



2005

The Impact of Revised Article 9

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Lupica, Lois R. (2005) "The Impact of Revised Article 9," *Kentucky Law Journal*: Vol. 93 : Iss. 4 , Article 3.
Available at: <https://uknowledge.uky.edu/klj/vol93/iss4/3>

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The Impact of Revised Article 9

BY LOIS R. LUPICA*

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I. INTRODUCTION

Article 9 of the Uniform Commercial Code (“UCC”), the state law establishing and defining the secured credit system in personal property,¹ has undergone a massive revision.² This complicated,³ collaborative,⁴ arduous,⁵ and at times contentious,⁶ process

¹ Article 9, originally enacted over forty years ago, has been the subject of a massive revision project, undertaken over the past ten years by the Permanent Editorial Board for the UCC (“PEB”), the American Law Institute (“ALI”), and the National Conference of Commissioners on Uniform State Laws (“NCCUSL”). Article 9’s revision process is complete, and the revised statute has been enacted into law in all 50 states and the District of Columbia. NCCUSL, *Introductions & Adoptions of Uniform Acts (2002)*, available at http://www.nccusl.org/Update/uniformact_factsheets/uniformacts-fsucca9.asp. As stated in the Official Comment to Section 9–101:

In 1990, the Permanent Editorial Board for the UCC . . . established a committee to study Article 9 of the UCC. The study committee issued its report as of December 1, 1992, recommending the creation of a drafting committee for the revision of Article 9 and also recommending numerous specific changes to Article 9. Organized in 1993, a drafting committee met fifteen times from 1993 to 1998. This Article was approved by its sponsors in 1998.

U.C.C. § 9–101 cmt. 2 (2001); see also PERMANENT EDITORIAL BOARD FOR THE UNIFORM COMMERCIAL CODE, PEB STUDY GROUP U.C.C. ARTICLE 9 REPORT (1992) [hereinafter PEB STUDY].

² The new Article 9 contains 126 sections. Thirty-six of these sections are completely new and seventy-one sections have language that was not included in former Article 9. “In terms of how the law is expressed, it would be more accurate to label . . . Article 9 as ‘new’ rather than ‘revised.’” JULIAN B. McDONNELL, *UNIFORM COMMERCIAL CODE: ANALYSIS OF REVISED ARTICLE 9*, 1 (1999).

³ The goal of simplicity was arguably not met by the drafters of Revised Article 9. In many places its language is highly ambiguous. Although no citation beyond the language of Revised Article 9 is necessary, see Jean Wegman Burns, *New Article 9 of the UCC: The Good, The Bad, and the Ugly*, 2002 U. ILL. L. REV. 29 (2002). The author refers to

redefined the contours of the relationship between secured creditors, unsecured creditors, and debtors.⁷ Under Revised Article 9, secured creditors are granted greater rights than they had under former⁸ Article 9 in myriad obvious and not-so-obvious ways. We now have a secured credit system whereby secured creditors can more easily encumber a

her “journey through new Article 9 [as] a descent into a new tenth ring of Dante’s Hell . . .” *Id.* at n.11. She makes the following observations:

[A]lmost every tree in the forest has been renumbered and moved; many old trees have been split into two or three smaller bushes, which the user must cross-reference to get a complete and accurate answer; there are few signposts to help one find the paths through the newly arranged forest; there are land mines throughout the forest, i.e., small, but significant, changes in the rules that only a careful reading will uncover; there are a fair number of new trees in the forest and some whole new groves of trees; while some of the changes bring major improvements to Article 9, others are counterintuitive or add entirely new areas of confusion; some sections of the new Article 9 are written in a language other than English and can only be understood if one has a preexisting knowledge of the law; and despite all the new trees and pruned old trees, a substantial number of questions . . . remain unanswered by the new Article 9.

Id. at 33–34.

⁴ PEB STUDY, *supra* note 1, at 2–3 (describing the various parties participating in the revisions process).

⁵ In contrast to former Article 9, which includes five parts and fifty-five subsections, Revised Article 9 has six parts and 126 subsections (not including the transitional rules and conforming amendments). U.C.C. §§ 9–101 to 9–628 (2001).

⁶ Steven L. Harris & Charles W. Mooney, Jr., *Reflections of the Reporters*, 74 CHI.–KENT L. REV. 1357, 1364 (1999) [hereinafter *Reflections*] (referring to the “level of dyspepsia . . . generated” by a discussion of an issue in connection with the revision); Edward J. Janger, *Predicting When the Uniform Law Process Will Fail: Article 9, Capture and the Race to the Bottom*, 83 IOWA L. REV. 569, 573–76 (1998) (describing the tension in the Article 9 drafting process in reconciling the central reform objectives—simplicity and the third-party effects of secured credit); Robert E. Scott, *The Politics of Article 9*, 80 VA. L. REV. 1783, 1784 (1994) (observing that the Article 9 revision debate concerned the “efficiency and social value of Article 9”).

⁷ Interestingly, the Co-Reporters for the drafting committee described Revised Article 9 as follows: “Revised Article 9 most assuredly *does not* embody a material alteration of the basic attributes of secured transactions law. As we explain more fully below, the revision clarifies, tinkers at the edges, refines, and generally seeks to make the statute more user friendly and more precise.” (footnotes omitted). Steven L. Harris & Charles W. Mooney, Jr., *Revised Article 9 Meets the Bankruptcy Code: Policy and Impact*, 9 AM. BANKR. INST. L. REV. 85, 92 (2001) [hereinafter *Policy & Impact*].

⁸ The process of drafting a uniform code governing secured credit transactions originally began in 1946. By 1950, the basic construct of Article 9 was completed. *See* 1 GRANT GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY 288, 289 n.1 (1965). Article 9 was substantially revised in 1962 and 1972. PEB FINAL REPORT (April 25, 1991) (proposal for changes in Article 9 of UCC). Louisiana was the last hold-out state, finally adopting the 1972 version of Article 9 of the UCC in 1988. Act No. 528, 1988 La. Acts 1367–422, effective Jan. 1, 1990, (codified at LA. REV. STAT. ANN. §§ 10:9-101 to 9-605).

greater number of particular types of debtors' assets⁹ and can more readily securitize more types of assets with greater certainty.¹⁰

The revision was justified largely on grounds of efficiency.¹¹ It was argued that if secured creditors' reach is broader and transaction costs are lower, secured credit will be more widely available at a reduced cost.¹² Therefore, secured lending's efficiency will increase, meaning that the benefits that flow to some affected parties will outweigh the detriment to others.¹³

This theoretical justification for Article 9's revision echoes the earliest explanation for the secured credit system offered by its original proponents.¹⁴ These scholars posited various theories in an attempt to explain why the gains from secured credit were greater than the corresponding costs.¹⁵ These explanations were ultimately inconclusive, and to date the efficiency of secured credit remains unproven.¹⁶ The absence of a proven justification for secured credit, however, did not hinder the use of economic efficiency as an initial argument favoring its continued use and expansion.¹⁷

An alternative theoretical perspective on the secured credit system that has gained momentum in the years during Article 9's revision states that in some credit markets, under certain circumstances, the gains that flow to secured creditors are had at the expense of unsecured creditors, who, as a practical matter, are unable to adjust to the risks presented by secured credit.¹⁸ These creditors, including tort creditors, trade creditors,

⁹ Professor Barry Zaretsky referred to the Article 9 revision as a "love feast for secured creditors." McDONNELL, *supra* note 2, at 2.

¹⁰ Indeed, in the words of the Reporters for the Drafting Committee, "[m]any of [Revised Article 9's] provisions make it easier and less expensive to create and perfect security interests and to achieve priority over competing claimants." Harris & Mooney, *Reflections*, *supra* note 6, at 1360; see also G. Ray Warner, *The Anti-Bankruptcy Act: Revised Article 9 and Bankruptcy*, 9 AM. BANKR. INST. L. REV. 3 (2001).

¹¹ Harris & Mooney, *Reflections*, *supra* note 6, at 1360.

¹² *Id.* at 1359-61.

¹³ This is known as Kaldor-Hicks efficiency. To be considered Kaldor-Hicks efficient, the gains to one party may not exceed the losses to another. RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 13-16 (4th ed. 1992).

¹⁴ Thomas H. Jackson & Anthony T. Kronman, *Secured Financing and Priorities Among Creditors*, 88 YALE L.J. 1143 (1979); James J. White, *Efficiency Justifications for Personal Property Security*, 37 VAND. L. REV. 473 (1984).

¹⁵ Jackson & Kronman, *supra* note 14, at 1158; White, *supra* note 14, at 503.

¹⁶ Alan Schwartz, *Security Interests and Bankruptcy Priorities: A Review of Current Theories*, 10 J. LEGAL STUD. 1, 37 (1981).

¹⁷ Harris & Mooney, *Reflections*, *supra* note 6, at 1360.

¹⁸ Lynn M. LoPucki, *The Unsecured Creditor's Bargain*, 80 VA. L. REV. 1887, 1896-98, (1994) [hereinafter *Creditor's Bargain*].

Article 9 artificially and unjustifiably advantages the institution of security over unsecurity. It holds involuntary unsecured creditors to an entirely fictitious

employees, and taxing authorities, are undiversified in their “credit” extensions and are less able to weather losses that result from a debtor’s secured credit arrangements.¹⁹ According to the theory, the externalization of the risk of non-payment to these parties misallocates resources and potentially encourages the excessive use of security.²⁰

Scholars have further argued that not only has the efficiency of secured credit not been proven, but the discussion concerning the wisdom of Article 9’s changes ought not begin and end with the issue of efficiency.²¹ These scholars have posited that economic analysis offers a limited perspective on the policy choice of continually expanding secured credit.²²

Clearly, the theoretical scholarship is divided on the expected impact of Revised Article 9.²³ Neither elaborate economic and financial models²⁴ nor detailed predictive descriptions of the impact of Revised

bargain. It holds voluntary unsecured creditors to the terms of security agreements to which they did not in fact agree and to which they did not have access. The terms of those agreements are binding regardless of how unreasonable they may be. This bizarre scheme subsidizes the institution of security, causing more secured lending than is optimal.

Id. at 1963; *see also* Lucian Arye Bebchuk & Jesse M. Fried, *The Uneasy Case for the Priority of Secured Claims in Bankruptcy*, 105 *YALE L.J.* 857, 872–79 (1996).

¹⁹ Barry E. Adler, *Finance’s Theoretical Divide and the Proper Role of Insolvency Rules*, 67 *S. CAL. L. REV.* 1107 n.35 (1994) [hereinafter *Finance’s Divide*] (describing undiversified creditors as those who extend credit to a limited number of debtors or to debtors in limited business sectors).

²⁰ Bebchuk & Fried, *supra* note 18, at 872–79. *See generally* C. Scott Pryor, *How Revised Article 9 Will Turn the Trustee’s Strong-Arm Into a Weak Finger: A Potpourri of Cases*, 9 *AM. BANKR. INST. L. REV.* 229 (2001); Warner, *supra* note 10 (observing that blanket liens may now cover deposit accounts, health-care insurance receivables, and commercial tort claims).

²¹ *See* Elizabeth Warren, *Making Policy with Imperfect Information: The Article 9 Full Priority Debates*, 82 *CORNELL L. REV.* 1373, 1386–87 (1997) [hereinafter *Imperfect Information*].

²² *Id.* at 1385–88.

²³ Robert E. Scott, *The Truth About Secured Financing*, 82 *CORNELL L. REV.* 1436, 1437 (1997).

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

Id. at 1436.

²⁴ *See, e.g.*, David Gray Carlson, *Secured Credit as a Zero Sum Game*, 19 *CARDOZO L. REV.* 1635 (1998).

Article 9 have proven the actual, societal effects of the statute.²⁵ As has historically been the case in other contexts, the theoretical appraisal of the commercial credit system has predated empiricism.²⁶

It must be recognized, however, that theory and empiricism are mutually dependent; a central role of theory is to channel research, and empiricism is employed to prove or disprove a particular theory or set of theories.²⁷ When the results of empirical research corroborate a particular theory, the theory gains independent validity.²⁸ Conversely, theories that empirical studies consistently fail to substantiate will be, and ought to be, abandoned.²⁹ Theoretical thinking on Article 9 is sufficiently advanced so that data can be used to test developed hypotheses—meaning specific statements of prediction—against their corollaries.³⁰ A causal study will have as its focus the effects of a cause (the revision of Article 9) on one or more outcomes (impacts on and behaviors of participants in the credit markets).

²⁵ See, e.g., Warner, *supra* note 10, at 3–9; Harris & Mooney, *Policy & Impact*, *supra* note 7, at 85–96.

²⁶ This type of inquiry has been referred to as the “land of theory” (as compared to the “land of observation”).

The land of theory is what goes on inside your mind, and your attempt to explain or articulate this to others. It is all of the ideas, theories, hunches and hypotheses that you have about the world. In the land of theory you will find your idea of the program or treatment as it should be. You will find the idea or construct of the outcomes or measures that you believe you are trying to affect.

William M. Trochim, *Idea of Construct Validity*, available at <http://www.socialresearchmethods.net/kb/considea.htm> (last visited Mar. 14, 2005).

²⁷ JOHN M. NEALE & ROBERT M. LIEBERT, *SCIENCE AND BEHAVIOR: AN INTRODUCTION TO THE METHODS OF RESEARCH* (3d ed. 1986).

Empirical research, the foundation of the scientific approach, refers to any activity that systematically attempts to gather evidence through observations and procedures that can be repeated and verified by others. The scientific approach requires that all claims be exposed to systematic probes. Statements, theories, and assertions, regardless of how plausible they seem, must be testable.

Id. at 7.

²⁸ *Id.* at 13.

²⁹ *Id.*

³⁰ Two mutually exclusive hypotheses must be identified that together exhaust all possible outcomes. The testing must be conducted so that one hypothesis is proven and one is rejected. This is known as the hypothetical deductive model of research—working from the more general to the more specific. See William M. Trochim, *Deductive and Inductive Thinking*, available at <http://www.socialresearchmethods.net/kb/dedind.htm> (last visited Mar. 14, 2005). “We might begin with thinking up a theory about our topic of interest. We then narrow down into more specific hypotheses that we can test. We narrow down even further when we collect observations to address the hypotheses with specific data—a confirmation (or not) of our original theories.” *Id.* See *infra* notes 246–58 and accompanying text for a detailed account of the empirical study’s proposed research protocol.

In this article, I outline a research protocol for the study of Revised Article 9.³¹ Part II sets forth a detailed account of the most significant changes made to Article 9. These changes are both substantive and procedural. Part III describes the competing theories justifying the existence and expansion of Article 9. I discuss, in concrete terms, the variety of predictions made concerning the effects of the Article 9 revisions on debtors and creditors where the debtor is not in bankruptcy. Since the vast majority of secured loans (and even distressed secured loans) are not administered within the bankruptcy process, this is an important context in which to examine the statutory changes. Part IV illustrates the importance of empiricism and describes recent empirical studies in commercial law. Part V discusses business bankruptcy theory and the intersection between theoretical perspectives on bankruptcy and Article 9. Part VI outlines a research protocol for the initial study of Article 9's impact on the credit markets. This part defines specific questions to be addressed, the methodology for addressing them, and the procedures to be followed. Part VII outlines a research protocol for the study of Article 9's impact when a debtor is in bankruptcy. Part VIII concludes by noting the importance of gaining sufficient empirical information in order to resolve the theoretical debate concerning the impact of Revised Article 9.

II. REVISED ARTICLE 9

A. Secured Credit-Related Changes

At the outset of the Article 9 revision process there was a definitive theoretical divide, not only concerning the wisdom of further expanding the statute's scope, but also concerning the fundamental issue of whether there ought to be some limit on the debtor's ability to pledge all of its assets.³² Accordingly, the open question on the minds of those watching

³¹ This article discusses Revised Article 9 in the context of the business (non-consumer) borrower. There are distinct and definite differences between the consumer finance market and the commercial finance market. A discussion of the consumer finance market is beyond the scope of this article.

