction of a bankruptcy proceeding. Most securitization is on a non-notification basis.<sup>218</sup> That is, the account debtors are never in-

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214. See *id.*

215. See *supra* notes 201-03 and accompanying text.

216. See *supra* notes 208-09 and accompanying text.

217. See *supra* notes 213-14 and accompanying text.

218. See U.C.C. §§ 9-318(3) cmt. 3, -308 cmt. 1. (1995).

structed to pay some third party assignee.<sup>219</sup> Instead, the originator serves as collecting agent.<sup>220</sup> The account debtors continue to pay the originator as if the originator were still the owner of the claim against them.<sup>221</sup> Such payments extinguish their obligations, thanks to section 9-318(3), which provides: "The account debtor is authorized to pay the assignor until the account debtor receives notification that the amount due or to become due has been assigned and that payment is to be made to the assignee."<sup>222</sup> Section 9-318(3) creates a classic power to "use" accounts or chattel paper by collecting them and thereby extinguishing them.<sup>223</sup> According to this power, the debtor may still collect accounts until the account debtor receives notice otherwise. This power would appear to be a property right of the debtor—under the Hohfeldian definition that identifies "power" as a connection with the thing.<sup>224</sup>

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219. See *id.* § 9-308 cmt. 1.

220. See *id.*

221. See *id.*

222. *Id.* § 9-318(3).

223. Some courts have found the power to collect influential in determining that a hypothecation, not a sale, of accounts has occurred. See, e.g., *Southern Rock, Inc. v. B & B Auto Supply*, 711 F.2d 683, 685 (5th Cir. 1983) (imposing obligation to perfect on a secured lender claiming general intangibles); Aicher & Fellerhoff, *supra* note 31, at 191-92. The argument presented here holds the sale-lien distinction irrelevant to determining bankruptcy jurisdiction. The argument is that the power to collect itself is always a debtor right in the thing itself.

224. See *In re Modern Settings, Inc.*, 74 B.R. 358, 360-61 (Bankr. E.D.N.Y. 1987). In *Pepper/Holt Joint Venture v. Roderick Group, Inc. (In re Hodevco, Inc.)*, 165 B.R. 855 (Bankr. M.D. Tenn. 1994), Judge George Paine said as much, though perhaps in mere dicta. In *Hodevco*, the debtor had only one asset—a promissory note. See *id.* at 857. The debtor pledged the note to a creditor in exchange for a loan but kept possession of the note itself. See *id.* The creditor therefore held an unperfected security interest in this asset. A judgment creditor of the debtor attempted to garnish the asset by serving notice of garnishment on the account debtor. See *id.* The real issue in the case was whether a judgment creditor can effectively garnish a claim against the account debtor that is embodied in a promissory note. Judge Paine held that the judgment creditor had to seize the note itself. See *id.* at 859.

In describing the debtor's property in the promissory note, Judge Paine wrote:

A holder of a note has the right to transfer or negotiate the note and the right to enforce payments on the note against its maker. The debtor thus retained the legal right to enforce payment of the note against . . . its maker. This right is a legal interest recognized by Tennessee law. Assuming the debtor retained this legal interest as holder upon filing bankruptcy, this interest became property of the estate under

When the debtor in a securitization deal files for bankruptcy, all the accounts to be collected by the debtor for the benefit of the buyer of the account are therefore property of the estate. To be sure, only the debtor's legal title enters the estate under section 541(a).<sup>225</sup> Section 541(d) reiterates the point by providing:

Property in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest, . . . becomes property of the estate . . . only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold.<sup>226</sup>

Nevertheless, section 363(a) defines cash collateral as the *whole* thing in which "the estate and an entity other than the estate have an interest."<sup>227</sup> Once collected, the debtor holds cash collateral of the buyer of the accounts. Cash collateral can be used with court permission.<sup>228</sup> According to section 363(a):

"[C]ash collateral" means cash, negotiable instruments, documents of title, securities, deposits 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 . . . 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.<sup>229</sup>

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§ 541(a)(1).

Nothing occurred prior to the debtor's bankruptcy to divest the debtor of his legal interest as holder of the note . . . . The debtor retained possession of the note and did not endorse it over to [the secured party]. [The] security interest in the note, therefore, did not divest the debtor of its legal interest as holder and payee of the note.

*Id.* at 858 (citation omitted). This remark is most inconsistent with the premises of securitization, in that the powers of the debtor as *holder* are said to decide the case. Of course, because the case involved the debtor's grant of an unperfected security interest, it followed that the security interest was voidable in the debtor's bankruptcy. But this is not the reasoning followed in the above passage.

225. *See* 11 U.S.C. § 541(a) (1994).

226. *Id.* § 541(d).

227. *Id.* § 363(a).

228. *See id.* § 363(c)(1).

229. *Id.* § 363(a).



Notice that this definition of cash collateral merely *includes* proceeds of a security interest. It does not therefore exclude proceeds of an account that a buyer owns outright.

Now section 363(a) requires the bankrupt estate *and* some other entity to have an interest in the same cash.<sup>230</sup> What kind of interest does the ultimate borrower, as collection agent, share with the buyer of the account?

It probably must be admitted that the collection agent is the trustee of an express or perhaps a constructive trust. Under either theory, the debtor, as collecting agent, has a legal interest, and the remote subsidiary buyer has the beneficial interest. It is widely assumed that these funds—the res of a trust—are not part of the bankrupt estate under section 541(a).<sup>231</sup> The usual basis for this claim is section 541(d).<sup>232</sup> But that provision does not actually exclude the funds *entirely* from the bankrupt estate. Rather, it only excludes the beneficial interest.<sup>233</sup> As a result, “the estate and an entity other than the estate have an interest”<sup>234</sup> in the cash, and therefore it can be used under section 363(c). Because it can be used, the trustee can have a turnover under section 542(a). As always, the trustee will have to provide adequate protection to the buyer of the accounts, but, on the theory just presented, the buyer has not rendered itself bankruptcy remote, and this particular premise of securitization is therefore defeated.

The foregoing remarks concerned cash in the hands of the collecting agent at the time of bankruptcy. What of the outstanding accounts not yet paid? When the debtor files for bankruptcy, does the debtor continue to have the power to collect these accounts?

The premise of the above discussion is that the debtor had power to collect accounts, and that this “power”—emanating from section 9-318(3)—is a property interest in the accounts

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230. *See id.*

231. *See In re Braniff Int'l Airlines, Inc.*, 164 B.R. 820, 825 (Bankr. E.D.N.Y. 1994).

232. *See, e.g., id.*

233. *See id.*; 11 U.S.C. § 541(d).

234. 11 U.S.C. § 363(a).

themselves.<sup>235</sup> This is a conclusion the Supreme Court has reached in *United States v. National Bank*.<sup>236</sup> In that case, the IRS levied a joint bank account shared by a taxpayer and two nontaxpayers.<sup>237</sup> The IRS had a lien on all the taxpayer's property and proceeded to levy the joint account.<sup>238</sup> The bank refused to pay on the ground that others owned the account in conjunction with the taxpayer.<sup>239</sup> The bank could not discern what ownership right the taxpayer had in the joint account and so it refused to pay anything.<sup>240</sup> Justice Blackmun, of *Whiting Pools* fame, ruled that the bank had to pay because the taxpayer's right to withdraw funds, i.e., collect an account, "qualifies as a right to property for purposes of [the tax lien statute]."<sup>241</sup> To be sure, the nontaxpayers could retrieve their property from the government later.<sup>242</sup> In the meantime, the bank had to pay the government, and the government could control the proceeds of nontaxpayers.<sup>243</sup> As the power to withdraw funds from a bank account or another is precisely identical to the power to collect the account of another, "property of the debtor" has been established in the bare collection right.<sup>244</sup>

If this is correct, then any interference with this power is a violation of bankruptcy's automatic stay.<sup>245</sup> Furthermore, in chapter 11, a trustee may use this power "in the ordinary course

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235. See *supra* notes 223-24 and accompanying text.

236. 472 U.S. 713, 722-26 (1985).

