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Finding Our Way: Secured Transactions and Corporate Bankruptcy Law and Policy in America and England*

I Introduction

This article is about the way in which England and America have historically sought to balance two sets of policy considerations, and the implications of the evolutionary history for current reform debates. The first set of policy concerns is those relating to the ability of a debtor to grant security over its assets, in order to promote the availability and affordability of capital for healthy companies in the economy. There is a voluminous literature on the theoretical case for secured credit,[1] but in practice most developed economies accept that secured transactions law plays some part in promoting the availability and pricing of credit. The second set of policy concerns is those relating to the availability of assets to meet the claims of unsecured creditors, and to fund the corporate bankruptcy case, when a company fails.

The organising principle at the heart of the article is that English courts and US courts answered a foundational question about the scope of security in almost diametrically opposed ways in the late nineteenth and early twentieth century, with the result that the legislature in each jurisdiction has been concerned with different sets of policy considerations for most of the rest of the twentieth century and into the twenty-first century. The article suggests that this has explanatory power when we examine current debates on reform of secured creditor priority in England and the US. On the one hand, in the late nineteenth century the English courts supported the development of security interests which enabled all or substantially all of the debtor's assets to be secured, with the result that legislative reform efforts over the next century and a half focused on corporate bankruptcy policy concerns which arose where the debtor had no unencumbered assets, leading to a complex regime for secured creditor priority in corporate bankruptcy. On the other hand, US courts reached determinations which made it very challenging for a lender to have a "blanket lien" over all of the debtor's assets, so that reform efforts over the next century and a half focused on the ability of the lender to take and perfect security over a wide range of asset types in order to support secured transaction policy concerns for the availability and cost of credit in the "healthy" economy. At the same time, the availability of unencumbered assets in the estate meant that no particular need to redistribute assets from the secured creditor to other creditors or to fund the case arose. Complex institutional structures emerged in both jurisdictions which contributed to the way in which the two

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The author is a member of the Executive Committee of the Secured Transactions Law Reform Project and Chair of the STLRP's Insolvency Working Group. Much of the underlying research in this paper was conducted for the purposes of informing a discussion paper for the STLRP on the case for abolishing the distinction between the fixed and floating charge in English law. The author is grateful to many members of the STLRP, and those who have provided feedback to the STLRP's work, for comments and suggestions which helped to scope the inquiry, notably Louise Gullifer and Hugh Beale. The author is also grateful to Adrian Walters, Steve Harris and Edwin Smith for comments on the US material. The usual disclaimers apply.

[1] See, for example, T. Jackson and A. Kronman, 'Secured Financing and Priorities Affecting Creditors' (1979) 88 Yale LJ 1143; A. Schwarz, 'Security Interests and Bankruptcy Policies: A Review of Current Theories' (1981) 10 J. Legal Studies 1; R.E. Scott, 'A Relational Theory of Secured Financing' 86 Columb. L. Rev 901; P.E. Shipak, 'Solving the Puzzle of Secured Transactions' 41 Rutgers L. Rev. 1067; George G. Triantis, 'Secured Debt Under Conditions of Imperfect Information' 21 J. Legal Stud. 225; H. Kanda and S. Leumore, 'Explaining Creditor Priorities' 80 Va. L. Rev. 2103; L.M. LoPucki, 'The Unsecured Creditor's Bargain' (1994) 80 Va. L. Rev. 1887; S.L. Harris and C.W. Mooney J., 'A Property-Based Theory of Security Interests: Taking Debtor's Choices Seriously' (1994) 2021, 2047-2053 and L. Bebchuk and J.M. Fried, 'The Uneasy Case for the Priority of Secured Claims in Bankruptcy' (1995) 105 Yale L.J. 857.

sets of policy concerns were balanced. In England, secured creditors and the courts supported the role of the insolvency practitioner as a crucial source of power to mediate the blunt edges of the inroads into secured creditor power in the corporate bankruptcy statute, whilst in the US the bankruptcy court emerged as a powerful institution with the willingness and capacity to support corporate bankruptcy law's policy objectives where it considered it necessary in the interests of the bankruptcy case, notwithstanding the rather blunt rules of priority in the US Bankruptcy Code.

The article argues that the evolutionary story explains the nature of the current debate on the case for reform on both sides of the Atlantic. In England, the debate principally centres on whether the legislative inroads into secured creditor priority in corporate bankruptcy have gone too far, affecting the availability and cost of capital for healthy companies in the economy. In the US, the debate principally centres on whether the reforms to secured transactions law have gone too far, so that secured creditors wield unprecedented power in the corporate bankruptcy case affecting the availability of returns for unsecured creditors, with wider consequences for the economy, and the availability of funding to meet the expenses of the case. The evolutionary history reveals that neither England nor America has taken one side of the theoretical debate or the other. When we look at the whole picture we see that, although each jurisdiction set off along its journey towards balancing the concerns from opposite ends of the telescope, there has been a continuous process in both jurisdictions of adjustments and readjustments to the balance struck between the two sets of policy objectives, supported by a complex institutional architecture which has developed along the way. This leads to the final part of the article which makes some tentative predictions for future developments. Drawing on the theory of path dependence, it suggests that there are reasons to doubt that the current reform debate will lead to a radical overhaul of either system, at least in the reasonably forseeable future. However, it suggests that there are comparatively modest reforms which could nonetheless continue the process of balancing the policy objectives, embedded in, and adjusted to, local institutional structures.

One last point on terminology: English law typically draws a distinction between bankruptcy, which relates to individuals, and insolvency, which relates to corporates, whilst that distinction is not drawn in the US. For ease of reference, this article uses "corporate bankruptcy" as a generic term applying to both jurisdictions.

II The Foundational Question, the English Answer and Corporate Bankruptcy Policy Concerns

In 1870 the English Court of Appeal determined that where a company charged its "undertaking and all sums of money arising therefrom" the word "undertaking" captured all present and future property of the company,[2] effectively recognising the ability of the secured creditor to bring all of the property and assets of the company within the scope of the security package. A conceptual problem remained with a fixed charge over all of the company's undertaking because it was an incidence of a fixed charge that the chargee's consent was required for any disposals (so that such an all-encompassing charge would paralyse the business).[3] This was first dealt with by transactional lawyers who included an express right to deal with the charged assets in the ordinary course of business until default, winding up or cessation of business where the charge was over all of the company's undertaking present and future. In time, such a term was implied by the courts into such

[2] Re Panama New Zealand and Australian Royal Mail Co (1869-70) LR Ch App 318

[3] J. Armour, 'The Chequered History of the Floating Charge' (2004) 13 Griffith L. Rev. 25, 27; G. Moss, 'Fictions and Floating Charges: Some Reflections on the House of Lords' Decision in *Spectrum*', 2 in J. Getzler and J. Payne (eds) *Company Charges: Spectrum and Beyond* (OUP 2006)

charges and they gradually became known as “floating charges”.[4] Thus, by the end of the nineteenth century the ability of a lender to take security over all or substantially all of the assets of an English company with comparative ease was well-established in law. This gave rise to several policy considerations familiar to corporate bankruptcy lawyers. First, there is the policy question of whether other classes of creditor are adequately protected in the corporate bankruptcy regime. Secondly, there is the policy consideration of whether secured creditors have achieved gains at the expense of unsecured creditors. Third, there is the policy question of whether there will be adequate financing for a bankruptcy case in order to hold those responsible to account, where appropriate, and to maximise returns for creditors as a whole. Not surprisingly, having answered the foundational question in favour of the secured creditor we find all of these corporate bankruptcy policy considerations firmly on the legislative agenda for the rest of the century and into the next.

The role of corporate bankruptcy law in redistributing proceeds from creditors who benefit from bargained-for security to other creditor classes is heavily contested by corporate bankruptcy law theorists,[5] but, in England, Parliament has worried from early in the history of corporate bankruptcy that no assets will be available in insolvency for creditors which it wishes, as a matter of policy, to protect. Of course, given the ability of the secured creditor to take security over all or substantially all of the debtor’s assets through a combination of fixed and floating charges, this is a very real concern. Thus, the Companies Act 1883 provided that certain unpaid wages and salaries should be paid before all other debts in the distribution of the assets of a company being wound up,[6] and the categories of preferential debts were widened to include rates and certain unpaid taxes by the Preferential Payments in Bankruptcy Act 1888.[7] In *Richard v Overseers of Kidderminster* it was held that the preferential status of overseers of the poor did not trump secured creditors who were not claiming as creditors in the winding up.[8] As a result, preferred creditors identified in the Preferential Payments in Bankruptcy Amendment Act 1897 were afforded priority over debenture holders,[9] and section 264 of the Companies Act 1929 made clear that, where the debenture created both fixed and floating charges, only assets subject to the floating charge were subordinated to the preferential debts.[10]

Financiers responded to the challenge. In *In re Griffin Hotel* the debenture holder appointed a receiver with the result that its floating charge crystallised and became fixed.[11] The court held that, as the charge had crystallised by the appointment of the receiver, section 264 of the Companies Act 1929 (which applied only if there was a charge which was still floating at the moment of winding up) had no operation and there was nothing for the priority of the preferential debts to bite on. Parliament responded in its turn and the Insolvency Act 1985 fixed the problem by defining a floating charge as a charge which "as created" was a floating charge. Thenceforth the floating charge would be identified at the end of its life by the character which it had had at its birth, so that the trick in *Re Griffin Hotel* was consigned to the history books.

