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# CHOOSING THE LAW GOVERNING SECURITY INTERESTS IN INTERNATIONAL BANKRUPTCIES

*Steven L. Harris*\*

As one who approaches international bankruptcies<sup>1</sup> with security interests<sup>2</sup> in the foreground, I was immediately struck by The American Law Institute's acknowledgment that two of the bankruptcy choice-of-law issues confronting holders of security interests—which jurisdiction's avoidance law should apply and which jurisdiction's priority scheme should apply—are particularly difficult to resolve as a practical matter and that “[p]riority problems, including the choice of law to govern [security interests], are among the greatest obstacles to achievement of a unified approach to the general default of multinational companies.”<sup>3</sup> Mindful of the Institute's admonition that the solution to these

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\* Professor of Law, Chicago-Kent College of Law. The author thanks Elizabeth DeArmond, David Gerber, Charles Mooney, and Mark Rosen for their helpful comments. Citations to the official text of, and comments to, the Uniform Commercial Code (“U.C.C.”) are to the version that appears in Uniform Commercial Code 1 (2005 ed. West). Citations to “former” U.C.C. Article 1 are to the version of Article 1 found *id.* at 1879. Citations to “former” U.C.C. Article 9 are to the version of Article 9 found *id.* at 1775.

1. As has become customary in this context, I use “bankruptcy” to include proceedings for liquidation and reorganization and limit my discussion to corporate debtors.

2. I use the term according to its definition in the Bankruptcy Code, 11 U.S.C. § 101 (2005). “The term ‘security interest’ means lien created by agreement.” Bankruptcy Code § 101(51). “The term ‘lien’ means charge against or interest in property to secure payment of a debt or performance of an obligation.” *Id.* § 101(37). As used in the U.C.C., the term “security interest” includes many outright sales of accounts and other receivables. U.C.C. § 1-201(37)(b)(35) (definition of “security interest”); § 9-109(a)(3), (d) (applicability of Article 9). I deal here only with security interests that secure obligations; however, the analysis may be relevant to a discussion of other transfers of personal property, including transfers of ownership (whether governed by or excluded from Article 9).

3. AMERICAN LAW INSTITUTE, TRANSNATIONAL INSOLVENCY PROJECT: PRINCIPLES OF COOPERATION AMONG THE NAFTA COUNTRIES 18 (2003) [hereinafter “ALI PRINCIPLES”] (relying upon Ulrik Rammeskov Bang-Pedersen, *Asset Distribution In Transnational Insolvencies: Combining Predictability and Protection of Local Interests*, 73 AM. BANKR. L.J. 385 (1999) and Jay L. Westbrook, *Universal Priorities*, 33 TEXAS INT’L L.J. 27 (1998)). Of course, holders of security interests are concerned about which law will govern various other aspects of a bankruptcy. These include whether (to the extent the security interest enjoys priority) the secured party will be entitled to recover the collateral itself or just the value of the collateral. If just the value, under which standard of valuation? How long a delay before the secured party will receive a distribution? What happens during the delay (e.g., may the debtor use or sell the collateral)? How are costs and risks attendant to the delay (e.g., the opportunity cost to the secured party; the risk of a

problems probably must await “some level of institutional advance,”<sup>4</sup> I nevertheless have chosen to avail myself of the opportunity that this Symposium presents by pursuing some tentative, exploratory work on the subject.

#### I. THE NEED FOR PREDICTABILITY

These important choice-of-law issues are difficult in large part because they implicate an array of desiderata, no one of which can be satisfied in full without impairing the satisfaction of another (or so it seems). As have others, I take “predictability” to be a principal desideratum of the content of choice-of-law rules.<sup>5</sup> Financial institutions and others who extend secured credit (“secured parties”) desire certainty. By entering into a secured transaction with a debtor, secured parties have taken steps designed to increase the likelihood of being paid. A security interest is meant to afford reasonable assurance that, if the debtor defaults in payment or performance of the secured obligation, the secured party will have the legal right and practical ability to use the collateral as a source from which the secured obligation can be recovered. Anything that prospectively undermines the assurance reduces the value of the security interest. Whatever reduces the value of the security interest increases the cost of the credit transaction. And, as we all know, the debtor typically bears at least part of the increase.

The desire for certainty concerning the choice of law governing security interests in personal property fueled the tremendous and remarkably successful drive for a uniform effective date for revised Uniform Commercial Code Article 9.<sup>6</sup> Inasmuch as revised Article 9 strongly resembles its predecessor in most respects, one might have minimized the im-

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reduction in the nominal value of collateral through depreciation or loss) allocated between the secured party and other creditors? This article does not address these concerns.

4. ALI PRINCIPLES, *supra* note 3, at 18.

5. Both territorialists and universalists claim that their approach to international bankruptcies fosters predictability. Lynn M. LoPucki, *The Case for Cooperative Territoriality in International Bankruptcy*, 98 MICH. L. REV. 2216 (2000); Jay Lawrence Westbrook, *Locating the Eye of the Financial Storm*, 32 BROOK. J. INT'L L. 1019 (2007); Jay Lawrence Westbrook, *Choice of Avoidance Law in Global Insolvencies*, 17 BROOK. J. INT'L L. 499 (1991). By stating that predictability is a desideratum, I should not be understood to say that it is the *only* desideratum. Other concerns are discussed below.

6. See U.C.C. § 9-701 (providing for effective date of July 1, 2001). All fifty states and the District of Columbia enacted revised Article 9 prior to the uniform effective date, and on that date the revised Article took effect in all but four states. G. Ray Warner, *Non-uniform Effective Dates and the Transition to Revised Article 9*, AM. BANKR. INST., available at <http://68.72.75.1/abidata/online/journaltext/01jullien.html> (last visited Apr. 25, 2007).

portance of temporal uniformity. The official comments observe, however, that “[w]hile always important, uniformity is essential to the success of this Article.” As the primary example, the comments refer to the change wrought by revised Article 9 in the designation of the jurisdiction whose law governs perfection of a security interest. “[H]orrendous complications may arise” if “the status of a particular security interest as perfected or unperfected[] would depend on whether the matter was litigated in a State in which former Article 9 was in effect or a State in which [the revised] Article was in effect. . . . Any one State’s failure to adopt the uniform effective date will greatly increase the cost and uncertainty surrounding the transition.”<sup>7</sup>

The differences among the various legal regimes governing secured credit around the world are, to say the least, substantially greater than the differences between former and revised Article 9. The absence of uniformity among potentially governing laws may impose much more significant costs on a secured transaction that implicates more than one nation than on an otherwise identical transaction that implicates only U.S. jurisdictions. The differences among national regimes go far beyond questions of how to “perfect” a security interest. Rather, the very effectiveness of a secured transaction may depend on the jurisdiction whose law governs.<sup>8</sup>

As others have explained at length, merely adding the possibility of a collective proceeding reduces predictability and increases costs (unless the collective proceeding has absolutely no effect on the rights of the secured party with respect to the collateral).<sup>9</sup> These include the costs attendant to strategic behavior (e.g., depending on whether bankruptcy law treats a particular creditor’s claim more or less favorably than non-bankruptcy law, the creditor has an incentive to push the debtor into bankruptcy or keep the debtor out) and those attendant to planning for multiple outcomes.<sup>10</sup> If maximizing predictability and minimizing costs for secured parties were the only considerations, we might prefer a bankruptcy law that affords to the secured party the identical rights as otherwise applicable non-bankruptcy law affords and that leaves security interests completely unaffected. Of course, the same could be said for unsecured claims; making the rights of unsecured creditors turn on whether

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7. U.C.C. § 9-701, cmt.