237. See *id.* at 716.

238. See *id.*

239. See *id.*

240. See *id.*

241. *Id.* at 725. As Justice Lewis Powell complained in dissent, Justice Blackmun's reasoning applies even if the taxpayer had a zero beneficial interest in the bank account. See *id.* at 735 (Powell, J., dissenting). According to one commentator, "in the view of the majority, that right to withdraw, without any ensuing legal possessory interest, is a sufficient 'string' on the property or 'stick' from the bundle of rights to authorize attachment of the tax lien." Steve R. Johnson, *Fog, Fairness, and the Federal Fisc: Tenancy-by-the-Entireties Interests and the Federal Tax Lien*, 60 MO. L. REV. 839, 874 (1995).

242. See *National Bank*, 472 U.S. at 731.

243. See *id.* at 730-33 (holding that the IRS had the power to levy the joint account).

244. The *National Bank* analysis is used to determine what is property of the bankruptcy estate for purposes of section 541(a)(1). See *In re Guardian Realty Group, L.L.C.*, 205 B.R. 1, 4 (Bankr. D.D.C. 1997).

245. See 11 U.S.C. § 362(a)(3) (1994) (barring "any act to . . . exercise control over property of the estate").

of business" without court authorization.<sup>246</sup> This power therefore suggests that, whenever securitization forgoes notification of the account debtor, the debtor retains a power to collect. This power to collect is clearly a property right in the account itself.<sup>247</sup> The right to collect was an incident of ownership prior to the sale of the account, and after the sale, the right to collect is retained by the debtor; only the remainder was transferred.<sup>248</sup>

Another consideration is that the originator is a collector by virtue of an executory contract. If the bankruptcy trustee assumes this contract, then all past defaults must be cured "promptly."<sup>249</sup> Such a requirement suggests that the originator must turn over collected proceeds precisely when the contract requires that they be turned over. Such an observation cannot help securitization, however. The contract can also be rejected.<sup>250</sup> If so, the moneys withheld and the forward-looking power to collect are still property of the estate that, *ex hypothesi*, a trustee can "use." Furthermore, pending assumption or rejection, the automatic stay prevents any attempt to obtain these property rights.<sup>251</sup> Hence, the status of the collection right as an executory contract provides no solace.

### C. *The Contingent Nature of Article 9 Perfection*

A third property interest in sold accounts or chattel paper can be identified. Unlike the first two, which rely on debtor powers over the accounts or chattel paper, this one relies on the trustee's own status as a judicial lien creditor under federal law and under Article 9.<sup>252</sup> According to Article 9, perfection of a sale of accounts or chattel paper is only provisional.<sup>253</sup> Because this is so, the trustee always retains a future interest in the sold accounts.<sup>254</sup> A future interest is enough for a court to take ju-

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246. *Id.* § 363(c)(1).

247. *See In re Modern Settings, Inc.*, 74 B.R. 358, 360-61 (Bankr. E.D.N.Y. 1987).

248. *See id.*

249. 11 U.S.C. § 365(b)(1).

250. *See id.* § 365(a).

251. *See id.* § 362(a)(3).

252. *See* U.C.C. § 9-301(3) (1995).

253. *See generally id.* § 9-403(2) (describing how the effectiveness of a filed financing statement lapses after five years).

254. *See generally id.* § 9-301(3)-(4) (describing the trustee in bankruptcy as a "lien

risdiction over the present interest.<sup>255</sup>

When a SPV buys accounts and chattel paper, it carefully files a proper financing statement, so that its "security interest"—as the UCC calls it<sup>256</sup>—is perfected.<sup>257</sup> Securitization presumes that this terminates the power of the debtor or her creditors to convey superior title to third parties.<sup>258</sup> With the demise of this power, the debtor is supposed to lose all in rem contact with the thing, and the sold account has forever escaped from bankruptcy jurisdiction. In Hohfeldian terms, the debtor or her creditors supposedly are "disabled" from transferring the account free and clear.

This premise, however, can be effectively attacked. When the security interest is perfected, the debtor's connection with the thing does not end. Rather, perfection under the UCC is merely provisional.<sup>259</sup> The debtor's power to convey free and clear of the account buyer's interest never disappears but simply goes to sleep and dreams of playing at nine-pins—for a period of five years.<sup>260</sup> According to section 9-403(2), "The effectiveness of a filed financing statement lapses on the expiration of the five year period unless a continuation statement is filed prior to the lapse."<sup>261</sup> After a secured party perfects an assignment of accounts, the debtor might still have the power to convey free and clear if the secured party forgets to file a continuation statement near the end of the five-year period.<sup>262</sup> This *future* power is implicit in the nature of the thing, and it proves that Article 9 coverage of accounts and chattel paper sales guarantees that bankruptcy jurisdiction always exists.

Chattel paper may be perfected by possession.<sup>263</sup> But this does not change the analysis. Perfection lasts only so long as

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creditor" who has a contingent interest in secured property).

255. See generally 11 U.S.C. § 105(a) (1994) (defining the power of the court); *id.* § 362 (detailing the automatic stay that goes into effect from the date of filing a petition for bankruptcy).

256. See U.C.C. § 1-201(37).

257. See *id.* § 9-302(1), -304(1).

258. See Coenen, *supra* note 179, at 1076-80.

259. See U.C.C. § 9-403(2).

260. See *id.*

261. *Id.*

262. See *id.* § 9-403(3).

263. See *id.* § 9-305.

possession is perpetuated.<sup>264</sup> Being provisional, the debtor retains a future power to convey free and clear of the buyer should perfection ever lapse.

The trustee's judicial lien attaches to the future contingent interest in these accounts, and so a trustee might presently sell a future interest to some buyer.<sup>265</sup> Such a buyer could only succeed to the rights of the trustee as lien creditor. The SPV with a financing statement on record would continue to have senior rights. But eventually the bankruptcy proceeding might end, and the SPV might fail to file a continuation statement. Under these circumstances, the second buyer, who succeeds to the trustee's rights, would gain a promotion. The second buyer would then be entitled to collect the accounts or the chattel paper obligation.

Undoubtedly, such a scenario is fantastic. What sensible buyer would pay good cash for such a right? Such a question, however, misses the point of the exercise. The premise of the Bankruptcy Code, as interpreted by *Whiting Pools*, is that any debtor property interest, or property interest of the bankruptcy trustee, no matter how hypothetical, is enough to ground bankruptcy jurisdiction.<sup>266</sup> The existence of an extremely contingent future interest may be valueless in the market place, but it still constitutes a property right in the sold account or sold chattel paper.

Interestingly, Professor Thomas Plank chastises Article 9 for requiring buyers to file continuation statements:

For a sale, however, filing is necessary to perfect the valid transfer of the account, to establish the record of the chain of title so to speak. If A sells to B and then B sells to C, none of the parties intend that the interest transferred be extinguished or that it become subordinate to subsequent creditors. The filing should remain in effect as long as the account exists. Section 9-403 does not recognize this difference. Instead, for C to maintain the perfection of its ownership interest in the account, the validity of the public record of its chain of title, C must do two things. First, she must file a

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264. See *id.*

265. See, e.g., *id.* § 2-403 cmt. 1 (describing the basic policy of law as allowing transfer of such title as the transferor has).

266. See *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 207-09 (1983); *supra* notes 145-46 and accompanying text.

continuation statement for the transfer to her. Second, she must get B to file a continuation statement to continue the perfection of the transfer from A. B has sold the account and normally has no interest in doing so. For C to file a continuation statement for the transfer from A to B, C must file a separate written assignment of the first financing statement. . . . Consequently, for C to have and maintain her ownership interest in the account, she must file not only her financing statement, commonly called a UCC-1, she must also file an assignment of the financing statement in favor of B, called a UCC-3. This double filing requirement is not necessary and should be eliminated.<sup>267</sup>

Professor Plank also acknowledges that the contingent nature of perfection constitutes an "inadvertent" interest in a sold account<sup>268</sup>—as if the inadvertence of the Article 9 drafters defeats the foundations of federal bankruptcy jurisdiction. Thus, Plank goes on to suggest that founding bankruptcy jurisdiction on such a property interest is "absurd."<sup>269</sup> Absurd it may be, but remember the fantastic grounds of *Whiting Pools*, in which bankruptcy jurisdiction was founded on the mere hypothetical chance of a surplus or the requirement that the IRS send notice to the taxpayer of any levy.<sup>270</sup> So long as the debtor has an in rem relation to the thing, no matter how tenuous or valueless, the bankruptcy trustee may insist that the property be turned over.<sup>271</sup>

So long as the formalist holding of *Whiting Pools* applies, Article 9 fails to provide for total alienation when a debtor sells accounts or chattel paper, even when the buyer promptly perfects.

