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Recharacterization & Asset Securitization: "When is a Duck a Duck"

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MR. BIENENSTOCK: Good afternoon. We consoled ourselves for this segment that in this field of recharacterizing transactions, nothing anyone says can be totally wrong because there is a lack of self-evident rules, and that's what led us to put this topic on the agenda.

I thought I would start by charting the field in a certain way leading up to a hypothesis to be tested by the panel and yourselves. And the hypothesis that I'd like to put out there for testing is this: That when you're talking about recharacterizing a transaction, you have to first determine whether you're doing it under a statute or under an equitable power, and if you're doing it under a statute, then if you satisfy the statute, it's done. If you're doing it under an equitable power, it's not enough to say this transaction looks more like a loan than a sale, so I will make it more a loan than a sale. What I suggest is that you really have to consider all the equities and make sure that the end result is consistent with the equities as opposed to being dead set against them, and I'll frame some hypotheticals as we go along to try to demonstrate that.

What I said in the hypothesis is by no means accepted dogma or jurisprudence. You're going to see in the jurisprudence that a lot of courts and commentators characterize transactions by what I call the scoring technique. They make a list as to how many attributes a transaction has that look like something else. And the more attributes it has that look like something else, the more likely it is in their view that the court should call it something else.

What I'm testing here in this discussion ultimately is whether the scoring technique is really appropriate when you're recharacterizing something not according to a statute, but according to an equitable inquiry.

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So let me start with some basics. No one has a problem disregarding a security interest if it's not perfected. Why? Because the Bankruptcy Code gives the trustee a strong arm power which works even under Revised Article 9. If the trustee is a lien creditor and under Revised Article 9 a creditor has an unperfected security interest, the trustee wins and the unperfected security interest loses. It's just as simple as that.

There's a lot of commentary, some or all of you may know, about Revised Article 9, and a lot of it has titles suggestive of its import, such as the strong arm power is now the weak finger.

There are basically two attacks that some commentators have launched against Revised Article 9, and I'll say upfront I had nothing to do with revising Article 9. No one asked me my opinion then or now. But one thing people complain about under Revised Article 9 is that it's now possible to take security interests in assets that you either couldn't take before or it was very difficult and subject to amorphous rules, like, for deposit accounts, tax refunds, and a lot of intangibles. And the theory is that this is bad because it can lock up more estate assets, can encumber more estate assets prior to a bankruptcy, and thereby leave fewer unencumbered assets with which to prosecute the bankruptcy.

From my way of thinking, that's just much too parochial thinking. It is good in the commercial world to have the ability to encumber an asset. It could be the difference between being able to borrow $2 million and $3 million.

And there's nothing wrong in the commercial world outside bankruptcy with letting the lending institutions get liens, in my view, on all assets. It just makes things more liquid, more commercial. It gives people more options, and there shouldn't be a duty to keep things unencumbered just in case there's a bankruptcy later on.

So I think it's clearly a benefit to commerce generally that Revised Article 9 makes rules and enables the encumbering of assets that before Revised Article 9 were somewhat questionable.

The second attack on Revised Article 9 by those who attack it seems to be that the avoiding power is weakened because Revised Article 9 bifurcates perfection against a bankruptcy trustee and perfection against other creditors in respect of certain types of assets.

I've asked many bankruptcy judges lately what their experience is in applying Revised Article 9, and if it has affected the administration of their cases. And so far, unanimously, they've said to me it's never come up. Now, some people explain that away on the grounds that it just hasn't been around long enough. I think it was basically codified in about the year 2001. But so far I don't think it's had any effect.

Anyway, that's one recharacterization that I think is fairly simple and straightforward in terms of saying a security interest shall not be deemed a security interest if the trustee trumps it.