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[4] Armour, ‘The Chequered History of the Floating Charge’ ibid, 28

[5] For a non-distributional role see T.H. Jackson, *The Logic and Limits of Bankruptcy Law* (Harvard University Press 1986); for the case for redistribution see E Warren, ‘Bankruptcy Policy’ (1987) 54 The University of Chicago Law Review 775

[6] The Companies Act 1883 (46 & 47 Vict. c. 28), s. 4

[7] 51 & 52 Vict. c.62

[8] Richard v Overseers of Kidderminster; Richards v Mayor of Kidderminster [1896] 2 Ch 212

[9] Although not with retrospective effect; see In re Waverley Type Writer; D’Esterre v Waverley Type Writer [1897 w. 1598] [1898] 1 Ch 699

[10] In re Lewis Merthyr Consolidated Collieries Limited [1928 L 281]; [1929] 1 Ch 498

[11] In re Griffin Hotel Company, Limited [1938] G 2627; [1941] Ch 129

Still, the types of debt which ranked as preferential debts ebbed and flowed with the political and economic climate. For example, certain rates were preferential debts in bankruptcy until the Insolvency Act 1986,[12] and by far and away the most significant of the categories of preferential debt which remained after the Insolvency Act 1986 were the monies owed to the Inland Revenue for certain taxes and social security contributions. Allowing for the expenses of the insolvency office holder (discussed below), it was common for the preferential debts to absorb the entire balance of the estate.[13] The normative basis of this priority for the State was also contentious,[14] and crown preference was eventually abolished by the Enterprise Act 2002.[15] The point, put shortly, is that against a background of easily perfected security over all of the assets of a debtor, considerable legislative attention has been paid to the question of adequate provision for other creditors which Parliament has determined, from time to time, it wishes to protect as a matter of corporate bankruptcy policy.

This provision for payments to so-called preferential creditors gives rise to a second persistent corporate bankruptcy policy concern in an environment of the all-encompassing security interest: that once the preferential and secured creditors have been paid in full, nothing will be left for other unsecured creditors. From quite early in the history of the floating charge, the English courts show concern for the problem of scope; a concern that the gains to the secured and preferential creditors are achieved at the expense of loss to the other creditors. Parliament sought to alleviate the perceived unfairness by a new system for registration of company charges,[16] but it was widely understood that there were limitations on the trade creditor's ability to search the register every time she transacted with the company, a limited range of options for the trade creditor even if she did search and always the possibility that another creditor would take security after the search had been completed.

In order to deal with this corporate bankruptcy policy concern, Professor Roy Goode apparently brought the idea of "carving out" a portion of the secured assets, and making them available to the unsecured creditors, to the attention of one of the members of the Cork Committee when they were comprehensively reviewing English insolvency law,[17] and the Committee did recommend that holders of floating charges give up ten per cent of their realisations to enable the money to be distributed among unsecured creditors.[18] Although the recommendation was not enacted, it came back onto the Parliamentary agenda in the late 1990s when it became clear that the government of the day might be prepared to review the Crown's preferential status on insolvency. If Crown preference were abolished without any amendment to the priority rules on insolvency it would essentially produce a windfall for the floating charge holders. As a result, the Enterprise Act 2002 reforms to the Insolvency Act 1986 did implement the abolition of crown preference, but introduced a "prescribed part" to be carved out of secured creditor receipts for the benefit of unsecured creditors, sized as a proxy for the preferential status which was being surrendered by the Crown.[19] The English courts have recognised the legislative intent to create a fund for unsecured creditors, and have resisted attempts by secured creditors to share in the prescribed part unless they go so far

[12] Insolvency Act 1986, s. 386 and Sch. 6

[13] See, for example, Re Pearl Maintenance Services Ltd [1995] BCC 657

[14] S.J. Cantlie, 'Preferred Priority in Bankruptcy' in J.S. Ziegel (ed), *Current Developments in International and Comparative Corporate Insolvency Law* (Clarendon Press 1994)

[15] Enterprise Act 2002, s. 251

[16] Companies Act 1900

[17] R. Goode, 'The Case for the Abolition of the Floating Charge', at fn 7 in Getzler and Payne (n 3)

[18] *Report of the Review Committee on Insolvency Law and Practice* (Cmnd 8558 1982), 1538-1549

[19] Insolvency Act 1986, s. 176A(3)(a) and the Insolvency Act 1986 (Prescribed Part) Order 2003

as to surrender their security.[20] In other words, both the legislature and the courts have worked to implement the prescribed part as a response to corporate bankruptcy policy's concern for unsecured creditors, particularly where secured creditors are able to take security over the entire estate with relative ease.

As the comprehensive security package developed in the English market, a further corporate bankruptcy policy concern has been how the costs and expenses of the winding up are to be met. The corporate bankruptcy policy concern is, of course, that if all the assets are effectively secured then, first, there will be no source of payment for costs and expenses, so that unviable companies will simply disappear from the register, and directors and others involved in the management of the company will avoid actions which should be taken against them for the benefit of creditors (and, perhaps, in the public interest) and, secondly, recovery-maximising possibilities may be closed off. In 1970, the English Court of Appeal held that the expenses of the liquidation ranked ahead of the floating charge holder's claim,[21] and it appears that the Enterprise Act 2002 was drafted on the basis that that case was correctly decided, so that the amendments made to the Insolvency Act 1986 clearly subordinated floating charges to the cost of administration proceedings (discussed below).[22] However, in *Buchler v Talbot* the House of Lords conducted a thorough review of the statutory history and the case law,[23] and determined that the costs and expenses of the liquidation were not payable out of floating charge property. Parliament responded swiftly, and section 1282 of the Companies Act 2006 inserted a new section 176ZA into the Insolvency Act 1986 overturning the decision.[24] Thus corporate bankruptcy policy's third concern was met in an environment of fully secured lending.

A further corporate bankruptcy policy concern which arises in an environment in which a creditor may have security over all or substantially all of the debtor's assets is how further funding can be raised for the corporate bankruptcy case, in order to pursue strategies which may be value-maximising for all creditors, if there are no free assets to offer as security. Under paragraph 99(4) of Schedule B1 to the Insolvency Act 1986 a sum payable in respect of a debt or liability arising out of a contract entered into by the administrator or a predecessor before cessation is payable in priority to property subject to the floating charge. This suggests that any loan agreement which the administrator enters into will rank above the floating charge in corporate bankruptcy's distributional order of priority. Under paragraph 59(1) of Schedule B1 to the Insolvency Act 1986, the administrator may do "anything necessary or expedient for the management of the affairs, business and property of the company", and Schedule 1 paragraph 3 expressly provides that the administrator has power "to raise or borrow money and grant security therefor over the property of the company." Putting this together, and recognising that the position is relatively untested, there is a good argument that the legislature is alive to this issue, and that the administrator has power to enter into a new financing agreement which would rank ahead of property subject to a floating

[20] Re JT Frith Ltd [2012] BCC 634, 639; In re Airbase Services (UK) Ltd [2008] EWHC 124 (Ch); [2008] 1 WLR. 1516, 1521-22; Re Permacell Finesse Ltd (in liq.) [2007] EWHC 3233 (Ch); [2008] B.C.C 208, 211

[21] Re Barleycorn Enterprises Ltd; Mathias and Davies (A Firm) v Down [1970] 2 WLR 898; [1970] Ch 465

[22] Insolvency Act 1986, Sch. B1 para. 99. For a discussion, see J. Armour, 'Floating Charges: All Adrift?' (2004) 63(3) CLJ 560

[23] Buchler v Talbot[2004] UKHL 9; [2004] 2 AC 298

[24] Subsequently, steps were taken to ensure that one of the perceived inequities of the *Barleycorn* position, that a liquidator might take the costs of unsuccessful litigation out of the floating charge assets, even where the floating charge holder had objected to the litigation, was corrected through the introduction of detailed provisions demanding floating charge holder consultation

charge (although not property subject to a fixed charge). There is also some scholarly support for this analysis.[25]

It must be acknowledged that there is some debate around the impact of any negative pledge clause in pre-administration loans for this analysis. It is suggested that provided the administrator considers it is in the interests of the creditors as a whole that the new financing is obtained, and that the existing lenders have shown themselves unwilling to provide it on equal terms, the court should be able to come to her aid on issues of the negative pledge in pre-administration financing on an application for court directions.[26] First, paragraph 99(5) of Schedule B1 to the Insolvency Act 1986 gives rise to a statutory charge over the assets which may not be caught by the negative pledge. Secondly, the administrator acts as agent of the company and may be protected by the rule in *Said v Butt* from a claim for inducing a breach of contract.[27] Finally, if neither of these routes assists, the defence of justification should be available to both the administrator and the company in administration.[28]

More straightforwardly, paragraph 70 of Schedule B1 to the Insolvency Act 1986 expressly provides that the administrator may "dispose of or take action relating to property which is subject to a floating charge as if it were not subject to the charge." Crucially, to the extent that the estate comprises cash at bank which is subject to a floating charge, the administrator will be able to use that cash to fund the administration case without the consent of the floating charge holder or the court (notwithstanding that the floating charge holder will have "the same priority in respect of acquired property as he had in respect of the property disposed of").[29] In other words, when we look at the distributional scheme in the English Insolvency Act arguably Parliament is alert to the problem of funding the corporate bankruptcy case in the absence of free assets.

