

2015

# The Logic and Limits of Liens

Edward Janger

*Brooklyn Law School*, [edward.janger@yale.edu](mailto:edward.janger@yale.edu)

Follow this and additional works at: <https://brooklynworks.brooklaw.edu/faculty>

 Part of the [Banking and Finance Law Commons](#), [Bankruptcy Law Commons](#), and the [Business Organizations Law Commons](#)

---

## Recommended Citation

2015 U. Ill. L. Rev. 589 (2015)

This Article is brought to you for free and open access by BrooklynWorks. It has been accepted for inclusion in Faculty Scholarship by an authorized administrator of BrooklynWorks.

# THE LOGIC AND LIMITS OF LIENS

Edward J. Janger\*

*Thomas Jackson, in his iconic book, The Logic and Limits of Bankruptcy Law, seeks to establish both a distributional baseline for bankruptcy reorganizations and a normative set of limits for bankruptcy policy. Nonbankruptcy entitlements should establish both the distributional priorities and the distributional floor in a bankruptcy case. A number of normative prescriptions follow. Equity should not seek reorganization on the backs of the unsecured creditors. Bankruptcy-specific priorities should be avoided, to the extent possible to avoid “forum shopping” into bankruptcy (unless, of course, bankruptcy is a more efficient forum). Most importantly, however, the rights of secured creditors should be respected.*

*Professor Janger argues that, paradoxically, bankruptcy courts have become the preferred venue for realizing value on a secured creditors’ collateral, and that Jackson’s rhetoric has allowed secured creditors to capture bankruptcy created value that is not necessarily allocated to them by the statute. Specifically, undersecured creditors argue that they have a blanket lien on all of the debtor’s assets and should have the power to determine their disposition. This article first seeks to reestablish the Jacksonian balance by arguing that state law security schemes do not provide for the creation of blanket liens that capture enterprise value, but instead create asset specific security devices that are limited in scope, and are not calculated to maximize value.*

*It then seeks to establish three key points, and develop their implications. The points are (1) an ownership rule, (2) a realization rule, and (3) an equitable tracing—or “no moving up”—rule. The ownership rule is that baseline entitlements of a secured creditor in bankruptcy are established by what could have actually been realized by that creditor outside of bankruptcy. The realization rule is that, unless the statute specifies otherwise, the baseline entitlement is valued as of the petition date. The equitable tracing rule recognizes the limits of the state law definition of proceeds and the limits of equitable tracing*

---

\* David M. Barse Professor, Brooklyn Law School. This Article further develops a set of ideas that Melissa Jacoby and I first articulated in our recent article, *Ice Cube Bonds: Allocating the Price of Process in Chapter 11 Bankruptcy*, 123 YALE L.J. 862 (2014). The author would like to thank Andrew Ceppos and Kristen Peltonen for able research assistance, Neil Cohen and participants in the University of Illinois Law Review/ABI Symposium for helpful comments on an earlier draft, and Dean Nick Allard and the Dean’s Research Fund at Brooklyn Law School for generous support of this research.

*to freeze the relative position of creditors on the date of the bankruptcy filing, and limit the ability of secured creditors to use their property-based claims to “roll up” all of the bankruptcy-created value. These three rules, if applied consistently, should encourage efficient value-maximizing governance of the debtor firm and fair allocation of bankruptcy-created value among its creditors.*

#### TABLE OF CONTENTS

I.	INTRODUCTION.....	590
II.	THE LEGAL LIMITS OF BLANKET LIENS.....	595
III.	THE LIMITS OF STATE LAW REMEDIES AND THE CONCEPT OF BANKRUPTCY-CREATED VALUE.....	600
	A. <i>Formal Rights v. Realizable Value</i> .....	601
	B. <i>Realizable Value and Coordination Problems</i> .....	603
	C. <i>Adequate Protection of What?</i> .....	605
	D. <i>Allocating Bankruptcy Created Value</i> .....	606
	E. <i>Bankruptcy-Created Value and the Creditors’ Bargain</i> .....	607
IV.	REALIZATION AND TIMING .....	608
	A. <i>Preserving Relative Creditor Positions</i> .....	609
	B. <i>Exceptions that Prove the Rule</i> .....	610
	C. <i>Conclusions</i> .....	611
V.	APPLICATIONS .....	611
VI.	CONCLUSION .....	614