Another recharacterization, if you can call it that, is the avoidance of a preference or a fraudulent transfer. You're basically saying something that was transferred has to come back, and I think that's pretty straightforward, too, in terms of we know what the rules are. Everyone knows them going in, and it's not subject to a whole lot of dispute. There can be individual items in some cases, but they're not really recharacterization issues that people gripe about because you have a set of rules on which to enforce the statute.

Then we get to Section 510 of the Bankruptcy Code. Especially § 510(c), which takes what's on its face straightforward debt and equitably subordinates it, makes it something less than plain vanilla debt on a parity with all other debt. And that is something where there are no crisp rules; although, jurisprudence has articulated some general rules that we're familiar with, such as if you want to equitably subordinate one claim to another, you have to show that the claimant did something wrong to benefit itself that harmed other creditors, and the remedy of equitable subordination should be compensatory and not punitive, and that's generally the formula given.

Related to that has been the notion that some claims should be recharacterized as equity in the first place. Now, this doesn't happen under Section 510, because under that Section, claims can be subordinated to claims, and interests-to-interests, but you don't take a claim and make it an interest.

So the recharacterization of a claim in bankruptcy to an equity interest pretty much follows non-bankruptcy law. The prototypical template being the person who creates a corporation and who knows that the new venture may be unsuccessful, so he or she takes a security interest in all the corporation's assets, puts virtually no equity into the corporation, gets a lot of unsecured debt to come in and participate in the new venture, and when the new venture fails, the owner says, well, sorry creditors, your claims aren't worth anything because I have a lien on everything.

Now, in some cases where everyone knows what risks they're taking upfront, it doesn't necessarily mean that the owner's secured claim will be recharacterized as equity. But in other cases where it's less than clear that the owner had a security interest upfront and there is evidence of inducing people to come in without knowing facts — Yes?

UNIDENTIFIED SPEAKER: If it was filed with the Secretary of State, why wouldn't these people be deemed to have knowledge of it?

MR. BIENENSTOCK: In that case, they may get away with it. It may be the type of perfection, though, that you do by possession that no one would know about.

MR. KIESELSTEIN: There are also notions, and this is where this doctrine has been extended in some ways that are scary, where it's not that someone undercapitalizes it from the beginning, but you've got a situation where a company is in trouble and the owner decides, well, I want to try and salvage the situation, but I don't have to put it in at the bottom of the capital structure. I'm going to put it in as debt. I'm going to paper it, and it's reasonable commercial terms.

But someone then later says when it doesn't work out, well, you were just investing good money at the top of the capital structure to try and salvage your out-of-the-money equity position. And in the meantime, other people continue to extend the credit-deepening-insolvency-type theory.

It's a little frightening, and some of the Seventh Circuit law, for instance, says, well, there is no reason not to have someone put in money to try and keep a venture alive. We should be encouraging that. On the other hand, if a commercial lender wouldn't have done it, then maybe there's something not right about it. Of course, if a commercial lender would have done it, it's highly unlikely you'd be putting your own money into the situation in any event. So this area of the law is kind of muddled.

I guess the other thing I would say on recharacterization is sometimes it's done in the reverse. That is, under § 510(b) you have people with equity claims try and bootstrap themselves up the ladder by suggesting that their equity claim is in fact some kind of breach claim. Maybe they had a collar on their equity transaction, there are all sorts of creative theories available, most of which have gotten very little pedway. But you see that recharacterization going the other way, too.

MR. BIENENSTOCK: Now, let's move to the next recharacterization. Is a lease a loan? First we will discuss recharacterizations for the sake of the antiforfeiture policy.

In the Ninth Circuit especially, but also in most of the other circuits, you can find decisions where things have been recharacterized to avoid forfeiture. The best examples I can think of are Ninth and Eleventh Circuit decisions such as *In re Morregia & Sons*,[1] the *Waterkist* decision,[2] *In re Ranch House*,[3] and *In re Windmill Farms*.[4]

As you know, Section 365 of the Code provides a Chapter 11 debtor-in-possession 60 days to assume or reject leases unless the time is extended. And probably the section of the Code that has given rise, certainly it's in competition for the section that gave rise, to the most litigation and the most fears of attorney malpractice is Section 365. Because on an unbelievable number of occasions, the debtor's attorney wakes up on the 60th day and says, "Oh, my gosh, my client's leases are going to be deemed rejected because I don't have an order extending the time to assume or reject."