The English courts have also shown themselves ready and willing to support the legislature's scheme for protecting and promoting corporate bankruptcy policy's concerns. Perhaps not surprisingly, given that all of the innovations we have considered thus far apply to the floating charge and not the fixed charge, financiers in England have actively sought to bring as much of their security package within fixed charges as possible. In determining whether security was fixed or floating, early cases focused on the ability of the chargee to prevent dealings with the charged property in the course of the business as a going concern.[30] The first innovation from the finance industry arose in this context where the bank took a charge over its customer's account. In *Siebe Gorman* the bank required the debtor to pay collections into an account with the bank, and the court was content to classify the charge as a fixed charge.[31] But this route was available only to a bank creditor, and not a non-bank creditor who could not take charge of collections. Thus, in *Re Brightlife*, Hoffman J (as he then was) held that although a debenture purported to create a "first specific charge" over the book and other debts, in reality the charge amounted to a floating charge since Brightlife was free to

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[25] P.R. Wood, 'Fixed and Floating Charges' (2001) 60(3) CLJ, 472-474; V. Finch, *Corporate Insolvency Law: Perspectives and Principles* (CUP 2009 2nd ed), 409-410; G, McCormack, 'Super-priority New Financing and Corporate Rescue' (2007) JBL 701, 728

[26] Insolvency Act 1986, Sch. B1 para. 63

[27] Lictor Anstalt v Mir Steel UK Ltd [2011] EWHC 3310 (Ch); [2012] Bus LR D84 (but see also SCI Games Ltd v Argonaut Games Plc [2005] EWHC 1403 (Ch); 2005 WL 165 0621 and views expressed by G. Lightman and G. Moss, *The Law of Administrators and Receivers of Companies* (OUP 2011 5th ed), 370-371)

[28] See Lightman and Moss ibid., 371

[29] Insolvency Act 1986 Sch. B1, para. 70(2)

[30] In re Horne and Hollard 22 April 1885 [1885 E 50] (1885) LR 29 Ch D 736; Benton v Electrical Engineering [1891 B. 1055] [1892] 1 Ch 434; Robson v Smith [1894 R 1267]; [1895] 2 Ch 118

[31] Siebe Gorman & Co Ltd v Barclays Bank Ltd [1979] 2 Lloyd's Rep 142

collect its debts and pay the proceeds into its bank account at which point they fell outside the charge over debts and the company was free to dispose of them as it wished. This right to deal with the charged assets for the company's own account was a "badge of a floating charge" and was inconsistent with a fixed charge, and a prohibition against factoring of the debts was not sufficient to convert the charge into a fixed charge.[32]

The finance industry responded with an innovation of its own. In *Re New Bullas Trading*, the draftsman purported to divide the book debts and the proceeds on collection, creating a fixed charge over the former and a floating charge over the latter.[33] Yet in *Brumark* the Privy Council thought such a distinction made no commercial sense, and that a restriction on disposition which nevertheless allowed collection and free use of the proceeds was inconsistent with a fixed charge because it allowed the debt and its proceeds to be withdrawn from the security by the act of the company collecting it.[34] This cast doubt on both *Siebe Gorman* and *New Bullas Trading* and the matter was finally put to rest in *Spectrum Plus Ltd* which overruled both cases and determined that for a charge over book debts to be a fixed charge the debts must be paid into a sufficiently blocked account on collection.[35] In other words, the legislature had developed a scheme for protecting corporate bankruptcy's policy concerns, and the English courts resisted the finance industry's attempts to circumvent that scheme by making all security fixed.

III The Foundational Question, the US Answer and Secured Transaction Law's Policy Concerns

Whilst English law started with a generous attitude to the pervasive floating charge which was to be subsequently clawed back by the legislature with regard to corporate bankruptcy law's policy concerns, matters developed almost completely in reverse in the US. *Benedict v Ratner* was an early twentieth century case concerning an assignment of the debtor's account receivables (book debts for the English lawyer). Prior to default the borrower was entitled to collect the debts and use the proceeds as it chose. No consent was required from the secured party and the debtors were not notified of the assignment of their debts. In the Supreme Court Justice Brandeis refused to recognise the priority of the lien, saying:

> Under the law of New York a transfer of property which reserves to the transferor the right to dispose of the same or to apply the proceeds thereof for his own use is, as to creditors, fraudulent in law and void.[36]

Following *Benedict*, the US finance industry developed other devices to mitigate the effects of the judgment.[37] Yet this gave rise to "a mismatch of complex and interlocking statutes, with intricate registration requirements, that lacked overall coherence and uniformity".[38] As a result, in 1951 Article 9 of the UCC (under the auspices of two sponsoring organisations, the American Law Institute and the National Conference of Commissioners on Uniform State Laws) expressly recommended validating security interests where the debtor was free to dispose of the collateral without consent (as with inventory) or collect collateral and use the proceeds (as with receivables),[39] validating

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[32] Re Brightlife Ltd [1987] Ch 200; [1987] 2 WLR 197
[33] Re New Bullas Trading Ltd [1994] BCC 36
[34] Brumark Investments Ltd Privy Council (NZ) [2001] 2 AC 710
[35] Spectrum Plus Ltd (in Liquidation) [2005] UKHL 41; [2005] 2 AC 680
[36] Benedict v Ratner 268 U.S. 353 (1925)
[37] J. Getzler, 'The Role of Security over Future and Circulating Capital', 250-251 in Getzler and Payne (n 3)
[38] G. McCormack, *Secured Credit Under English and American Law* (CUP 2004), 74
[39] UCC 1951 § 9-205(a)

contractual provisions for security interests in after-acquired property,[40] and giving an automatic security interest in proceeds.[41]

The American Law Institute and the National Conference of Commissioners are not legislatures. For their recommendations to take effect it was necessary for individual states to adopt them, and UCC Article 9 was not widely adopted until further revisions in 1962. Although these revisions made it substantially easier to acquire a perfected security interest in assets falling within Article 9 than it had been under the common law, it remained challenging for a lender to obtain a security interest over substantially all of the assets of the company (what US lawyers and financiers call a "blanket lien"). The corporate bankruptcy policy concerns which English law had dealt with by specific amendments to insolvency law's distributional order of priority were typically much less acute in the US, where secured creditors did not have a blanket lien and debtors continued to have unencumbered assets. Instead, the evolutionary story focuses on successive efforts to deal with secured transaction law's policy concerns for easily perfected security over as wide a range of assets as possible in order to promote the availability of affordable capital for healthy companies, eventually leading to substantial revisions to Article 9 in 2001. At the same time, no special legislative effort was regarded as necessary to deal with corporate bankruptcy law's policy concerns in an environment in which estates were not fully encumbered: no distinct species of security interest was created; and a floating lien was treated in the same way as any other type of security interest for the purposes of bankruptcy priority.

Before 2001, we see the first secured transaction policy concern when we consider the complex, and frequently litigated, perfection requirements in US secured transactions law. Section 544(a) of the US Bankruptcy Code (the so-called "strong arm" clause) affords the bankruptcy trustee or debtor in possession the status of a hypothetical judicial lien creditor, entitling him to avoid security interests that are unperfected at the commencement of the bankruptcy. Most security interests are perfected by the filing of a financing statement, but both the place of filing rules and the description requirements under Article 9 have traditionally been notoriously challenging. "Old" Article 9's place of filing rules turned on the category of asset over which security was taken, and there are over 4,000 filing systems in the US, divided not only into state filing systems but also into different county filing systems.[42] Relatively complex steps were required to maintain perfection where the proceeds of collateral were invested in assets of a different type from the original collateral, and the complex place of filing rules meant that if the collateral or the borrower changed location to a new state it was easy enough for the secured party to fail to make new filings which were required by the filing rules. Furthermore, secured creditors were required to set out in the financing statement each category of collateral separately. Thus it was comparatively difficult to take a "blanket lien", and it was not unusual for a financier to discover that a significant portion of the collateral package had not been properly perfected. As a result, unencumbered assets were frequently available to support corporate bankruptcy policy concerns, but reformers were concerned that these complex perfection requirements undermined secured transaction policy considerations, with damaging implications for the availability and cost of credit for healthy companies in the economy.

[40] UCC 1951 § 9-204
[41] UCC 1951 § 9-306
[42] See L.R. Lupica, 'The Impact of Revised Article 9' (2005) 93 Ky. L.J. 867, 887 for the old system and L. LoPucki and E. Warren, *Secured Credit: A Systems Approach* (Aspen Law & Business 2000 3rd ed), 408, for a description of the filing system

It is in this context that the perfection requirements were the subject of significant reform in the amendments to Article 9 which came into force in 2001.[43] First, the 2001 amendments relaxed the description requirements, so that a more limited list of information now needs to be correctly reflected in order for the security interest to be perfected.[44] Moreover, for the first time it became possible to state simply that the security interest was in "all assets", making it significantly less likely that there would be an error in the description of the collateral.[45] The "place of filing" rules were also significantly simplified so that all financing statements were required to be filed in the state where the borrower is located.[46] Thus, overall it has become less likely that the unsecured creditor will be able to rely on secured creditor error to carve out a portion of unencumbered assets, and the overall regime has moved towards supporting a policy objective of easily perfected security in order to encourage lending at a good price in the "normal" economy. At the same time, it is less likely that there will be unencumbered assets in the corporate bankruptcy case if the debtor fails.