³² Steven L. Harris & Charles W. Mooney, *A Property-Based Theory of Security Interests: Taking Debtors' Choices Seriously*, 80 VA. L. REV. 2021, 2051–53 (1994) [hereinafter *A Property-Based Theory*].

It seems enough that security interests, under Article 9 and real estate law alike, are interests in property. The legal regime for security interest reflects property law functionally as well as doctrinally. We believe it follows that the law should honor the transfer or retention of security interests on the same normative grounds on which it respects the alienation of property generally.

Id. But see 1 GILMORE, *supra* note 8, at 248–49:

Considerations of policy and common sense suggest that there must be a limiting point somewhere. Borrowers should not be encouraged or allowed to

and waiting for the new Article 9 was how equilibrium would be struck between the interests of those most and least able to diversify the risk of a debtor's financial distress.³³ More specifically, how would the law defining, allocating, and distributing property entitlements between secured and unsecured creditors be balanced so that the interests of all affected parties are duly recognized?

While the drafters claim to have struck a fair balance between secured and unsecured creditors, on its face Article 9 departs considerably from the former law governing secured transactions.³⁴ There is the

hypothecate all that they may ever own in the indefinite future in favor of a creditor who is willing to make the loan now. . . . And ways should be found to penalize a lender, who, after allowing his borrower to pile up an intolerable weight of debt, then claims all the assets of the insolvent estate, leaving nothing to satisfy other claims.

Id. See also William J. Woodward, *The Realist and Secured Credit: Grant Gilmore, Common-Law Courts, and the Article 9 Reform Process*, 82 CORNELL L. REV. 1511 (1997).

³³ This has also been one of the central issues of dissension in connection with the recent efforts to revise the Bankruptcy Code. Unfortunately, the efforts on the part of those advocating for reforms are designed to tip the balance of power in favor of those most able to spread the risk of financial losses. See Philip Shenon, *Hard Lobbying on Debtor Bill Pays Dividend*, N.Y. TIMES, Mar. 13, 2001, at A1 (describing efforts by the National Consumer Bankruptcy Coalition, a powerful lobbying group formed by members of the consumer credit industry, to push a major, creditor-friendly Bankruptcy Code overhaul through Congress). The success rate for three- to five-year Repayment plans is less than 30%. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, available at <http://www.law.unlv.edu/faculty/rlawless/5256-passed-senate.pdf>. (last visited Apr. 1, 2005).

³⁴ It was noted that the Drafting Committee "sought balance [between secured and unsecured creditors] at every turn." Harris & Mooney, *Reflections*, *supra* note 6, at 1363-64. An example of the balance sought (and purportedly achieved) includes the Drafting Committee's failure to disrupt the ability of the bankruptcy trustee to avoid an unperfected security interest. Reporters for the Drafting Committee observed that "[t]he appropriate relationship between secured and unsecured creditors may present the single most important cluster of issues . . ." *Id.* at 1358-59; see also Steven L. Harris & Charles W. Mooney, Jr., *The Article 9 Study Committee Report: Strong Signals and Hard Choices*, 29 IDAHO L. REV. 561, 569 (1993). The PEB Commentary contained the following explanation of its mission:

[One could ask] . . . whether Article 9 should limit the types of property that can be subjected to a security interest or the extent to which a debtor's property can be so encumbered. Or one might question whether any perfection step should be necessary to obtain priority over judicial lien creditors or other competing claimants. Or one might question whether security interests ought to be enforceable at all.

Although it is well aware of challenges to the validity of some basic principles that underlie Article 9, the Committee chose not to undertake a thorough reexamination of those principles. Nor did the Committee's deliberations reflect strong support for making major adjustments in the balance that Article 9 now strikes between secured parties and unsecured creditors. But insofar as the Committee's recommendations would make it

potential for secured creditors more easily to dominate a debtor's assets, and thus the debtor's business, to the exclusion of other creditors' interests. New collateral categories have been added, the concept of "proceeds" has been augmented, and certain formerly non-assignable rights are now assignable as security.

1. *New Article 9 Assets*

A number of new categories of collateral have been added to the Revised Article 9. These include health-care insurance receivables,³⁵ commercial tort claims,³⁶ payment intangibles,³⁷ and deposit accounts.³⁸ Each of these is discussed below.

a. *Health-care Insurance Receivables*

"Health-care insurance receivables" are listed as a new variety of "account."³⁹ Interests or claims that arise under health insurance policies or health-care insurance receivables are new Article 9 collateral,⁴⁰ except to the extent that Article 9 is preempted by "a statute, regulation or treaty of the United States . . ." ⁴¹ Federal law provides such a stumbling block by prohibiting the assignment of federal government-sponsored health

easier and less costly to take and perfect security interests, they are likely to have the effect of improving the position of secured parties relative to that of unsecured creditors. . . . The Committee believes that any necessary adjustments for the protection of third parties should be made directly, as by changing Article 9's priority rules or by modifying the avoidance powers or other distributional rules of the Bankruptcy Code, and not indirectly, as by increasing the difficulty and expense of creating perfected security interests.

PEB STUDY, *supra* note 1, at 8–9 (footnotes omitted); *see also* James J. White, *Work and Play in Revising Article 9*, 80 VA. L. REV. 2089, 2089 (1994) (declaring the efficiency of Article 9 irrelevant to the revision process).

³⁵ U.C.C. §§ 9–102(a)(2) & 9–102(a)(46) (2001).

³⁶ § 9–102(a)(13).

³⁷ § 9–102(a)(61).

³⁸ § 9–102(a)(29).

³⁹ One of the historical problems with using health-care insurance receivables as collateral was old Article 9's exclusion of insurance proceeds from Article 9 coverage. *See* former U.C.C. § 9–104(g) (1998) ("This article does not apply . . . (g) to a transfer of an interest in or claim in or under any policy of insurance, except as provided with respect to proceeds (Section 9–306) and priorities in proceeds (Section 9–312).").

⁴⁰ A health-care insurance receivable is defined as "an interest in or claim under a policy of insurance which is a right to payment of a monetary obligation for health-care goods or services provided . . ." U.C.C. § 9–102(46) (2001). Assignments to health-care providers (i.e., doctors and hospitals) are automatically perfected. *See* U.C.C. § 9–309(5) (2002).

⁴¹ § 9–109(c)(1).

insurance receivables.⁴² Revised Article 9 avoids this problem by separating attachment and perfection of security interests from those Article 9 remedies that allow direct collection from account debtors.⁴³ Specifically, section 9-408 invalidates restrictions on assignments that impair the creation and perfection of security interests in health-care receivables.⁴⁴ This invalidation neither empowers the secured party to enforce the security interest nor imposes any duties on the secured party.⁴⁵ It does, however, allow the debtor to obtain additional credit and permits the secured party to attach the proceeds of the health-care receivable in the event of default.⁴⁶

As a result of this revision, both federal and private health-care insurance receivables can now be used as collateral in much the same way as other rights to payment.

b. Commercial Tort Claims

The prohibition against the use of commercial tort claims as collateral has also been lifted. Revised section 9-102(a)(13) defines commercial tort claims as those claims that arise in tort in the course of a claimant's business.⁴⁷ The Article 9 Drafting Committee, considering the

⁴² Federal health insurance programs, such as Medicare and Medicaid, currently include provisions that prevent their assignment, and state law (meaning Article 9) cannot preempt federal law provisions. See Social Security Amendments of 1972 (codified at 42 U.S.C. § 1395g(c) (1994) and 42 U.S.C. § 1396a(a)(32) (1994)) and the Medicare-Medicaid Anti-fraud and Abuse Amendments to the Social Security Act (codified at 42 U.S.C. § 1395g(c) (1994)). Federal government sponsored health-care programs (i.e., Medicare and Medicaid) do not allow payments to be made to any person other than the health-care provider. Pursuant to a letter from the Acting Director of the Health Care Finance Agency, when the transaction involves the sale of Medicare or Medicaid receivables, payments may be made directly to the provider and then transferred to a special account that may then be accessed by the lender. Letter from Kathleen Buto, Acting Director of the HCFA Bureau of Eligibility, Reimbursement and Coverage, Sept. 15, 1988, quoted in Patrick A. Guida, *1999 Financing Health Care Providers*, SD71 A.L.I.-A.B.A. 401, 421 (1999).

⁴³ Section 9-408 renders such contractual terms ineffective only to the extent that they "would impair the creation, attachment or perfection of a security interest." U.C.C. § 9-408(a)(1) & (c)(1) (2001).

⁴⁴ *Id.*

⁴⁵ Note also that § 9-408(d) relieves the health-care receivable account debtor from virtually every obligation to the secured creditor. "By making available previously unavailable property as collateral, this section should enable debtors to obtain additional credit." *Id.* at cmt. 8.

⁴⁶ *Id.*

⁴⁷ U.C.C. § 9-102(a)(13) (2001). Section 9-109(d)(12) explicitly states that non-commercial tort claims are not included within the scope of Revised Article 9. See § 9-408 cmt. 8. ("By making available previously unavailable property as collateral, this section should enable debtors to obtain additional credit.")

fact that many jurisdictions allow the assignment of tort claims that arise from a breach of contract, “[saw] little reason to continue the general exclusion of tort claims that are otherwise assignable under non-UCC law.”⁴⁸

Under the Revised UCC there are some limits placed on the use of commercial tort claims as collateral. Commercial claims must exist at the time of the original agreement, meaning after-acquired tort claims cannot be taken as collateral.⁴⁹ Moreover, the commercial tort claim must be described with some specificity in the security agreement—“all commercial tort claims of the debtor” will not do.⁵⁰

c. *Payment Intangibles*

“Payment intangibles,” defined as “general intangible[s] under which the account debtor’s principal obligation is a monetary obligation,” are a new type of Article 9 collateral.⁵¹ Receivables that are not “chattel paper,” “instruments,” or “accounts” (because they do not arise out of property that has been or is to be sold, leased, licensed, assigned, or otherwise disposed of) are “general intangibles” for the payment of money—“payment intangibles.”⁵²

The classic example of “payment intangibles” is payment streams from the sale of loan pool participations, typically originated by financial

⁴⁸ PEB STUDY, *supra* note 1, at 59. There is a specific exclusion for tort claims that arise out of personal injury or death. § 9–102(a)(13)(B)(ii). This is thought to be traceable to prohibitions against champerty and maintenance. See PEB STUDY, *supra* note 1, at 58 nn.2–3 (citing BLACK’S LAW DICTIONARY 231 (6th ed. 1990) (defining “champerty” as a “bargain between a stranger and a party to a lawsuit by which the stranger pursues the party’s claim in consideration of receiving part of any judgment proceeds” and “maintenance” as “maintaining, supporting or assisting, the litigation of another.”)).

⁴⁹ § 9–109 cmt. 15.

⁵⁰ § 9–102(a)(13). A creditor, however, can include a categorical description of “commercial tort claims” (and all types of collateral) in the financing statement. § 9–502(a)(3).

⁵¹ § 9–102(61).

⁵² *Id.* Comment 5(d) notes that “payment intangibles” are a subset of “general intangibles.” “Virtually any intangible right could give rise to a right to payment of money once one hypothesizes, for example, that the account debtor is in breach of its obligation. The term ‘payment intangible,’ however, embraces only those general intangibles ‘under which the account debtor’s principal obligation is a monetary obligation.’” *Id.* at cmt. 5(d). General intangibles are a residual category of “personal property” under Revised Article 9. Section 9–102(42) states that “any personal property, including things in action, other than accounts, chattel paper, commercial tort claims, deposit accounts, documents, goods, instruments, investment property, letter-of-credit rights, letters of credit, money, and oil, gas or other minerals before extraction” are general intangibles. Examples cited in the Official Comment include “intellectual property and the right to payment of a loan of funds that is not evidenced by chattel paper or an instrument.” *Id.*; see also § 9–102(a)(2), (11), (42), (47), & (61).

institutions.⁵³ The transfer of these loan pool participations was not governed by former Article 9 and, accordingly, buyers of fractional interests of commercial loans have not customarily filed financing statements to perfect their interests. In the course of the Article 9 revision process, parties to loan pool participation transactions expressed the potentially conflicting desire of wanting the benefits of increased certainty and decreased risk provided by Article 9 perfection, but without the burden of required public filing. In response, the drafters provided for automatic perfection of payment intangibles.⁵⁴

d. Deposit Accounts

Article 9 now provides that businesses' deposit accounts may be encumbered as original collateral.⁵⁵ Deposit accounts are defined to include demand, time savings, or passbook accounts maintained with a bank.⁵⁶ Prior to the widespread adoption of Revised Article 9, a number of states enacted non-uniform amendments that included deposit

⁵³ Some courts have held, however, that sales of loan participations characterized by the parties as "sales" are in fact disguised security transactions. *See, e.g., In re Coronet Capital Co.*, 142 B.R. 78, 80 (Bankr. S.D.N.Y. 1992) (discussing factors indicative of a disguised security transaction). Sales of payment intangibles as collateral are automatically perfected, whereas transfers of payment intangibles as collateral are not. Harris & Mooney, *Reflections, supra* note 6, at 1371-72; *see also* Paul M. Shupack, *Making Revised Article 9 Safe for Securitizations: A Brief History*, 73 AM. BANKR. L.J. 167, 170 (1999) (noting that, under former Article 9, the cash flows from the sale of loan pools are deemed to be general intangibles, thus their sale is not governed by Article 9); U.C.C. § 9-309(3) (2001) ("The following security interests are perfected when they attach . . . (3) a sale of a payment intangible . . .").

⁵⁴ *See* Shupack, *supra* note 53, at 179. With automatic perfection of a transfer of payment intangibles, secured parties run the risk that searchers of the public records will not discover the prior interest in their assets. Article 9 similarly allows for automatic perfection of the sale of promissory notes. Under Revised Article 9, a transfer of a promissory note as collateral for a loan may, however, be perfected by filing. U.C.C. §§ 9-310(a), 9-312(a) (2001). The definition of "promissory note" is new and, according to the Official Comment, was "necessitated by the inclusion of sales of promissory notes within the scope of Article 9." § 9-102 cmt. 5(d). The definition reads:

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

§ 9-102(a)(65).

⁵⁵ Article 9 does not explicitly list deposit accounts as eligible original Article 9 collateral, but expansively states that all personal property is included within its scope, except for that property that is explicitly excluded. § 9-109(a)(1). Section 9-109(d)(13) explicitly states that Article 9 does not apply to assignments of deposit accounts in consumer transactions. § 9-109(d)(13).

⁵⁶ § 9-102(a)(29).

accounts in their versions of former Article 9.⁵⁷ In other states, common law provided a process for taking security interests in deposit accounts.⁵⁸ In order to further the goal of uniformity, the Revised Article 9 drafters included commercial deposit accounts as a new type of eligible collateral.⁵⁹

The perfection provisions for deposit accounts outline separate rules for when i) the party seeking to encumber the deposit account is the bank in which the account is held, and ii) the party seeking to encumber the account is a third party.⁶⁰ “Control” (and thus perfection) is automatic if the bank in which the account is held is the secured party.⁶¹ Other secured creditors can obtain “control” (and thus perfection) by getting either an “authenticated”⁶² agreement from both the bank and the debtor,

⁵⁷ See, e.g., CAL. COM. CODE §§ 4210 & 9104 (1992); HAW. REV. STAT. § 490:9-104 (1992); ILL. COMP. STAT. 26/9-104 (West 1992); LA. REV. STAT. ANN. § 10:9-104 (West 1992); IDAHO CODE § 28-9-306 (Michie 1992).

⁵⁸ See, e.g., *First Tenn. Bank Nat'l Ass'n v. Resolution Trust Corp.* (*In re Creekstone Apts. Assocs.*), 165 B.R. 851, 854 (Bankr. M.D. Tenn. 1994).