And different circuits have gone to different lengths to relieve the debtor's attorneys of the malpractice claim. Some say that it's okay to file your motion on that day. Some say you can file a motion to extend on that day. Others say, well, he can just file a motion to assume on that day. I guess you can file a motion to assume and then change your mind later.

But it's a very scary thing, and I don't know if it's happened to any of you, but I will just put this in parenthetically. Traditionally, on the first day of the case I ask the court ex parte to extend the confirmation time to assume or reject all leases, subject to two very important protections for the nondebtor lessors. The first protection is that they can come in and ask that the time be shortened at any time. And the second protection is that when they come in, the burden of proof will remain on the debtor-in-possession, not on the moving party. Subject to those protections, it's nothing but a procedure that gets put into place day one, which saves the debtor from forfeiting the lease, saves the debtor's attorneys from malpractice, and is fair to the landlords. This practice has actually been approved in reported decisions in both the Fifth Circuit and the Ninth Circuit because it is fair. Furthermore, it can be done ex parte because it is fair.

MR. KIESELSTEIN: Now, do you get the order entered on a final basis on the first day or is it put out for objection?

MR. BIENENSTOCK: It depends on the court.

MS. MILLER: Does it also include a provision that is an acknowledgment of compliance with your obligations under § 365, and does it have any triggering points where if you fail to comply, let's say, you

1. 852 F.2d 1179 (9th Cir. 1988).
2. 775 F.2d 1089 (9th Cir. 1985).
3. 773 F.2d 1166 (11th Cir. 1985).
4. 841 F.2d 1467 (9th Cir. 1988).

fail to make the payment, that it triggers an expedited hearing in order to get the—

MR. BIENENSTOCK: Well, sometimes the order provides the landlord can always get an expedited hearing, but usually we say just a hearing subject to the court's docket, whatever.

MR. FISCHER: Do you have to pay stub rent?

MR. BIENENSTOCK: No, we don't get into substantive issues. It's just a procedure.

MR. FISCHER: Well, but what I would suggest to you is when these motions come up, it's an opportunity for a landlord to insist on things, like stub rent, because the debtor is supposed to, on some level, make a showing, when he gets the extension, that he's in compliance with all terms. And that's where the stub rent issue comes up.

And I must tell you that I haven't been in one of your cases, but it's a good way to trump the issue so it doesn't come up.

HON. FITZGERALD: Why would the stub rent issue come up in that context?

MR. FISCHER: Because the landlords object and say that at that point it has to be paid or the debtor is—

HON. FITZGERALD: Why? Because it's not a motion to assume?

MR. BIENENSTOCK: That's what my response would be. That should be a separate motion.

HON. FITZGERALD: Absolutely.

MR. FISCHER: Well, the way it comes up is that you're not complying with all lease terms.

MR. KIESELSTEIN: Right. If you want an extension under § 365 —

MR. FISCHER: You've got to pay stub rent. Whether you agree or not that it's proper.

HON. FITZGERALD: But you are in compliance with the Code provided that you're not paying your prepetition debt until you file a motion to assume, at which point you have to show that you have a reasonable chance to cure. But until you file that motion to assume, as long as it's a prepetition claim, I don't see how you're in violation.

MR. FISCHER: But a smart debtor who files his case on the second day of a month creates a great opportunity to get a lot of funding, particularly in a retail context, and the way that that has traditionally been righted is when the motion to extend comes up, there is a demand and usually somehow or other it happens that the stub rent gets paid.