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267. Plank, *supra* note 18, at 487-88.

268. *See id.* at 460.

269. *See id.* at 460-61 n.280. Plank reported that Article 9 inadvertently gives sellers of accounts and chattel paper some rights in the collateral sold. *See id.* Buyers, i.e., secured parties, must therefore take reasonable care of chattel paper in their possession. *See* U.C.C. § 9-207(1). Buyers must verify the amount of the secured claim upon the debtor's request. *See id.* § 9-208. The buyer must file a termination statement at the seller's request. *See id.* § 9-404(1). All of these duties are nonsensical; they are simply the result of defining secured parties to include buyers of accounts and chattel paper. *See* Plank, *supra* note 18, at 488-94.

270. *See Whiting Pools*, 462 U.S. at 201 n.4, 210-11.

271. *See id.* at 211.

#### *D. The Bankruptcy Code's Policy*

Thus far, we have seen that the Bankruptcy Code itself permits the trustee to use any liquid property in which the debtor has *any* property interest, no matter how remote. It does not seem to permit the use of *any* illiquid property. This is the result if we read the Bankruptcy Code word for word, "with the ease of a computer."<sup>272</sup>

This reading contradicts the *practice* of bankruptcy law over the past two decades. It is therefore apparent that the practice of law assumes that the Bankruptcy Code does not alone supply the governance of the bankruptcy estate. Instead, bankruptcy courts must make policy. They must legislate as a supplement to, and sometimes even in derogation of, the actual words of the Bankruptcy Code. But what should this policy be?

One thing should be apparent: just because Wall Street has invested its countless billions in securitization does not prove that this investment should be supported by the Bankruptcy Code. The securitization industry moved into this business in the face of an inadequate legal regime and may not now insist that judges legislate in their favor simply because the financial consequences to themselves are supposedly great.

Presumably not everything that is, is right.<sup>273</sup> A large institution that has grown up around tax avoidance elicits little sympathy when its legitimacy is called into question. Rather, some universal principle more noble than tax avoidance should be identified to uphold or condemn the practice. If universal principles exist, then securitization may continue its lucrative business. If not, then let the massy wheel of securitization fall, and let each petty consequence and small annexment attend the boisterous ruin.

There are powerful reasons for bankruptcy courts to take jurisdiction over sold accounts and chattel paper when the opportunity arises. Let us assume for the sake of argument that the question before us is one of taxation.<sup>274</sup> Under the inherent

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272. *Bank of Marin v. England*, 385 U.S. 99, 103 (1966).

273. *But see* Alexander Pope, *An Essay on Man*, in *THE NORTON ANTHOLOGY OF ENGLISH LITERATURE 1720, 1727* (M.H. Abrams ed., W.W. Norton & Co. 1968) (1733).

274. *See supra* pp. 1064-65 (discussing the Bankruptcy Tax on secured creditors).

principle of the legislative history, but not the statute, secured creditors should pay the Bankruptcy Tax, and beneficiaries of trust property should not.<sup>275</sup> The issue is whether securitization is more like secured credit or more like beneficial interests in fiduciary property. In short, the question can only be answered by quantifying similarity and difference into the comfortable intuition of "more or less."

The securitization industry, eminently aware of the above distinction, specifically designed its product to fall on the nontaxation side of the line.<sup>276</sup> This was done with the full consent of debtors, who enjoyed lower interest rates because they were "financed" by the securitization industry's expectation of tax avoidance.

The first thing to note is that Congress is hostile to contractual devices designed solely to avoid bankruptcy jurisdiction and the Bankruptcy Tax it implies.<sup>277</sup> The Bankruptcy Code prohibits any condition subsequent on property that is tied to a debtor's insolvency.<sup>278</sup> Antialienation clauses are struck down because such clauses deprive the bankruptcy trustee of the opportunity to sell a debtor's asset for a profit.<sup>279</sup> And finally, Congress has decided that debtors may not waive their bankruptcy rights.<sup>280</sup>

Securitization attempts to contract around the trustee's right to a bankruptcy turnover, when such rights are supposed to be unwaivable by a prepetition debtor. Why should clients of the securitization industry have a special privilege to waive their bankruptcy rights when ordinary debtors must bear the overweening paternalism of bankruptcy law? Securitization may demand freedom of contract for its clients, but this demand must be made to Congress, not to individual bankruptcy courts who are not supposed to legislate in competition with Congress. If

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275. See *Whiting Pools*, 462 U.S. at 204 n.8.

276. See generally William R. Giusti, *Asset Securitization*, in *ASSET-BASED FINANCING INCLUDING SECURITIZATION AND ACQUISITION FINANCING* 1994, at 335, 350-55 (PLI Commercial L. and Practice Course Handbook Series No. A4-4447, 1994) (discussing the use of tax exempt trusts for SPVs).

277. See generally 11 U.S.C. § 1129(d) (1994) (providing that a court may refuse a proposed chapter 11 plan if the principle purpose of the plan is avoidance of taxes).

278. See *id.* § 541(c)(1).

279. See *id.* § 365(e)(1).

280. See *id.* § 522(e).



Congress deems Fortune 500 companies incompetent to waive their bankruptcy rights, then bankruptcy courts are obliged to follow this legislative choice.

The intent of the parties to place securitization on the tax avoidance side of the line cannot carry weight unless securitization *essentially* belongs there. Yet, the UCC itself, by legislating in the area of sales of accounts and chattel paper, indicated that sales belong on the secured credit side of the line.<sup>281</sup> Comment 2 to UCC Section 9-102, as it was drafted initially, strongly indicates that Article 9 is unconcerned with whether a sale or a lien was created, when it comes to accounts or chattel paper.<sup>282</sup> According to this comment:

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. . . . The buyer then is treated as a secured party, and his interest as a security interest.<sup>283</sup>

The UCC's comments indicate that regardless of whether a sale or a security interest was intended, the transfer should be treated alike.<sup>284</sup>

To be sure, the UCC was drafted when the Bankruptcy Tax on secured credit in bankruptcy was much less severe than it is now.<sup>285</sup> In the 1950s, when the above language was written, undersecured creditors were entitled to postpetition interest.<sup>286</sup>

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281. See U.C.C. § 9-102(1)(b) (1995). Article 9 of the UCC is, in fact, titled "Secured Transactions; Sales of Accounts and Chattel Paper."

282. See *id.* § 9-102 cmt. 2.

283. *Id.*

284. See *id.*

285. See *supra* note 73 and accompanying text (discussing the limited bankruptcy jurisdiction over the interest of secured creditors under the Bankruptcy Act of 1898).

286. Aphorisms to the contrary abound, because of Justice Oliver Wendell Holmes's remarks in *Sexton v. Dreyfus*, 219 U.S. 339, 344 (1911). In practice, however, any secured party could cause collateral to be expelled from bankruptcy jurisdiction whenever the secured party was not obtaining interest compensation. See Carlson, *supra* note 73, at 593-95. The Bankruptcy Code, however, apparently reversed this

Because the Bankruptcy Tax was light or nonexistent, the UCC was insouciant. Congress, however, has now increased the Bankruptcy Tax.<sup>287</sup> It would be unseemly for Article 9 to change its meaning just so that debtors and secured parties can avoid taxes. The Bankruptcy Tax has been imposed on secured creditors, and therefore on debtors, on behalf of the unsecured creditors and on behalf of debtors who would like to rehabilitate themselves. Article 9 should not change its meaning, depending on the economic self-interest of only *some* of the parties concerned with the impact of Article 9.