#### I. INTRODUCTION

Thomas Jackson, in his iconic book, *The Logic and Limits of Bankruptcy Law*, seeks to establish both a distributional baseline for bankruptcy reorganizations and a normative set of limits for bankruptcy policy.<sup>1</sup> As he sees it, state law (or, more accurately, nonbankruptcy) entitlements establish both the distributional priorities and the distributional floor in a bankruptcy case.<sup>2</sup> Bankruptcy law exists solely because the first-in-time nature of state law remedies can lead to a race of diligence and inefficient dismemberment of viable debtors.<sup>3</sup> Thus, the purpose of bankruptcy policy should be limited to avoiding these inefficient liquidations—preserving going concern value where it exists, while respecting nonbankruptcy distributional priorities.

Value maximization and Pareto optimality are hard goals to argue with, but as limiting principles they are more controversial.<sup>4</sup> A number of

1. THOMAS H. JACKSON, *THE LOGIC AND LIMITS OF BANKRUPTCY LAW* (2001).

2. *Id.*

3. *Id.* at 84.

4. For the purposes of this Article, I accept these limits, as they represent a least common denominator for bankruptcy scholars. See Ted Janger, *Crystals and Mud in Bankruptcy Law: Judicial*

normative prescriptions follow. Equity should not seek reorganization on the backs of the unsecured creditors. Bankruptcy-specific priorities should be avoided, to limit “forum shopping” into bankruptcy (unless, of course, bankruptcy is a more efficient forum).<sup>5</sup> Most importantly, however, the rights of secured creditors should be respected.<sup>6</sup>

The Jacksonian prescription to respect a secured creditor’s non-bankruptcy rights has been at the base of many of the most celebrated bankruptcy disputes of the last thirty years. To wit: Should undersecured creditors be compensated for the delay in foreclosure caused by the automatic stay (*Timbers*)?<sup>7</sup> Does the absolute priority rule permit the secured creditor to propose a “gift plan” (*DBSD*)?<sup>8</sup> Does a secured creditor have the absolute right to credit bid in a sale under a plan (*RadLAX*)?<sup>9</sup>

I argue in this Article, however, that routine invocation of this prescription has actually led to a significant expansion of secured creditors’ rights, well beyond what they could achieve under state law and, perhaps, beyond what the Bankruptcy Code prescribes.

The contested questions raised by Jackson’s paean to *Butner*<sup>10</sup> can be broadly reframed as: (1) what can a secured creditor insist on in cramdown; and (2) when should a secured creditor be able to assert governance rights over its collateral, and hence over the debtor’s decision whether to reorganize or liquidate?<sup>11</sup> In the years that have followed, courts and lawyers have accepted a formal and expansive view of the secured creditors’ entitlement on both fronts.<sup>12</sup> As a result, notwithstanding considerable secured creditor bellyaching, current bankruptcy practice allows creditors with consensual liens to obtain (and perhaps insist on) a greater recovery in bankruptcy than would be available under other law.<sup>13</sup> This is true on both a practical and a formal level. Bankruptcy has turned into a phenomenally effective foreclosure device.<sup>14</sup> Chapter 11

---

*Competence and Statutory Design*, 43 ARIZ. L. REV. 559, 589 (2001). Others would go further. See, e.g., KAREN GROSS, FAILURE AND FORGIVENESS: REBALANCING THE BANKRUPTCY SYSTEM 15 (1997); Donald R. Korobkin, *Rehabilitating Values: A Jurisprudence of Bankruptcy*, 91 COLUM. L. REV. 717, 721 (1991).

5. JACKSON, *supra* note 1, at 64.

6. *Id.* at 9.

7. *United Sav. of Texas v. Timbers of Inwood Forest Assocs.*, 484 U.S. 365, 365 (1988).

8. *Dish Network Corp. v. DBSD N. Am., Inc. (In re DBSD N. Am., Inc.)*, 634 F.3d 79, 85 (2d Cir. 2011).

9. *RadLAX Gateway Hotel, L.L.C. v. Amalgamated Bank*, 132 S. Ct. 2065, 2073 (2012).

10. *Butner v. United States*, 440 U.S. 48 (1979).

11. See JACKSON, *supra* note 1, at 21–23.

12. See *infra* Part III.

13. Melissa B. Jacoby & Edward J. Janger, *Ice Cube Bonds: Allocating the Price of Process in Chapter 11 Bankruptcy*, 123 YALE L.J. 862, 892–95 (2014).