⁵⁹ Bruce A. Markell, *From Property to Contract and Back: An Examination of Deposit Accounts and Revised Article 9*, 74 CHI.-KENT L. REV. 963, 973 (1999). The author notes that, in recent years, credit and depository institutions have increasingly been engaged in interstate business. As such, the non-uniformity among the states under former Article 9 became more onerous. Under some states' non-uniform versions of former Article 9, creditors could take a security interest in deposit accounts as original collateral. *Id.*

⁶⁰ Perfection of original security interests in deposit accounts is not achieved by filing, but by the newly defined perfection concept of gaining “control.” According to the Official Comment to section 9-104, “control . . . pursuant to the debtor's agreement” may substitute for an authenticated security agreement as an element of attachment.” U.C.C. § 9-104 cmt. 2 (2001).

⁶¹ “Control” is defined in section 9-104. The definition reads:

A secured party has control of a deposit account if:

- (1) the secured party is the bank with which the deposit account is maintained;
- (2) the debtor, secured party, and bank have agreed in an authenticated record that the bank will comply with instructions originated by the secured party directing disposition of the funds in the deposit account without further consent by the debtor; or
- (3) the secured party becomes the bank's customer with respect to the deposit account.

§ 9-104(a) (2001).

⁶² The UCC defines “authenticate” as:

- (A) to sign; or
- (B) to execute or otherwise adopt a symbol, or encrypt or similarly process a record in whole or in part, with the present intent of the authenticating person to identify the person and adopt or accept a record.

§ 9-102(a)(7).

granting the creditor access and rights to the account, or becoming a customer of the bank in which the account is held.⁶³

2. Relaxation of Asset Transfer Restrictions

In addition to adding new types of collateral, Revised Article 9 relaxes many statutory and contractual restrictions on the transfer of certain assets.⁶⁴ Reflecting Revised Article 9's strong policy in favor of free assignability, these provisions have the effect of overriding most restrictions on the assignment of accounts, general intangibles, promissory notes, and other contract and intangible property interests.⁶⁵ Although this is not a pure "scope" provision, the anti-assignment rules facilitate the creation of a valid, perfected Article 9 security interest in a broader variety of a debtor's assets.⁶⁶

3. Expansion of Proceeds Definition

The new definition of "proceeds" is another major change to Article 9's scope.⁶⁷ Section 9-102(a)(64) defines "proceeds" as "whatever is acquired upon the sale, lease, license, exchange, or other disposition of collateral" and "rights arising out of collateral."⁶⁸ This newly crafted description of proceeds is designed to capture any property with a connection to the original collateral as proceeds.⁶⁹ It eliminates the requirement that only collateral that has been "disposed of" gives rise to

⁶³ § 9-104(a).

⁶⁴ See §§ 9-406 & 9-408 (limiting certain restrictions on asset transfers).

⁶⁵ §§ 9-406 & 9-408.

⁶⁶ § 9-315(a)(2), (c). Article 9's broader "proceeds" definition includes, *inter alia*, any proceeds of sale upon the disposal of the intangible collateral, any license fees if the debtor is the licensor of an intellectual property right, and any property collected on, or distributed on account of, the collateral. § 9-102(64). Beyond obtaining a bare "security interest" in the non-assignable intangible right and a right to proceeds, however, the secured creditor receives few of the rights usually associated with a security interest. Because of this, the interest in a contract's value outside of bankruptcy may only be realized if the party with the anti-assignment provision is willing to recognize the security interest and consent to an assignment of the proceeds at liquidation. In such cases, proceeds generated from non-assignable contracts may prove to be valuable collateral. See generally Thomas E. Plank, *The Limited Security Interest in Non-Assignable Collateral Under Revised Article 9*, 9 AM. BANKR. INST. L. REV. 323, 329-30 (2001).

⁶⁷ U.C.C. § 9-102(a)(64) (2001).

⁶⁸ *Id.*

⁶⁹ Unlike a security interest in original collateral, security interests in proceeds attach automatically at the time the proceeds arise. The section 9-203 formalities for attachment are not required for a secured creditor's interest in proceeds to arise. See *id.* §§ 9-203(f), 9-315(a)(2).

proceeds.⁷⁰ For example, payment streams from the licensing of intellectual property collateral fall within the section 9–102(a)(64)(A) definition of proceeds of the subject intellectual property, whether or not any portion of the underlying intellectual property was “disposed of” under the license.⁷¹

Section 9–102(a)(64)(C)’s “rights arising out of collateral” language could potentially embrace a variety of rights associated with original collateral, including a broad spectrum of intangible rights. For example, a security interest in a copyright could conceivably reach a later-produced derivative work as a proceed of the original copyright.⁷² The concept of “proceeds” may also include damage claims arising out of the “infringement of rights in” collateral, at least “to the extent of value of [the] collateral.”⁷³ This new definition significantly departs from the “disposition”-based definition of proceeds under former Article 9.⁷⁴

4. *Purchase–Money Security Interests*

As was true of its predecessor, Revised Article 9 operates on a system of presumptive priority for the first secured party to give public notice of an interest.⁷⁵ Revised sections 9–103 and 9–324 provide an exception to this presumptive rule for those creditors who provide purchase money financing of goods and software.⁷⁶ Purchase money transactions involving software are limited to cases where the “debtor acquired its interest in the software in an integrated transaction in which it acquired an interest in the goods,” and the software is principally used in the goods.⁷⁷ This limitation forecloses purchase–money security interests in other types of intellectual property, thus potentially fore–

⁷⁰ Former Article 9 defines “proceeds” as what “is received upon the sale, exchange, collection, or other disposition of collateral or proceeds.” U.C.C. § 9–306 (1995).

⁷¹ THOMAS M. WARD, *INTELLECTUAL PROPERTY IN COMMERCE* § 2:11 at 2–37–2–38 (2004). Royalties and other income streams from the licensing of intellectual property are captured under the broader definition of “account” in Revised Article 9 and are also “proceeds” of the intellectual property. *Id.*

⁷² *See id.*; *see also* Jonathan C. Lipson, *Remote Control: Revised Article 9 and the Negotiability of Information*, 63 OHIO ST. L.J. 1327, 1375 (2002/03) (“This subsection provides explicitly what section 9–102(a)(64)(C) only implies: namely, that a claim for infringement of rights associated with original collateral (e.g., patent and copyrights) will be proceeds.”).

⁷³ WARD, *supra* note 71, § 2:11 at 2–37–2–38; *see* U.C.C. § 9–312 (1995); U.C.C. § 9–301 (2001).

⁷⁴ *Compare* U.C.C. § 9–306(1) (1995) (defining “proceeds” as “whatever is received upon the . . . disposition of collateral or proceeds”), *with* U.C.C. § 9–102(a)(64) (2001) (broadening the definition of “proceeds” beyond that of former § 9–306(1)).

⁷⁵ § 9–322(a).

⁷⁶ §§ 9–103 & 9–324.

⁷⁷ § 9–103(c).

closing "new value" opportunities in the form of intellectual property for debtors encumbered by blanket liens.⁷⁸

5. *Default and Foreclosure under Revised Article 9*

Revised Article 9's section on default does much to expand the rights of foreclosing secured parties.⁷⁹ Collection and foreclosure remedies have been enhanced, both substantively and procedurally.⁸⁰ For example, secured parties now have the right to exercise their collection and enforcement rights not only against debtors and account debtors, but also against guarantors and other persons obligated on collateral.⁸¹

Moreover, with respect to specific collateral types such as deposit accounts, the non-judicial collection procedures have been streamlined.⁸² For example, security interests in deposit accounts can be enforced by the creditor or bank in which the deposit account is held by "apply[ing] the balance of the deposit account to the obligation secured by the deposit account."⁸³ With respect to other secured parties who have perfected an interest in a deposit account by control, the secured party may instruct the depository bank to pay the balance of the account to the secured party upon a debtor's default.⁸⁴

B. *Article 9's Securitization Revisions*

Among the more dramatic modifications made to Article 9 are those designed to have an impact upon securitization transactions. Securitization⁸⁵ is a process by which a firm raises money by selling its

⁷⁸ WARD, *supra* note 71, § 2:49.

⁷⁹ Moreover, Revised Article 9 attempts to offer guidance to foreclosing parties with respect to the requirement that foreclosure sales be conducted in a commercially reasonable manner by setting forth far more specific requirements with respect to notice of sales. § 9-611(c)(3)(A), (B) & (C).

⁸⁰ Donald J. Rapson, *Default and Enforcement of Security Interests Under Revised Article 9*, 74 CHI.-KENT L. REV. 893, 945 (1999).

⁸¹ Section 9-607 states that Article 9 can be enforced against debtors, account debtors, and any "other person obligated on collateral to make payment or otherwise render performance to or for the benefit of the secured party." § 9-607(a)(1). This phrase is broad enough to include not only an "obligor" on an instrument, but also the debtor's rights against persons under contracts relating to the collateral, arising out of covenants, representations, and warranties that may have been breached.

⁸² § 9-607.

⁸³ § 9-607(a)(4).

⁸⁴ § 9-607(a)(5).

⁸⁵ Securitization's market predecessor was a method of finance known as factoring. With its origins in the 19th-century English textile industry, factoring is the sale of payment streams to third parties. Since the purchaser of the receivables conducted a credit review of customers, the seller was both relieved of the burden of conducting a

receivables⁸⁶ to a special purpose entity, which in turn sells the receivables-backed securities in the public or private capital markets.⁸⁷ The paradigmatic and most commonly securitized receivables fall within the Revised Article 9 definition of “account.”⁸⁸ Securitization allows purchasers of these receivables-backed assets to insulate themselves from many of the risks related to their originator’s business, relative to their risks if collateral were transferred to them in connection with a secured loan. Their risk is reduced because the asset-backed securities (“ABS”) purchasers are subject only to the risks associated with the transferred assets, not to the full array of risks associated with the originator’s business.⁸⁹

The paramount risk that ABS purchasers seek to avoid is the originator’s bankruptcy.⁹⁰ The extent of the securitized assets’ isolation from the originator’s bankruptcy risk, however, depends upon the strength of the transaction’s structure, which in turn is a product of the legal regime governing the transaction.⁹¹

credit review and able to readily liquidate its assets so that it could purchase more raw materials. See SUSAN CRICHTON & CHARLES W. FERRIER, UNDERSTANDING FACTORING AND TRADE CREDIT 7–9 (1986).

⁸⁶ Neither former nor Revised Article 9 defines the term “receivables.” For purposes of this article, the term “receivables” is defined as payment obligations owed to a company from a third party.

⁸⁷ JAMES A. ROSENTHAL & JUAN M. OCAMPO, SECURITIZATION OF CREDIT: INSIDE THE NEW TECHNOLOGY OF FINANCE 3 (1988). Professor Tamar Frankel, in her treatise on securitization, broadly defines “securitization” as the transformation of an asset into securities. This definition includes both loan participations as well as the substitution of securities for loans. TAMAR FRANKEL, SECURITIZATION: STRUCTURED FINANCING, FINANCIAL ASSET POOLS, AND ASSET-BACKED SECURITIES 4–5 (1991).

⁸⁸ U.C.C. § 9–102(a)(2) (2001).

⁸⁹ Among them are the risks of principal concern to secured creditors: exposure to external events such as business downturns, interest-rate fluctuations, management decisions, and, most importantly, the originator’s insolvency or bankruptcy. See ROSENTHAL & OCAMPO, *supra* note 87, at 8–9, 42–43.

⁹⁰ See *id.* at 42–43. “Generally, . . . [securitized assets] are insulated from the risk of an originator’s bankruptcy by structuring the transaction so that the underlying assets are not the property of the originator.” *Id.* at 43. Moreover, the asset purchaser, in contrast to the secured creditor, is not a “party in interest” in the securitizing debtor’s bankruptcy case. Section 1109(b) of the Bankruptcy Code defines “party in interest” to include “the debtor, the trustee, a creditors’ committee, an equity security holders’ committee, a creditor, an equity security holder, or any indenture trustee . . .” 11 U.S.C. § 1109(b) (2000); see also *In re Martin Paint Stores*, 199 B.R. 258, 264 (Bankr. S.D.N.Y. 1996) (stating that, for standing purposes, “party in interest” is reserved to one that is able to assert an equitable claim against the estate).

⁹¹ See Lois R. Lupica, *Asset Securitization: The Unsecured Creditor’s Perspective*, 76 TEX. L. REV 595 (1998) [hereinafter *Asset Securitization*] (describing the risks to which traditional asset-based lenders are subject); Shane Kite, *Insiders’ Predictions Point to Maturing Market*, ASSET SALES REP., Oct. 18, 1999 (“In terms of credit risk, the phrase ‘bankruptcy remote’ is sounding thinner and thinner, say insiders, as most feel the

Since its original enactment, Article 9 has governed not only traditional secured transactions, but also the *sale* of accounts.⁹² Because the distinction between assets sold and assets transferred as security is often blurred, Article 9 has always required public notice filing for both types of transactions.⁹³ There was a dark cloud of uncertainty, however, hanging over the heads of many investors of securitized assets under the

legal protection offered to bond investors from an issuing company's credit troubles has been oversold."); Suzanne Woolley, *What's Next, Bridge Tolls? Almost Any Risk Can Be Securitized—But Quality May Be Iffy*, BUS. WK., Sept. 2, 1996, at 64 (quoting a rating agency managing director urging caution to ABS investors); see also *Dinsmore v. Squadron*, Ellenoff, Plesent, Sheinfeld & Sorkin (*In re* Towers Financial Corp.), 135 F.3d 837, 838–40 (2d Cir. 1998) (the originator and five SPCs filed for bankruptcy protection, resulting in substantial losses for Tower's ABS investors). But see *In re* Carter Hawley Hale Stores, Inc., No. LA 64140 JD Chapter 11, 1991 Bankr. LEXIS 2186 (Bankr. C.D. Cal. July 30, 1991) (holding that debtor's "assignment and sale of the property" relieved the debtor from other liability under the agreement); *In re* Federated Dept. Stores, Inc., 1992 Bankr. LEXIS 392 (Bankr. S.D. Ohio, Jan. 10, 1992) (where the court, in both cases, respected the bankruptcy remote structure of the transaction). A recent Bankruptcy Court opinion, in connection with its issuance of a cash collateral order, said the following about the debtor's securitized assets:

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

In re LTV Steel Co., 274 B.R. 278, 285 (Bankr. N.D. Ohio 2001).

⁹² The original version of Article 9, enacted in 1962, governed the sales of "contract rights." The term "contract rights" was originally defined in Article 9 as "any right to payment under a contract not yet earned by performance and not evidenced by an instrument or chattel paper." This definition meant that once performed, some contract rights became accounts and others became general intangibles. As such, under the original version of Article 9, the statute potentially governed the sale of general intangibles. U.C.C. § 9–106 (1962); see GILMORE, *supra* note 8, at 379. The definition of "account" in the 1972 Amendments to Article 9 (the first version adopted by all fifty states), however, was narrowed in scope from its original definition. Sales of contract rights and other general intangibles were excluded (but the sale of chattel paper was included). Dan T. Coenen, *Priorities in Accounts: The Crazy Quilt of Current Law and a Proposal for Reform*, 45 VAND. L. REV. 1061, 1066 (1992); U.C.C. § 9–102(1)(a) & (b) (1998); see also Morton M. Sult, *Accounts Receivable Financing: Operational Patterns Under the Uniform Commercial Code*, 11 ARIZ. L. REV. 1 (1969) (describing accounts receivable financing prior to the enactment of Article 9 and under the UCC).

⁹³ The definition of "security interest" in section 1–201(37) includes the interest of the "buyer of accounts . . . subject to Article 9" as a security interest. U.C.C. § 1–201(35) (2001).

old Article 9 regime. While Article 9 governed the sale of accounts,⁹⁴ many commonly securitized assets fell outside the definition of “account,” and it was not always clear, or if clear it was not always easy, for transferees to perfect their interests in these assets.⁹⁵ Perhaps because there was so much money to be made by so many participants, this cloudiness did not inhibit the enthusiastic growth of the market for securitized debt.⁹⁶

Notwithstanding robust participation in the securitization market over the past decade and a half, there remained the problem of a discrepant legal regime governing securitizations.⁹⁷ In an attempt to reconcile the governing law with common securitization transactions, the Article 9 drafters included a wider variety of rights to payment arising from the transfer of rights in both tangible and intangible property within Revised Article 9’s definition of “account.”⁹⁸ The sale of the right to

⁹⁴ *Id.* Former article 9 also governed the sale of chattel paper. *See* U.C.C. § 9–102(1)(b) (1995).