In light of the *Octagon Gas* opinion,<sup>288</sup> the original intent of the drafters to erase the line between sales and secured transactions has now been renounced by the Permanent Editorial Board in an unsatisfactory "commentary."<sup>289</sup> According to this commentary, the *Octagon Gas* court is guilty of rendering accounts inalienable.<sup>290</sup> Thus:

It is a fundamental principle of law that an owner of property may transfer ownership to another person. Were a statute intended to take away that right, it would do so explicitly and such a significant curtailment of rights would be supported by substantial reason. No such reason is expressed or implied in the Code or the Official Comments.<sup>291</sup>

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assumption, or so the Supreme Court assumed in *United Saving Ass'n v. Timbers of Inwood Forest Ass'ns, Ltd.*, 484 U.S. 365, 370-80 (1988). For a fuller account of this story, see Carlson, *supra* note 73, at 601-10.

287. See *supra* notes 66-68 and accompanying text.

288. *Octagon Gas Sys., Inc. v. Rimmer (In re Meridian Reserve, Inc.)*, 995 F.2d 948 (10th Cir. 1993).

289. See P.E.B. COMMENTARY, *supra* note 35.

290. See *id.*

291. *Id.* On the basis of this commentary, the Permanent Editorial Board added the following new language to comment 2 to section 9-102:

Neither Section 9-102 nor any other provision of Article 9 is intended to prevent the transfer of ownership of accounts or chattel paper. The determination of whether a particular transfer of accounts or chattel paper constitutes a sale or a transfer for security purposes (such as in connection with a loan) is not governed by Article 9. Article 9 applies both to sales of accounts or chattel paper and loans secured by accounts or chattel paper primarily to incorporate Article 9's perfection rules.

U.C.C. § 9-102 cmt. 2 (1995).

This comment is unsatisfactory because it substitutes clumsy word play and Cartesian anxiety for real analysis. The above commentary assumes that *either* the buyer *or* the seller "owns" the property.<sup>292</sup> It assumes that the two cannot *simultaneously* be the owner.

Property ownership cannot be conceived as an all-or-nothing proposition. Twentieth-century lawyers would never say that either a person owns the whole of a thing or otherwise nothing at all. Rather, property is a continuum.<sup>293</sup> A person may transfer some of her rights to a thing without severing all relations to the thing.<sup>294</sup> This, I think, is what is meant when lawyers refer to property as a "bundle of sticks."<sup>295</sup> A "transfer" of property implicates the voluntary or involuntary passage of some of these sticks from the transferor to the transferee.<sup>296</sup> Whether all or merely some of the sticks are transferred can only be answered by reference to the law of sales, which, in our case, is supplied by Article 9.

One of the sticks in the *fascies* is the transferor's right to make transfers.<sup>297</sup> Another is the right to "use" the account or chattel paper by collecting the account.<sup>298</sup> The very program of Article 9 is to *prevent* transferors from transferring all the sticks in the

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292. See P.E.B. COMMENTARY, *supra* note 35.

293. See *Dickman v. Commissioner*, 465 U.S. 330, 336 (1984) ("Property" is more than just the physical thing—the land, the bricks, the mortar—it is also the sum of all the rights and powers incident to ownership of the physical thing. It is the tangible and the intangible. Property is composed of constituent elements. . . .") (quoting *Passailaigue v. United States*, 224 F. Supp. 682, 686 (M.D. Ga. 1963)).

294. See *generally* U.C.C. § 2-403(1) (describing how a purchaser of a limited interest acquires rights only to the extent of the interest purchased).

295. Benjamin Cardozo was one of the first lawyers to use this metaphor. See BENJAMIN N. CARDOZO, *THE PARADOX OF LEGAL SCIENCE* 129 (1927) ("The bundle of power and privileges to which we give the name of ownership is not constant through the ages. The faggots must be put together and rebound from time to time.").

296. See U.C.C. § 2-403(1).

297. See *id.* § 9-311.

298. See *generally id.* § 9-106 (defining an "account" as any right to payment for goods sold or for services rendered that is not evidenced by an instrument or chattel paper). Frequently, a security interest will be created by the creditor in all debtor's accounts, existing and after acquired. The debtor may maintain a steady cash flow by collecting on the accounts, and the secured party continues to be secured by the after acquired accounts.

bundle.<sup>299</sup> A debtor under Article 9 cannot give up her powers to make transfers, regardless of her intent. Rather, Article 9 makes certain ownership rights inalienable.<sup>300</sup> It does so with the specific intention of providing an incentive for the transferee to take the perfecting steps.<sup>301</sup> Without reserving in the debtor the right to convey superior title to purchasers of lien creditors, the entire Article 9 perfection regime would collapse.<sup>302</sup> It is simply false that “[i]t is a fundamental principle of law that an owner of property may transfer ownership to another person.”<sup>303</sup> The “fundamental principle” is quite the opposite. Whenever the law subjects property to a perfection scheme or when legal and equitable title are divided, the law disables alienation of *all* the property.<sup>304</sup> Indeed, it is rare that a transferor is unilaterally capable of conveying all the sticks in the bundle in one act of manifested intent.<sup>305</sup> In the United States, no real or personal property can be conveyed in this way. Almost always some act of recordation or delivery of the transferred thing is required to “perfect” the transaction.<sup>306</sup> Virtually any property subject to “equity” jurisprudence empowers the legal owner to convey good title free and clear of the rights of the *cestui que trust*, but only to bona fide purchasers. Even Article 2 empowers sellers to resell sold items, in many cases.<sup>307</sup> Hence, the power to alienate *absolutely* is precisely what Article 9—and commercial law generally—prevents.

The above quoted “commentary” accuses Judge Baldock, in *Octagon Gas*, of suggesting that the “sale” of an account is an

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299. See generally *id.* § 9-403(2) (describing how a filed financing statement automatically lapses after a five-year period, unperfecting the interest of the secured party, recreating by implication ownership rights in the debtor or the debtor's transferee).

300. See *id.*

301. See *id.*

302. See *id.*

303. P.E.B. COMMENTARY, *supra* note 35.

304. See U.C.C. § 9-403(2).

305. See *id.* But cf. *id.* § 9-305 (describing how a secured party may perfect his interest in chattel paper by taking possession of it).

306. See § 9-403(2). But cf. *id.* § 9-305 (perfecting a security interest with possession).

307. See § 2-403(1)(2) (voidable title and entrustment).

impossibility.<sup>308</sup> "Sale" in this sense is supposed to mean the absolute and final transfer of the very last stick in the bundle. Of course it is Article 9 that interferes with this notion, not Judge Baldock. The most that can be said of Article 9, as it was promulgated thirty years ago, is that the debtor's power to alienate cannot itself be permanently alienated. Before the transferor perfects, the debtor has substantial power to alienate and to "use" the account.<sup>309</sup> After the transferor perfects, the debtor's power of alienation is reduced. By no means does this power disappear. It is one of our "inalienable rights."

The drafters of Article 9 decided to tax secured creditors—and debtors—by imposing the costly step of perfection upon them.<sup>310</sup> Recently, Congress has further taxed secured creditors by forcing them to contribute to debtor rehabilitation.<sup>311</sup> The current Permanent Editorial Board opposes the Bankruptcy Tax. But it is for Congress, not the Permanent Editorial Board, to decide who shall pay the Bankruptcy Tax and who shall not. For this reason, the Permanent Editorial Board's officious advice to the bankruptcy courts regarding their own jurisdiction should be politely but firmly declined.

To summarize, Congress has decided that secured creditors should contribute collateral to debtors in order to help rehabilitate them. Securitization wishes to avoid the Bankruptcy Tax by characterizing the transfer of general intangible property as a "sale" rather than as a "security interest." The policy of the UCC in a tax-free era was that the distinction between sales and security interests in accounts and chattel paper was insubstantial.<sup>312</sup> This policy should still hold true now that Congress has raised taxes. Although many today view the Bankruptcy Tax to be socially undesirable, it is the tax imposed by Congress.<sup>313</sup> It is up to Congress—not to private parties, judg-

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308. See P.E.B. COMMENTARY, *supra* note 35.