14. See, e.g., *In re Lehman Bros. Holdings, Inc.*, 445 B.R. 143, 153 (Bankr. S.D.N.Y. 2011) (“At the time, the transaction was regarded by many as an admirable, even heroic, achievement that helped to salvage jobs, preserve going concern values and provide for the orderly transition of many thousands of brokerage accounts to a financially secure firm with the resources to manage and service the financial assets held in those accounts.”). The value of going concern sales has been recognized internationally as well. Espen Eckbo and Karin Thorburn studied mandatory auctions in Sweden, and

gives secured creditors far greater ability to maximize the value of their collateral than would have been available under state law foreclosure regimes. This value maximization can occur through either reorganization or liquidation in Chapter 11.<sup>15</sup> Moreover, control of the debtor's assets also gives the secured creditor control over governance in bankruptcy. Control over bankruptcy decisionmaking may, in turn, allow the secured creditor to capture a disproportionate share of bankruptcy-created value, or even prevent value maximizing reorganizations.<sup>16</sup> This can result in harm to the estate and to other creditor constituencies (even where the secured creditor is undersecured).

The most extreme, but also very common, version of this problem manifests when an undersecured creditor announces that it has a "blanket lien" on all of the debtor's assets, and that it therefore should have the unfettered right to determine how to dispose of those assets.<sup>17</sup> Secured creditors often get away with making this argument, but I will seek to show: that the success of this argument is a product of a failure by lien lawyers to understand the treatment of liens under bankruptcy law; and, more importantly, that it reflects a failure by bankruptcy lawyers themselves to understand the limited scope of liens under nonbankruptcy law. The result is that secured lenders, by aggrandizing and overstating the scope of relatively inefficient state law remedies, have managed to gain a practical and rhetorical stranglehold over the bankruptcy process. The result is a paradoxical violation of Jackson's prescription. Just as reorganization should not occur on the backs of the secured creditor, secured creditors should not be able to use the hostage value of their liens to extort value and thereby foreclose at the expense of junior creditors.

This Article proceeds in four steps. First, it seeks to establish the legal limits of secured lending under nonbankruptcy law. A secured loan does not confer a distributional priority ahead of all other claimants against the debtor—it establishes a property right in specific property with distinct attributes defined by nonbankruptcy law. A debtor may intend to grant a lender a security interest in all of its assets, but the ability to do this is not governed by intent; it is governed by property law. Prop-

---

found that where small companies were involved, the survival rate was relatively high and the values received compared favorably with the book value of the company. B. Espen Eckbo & Karin S. Thorburn, *Bankruptcy as an Auction Process: Lessons from Sweden*, 21 J. APPLIED CORP. FIN. 38, 48 (2009).

15. This ability derives from the ability to reorganize (and preserve going concern value), 11 U.S.C. § 1129 (2012), or to sell as a going concern outside the ordinary course of business. *Id.* § 363(b). As a sale device, bankruptcy holds over compulsory state law processes. First, the Code creates a "global" estate consisting of all of the debtors property, wherever it may be, or by whomever it is held. *Id.* § 541(a). State courts have only local (and longarm) jurisdiction and can reach only local assets. Second, the trustee-in-bankruptcy (or debtor-in-possession) has the power to sell property of the estate free and clear of liens. *Id.* § 363(f). This allows the debtor to sell property in bundles that may or may not track the state law foreclosure regimes and to transfer clear title, shifting the various liens to the proceeds of sale.

16. See Jacoby & Janger, *supra* note 13, at 910.

17. Kenneth M. Ayotte & Edward R. Morrison, *Creditor Control and Conflict in Chapter 11*, 1 J. LEGAL ANALYSIS 511, 513-14 (2009).

erty rights are limited in scope, and the means for effective alienation are legally regulated and often quite formal.<sup>18</sup> A debtor who intends to grant a lender a security interest in a particular asset may fail for a variety of reasons.<sup>19</sup> They may not be able to do so under applicable law, or may fail to do so properly. As a result, the fact that a secured party is undersecured does not necessarily lead to the conclusion that unsecured creditors will not be entitled to a distribution.