8. To a very limited extent, this was the case with respect to the difference between former and revised Article 9. *See id.*

9. *See, e.g.*, THOMAS H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW 203–04 (1986). A collective proceeding addresses the claims of many, and sometimes all, creditors of a given debtor.

10. *Id.* at 196–97.

the debtor is the subject of a collective proceeding imposes costs. Presumably, a bankruptcy proceeding confers benefits that more than offset these costs. Otherwise, we would be content with non-bankruptcy law.

This analysis suggests that bankruptcy law should affect a secured party's non-bankruptcy rights only to the extent necessary to produce the benefits that a collective proceeding affords. A secured party's principal concern is recovering promptly the full amount of its claim. From this perspective, one might favor a bankruptcy law that gives a secured party a recovery whose value equals the recovery that, as a practical matter, would have been obtained in the absence of a bankruptcy. In the first instance, this means that a security interest should be eligible for priority with respect to the value of the collateral. That is, a bankruptcy law should recognize the distinction between secured and unsecured claims.<sup>11</sup> If applicable non-bankruptcy law treats a given claim as secured by particular assets, the claim should be eligible for the same treatment under bankruptcy law.<sup>12</sup>

## II. UNIFORM CHOICE-OF-LAW RULES: A SECOND-BEST SOLUTION

Where a secured transaction implicates more than one jurisdiction, which jurisdiction's non-bankruptcy law is applicable? The answer would make little difference if the substantive law governing creation of a security interest were uniform throughout the world and all the various bankruptcy laws gave effect to security interests: The same outcome would obtain regardless of which jurisdiction's substantive law a bankruptcy court were to apply.<sup>13</sup> The fact is, however, that secured-credit regimes are notoriously nonuniform, and there is little reason to believe that uniformity will be achieved in the near, or even the middle, term. Given this substantive nonuniformity, the best way to achieve predictability may well be to push for uniformity in the governing choice-of-law rule.<sup>14</sup>

With a single choice-of-law rule (or set of choice-of-law rules) that is applied universally, a secured party would know which jurisdiction's

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11. I use the terms "secured claim" and "unsecured claim" as they are used in Bankruptcy Code, 11 U.S.C. § 506(a)(1) (2005).

12. As I suggested, the fact that a security interest is being treated in a collective proceeding is likely to require that the treatment it receives will differ from the non-bankruptcy treatment. Differences in treatment arising from collectivist considerations, including the application of avoidance powers, are discussed below.

13. This is not to say that we would be living in a world of complete predictability. Uncertainty of meaning and application would attend even a uniform law.

14. Note, however, that the unpredictability that attends any judicial determination is exacerbated when the court applies the law of a foreign jurisdiction.

substantive secured-credit regime would apply to any given secured transaction. A uniform choice-of-law rule would be more costly than a uniform substantive law of secured transactions.<sup>15</sup> It would require secured parties whose transactions implicate many jurisdictions to familiarize themselves with a variety of secured-transactions laws. However, a uniform choice-of-law rule would be a marked improvement over the current situation, where a secured party in an international transaction must assess the likelihood of its security interest being challenged in courts of different nations and determine which substantive law each of those courts would be likely to apply.

### III. CHOOSING THE CHOICE-OF-LAW RULE

#### *A. The Lex Situs Approach*

What should be the content of a uniform choice-of-law rule? As a general matter, courts apply the law of the situs of property—the *lex situs*—to determine the existence and enforceability of claims to the property.<sup>16</sup> While some have criticized the results of indiscriminate application of the situs rule, even with respect to real property,<sup>17</sup> there would seem to be good reasons to apply the law of the situs to determine in the first instance whether a security interest will be recognized in a debtor's bankruptcy.

Suppose, for example, that a secured party (“*SP*”) claims a security interest in goods owned by a debtor (“*Debtor*”) and located in a particular nation (“*State A*”). The physical presence of the goods is the only (or at least the primary) connection between *State A* and the transaction parties, whose other contacts are all with another nation (“*State B*”). If *SP* wants to enforce its security interest against an unwilling *Debtor*, in all likelihood it will need to invoke the assistance of a sheriff or comparable public official from *State A*. It may be the case that a public official will assist *SP* in response to a judgment entered by *State B*. But *SP*'s safest and surest course is to seek a determination by a *State A* court that *SP* has a property claim that supports enforcement. To make this determination, the *State A* court normally will consult its own law. At least as to the effectiveness of the secured transaction between the immediate parties, the law of *State A* may well give effect to the parties' express choice

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15. The statement in the text assumes that the uniform substantive law does not itself impose large, unnecessary costs.

16. Restatement (Second) of Conflict of Laws § 222, cmt. b (1971).

17. See, e.g., RUSSELL J. WEINTRAUB, COMMENTARY ON THE CONFLICT OF LAWS (5th ed. 2006).

of law within fairly broad limits.<sup>18</sup> If State A law gives effect to party autonomy in this setting and the parties to the security agreement provide that their rights are governed by the law of State B, then a State A court is likely to look to the substantive law of State B to determine whether a security interest has been created. If not, then a State A court is likely to look to the substantive law of State A.

The determination whether *SP* has an in rem claim to the collateral may be relevant not only to the resolution of a “property” question, i.e., whether *SP* holds a security interest enforceable against the debtor,<sup>19</sup> but also to the resolution of a “priority” question: How is the value of the collateral to be allocated between *SP* and a competing creditor or purchaser of the collateral (“X”)? Just as recognition of *SP*’s security interest should depend on whether it would be recognized by the courts of State A, so should the recognition of other asserted in rem claims. That is to say, where property is located in State A, a third party may need to invoke the power of the courts of State A to realize the benefits of its property interest. For the same reason, the relative ranking of two in rem claims (e.g., whether X’s claim is superior or junior to *SP*’s), should be (and in many jurisdictions is) decided by the law of situs of the goods. There also is likely to be a cost savings if a court applies the law of State A to both the property and priority questions.