309. See, e.g., U.C.C. § 9-304(1) (describing the protection afforded a buyer in the ordinary course of business from a security interest created by his seller).

310. See *id.* §§ 9-302, -304(1), -305, -306(3).

311. See *supra* notes 67-68 and accompanying text (describing the Bankruptcy Tax on secured creditors).

312. See U.C.C. § 9-102(1)(b) cmt. 2.

313. See *supra* notes 67-68 and accompanying text.

es, or even the admittedly august Permanent Editorial Board of the UCC—to change this federal tax structure.

## VI. OCTAGON GAS

The proposition that upsets the securitization industry is that a debtor who sells an account retains some sort of property interest in it, which justifies bankruptcy jurisdiction over the account. Judge Bobby Baldock, in *Octagon Gas Systems, Inc. v. Rimmer (In re Meridian Reserve, Inc.)*,<sup>314</sup> made such a statement<sup>315</sup> and, accordingly, sent off national shock waves that registered in the higher octaves of the Richter scale. We have seen that his dictum is quite justifiable, however. Because debtors have a contingent power to convey the assigned accounts a second time free and clear of the first buyer's rights, once the buyer's financing statement has lapsed, the debtor always has a connection to the thing in question.<sup>316</sup> This and like connections mean that the account is not fully alienated yet. Bankruptcy jurisdiction still exists. The debtor's property right is, of course, valueless and ephemeral, but quite enough to sustain the prodigal weight of bankruptcy jurisdiction. This is the lesson of *Whiting Pools*, in its fantastic mode, rather than the prudential mode of the footnoted dicta.

*Octagon Gas* matters only for its controversial dictum, but, for the record, it can also be shown that the case was decided rightly on its facts. In *Octagon Gas*, Judge Baldock remanded to the bankruptcy court to determine whether a sale of the debtor's assets in a chapter 11 plan was free and clear of a cotenancy in "proceeds" of natural gas claimed by a buyer of that cotenancy.<sup>317</sup> This holding was perfectly correct.

In *Octagon Gas*, the debtor ran a gas-gathering business.<sup>318</sup> Essentially, the debtor bought gas from wells at wholesale and resold at retail.<sup>319</sup> In 1976, a shareholder of the debtor bought

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314. 995 F.2d 948 (10th Cir. 1993).

315. See *id.* at 956.

316. See U.C.C. §§ 9-403(2), -312(5).

317. See *Octagon Gas*, 995 F.2d at 958.

318. See *id.*

319. As Judge Baldock put it, the debtor's system "included all gas purchase and

all other outstanding shares.<sup>320</sup> In exchange, the buying shareholder granted to the selling shareholders an "overriding royalty interest" in the gross proceeds received by the shareholder from gas sold by the debtor.<sup>321</sup> Now this was a peculiar transaction.<sup>322</sup> The shareholder of the debtor had no direct interest in the proceeds of the gas sold.<sup>323</sup> Therefore, Judge Baldock observed that the phrase "royalty" was a misnomer.<sup>324</sup> The shareholder was entitled to whatever dividends the board of directors might vote in its discretion.<sup>325</sup> The shareholder, apparently, was selling a participation in dividends received by the shareholder from the debtor.<sup>326</sup> If so, the selling shareholders were not receiving an interest in the surviving shareholder's shares, but in the cash such shares generated.<sup>327</sup> It is common for *lenders* to take a pledge of stock, thereby entitling them to any dividends that the shares might engender.<sup>328</sup> But it is uncom-

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sales contracts pursuant to which the System buys and sell gas and all accounts receivable from the sale of gas or gas liquids by the System." *Id.* at 952 n.1; see also *id.* at 959 (Seth, J., dissenting) (describing the transaction in similar terms).

320. See *id.* at 959 (Seth, J., dissenting)

321. See *id.* at 952.

322. Cf. *Crockett v. McKenzie*, 867 P.2d 463, 467 (Okla. 1994) ("An 'overriding royalty' generally arises through contracts between the lessee and a third person. It is a fractional interest in the gross production of oil and gas under a lease in addition to the royalty reserved to the land owner or lessor.").

323. See *Octagon Gas*, 995 F.2d at 953.

324. See *id.* at 953 n.3.

325. See *id.* at 953-54.

326. Judge Baldock also found this agreement peculiar:

The language of the 1976 Agreement is ambiguous. For example, the Agreement specifies that the interests created in favor of the selling shareholders are interests in the proceeds *received by [the shareholder]* through the [debtor's] System. However, [the shareholder] itself received, under the 1976 Agreement, one of these interests in the amount of ten percent. In other words, to give this phrase its literal effect, we would have to conclude that [the shareholder] made an agreement to pay itself.

*Id.* at 953 n.4.

327. See *In re Mintz*, 192 B.R. 313, 317 (Bankr. D. Mass. 1996) (holding that a right to distribution from arguable Article 8 securities is not an interest in the securities themselves, but rather a general intangible).

328. Oddly, Judge Wade Brorby, Judge Baldock's colleague on the Tenth Circuit, implied that, if pledgees of stock obtain the right to dividends, they must do so in a transaction separate from the one creating an interest in the underlying stock. See *FDIC v. Hastie (In re Hastie)*, 2 F.3d 1042, 1047 (10th Cir. 1993). Judge Brorby ruled that cash dividends are not "proceeds" of pledged stock because dividends do

mon for *buyers* to buy the right to dividends separate from the shares themselves.

So characterized, this sale was not an Article 9 transaction. The buyer purchased a cotenancy in a *general intangible*,<sup>329</sup> not in accounts or chattel paper. Article 9 applies to the sale of accounts and chattel paper, but it does not apply to the sale of general intangibles.<sup>330</sup> In addition, to the extent the buyers bought a general intangible from a *shareholder*, the buyers had no status in the debtor's bankruptcy.<sup>331</sup> They certainly bought no "accounts" from the debtor.<sup>332</sup>

These defects were mitigated when the debtor corporation later assumed the shareholder's contractual obligation and made itself liable to pay a share of the proceeds directly to the selling shareholders.<sup>333</sup> This assumption of liability arguably referred to the promise to pay any discretionary dividends to the selling shareholders, not an obligation to pay proceeds from the sale of natural gas.<sup>334</sup> The successor to the selling shareholders, Rimmer, was able to convince the court, however, that the parties intended to create a "royalty interest" in gas proceeds, not a royalty interest in corporate dividends that the debtor might choose to vote to its shareholders.<sup>335</sup>

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not come from "disposition" of the shares, within the meaning of section 9-306(1). *See id.* at 1045-46. Instead, cash dividends must be general intangibles, not necessarily transferred along with the stock unless a pledge agreement says so. *See id.* at 1046. In any case, it is still true that those lenders who wish to be secured with cash dividends usually take the underlying stock as well.

329. *See* U.C.C. § 9-106 (1995).

330. *See id.* § 9-102(1).

331. *See* *Octagon Gas*, 995 F.2d at 954-56.

332. Judge Oliver Seth, in dissent, was much more willing to find that the agreement of the buying shareholder bound the debtor to give over a percentage of the debtor's proceeds from the sale of gas to the selling shareholders. *See id.* at 959 (Seth, J., dissenting).

333. Actually, the corporate debtor never agreed to assume liability. Only the shareholders did. Nevertheless, Judge Baldock ruled that the agreement between the shareholders was intended to bind the debtor—not a party to the contract. *See id.* at 953. A and B cannot usually agree that C should be liable, but, under Oklahoma law, "[c]ontracts involving all of a corporation's shareholders are binding on the corporation." *Id.* In addition, the debtor ratified the contract later through its performance of its terms. *See id.*

334. *See id.* at 953.