A further limitation on taking full security over all assets under "old" Article 9 was the exclusion of certain types of assets from its scope. Although security could be taken over most of these assets at common law, this was a complex exercise which did not facilitate security grants in a range of valuable assets, with all of the concerns for credit availability and cost which that gives rise to. Once again, then, the evolutionary history has been concerned with this secured transaction policy concern, rather than the corporate bankruptcy policy concerns which could already be addressed using the unencumbered assets in many estates. Thus, when new categories of collateral were added to Article 9 in 2001, it made the process of taking security over them more straightforward.

These new categories include health-care insurance receivables,[47] commercial tort claims,[48] and deposit accounts.[49] Historically, Article 9 of the UCC did not apply to most security interests in deposit accounts (although some states did make non-uniform amendments to state law to bring deposit accounts within Article 9).[50] The 2001 revisions, however, extended Article 9 to include security interests in non-consumer deposit accounts.[51] The common law requirements for deposit accounts presented real practical impediments to the taking of security over an account used in day-to-day operations, so that this represents a particularly significant extension.[52] Notably, the method of perfection for deposit accounts is different. Instead of filing a financing statement, it is necessary for the secured creditor to have "control" established in one of three ways. First, if the secured party is the bank that maintains the deposit account, then control and hence perfection is automatic.[53] Secondly, if the borrower, the secured party and the bank agree in a "control

[43] Preparatory work for the Study Committee for these reforms started in the autumn of 1989, finishing in 1999 with the revisions coming into effect in 1 July 2001

[44] UCC §9-506(a)

[45] UCC §9-504(2)

[46] UCC §9-103(1)

[47] UCC §9-102(a)(2) & §9-102(a)(46)

[48] UCC §9-102(a)(13)

[49] UCC §9-102(a)(29)

[50] G.R. Warner, 'The Anti-Bankruptcy Act: Revised Article 9 and Bankruptcy' (2001) 9 Am. Bankr. Inst. L. Rev 3, 45 fn 238 citing B Clark, 'Revised Article 9 of the U.C.C.: Scope, Perfection, Priorities and Default' (2000) 4 N.C. Banking Inst. 129, 134 and B. Markell, 'From Property to Contract and Back: An Examination of Deposit Accounts and Revised Article 9' (1998-2000) 74 Chi-Kent L. Rev. 963, 968-969

[51] UCC §9-109

[52] D.L. Greene, 'Deposit Accounts as Bank Loan Collateral Beyond Setoff to Perfection – The Common Law is Alive and Well' (1990) 39 Drake L. Rev. 259 cited in S.L. Harris and C.W. Mooney, Jr., 'How Successful Was the Revision of UCC Article 9? Reflections of the Reporters' 74 Chi-Kent L. Rev. 1357, 1368 fn 48

[53] UCC §9-104(a)(1)

agreement" that the bank will comply with the secured party's instructions to pay out the funds in the deposit account without further consent by the debtor, then the control requirements will be satisfied.[54] Finally, the control requirement will be met if the borrower becomes the bank's customer with respect to the account.[55] Crucially, there is no need to maintain day-to-day operating control of the account to obtain priority. Section 9-104(b) of the UCC provides that a secured party that has satisfied the minimum requirements for control (such as entering into a control agreement) is perfected by control, "even if the debtor retains the right to direct the disposition of funds from the deposit account." Perfection of a security interest in a deposit account is thus now a relatively straightforward matter, once again supporting a policy move towards blanket liens to encourage availability and pricing of credit, and reducing the likelihood of unencumbered assets to support any corporate bankruptcy case.

A further policy question for secured transactions law is the extent to which a security interest should attach to assets coming into the estate after commencement of the bankruptcy case. In English law the floating charge continues to attach to property within the scope of the charge coming into the estate after an insolvency filing. In contrast, the usual rule in US bankruptcy is that a pre-petition security interest cannot reach property that comes into the estate after the bankruptcy petition,[56] other than “proceeds, products, offspring, profits or rent" of the pre-petition collateral.[57] At the time the Bankruptcy Code was enacted, the definition of "proceeds" in Article 9 of the UCC was relatively limited, so that once again a pot of assets was likely to exist which fell outside the scope of the security package. However, this can be a serious limitation for a secured creditor relying on the debtor’s receivables as a, or even the, principal asset class in its security package. The 2001 reforms appear to have recognised this issue and apply the concept of proceeds to future property that is generated by or related to the original collateral. It must be admitted, though, that spirited debate has followed in the US as to whether this amounts to a clarification of the original position or whether it amounts to an expansion of the proceeds concept.

When a debtor commingles cash proceeds with other monies standing to the credit of a bank account, Article 9 provides that the secured party can continue to assert a security interest in the monies standing to the credit of the bank account using “a method of tracing, including application of equitable principles, that is permitted under non-UCC law with respect to the type of collateral”.[58] Insofar as cash proceeds are concerned, ordinarily the “lowest intermediate balance rule” has the result that the amount of the secured creditor’s collateral in the monies standing to the credit of the account is equal to the lowest balance of all funds in the account between the time the collateral was deposited and the time the tracing rule is applied. Historically, in bankruptcy this rule has been limited to cash proceeds received by the borrower within ten days before the institution of the bankruptcy proceedings. However, the revised UCC eliminates the difficult to apply insolvency tracing rules, and provides for the continuation of a security interest in identifiable cash proceeds. Overall, it appears once again that the reforms to the proceeds rules are motivated by secured transaction law’s policy concern for the scope and value of the security package in order to

[54] UCC §9-104(a)(2)

[55] UCC §9-104(a)(3). For a detailed exploration of the requirements, see B. Markell, 'From Property to Contract and Back: An Examination of Deposit Accounts and Revised Article 9' (1998-2000) 74 Chi-Kent L Rev. 963, 984-987

[56] 11 U.S.C. §552(a)

[57] 11 U.S.C. §552(a) and (b). For a discussion see L.M. LoPucki, A.I. Abraham and B.P. Delahaye, 'Optimising English and American Security Interests' (2012-2013) 88 Notre Dame L. Rev 1785, 1828 and G.R. Warner, 'The Anti-Bankruptcy Act: Revised Article 9 and Bankruptcy' (2001) 9 Am. Bankr. Inst. L. Rev. 3, 525

[58] UCC §9-315(b)

encourage lending to healthy companies. And once again the reforms reduce the likelihood of unencumbered assets.

The evolutionary histories of English and American secured transaction laws also differ with respect to the sale of book debts. American secured transactions law regards sales of book debts as the functional equivalent of a security interest, and broadly treats the two types of transaction in the same way, whilst English law takes a more formalistic approach. Before the 2001 revisions, Article 9 reflected a strong policy commitment to free assignability and provided that contractual anti-assignment clauses in accounts and general intangibles for money due or to become due were ineffective.[59] However, it applied only to sales of what were called chattel paper, instruments or accounts. Essentially, this meant that only sales of goods and service related rights fell within Article 9's scope. Homer Kripke had suggested in the 1960s that this was a mistake,[60] and revised Article 9 expanded the scope of the provision to include "payment intangibles" defined as "general intangible[s] under which the account debtor's principal obligation is a monetary obligation."[61] In essence, this was intended to capture payment streams arising otherwise than out of a sale or disposal of goods. Moreover, revised Article 9 relaxed many statutory and contractual restrictions on asset transfers.[62] In their review of the revisions Steven Harris and Charles Mooney (Reporters for the Drafting Committee to Revised Uniform Commercial Code Article 9) go so far as to say, "The revised Article overrides virtually all contractual and legal restrictions to the creation, attachment and perfection of security interests in intangibles."[63] Once again, the overall effect is to make it more likely that all of the company's assets will be validly encumbered, and thus to support secured transaction policy concerns.

This overall shift towards more readily facilitating the blanket lien has also had implications for the funding of the corporate bankruptcy case in the US. US Chapter 11 provides that a debtor which seeks to use cash which is the subject of a security interest granted to a creditor requires either the consent of that creditor or the consent of the court. Court consent will only be given if the court is satisfied that the creditor has been provided with "adequate protection" of its security interest. Section 361 of the Bankruptcy Code provides a non-exclusive list of methods for providing adequate protection: (i) cash payments, (ii) replacement security, or (iii) other protection that will result in the realisation of the "indubitable equivalent" of the secured creditor's interest in the property. The 2001 revisions to the UCC have an impact on the operation of these bankruptcy provisions in two ways. First, it is more likely that cash within the estate will be validly secured in favour of the secured creditor, so that section 361 is engaged. Secondly, it is more likely that all of the bankruptcy estate's assets will fall within the security package, so that the debtor will find it very difficult to meet the adequate protection requirements. The practical consequence is to deliver the secured creditor control of the case through effective control of the cash in the estate.[64]

Famously, section 364 of Chapter 11 of the US Bankruptcy Code permits the distressed company to obtain financing after it has petitioned for Chapter 11 on either an unsecured basis or, after notice and a hearing, in exchange for priority (so-called DIP financing). Priority may be (i) a super-priority administrative claim, ranking after existing secured lenders, (ii) a secured claim in unencumbered