MR. BIENENSTOCK: Under Section 365, rent has to be paid timely, and there's a big issue that seems to have crystallized in the last several years as to when the rent first arises. And it clearly does not first arise when the lease is signed sometimes years before bankruptcy. There's a lot of real property law to the effect that the obligation to pay rent doesn't arise until the payment date. Normally it's the first day of the month.

So then the argument or the question is, if the obligation arises the first day of the month and you file the second day of the month, does that mean that you no longer have an obligation to pay rent that month? Your obligation was all prepetition. Do you get that month for free, and then you start paying rent the next month? Or do you pay pro rata for the 29 days or the 30 days or the 27 days you're in bankruptcy that month? Courts are all over the lot on that.

And that dovetails with a bunch of decisions concerning a bill from your landlord for real property taxes which are part of your rent. In most shopping center leases you pay base rent, then you pay these add-ons which include incremental real property taxes. If the period the real property taxes accrued was prepetition but you get billed for it post petition, is that a prepetition claim or a post-petition claim? If it overlaps, do you pro rate it?

MR. KIESELSTEIN: This is an example of where you see that the lawyers are not bogged down by foolish consistency because with the same situation, we will take the position, for instance, that those real estate taxes would all be prepetition even though the time for our payment arose post petition because you've got to relate them back to the prepetition period.

Part of the rent was due for the entire month on the 1st and we filed on the 2nd, even though we occupied it for 29 days post petition we would argue, entirely consistent in our minds, that that entire post-petition period is in essence a prepetition claim.

MS. MILLER: And even though the taxes are defined in the leases as additional rent, and you would think that thereby they would follow along the same line, the cases go different ways even in the same circuit depending upon whether or not the obligation is pure rent for occupying the space versus the tax component.

MR. KIESELSTEIN: As in the *Handy Andy* case.

MS. MILLER: Right. And *Koenig Sporting Goods* and there's another decision now in the Sixth Circuit on taxes going inward.

MR. BIENENSTOCK: To round out our detour into landlord-tenant law, the issue also comes up in the context of percentage rent. If your obligation is for the debtor tenant to pay the landlord a percent of all sales once sales have exceeded a million dollars, how much of the percentage rent is due to the post-petition period? If the debtor got up to a million dollars prepetition, are all sales post petition, post petition rent, or do you look at the entire year and say, well, since you were in bankruptcy for three-quarters of a lease year, you only pay three-quarters of the percentage rent. The majority seems to be today that once the threshold is met, everything after is post petition rent.

Okay. Back to recharacterization. What happened in *Morregia* was that the debtor had a lease that I believe went several hundred years. It might have even been 900, but it was several hundred, and the debtor was in danger, because of § 365(d)(4), of losing the lease as a forfeiture because it hadn't extended the time to assume or reject it.

And the court basically said was this is not the type of lease that Congress had in mind with § 365, so for § 365 purposes, this is not a lease, more of a fee title.

Clearly it was antiforfeiture. It was just too much to stomach that a debtor was going to lose a leasehold like that where I think most of the rent had been prepaid, as a matter of fact, because of the passage of 60 days.

MR. FISCHER: Was it a ground lease?

MR. BIENENSTOCK: Probably. Now, in the Second Circuit in a case called *PCH Associates*, there are actually two of them, there had been a sale-leaseback transaction which is fairly typical where the people putting in the money, putting in $4 million got title to the land and leased it back. The lease back gave them a fixed return on their $4 million. A developer who put in other money to build the improvement on the land basically got the upside from improvement's income.

If it were accepted as being what it said it was, then the return on the land lease was an obligation under Section 365(d)(3) to pay that timely. But, the debtor contended it shouldn't have to pay that rent timely because it wasn't really a lease for purposes of § 365.