335. *See id.*



The corporate debtor also sold a separate "overriding royalty interest"<sup>336</sup> in proceeds of gas directly to a buyer, who resold to Rimmer.<sup>337</sup> Rimmer therefore held rights through a shareholder, obligations later assumed by the debtor, and rights directly from the debtor.<sup>338</sup> Together, Rimmer was entitled to five per cent of all cash proceeds from natural gas and liquids sold by the debtor.<sup>339</sup>

These rights coming directly from the debtor are also replete with ambiguity. Was Rimmer buying the gas directly, or merely proceeds from the gas? According to Judge Baldock, the buyer had no right to the gas at all: "As a threshold matter, we agree with the bankruptcy court that the use of the term 'overriding royalty interest' in the underlying transaction is technically incorrect for *lack of an oil and gas leasehold estate*. Nevertheless, the transactions created an enforceable interest in the [debtor] System's gas sale proceeds."<sup>340</sup> A sale of an interest in proceeds of gas, with no right to the gas itself,<sup>341</sup> is not necessarily a sale of accounts. Accounts are "any right to payment for goods sold or leased or for services rendered which is not evidenced by an instrument or chattel paper, whether or not it has been earned by performance."<sup>342</sup> Proceeds of natural gas might include all sorts of property, including cash, checks, and accounts receivable.<sup>343</sup> Nevertheless, it appears that the debtor arranged to sell natural gas through long term executory contracts with utilities.<sup>344</sup> Hence, it is likely that all proceeds of the natural gas were initially accounts and, later, some sort of cash equivalent, as the utilities paid their obligations under these contracts.

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336. *Id.* at 952.

337. *See id.*

338. *See id.*

339. *See id.*

340. *Id.* at 953 n.3 (citation omitted).

341. The sale of royalties is routine, however, when the gas is still in the ground. Here, however, the gas is purely personal property, bought by the debtor after severance from the earth. *See id.* at 954.

342. U.C.C. § 9-106 (1995).

343. *See generally id.* § 9-306(1) (defining "proceeds" as embodying any payment).

344. *See generally Octagon Gas*, 995 F.2d at 952 (describing the debtor's reorganization plan).

A sale of an executory contract is the sale of an account<sup>345</sup>—an Article 9 transaction.<sup>346</sup>

The sale of proceeds, but not of the underlying goods, may implicate the sale of after-acquired property.<sup>347</sup> Does the UCC even authorize such a transaction? This is very doubtful indeed.<sup>348</sup> A sale of proceeds implies that after-acquired property clauses might be applied to outright purchases of accounts, chattel paper, and, indeed, any property that might constitute proceeds.<sup>349</sup>

To be sure, after-acquired property clauses are routine in security agreements pertaining to accounts receivable—but only where the accounts are collateral for a *loan*. Although Article 9 applies to the outright sale of accounts,<sup>350</sup> it is not clear that Article 9 sanctions an after-acquired property right in the context of purchases. According to UCC section 9-204(1): “a security agreement may provide that any or all obligations covered by the security agreement are to be secured by after-acquired collateral.”<sup>351</sup> This authorization of after-acquired property clauses contemplates an *obligation* secured by *collateral*.<sup>352</sup> Of course, the collateral in question—accounts—are obligations of the account debtors. But *these* obligations are not the obligations referenced in section 9-204(1). These obligations are in fact *the collateral*. The obligations referenced in section 9-204(1) can only be the debtor’s obligations to the secured party, not the account debtor’s obligations to the debtor. Yet no such obligation existed in *Octagon Gas*. That is to say, Article 9 does not expressly authorize after-acquired property clauses when accounts are *sold*. Rather, it authorizes after-acquired property clauses only when a lender advances

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345. See U.C.C. § 9-106.

346. See *id.* § 9-102(1)(b).

347. See generally *id.* §§ 9-204, -306 (discussing after-acquired property and proceeds).

348. See generally *id.* §§ 9-204, -306 (lacking concrete guidance on whether after-acquired property is involved in the sale of proceeds).

349. See *id.* § 9-306. Oil and gas law certainly recognizes the sale of proceeds—these are royalties and are conceived as real estate interests. But here the natural gas was personalty because it was already extracted, as Judge Baldock recognized. See *Octagon Gas*, 995 F.2d at 954-55.

350. See U.C.C. § 9-102(1)(b).

351. *Id.* § 9-204(1).

352. See *id.* § 9-204(3).

a loan and takes after-acquired accounts as collateral.<sup>353</sup>

After filing bankruptcy in 1988, the debtor continued to pay Rimmer a percentage of the proceeds received, even after bankruptcy.<sup>354</sup> In 1990, the bankruptcy court confirmed a chap-

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353. See *Octagon Gas*, 995 F.2d at 955. Nor can anything in Article 2 authorize after-acquired property clauses, even by analogy. First, Article 2 does not apply to the sale of intangibles. See U.C.C. § 2-105. Second, even by analogy, Article 2 requires "goods" to be identified to the contract before the buyer can claim any *in rem* property interest in things that are after-acquired. See *id.* § 2-501. Accordingly, "[g]oods must be both existing and identified before any interest in them can pass. Goods which are not both existing and identified are 'future' goods. A purported present sale of future goods or of any interest therein operates as a contract to sell." *Id.* § 2-105(2). When the buyer claims a share of a fungible bulk of choses in action, it is hard to claim that the "goods" have been identified to the contract when the seller acquires a particular chose in action in which the buyer claims a percentage share.

354. See *Octagon Gas*, 995 F.2d at 952. These surrenders are replete with ambiguity. If the proceeds surrendered to Rimmer were generated by prepetition executory contracts that existed at the time Rimmer's predecessors in interest paid for their "royalty," then Rimmer had a valid cotenancy. Yet the surrendered proceeds would have been produced by debtor-in-possession expense. Why should Rimmer capture the benefit debtor-in-possession investments?

A theory of surcharge is most unclear. If Rimmer had a "secured claim" in the bankruptcy proceeding, then the debtor-in-possession could charge Rimmer for his share of the costs under section 506(c), which provides: "The trustee may recover from property securing an allowed secured claim the reasonable, necessary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holder of such claim." 11 U.S.C. § 506(c) (1994). But Rimmer did not have a secured claim against the bankruptcy estate—only a cotenancy in executory contracts. Nor can the "equities exception" to either section 552(b)(1) or (2) apply for exactly the same reason. Section 552(b)(1) and (2) refer to proceeds covered by prepetition "security agreements" creating "security interests." See *id.* § 552(b)(1)(2). A "security interest" is defined as a consensual lien. See *id.* § 101(51).

Nevertheless, under state law, cotenants of property often have the obligation to contribute to the upkeep of the co-owned property. See, e.g., OKLA. STAT. ANN. tit. 60 § 74 (West 1992) (providing that a cotenant can require a fellow cotenant to pay for the upkeep of the land in common). Perhaps the trustee could have invoked state law to require Rimmer to make a contribution to the natural gas bought to meet the executory contracts. This contribution could then be used to offset the proceeds the debtor-in-possession owed Rimmer.