In some jurisdictions, the bankruptcy administrator (in the U.S., the trustee in bankruptcy) enjoys the rights and powers of an in rem creditor or purchaser.<sup>20</sup> In such cases I would determine those relative rights by reference to the same law as I would apply to determine the existence of a cognizable security interest—the law of the location of the collateral. So, in the example above, if the applicable bankruptcy law provides that collateral comes into the bankruptcy estate free of any security interest that would be subordinate to the rights of a judicial lien creditor, then the court would look to the substantive law of State A to determine whether *SP*’s security interest would be junior or senior to the rights of a creditor who acquires a judicial lien through the judicial process of State A.<sup>21</sup>

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18. See, e.g., U.C.C. § 1-301(c) (2001) (a transaction bearing a “reasonable relation” to that state will trigger application of that state’s act); former U.C.C. § 1-105(1) (2000).

19. Under Article 9, a security interest that has become enforceable against the debtor is said to have attached. See U.C.C. § 9-203(a) (2001) (“[a] security interest attaches when it becomes enforceable against the debtor with respect to the collateral”); *id.* 9-203(b) (explaining when a security interest becomes enforceable).

20. See, e.g., Bankruptcy Code, 11 U.S.C. § 544(a) (2005).

21. Even a state that permits the parties to establish property rights between themselves under the law of another state is most unlikely to permit the parties to impose the other state’s law on third parties. Compare U.C.C. § 1-301(c)(2) (2001) (affording parties broad autonomy to choose the governing law) with U.C.C. § 1-301(g) (2001) (providing

ALI Principles observes that “the traditional choice-of-law rules for secured transactions are coming under increasing pressure.”<sup>22</sup> It refers specifically to the fact that revised Article 9 “abandons for certain purposes the traditional *lex situs* rule in favor of a location rule that depends internationally on a post-hoc conclusion about the substance of the debtor’s security-interest law.”<sup>23</sup> The scope of this abandonment should not be overstated. Where the security interest is possessory (i.e., tangible collateral is in the possession of the secured party), the law of the jurisdiction in which the collateral is located governs the priority of competing claims to the collateral.<sup>24</sup> And even in the much more common case where the debtor remains in possession of tangible collateral, the *situs* rule applies: the priority of a security interest is governed by the law of the jurisdiction where the collateral is located.<sup>25</sup> Indeed, as regards tangible collateral, revised Article 9 departs from the *situs* rule only with respect to whether a nonpossessory security interest is perfected. As to such a security interest, perfection is governed by the law of the jurisdiction in which the debtor is located.<sup>26</sup> The “location of the debtor” choice-of-law rule tells the forum court that (1) the applicable priority rule is that of the law of the *situs* and (2) if the priority law of the *situs* turns on whether a security interest is perfected or unperfected, the court should determine whether the security interest enjoys perfected status by reference to the perfection requirements of the debtor’s location.

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that, to the extent the U.C.C. governs a transaction, the parties’ agreement is ineffective to the extent it is contrary to the Article 9 choice-of-law rules governing perfection and priority).

22. ALI PRINCIPLES, *supra* note 3, at 19.

23. *Id.* The rule in question is found in U.C.C. § 9-307(b) (2001). For a discussion of this choice-of-law rule and its potential for universal applicability, see Charles W. Mooney, Jr., *Extraterritorial Impact of Choice of Law Rules for Non-United States Debtors under Revised Uniform Commercial Code Article 9 and a New Proposal for International Harmonization*, in CROSS-BORDER SECURITY AND INSOLVENCY 187 (Michael Bridge & Robert Stevens eds. 2001).

24. *See* U.C.C. § 9-301(2) (2001). For these purposes, “tangible” collateral that is subject to “possession” includes not only goods but also money and intangibles that have been reified, such as instruments, tangible negotiable documents of title, and tangible chattel paper. *See* U.C.C. § 9-313(a) (2001); U.C.C. § 9-102(a) (2001) (defining “instrument,” “document,” “chattel paper,” and “tangible chattel paper”); U.C.C. 1-201(b)(16) (2001) (defining “tangible document of title”); U.C.C. § 7-104 (2001) (explaining when a document of title is negotiable).

25. U.C.C. § 9-301(3)(c) (2001).

26. U.C.C. § 9-301(1) (2001).

As a general matter, nonpossessory perfection will be accomplished by filing a financing statement in the public record.<sup>27</sup> From the perspective of predictability, assuming that the court applies the “uniform” choice-of-law rules in Article 9, a secured party has comfort that, if it takes the perfection steps specified by the local law of the debtor’s jurisdiction, it will enjoy perfected status for purposes of applying the priority rules of the situs. Put otherwise, from a planning perspective, as applied to security interests in goods, the effect of Article 9’s nontraditional choice-of-law rule (location of the debtor) ordinarily is to tell the secured party what to file and where to file it. The wrinkle for international transactions, under which the law governing perfection turns on a “post-hoc conclusion about the substance of the debtor’s security-interest law,”<sup>28</sup> reflects Article 9’s paramount concern for public notice in a world in which most non-U.S. jurisdictions do not have a public-notice system for secured transactions in personal property.<sup>29</sup> In short, nothing in the policy underlying revised Article 9’s choice-of-law provisions suggests that the validity and priority of a security interest in the debtor’s bankruptcy should be determined other than under the non-bankruptcy substantive law of the jurisdiction where the collateral is located (in the example, State A).<sup>30</sup> Indeed, this is the approach of the UNCITRAL Draft Legisla-

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27. See § U.C.C. 9-310(a) (2001) (stating the general rule that a financing statement must be filed to perfect all security interests and setting forth exceptions); U.C.C. § 9-307(b) (2001) and (c) (debtor is located in the District of Columbia if the ordinary rules for determining its location point to a jurisdiction whose law does not generally condition perfection on public filing or recording). Filing works to perfect a security interest in nearly all kinds of collateral. See U.C.C. § 9-310 (2001). The principal exceptions are deposit accounts, money, letter-of-credit rights, and goods covered by a certificate of title. See U.C.C. § 9-311(a) (2001); § 9-312(b) (2001).

28. ALI PRINCIPLES, *supra* note 3, at 19.

29. One might infer from U.C.C. § 9-307(c) (2001) that Article 9’s concern that security interests be evidenced by public notice trumps its concern that outcomes be predictable.

30. By “non-bankruptcy substantive law of the jurisdiction where the collateral is located,” I mean the substantive law that the court would apply, taking into account its choice-of-law rules. The *renvoi* would seem to serve no useful purpose in this setting. See Larry Kramer, *Return of the Renvoi*, 66 N.Y.U. L. REV. 979, 997–1002 (1991). Ideally, then, if State A’s choice-of-law rules referred to the law of another state, it would refer only to that state’s local law and not its whole law. Revised Article 9 adopts this approach. See U.C.C. § 9-301.