Second, this Article seeks to establish the practical limits of secured lending under nonbankruptcy law. A secured loan does not confer fee ownership. Just as one should take a realistic view of the scope of a lien—what property is covered, it is essential to be realistic about how much value could actually be realized by the lienholder. A lien, whether consensual, judicial, or statutory, confers the power to sell the collateral and credit the proceeds of sale against the outstanding debt.<sup>20</sup> That right to realization is subject to a variety of procedural requirements, from the comparatively streamlined rules of Article 9 that allow self-help repossession and require only notice and commercial reasonableness,<sup>21</sup> to the comparatively difficult procedures for judicial foreclosure on residential real property,<sup>22</sup> to the restrictions on the alienation of intellectual property licenses.<sup>23</sup> This raises two distinct issues: valuation and timing. What is the value to which the lienholder is entitled, measured as of when? This Part of the Article concludes by arguing that, while it is possible for bankruptcy law to adjust this rule, the baseline entitlement is the value that could have been received had the creditor pursued its actual state law remedies. Deviations from this baseline must be justified by policies other than entitlement.

Third, the Article takes on the second question—timing. In this Part, I will argue that the value of the secured creditor's entitlement should be measured as of the petition date, unless the Bankruptcy Code

18. See Jacoby & Janger, *supra* note 13, at 914–25.

19. A security interest may fail for a variety of reasons, including failure to comply with formalities of a security interest (see U.C.C. §§ 9-109 (2014), 1-201(b)(35) (2014); U.C.C. § 9-203(a)-(b) or for failure to perfect a security interest (see U.C.C. §§ 9-308, 9-310, 9-316). See also *infra* Part I.

20. See, e.g., U.C.C. §§ 1-201(b)(35), 9-607, 9-610; Enforcement of Money Judgments, N.Y. C.P.L.R. 5201–03 (McKinney 2006).

21. U.C.C. §§ 9-610, 9-611.

22. RESTATEMENT (THIRD) OF PROP.: MORTGS. (1997) [hereinafter RESTATEMENT OF PROP.]

As the Reporters note in the introductory note to the Restatement:

Lenders in the United States have made use of a variety of real estate security devices. The oldest, of course, is the mortgage, a legacy of medieval England, and its virtual twin, the deed of trust. Other devices include the absolute deed as security, the contract for deed, and the “negative pledge.” Lenders developed these instruments because they felt dissatisfied with the mortgage, either because its foreclosure procedure was considered unduly cumbersome or because the substantive protection provided to borrowers was considered excessive. The result has been a plethora of devices and a corresponding profusion of legal uncertainty in most jurisdictions. The picture is not a tidy or an efficient one.

*Id.* at intro.

23. U.C.C. sections 9-406 and 9-408 seek to override legal and contractual restrictions on the transfer of certain types of property. U.C.C. §§ 9-406, 9-408.

(the “Code”) changes that rule.<sup>24</sup> Section 552 of the Code stops floating liens from floating, and limits the secured creditor to collateral held at the time of bankruptcy and its proceeds—subject to equitable tracing (or, as section 552 puts it, “the equities”).<sup>25</sup> If one takes section 552 seriously and treats the petition date as a realization moment, then the secured creditor does not “own” much of what the postbankruptcy debtor creates. Work of at-will employees is not proceeds of anything owned by the secured creditor on the petition date.<sup>26</sup> At a certain point, purchased inventory is no longer traceable to collateral owned on bankruptcy day (though it may be traceable to cash collateral).<sup>27</sup> In other words, if one takes a realistic (and realist) view of a secured creditor’s property rights in bankruptcy, she “owns” much less than she might assert.

That this sleight of hand often works is not a reason to criticize secured creditors. It results from a failure on the bankruptcy side to distinguish a secured creditor’s collateral from bankruptcy-created value. This fourth point is not entirely new. Ronald Mann made a similar point nearly two decades ago.<sup>28</sup> Where Mann sought to separate bankruptcy-created value from the interests of creditors generally, I make a narrower point by seeking to distinguish what belongs to the secured creditor from what belongs to the firm. Mann asked whether noncreditor interests could be considered under bankruptcy, or, to put it another way, what value could properly be allocated to the “public policy” space.<sup>29</sup> I, by contrast, seek to allocate value within the firm for distributional purposes in bankruptcy, and, more importantly, to allocate governance rights, also within the firm, for the purposes of determining the disposition of the firm’s assets.