An executory contract created after the original tender of the purchase price to the debtor would be an "after-acquired" executory contract. A cotenancy in such a contract might have been a fraudulent conveyance, if the debtor was insolvent at the time of the contract's creation. Or, if the debtor-in-possession entered into new executory contract after bankruptcy, then the executory contract would certainly not belong to Rimmer. Rather, the contract would belong to the debtor-in-possession free and clear of Rimmer's prepetition agreement. Such a result, however, is not commanded by section 552(a), which destroys after-acquired property clauses in

ter 11 liquidation plan, which sold the gas collecting system to a secured party whose lien encumbered the system.<sup>355</sup> According to the plan, the sale was "free and clear of liens, claims, interests, and encumbrances."<sup>356</sup> The secured creditor later resold to Octagon Gas Systems.<sup>357</sup> After confirmation, Rimmer's secured creditor sought a declaration from the bankruptcy court that Octagon was obliged to pay a percentage of all proceeds to it, as Rimmer's creditor.<sup>358</sup> Rimmer intervened and took over management of this litigation.<sup>359</sup>

The bankruptcy court ruled for Rimmer, on the theory that the cotenancy never entered the bankruptcy estate in the first place, and so a chapter 11 plan could not possibly have any effect on Rimmer's cotenancy.<sup>360</sup> This is the result that securitization demands. Octagon had argued that the plan was binding on Rimmer, so that Octagon bought the assets free and clear of this cotenancy.<sup>361</sup>

Octagon's position had considerable merit. Section 363(h) refers to a bankruptcy trustee power to sell free and clear of cotenancies.<sup>362</sup> According to Section 363(h):

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prepetition security agreements. See 11 U.S.C. § 552(a). This section destroys after-acquired property clauses in security agreements, insofar as they created *liens*. See *id.* Rimmer, however, was claiming a cotenancy, not a lien. See *Octagon Gas*, 995 F.2d at 952. Assuming such an after-acquired property interest is possible, it is not clear that section 552(a) would avoid it. Fortunately, section 552(a) is a superfluous provision. Even if it did not exist, postpetition property obtained by a bankruptcy trustee would not be subject to a prepetition agreement to which the trustee was not a party. See generally David Gray Carlson, *Bulk Sales Under Article 9: Some Easy Cases Made Difficult*, 41 ALA. L. REV. 729 (1990) (exposing the complexities of analyzing priority disputes between buyers and secured parties). That the trustee is a debtor-in-possession does not change the analysis, as the debtor-in-possession—a fiduciary of the unsecured creditors—does not act in the same capacity as the prepetition debtor.

On this analysis, Rimmer was entitled only to proceeds of executory contracts that existed prepetition, provided the executory contract was not created after the purchase of the royalty and at a time when the debtor was insolvent.

355. See *Octagon Gas*, 995 F.2d at 952.

356. *Id.*

357. See *id.*

358. See *id.*

359. See *id.*

360. See *id.*

361. See *id.*

362. See generally 11 U.S.C. § 363(h) (1994) (describing when a trustee may sell

Notwithstanding subsection (f) of this section, the trustee may sell both the estate's interest . . . and the interest of any co-owner in property in which the debtor had, at the time of the commencement of the case, an undivided interest as a tenant in common, joint tenant, or tenant by the entirety, only if—

(1) partition in kind of such property among the estate and such co-owners is impracticable;

(2) sale of the estate's undivided interest in such property would realize significantly less for the estate than sale of such property free of the interests of such co-owners;

(3) the benefit to the estate of a sale of such property free of the interests of co-owners outweighs the detriment, if any, to such co-owners; and

(4) such property is not used in the production, transmission, or distribution, for sale, of . . . natural . . . gas.<sup>363</sup>

This section arguably applied to Rimmer's cotenancy. Although subsection (4) refers to cotenancies in facilities used to distribute natural gas,<sup>364</sup> it does not negate the trustee's power of sale in *Octagon Gas*.<sup>365</sup> Recall that Rimmer never purchased a cotenancy in "the production, transmission, or distribution" of natural gas—only a cotenancy in the *proceeds of gas*.<sup>366</sup> The trustee's power of sale was therefore quite sufficient to terminate Rimmer's cotenancy in existing accounts and other proceeds. It was certainly good enough to terminate Rimmer's after-acquired property rights, which should not have encumbered the debtor's assets as a matter of state law.<sup>367</sup>

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free of tenancy claims).

363. *Id.*

364. *See id.* § 363(h)(4).

365. *See Octagon Gas*, 995 F.2d at 955.

366. *See id.* at 953.

367. In addition, the trustee may have had power to sell the cotenancy under Bankruptcy Code Section 363(f), which provides:

The trustee may sell property under subsection (b) or (c) of this section free and clear of any interest in such property of an entity other than the estate, only if—

(1) applicable nonbankruptcy law permits sale of such property free and clear of such interest;

(2) such entity consents;

Judge Baldock reversed the bankruptcy court's declaration that Rimmer's cotenancy was never within the jurisdiction of the bankruptcy court.<sup>368</sup> Although he might have cited section 363(h) as proof of the proposition, Judge Baldock decided instead to rely upon Article 9 to establish the debtor's relation to the thing—the cotenancy claimed by Rimmer.<sup>369</sup> Judge Baldock wrote that the sale of "proceeds" was in effect a sale of accounts.<sup>370</sup> Hence, Article 9 governed the sale.<sup>371</sup> Here, at last, we see the statements that have upset the proud dream that plays so subtly with securitization's repose. According to Judge Baldock:

The impact of applying Article 9 to Rimmer's account is that Article 9's treatment of accounts sold as collateral would place Rimmer's account within the property of the bankruptcy estate. Further, if it is determined that Rimmer's account was not properly perfected, then, upon [the debtor's] filing of bankruptcy, the bankruptcy trustee as a lien creditor would have a security interest superior to that of Rimmer.<sup>372</sup>

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(3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;

(4) such interest is in bona fide dispute; or

(5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.

11 U.S.C. § 363(f). Section 363(f)(1) would probably not apply to accounts that existed at the time of the bankruptcy petition. Section 363(f)(3) would not apply because the cotenancy was not a lien. Section 363(f)(4), however, might have applied, as Rimmer's confusing property interest was certainly in bona fide dispute. *See Octagon Gas*, 995 F.2d at 952-55 (analyzing Rimmer's property interest as related to that of the debtor).

Another possibility is that the debtor's lender had a senior security interest that outranked an unperfected cotenancy of Rimmer. The case was remanded to determine whether Rimmer had perfected. *See id.* at 957. If so, and if one follows the unexamined premise that Article 9 establishes a race priority between secured creditors, then the secured party had the right to sell out Rimmer. In such a case, section 363(f)(1) would apply to authorize the "free and clear" sale. *See* 11 U.S.C. § 363(f)(1).

368. *See Octagon Gas*, 995 F.2d at 957.

369. *See id.* at 955-57.

370. *See id.* at 954.

371. This is only contingently correct. If all proceeds were accounts, then Article 9 did govern, as Baldock predicted. If only some of the proceeds were accounts, then Article 9 governed only some of the time. In any case, Baldock assumed, perhaps correctly, that Article 9 applied *all* of the time. *See id.*

372. *Id.* at 955. This statement is imprecise. A security interest is defined as a "lien created by an agreement." 11 U.S.C. § 101(51). A judicial lien therefore does

Although the second sentence is taken for granted, the first sentence violates the premises of securitization.

Invoking the UCC's hostility to the formal notion of title, Baldock noted that:

Article 9 grants rights in the collateral to creditors in the event a secured party fails to perfect his interest, regardless of the location of title and regardless of the debtor's or secured party's legal interest in the collateral. This Article 9 scheme applies with equal force to the sale of accounts. Article 9 treats the interest acquired by a buyer of accounts as a security interest and treats the buyer as a secured party. Accordingly, the seller or assignor of the account "does not part with all transferable rights in . . . [accounts] even following an absolute assignment."<sup>373</sup>

That is, Article 9 implies a property right in debtors, even after the sale of an account, because, if the sale is unperfected, lien creditors and the like might have priority over the unperfected buyer.

In *Octagon Gas*, Judge Baldock remanded to the bankruptcy court in order to determine whether the plan could affect Rimmer's cotenancy interest.<sup>374</sup> Finding the record silent as to whether Rimmer had filed a financing statement, he asked for a ruling on that question.<sup>375</sup> It is tempting to conclude, there-

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not qualify as a security interest.

373. *Id.* at 956 (citing Coenen, *supra* note 179, at 1079), (other citations omitted); see also *id.* at 957 ("[W]e hold that because, under Article 9, a sale of accounts is treated as if it creates a security interest in the accounts, accounts sold by a debtor prior to filing for bankruptcy remain property of the debtor's bankruptcy estate.").

The citation to Professor Coenen's article invokes his refutation of the argument that a buyer of an account need never perfect by filing a financing statement because the debtor has zero interest in the collateral after such an assignment takes place. More specifically, Coenen rejects this suggestion: "The Code's description of the absolute transfer of accounts as a 'security interest' further suggests that the assignor does not part with all transferable rights in accounts even following an absolute assignment." Coenen, *supra* note 179, at 1079.