Whether the validity and priority of a security interest should be determined by a court of the jurisdiction whose substantive law governs (in the example, a State A court) or by another state’s court (with or without the assistance of a State A court) is a separate issue, which I leave to others.

tive Guide on Secured Transactions (“UNCITRAL Secured Transactions Guide”).<sup>31</sup>

*B. Shortcomings of the Lex Situs Approach*

Uniform adoption of the choice of the *lex situs* would enhance predictability greatly but is by no means ideal. The approach may require the bankruptcy court of one state to apply the secured-transactions law of another. Secured-credit regimes are widely diverse, and many secured-transactions laws are complicated. Predictable outcomes are by no means assured, even if judges try their best.

Moreover, even if every bankruptcy court were certain to apply the *lex situs*, a secured party never could be absolutely sure which nation’s secured-transactions law would govern. This uncertainty arises because a secured party never can be certain where tangible collateral will be situated at any given moment in the future. I suspect that, in most cases, this uncertainty would be of little, if any, concern. Most tangible collateral does not move; it just sits there. Or, if it does move, its movement can be anticipated by the secured party. Security agreements typically prohibit the debtor from relocating the collateral without the consent of the secured party. One cannot discount entirely the possibility that, shortly before entering bankruptcy, a debtor may relocate collateral with a view towards depriving the secured party of its security interest. For this strategic behavior to succeed, however, the secured-transactions law of the “new” location must be materially different from that of the “old” location. To the extent that the substantive law of secured transactions becomes uniform, the risk is reduced.

Of course, a more narrowly drawn choice-of-law rule or rule of substantive law might prevent this risk from materializing. Former Article 9 directly addressed the risk that collateral will be relocated by giving effect to perfection accomplished under the law of the “old” situs for a fixed period of time after the collateral is removed to the “new” location,<sup>32</sup> and the UNCITRAL Secured Transactions Guide recommends the

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31. United Nations Commission on International Trade Law, Draft legislative guide on secured transactions: terminology and recommendations 102 (July 17, 2006), <http://daccessdds.un.org/doc/UNDOC/LTD/V06/560/12/PDF/V0656012.pdf?OpenElement> (last visited Apr. 4, 2007) [hereinafter UNCITRAL Secured Transactions Guide] (“The law should provide that, except as otherwise provided . . . , the creation, the effectiveness against third parties and the priority as against the rights of competing claimants of a security right in tangible property are governed by the law of the State in which the encumbered asset is located.”)

32. See former U.C.C. § 9-103(1)(d) (2000). Under revised Article 9, the situs of the collateral is irrelevant to the choice of law governing perfection of nonpossessory secu-

same approach.<sup>33</sup> It remains to be seen whether narrowly drawn rules along these lines will be widely enacted. Another route to the same result may be to use equitable principles (or their non-common-law analog) to protect the secured party.<sup>34</sup> Absent protection of some kind, a secured party will take into account the risk of debtor misbehavior in determining whether, and on what terms, to extend credit. In other words, the cost of credit can be expected to be greater.

Although most types of tangible collateral remain stationary, certain types do move—they are meant to move—across national borders. Creditors of North American railroads face this problem today with respect to rail cars. Creditors secured by these rail cars routinely assume that both U.S. and Canadian law will apply to their secured transactions, and so they perfect according to the laws of each. But the track on which the cars travel extends into Mexico, where security interests may be ineffective. Creditors deal with this by covenant, typically to the effect that at any given time only a specified small percentage of cars (say, five percent) will be physically located in Mexico.<sup>35</sup> Greater predictability would be accomplished if the secured-transactions law of every country were to afford the same recognition to any given security interest. This could be accomplished either by adopting the same substantive law of secured transactions or by including, as part of each nation's secured transactions law, a choice-of-law rule that designates the same "home" jurisdiction for mobile goods. Former Article 9 followed the latter approach,<sup>36</sup> which the UNCITRAL Secured Transactions Guide recommends.<sup>37</sup> Perhaps a less unlikely method for reaching the same result is an international convention. For example, UNIDROIT recently adopted a protocol on railroad rolling stock to accompany the Convention on International Interests in Mobile Equipment ("Cape Town Convention").<sup>38</sup> By adopting the

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rity interests. *See* U.C.C. § 9-301(1) (2001). Accordingly, revised Article 9 has no need for a provision comparable to former U.C.C. § 9-103(1)(d).

33. UNCITRAL Secured Transactions Guide, *supra* note 31, at 106.

34. *See, e.g., In re Howard's Appliance Corp. v. Howard's Appliance Corp.*, 874 F.2d 88 (2d Cir. 1989) (imposing a constructive trust on collateral subject to an unperfected security interest where the secured party's failure to file in the appropriate state resulted from the debtor's wrongful relocation of the collateral).

35. Information from Louis P. Warchot, Senior Vice President for Law, Association of American Railroads.

36. For an example of the latter, see former U.C.C. § 9-103(3) (2000) (applying law of the debtor's location to "goods which are mobile and which are of a type normally used in more than one jurisdiction"). U.C.C. § 9-103(3)(a).

37. UNCITRAL Secured Transactions Guide, *supra* note 31, at 102.

38. UNIDROIT, the International Institute on the Unification of Private Law, adopted The Luxembourg Protocol to the Convention on International Interests In Mobile Equip-

Cape Town Convention and the Rail Protocol, a State binds itself to recognize security interests in railway rolling stock that are created by a debtor situated within any Contracting State.<sup>39</sup>

*C. An Alternative Approach: The Location of the Debtor*

Linking the applicable law to the location of the debtor, rather than the location of the collateral, would eliminate the risk that the potential relocation of collateral imposes on secured parties under the situs rule. A debtor-location rule also would provide a single applicable substantive law with respect to all the collateral of a given debtor, regardless of where the collateral is located and even if it lacks a physical location (as is the case with intangibles). Applying the substantive law of the debtor's location may come close to mirroring the non-bankruptcy outcome, inasmuch as a court having jurisdiction over the debtor can compel the debtor to turn over the collateral to the secured party, even if the collateral is located outside the court's territorial reach.