⁹⁵ The asset-backed securities market began in 1985 when the Sperry Corporation originated the first true securitization, in which it sold \$192 million lease-backed notes in the public markets. The second deal was originated by General Motors Acceptance Corporation, in which eight billion dollars between late 1985 and 1986 was securitized. Three investment banking organizations captured the bulk of the lucrative commissions from these deals. Seeing an opportunity to expand into this market, at least fourteen major investment banks began aggressively seeking asset-backed security issuances to underwrite. *See* Comm. on Bankr. & Corp. Reorganization of the Ass’n of the Bar of the City of New York, *Structured Financing Techniques*, 50 *BUS. LAW.* 527, 538–39 (1995). *See* Lupica, *Asset Securitization*, *supra* note 91, at 608–09. The article states:

Following [the] early [securitization] transactions, firms became increasingly more creative and began securitizing automobile loans, leases, and credit card receivables. As the market for ABS has expanded in recent years, issuers have become even more imaginative with respect to the type of receivables securitized. Examples of recently issued [asset-backed securities] include bond issuances backed by unpaid real estate taxes, securities backed by hotel and hospitality receivables, taxi cab medallion-backed securities, securities backed by the excess spread from previously issued credit card securitizations, securities backed by health-care receivables, and securities backed by government-contract receivables.

Id. at 602–03 (citations omitted). The total debt owed by issuers of asset backed securities (excluding mortgages) was \$713 billion at the end of 1995. By the end of September 2001, it was \$2.02 trillion. *See* Board of Gov. of Fed. Res. System: *Summary of Credit Market Debt Outstanding*, 88 *FED. RES. BULL.* A40, tbl. 1.59 (2002).

⁹⁶ Lupica, *Asset Securitization*, *supra* note 91, at 608–09.

⁹⁷ *Id.* at 610; *see also* Ted Janger, *Crystals and Mud in Bankruptcy Law: Judicial Competence and Statutory Design*, 43 *ARIZ. L. REV.* 559 (2001) (examining the statutory structure governing securitization transactions).

⁹⁸ Revised Section 9–102(a)(2) now reads:

[A] right to payment of a monetary obligation, whether or not earned by performance, (i) for property that has been or is to be sold, leased, licensed, assigned or otherwise disposed of, (ii) for services rendered or to be rendered,

payment arising from the sale, lease, license, or assignment of commercial and consumer loans (including credit card receivables), leases, public utility and hotel services, insurance and franchise payments, and income streams from the license of intellectual property, will all give rise to "accounts" under Revised Article 9.⁹⁹

As a final "belt and suspenders" provision, Revised Article 9 also includes new section 9-318, which states that "a debtor that has sold an account, chattel paper, payment intangible, or promissory note" (all commonly securitized assets) retains no "legal or equitable interests in the collateral sold."¹⁰⁰ While this provision does not determine whether a transfer is a sale or a loan,¹⁰¹ if the transfer is determined to be a sale under non-Article 9 law,¹⁰² section 9-318 makes "explicit what was implicit"—that the debtor retains no interest in the receivables sold.¹⁰³

(iii) for a policy of insurance issued or to be issued, (iv) for a secondary obligation incurred or to be incurred, (v) for energy provided or to be provided, (vi) for the use or hire of a vessel under a charter or other contract, (vii) arising out of the use of a credit or charge card or information contained on or for use with the card, or (viii) as winnings in a lottery or other game of chance operated or sponsored by a State or governmental unit of a State The term includes health-care-insurance receivables. The term does not include (i) rights to payment evidenced by chattel paper or an instrument, (ii) commercial tort claims, (iii) deposit accounts, (iv) investment property, (v) letter-of-credit rights or letters of credit, or (vi) rights to payment for money or funds advanced or sold, other than rights arising out of the use of a credit or charge card or information contained on or for use with the card.

U.C.C. § 9-102(a)(2) (2001). As noted above, Article 9 sales coverage is further expanded to include payment intangibles and promissory notes. Loan pool participations are paradigmatic payment intangibles. Article 9 provides for the automatic perfection of transfers of loan participations. See § 9-109(a)(3) ("[T]his article applies to . . . a sale of accounts, chattel paper, payment intangibles, or promissory notes.").

⁹⁹ See § 9-102(a)(2). For example, the securitization of payments from the licensing of intellectual property are accounts and thus subject to the filing and priority rules of Revised Article 9. The securitization of securities backed by royalty streams from the sale of music has recently become a more common phenomenon. Investment banker David Pullman, architect of the first such deal—the sale of assets backed by David Bowie's royalty stream—observed, "There is a tremendous shift in wealth from hard assets—steel and manufacturing—to intellectual property, entertainment." Kathy Bergen, *100 Shares of Pavarotti? Stars Turn to Securitization*, SUN-SENTINEL (Miami), Dec. 6, 1997, at 16C; see also Joe Queenan, *Dead Men Earning*, FORBES, Mar. 22, 1999 at 253; Brendan Weston, *The Bonds Formerly Known as Artists*, ROB MAGAZINE REPORTER, May 1999.

¹⁰⁰ § 9-318(a).

¹⁰¹ This state-law determination turns largely on the extent to which the transferor has transferred the risks of the asset's collectability. See *Major's Furniture Mart, Inc. v. Castle Credit Corp.*, 602 F.2d 538, 545-46 (3d Cir. 1979).

¹⁰² Historically, the Bankruptcy Code has relied upon non-bankruptcy law to define property interests under the Code. When the issue is whether a transfer of Article 9 assets is properly included in the transferee's bankruptcy estate, the nature of the transfer, as well as the necessary steps to establish the transferee's property rights, has always been determined by state law. Recently, Congress tried to change this. There was a provision

C. Article 9's Procedural Revisions

1. Single Place to File and Supergeneric Descriptions

In an effort to improve the functional efficiency of the secured transactions system, Revised Article 9 simplifies the procedures for the perfection of Article 9 security interests.¹⁰⁴ For example, in contrast to the complicated rules setting forth office or offices in which secured creditors should file their financing statements (which turned on the category of asset taken as collateral, as well as whether such asset was tangible¹⁰⁵ or intangible¹⁰⁶), Revised Article 9 provides for a single place to file against all of a debtor's assets.¹⁰⁷ Secured parties seeking perfection no longer have to determine the location of their debtor's collateral or worry about whether it has been moved. The often-clouded issue of locating the debtor's "chief executive office"¹⁰⁸ is eliminated by Revised Article 9's new rule for determining the location of the debtor.¹⁰⁹ Secured creditors seeking to perfect security interests in debtors who are corporations, partnerships, or limited liability companies will file their financing statements in the jurisdiction where the debtor entity was organized.¹¹⁰ The new Article 9 rule eliminates the need for creditors to

included in the original draft of the Bankruptcy Reform legislation redefining the concept of "estate." Bankruptcy Reform Act, H.R. 2415, 106th Cong. § 912 (2000). Such redefinition would have removed from the bankruptcy court's jurisdiction "eligible assets" transferred by the debtor to an "eligible entity in connection with an asset-backed securitization." "Eligible assets" are defined to include commonly securitized receivables. This provision would have been a dramatic change in the law defining estate property. *Id.* In 2001, this provision was removed from the Bankruptcy Reform bill. See Glenn R. Simpson & Susan Pulliam, *Congressional Negotiators Drop Measure in Bankruptcy Bill Tied to Enron Failure*, WALL ST. J., Feb. 28, 2001, at A4.

¹⁰³ U.C.C. § 9-318 cmt. 2 (2001).

¹⁰⁴ Harris & Mooney, *Reflections*, *supra* note 6, at 1360.

¹⁰⁵ Under former Article 9, a party seeking to perfect its security interest against tangible assets had to file a financing statement in the jurisdiction where the assets were located. See U.C.C. § 9-103 (1995).

¹⁰⁶ Former Article 9 provided that security interests against intangible assets could be perfected by filing in the jurisdiction where the debtor was located. See § 9-103(3)(a) & (b).

¹⁰⁷ U.C.C. § 9-301 (2001).

¹⁰⁸ U.C.C. § 9-103(3)(d) (1995) ("A debtor shall be deemed located at his place of business if he has one, [and] at his chief executive office if he has more than one place of business . . .").

¹⁰⁹ U.C.C. § 9-307 (2001).

¹¹⁰ *Id.* Section 9-307(e) states, "A registered organization that is organized under the law of a State is located in that State," thus determining that for a "registered" entity, the place to file is the place of organization. § 9-307(e). This results in a corresponding headache for searchers, although not as much of a headache as looking everywhere an

make judgment calls about where businesses are located and to chase inventory, equipment, and debtors as they move from state to state in order to maintain perfected status.¹¹¹

Another striking change to Article 9 permits secured parties to use “supergeneric” descriptions of collateral in financing statements.¹¹² Typically, supergeneric collateral descriptions read, “all the debtor’s assets.”¹¹³ Multi-page attachments enumerating every item of collateral or collateral type are no longer necessary for secured parties to take a blanket lien on a debtor’s assets. These rules are simplifications of the formalities Article 9 requires that will, in effect, make it easier to perfect and maintain a blanket lien and harder for secured parties to make mistakes.¹¹⁴

2. Two-Tier Perfection Rules

Revised Article 9 includes a two-tier rule for omissions in financing statements.¹¹⁵ Pursuant to section 9-502(a), only three types of errors in the financing statement make it vulnerable to a bankruptcy trustee’s “strong arm”¹¹⁶ challenge: the omission of i) the debtor’s name, ii) the creditor’s name, or iii) a description of the collateral.¹¹⁷ There are, however, additional requirements that the financing statement must satisfy in order to be accepted by the filing office;¹¹⁸ it must include the

organization had tangible assets under old Article 9. For a non-registered organization, a debtor is located “at its place of business.” § 9-307(a) & (b).

¹¹¹ To illustrate, a secured party will file a financing statement in the Maine Secretary of State’s office to perfect a security interest in the assets of Smith’s Provisions, Inc., a Maine corporation, with inventory and equipment located in New York and Pennsylvania and its principal place of business in New Hampshire. If the chief executive office of Smith’s Provisions, Inc., moves to another state, or if inventory or equipment is relocated, unlike under former Article 9, a creditor having filed a financing statement in Maine would remain fully perfected.

¹¹² See § 9-502(a)(3) (“a financing statement is sufficient only if it . . . indicates the collateral covered by the financing statement”); § 9-504 (“A financing statement sufficiently indicates the collateral that it covers if the financing statement provides: (1) a description of the collateral pursuant to Section 9-108; or (2) an indication that the financing statement covers all assets or all personal property.”); § 9-108(a) (“if it reasonably identifies what is described”); § 9-504 cmt. 2 (stating that a financing statement sufficiently indicates the collateral if it covers “all assets or all personal property”).

¹¹³ § 9-108(c) & cmt. 2.

¹¹⁴ Harris & Mooney, *Policy & Impact*, *supra* note 7, at 99-101.

¹¹⁵ § 9-502(a).

¹¹⁶ Section 544(a) of the Bankruptcy Code allows for the avoidance of unperfected security interests. See 11 U.S.C. § 544(a) (2000). See generally Pryor, *supra* note 20.

¹¹⁷ § 9-502(a).

¹¹⁸ § 9-502(a), 9-516(b)(5)(C), 9-520(a).

debtor's jurisdiction of organization, organizational type, and organizational identification number.¹¹⁹ If, however, notwithstanding the absence of any or all of this "required" information, the financing statement is accepted by the filing office, the secured party, while not perfected in a priority contest between it and another secured creditor or purchaser, is deemed validly perfected when subject to the scrutiny and powers of the debtor's bankruptcy trustee.¹²⁰ Thus, it is less likely that a filed creditor will have its security interest defeated by a bankruptcy trustee than it is that a creditor with a flawed financing statement will lose a priority contest against another secured creditor or purchaser.

Moreover, with respect to certain specified types of collateral, Revised Article 9 similarly makes it easier to protect secured creditors from the bankruptcy trustee's strong arm. For example, security interests in deposit accounts can be perfected by third-party creditors gaining "control"¹²¹ over the account, but that secured party is vulnerable to defeat by the bank in which the account is held if the bank exercises its right of setoff.¹²² A secured creditor that has established "control" over a deposit account, however, is fully secured in a contest against the trustee in bankruptcy.¹²³

There is a similar rule with respect to instruments.¹²⁴ For example, a transfer of instruments may be perfected by filing, and such perfection will defeat the interest of the bankruptcy trustee.¹²⁵ Perfection by possession, however, is required to win a priority contest with another secured party or a purchaser.¹²⁶

¹¹⁹ §§ 9–502(a), 9–516(b)(5)(c), 9–520(a).

¹²⁰ §§ 9–338(1)–(2), 9–502(a).

¹²¹ See *infra* notes 212–24 and accompanying text.

¹²² "Setoff" is defined as "a debtor's right to reduce the amount of a debt by any sum the creditor owes the debtor; the counterbalancing sum owed by the creditor." BLACK'S LAW DICTIONARY 1376 (7th ed. 1999).

¹²³ §§ 9–104(a), 9–317(a).

¹²⁴ "Instruments" are defined in Section 9–102(a)(47) as:

[A] negotiable instrument or any other writing that evidences a right to the payment of a monetary obligation, is not itself a security agreement or lease, and is of a type that in ordinary course of business is transferred by delivery with any necessary indorsement or assignment. The term does not include (i) investment property, (ii) letters of credit, or (iii) writings that evidence a right to payment arising out of the use of a credit or charge card or information contained on or for use with the card.

§ 9–102(a)(47). This was the rule under former Article 9, too.

¹²⁵ § 9–312(a).

¹²⁶ §§ 9–330(d), 9–312(a), 9–314(a). This has been the rule under former Article 9 with respect to "investment property." A secured party seeking to perfect an interest in investment property could file a financing statement. That filing, however, would not defeat the interest of a competing secured creditor or purchaser. It would, however, defeat the interest of a trustee in bankruptcy exercising its strong arm powers. See U.C.C. § 9–

III. THEORY AND REVISED ARTICLE 9

A. *The Theoretical Defense of Revised Article 9*

As described in Part II above, Revised Article 9 is a significant departure from the former version of Article 9. Clearly, the changes made were designed to enhance the effective operation and efficiency of what has been viewed by some as a very effective and theoretically defensible statute.¹²⁷ Each specific revision was included to address a perceived problem or deficiency in the old statute.¹²⁸

The revisions were premised on the idea of increased efficiency—gains to secured creditors would outweigh any losses to third parties.¹²⁹ The gains enjoyed by secured creditors include a lower lending risk and a correspondingly increased chance of repayment. The lowered risk results from the lender's enhanced ability to monitor and control a debtor's behavior, the initial diligence concerning the identified collateral, and the lender's greater confidence in the value of the collateral relative to debtor's cash flow.¹³⁰ Proponents of Revised Article 9 predicted that the changes would make it "easier and less expensive to create and perfect

115(5) (1995). Revised Article 9 carries this rule forward with respect to investment property. See §§ 9-312(a), 9-314(a).