[59] Former UCC §9-318(4)
[60] H. Kripke, 'Suggestions for Clarifying Article 9: Intangibles, Proceeds and Priorities' (1966) 41 NYUL Rev. 687, 690-93
[61] UCC §9-102(61)
[62] UCC §9-406 and §9-408
[63] Harris and Mooney, 'How Successful Was the Revision of UCC Article 9?' (n 52), 1363
[64] For criticism see E. Warren & J.L. Westbrook, 'Secured Party in Possession' (2003) Am. Bankr. Inst. J., 12

property, (iii) a junior secured claim, or (iv) a senior secured claim which takes priority over, or "primes", pre-petition senior secured creditors. This regime has the benefit of an express statutory scheme and a depth of guidance through judicial decision-making which compares favourably with the uncertain position in English law, and in the 1990s a broad market for specialist rescue finance developed in the US. However, the DIP finance market has been in decline in the US.[65] Doubtless this is partly in response to the retreat of many traditional lenders from areas of business hit by post-financial crisis regulatory reform, but the UCC reforms may also have had an impact. Although it is possible to prime existing security interests, this appears to be difficult to achieve, first because it requires the debtor to show that no other financing is available, and secondly because it requires that the interests of pre-petition secured creditors that would be primed by the new facility are adequately protected. Indeed, Lynn LoPucki and Elizabeth Warren state that, "Granting senior liens to post-petition lenders is not a common occurrence."[66] Instead, the original market for so-called DIP financing appeared to rely on a pool of unencumbered assets to act as collateral for the new loan. Once again, as the UCC reforms make it more likely that there will be no free assets, it becomes less likely that a third party financier will be interested in financing the case. Instead, in some cases (though by no means all) secured creditors have used the DIP financing as a way to further protect their position, notably through what is known as "roll-up." When a DIP loan is rolled up, existing secured creditors provide the DIP loan on the condition that it is used to repay the pre-bankruptcy loan. This ensures that any remaining concerns about the pre-bankruptcy security package are dealt with as the original loan is "rolled-up" into the DIP financing.[67] Thus, in mediating between secured transaction law's concern for the availability and cost of credit for healthy companies and corporate bankruptcy law's concern for the financing of the bankruptcy case in order to maximise recoveries, the balance appears to be tipped towards secured transaction law's policy concerns.

IV The Institutional Environment

Thus far, we have seen that English law facilitated the taking of security over all or substantially all of a debtor's assets by the end of the nineteenth century, so that legislative efforts largely focused on the corporate bankruptcy policy concerns which arise as a result, whilst the US Uniform Commercial Code and the state legislatures have been much slower to facilitate the taking of a so-called "blanket lien", with the result that reform efforts have focused on secured transaction law's policy concerns in supporting the availability and cost of credit in the healthy economy. However, this does not give a full picture. In each jurisdiction, a complex institutional environment has developed around corporate bankruptcy which further influences the balance between secured transaction law's policy concerns, on the one hand, and corporate bankruptcy law's policy concerns, on the other.

In England, accountants expert in insolvency began actively to support creditors in corporate bankruptcy from the middle of the nineteenth century,[68] and by the end of the first world war leading practitioners had developed a business of reorganising distressed businesses and selling them off to a new purchaser on behalf of the creditors, or where that was not possible auctioning the assets.[69] By the mid-1950s this was normally achieved by appointing the insolvency practitioner

[65] ABI Commission to Study Reform of Chapter 11 Final Report, 75 fn 296
[66] LoPucki and Warren, *Secured Credit* (n 42), 517
[67] See M.J. Roe and F. Tung, 'Breaking Bankruptcy Policy: How Rent-Seeking Upends the Creditors Bargain' (2013) 99:12 Virginia Law Review 1235
[68] E. Jones, *True and Fair: A History of Price Waterhouse* (Hamish Hamilton 1995), 10
[69] K. Cork, *Cork on Cork* (Macmillan 1988), 10

as a receiver. Kenneth Cork (one of the leading practitioners of his day) provides a pithy description of this role in the context of the English secured transaction regime in his autobiography:

> "… a receiver … was invariably a Chartered Accountant (though the law did not say he should be) appointed in most cases by a bank who had lent a large sum of money to a company on the security of its assets (a "floating charge") and on calling in the debt was told the company could not pay. At the time of the loan the bank received from the company a debenture which gave repayment of the loan priority over any other debts in the event of the company becoming insolvent. It was called the debenture holder, and it had the power to appoint a receiver if the debt was called and not repaid.
>
> The receiver so appointed, as English law prescribed, had dictatorial powers to accomplish one thing and one thing only: to extract from the stricken company by any means it could enough money to pay the 'preferential creditors' as defined by law … , the debenture holder and his own costs. Once he had discharged that duty, he withdrew."[70]

This system underwent two significant reforms but the idea of secured creditor power which was explicit in the duties owed in the receivership regime was, in reality, retained implicitly in the new regime. In 2002 the Enterprise Act largely abolished receivership and significantly reformed the administration procedure (which had been introduced into English law in 1986 to be used either where there was a floating charge but the debenture holder did not want to appoint a receiver, or where there was no floating charge enabling a receiver to be appointed). Two routes are prescribed for appointing an administrator. The first is appointment by the court on an application by the company, the directors of the company or one or more of the creditors.[71] The second is an out-of-court appointment by the holder of a qualifying floating charge (essentially the holder of a floating charge which, together with any fixed charges, secures all or substantially all of the company's property),[72] the company or its directors.[73] Crucially, however, the qualifying floating charge holder is given the power to control the identity of the administrator in *each* route.[74] Administrators continue to be repeat players in the market, and this appointment power provides considerable soft incentives to comply with the wishes of the floating charge holder,[75] whilst the legislative scheme largely protects the administrator's commercial decisions by making them susceptible to challenge only on rationality grounds.[76] Thus, although it may be the case that administrators have the power to raise new financing for the case which ranks ahead of the pre-administration floating charge, or to use floating charge assets without consent, in reality they have little incentive to do so. The position is different in liquidation, but a qualifying floating charge holder is likely to be able to veto

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[70] Ibid., 33

[71] Insolvency Act 1986 Sch B1, para. 12(1)

[72] Insolvency Act 1986 Sch B1, para. 14

[73] Insolvency Act 1986 Sch B1, para. 22

[74] Insolvency Act 1986 Sch B1, para. 26 (which requires that the directors give five days' notice of intention to appoint to a qualifying floating charge holder, who may then proceed to make her own appointment) and Insolvency Act 1986, Sch B1 para. 36 (which entitles the qualifying floating charge holder to apply to court to have a specified person appointed and provides that the court shall grant the application unless it thinks it right to refuse it because of the particular circumstances of the case)

[75] There is an extensive literature on this point. See, for example, J. Armour and R. Mokal, 'Reforming the Governance of Corporate Rescue: the Enterprise Act 2002' (2005) Lloyds Maritime and Commercial Law Quarterly 28, 36-37; R Stevens, 'Security After the Enterprise Act' in Getzler and Payne (n 3), 160; Finch (n 25), 435; Office of Fair Trading, 'The Market for Corporate Insolvency Practitioners: A Market Study' (2010), 32 and A Walters 'Statutory Erosion of Secured Creditors' Rights: Some Insights from the United Kingdom' (2015) University of Illinois Law Review 543, 565-568

[76] Insolvency Act 1986 Sch B1, para. 3

liquidation by appointing an administrator, and recent reforms which expand the power of the administrator to distribute proceeds make it increasingly unlikely that the company will be placed into liquidation at all.

The courts have supported the overall scheme by firmly indicating, with one exception, that the insolvency practitioner is the guardian of commercial decision-making for the corporate bankruptcy case,[77] and remaining extremely reluctant to interfere in the administrator's decisions as a result. Thus, typically, an administrator will pay high regard to the wishes of the secured creditor, and this provides the secured creditor with considerable "soft" power in rebalancing the trade-off between secured transaction policy concerns and corporate bankruptcy policy concerns which would otherwise be achieved. Notably, the one area in which the courts have shown themselves somewhat willing to interfere in the administrator's decision-making is where the administrator has rode rough shod over the secured creditor's wishes. In *Clydesdale* this resulted in the successful removal of the administrator, notwithstanding that fact that David Richards J. (as he then was) had not determined that there had been any wrong doing,[78] and in *Capitol Films* Richard Snowden Q.C. (as he then was) ordered an administrator who had sought the court's consent to a sale of assets subject to a fixed charge (under paragraph 71 of Schedule B1 to the Insolvency Act 1986) to pay costs on the application, commenting that whilst "the court will generally defer to the commercial judgment of the office- holders where what is in issue is a challenge to the office-holder's assessment of the merits of one particular bid for a company's assets over another", a paragraph 71 application "requires the court to balance the competing rights and interests of the holders of fixed charges with the rights and interests of other creditors" and that "On that type of issue, the court does not simply … defer to the administrators' business judgment provided that it is rational, the court will decide for itself how to resolve the interests of creditors."[79] In *Capitol Films* Snowden Q.C. firmly decided the case in the secured creditor's favour.