In the abstract, if asked to create a non-bankruptcy choice-of-law rule (that, in turn, would be followed in bankruptcy), secured creditors might well prefer a debtor-location rule to the costs attendant to a situs rule, i.e., restricting the movement of collateral by contract, monitoring its location, and pricing the remaining risk. In practice, however, their enthusiasm likely would be tempered by concerns over whether a debtor-location rule would become widely adopted and applied. One might expect a state's<sup>40</sup> legislature to be reluctant to require its courts to determine claims against property located within the state's territory by reference to the substantive law of another state. One might expect a similar reluctance from a court asked to apply the substantive law of another state to property subject to its administration. And, to the extent that security interests might be governed by the lex situs outside bankruptcy, linking the applicable law in bankruptcy to the debtor's location would mean that a secured party that wished to reduce its risk would need to incur the costs of satisfying the requirements of two different laws.

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ment On Matters Specific to Railway Rolling Stock on February 23, 2007. The Rail Protocol has not yet entered into force. See <http://www.unidroit.org/english/implement/i-2007-railprotocol.pdf> (last visited Mar. 4, 2007) [hereinafter Rail Protocol].

39. International Institute on the Unification of Private Law, Convention on International Interests in Mobile Equipment, art. 4(1), <http://www.unidroit.org/english/conventions/mobile-equipment/mobile-equipment.pdf> (last visited Mar. 5, 2007) [hereinafter Cape Town Convention].

40. Here, I use "state" to mean "nation," which is the usual meaning in the international choice-of-law context.

Moreover, even if widespread agreement could be reached that the validity and priority of security interests in bankruptcy would be determined by the substantive law of the debtor's location, it is by no means certain that a similar agreement can be reached on determining where a debtor is located. Jurisdiction over a debtor may lie in any one of a number of jurisdictions.<sup>41</sup> The U.S. and Canadian secured-transactions regimes, though similar in many regards, designate different debtor locations for choice-of-law purposes. Under the Canadian Personal Property Security Acts, a corporate debtor having more than one place of business is located at its chief executive office.<sup>42</sup> Under revised Article 9, a domestic corporation is located in its jurisdiction of organization.<sup>43</sup> Likewise, recent international instruments addressing secured transactions differ significantly in their provisions with respect to a debtor's location. For purposes of the United Nations Convention on the Assignment of Receivables in International Trade ("Receivables Convention"), a debtor having more than one place of business is located in the place where its "central administration . . . is exercised."<sup>44</sup> In contrast, for purposes of the Cape Town Convention, a debtor is located in "any Contracting State: (a) under the law of which it is incorporated or formed; (b) where it has its registered office or statutory seat; (c) where it has its centre of administration; or (d) where it has its place of business."<sup>45</sup>

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41. Cf. RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 421 (1987) (providing that a foreign state's exercise of jurisdiction with respect to a person is reasonable, and thus a judgment of its courts may be recognized by the U.S., if any one of several relationships between the person and the foreign state is present).

42. See, e.g., Personal Property Act, REVISED STAT. BRIT. COLUM. 1996, ch. 359, § 7(1). Former Article 9 contained a similar rule. See former U.C.C. § 9-103(3)(d).

43. See U.C.C. § 9-307(e). The Ontario PPSA may soon be amended to adopt a similar approach. See Proposed Amendment – 7(3), CONSOLIDATED STAT. ONTARIO 2006, c. 34, Sched. E, § 3(2) (proposed amendment to Personal Property Security Act, CONSOLIDATED STAT. OF ONTARIO 1990, c. P.10, § 7(3)).

44. United Nations Convention on the Assignment of Receivables in International Trade, art. 5(h), <http://www.uncitral.org/pdf/english/texts/payments/receivables/ctc-assignment-convention-e.pdf#search=%22uncitral%20assignment%20receivable%22> (last visited Oct. 9, 2006) [hereinafter Receivables Convention].

45. Cape Town Convention, *supra* note 39, art. 4(1), available at <http://www.unidroit.org/english/conventions/mobile-equipment/mobile-equipment.pdf>. The Cape Town Convention uses a debtor's location primarily to determine whether the Convention applies. See *id.* art. 3(1) ("Convention applies when, at the time of the conclusion of the agreement creating or providing for the international interest, the debtor is situated in a Contracting State"). However, it provides for declarations whereby a Contracting State may exclude from application of the Convention certain transactions "where the centre of main interests of all parties to such transaction is situated" in that Contracting State. See *id.* arts. 50, 1(n) (defining "internal transaction").

Similar differences have arisen in the context of international bankruptcy. The European Union Council Regulation on Insolvency Proceedings provides that “the law applicable to insolvency proceedings and their effects shall be that of the Member State within the territory of which such proceedings are opened,”<sup>46</sup> i.e., “the Member State within the territory of which the centre of a debtor’s main interest [“COMI”] is situated.”<sup>47</sup> The UNCITRAL Model Law on Cross-Border Insolvency takes a similar approach.<sup>48</sup> Under both the EU Regulation and the UNCITRAL Model Law, the place of the registered office is presumed to be a company’s COMI in the absence of proof to the contrary.<sup>49</sup> But the Protocols to the Cape Town Convention provide that a debtor’s COMI “shall be deemed to be the place of the debtor’s statutory seat or, if there is none, the place where the debtor is incorporated or formed, unless proved otherwise.”<sup>50</sup>

As Jay Westbrook ably demonstrates in his contribution to this Symposium, the COMI standard is, and already has been, “subject to various interpretations.”<sup>51</sup> As regards the choice of applicable bankruptcy law, flexibility may have its virtues, and, in the aggregate, these virtues may outweigh the attendant costs.<sup>52</sup> However, secured creditors place a premium on certainty. Unlike tort victims and other involuntary creditors, secured parties choose their debtors and do so with care. Unlike unsecured creditors, who rely generally on a debtor’s creditworthiness, secured creditors extend credit in reliance on their anticipated ability to have recourse against specific assets upon the debtor’s default. Given the unlikelihood of achieving widespread application of a debtor-location rule whose content is reasonably certain, secured creditors might well prefer to incur the costs attendant to the application of the *lex situs*.

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46. Council Regulation (EC) No. 1346/2000 of May 29, 2000, art. 4, § 1, 2000 O.J. (L 160) 1, 5 [hereinafter EU Regulation].

47. *Id.*, art. 3, § 1.

48. UNCITRAL, *UNCITRAL Model Law on Cross-Border Insolvency With Guide to Enactment*, art. 17, § 2(b) [hereinafter *UNCITRAL Model Law*] (defining “foreign main proceeding” by reference to “the State where the debtor has the centre of its main interests”). Bankruptcy Code, 11 U.S.C. § 1502(4) (2005), is to the same effect.

49. See EU Regulation, *supra* note 46, art. 3, § 1; *UNCITRAL Model Law*, *supra* note 48, art. 16, § 3. Bankruptcy Code, 11 U.S.C. § 1516(c) (2005), is to the same effect.

50. Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment, art. I, § (2)(n), <http://www.unidroit.org/english/conventions/mobile-equipment/aircraftprotocol.pdf> (last visited Mar. 5, 2007) (defining “primary insolvency jurisdiction”); Rail Protocol, *supra* note 38, art. I, § (2)(d).