¹²⁷ Harris & Mooney, *A Property-Based Theory*, *supra* note 32, at 2052-53. The authors state:

The positive value of permitting debtors to give security freely and effectively suggests two important rules of thumb to be followed in the process of revising Article 9. First, the drafters should purge Article 9 of obstacles to the creation of effective security interests. Because there is nothing generally unsound or suspect about the creation of effective security interests, formalistic requirements that upset the intentions of the parties and prove to be traps for the unwary should be eliminated. Second, the scope of Article 9 should be expanded. Many of the common-law rules governing the creation of security interests in personal property are uncertain and cumbersome. Insofar as the creation of security interests is easier, less costly, and more certain under Article 9 than under common-law rules, expansion of the statute is likely to serve the overarching goal of effectuating the will of the parties. The drafters should add limitations and restrictions only when they are demonstrably warranted in particular circumstances. Moreover, the presumption against interference with party autonomy should extend to existing impediments (e.g., public notice requirements) as well as to proposed new ones.

Id.

¹²⁸ Harris & Mooney, *Policy & Impact*, *supra* note 7, at 86-88.

¹²⁹ Harris & Mooney, *Reflections*, *supra* note 6, at 1360.

¹³⁰ See generally, e.g., Richard L. Barnes, *The Efficiency Justification for Secured Transactions: Foxes with Soxes and Other Fanciful Stuff*, 42 U. KAN. L. REV. 13 (1993) (describing attempts by legal scholars to provide economic justifications for secured credit).

security interests and to achieve priority over competing claimants.”¹³¹ As argued, Revised Article 9’s expanded scope and procedural simplifications, in enabling creditors to take security interests in a greater number and type of assets with greater facility, simply make a good thing better.¹³²

B. A Competing Vision

Not surprisingly, a competing vision has been put forth of what may result from Article 9’s revision. First, if streamlining procedures and expanding Article 9’s scope results in an increase in the availability and a decrease in the price of secured credit, it may also have the pernicious effect of raising the price of unsecured credit.¹³³ Further, because Article 9 offers the enhanced potential for a dominant secured creditor to encumber all of a debtor’s assets, subsequent financing may be more difficult to obtain.¹³⁴ This may result in reduced cash flow, which correspondingly may mean that trade creditors, employees, tort claimants, and other undiversified creditors¹³⁵ will be compromised.¹³⁶

The Article 9 revision may also have an impact on the business bankruptcy process.¹³⁷ A secured creditor, by virtue of its blanket security interest, places constraints on a debtor’s decision with respect to both its assets and its business. Once bankruptcy is filed however, such constraints become control over the debtor’s reorganization.¹³⁸ Such control by a dominant secured party, as a proxy for the privatization of business bankruptcy, has far-reaching implications.¹³⁹

¹³¹ Harris & Mooney, *Reflections*, *supra* note 6, at 1360.

¹³² Harris & Mooney, *A Property-Based Theory*, *supra* note 32, at 2053.

¹³³ Kenneth N. Klee, *Barbarians at the Trough: Riposte in Defense of the Warren Carve-out Proposal*, 82 CORNELL L. REV. 1466, 1469 (1997); LoPucki, *Creditor’s Bargain*, *supra* note 18, at 1898; Warren, *Imperfect Information*, *supra* note 21, at 1386.

¹³⁴ Klee, *supra* note 133, at 1475.

¹³⁵ Undiversified creditors are those that lend in one (or few) industries. See Adler, *Finance’s Divide*, *supra* note 19, at n.35.

¹³⁶ LoPucki, *Creditor’s Bargain*, *supra* note 18, at 1898; Lynn LoPucki, *The Death of Liability*, 106 YALE L.J. 1, 14–16 (1996) [hereinafter *Liability*].

¹³⁷ Jay Lawrence Westbrook, *The Control of Wealth in Bankruptcy*, 82 TEX. L. REV. 795, 837–43 (2004) [hereinafter *The Control of Wealth*].

¹³⁸ *Id.*

¹³⁹ Douglas G. Baird & Robert K. Rasmussen, *The End of Bankruptcy*, 55 STAN. L. REV. 751, 784–85 (2002) [hereinafter *End of Bankruptcy*].

IV. BEYOND THEORY TO EMPIRICISM

Even if one or more of the above-described theories is intuitively appealing, its predictive power remains unproven.¹⁴⁰ There has been no comprehensive empirical study of Revised Article 9's effects on the credit markets or on the bankruptcy process verifying or disproving any academic theories advanced.¹⁴¹ The execution of such a study would bring a higher level of confidence and objective certainty to the various "conclusions" concerning the effects of the secured credit system than is possible based merely on speculation and prediction. Once we have objective, scientifically verifiable information about the effects of secured credit, many of us will have to modify our "theories, opinions and beliefs" in accordance with empirical findings.¹⁴² At that point, we can engage in a normative discussion about the wisdom of the unlimited and unqualified use of secured credit.

A. *Empiricism v. Theory – The Case of Durrett*

The importance of empiricism in evaluating legal rule changes is well illustrated by what is known as the "Durrett Controversy."¹⁴³ In 1980, in the case of *Durrett v. Washington National Insurance Co.*,¹⁴⁴ the Fifth Circuit held that a regularly conducted, non-collusive pre-bankruptcy foreclosure sale of a debtor's real property at less than 70% of the property's fair market value was voidable as a fraudulent

¹⁴⁰ See Mario J. Rizzo, *The Mirage of Efficiency*, 8 HOFSTRA L. REV. 641, 642 (1980) ("Unless the empirical counterpart to a theoretical standard can be identified, advocacy of the latter cannot lead to any change in or validation of existing law."); Gordon Tullock, *Two Kinds of Legal Efficiency*, 8 HOFSTRA L. REV. 659, 668 (1980) ("[T]he statement is made that . . . this particular rule is the most efficient. It may or may not be. The only way to tell is to engage in careful research . . .").

¹⁴¹ There have, however, been myriad studies of the credit markets conducted by business and economics scholars. None of these have endeavored to address the debate concerning the effects and efficiency of the continued existence and expansion of secured credit. See e.g., EDWARD I. ALTMAN, *BANKRUPTCY, CREDIT RISK AND HIGH YIELD JUNK BONDS*, at xxiii (2002) (detailing studies conducted by Professor Altman and other scholars of what was referred to as "the 'dark side' of Finance—bankruptcies, corporate distress, defaults, etc." (Preface)); Mitchell A. Petersen & Raghuram G. Rajan, *Trade Credit: Theories and Evidence*, REVIEW OF FINANCIAL STUDIES, v. 10 n.3 (1997); ALLEN N. BERGER ET AL., *THE EFFECT OF MARKET SIZE STRUCTURE ON COMPETITION, THE CASE OF SMALL BUSINESS LENDING* (Fed. Reserve Bank of Chicago Research, Working Paper No. 01-10, 2001); JEREMY BERKOWITZ, *BANKRUPTCY AND SMALL FIRMS' ACCESS TO CREDIT* (Nat'l Bureau of Econ. Research, Working Paper No. 9010, 2002).

¹⁴² NEALE & LIEBERT, *supra* note 27, at 9.

¹⁴³ Philip Shuchman, *Data on the Durrett Controversy*, 9 CARDOZO L. REV. 605 (1987).

¹⁴⁴ *Durrett v. Washington Nat'l Ins. Co.*, 621 F.2d 201 (5th Cir. 1980).

conveyance.¹⁴⁵ When this dramatic pronouncement was made, members of the commercial law community expected a seismic market response;¹⁴⁶ it was widely anticipated that the availability of credit would contract and the price of credit would increase.¹⁴⁷ This anticipation was fueled by writings critical of *Durrett* asserting the various adverse effects the rule would impose on the credit market.¹⁴⁸

In seeking to determine the extent to which credit markets responded to the rule change announced in *Durrett*, Professor Philip Shuchman undertook an empirical study of the cost and availability of residential mortgage loans in states in which the *Durrett* rule was adopted, and he compared that data to the cost and availability of residential mortgage loans in states that rejected the *Durrett* rule.¹⁴⁹ Data was collected from a variety of publicly available sources, including Federal Home Loan Bank Board and Housing and Urban Development surveys.¹⁵⁰ Interest rates,

¹⁴⁵ *Id.* at 202.

¹⁴⁶ Shuchman, *supra* note 143, at 616.

¹⁴⁷ See generally *id.*

¹⁴⁸ *Id.* at 618; see also Robert M. Zinman et al., *Fraudulent Transfers According to Alden, Gross and Borowitz: A Tale of Two Circuits*, 39 BUS. LAW. 977, 1013 (1984):

The immediate effect of the acceptance of the *Durrett* rule would be to chill bidding at foreclosure sales. Third parties will be unlikely to bid for properties knowing that the application of fraudulent-conveyance laws could set aside the sale at a later date. The absence of competitive bidding will in all likelihood reduce prices at foreclosure sales and increase the likelihood of deficiency judgments in those states where they are permitted.

Id.; Lawrence D. Coppel & Lewis A. Kann, *Defanging Durrett: The Established Law of "Transfer"*, 100 BANKING L.J. 676, 682 (1983) ("*Durrett* . . . drives bids down [on foreclosure sale prices] . . ."). Two years following the *Durrett* decision, the Ninth Circuit heard the case of *Madrid v. Lawyers Title Insurance Corp.*, in which it similarly faced the question whether a non-collusive, regularly conducted nonjudicial foreclosure sale could be deemed a fraudulent conveyance. Among the writings critical of *Durrett* that predicted dire and significant effects were amicus briefs in the *Madrid* case. The court in *Madrid* ultimately concluded that a sale under such conditions at least satisfies the "reasonably equivalent value" requirement of Bankruptcy Code Section 548(a)(2). *Lawyers Title Ins. Co. v. Madrid (In re Madrid)*, 21 B.R. 424, 426–27 (B.A.P. 9th Cir. 1982) (B.A.P.), *aff'd on other grounds*, 725 F.2d 1197 (9th Cir. 1984).

¹⁴⁹ Shuchman, *supra* note 143, at 624. In the study conducted by Professor Shuchman, interest rates, loan to price ratios, and total real estate-related loans were studied between the period before *Durrett* was decided and after the Ninth Circuit's decision in *In re Madrid*, 725 F.2d 1197 (9th Cir. 1984).

¹⁵⁰ Data for Professor Shuchman's study was collected from the Federal Home Loan Bank Board (Primary Mortgage Interest Rate Surveys), the Federal Home Loan Mortgage Corporation, the Federal Home Loan Bank of San Francisco, the Federal Home Loan Bank of Cincinnati, the Department of Housing and Urban Development, the Sovran Mortgage Corporation, and HSH Associations. Professor Shuchman noted, "While problems can arise from non-uniform methods of data collection, in the gross terms we employed for our purposes, the possible errors due to this artifact should not

loan-to-price ratios, and the number of real estate acquisition loans were measured in the relevant jurisdictions before and after the *Durrett* decision.¹⁵¹

The study revealed that the *Durrett* rule had little, if any, impact on the market for real-estate-related financing.¹⁵² Though Professor Shuchman cautiously offered possible alternative causes for the absence of a market response to the *Durrett* ruling,¹⁵³ there was sufficient data to logically deduce that the “claimed societal effects” of the *Durrett* rule were without basis.¹⁵⁴ Professor Shuchman observed that many of the pre-study conclusions concerning the effects of the *Durrett* rule on the market were derived from theoretical models, not “the known sets of empirical facts.”¹⁵⁵ He cautioned legal scholars and other commentators against drawing conclusions concerning the causal effects of new legal rules based solely on theories untested by empirical study.¹⁵⁶

B. Empiricism and Revised Article 9

The path to the empirical study of Article 9 has recently been forged, and this early empiricism will go far to help form the contours of more comprehensive studies to come.¹⁵⁷ With the objective of explaining how

distort matters. The numbers of mortgages and the total dollar amounts are so great that the variations should be relatively small.” Shuchman, *supra* note 143, at 624–25.

¹⁵¹ *Id.*

¹⁵² *Id.* at 615–16.

¹⁵³ *See id.* at 637–40 (setting forth eleven “other possible and plausible explanations for the before-and-after data” in his study).

¹⁵⁴ *Id.* at 640–41.

¹⁵⁵ *Id.* at 618.

¹⁵⁶ *Id.* at 618–19. Recognizing the limited scope of his study, Professor Shuchman observed that no one had proved “the conventional economic model[,] which holds that the perception of increased risk flowing from what will or what might happen in the legal process . . . [would] have dramatic effects on the mortgage market.” *Id.* at 619. Indeed, recent studies in behavioral economics have called into question the accuracy of the traditional wisdom that markets readily respond to changes in legal rules. Robert K. Rasmussen, *Behavioral Economics, The Economic Analysis of Bankruptcy Law and the Pricing of Credit*, 51 VAND. L. REV. 1679, 1691–92 (1998) (noting skepticism that the Supreme Court’s decision in *Barnhill v. Johnson* (holding that a payment to a lender is deemed to be made when the payment check is honored by the debtor’s bank for purposes of preference law) would be reflected in an increase in the price of credit); Symposium, *Contemporary Issues in Bankruptcy and Corporate Law, Panel Discussion and Question-Answer Session*, 61 U. CIN. L. REV. 569, 571 (1992). Professor David Gray Carlson noted that “not every change in the law produces a change in the price of credit” and further observed that the extent to which the market responds to changes in the law is an empirical question. *Id.*

¹⁵⁷ *See, e.g.*, Claire A. Hill, Essay: *Is Secured Debt Efficient?*, 80 TEX. L. REV. 1117 (2002); Ronald J. Mann, *Strategy and Force in the Liquidation of Secured Debt*, 96 MICH. L. REV. 159, 233 (1997) [hereinafter *Strategy and Force*]; Ronald Mann,

the credit markets work in practice, two scholars have made recent contributions that help place many of the questions concerning the workings of the credit markets in their proper context.¹⁵⁸ Though the narrow scope and abbreviated methodology of these studies invite a more extensive empirical study,¹⁵⁹ a number of interesting and intuitively appealing observations were made.

First, it was observed that there is not one market for credit, but many.¹⁶⁰ Factors such as the size of the business, the nature of the business, the type of assets a firm has, and the circumstances in which a firm finds itself,¹⁶¹ all have an impact on whether, and the extent to which, secured credit is used.¹⁶² Thus, conclusions drawn in a study of one market segment will not necessarily be valid as applied to another segment.

Moreover, there are a variety of transaction structures that have the “paradigmatic features” of secured debt.¹⁶³ These include the grant of a security interest in all of a debtor’s assets (otherwise known as a “blanket lien”), as well as in part of a debtor’s assets, including a targeted security interest in certain specified assets.¹⁶⁴ Additionally, a “secured credit” transaction can take the form of a transfer of assets as collateral, or the securitization or sale of liquid assets, commonly known as receivables.¹⁶⁵

Explaining the Pattern of Secured Credit, 110 HARV. L. REV. 625, 628–29 (1997) [hereinafter *Explaining the Pattern*].

¹⁵⁸ Hill, *supra* note 157; Mann, *Explaining the Pattern*, *supra* note 157.

¹⁵⁹ In the study conducted by Professor Hill, twenty lawyers, bankers, and business people with expertise in the credit markets were interviewed. Hill, *supra* note 157, at 1117. Similarly, Professor Mann’s studies were based on twenty-three interviews with participants in the credit markets, as well as three case studies, each one with a separate type of lender. Mann, *Explaining the Pattern*, *supra* note 157, at 631; Mann, *Strategy and Force*, *supra* note 157, at 235.

¹⁶⁰ Mann, *Explaining the Pattern*, *supra* note 157, at 628–29. There is “relatively infrequent use of secured credit by [large] companies.” *Id.* at 626; LoPucki, *Liability*, *supra* note 136, at 14 (“[S]ecured debt strategies . . . are employed primarily by small, relatively uncreditworthy businesses.”); Robert E. Scott, *A Relational Theory of Secured Financing*, 86 COLUM. L. REV. 901, 940 (1986) (“Most secured debt is issued by relatively small, young, and growing firms.”). One scholar who has studied the market noted that “as a borrower’s financial strength increases, secured credit becomes a less attractive alternative.” Mann, *Explaining the Pattern*, *supra* note 157, at 674.

¹⁶¹ The factors by which firms can be distinguished include credit history and quality. Hill, *supra* note 157, at 1124.

¹⁶² *Id.*

¹⁶³ *Id.* at 1124–26.