The Article concludes with a number of applications of the principles articulated here to a variety of bankruptcy hot topics. In sum, mod-

---

24. The anti-lienstripping rules contained in § 1325(a) and § 1111(b)(2) of the Code have the effect of postponing the secured creditor’s moment of realization. Similarly, § 1129(a) measures the value of the secured creditor’s collateral as of the effective date of the plan, but these exceptions prove the rule. With regard to § 1129(a), usually the assumption is that the value of the collateral will have declined over time, and the creditor will have received adequate protection payments to preserve full payment of that value. It can happen that the collateral may increase in value, however, the effect of this is less clear. See 11 U.S.C. §§ 1111(b)(2), 1325(a), 1129(a) (2012).

25. 11 U.S.C. § 552(b).

26. While employees may be paid with “cash collateral,” and some of the postpetition value they create may be considered proceeds, to the extent that the employee creates value beyond his or her wages, there is no reason to, and most courts would not, allocate all of the postpetition value to the secured creditor. See *infra* note 120 and accompanying text.

27. 11 U.S.C. § 363(a), (c); *In re Oriental Rug Warehouse Club, Inc.*, 205 B.R. 407, 410 (Bankr. D. Minn. 1997).

28. Ronald J. Mann, *Bankruptcy and the Entitlements of the Government: Whose Money Is It Anyway?*, 70 N.Y.U. L. REV. 993, 1040 (1995) (“The creditor’s bargain with the debtor may entitle it to any value attributable to the actions of the debtor and its management, but the government’s role in creating and preserving those gains gives it an entitlement to some share of any gains from reorganization. Hence, the government is entitled to a say in disposing of that value, which it might exercise in several ways: by taking some portion of the value for itself through taxes or fees, by delivering it to the creditors, or by allowing the management or owners of the debtors to retain it.”).

29. *Id.* at 999.

ern bankruptcy practice has turned the Jacksonian prescription on its head. Jackson argues that unsecured creditors should not be encouraged to forum shop into bankruptcy to extort value from secured creditors. By the same logic, secured creditors should not be encouraged to forum shop into (or use their leverage in) bankruptcy to capture the value of assets that they do not own. In this regard, careful attention to the limits of the secured creditor's entitlements under nonbankruptcy law, recognition of the practical value of those entitlements, and a careful tracing of those rights during the bankruptcy process, would lead to a very different allocation of governance rights between secured creditors and other stakeholders, and to a very different distribution of value at the end of the case, than is typical under modern practice.

## II. THE LEGAL LIMITS OF BLANKET LIENS

At least since 1978, and perhaps longer, law professors and economists have asked whether it is possible as a legal matter, or should be possible as a normative matter, for a debtor to transfer all of its assets—indeed, all of its value—to a consensual lien creditor as security for a debt.<sup>30</sup> In other words, should a secured creditor be able to bargain for a lending contract that is supported by a distributional priority in all of the firm's value (present and future) that is enforceable as a property right, good against the world? As a normative matter, Jackson and others have argued that such a hierarchical capital structure would facilitate governance and efficient allocation of assets.<sup>31</sup> But they concede that this is not necessarily possible under current law.<sup>32</sup>

Notwithstanding this concession, investors often speak of “blanket liens” as if there is such a thing. This assumption comes from a number of places: a libertarian view of property rights that would allow an owner to dispose of his or her property in any manner; a “finance-based” approach that treats secured credit as if it were a global distributional priority rather a lien on specific property; but, mostly, an inattention to the

---

30. See, e.g., Douglas G. Baird & Anthony J. Casey, *No Exit? Withdrawal Rights and the Law of Corporate Reorganizations*, 113 COLUM. L. REV. 1, 17 (2013); Douglas G. Baird & Thomas H. Jackson, *Bargaining After the Fall and the Contours of the Absolute Priority Rule*, 55 U. CHI. L. REV. 738, 782–83 (1988).

31. See JACKSON, *supra* note 1, at 218.

32. Baird and Jackson argued that a secured creditor should be able to bargain for its security interest to include the going-concern (or enterprise) value of the debtor, although they did not assert that this view reflected the law at the time of their publication:

Thus, we believe, a secured creditor with a security interest in specific ‘hard’ assets should be treated as having a claim to the asset’s liquidation value. Its secured claim should reach no further. . . .