The Second Circuit looked at it and said, you know, the $4 million doesn't look like that was really the value of the land. It was just part of the overall deal that the people putting up the four were going to get a fixed return, and the people putting up the other money were going to ride with the results of the venture. So we don't think this was a lease for § 365(d)(3) purposes, and so timely rent doesn't have to be paid. And the Second Circuit stopped short of saying what it was. It just said all we have to decide is it's not a lease for purposes of having to pay rent timely under § 365(d)(3).

So it went back to the bankruptcy court, and the debtor took the position that if it's not a lease, it's obviously a joint venture. And the bankruptcy court thought that was the right result, so it went back up to the Second Circuit.

Now it's getting serious because the people who put in the $4 million don't want to be told that they don't have a pretty ironclad right to either ownership of the property, in which case they can sell it, or at least a secured loan so they get their $4 million back. Now they're being told they're like equity all of the sudden.

And the Second Circuit very methodically went through the transaction and said there's nothing hidden here. This isn't like a hidden security interest where these people own the land and nobody knew it. They had title to the land. It was in the public record. And while we didn't acknowledge it was a lease for purposes § 365(d)(3), and this group maybe shouldn't be deemed to have absolute title, because if it has title, then it must have been a lease, we're not going to do something that is unfair just because the debtor is asking us. There's no principle that says the debtor gets what it wants because it's the debtor.

Some of us sometimes feel that too many decisions might go in that direction. But to the extent most results in the bankruptcy court appear to the public as debtor-biased, my experience has been it's not that the results are debtor-biased, it's that the Bankruptcy Code is being enforced. And the Bankruptcy Code is unlike insolvency laws in most every other country, except Ireland fosters reorganization and rehabilitation before it fosters return of payment of creditor claims, and the legislative history is clear about that.

So, anyway, getting back to *PCH Associates*. On the second time around, the Court said we know we've prevented ourselves from saying that the people who put up the $4 million have title to the property, but that doesn't mean we're going to just take it away from them and give them just a $4 million unsecured claim to the property because they thought they had rock solid title, and they didn't do anything wrong. There's no inequity on their part. So what we're going to do is we're going to give them an equitable lien against the property for $4 million so they come out whole, but meanwhile, the debtor didn't have to pay rent timely under § 365(d)(3) because we don't think this was really a lease for those purposes, and that was the end result.

To me that's a very telling decision and very instructive for how recharacterizations have to be analyzed. If you're doing a recharacterization, you have to ask yourself, number one, why? What would be wrong if I didn't do it? Well, in that case, § 365(d)(3) would have been enforced against the transaction that maybe shouldn't have been put into § 365(d)(3); although, that's probably not crystal clear either except for the Second Circuit's first decision. But once having made that decision, you just can't finish the recharacterization without regard to the people—the creditors whose interests that you're affecting or the owners whose interests you're affecting.

Okay. So that's antiforfeiture or recharacterization based on equity.

Now, let me just throw out for you the nouveau transaction that is now being considered in all sorts of Chapter 11 cases with no clear results yet. But before I do that, let me just give you one more recharacterization example it's the Second Circuit case called *In re Joseph Kanner HatCompany, Inc.*[5]

In *Kanner*, a company called the Hat Company got $25,000 from a bank and simultaneously transferred to the bank a receivable, a note receivable that it held, and the transfer document was absolute. I hereby transfer, sell, convey, da-da, da-da, da-da, this note to you.

The company gave a note to the bank for the $25,000, and the company's two principals, or shareholders, endorsed the note, basically supplying their guarantees just in case the note was insufficient.

When the company ended up in bankruptcy later, the bank took the position that the note receivable, that had been assigned absolutely, was its property. The company took the position that it wasn't its property, it was its collateral, and it had not perfected a lien against the collateral.

And what the court did was it looked at the facts surrounding the transaction, and the facts were that the bank, if it managed to collect from the shareholders, was going to give the note back to the company. And if it managed to collect from the note receivable itself, it was not going to go against the shareholders.