The institutional environment of corporate bankruptcy in the United States has evolved in a strikingly different way. Yet the institutional environment enables some protection of corporate bankruptcy's re-distributional policy concerns vis-à-vis secured creditors, notwithstanding the priority of the secured creditor in the corporate bankruptcy statute, just as the institutional environment in England facilitates some protection of secured creditor interests notwithstanding the focus on re-distributional policy concerns in the English corporate bankruptcy statute. In other words, the institutional environment in each jurisdiction is an essential part of the overall balance struck between secured transaction policy concerns and corporate bankruptcy policy concerns. The most significant aspect of this institutional environment in the United States is the central role afforded to the court in the US scheme when compared with the English scheme, right from the start of modern US bankruptcy in 1898. The 1898 Bankruptcy Act in the United States gave the court, and not the creditors, the power to appoint a trustee or trustees to administer the estate,[80] who was usually a lawyer. A powerful bankruptcy bar emerged, rather than an insolvency profession of accountants with essentially a business focus.[81] The central role of the court was reinforced by reform in the 1930s,[82] and firmly entrenched in modern US bankruptcy in the form of the 1978 US

[77] Four Private Investment Funds v Lomas [2008] EWHC 2869 (Ch); [2009] BCC 632
[78] Clydesdale Financial Services Ltd v Smailes [2009] EWHC 1745 (Ch); [2009] BCC 810
[79] Rubin v Another (Capitol Films Ltd) v Cobalt Pictures Ltd & 24 Ors [2010] EWHC 3223 (Ch); [2011] BCLC 359
[80] V. Markham Lester, *Victorian Insolvency: Bankruptcy, Imprisonment for Debt, and Company Winding-up in Nineteenth Century England* (Clarendon Press 1994), 299
[81] D.A. Skeel, Jr., *Debt's Dominion: A History of Bankruptcy Law in America* (Princeton University Press 2004), 46-47
[82] Ibid., 120

Bankruptcy Code.[83] What emerges in the US is a system which affords considerable discretion to the bankruptcy judge,[84] who typically performs a far more interventionist role than we are used to in England.

This institutional structure has been crucial in the US for balancing the relatively unassailable position of the secured creditor at the top of corporate bankruptcy's distributional tree, with corporate bankruptcy policy's concerns for unsecured creditors, funding of the case and maximising recoveries, as secured transactions law has moved steadily closer to supporting blanket security. Thus, the US bankruptcy courts have shown themselves creative in limiting the reach of secured claims into proceeds where necessary to preserve cash for the estate. Sometimes the court has been able to arrive at what it views as the right result as a matter of interpreting the security contract to determine precisely what is within its scope.[85] Lynn LoPucki and Elizabeth Warren recount how, prior to the 1994 amendments to the Bankruptcy Code, several courts had "reached the somewhat surprising conclusion that the bill paid by customers of a hotel when they checked out was the "account" arising out of a sale of services, rather than "rent" for the use of the hotel room."[86] It will be recalled that section 552 of the Bankruptcy Code permits secured creditors to trace the value of its collateral into products, offspring, rents or profits, as well as into proceeds. Thus, by concluding that the hotel receipts were not rent, the debtor was free to use the revenue to fund the case (or to provide adequate protection or security to other funders). In 1994 Congress amended section 552 specifically to clarify that a security interest could extend to room charges. But the authors tell us that a ninth circuit court "casually sidesteps the amendment by interpreting it to mean only the *net* room revenues, after allowing the debtor to pay the expenses necessary to stay in business and complete the reorganization."[87]

Furthermore, section 552(b) of Chapter 11 specifically authorises the court to limit the reach of the proceeds security interest "based on the equities of the case",[88] and so in appropriate cases the US bankruptcy court, as a court of equity, may choose to limit the scope of the proceeds rule. The Bankruptcy Code does not define "equities of the case", and there appears to be relatively little case law on the point. Interestingly, the recent American Bankruptcy Institute Commission which has studied reform of Chapter 11 has suggested that the paucity of cases may be because trustees frequently agree to waive their right to assert a section 552(b) claim in return for post-petition finance from a secured creditor, or the use of cash collateral.[89] The fact, therefore, that a Court which is known to be activist has discretion to limit the proceeds to which the security interest attaches may provide negotiating leverage to the debtor team to raise finance.

LoPucki, Abraham and Delahaye also report that although US bankruptcy law does not have an express carve-out for unsecured creditors from secured creditor proceeds:

> A few American bankruptcy courts have imposed such a carve-out informally, as a condition of bankruptcy relief in cases the filing of which might not otherwise have been appropriate.[90]

[83] Ibid., 180
[84] Ibid., 231
[85] *In re Las Vegas Monorail Company* 429 B.R. 317 (2010)
[86] LoPucki and Warren, *Secured Credit* (n 42), 216
[87] LoPucki and Warren, *Secured Credit* (n 42), 217
[88] 11 U.S.C. §552(b)(1)
[89] ABI Commission to Study Reform of Chapter 11 Final Report, 232
[90] LoPucki, Abraham and Delahaye (n 57), fn 349

There is further evidence of the bankruptcy judges insisting that secured creditors meet the expenses of the case against the counterfactual of dismissing the Chapter 11 case, and leaving it to the secured creditor to enforce in numerous different states, or of the trustee bargaining for such a carve-out in return for giving up the equities of the case exception referred to above, or the right under section 506 of the Bankruptcy Code to assert that certain costs and expenses are associated with the collateral and should be met out of it.[91] The point here is that the US Bankruptcy Code provides secured creditors in the US with a mechanism for foreclosing against security nationwide, without incurring the costs and complexities of enforcing in each State using non-bankruptcy law.[92] In these circumstances, both the bankruptcy judge and the trustee have quite a bit of leverage in persuading secured creditors to give up just a little upside for the benefit of the case, particularly because there is lively debate in the U.S. about whether a Chapter 11 case should be dismissed if it only benefits the secured creditor.[93] As Charles Mooney puts it, "Commentators have noted that in a secured creditor bankruptcy the secured creditor may be required to 'pay to play' – i.e. to carve out of its collateral funds for the benefit of general unsecured creditors."[94]

What emerges, then, is a complex picture. In England, legislative reform efforts focus on corporate bankruptcy's policy concerns, but secured creditors receive support for their interests through an institutional structure comprised of an insolvency profession which takes the commercial decisions in the case and which has incentives to pay high regard to their wishes, and a non-interventionist court. In the US, the efforts of the National Conference of Commissioners on Uniform State Laws, reflected in state legislation, is focused on promoting secured transaction policy, but a powerful and interventionist specialist bankruptcy court pays high regard to corporate bankruptcy policy concerns in the conduct of the corporate bankruptcy case. This brings us to the final question for this article: what does the evolutionary analysis mean for current reform efforts?

V Some tentative predictions for the reasonably forseeable future

Both England and America have been reflecting recently on whether the current balance between secured transaction and corporate bankruptcy policy concerns has been appropriately struck. Not surprisingly, given the different evolutionary paths trodden in each jurisdiction, in England this has focused on whether too many inroads have been made into secured creditor priority, whilst in the US it has focused on whether recent reforms to the Uniform Commercial Code, as reflected in state legislation, have gone too far in prioritising concerns for secured credit at the expense of corporate bankruptcy's policy concerns. The debate in England can be seen in the work of the Secured Transactions Law Reform Project,[95] and the work of the City of London Law Society Financial Law Committee,[96] and the debate in the United States can be seen in the report of the recent American

[91] ABI Commission to Study Reform of Chapter 11 Final Report, 228
[92] E.J. Janger, 'The Logic and Limits of Liens' (2015) U. Ill. L. Rev. 589.
[93] C.W. Mooney, Jr. 'The (Il)legitimacy of Bankruptcies for the Benefit of Secured Creditors' (2015) U. Ill. L. Rev. 735, 749-751
[94] ibid fn 92 and 751
[95] https://securedtransactionslawreformproject.org/
[96] See, in particular, CLLS Financial Law Committee Secured Transactions Reform Discussion Paper 2: Fixed and Floating Charges on Insolvency available at: http://www.citysolicitors.org.uk/index.php?option=com_content&view=category&id=129

Bankruptcy Institute Commission to Study Reform of Chapter 11,[97] and the response of the Loan Syndications and Trading Association to that Report.[98]

The theory of path dependence is clearly visible in our account in this article.[99] First, the overall system of secured transactions law, corporate bankruptcy distributional priority and institutional structure developed in part in both jurisdictions because of initial decisions on the ability of a secured creditor to take security over substantially all of a debtor's assets. Secondly, as a result of these initial decisions, each jurisdiction focused on different aspects of the same policy debate so that the rules developed in a different fashion in each jurisdiction. It is appropriate, then, to see what path dependence theory may be able to tell us about future developments. Path dependence theory tells us that once a complicated system has developed, even if that system has developed in response to historical issues which are no longer relevant, the system may continue to persist because the cost of demolishing it and building an entirely new system may not be regarded as worthwhile.[100] As Mark Roe puts it, "we resurface, we do not revolutionize".[101] Furthermore, incumbent groups may mobilise to block change.[102] Given these factors of cost and interest group politics it may not be possible to drive change through unless the system is completely unsatisfactory (rather than not the best scheme available).[103] Nonetheless, it is possible for there to be a shock to the system of sufficient severity that radical change follows, so that (borrowing another idea from evolutionary biology) institutional change follows a pattern of "punctuated equilibrium" in which "periods of relative stasis give way at "critical junctures" to phases of accelerated development".[104] Applying this theory to our evolutionary account, there is reason to believe that the conditions are not right in either jurisdiction for a radical overhaul.