This conclusion, however, does not undercut the idea that a creditor should be able to bargain for a priority interest in the going-concern surplus in priority to other creditors. Baird & Jackson, *supra* note 30, at 782–83. See also Baird & Casey, *supra* note 30, at 17 n.59 (citing *Bargaining After the Fall* as defending the liquidation value as the creditor’s entitlement).



limits of lien law.<sup>33</sup> It is true that loan documents are often structured to manifest an intention to encumber all assets in favor of a secured lender:<sup>34</sup> mortgages are granted against all real property; leases are assigned; and an Article 9 security interest is granted in all property that comes within the scope of Article 9 of the Uniform Commercial Code (“UCC”).<sup>35</sup> This package of conveyances is then described as a “blanket lien.” It is not by any means clear, however, that such a conveyance actually achieves the stated result, at least insofar as it applies to claims by third parties against those assets. Whether a purported conveyance of property is effective is determined by state property law, not contract law, so one must look beyond the intent of the parties to determine the legal effect of the transaction, especially with regard to third parties.

To create a mortgage on real property one must comply with the mortgage law of the state in which the real property lies.<sup>36</sup> This may seem reasonably straightforward, but as evidenced by the recent experience with the Mortgage Electronic Registration System (“MERS”), it is necessary to pay attention to the vagaries of state law for creation, perfection, and assignment of these rights.<sup>37</sup>

For personal property, Article 9 makes the lien creation process reasonably straightforward.<sup>38</sup> One can create the lien by creating an authenticated record memorializing the intended conveyance.<sup>39</sup> One can perfect it by filing a financing statement, taking possession of certain types of collateral, and taking control of certain other types of collateral.<sup>40</sup> However, the scope of Article 9 is not all-encompassing. It is worth listing a few examples, because the gaps are not trivial.

First, 9-109 excludes a variety of types of property from the scope of Article 9.<sup>41</sup> Some of these exclusions are purely technical. Some are likely

33. See 11 U.S.C. § 363(f) (2012); Carole Patemen, *Self Ownership and Property in the Person: Democratization and a Tale of Two Concepts*, 10 J. POL. PHIL. 20, 25 (2002).

34. See *infra* note 46; see also Christopher J. Rockers & Christine Gould Hamm, *Exploring the Possibilities for No. 2: All About Second-Lien Loans*, 14 A.B.A. BUS. L. SEC. (2005), available at <http://www.americanbar.org/content/dam/aba/publications/blt/2005/01/exploring-possibilities-no2-200501.authcheckdam.pdf> (“A second-lien loan is a loan secured by a lien on part or all of the borrower’s assets.”).

35. U.C.C. § 9-109 (2014).

36. See RESTATEMENT OF PROP, *supra* note 22, at intro. (“[T]here can be no doubt that legal differences from state to state act as a serious impediment to the carrying out of these business arrangements. A major goal of this Restatement . . . is to assist in unifying the law of real property security by identifying and articulating legal rules that will meet the legitimate needs of the lending industry while at the same time providing reasonable protection for borrowers.”).

37. See Gretchen Morgenson, *Mortgage Registry Muddles Foreclosures*, N.Y. TIMES, Sept. 1, 2012, [www.nytimes.com/2012/09/02/business/fair-game-mortgage-registry-muddles-foreclosures.html?\\_r=0](http://www.nytimes.com/2012/09/02/business/fair-game-mortgage-registry-muddles-foreclosures.html?_r=0).

38. See U.C.C. §§ 9-109, 1-201(b)(35), 9-203(a)–(b).

39. See *id.*

40. U.C.C. §§ 9-308, 9-310–316.

41. U.C.C. § 9-109(d) excludes from Article 9’s scope:

- (1) a landlord’s lien, other than an agricultural lien;
- (2) a lien, other than an agricultural lien, given by statute or other rule of law for services or materials, but section 9-333 applies with respect to priority of the lien;
- (3) an assignment of a claim for wages, salary, or other compensation of an employee;

to apply only in “individual” cases, because they protect exempt property or apply to consumer transactions. But some are significant. The exclusion of many tort claims; real estate; recoupment and setoff; insurance claims; and so on, make it seem as if a blanket “Article 9” security interest may not be as all-encompassing as it sounds.

This is not to say that many of the excluded items may not be encumberable by other methods. Rather, it merely highlights the fact that a statement of intent to create a blanket lien by a lender and borrower, coupled with the filing of an all-encompassing financing statement, does not necessarily make it so.