So Judge Friendly concluded that this was an easy one. Notwithstanding what they wrote in the document, this note receivable was obviously given as collateral, they forgot to perfect, and therefore the bank has nothing but an unsecured claim against the hat company.

5. 482 F.2d 937 (2nd Cir. 1973).

Well, how many people would decide it differently in addition to you guys?

UNIDENTIFIED SPEAKER: No, I just— that's a good—I like the ending of that.

MR. BIENENSTOCK: Okay. Just before I jump over to what I was going to say was the nouveau transaction, I wanted to go over one other—

MR. FISCHER: But there's a key element in the *Kanner* case that pervades everything, and it's there was no perfection. In his real estate case, one could argue that by recording the deed, they in effect recorded a mortgage because they created a public record so that nobody else would be duped into losing their rights because of a hidden lien and so forth. With this note, if it wasn't perfected, who would know?

MR. BIENENSTOCK: Right. And that's a very important point. Yes?

GARY PLOTKIN: What I don't understand is that there are many times when a person buys the piece of property on a net-net situation whether it be the land you build or—I've got some shopping centers where I have Wal-Marts as my tenant. They're all tripled in leases. What's the difference? Basically at the end of the term, you end up with the land because the buildings are down to zero.

MR. FISCHER: It's about a forfeiture.

MR. BIENENSTOCK: No, I think there is a difference. The difference is that you have classic net leases. There's no question that they're leases, and there's no question that the rent should be paid timely under § 365(d)(3). That's why subsection (d)(3) was put there in 1984.

GARY PLOTKIN: How is yours any different?

MR. BIENENSTOCK: The difference in *PCH Associates* was, what it looked like from the facts, that whether intentionally or accidentally the owners of the fee lucked into treatment under § 365(d)(3) on what could really have been considered a secured loan and shouldn't be considered rent that has to be paid timely.

And the key fact was that the land was not worth the $4 million. It was a lot more or a lot less, so it's clear that it was probably structured in that way for tax purposes and because it satisfied people's investment objectives. But it was as if by happenstance they lucked into § 365(d)(3), which the court thought they shouldn't have.

GARY PLOTKIN: But if the land—when you go into a transaction, if the land has a value, and you are charging a reasonable rent for the use of that land to a person who constructs the building in downtown Chicago—

MR. BIENENSTOCK: That should not be recharacterized.

MR. FISCHER: But that's not what happened here. Also, there are other cases like it where somebody would sell the property to a fund, and then also give the fund a cash flow mortgage of some type, and those transactions would be recharacterized as loans.

GARY PLOTKIN: Or if you had a high percentage rent or something.

MR. FISCHER: But virtually all of these deals wind up with the economics in a crash, and that's what really happened here. The court recharacterized it because when it crashed, the "lessor" got way too much for the value of his investment, and that was going to be a forfeiture against the debtor.

GARY PLOTKIN: I don't mean to belabor this, but at what point in time do you look at the transaction to make that decision, at the time the transaction took place or later?

MR. FISCHER: What he started with is nobody is ever going to be right. Nobody is ever going to be wrong. And this has a lot of a feel to it—once a court decides to recharacterize a transaction, get the angels out because they're going to start dancing on the head of a pin.

And once the recharacterization starts, who can predict where it's going to go because the transaction as recharacterized doesn't fit what the parties wrote. And especially if the parties wrote this much, as they often do, it gets a little strange when somebody says do you see all those papers, they don't mean it.

MR. BIENENSTOCK: We've been advised we have five minutes to cover the issue. This discussion can't end without at least mentioning UCC Section 1-201(37), which is the section that gives criteria for determining whether something is a lease or a security interest.

Now let's get to the nouveau transaction. A company sells an asset to a special-purpose entity. The special-purpose entity has raised money from the public or from banks that it uses to buy the asset. At that point it seems all very plain vanilla.