374. See *Octagon Gas*, 995 F.2d at 958.

375. See *id.* at 957-58. It is not clear that Rimmer's failure to perfect the cotenancy should be relevant. According to a majority of courts, avoidance requires an adversary proceeding and may not be accomplished directly in a confirmed plan. See generally David Gray Carlson, *Proofs of Claim in Bankruptcy: Their Relevance to Se-*

fore, that Baldock addressed *unperfected* purchases of accounts,<sup>376</sup> but this cannot be maintained. Baldock clearly assumed that his holding—that the bankrupt estate retained property in accounts after they are sold—applies whether or not the buyer filed a financing statement:

Of course, this is not to say that an account buyer with a perfected security interest in an account forfeits his interest upon the debtor's filing for bankruptcy. Although property subject to a security interest is property of the debtor's

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*cured Creditors*, 4 J. BANKR. L. & PRAC. 555, 578-83 (1995) (discussing case law on lien avoidance plans). If the debtor-in-possession has not waived the right to avoid the unperfected cotenancy, then avoidance would be relevant to distribution of the proceeds of the cotenancy. It would not necessarily go to the power of sale, which exists under section 363(h) or perhaps under section 363(f). See *supra* note 363 and accompanying text.

376. For example, Judge Baldock relied on cases involving unperfected buyers of accounts who fall to persons, rightly or wrongly, determined to be "lien creditors" under section 9-301(3). See *Octagon Gas*, 995 F.2d at 956 (discussing *United States v. Trigg*, 465 F.2d 1264, 1268) (8th Cir. 1972) (holding that the IRS's car lien made it a "lien creditor" under state law); *In re Cripps*, 31 B.R. 541, 543 (Bankr. W.D. Okla. 1983) (holding an unperfected sale of accounts subordinate to a trustee's hypothetical judicial lien under Section 544(a)(1)).

Other cases relied upon by Judge Baldock for the proposition that perfected sales of accounts are subject to the trustee's turnover powers include *Flowers v. United States (In re Flowers)*. See *Octagon Gas*, 995 F.2d at 956 (citing *Flowers v. United States (In re Flowers)*, 78 B.R. 774 (Bankr. D.S.C. 1986)). In *Flowers*, the government claimed a security interest in "milk proceeds," but not in the underlying cows. See *Flowers*, 78 B.R. at 776. In this case, Judge Bratton Davis also remarked that, even if perfection had occurred, postpetition milk would be the property of the estate, under section 552(a). See *id.* at 776-77. If anything, this case cuts radically against the result in *Octagon Gas*, because it indicates that a proceeds-only assignment is disencumbered by the bankruptcy petition. See *id.* at 776-77. Similarly, the sale of proceeds on postpetition gas would likewise be disencumbered.

Judge Baldock also cited *In re Cawthorn* in which the debtor claimed the government had never perfected its security interest in milk proceeds. See *Octagon Gas*, 995 F.2d at 956 (citing *In re Cawthorn*, 33 B.R. 119, 121 (M.D. Tenn. 1983)). Judge John Nixon disagreed, but remarked rather gratuitously: "Even if Tennessee law defined a milk assignment as an absolute transfer of all the debtor's rights in the future milk proceeds, § 541(a)(6) would still include these proceeds as property of the estate." *Cawthorn*, 33 B.R. at 121 n.2. This dictum might support Judge Baldock if the assignment of milk proceeds related to the sale of a prepetition account of some farmers' cooperative to pay for milk produced, but perhaps Judge Nixon was simply repeating what Judge Davis said in *Flowers*—that postpetition milk is disencumbered from prepetition security interests under section 552(a) of the Bankruptcy Code. See *Flowers*, 78 B.R. at 776-77. Neither case gives much information about the assignment of milk proceeds.



bankruptcy estate, secured creditors of the debtor are provided "adequate protection" for their interest.<sup>377</sup>

This language indicates that Baldock did indeed mean to say that *perfected* sales of accounts are as much part of the bankrupt estate as classic perfected security interests in accounts.<sup>378</sup>

On remand, the bankruptcy court would have determined the meaning of the plan, given the assumption that Rimmer's cotenancy *was* part of the bankruptcy estate. Under the authority of section 363(h), the plan was probably capable of selling free and clear of Rimmer's interest.<sup>379</sup> But whether the plan actually gave Octagon good title would depend on the meaning of the plan itself and also on whether Rimmer received the protection of due process of law.<sup>380</sup> It would thus be necessary for the debtor-in-possession to have notified Rimmer that the sale would be free and clear of the cotenancy. The ultimate merit of Rimmer's action thus probably reduces to a question of whether the plan *intended* to sell free and clear and whether Rimmer received notice and an opportunity to be heard with regard to the sale.

*Octagon Gas* has drawn sharp criticism. According to Professor Thomas Plank: "The court's confused characterization of a sale of accounts as a security interest in substance has the potential of destroying the legal foundation for securities backed by automobile loans, trade receivables, equipment leases, and other loans

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377. *Octagon Gas*, 995 F.2d at 957 n.9 (citing 11 U.S.C. § 363(e) (1988)).

378. By way of further evidence, Baldock spent some time disapproving of *Dewhirst v. Citibank (Arizona)* (*In re Contractors Equip. Supply Co.*), in which Judge Albert Lee Stephens, Jr., upheld the turnover of proceeds from accounts encumbered by the genuine perfected security interest in accounts. See *Octagon Gas*, 995 F.2d at 957 n.8 (citing *Dewhirst v. Citibank (Ariz.)* (*In re Contractors Equip. Supply Co.*), 861 F.2d 941 (9th Cir. 1988)). In so doing, Judge Stephens remarked in dictum that the result would have been otherwise had the account been sold. See *Contractors Equip. Supply*, 361 F.2d at 245. Baldock's disapproval of this dictum shows that Baldock did not simply intend to say that unperfected sales of accounts are subject to the trustee's strong-arm power, but rather, that perfected sales interests are susceptible to the trustee's turnover power. See *Octagon Gas*, 995 F.2d at 957 n.8.

379. See 11 U.S.C. § 363(c); see also *id.* § 363(h) (discussing when a trustee may sell free and clear of any interest in such property).

380. See Carlson, *supra* note 375, at 588-93 (discussing a secured party's right to due process in connection with plan confirmation).

and leases that are accounts or chattel paper.”<sup>381</sup> Yet, as demonstrated, Judge Baldock was justified fully in remanding the case for findings on what effect the plan had on Rimmer’s cotenancy. Article 9 is certainly part of the story of bankruptcy jurisdiction, but the cotenancy of Rimmer in a debtor asset also justifies bankruptcy jurisdiction under the provisions of section 363(h).

## VII. CONCLUSION

Securitization is a multibillion dollar practice that has grown up in response to the radical increase in bankruptcy jurisdiction invoked by the Bankruptcy Code in 1978. Its premise is that sales of accounts and chattel paper put assets beyond the hypothetical reach of the originator’s bankruptcy trustee. This Article has shown that the bankruptcy remoteness of these sales cannot be sustained on either the black letter or on the spirit of the Bankruptcy Code, which requires that secured creditors should contribute collateral in order to rehabilitate debtors. Because the drafters of Article 9 intended that there be no difference between security interests in and sales of accounts and chattel paper, it is plausible to believe that Congress, in 1979, intended that buyers of accounts and chattel paper contribute to the rehabilitation of debtors, just as other secured creditors should. That the securitization industry wishes to avoid a tax cannot count as an argument. It is sometimes maintained that only little people pay taxes. But not so. The Bankruptcy Code applies to little people and Fortune 500 companies alike. No one wants to pay taxes; yet, if Congress says we must, then we must. This principle applies just as much to securitization as to other forms of secured lending.

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381. Plank, *supra* note 18, at 456-57; see also John C. Chobot, *Some Bankruptcy Stay Metes and Bounds*, 99 COM. L.J. 301, 312-15 (1994) (criticizing the uncertainty caused by the *Octagon Gas* ruling).