¹⁶⁴ *Id.* at 1124–25. An example of this type of grant of security is inventory and accounts financing. *Id.* at 1141.

¹⁶⁵ *Id.* at 1125. Professor Hill also includes a description of a lease financing transaction, making the point that:

The longer the term of the lease relative to the life of the asset, the more leasing resembles secured debt. . . . A continuum exists between the most

Not all firms can or will engage in all varieties of secured transactions, and therefore explanations concerning the use of secured credit are not likely to hold across market segments.

Beyond the description of the types of borrowers that access the secured credit market, it was further reported that the experience of managing a lending relationship may be somewhat different than assumed.¹⁶⁶ According to some survey respondents, the legal framework governing secured transactions sets forth a system where a debtor's behavior is guided toward secured lender repayment well before loans fall into distress.¹⁶⁷ Belying the traditional perspective that Article 9's grant of a right to repossess and liquidate collateral is at the center of a creditor's motivation in taking a security interest, the study observed that the strategic aspects of the secured lending arrangement were more important to secured lenders than their ability to ultimately force a liquidation of collateral.¹⁶⁸ Instead, most secured lenders holding distressed loans were paid either from the cash flow resulting from the borrower's continued operation, from the debtor's sale of the collateral, or from the proceeds of the debtor's refinancing.¹⁶⁹ Because the liquidation value of collateral rarely, if ever, approaches the value of an outstanding loan, the Article 9 foreclosure and sale provisions were viewed by the lenders surveyed as the repayment option of last resort.¹⁷⁰ By strategically using collection devices outside the scope of Article 9's remedial provisions, lenders in the majority of cases studied were paid in full.¹⁷¹

The "strategic pressure" that most influences creditor repayment begins long before a debtor's financial distress.¹⁷² This pressure includes the lender's ability to limit subsequent borrowing, to exert leverage to encourage repayment, and to motivate the borrower not to engage in risky behavior.¹⁷³ Although these behavior-maximizing incentives all operate in the shadow of Article 9 remedies, the study concluded that there was limited reliance by lenders on the formal statutory liquidation

lease-like lease (such as a short-term lease of a water cooler) and a debt-like lease (such as a long-term lease of an aircraft); much leasing falls somewhere in the middle.

Id. at 1128 (footnotes omitted).

¹⁶⁶ Mann, *Strategy and Force*, *supra* note 157, at 233.

¹⁶⁷ *Id.*

¹⁶⁸ *Id.* at 233-36.

¹⁶⁹ *Id.* at 234.

¹⁷⁰ *Id.* at 164.

¹⁷¹ *Id.*

¹⁷² The issue of leverage in negotiation has been assiduously studied in negotiation theory literature. *See, e.g.*, Robert S. Adler & Elliot M. Silverstein, *When David Meets Goliath: Dealing with Power Differentials in Negotiations*, 5 HARV. NEGOT. L. REV. 1 (2000).

¹⁷³ Mann, *Explaining the Pattern*, *supra* note 157, at 641.

processes.¹⁷⁴ Control over the debtor's business and behavior offered the primary benefit to secured lenders.¹⁷⁵

V. REVISED ARTICLE 9 AND BUSINESS BANKRUPTCY THEORY

When a business debtor files for bankruptcy, a lender's "strategic pressure" to coerce repayment will be to no avail. Once the bankruptcy system is accessed, voluntary repayment is no longer an option and the distributive baseline with respect to creditors' interests in debtors' assets is established by Article 9.¹⁷⁶ As such, changes made to the Article 9 rules have the potential to resonate far more loudly in bankruptcy. Depending upon how one sees the theory and purpose of the bankruptcy system,¹⁷⁷ this may or may not be a positive development.

A. Critics of Judicially Supervised Reorganization

The business bankruptcy system continues to be the subject of intense scholarly debate.¹⁷⁸ Some scholars have been openly critical of the current business bankruptcy system, with many of these critics subscribing to what has been characterized as the contract theory

¹⁷⁴ *Id.* at 639–41.

¹⁷⁵ *Id.* at 641.

¹⁷⁶ *Butner v. United States*, 440 U.S. 48, 55 (1979) ("Property interests are created and defined by state law.").

¹⁷⁷ For a survey of current bankruptcy scholarship, see Douglas G. Baird, *Bankruptcy's Uncontested Axioms*, 108 *YALE L.J.* 573, 577 (1998) (referring to those holding each of the two primary perspectives on business bankruptcy as "proceduralists" and "traditionalists"); see also JANIS SARRA, *CREDITOR RIGHTS AND THE PUBLIC INTEREST* 34–50 (2003) (identifying four general bankruptcy theories: 1) Market Theory, under which "clarify[ing] priority of creditors' claims" is the sole objective; 2) Debt Collection Theory, under which "bankruptcy's normative policy objective is to collectivize the process by which a debtor's assets are made available to claimants"; 3) Rehabilitation Theory, under which the "preservation of the firm as an ongoing entity" is a primary objective; and 4) Enterprise Theory, under which "enterprise value maximization" is the "normative objective of corporate decision making").

¹⁷⁸ The issue of whether and to what extent the bankruptcy system ought to be reformed has been before Congress for four consecutive congressional sessions. While much of the proposed bankruptcy reform legislation has targeted the consumer bankruptcy system, reform of the business bankruptcy system has also been part of the legislative agenda. Chapter 11 has been criticized for being both inefficient and ineffective. There has been no legislative provision, however, to directly abolish business reorganization. See 11 U.S.C. § 365 (2000) (allowing for the acceptance or rejection of executory contracts); 11 U.S.C. § 544(a) (2000) (allowing for the avoidance by the trustee of unperfected security interests).

approach to bankruptcy.¹⁷⁹ Adherents to this theoretical approach posit that business bankruptcies today are dominated by a single controlling party.¹⁸⁰ Indeed, in recent years contract theory bankruptcy scholars have focused their energy on advancing criticism of and alternatives to the traditional judicially supervised chapter 11.¹⁸¹ For example, in a recent article, Professors Douglas Baird and Robert Rasmussen declared chapter 11 obsolete and offered three central arguments in support of this declaration.¹⁸² First, they claimed that where firms' assets are largely fungible, going concern value is an antiquated notion. In the absence of specialized, firm-specific assets, there is nothing unique to be preserved through reorganization that could not be deployed and utilized in another enterprise.¹⁸³ Second, they argued that bankruptcy-court supervision of a firm as a surrogate for responsible management is no longer necessary,

¹⁷⁹ Barry E. Adler, *Financial and Political Theories of American Corporate Bankruptcy*, 45 STAN. L. REV. 311, 319-24 (1993); Baird & Rasmussen, *End of Bankruptcy*, *supra* note 139, at 758-59.

¹⁸⁰ Baird & Rasmussen, *End of Bankruptcy*, *supra* note 139, at 784-85. Baird and Rasmussen explain:

The revolving credit facility, installed as the firm begins to have trouble making debt payments, also gives the lender who runs it the ability to control the firm inside of chapter 11 as well as out. Most large firms that enter chapter 11 lack enough free cash flow to operate without debtor-in-possession (DIP) financing. The control that the lender has over cash collateral makes it hard to enter into a financing arrangement without its explicit blessing. Its blessing can be contingent upon many things, including a requirement that the firm be sold as a going concern within a fixed period of time. At other times, the lender may give the current managers one more chance to turn around the fortunes of the firm, but it may be time constrained. A sale of assets may not be required immediately, but the DIP lending agreement may require that the assets be sold if the firm is not cash flow positive in a relatively short time. In other words, it is the lender, and not the Bankruptcy Code or the bankruptcy judge, that is deciding how long the managers will have to make a go of things.

Id. (footnotes omitted).

¹⁸¹ THOMAS H. JACKSON, *THE LOGIC AND LIMITS OF BANKRUPTCY LAW* 218-24 (1986); Douglas G. Baird, *The Uneasy Case for Corporate Reorganizations*, 15 J. LEGAL STUD. 127 (1986); Michael Bradley & Michael Rosenzweig, *The Untenable Case for Chapter 11*, 101 YALE L.J. 1043 (1992); Robert K. Rasmussen, *Debtor's Choice: A Menu Approach to Corporate Bankruptcy*, 71 TEX. L. REV. 51 (1992); Lynn M. LoPucki, *Chapter 11: An Agenda for Basic Reform*, 69 AM. BANKR. L.J. 573 (1995); see also Lucian Arye Bebchuk, *Chapter 11*, in 1 NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 219, 221-22 (1998).

¹⁸² See generally Baird & Rasmussen, *End of Bankruptcy*, *supra* note 139; Douglas G. Baird & Robert K. Rasmussen, *Chapter 11 at Twilight*, 56 STAN. L. REV. 673 (2003). But see Lynn M. LoPucki, *The Nature of the Bankrupt Firm: A Response to Baird and Rasmussen's The End of Bankruptcy*, 56 STAN. L. REV. 645 (2003) [hereinafter, *The Nature*] (offering empirical evidence to refute Baird and Rasmussen's claim that chapter 11 has become obsolete as a means for firms to reorganize).

¹⁸³ Baird & Rasmussen, *End of Bankruptcy*, *supra* note 139, at 773.

given that control rights are commonly vested by contract in the hands of a dominant lender.¹⁸⁴ This lender is functionally the residual owner of the firm and therefore its interests are perfectly aligned with those of the enterprise.¹⁸⁵ Finally, they asserted that the market for distressed firms has become more sophisticated so that court supervised reorganizations are not only unnecessary, but irrelevant.¹⁸⁶ Firms that have continued viability can be more efficiently sold than rehabilitated.¹⁸⁷

The development of theoretical alternatives to chapter 11's messy, multi-party, negotiated process have gained momentum largely because of the supposed inefficiencies in the current system and because of the perceived inequities inherent in the compromise of secured creditors' property interests.¹⁸⁸ Revised Article 9, with its facilitation of the encumbrance of all of a debtor's assets, may result in striking changes in the operation of chapter 11, toward a "secured-party-in-control" model.¹⁸⁹ It remains to be proven through empirical study whether Article 9's revision has dictated this direction of bankruptcy policy.

B. *The Value of Reorganization*

There are scholars, however, who challenge the "control rights account of modern chapter 11 practice."¹⁹⁰ Moreover, our current judicially supervised business bankruptcy system continues to have its champions.¹⁹¹ These scholars recognize chapter 11 as imperfect but, with some adjustment, still capable of embracing positive normative objectives beyond the repayment of a single controlling creditor.¹⁹² Chapter 11 not only allows for the enhancement of creditor welfare but is

¹⁸⁴ *Id.* at 778.

¹⁸⁵ *Id.* at 786.

¹⁸⁶ *Id.*

¹⁸⁷ *Id.* at 784.

¹⁸⁸ *Id.*

¹⁸⁹ Elizabeth Warren & Jay L. Westbrook, *Secured Party in Possession*, AM. BANKR. INST. J., Sept. 2003, at 12.

¹⁹⁰ Stephen J. Lubben, *The "New and Improved" Chapter 11*, 93 KY. L.J. 839, 848 (2005).

¹⁹¹ LoPucki, *The Nature*, *supra* note 182. This study was conducted using Professor LoPucki's database of public companies who have filed for bankruptcy. See generally Lynn M. LoPucki's Bankruptcy Research Database, available at <http://lopucki.law.ucla.edu> (last visited Mar. 14, 2004). Teresa A. Sullivan et. al., *The Use of Empirical Data in Formulating Bankruptcy Policy*, 50 LAW & CONTEMP. PROBS. 195, 196 (observing that "empirical research is vitally needed in the formation of bankruptcy policy").

¹⁹² Elizabeth Warren & Jay L. Westbrook, *Contracting Out of Bankruptcy: An Empirical Intervention*, 118 HARV. L. REV. 1197 (2005) [hereinafter *Contracting Out of Bankruptcy*] (setting forth empirical data demonstrating that a debtor in bankruptcy negotiates myriad economic as well as non-contractual obligations).

also capable of facilitating the preservation of a debtor's going concern value.¹⁹³

Chapter 11 also provides a structure that makes apparent the central role an insolvent firm may play in a micro- or macro-economy.¹⁹⁴ A multitude of parties beyond traditional debt and equity holders have an interest in a firm at the time of its insolvency, including employees, suppliers, customers, and members of the firm's greater community.¹⁹⁵ This perspective rejects the narrow view that the sole policy objective of bankruptcy law is to maximize the recovery of a dominant party or parties holding formalized claims.¹⁹⁶

In response to the scholars decrying the obsolescence of chapter 11, Professor Lynn LoPucki offers both reason and empirical evidence as proof that chapter 11 continues to have a function and a purpose.¹⁹⁷ He first refutes the claim that going concern value is an anachronistic notion.¹⁹⁸ He identifies "going concern value" not only as the value that a group of assets, functioning as a unit, will generate in the future, but also as the value embodied in the relationship between a firm and its fungible assets, and finally as the value in the full range of the know-how and expertise possessed by the firm's high-level and low-level workers.¹⁹⁹ The very real value that results from these relationships would not survive a market sale.²⁰⁰

Second, LoPucki challenges the notion that there is a universal contract capable of placing a single residual owner of a firm in control

¹⁹³ According to adherents to this approach, chapter 11, given its inherent flexibility, continues to have "unrecognized" and "underemphasized virtues." William C. Whitford, *What's Right About Chapter 11*, 72 WASH. U. L.Q. 1379, 1381 (1994).

¹⁹⁴ Moreover, in addition to its powers to preserve going concern value, chapter 11 has the additional virtue of inherent flexibility. Chapter 11 offers the possibility, in appropriate circumstances, of creatively managing some of a viable debtor's more crippling obligations. Such obligations may include both tort claims and untenable capital structures. Bankruptcy allows for the adjustment of a firm's capital structure so that it can resume its operation as a going concern. There is a distinction to be made between financial distress and economic distress. Economic distress comes about when a firm fails to be successful in the marketplace. A firm is in financial distress when it is unable to pay its creditors. JACKSON, *supra* note 181, at 4 ("A business is in financial distress when its own 'internal mechanisms for adaptation to actual or anticipated' demands of parties with an interest in the business are 'impaired.'").

¹⁹⁵ See generally KAREN GROSS, FAILURE AND FORGIVENESS: REBALANCING THE BANKRUPTCY SYSTEM 248-49 (1997); Donald R. Korobkin, *Rehabilitating Values: A Jurisprudence of Bankruptcy*, 91 COLUM. L. REV. 717, 763 (1991).

¹⁹⁶ SARRA, *supra* note 177, at 47.

¹⁹⁷ LoPucki, *The Nature*, *supra* note 182.

¹⁹⁸ *Id.* at 651-53.

¹⁹⁹ *Id.* at 652, 654-55.

²⁰⁰ See generally *id.*

during the insolvency proceeding.²⁰¹ He argues that a firm's residual interest is often held more broadly and investors with different priorities promote interests that conflict with each other and those of the firm.²⁰² Chapter 11's reorganization system allows a board of directors, constrained by their fiduciary obligations to all parties-in-interest and under the supervision of a bankruptcy judge, to reconcile these conflicts.²⁰³ Reorganization's "continued vitality" supports this claim.²⁰⁴

Finally, while the market for the sale of distressed firms has developed in recent years, the growing number of reorganizations belies the claim that the chapter 11 system is obsolete.²⁰⁵ After citing potential reasons, in addition to the presence of "going-concern value," for boards of directors to opt for reorganization, LoPucki concludes by observing that many firms resist liquidations and noting that the complex reasons for this resistance are ripe for further study.²⁰⁶

In similarly recognizing the value of public, judicial control of the reorganization process, Professor Westbrook observes in a recent article that if there is a universal contract that places a single residual owner of a firm in "control" during a bankruptcy, as asserted by the "contractualists," it is a dominant secured creditor.²⁰⁷ Contending that the secured credit system is central to the discussion of "control" of a business debtor's bankruptcy, Westbrook observes that there is a direct relationship between "contractualism and a dominant security interest."²⁰⁸ He argues that if the "contractualists" are correct in asserting that business bankruptcy has moved from a multi-party negotiated process to a control model, secured credit law is the "necessary and singular stronghold of the . . . privatization of [business bankruptcy] because a security interest provides the institutional mechanism for control of that process."²⁰⁹

The revisions made to Article 9 may provide support for the theory that business bankruptcies are now controlled by a single party. Alternatively, it may be the case that this position is overstated—not

²⁰¹ *Id.* at 661. "The residual owner of a firm is the investor who will reap the marginal dollar of gain or suffer the marginal dollar of loss from the firm's activities. If such an investor exists, it is the perfect person to control the firm. Its interests and the firm's interest are identical." *Id.* (footnotes omitted).