But the special-purpose entity then enters into a separate—well, a separate but integral transaction with the seller, and we'll call it a total rate of return swap. Under that total rate of return swap, if the property—if the asset that was sold to the special-purpose entity ultimately is sold for more than it cost and more than the money raised from the outside to buy it, the upside goes back to the seller.

If, however, the asset is sold for less than it originally cost or it generates losses as opposed to profits, the seller is obligated to make good on the debt the special-purpose entity raised to buy the asset in the first place.

So there you have a situation where the asset is sold, but most of its upside goes back to the seller, most of its downside goes back to the seller. The reason I say most is that the special-purpose entity usually issues two types of certificates. One is a debt certificate, and the other is an equity certificate. And both the debt certificates with their interest rate and the equity certificates with their returns get first call on the profits and proceeds from the asset. And then after the lenders and the equity owners are paid off, the surplus, if any, goes back to the seller or the losses go to the seller.

And usually the equity owners are not guaranteed. The seller only guarantees the amount of the financing that came from the debt people.

If you use what I call the scoring technique, you would say notwithstanding that the asset was sold, the seller retained all the attributes of ownership. It had the upside, most of the upside, most of the downside, and it had control or management of the property all the way through.

So if you're just using the scoring technique, you would say if the seller goes into bankruptcy, the seller should get the asset back because it wasn't really sold. And the debt financiers and the equity financiers of the special-purpose entity are now in deep, deep trouble because they now have claims against an entity that doesn't have an asset anymore. And that's very appealing, and I think a lot of courts will do the analysis that way, and I just put that out there as a plausible result. Maybe that should always be the result. If you ask yourself what are the equities here, you may not come out that way.

You could also say to yourself, well, what was the essence of the transaction? The essence of the transaction looks more like a loan than a sale. But that one I think you have to do a double-take on. Why should we say that was a loan as opposed to a sale any more than we should say that a loan is nothing but a sale with a total rate of return swap attached to it? Why is one more substantive than the other? And once you put it in those terms, I don't know why you would say one is more substantive than the other.

Now you go to a third way of analyzing this. What are the equities? The asset was clearly transferred to the special-purpose entity. It wasn't hidden. It wasn't on the seller's balance sheet after it was sold.

The people who financed the asset provided good money to finance it. What is the great equity in telling them that they lose all their money? The seller was already paid once for the asset, and now we're saying because it gave a total return swap, it's going to take it back and get the asset a second time. It's hard to come up with equities in that situation.

MR. KIESELSTEIN: And there's a capital markets consideration if a court wants to be sort of far seeking beyond the one case that's in front of him that you'd wreak havoc in the financial markets if you don't respect it.

MR. FISCHER: You'd create a much higher interest rate than you would get because you created this remote mechanism.

MR. BIENENSTOCK: Well, as the jurisprudence is today, I think the scoring technique is so far in the majority and will likely prevail in most of these cases. The substance of the transaction analysis to me doesn't go one way or the other, but for those people who would tilt it, they would say it goes in favor of the loan because not many people look at loans and say, oh, that's a sale with a total rate of return swap, although, I don't know intellectually why you couldn't say that.

And then if you look at the equities the debt financiers are losing for no apparent reason. And I don't think you can use the argument that you've got to go in favor of the debtor-in-possession if that's the seller because what if the special-purpose entity goes into bankruptcy? Now you have two debtors-in-possession, so which way are you going to tilt? I don't think you can use the existence of a debtor in possession to tilt the result.

That's really the frontier in today's special-purpose transactions. You might ask why people do what I just described. Why don't they just set it up as a loan in the first place? And the reason, in at least some cases, has been that it was a technique developed by fancy accountants, investment bankers, and lawyers as to how companies could control their quarterly earnings because a company would basically take one of its assets, sell it to a captive special-purpose entity for a certain price that would yield a certain profit that would hit the earnings that quarter and that's why it was a sale. A loan wouldn't have had that effect. It would have just affected the funds flow. It would not have affected earnings and losses.

So that's the genesis of a lot of these transactions.