51. Westbrook, *Locating the Eye of the Financial Storm*, *supra* note 5, at 1020.

52. See generally *id.*

The foregoing analysis suggests that there is much to recommend a choice-of-law rule under which a bankruptcy court applies the law of the situs (State A) to determine whether to give effect to a security interest. It also suggests that much might be gained from persuading jurisdictions that do not apply the lex situs to change their choice-of-law rule, at least for bankruptcy purposes if not also for non-bankruptcy purposes. Under the lex situs approach, if the law of State A would permit *SP* to reach the collateral, a bankruptcy court should give effect to *SP*'s security interest, even if the applicable non-bankruptcy law of the forum state would not give effect to this security interest.

Suppose, conversely, that the non-bankruptcy law of the situs (State A) would refuse to permit *SP* to reach the collateral. The approach under discussion would suggest that, because *SP* would be unable to obtain value from the collateral without the debtor's cooperation, the putative security interest would not be recognized in bankruptcy. *SP* would hold an unsecured claim in bankruptcy, regardless of which state is the bankruptcy forum. This result would obtain even if the parties' operations were centered in another nation (State B), the parties had agreed that State B's substantive law would govern the creation of the security interest, State B's substantive law would have given effect to the security interest between the parties, and a State B court actually had issued a judgment determining that the security interest is valid and enforceable between the parties. While this potential state of affairs underscores the desirability of moving towards uniformity in the substantive law of secured transactions, the approach underlying it does provide a significant amount of certainty.

#### *D. Choosing the Law Governing Security Interests in Intangibles*

Whatever the advantages of a choice-of-law rule keyed to the location of the collateral may be, such a rule can have no application to intangibles, which have no physical location.<sup>53</sup> In fashioning a bankruptcy choice-of-law rule that, as a first approximation, tracks non-bankruptcy outcomes, one must take into account the fact that the value of many intangibles depends in large part upon the cooperation of a third person, namely, the person who is obligated on the collateral. For example, the value of a debt owing to the debtor (i.e., a receivable owned by the debtor) depends in part on the obligor's willingness to pay. A secured party who wishes to collect a receivable owed by a recalcitrant obligor

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53. As a formal matter, the law might assign a "situs" to an intangible and use this fictional location for purposes of the lex situs rule.

(to use Article 9 terminology, “account debtor”)<sup>54</sup> and who cannot succeed through persuasion must resort to the judicial process. This fact might argue for a choice-of-law rule keyed to the account debtor. On the other hand, the effectiveness of a secured party’s claim to rights in the receivable as against other claimants (e.g., competing creditors to whom the debtor has also purported to give a security interest) depends on which of the purported assignments is given effect and, if more than one is, on the relative priority of the assignments. This fact might argue for a choice-of-law rule keyed to the debtor.

If we are looking to mimic the non-bankruptcy outcome where the issues concern the relative rights of the debtor, secured party, and other claimants (including the bankruptcy administrator) to intangible property, ought we look to the non-bankruptcy law of the account debtor’s location or to the non-bankruptcy law of the debtor’s location?<sup>55</sup> A typical financing transaction involves the assignment of not one but many (if not all) of the assignor’s receivables, not all of which will be owed by account debtors located in a single jurisdiction (however determined). To reduce the cost of financing receivables, some non-bankruptcy law looks to the location of the debtor-assignor, at least with respect to questions of perfection and priority. This was the approach taken by former Article 9,<sup>56</sup> and it is the rule under revised Article 9<sup>57</sup> and the Receivables Convention.<sup>58</sup> It seems like a plausible rule for a court to apply in a bank-

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54. See U.C.C. § 9-102(a)(3) (2001) (definition of “account debtor”).

55. As the discussion above suggests, even if every jurisdiction applies the law of the debtor’s (or account debtor’s) location, the governing law may differ depending on each jurisdiction’s method of determining where a given debtor (or account debtor) is located. There are problems galore in determining the account debtor’s location for these purposes, depending on how precisely one wishes to mimic non-bankruptcy outcomes. Arguably, it could be any jurisdiction in which a judgment against the account debtor might be entered (i.e., with in personam jurisdiction over the debtor). Or perhaps it should be a jurisdiction that also has in rem jurisdiction over property of the account debtor’s that can be used to satisfy the judgment.

56. See former U.C.C. § 9-103(3) (2000).

57. See U.C.C. § 9-301(1) (2001).

58. See U.C.C. § 9-301(1) (2001); Receivables Convention, *supra* note 44, arts. 22 (the law of the State in which the assignor is located governs priority), 5(i) (defining the “law” of a State to exclude the State’s choice-of-law rules). The UNCITRAL Secured Transactions Guide takes a similar approach. See UNCITRAL Secured Transactions Guide, *supra* note 31, at 104.

Although its primary focus is international interests (including security interests) in mobile equipment, the Cape Town Convention also applies to assignments of “associated rights,” i.e., “rights to payment or other performance by a debtor which are secured by or associated with” the equipment. See Cape Town Convention, *supra* note 39, ch. IX (dealing with, *inter alia*, assignments of associated rights), art. 1(c) (defining “associated

ruptcy proceeding, where the account debtors may be widely dispersed and where applying the substantive law of the account debtor's location might require the bankruptcy court to examine the law of a large number of jurisdictions. And, if the bankruptcy forum also is determined by reference to the debtor's location, a bankruptcy court deciding the validity and priority of a security interest under the substantive law of the debtor's location may be more familiar with the law and thus more likely to apply it correctly.

On the other hand, consider the case in which the non-bankruptcy law governing enforcement of the account debtor's obligation would prevent the secured party from judicially enforcing its security interest against the account debtor. For example, that law may not recognize the validity of the security interest or may afford a remedy only to the original obligee (here, the debtor). As between the debtor and secured party, only the debtor may be able to get value from the receivable through the judicial process. And, if the debtor collects that value, it should go to creditors generally. Suppose also that, as between the secured party and other creditors, a court in the debtor's location would award any collections to the secured party and not to the debtor. One might argue that, to properly reflect the non-bankruptcy outcome, the substantive law of the account debtor's location should apply to receivables that are uncollected at the time the debtor enters bankruptcy, whereas the law of the debtor's location should apply to determine the validity and priority of a security interest in the collections held by the debtor at that time.<sup>59</sup>

This bifurcated approach corresponds roughly with the approach to security interests in goods and other tangible property discussed above. The location of goods is analogous to the location of an account debtor; it is the jurisdiction whose courts have the power to enforce the security interest against the collateral. Consider the example in the preceding

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rights"). The Convention applies "when, at the time of the conclusion of the agreement creating or providing for the international interest, the debtor is situated in a Contracting State." *Id.* art. 3(1).