A second limitation on the scope of liens can be described as “inalienable property” or “nonproperty.” Not all of a firm’s value can be separated from the firm itself. For example, judicial lien creditors have been held unable to levy on domain names.<sup>42</sup> Some elements of firm value may not be property at all.<sup>43</sup> For example, government-granted licenses that are personal in nature and nontransferable, or accumulated corporate goodwill simply may not be subject to liens.<sup>44</sup> There have been both judicial and statutory attempts to work around this type of gap, but none have been universally accepted. For example, a number of cases involv-

(4) a sale of accounts, chattel paper, payment intangibles, or promissory notes as part of a sale of the business out of which they arose;

(5) an assignment of accounts, chattel paper, payment intangibles, or promissory notes which is for the purpose of collection only;

(6) an assignment of a right to payment under a contract to an assignee that is also obligated to perform under the contract;

(7) an assignment of a single account, payment intangible, or promissory note to an assignee in full or partial satisfaction of a preexisting indebtedness;

(8) a transfer of an interest in or an assignment of a claim under a policy of insurance, other than an assignment by or to a health-care provider of a health-care-insurance receivable and any subsequent assignment of the right to payment, but sections 9-315 and 9-322 apply with respect to proceeds and priorities in proceeds;

(9) an assignment of a right represented by a judgment, other than a judgment taken on a right to payment that was collateral;

(10) a right of recoupment or set-off, but:

(A) Section 9-340 applies with respect to the effectiveness of rights of recoupment or set-off against deposit accounts; and

(B) Section 9-404 applies with respect to defenses or claims of an account debtor;

(11) the creation or transfer of an interest in or lien on real property, including a lease or rents thereunder, except to the extent that provision is made for:

(A) liens on real property in sections 9-203 and 9-308;

(B) fixtures in section 9-334;

(C) fixture filings in sections 9-501, 9-502, 9-512, 9-516, and 9-519; and

(D) security agreements covering personal and real property in section 9-604;

(12) an assignment of a claim arising in tort, other than a commercial tort claim, but sections 9-315 and 9-322 apply with respect to proceeds and priorities in proceeds; or

(13) an assignment of a deposit account in a consumer transaction, but sections 9-315 and 9-322 apply with respect to proceeds and priorities in proceeds.

42. See *Network Solutions, Inc. v. Umbro Int’l, Inc.*, 529 S.E.2d 80, 80 (Va. 2000).

43. See *Straffi v. New Jersey (In re Chris-Don, Inc.)*, 308 B.R. 214, 217 (Bankr. D.N.J. 2004).

44. Some things of value to the enterprise (such as government-granted licenses) have been construed not to be property to which an Article 9 security interest can attach. See *New Jersey v. Div of Taxation (In re Chris-Don, Inc.)* 367 F. Supp. 2d 696, 696–97 (D.N.J. 2005) (finding that a liquor license is not property for Article 9 purposes under New Jersey law); *Banc of Am. Strategic Solutions, Inc. v. Cooker Rest. Corp.*, No. 05AP-1126, 2006 WL 2535734, at \*7 (Ohio Ct. App. Sept. 5, 2006) (finding that liquor licenses are not property under Ohio law).

ing FCC licenses have deemed the value of transferred licenses (realized in bankruptcy) as proceeds, notwithstanding that the underlying license was not collateral.<sup>45</sup>

A similar attempt is made in sections 9-406 and 9-408 of the UCC.<sup>46</sup> Those sections override nonassignment clauses contained in contracts, intellectual property licenses, and government licenses. While section 9-406 is a complete override, section 9-408 overrides nonassignment provisions only to the extent necessary to allow a security interest to attach, but not to enforce the lien.<sup>47</sup> section 9-408 does not alter, the fact that these rights would not be realizable by the secured party outside of bankruptcy. Nonetheless, they seek to ensure that any value realized in bankruptcy will be allocated to the secured party as proceeds.<sup>48</sup> This is a bold attempt to use the state law definition of property to alter the federal bankruptcy definition of proceeds. There is no particular reason to treat this result as a given or even as intended by Congress. Indeed, if the creditors' allowed secured claim is to be calculated, for adequate protection purposes, as of the petition date, the realizable value of the lien (outside of bankruptcy) would be zero.