Modern markets have become increasingly specialised, with practitioners and scholars focusing on specific areas in which they are expert. In the reform debate we see those primarily concerned with non-distressed capital promoting secured transaction policy concerns, whilst we see those primarily concerned with reorganisation and liquidation of distressed companies promoting corporate bankruptcy policy concerns, and within each of those fields of practice and study, right thinking individuals disagree on the "correct" policy objectives. Debate rages about how significant corporate bankruptcy law is for, and the role which it should play in, capital raising in the healthy economy,[105] reducing the agency costs associated with debt,[106] and protecting vulnerable classes of creditor.[107] At the same time, as noted at the start of this article, there is a voluminous literature on the theoretical case for secured credit to promote the availability of low-cost credit.[108] When we

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97 Available at: http://commission.abi.org/full-report

98 The Loan Syndications and Trading Association *The Trouble with Unneeded Bankruptcy Reform: The LSTA'S Response to the ABI Chapter 11 Commission Report* October 2015

99 For path dependence theory and the law see M.J. Roe, 'Chaos and Evolution in Law and Economics' (1996) Harv Law Review 641; L.A. Bebchuk and M.J. Roe, 'A Theory of Path Dependence in Corporate Ownership and Governance' (1999) 52 Stanford Law Review 127

100 Ibid. Roe, 'Chaos and Evolution', 648

101 Ibid., 650

102 Ibid., 651

103 Ibid., 662

104 B. Aherling and S. Deakin, 'Labor Regulation, Corporate Governance, and Legal Origin: A Case of Institutional Complimentarity?' (2007) 41 Law & Society Review 865, 889. See also ibid, 663

105 See, for example, D.G. Baird, 'Bankruptcy's Uncontested Axioms' (1998) 108(3) The Yale Law Journal, 578

106 M.C. Jensen and W.H. Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure' (1976) 3(4) J. Financ. Econ. 305

107 M.J. Roe, 'Bankruptcy and Mass Tort' (1984) 84(4) Columbia Law Review 846

108 Fn 1 and accompanying text

analyse the ways in which these issues have been tackled in real-world England and America, we see that the process in both jurisdictions has been one of attempting to find some sort of balance between all of the policy objectives through a highly complex interplay of secured transaction legislation (and federal codes, in the US), corporate bankruptcy legislation and the institutional environment in which that legislation operates. It is probably impossible to test empirically whether one jurisdiction does a "better" job of balancing the competing policy objectives than the other, or to determine what the "right" balancing point is; what emerges from the account is a process of "finding our own way". Thus, although some changes are more significant than others (the 2001 reforms to Article 9 of the Uniform Commercial Code in the US appear to have been particularly significant), in truth all of the changes have been arrived at slowly and incrementally, precisely because it is so difficult to find the appropriate point of balance. In other words, it is arguably not sufficiently apparent that either system is completely unsatisfactory so as to motivate the cost and contention of a complete overhaul.

Indeed, whilst the ABI Commission has suggested several legislative reforms intended to assist in tilting the balance away from the secured creditor in the US, all of its suggestions are firmly embedded within the existing legal and institutional structure. First, as we have seen section 552(b) of Chapter 11 specifically authorises the court to limit the reach of the proceeds security interest "based on the equities of the case",[109] and so in appropriate cases the US bankruptcy court, as a court of equity, may choose to limit the scope of the proceeds rule. The ABI report concluded that the legislative history indicated that the exception "was intended to compensate the estate for use of unencumbered property expenditures that enhanced the value of the secured creditor's lien and to protect the rehabilitative purposes of the Bankruptcy Code."[110] They recommended that the trustee should be able to satisfy the equities of the case exception with evidence of the estate contributing value, whether through time, effort, money, property or costs savings,[111] and suggested that the parties should not be permitted to waive the equities of the case exception in return for post-petition financing or use of collateral.[112]

Secondly, the ABI report makes several controversial suggestions for legislative reform on the question of how to value the secured creditor's collateral. The value of the collateral is relevant in a number of different ways. First, the secured creditor is only entitled to accrue post-petition interest, attorney’s fees or costs on its claim where the value of its collateral exceeds the amount of its claim (in other words, where it is over-secured).[113] Secondly, where the debtor plans to use the secured creditor’s collateral during the bankruptcy case and proposes arrangements which it argues “adequately protect” the secured creditor, valuation of the collateral is crucial in determining what the secured creditor should be adequately protected for. Thirdly, it is relevant for the question of whether a plan of reorganisation can be confirmed against the secured creditor’s wishes (or "crammed down") on the basis that secured creditors are receiving the full amount of their allowed secured claims.[114] Courts are divided as to the question of when the value to be protected is to be assessed,[115] and courts are further divided on how to approach the valuation methodology: in other words, whether the value to be protected is the value which the secured creditor would get if she were to foreclose on the secured assets and sell them (potentially in numerous different states) or

[109] 11 U.S.C. §552(b)(1)
[110] ABI Commission to Study Reform of Chapter 11 Final Report, 231
[111] ABI Commission to Study Reform of Chapter 11 Final Report, 234
[112] ABI Commission to Study Reform of Chapter 11 Final Report, 234
[113] 11 U.S.C. §506(b)
[114] 11 U.S.C. §1129
[115] A.N. Resnick and H.J. Sommer (eds), *Collier in Bankruptcy* (LexisNexis 2016 16th ed), 361.02

whether it is the going concern value of the assets after the reorganisation.[116] Furthermore, the answer is not necessarily the same in all of the scenarios which we have outlined.[117] The ABI Report proposes that secured creditors receive adequate protection based on the foreclosure value of their collateral, but that the question of whether they have received distributions under a plan of reorganisation with a value equal to the value of their allowed secured claim should be determined on a going concern basis: arguably a valuation framework firmly tilted in favour of corporate bankruptcy policy considerations.

Even so, there is reason to be doubtful about even these reforms. The ABI hoped that their report would make its way to Congress. In the event the proximity of the US election at the time that it was published meant that that did not come to pass, but it has also been argued elsewhere that changes in the market, notably the rise of distressed debt investing and pre-packaged or pre-arranged Chapter 11 plans which compromise only financial liabilities, have meant that increasing secured creditor control in US corporate bankruptcy has not led to increasing losses to priority or trade creditors in large cases.[118] Consistent with the predictions of path dependency theory for the role of interest group politics, the ABI proposals have been vigorously contested by the US Loan Syndication and Trading Association.[119] Ultimately, it may be that a sufficiently compelling case has not been made out to motivate Congress to commit serious legislative time to bankruptcy reform. In England, on the other hand, legislative time is likely to be at a premium as a result of the decision of the British people to leave the European Union on 23 June 2016. Once again, it seems unlikely that the issues discussed in this article will be seen as priorities in a challenging legislative timetable. Nonetheless, it may be that the process of small and incremental adjustments to the balance between the competing policy objectives will continue on a more modest scale, even if a radical prescription for a completely new system is not written.

Taking England first, one area in which the balance might be thought to have tipped too far is in the area of corporate bankruptcy expenses. Until the Enterprise Act 2002 reforms, administration expenses broadly fell into one of three categories under section 19 of the Insolvency Act 1986. The first of these was post administration liabilities incurred by or on behalf of the administrator for the benefit of the administration; the second was post-administration liabilities which it would be inequitable not to pay (for example, because a creditor's property was being used at that creditor's expense to further the purpose of the administration for the benefit of all creditors); and the last was those expenses which statute imposed upon the company in administration or the office holder in such a way as to give priority as an expense for policy reasons, such as certain tax liabilities.[120] The approach in liquidation was different and was to be found in Insolvency Rule 4.218. In 2002, when administrators were given the power to distribute assets so that all administrations would no longer necessarily be followed by liquidation, Insolvency Rule 2.67 was introduced to align the administration expenses position with the position on liquidation. However, the rules were not

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[116] C.J. Tabb, 'The Bankruptcy Clause, the Fifth Amendment, and the Limited Rights of Secured Creditors in Bankruptcy' (2015) U. Ill. L. Rev. 765, 768-769

[117] See, for example, Associates Commercial Corp. v Rash 520 U.S. 953 (1997) (relating to value of collateral for the purposes of a plan of reorganization) and Matter of MPM Silicones, LLC, No. 15-1682, 2017 WL 4772248 (2d Cir. 2017) (relating to the interest rate to be paid under a plan of reorganization)

[118] S. Paterson. 'Rethinking Corporate Bankruptcy Theory in the Twenty-first Century' (2016) 36(4) OJLS 697

[119] The Loan Syndications and Trading Association *The Trouble with Unneeded Bankruptcy Reform: The LSTA's Response to the ABI Chapter 11 Commission Report* October 2015

[120] In Re Atlantic Computers Plc. [1992] 2 WLR 367; [1992] Ch 505

perfectly aligned. In fact, the new Insolvency Rule 2.67 seemed to be a slightly curious mix of the *ancien* administration regime and the approach in liquidation.

Judicial clarification has followed slowly, and uncertainties remain. *Pillar Denton* told us that the equitable principle known as the Lundy Granite principle (that a claim which would otherwise have been provable as an ordinary unsecured claim in the administration should be elevated to be treated *as if* it is an expense because it would be inequitable not to do so) had survived subsequent legislative interventions. [121] The principal example of a claim falling into this category would be rent payable in respect of a period of beneficial occupation of a leasehold property by the company in administration, but there is still uncertainty as to whether a number of liabilities would fall within the principle or not. For example, there is some doubt as to whether dilapidations claims (claims for damage to the property arising before or during the administration), service charge liabilities or claims for partial occupation fall within the principle or do not.