²⁰² *Id.* at 662.

²⁰³ *Id.* at 665.

²⁰⁴ *Id.* at 664–65.

²⁰⁵ *Id.* at 670.

²⁰⁶ *Id.* at 667–69 (describing how a firm's sale upsets implicit agreements between the original board of directors, shareholders, creditors, and other interested parties—agreements that often prompted each party to make its respective financial, contractual, or societal commitment with the firm in the first place).

²⁰⁷ Westbrook, *The Control of Wealth*, *supra* note 137, at 798.

²⁰⁸ *Id.*

²⁰⁹ *Id.*

borne out by the evidence of how the statute is working in practice. If the contract theorists are correct and one dominant party, the secured creditor, controls the bankruptcy process, two unaddressed issues remain: the unproven efficiency of secured credit and the dominant secured party's bias in controlling a reorganization that has an impact on third parties and on the debtor as an enterprise.²¹⁰

1. *The Worst Case – Article 9's Impact in Bankruptcy*

a. *Debtor-in-Bankruptcy's Cash Flow*

If one sees virtue in the continued availability of a judicially supervised business reorganization system, revisions made to Article 9 raise compelling concerns. Fundamentally, these revisions may increase both the circumstances in which a dominant secured creditor has control of a debtor's business reorganization and the scope of that control.

To illustrate, myriad provisions in Revised Article 9 facilitate the encumbrance of the debtor-in-possession's cash.²¹¹ The Bankruptcy Code designates encumbered cash as "cash collateral"²¹² and, because the risk of dissipation or loss is greater with cash than with less liquid assets, there are specific limitations on its use by the estate.²¹³ For example, a debtor-in-possession must segregate and account for any cash collateral in its possession, custody, or control.²¹⁴ Moreover, cash collateral may not be used without either the secured creditor's or the bankruptcy court's prior permission.²¹⁵

There is, however, a correspondingly greater need by the debtor-in-possession for cash than for other types of unencumbered assets.²¹⁶ This

²¹⁰ *Id.* at 838–53.

²¹¹ 11 U.S.C. § 1107(a) (2000). In many reorganizations, the debtor-in-possession is granted the power and authority of the trustee in bankruptcy and is charged with the responsibility of administering the estate for the benefit of the debtor's creditors. *Id.*

²¹² As defined by the Bankruptcy Code, cash collateral includes "cash, negotiable instruments, documents of title, securities, deposit accounts, or other cash equivalents whenever acquired in which the estate and an entity other than the estate have an interest . . ." 11 U.S.C. § 363(a) (2000).

²¹³ § 363(c)(2)–(4).

²¹⁴ § 363(c)(2).

²¹⁵ § 363(c)(4).

²¹⁶ *In re Greenwood Bldg. Supply, Inc.*, 23 B.R. 720, 721 (Bankr. W.D. Mo. 1982) (noting that without cash collateral a debtor could not reorganize); *Sun-Bank/Suncoast v. Earth Lite, Inc.* (*In re Earth Lite, Inc.*), 9 B.R. 440, 443 (Bankr. M.D. Fla. 1981) (noting that "few, if any" debtors could successfully reorganize without cash collateral); *In re Rancourt*, 123 B.R. 143 (Bankr. D. N.H. 1991) (recognizing the necessity of a debtor's use of cash collateral rents in the first months following a bankruptcy in order to conduct its business during the reorganization effort); *In re Dynaco Corp.*, 162 B.R. 389, 393 (Bankr. D. N.H. 1993) (same).

need comes from the financial demands of employees, suppliers, and others who are working for and with the debtor—in-possession as it attempts to reorganize.²¹⁷

An example of how Article 9 facilitates the encumbrance of a debtor's cash flow is found in its inclusion of commercial deposit accounts as original collateral.²¹⁸ Banks hold substantial business deposits and provide a significant portion of business credit.²¹⁹ Now that deposit accounts may be encumbered as original collateral, the cash in such accounts is more likely to be encumbered. If the account is encumbered, then it is not simply cash upon a debtor's bankruptcy but rather "cash collateral."²²⁰ As such, the debtor must get either the secured creditor's or the court's permission to use the cash in the account. If such permission is granted by a court, "adequate protection" of the secured creditor's interest must be provided,²²¹ which requires the use of *other* unencumbered assets.²²² Because of the ease with which secured creditors can obtain a blanket lien on all of a debtor's assets,²²³ it is much less likely that there will be any unencumbered assets for adequate protection and thus less likely that a court could grant permission for a debtor—in-possession to use its cash collateral.

In a related manner, the expanded definition of proceeds may result in less unencumbered cash with which to reorganize.²²⁴ Since the new definition of proceeds includes a wider range of assets generated by the original collateral, there is an increased chance that the debtor will have "cash collateral" rather than unencumbered cash in its deposit accounts.²²⁵ For example, if royalties from the licensing of intellectual property are deposited into a debtor's bank account prior to a bankruptcy

²¹⁷ Jean Braucher, *Bankruptcy Reorganization and Economic Development*, 23 CAP. U. L. REV. 499, 500–01 (1994) (describing chapter 11 as a "prelude to liquidation since most chapter 11 cases fail," but also positing that even a failed chapter 11 may be considered a proceeding that "gets a business in the bankruptcy system, subject to the scrutiny of a judge and of creditors and usually headed toward an orderly liquidation"); see also *Reconstruction Fin. Corp. v. Kaplan (In re Waltham Watch Co.)*, 185 F.2d 791 (1st Cir. 1950).

²¹⁸ See discussion *infra* Part II.A.1.d.

²¹⁹ Markell, *supra* note 59, at 975.

²²⁰ 11 U.S.C. § 362 (automatic stay); § 363 (defines and limits trustee's powers to dispose of estate property); § 364 (governs trustee's ability to obtain credit and incur debt on behalf of the estate).

²²¹ § 361 (providing that a secured creditor is entitled to the "value" of its security interest, providing a non-exhaustive list of adequate protection of this entitlement, and permitting the court to order a collateral substitute or some other interest that is the "indubitable equivalent").

²²² *Id.*

²²³ See *supra* notes 113–114 and accompanying text.

²²⁴ See *supra* notes 67–74 and accompanying text.

²²⁵ See *supra* notes 211–213 and accompanying text.

filing, such funds will become the “cash collateral” of the creditor holding a security interest in the intellectual property as original collateral. Accordingly, these funds are available to the bankruptcy estate only after court (or creditor) approval.²²⁶

b. Procedural Modifications

The Revised Article 9 procedural modifications also have the potential to be more pronounced in bankruptcy. Many of Revised Article 9’s two-tier perfection rules, including the diluted financing statement information requirements applicable when a security interest is challenged by the bankruptcy trustee, may have the effect of subverting the trustee’s strong arm.²²⁷ The trustee’s strong-arm power has historically been exercised to “free up [certain] assets [in bankruptcy], that could not be reached . . . outside of bankruptcy.”²²⁸ The new two-tier perfection rules have the opposite effect. They allow for the perfection of security interests in certain assets in bankruptcy that would likely be deemed unperfected and thus unencumbered under state law.²²⁹

c. Expansion of Proceeds in Bankruptcy

When a debtor files for bankruptcy, the expanded definition of proceeds impacts debtors and other creditors in ways it does not outside of bankruptcy. In bankruptcy, creditors are paid from the assets that are included in the debtor’s bankruptcy estate. A bankruptcy estate is automatically created upon a debtor’s bankruptcy filing and includes “all legal or equitable interests of the debtor in property as of the

²²⁶ 11 U.S.C. § 363(c)(2)(A)–(B). In addition, secured creditors with a claim to proceeds deposited in commingled accounts will no longer be limited to proceeds received within ten days of bankruptcy. Equitable tracing principles, such as the “lowest intermediate balance rule,” are an expressly recognized way of determining which commingled assets are identifiable proceeds of the creditor’s original collateral. Former section 9–306(4)(d) limited creditors’ claims to proceeds in commingled accounts to those proceeds received within ten days of the filing of the bankruptcy petition. U.C.C. § 9–306(4)(d) (1995). See U.C.C. § 9–315 cmt. 3 (2001) (permitting any means of tracing allowed by other law when identifying proceeds in commingled account).

²²⁷ 11 U.S.C. § 544(a)–(b) (2000); see also Pryor, *supra* note 20, at 245. See discussion *infra* Part II.B.3 on Revised Article 9’s two-tier perfection rules.

²²⁸ Warner, *supra* note 10, at 27.

²²⁹ Elizabeth Warren, *Bankruptcy Policy*, 54 U. CHI. L. REV. 775, 809 (1987) [hereinafter *Bankruptcy Policy*] (observing that given the difficulty many secured creditors have realizing the value of their collateral upon a debtor’s default, many may prefer the one-forum benefits offered by the bankruptcy system); Warner, *supra* note 10, at 31 (“[T]he priority of secured credit[ors] should not be recognized in bankruptcy unless the notice of lien [is] meaningful notice.”).

commencement of the case,”²³⁰ “wherever located and by whomever held.”²³¹ The bankruptcy estate also includes “[p]roceeds, product, offspring, rents, or profits of or from property of the estate.”²³²

The Bankruptcy Code makes a sharp distinction between “proceeds” of collateral and other after-acquired collateral. Section 552 of the Bankruptcy Code recognizes security interests in proceeds of pre-petition collateral, but does not recognize security interests in assets acquired by the debtor post-petition that are not deemed to be proceeds.²³³ The interesting and difficult question is whether the expansion of the Article 9 definition of “proceeds” will expand the meaning of the term “proceeds” under the Bankruptcy Code.²³⁴

Currently, the courts are split as to the proper interpretation of the term “proceeds” under § 541 and § 552 of the Bankruptcy Code. Some courts have used a liberal federal bankruptcy law definition that emphasizes the rehabilitative purpose of bankruptcy law.²³⁵ Others have applied former Article 9’s definition.²³⁶ Still others rely on the legislative history of § 552 to create a definition of proceeds that is more liberal than former Article 9’s.²³⁷ If Revised Article 9’s broad definition of proceeds is adopted by bankruptcy courts, what was after-acquired property will become proceeds, and, accordingly, there will be a greater number of encumbered assets in a debtor’s bankruptcy estate and a

²³⁰ 11 U.S.C. § 541(a)(1) (2005).

²³¹ § 541(a); *see also* CHARLES JORDAN TABB, *THE LAW OF BANKRUPTCY* 274–81 (1997). Property subject to security interests (collateral) is included in the estate, is subject to the automatic stay and turnover orders, and may be used by the debtor in furtherance of its reorganization if deemed necessary for the reorganization to be effective. If the court deems collateral necessary for an effective reorganization, the secured creditor is granted adequate protection, but any motion to lift the automatic stay will be denied. Contrast this with property the debtor has sold in connection with a securitization, which is generally not included in the estate—one reason securitization attracts investors. 11 U.S.C. §§ 361, 364(d), 541 (2000).

²³² TABB, *supra* note 231, at 284–85.

²³³ 11 U.S.C. § 552(a)–(b).

²³⁴ *See generally* WARD, *supra* note 71, at §§ 4:57–4:59.

²³⁵ *Casey v. Hochman*, 963 F.2d 1347, 1350 (10th Cir. 1992) (suggesting that the concept of proceeds in bankruptcy under section 541(a)(6) is broader than the Article 9 conception).

²³⁶ *See Fed. Deposit Ins. v. Hastie (In re Hastie)*, 2 F.3d 1042, 1045–47 (10th Cir. 1993) (stating a security interest in stock dividends was not perfected because the dividends were not received in exchange of stock that was disposed of, as per § 9–306(4)); *Bumper Sales, Inc. v. Marepcon Fin. Corp (In re Bumper Sales, Inc.)*, 907 F.2d 1430, 1437 (4th Cir. 1990) (holding Article 9’s definition of “proceeds” established the scope of Bankruptcy Code § 552(b)); *J. Catton Farms, Inc. v. First Nat’l Bank of Chicago (In re J. Cotton Farms, Inc.)*, 779 F.2d 1242 (7th Cir. 1985) (a security interest in receivables and accounts extended to a payment received post-petition).

²³⁷ S. REP. NO. 95–989 at 82, 83 (1978) (stating the term “proceeds” is not limited to the technical definition of that term in the UCC); H. REP. NO. 95–595 at 368 (1977).

correspondingly smaller number of unencumbered assets available for the debtors' residual claimants. Secured creditors may now be able to assert a § 552(b) secured claim to, for example, license fees, derivative works of a copyright, patent infringement claims, and post-petition rental fees.²³⁸

d. *Securitization in Bankruptcy*

The changes in Article 9 designed to facilitate securitization transactions present a somewhat different issue.²³⁹ As described above, when a debtor engages in a securitization, it sells its cash flow to third party investors.²⁴⁰ Once sold, the cash flow is no longer part of the debtor's bankruptcy estate,²⁴¹ even though it may have been the only

²³⁸ 11 U.S.C. § 552(b)(1)–(2) (2000). There is, however, a possible limitation on the impact of this Article 9 change in bankruptcy. Though § 552(b)(1) recognizes the secured creditor's lien on post-petition assets, including proceeds from pre-petition collateral (if applicable non-bankruptcy law and the security agreement so provide), it also permits the bankruptcy court, "after notice and a hearing and based on the equities of the case, [to order] otherwise." § 552(b)(1) & (2). This § 552(b) exception was intended to strike "an appropriate balance between the rights of secured creditors and the rehabilitative purposes of the Bankruptcy Code." *United Va. Bank v. Slab Fork Coal Co.* (*In re Slab Fork Coal Co.*), 784 F.2d 1188, 1191 (4th Cir. 1986). This exception is typically applied only to business reorganizations under chapter 11 where the secured party is oversecured and will come by a windfall "from collateral that has appreciated in value as a result of the trustee's/debtors-in-possession's use of other assets of the estate (which would normally go to general creditors) to cause the appreciated value." *Delbridge v. Prod. Credit Assoc.*, 104 B.R. 824, 826 (E.D. Mich. 1989); *see also In re J. Catton Farms, Inc.*, 779 F.2d at 1247 (discussing § 552(b)'s equitable exception); *In re Patio & Porch Sys., Inc.*, 194 B.R. 569, 575 (Bankr. D. Md. 1996) (same); *Airport Inn Assocs., Ltd. v. Travelers Ins.* (*In re Airport Inn Assocs., Ltd.*), 132 B.R. 951, 959 (Bankr. D. Colo. 1990) (same); *Wilke Truck Serv. v. Wiegmann* (*In re Wiegmann*), 95 B.R. 90 (Bankr. S.D. Ill. 1989) (same).

²³⁹ Lois R. Lupica, *Circumvention of the Bankruptcy Process: The Statutory Institutionalization of Securitization*, 33 CONN. L. REV. 199, 200 (2000); Lois R. Lupica, *Revised Article 9, Securitization Transactions and the Bankruptcy Dynamic*, 9 AM. BANKR. INST. L. REV. 287, 314 (2001) [hereinafter *Bankruptcy Dynamic*].

²⁴⁰ *See supra* notes 86–89 and accompanying text.