59. One might say that security interests in pre-bankruptcy collections should be governed by the location of the proceeds, but these are likely to be intangible (most likely in some form of deposit account or investment property).

U.C.C. § 9-408(d) presents a situation similar to the one under discussion in the text. It contemplates security interests that attach to, but are only conditionally enforceable against, the original collateral; however, they are unconditionally enforceable against the proceeds of the collateral. *See* U.C.C. § 9-408(d) (2001). The official comments suggest that, once the proceeds arise, the security interest would attach to them even if the debtor is in bankruptcy. *See* U.C.C. § 9-408, cmt. 7 (2001). The comment assumes the applicability of Bankruptcy Code § 552, which gives effect to certain security interests in property acquired by the debtor during the bankruptcy case.

paragraph, with the collateral being goods rather than receivables. The goods are subject to a security interest that the law of the situs does not recognize. The earlier discussion of tangible collateral suggested that a bankruptcy proceeding should not recognize these security interests, even if they would be enforceable under the non-bankruptcy law of the forum, which might well be the law of the debtor's location.

Even if a bifurcated approach makes theoretical sense, it has serious practical drawbacks where the substantive law of the debtor's location would yield a different result from the substantive law of the account debtor's location. The debtor generally can control the timing of its entry into bankruptcy. Making the relative rights of the secured party and competing creditors turn on whether the receivables have been collected before the debtor enters bankruptcy would enable the debtor to allocate value among its competing creditors by deciding whether and when to collect receivables and whether and when to enter bankruptcy. In addition, the rule may be too complicated to achieve widespread acceptance.<sup>60</sup>

Applying the same choice-of-law rule to all receivables, whether collected or not, would seem to make more sense. The practical considerations described above suggest that the law governing security interests in receivables should be the one applicable to collected receivables, i.e., the law of the debtor's location.<sup>61</sup>

#### IV. GOING BEYOND EFFECTIVENESS AND PRIORITY

The foregoing presents an approach for developing a choice-of-law rule to govern whether a claim should be treated as secured in bankruptcy and, if so, the relative priority of the security interest. We turn now to a brief consideration of other aspects of bankruptcy law that may affect the expected value of a bankruptcy distribution to a secured party. As discussed above, insofar as predictability and certainty are concerned, the choice-of-law rule generally should be one whose application would yield the non-bankruptcy outcome. But the desire to replicate the non-bankruptcy world may conflict with the desire to obtain the benefits of a collective proceeding that takes account of the claims of all (or nearly all) the debtor's creditors. Many bankruptcy rules are reasonably de-

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60. For example, questions may arise concerning when a receivable has or has not been "collected." Consider, for example, a check that is in the process of being collected when the bankruptcy case begins.

61. Distinguishing between tangible and intangible property for choice-of-law purposes creates line-drawing issues that may lead to uncertainty. For example, some legal systems reify certain receivables (and thus treat them as tangible for choice-of-law purposes) that other legal systems treat as pure intangibles.

signed to foster the collectivist goals of a bankruptcy. These goals include maximizing the value of assets, reducing the costs attendant to creditor recovery (including the costs of administering the bankruptcy), and safeguarding the integrity of the proceeding. Most, if not all, of these collectivist rules have incidental effects on the distribution of a bankrupt debtor's assets. In evaluating whether a secured party's distribution should be affected by any particular bankruptcy rule, it is useful to distinguish between those rules where the distributional effect is incidental and those where it is not. To a considerable extent, the difference ultimately may be a question of degree rather than of kind.

Some adjustments to the rights of creditors arise from the fact that a bankruptcy court deals with a large number and wide variety of claims against a debtor. For example, the Bankruptcy Code often reflects a leveling, rather than a precise valuation, of claims. Each unsecured claim is allowed by reference to the amount owing as of the commencement of the case, rather than by what the claim would be worth in the market at that time.<sup>62</sup> A claim for \$10,000 (including principal and accrued interest) that bears interest at ten percent is more valuable outside bankruptcy than one bearing interest at five percent. However, under the Bankruptcy Code, each of these claims is allowed for the same amount, i.e., \$10,000.<sup>63</sup> An unmatured claim for \$10,000 is allowed in its face amount, as is a claim that has been reduced to judgment and as to which execution may issue, as is a claim that has been paid or secured shortly before bankruptcy.<sup>64</sup>

A fair amount of bankruptcy law is devoted to maximizing the total value of the assets that make up the bankruptcy estate. One way in which this maximization is accomplished is by automatically staying the enforcement of security interests, thereby preserving for the estate the benefit of any going-concern value or other synergies.<sup>65</sup> The imposition

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62. See Bankruptcy Code, 11 U.S.C. § 101(5) (definition of "claim"), § 502(b) (2005).

63. *Id.*

64. *Id.* A creditor who receives payment of its unsecured claim shortly before bankruptcy may be obligated to disgorge the payment for the benefit of the bankruptcy estate. Likewise, a creditor who receives a security interest to secure its unsecured claim shortly before bankruptcy may lose the security for the benefit of the bankruptcy estate. See *id.* § 547 (providing for the avoidance of preferential transfers); § 550 (providing for recovery of avoided transfers); § 551 (providing that avoided transfers are preserved for the benefit of the estate).

65. See *id.* § 362(a) (imposing a stay of creditor activity upon the filing of a bankruptcy petition). The court must grant relief from the stay where the collateral is of no greater value in the hands of the estate than in the hands of the secured party or where stay puts the value of the security interest at risk. See U.C.C. § 362(d).

of the automatic stay gives rise to a set of provisions dealing with its effect, including those that determine what is to be done with the collateral while the stay remains in effect and those that address the risks associated with the stay.<sup>66</sup> Although they are not couched in priority terms, the application of these provisions may have distributional effects.<sup>67</sup>

Of particular concern to secured parties are bankruptcy rules that directly address the recognition of a security interest and its priority. This article has already discussed bankruptcy rules that invalidate security interests that are not enforceable outside bankruptcy against certain third-party claimants.<sup>68</sup> It suggested that, if such a rule applies, then the question, “is the security interest enforceable outside bankruptcy against a judicial lien creditor?” would be answered best by reference to the priority rules of the situs of the collateral. To return to an earlier example, suppose tangible collateral is located in State A and the debtor enters bankruptcy in State B. State B’s bankruptcy law invalidates security interests that are junior to the rights of judicial lien creditors but State A’s does not. If this provision of State B’s bankruptcy law applies, then the analysis developed above would suggest that the security interest should be invalidated if, under the law of State A, it is junior to the rights of a lien creditor.<sup>69</sup>

Among the bankruptcy rules that directly address the recognition of a security interest are rules that permit the avoidance of preferential trans-

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66. See, e.g., Bankruptcy Code, 11 U.S.C., § 542(a) (2005) (requiring the secured party to turn over collateral to the trustee in bankruptcy); § 363 (governing the sale and use of collateral); § 362(d)(1) (requiring a court to grant relief from the stay for cause, including lack of adequate protection of a security interest).