In the Nortel administration the Supreme Court provided guidance on the meaning of "necessary disbursement" for the purposes of Insolvency Rule 2.67.[122] Lord Neuberger suggested two circumstances (whilst caveating that it would be dangerous to treat his formulation as an absolute rule) in which a liability is a necessary disbursement. The first was where a liability arose out of something done in the administration (normally by the administrator or on the administrator's behalf), and the second was a liability imposed by a statute, "whose terms render it clear that the liability to make the disbursement falls on an administrator as part of the administration." However, once again this gives rise to a number of uncertainties. First, what is meant by something "done in the administration"? For example, where the administrator does something which gives rise to a tax liability, should the tax liability be treated as an expense? Secondly, how easy is it to determine, simply by looking at a statute, whether a liability has been imposed on the administrator as part of the administration? Consider, for example, section 22 of the Environment Protection Act 1990:

> It is an offence for a person to deposit controlled waste or extractive waste or knowingly cause or knowingly permit controlled waste to be deposited in/on land without an environmental permit or to treat, keep or dispose of controlled waste in a manner likely to cause pollution of the environment or harm to human health.

Many statutory liabilities for environmental protection make clear that they do not fall on insolvency practitioners, but there is no express carve-out for insolvency practitioners in section 22 of the EPA, so that it is not clear whether the EPA "imposes a liability on the administrator" or not. Thus there are two risks for the floating charge holder: first, the general risk of subordination to the costs and expenses of the proceeding and, second, the potential for the costs and expenses to be swelled by claims which have not been in the contemplation of the courts before, so they cannot be quantified and priced ex *ante*. At the time of writing, a major exercise to modernise England's insolvency rules has just been completed. Initially there was an expectation that this exercise would include clarification of the position on expenses but ultimately a decision appears to have been taken that this would be too challenging within the time frame for the project, and the matter accordingly rests with the courts. This is an unsatisfactory state of affairs for domestic lenders, but raises even greater challenges for the successful importing of capital. This is a technical issue for secondary

[121] Jervis and others v Pillar Denton Ltd and others [2014] EWCA Civ 180; [2015] Ch 87
[122] Bloom v Pensions Regulator [2013] UKSC 52; [2014] AC 209

legislation on which the English insolvency legal profession should be able to provide a great deal of help, and it may be that it can be implemented even in the absence of a substantial revision of the system as a whole.

Secondly, it is tentatively suggested that England will resist the temptation to deal with each emerging priority challenge by creating new classes of preferential debt. At the time of writing the Law Commission has reported on its study of the protection of retail consumer deposits and gift vouchers by recommending a new class of preferential debt.[123] The global trend has been in the other direction; reducing the number of claims which benefit from the rather blunt tool of preferential status in the insolvency hierarchy, and it is suggested here that there will be a reluctance to buck this trend without a thorough overhaul of the system. Thirdly, the ability (or not) of the administrator to raise financing for the case ranking ahead of the floating charge may yet benefit from legislative clarification. Responses to a recent consultation by the Insolvency Service (the executive agency responsible for insolvency in England and Wales) on reform to the English insolvency system revealed different views on this issue from highly experienced and knowledgeable market participants,[124] with implications for the advice which secured lenders to healthy companies receive and their ability to price credit *ex ante*. And finally, the current reform debate may lead England to consider again whether the factors for determining whether a charge is fixed or floating are too complex, raising the cost of secured transactions in the healthy economy unnecessarily and whether an alternative formulation might be found. It is not possible to expand on the range of possibilities in the time and space available here, but industry papers have begun to consider possible approaches to the question.[125] Overall, the prediction is that England will continue to reassess the extent to which the balance struck between secured transaction policy concerns and corporate bankruptcy policy concerns has tipped too far one way or the other, but will rebalance slowly and incrementally, and with an awareness of those reforms fit into our overall institutional environment, rather than by a radical overhaul of the entire system.

Similarly, even if the ABI proposals are never taken any further, a number of levers remain in the US scheme, taken as a whole, which can be pulled in favour of altering the balance between secured transaction policy and corporate bankruptcy policy. First, and crucially, Article 9 of the UCC still does not cover all types of collateral. Notably, real estate collateral, and some types of intellectual and foreign collateral fall outside its scope. This means that the borrower may still have assets in which a secured creditor does not have a perfected security interest. Moreover, it remains common in the US for borrowers to bargain for certain collateral to be excluded from the grant of the security interest on the basis that the costs of perfection exceed the benefit.

Secondly, as Ray Warner has pointed out, there is a question as to whether US bankruptcy courts are obliged to use the UCC definition of proceeds.[126] As we have seen this is important as a result of the new definition of proceeds in modern Article 9-102(64) (c). Lynn LoPucki and Elizabeth Warren note that in 1996 the eleventh circuit held (whilst noting that the fifth and the ninth circuit had gone the

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[123] Law Com No 368, *Consumer Prepayments on Retailer Insolvency*

[124] Published responses to The Insolvency Service, *A Review of the Corporate Insolvency Framework: A Consultation on Options for Reform* May 2016 available at: https://www.gov.uk/government/consultations/a-review-of-the-corporate-insolvency-framework - Grant Thornton, "Possibly negative pledge clauses might be legislated to be ineffective in relation to the creation of new charges of inferior ranking, but further research may be necessary to understand any impact on price and availability of finance" cf Loan Market Association, "it should be noted that there are already mechanisms in place for giving funding priority over existing floating charges (through the administration expense route)"

[125] CLLS Discussion Paper (n 96)

[126] Warner, 'The Anti-Bankruptcy Act' (n 50), 65

other way) that the bankruptcy court was not obliged to apply the UCC concept of proceeds as to conclude otherwise would be to accord state lawmakers authority to set definitions for federal law.[127] When Ray Warner reviewed the position in 2011 it appeared that US bankruptcy courts were adopting the revised Article 9 definition of proceeds,[128] and the American Bankruptcy Institute Final Report into Reform of Chapter 11 declined to propose a federal definition.[129] But it must remain the case that future courts could seek to draw a distinction, and the point may yet make it to the Supreme Court.

Thirdly, we have already seen that, even without legislative reform prohibiting waiver of the "equities of the case" exception, the very existence of the exception provides negotiating leverage which itself can result in some rebalancing. Further, although perfection is a more straightforward matter following the UCC reforms, it is still not entirely straightforward. Bankruptcy trustees continue to show they are willing to litigate the issue of perfection, and to plead errors in the financing statement, and the courts have shown themselves willing to entertain such claims. Indeed, one commentator has noted

> "There is a dangerous trend toward holding secured creditors to more stringent standards with respect to perfection. *In re EDM Corporation* 431 B.R. 459 (8th Cir. BAP 2010), is as instructive as it is scary. In that case, the creditors' UCC-1 financing statement accurately recited the debtor's name, except that it also included a DBA. The court held that such an alteration was enough to render the statement "seriously misleading"."[130]

Thus the threat of a challenge to perfection remains both a negotiating lever in reaching an accommodation with the secured creditor, and a route by which the interventionist US bankruptcy court can potentially carve assets out of the security package.

Finally, and arguably most importantly of all, the extensive power of the bankruptcy judge in the conduct of the case, and the instructions and advice which may be handed down in judge's chambers, provide capacity for the balance of the US regime between secured transaction policy concerns and corporate bankruptcy policy concerns to be carefully adjusted on an ongoing basis. Overall, even without legislative reform, it is argued that there is plenty of capacity in the US system to continue the process of balancing the policy concerns.

VI Conclusion

This article has sought to make a contribution to current debate on the shape of reform of secured creditor priority in England and the US. By undertaking a detailed analysis of the evolutionary history it has shown how nineteenth century English courts adopted a permissive approach to security over substantially all of a debtor's assets, with the result that legislative reform efforts focused on the corporate bankruptcy policy concerns which arose in the absence of unencumbered assets, whilst the US Supreme Court adopted a more restrictive approach to blanket liens, with the result that reform efforts in the US have focused on secured transaction law's policy concerns in promoting available capital at a good price for non-distressed companies in the economy. It has also analysed how a complex institutional environment developed in each jurisdiction which responds to,

[127] In Financial Security Assurance Inc v Tollman-Hingley Dalton, L.P. 74 F.3D 1120 (11TH Cir. 1996) cited in LoPucki and Warren, *Secured Credit* (n 42), 219

[128] G.R. Warner, 'Article 9's Bankrupt Proceeds Rule: Amending Bankruptcy Code Section 552 through the UCC's "Proceeds" Definition' (2010-2011) 46 Gonz. L. Review 521, at 526

[129] ABI Commission to Study Reform of Chapter 11 Final Report, 233

[130] S.H. Silton and T.G. Wallrich, 'Representing Creditors in a Chapter 11 Case' 100-101 in *Creditors' Rights in Chapter 11 Cases* (Aspatore 2011)

and contributes to, the overall balance struck between the policy concerns. Applying the theory of path dependence to the analysis, the article concludes by arguing that both England and the US are likely to proceed, at least for the reasonably forseeable future, by cautious and incremental tilts in the balance between secured transaction policy and corporate bankruptcy policy concerns, rather than dramatic shifts, adapted to and embedded within the complex local and legal institutional environment which has developed. Thus the article finishes with some relatively modest, tentative predictions as to how this might be achieved in England and the US.