²⁴¹ *Worcester County Nat'l Bank v. Xinde Int'l Inc.* (*In re Xinde Int'l Inc.*), 13 B.R. 212, 215 (Bankr. D. Mass. 1981) (cautioning courts to "balance the needs of the creditor's protection against the debtor's likelihood of a successful rehabilitation" so that adequate protection requirements do not foreclose a debtor's opportunity to reorganize). While bankruptcy law respects non-bankruptcy property interests, including security interests, secured creditors are entitled in bankruptcy to receive only the *value* of their collateral, not the collateral itself. A secured creditor may merely be offered "adequate protection" in the form of substitute collateral or some other interest that is the "indubitable equivalent." 11 U.S.C. § 361 (1997). The Supreme Court has recognized that secured creditors' property interest in their collateral continues, notwithstanding debtor's bankruptcy. *United States v. Sec. Indus. Bank*, 459 U.S. 70

cash or cash equivalent available to pay trade creditors, employees, consumer claims, and other unsecured creditors during the pendency of the bankruptcy proceeding.²⁴² In the absence of cash flow, there will likely be a dearth of cash collateral as well as unencumbered cash.²⁴³ Not only will unsecured creditors of a securitizing originator be harmed by the increased chance of business liquidation, even in cases where the debtor is worth “more alive than dead,” but repayment to unsecured creditors in bankruptcy may be smaller if a debtor securitizes all or a portion of its liquid assets than it would be if the originator offered its liquid assets as collateral for a loan.²⁴⁴ “Viewed through the lens of control,”²⁴⁵ securitization permits a party to take the economic equivalent of a security interest, yet opt out of its debtor’s bankruptcy—leaving in its wake a compromised chance of the debtor’s reorganization.

VI. PROPOSED AGENDA FOR RESEARCH – THE INITIAL STUDY

A. *The Objectives of Empiricism*

The objective of any empirical research study is to create a higher level of confidence in resulting conclusions than is possible by prediction, opinion, or reason alone. A study of the market for credit must build upon the work of others—theorists and empiricists alike.²⁴⁶ Drawing on the work of Hill and Mann we have learned, to date, that there are many segments of the market for secured debt.²⁴⁷ Accordingly, each market must be studied individually, and each study must target a particular market segment.

(1982); see also H.R. REP. NO. 595, 95–595 (1977); 11 U.S.C. §§ 361, 363(f)(3), 1129(b)(2)(B) (1997).

²⁴² See *supra* note 136 and accompanying text.

²⁴³ See 11 U.S.C. § 726 (2000); Lupica, *Bankruptcy Dynamic*, *supra* note 239, at 290. According to the Bankruptcy Code’s priority scheme, secured creditors are paid the value of their collateral first, before any distribution can be made to any other party. Unsecured creditors share in a pro rata distribution of assets that remain after secured creditors, administrative expenses, and priority claims are paid. See 11 U.S.C. § 507 (setting forth the Bankruptcy Code’s priority scheme). As the secured creditors encumber more assets, fewer assets are available to any other party with an interest or claim.

²⁴⁴ See Lupica, *Asset Securitization*, *supra* note 91, at 618–35; Lupica, *Circumvention*, *supra* note 239, at 232–40.

²⁴⁵ Jay L. Westbrook, *Bankruptcy Control of the Recovery Process*, 12 AM. BANKR. INST. L. REV. 245, 256 (2004).

²⁴⁶ There are a variety of funding sources potentially available to finance such a study. See, e.g., American Bankruptcy Institute Endowment, at <http://www.abiworld.org>; National Conference of Bankruptcy Judges Educational Endowment, at <http://www.ncbj.org>.

²⁴⁷ See Hill, *supra* note 157; Mann, *Strategy and Force*, *supra* note 157; Mann, *Explaining the Pattern*, *supra* note 157.

As noted above, one of the enduring questions in the theoretical scholarship on Article 9 is whether secured debt is efficient or whether it enables firms to externalize liabilities on non-adjusting third-party creditors. The enactment of Revised Article 9 raises questions regarding the practical effects of the statute's expanded scope and procedural modifications, and the impact, if any, on borrowers' third-party creditors and on the bankruptcy process. Moreover, the tentative hypothesis that borrower repayment can be attributed to strategic pressure exhibited by lenders at various points in the lending relationship must also be studied empirically.

The specific questions that will frame the hypotheses to be tested include:

- i) Have secured creditors extended more credit to debtors since the Article 9 rule changes? If so, have secured creditors extended secured credit because of the new Article 9 rules? To what extent has Revised Article 9 influenced secured creditors' credit-extension decision making?
- ii) Have secured creditors been more inclined to encumber collateral since Revised Article 9's enactment? If so, to what extent? Is there an increased incidence of creditors taking "blanket liens?"
- iii) If more assets have been typically encumbered as a consequence of Article 9's revision, how have trade creditors adapted? Are trade creditors responding any differently under Revised Article 9 than they did under the former rules? Are they requiring cash upon delivery of goods? Are they more likely to take purchase-money security interests?
- iv) Have trade creditors benefited from long-term relationships with debtors? Has the presence of dominant secured creditors increased or decreased the incidence of prompt repayment?
- v) What factors influence the decision to lend on a secured basis? On an unsecured basis?
- vi) What percentage of loans made were repaid in full? What percentage of loans made were repaid without resort to Article 9 remedies (collateral repossession)? What is your institution's policy for responding to information that borrower repayment is threatened?

Based upon the foregoing issues, both qualitative and quantitative work must be done, especially as it relates to small business. To that end, I propose the design of an initial study in three parts.

B. Research Protocol – A Study in Three Parts

1. Information Gathered by Interviews

The first part of the study would be a series of telephone and in-person interviews of commercial lawyers and credit providers. With the cooperation of several states' bar associations, interviews would be conducted with a random sample of attorneys who are members of their bar association's commercial law sections.²⁴⁸ Also, the AllRegs' Lender Directory, a database of 20,000 lending institutions, and the Small Business Administration directory of lenders would be used to generate a random sample of various credit providers.²⁴⁹ Interviews would be similarly conducted with providers from this random sample.

The information gleaned from these interviews would be analyzed in light of the information gathered from the database and the survey questionnaires.²⁵⁰ The interview component of the study, however, would have as its primary objective an analysis of the attitudes and information about the secured credit process. The interview portion of the survey would focus on the issue of leverage and power in the credit relationship and would also seek to confirm the discoveries in the quantitative portion of the study.

2. Information Gathered by Survey

A survey of creditors and creditors' attorneys working in a specific geographic region would be similarly conducted. Survey subjects would

²⁴⁸ States with integrated bar associations will be identified. An integrated bar association is one to which every lawyer must earn membership prior to practicing in that state. Each survey recipient will be sent three items: 1) a letter of introduction describing the study and urging their participation, 2) the survey itself—with a deadline for completion, and 3) a postcard reminding them to return the survey, sent after the deadline. Because each survey will be anonymous, it will not be possible to determine who did and did not return the survey.

²⁴⁹ AllRegs' Lender Directory is a database of lending institutions. It includes more than 20,000 lenders, servicers, institutional investors, and financial entities of all types, including credit unions. AllRegs' Lender Directory, available at <http://www.allregs.com/products/lender/default.asp>. The Small Business Association also maintains a database of small business lenders. U.S. Small Business Administration, SBA Certified and Preferred Lenders, available at <http://www.sba.gov/gopher/Local-Information/Certified-Preferred-Lenders/>.

²⁵⁰ See *infra* Part VI.A.2 describing survey questionnaires.

be selected in the same way interview respondents were selected. The survey would include dichotomous questions²⁵¹ and questions that attempt to measure on an interval level,²⁵² both of which are ultimately susceptible to quantitative analysis. Findings from the analysis of survey responses would be used to develop the framework for the quantitative component of the study.

3. *Data from the Survey of Small Business Finances*

There is excellent publicly available data concerning the financial practices of small business borrowers. The Federal Reserve Bank, in cooperation with the United States Small Business Administration, conducts a study of small business borrowers every five years. Known as the Survey of Small Business Finances (“SSBF”),²⁵³ this study collects data concerning roughly 4000 small business borrowers, which are defined as firms having fewer than 500 employees.²⁵⁴ The database includes information about loans applied for and granted to the target businesses, as well as the extent to which they were collateralized.²⁵⁵ The source of credit is divided between bank loans,²⁵⁶ non-bank financiers,²⁵⁷

²⁵¹ A dichotomous question is one with two possible responses (i.e., yes or no). See William M.K. Trochim, *Types of Questions*, at <http://www.socialresearchmethods.net/kb/questiontype.htm> (Apr. 2, 2005).

²⁵² The most common types of interval level questions ask the respondent to respond to a question on a 1–5 rating scale, with “1” meaning “strongly disagree” and “5” meaning “strongly agree.” *Id.*

²⁵³ This was formerly known as the National Survey of Small Business Finances (“NSSBF”).

²⁵⁴ The 1998 data can be accessed at Federal Reserve Board, Survey of Small Business Finances, available at <http://www.federalreserve.gov/pubs/oss/oss3/ssbf98/ssbf98home.html> (last visited Mar. 14, 2005). This database is publicly available and includes information about borrowers, coded by organizational form (S–corporations, C–corporations, LLCs, or partnerships), whether the business is family owned, the education level of the firm owner, whether the firm is in a service business, whether the firm is rated as “significant risk” or “high risk” by Dun & Bradstreet, and whether the firm had bad credit. “Bad credit” exists if the firm or its principal owner declared bankruptcy within the past seven years, the principal owner was delinquent on personal obligations within the past three years, the firm was delinquent on business obligations within the past three years, or judgments were rendered against the owner within the past three years. *Id.*

²⁵⁵ See *id.*

²⁵⁶ Bank loans include loans from commercial banks, savings banks, and savings and loans. See *id.*

²⁵⁷ Non-bank financial sources include loans from credit unions, finance companies, insurance companies, brokerage or mutual fund companies, leasing companies, mortgage companies, and venture capitalists. See *id.*

and non-bank, non-financial sources.²⁵⁸ The 1998 database is currently available, and the 2003 database is expected to be released in June 2004.²⁵⁹ These data reflect the behavior of small business borrowers under the former Article 9 regime. The 2008 data (expected to be released in 2009) will reflect the behavior of borrowers operating under the Revised Article 9 rules.²⁶⁰

These data would be analyzed to determine the relative incidence of secured and unsecured credit among borrowers surveyed. Borrowers' credit risk would be correlated with the type of borrowing engaged in (secured or unsecured), as well as with the type of lender.

VII. THE SECOND STUDY – ARTICLE 9 DEBTORS IN BANKRUPTCY

To objectively understand the impact of Revised Article 9, the statute must also be studied in the context of a business debtor's bankruptcy. Business debtors that access the bankruptcy system, for purposes of a study, can be divided into small companies (less than 500 employees), large but privately held companies, and public companies.

Building upon the work done as part of the Business Bankruptcy Project,²⁶¹ the same questions set forth in Part VI above—what are the practical effects of Article 9's expanded scope and procedural modifications, and the impact, if any, on third party creditors of borrowers—must be asked in the context of bankruptcy. In addition, further questions arise concerning the recovery of general creditors with and without dominant secured creditors. A further issue for study will be the extent to which the bankruptcy process was controlled by a single party, and the nature of that party (*ex ante* creditor, *ex post* lender).

A random sample of small business debtors' bankruptcy files from several districts would be examined to identify both the nature of the collateral taken by the original, pre-bankruptcy lender and the type of collateral being offered to the debtor-in-possession lender. Files of debtors who declared bankruptcy when their financing arrangements were governed by former Article 9 would be examined and compared

²⁵⁸ Non-bank, non-financial sources include loans from other business firms, families or individuals, government agencies, supplier loans, credit cards, check clearing, factoring, loans from the owner herself, and loans from a retirement account. See Federal Reserve Board, Survey of Small Business Finances, available at <http://www.federalreserve.gov/pubs/oss/oss3/ssbf98/ssbf98home.html> (last visited Mar. 14, 2005).

²⁵⁹ Telephone Interview with John Wolken, Senior Economist and Principal Investigator, Federal Reserve Board (Feb. 23, 2004).

²⁶⁰ *Id.*

²⁶¹ Warren & Westbrook, *Contracting Out of Bankruptcy*, *supra* note 192; Elizabeth Warren & Jay L. Westbrook, *Financial Characteristics of Business Bankruptcy*, 73 AM. BANKR. L.J. 499 (1999).

with files of debtors who filed for bankruptcy following Revised Article 9's enactment. The results of such a study would be controlled to prove or disprove a causal relationship between Revised Article 9's expanded scope and any identified effects in bankruptcy. The practical implications of such a study, however, would be dictated by one's normative perspective on the function and purpose of business bankruptcy.

VIII. CONCLUSION

Revised Article 9 has redefined the contours of the relationship between secured creditors, unsecured creditors, and debtors by granting secured creditors greater rights than they had under former Article 9. These revisions were made at a time when there was neither consensus as to secured credit's theoretical justification nor empirical evidence to support any of the theories justifying or criticizing the unqualified use of secured credit. In the absence of empirical evidence, in a world of conflicting theories it is difficult to defend legal reforms that encourage a further expansion of the secured credit system.

Moreover, the revision of Article 9 may have dictated the future course of the bankruptcy system without resolving the normative debate on the function and purpose of business bankruptcy. When viewed through the lens of bankruptcy, with its focus on satisfying the interests of the collective, Article 9's distributive scheme raises compelling concerns. As a result of the Article 9 revisions, when a debtor files for bankruptcy, assets that are inadvertently encumbered,²⁶² assets acquired post-petition, assets described in flawed documentation, and the debtor's cash flow, are all diverted from unsecured to secured creditors to a far greater degree than was the case under former Article 9.

The question whether the Revised Article 9 rules are inconsistent with or adverse to bankruptcy policy was raised by scholars commenting on the final version of Revised Article 9.²⁶³ One response was that the question was "incoherent" because "allocating property rights (such as priorities) cannot conflict with bankruptcy policies."²⁶⁴ Adhering to that logic, Article 9 could have been revised to allow secured creditors to take secret liens in every conceivable type of property²⁶⁵ without even a nod

²⁶² My Point is not that unsecured creditors under former Article 9 relied on sloppy commercial lawyering to receive their "fair share" of the debtor's assets in bankruptcy, but rather that new Article 9's "pass" for secured creditors who do not comply with the basic formalities of the attachment and perfection procedure has the potential to redistribute wealth from unsecured to secured creditors.

²⁶³ Harris & Mooney, *Policy & Impact*, *supra* note 7, at 94.

²⁶⁴ *Id.*

²⁶⁵ See Warren, *Imperfect Information*, *supra* note 21, at 1386 (suggesting (though not requesting the drafters to get any "new ideas") that security interests in body parts

to any other third party's (or even the debtor's) interests and still have been perfectly consistent with bankruptcy policy. As long as bargains between the debtor and its creditors were consensual with the limits of that bargain defined by state law, then bankruptcy, in deference to state law rules, would simply be a process for administering that allocational bargain from an inadequate resource pool. Secured creditors would get everything and control the process and unsecured creditors would be left with nothing. Moreover, all bankruptcies would be swift liquidations, notwithstanding the presence of a going concern value, because there would be no resources to use in reorganization. The question how might Article 9 potentially affect bankruptcy and the range of interests implicit in bankruptcy is not only coherent but incalculably important.

Without the results of an empirical study, it is impossible to estimate what the actual effects of the revision will be either in or out of bankruptcy. There remain many unanswered questions. An empirical study of Revised Article 9's impact will add much to the debate concerning the impact and the wisdom of secured credit.

would allow certain parties to get either credit they otherwise could not obtain or more favorable credit terms, and that the threat of foreclosure (on a cornea!) would provide a strong incentive for repayment). "Revised Article 9 is not an amendment so much as a reconfiguration of current law." Corrine Cooper, *Preface to THE NEW ARTICLE 9 UNIFORM COMMERCIAL CODE* (Corrine Cooper ed., 2d ed. 2000); see also Melissa M. Perry, Comment, *Fragmented Bodies, Legal Privilege, and Commodification in Science and Medicine*, 51 ME. L. REV. 169 (1999).