67. For example, under non-bankruptcy law, a secured creditor normally is free to take steps to liquidate the collateral and reinvest the proceeds immediately upon the debtor’s default. However, in bankruptcy an undersecured creditor who is stayed from enforcing its security interest is not entitled to be compensated for any reinvestment income of which he is deprived. See *United Sav. Ass’n v. Timbers of Inwood Forest Assoc. Ltd.*, 484 U.S. 365 (1988).

68. See, e.g., Bankruptcy Code, 11 U.S.C. § 544(a) (2005). If one thinks that an unperfected secured party is more likely than an unsecured creditor ultimately to reach the asset in question, one may view the “strong-arm power” as another example of the “leveling” of claims. Alternatively, one might view the rule as, in essence, treating the assertion of jurisdiction by the bankruptcy court over the asset for the purpose of distributing it to creditors as analogous to the acquisition of non-bankruptcy liens by each of the creditors in the case.

69. This example raises another important question: Which state’s bankruptcy avoidance law should apply? Professor Westbrook took “the most tentative and preliminary first steps towards a general analysis” of this issue. Westbrook, *Choice of Avoidance Law in Global Insolvencies*, *supra* note 5, at 537. For the most part, this useful article did not address security interests.

fers.<sup>70</sup> Historically, the avoidance of preferential transfers protected the integrity of the bankruptcy proceeding. These rules blunt the ability of certain creditors to “opt out” of an impending collective proceeding. They also can be viewed as a device for maximizing the value of the bankruptcy estate by discouraging creditors from bringing about a piecemeal distribution before the bankruptcy case has begun. To the extent that a preference law is reasonably designed to accomplish these goals, its distributional effects probably should be treated as incidental. A preference law may also reflect a policy of defeating secured claims in bankruptcy.<sup>71</sup> To that extent, it would not seem to justify a departure from the baseline principle that bankruptcy should respect the non-bankruptcy value of security interests.

Avoidance provisions that address potential injury to all creditors also have a distributional effect. Fraudulent transfer rules might fall in this category, though only roughly speaking. One can easily imagine creditor misconduct that is injurious to some of the other creditors yet gives rise to a remedy that benefits all.<sup>72</sup> To the extent that these remedies are unavailable under applicable non-bankruptcy law, what justifies imposing them in bankruptcy?<sup>73</sup> Arguably, the presence of fraudulent transfer provisions in the bankruptcy law reflects a policy to deter, or condemn, conduct that has the potential to be injurious to many. Even if the bankruptcy law were to incorporate applicable non-bankruptcy fraudulent transfer law, determining the non-bankruptcy choice-of-law rules for fraudulent transfers may be difficult.

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70. See, e.g., Bankruptcy Code, 11 U.S.C. § 547 (2005).

71. As applied to security interests, U.S. preference law may not necessarily reflect either an anti-opt-out or an estate-maximizing policy. Given the automatic stay and the trustee's right to use collateral during the bankruptcy, avoiding a security interest would seem to have a distributional effect without increasing the value of the estate. Although an avoidance that results solely from a delay in perfection might be addressing an opt-out problem (as where the secured party's concern about a potential bankruptcy motivates the secured party to investigate the status of its security interest and fix any shortcoming in perfection), it seems at least equally likely to be promoting an independent distributive goal.

72. See Bankruptcy Code, 11 U.S.C. § 548 (2005) (affording to the trustee in bankruptcy the power to avoid fraudulent transfers and fraudulent obligations); § 544(b) (affording to the trustee in bankruptcy the power to avoid fraudulent transfers and fraudulent obligations that are avoidable under applicable non-bankruptcy law and preserve the entire avoided transfer for the benefit of the estate, even if only a single creditor would have been able to avoid the transfer outside bankruptcy).

73. Jackson has suggested that the avoidance power in Bankruptcy Code § 548 may be to eliminate any need to find an aggrieved creditor under non-bankruptcy law. See JACKSON, *supra* note 9, at 146–47.

Last, there are bankruptcy rules that are openly distributive. Principles of equitable subordination can be used to subordinate secured claims by allocating the value of a secured party's collateral to competing creditors.<sup>74</sup> In some jurisdictions, unsecured claims of a particular type enjoy priority in collateral. To the extent they subordinate claims that would not be subordinated outside bankruptcy and do so without a bankruptcy-related reason, these openly (re)distributive rules impose costs without conferring any offsetting benefits. Redistributive rules that promote the interests of a designated class of creditors may be particularly difficult to remove, as they may represent a strongly held value judgment of the people of the bankruptcy jurisdiction or may be the product of a politically powerful group.

#### V. CONCLUSION

Resolving the tension between, on one hand, replicating non-bankruptcy results so as to increase predictability and reduce uncertainty costs and, on the other hand, achieving the cost savings that come from a single collective proceeding is a difficult task that may never be fully accomplished. There is some experience to suggest that agreement of choice-of-law rules may be easier to forge than agreement on substantive law. One step in the right direction would be the widespread adoption of choice-of-rules that determine whether a creditor holds a secured claim in bankruptcy and, if so, the priority of that claim, by reference to the substantive law of the location of collateral, where the collateral is tangible, and to the location of the debtor, where the collateral is intangible. In addition, where a secured transaction touches more than one state, a universally shared choice-of-law rule giving effect to the bankruptcy avoidance law of a specified jurisdiction would significantly increase the value of the security interest.

As the values promoted by collective insolvency systems coalesce, the differences among non-bankruptcy secured-credit regimes will be reduced. And, to the extent bankruptcy law reflects the values that underlie the non-bankruptcy legal regimes, we will get increasingly consistent results in bankruptcy as the non-bankruptcy laws become increasingly similar. This suggests we ought to proceed along parallel tracks: to move towards generally accepted choice-of-law rules, to regularize the non-bankruptcy law governing creditors' rights (which, in this context, in-

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74. See Bankruptcy Code, 11 U.S.C. § 510(c) (2005). Compare *id.* § 506(c), which allows the trustee in bankruptcy to recover from collateral "the reasonable, necessary costs and expenses of preserving, or disposing of [the collateral] to the extent of any benefit to the holder of [the secured claim]."

cludes not only moving towards consistent secured-transactions laws but also regularizing the ability of creditors to reach assets through the judicial process, with respect to both property claims and in personam claims), and to eliminate the most egregious distributional effects of bankruptcy avoidance powers.