A third limitation on a secured creditors' lien is that there may be problems with perfection or priority.<sup>49</sup> Liens are property rights, and the question in bankruptcy is not whether these property rights are enforceable against the debtor, but whether they are enforceable against third parties.<sup>50</sup> Sometimes a mere paper grant is sufficient,<sup>51</sup> but for many types of property interests, a public filing, the taking of possession or control may be required to ensure priority over later lien creditors under state law, or the bankruptcy trustee.<sup>52</sup> Again, loan documents may reflect an intent to convey a property interest, but unless the appropriate steps are followed, the promise may be ineffective. Property may fall through the cracks.

A fourth limitation is the concept of traceable proceeds. Under Article 9 of the UCC, a security interest automatically covers proceeds of the collateral, if it is sold or otherwise disposed of.<sup>53</sup> That concept of iden-

45. Compare *New Bank of New England, N.A. v. Tak Commc'ns, Inc.* (*In re Tax Commc'ns, Inc.*), 138 B.R. 568, 568 (W.D. Wis. 1992) (holding that value of broadcast license is not proceeds of secured creditor's collateral), with *In re Ridgley Commc'ns, Inc.*, 139 B.R. 374, 374 (Bankr. D. Md. 1992) (holding that value of broadcast license is proceeds of secured creditor's collateral).

46. See U.C.C. §§ 9-406, 9-408.

47. See *infra* note 55.

48. Whether this will work will turn on the nature of proceeds in bankruptcy. Compare *In re Wiersma*, 283 B.R. 294, 294 (Bankr. D. Idaho 2002) (holding that insurance claims arising out of electrocution of cattle are proceeds), with *Helms v. Certified Packaging Corp.* 551 F.3d 675, 678 (7th Cir. 2008) (holding that claims for failure to obtain business interruption insurance were not proceeds of collateral). Also, Article 9's concept of proceeds only reaches property. *Straffi v. New Jersey (In re Chris-Don, Inc.)*, 308 B.R. 214, 217 (Bankr. D.N.J. 2004).

49. See U.C.C. §§ 9-308, 9-310-317; 9-320, 9-322-324.

50. See 11 U.S.C. § 544 (2012).

51. *Bluxome St. Assocs. v. Fireman's Fund Ins. Co.*, 254 Cal. Rptr. 198, 198 (Cal. Ct. App. 1988).

52. See U.C.C. §§ 9-308, 9-310-316.

53. U.C.C. § 9-203(f).

tifiable proceeds is extended by equitable tracing rules, but only as far as those rules themselves can reach.<sup>54</sup> To claim property as proceeds, one must be able to trace the proceeds to original collateral, subject to a perfected security interest.<sup>55</sup> Sometimes this is possible, but often it is not. Where a blanket lien is involved, outside of bankruptcy, tracing rules may not matter much because as property changes from one form to another, it may simply float between and among collateral types, changing from inventory to an account, then to a deposit account and back to inventory. Because the security agreement covers after-acquired property, no value slips out of the security interests.<sup>56</sup> Similarly, when an employee develops intellectual property or provides services, the value becomes collateral as an after-acquired general intangible.<sup>57</sup>

Tracing becomes crucial in bankruptcy, however. Under section 552(a) of the Code, liens on after-acquired property no longer attach.<sup>58</sup> To put it another way, floating liens stop floating.<sup>59</sup> By contrast, if the prepetition security interest covers proceeds, then, when property is sold by the debtor, the security interest will attach to the proceeds.<sup>60</sup> But, significantly, after-acquired property only becomes collateral if it is proceeds of prepetition collateral. The interest in proceeds is only perfected if the interest in the original collateral was perfected.<sup>61</sup>

It is not uncommon for a putative “blanket lien” creditor to assert that since it has a lien on all of the debtor’s prepetition property, any postpetition value of the firm must, by definition, be proceeds.<sup>62</sup> Such creditors often get away with it, but they should not. First, postpetition value may not be a product of prepetition collateral. Just to offer one example, imagine that an at-will employee of a software company develops an algorithm that is extremely valuable postpetition. It is work for hire, so it belongs to the firm, but it is difficult to figure out how that intellectual property is proceeds of prepetition collateral.<sup>63</sup> In a restaurant, the

54. U.C.C. § 9-315(b)(2).

55. See *In re Oriental Rug Warehouse Club, Inc.*, 205 B.R. 407, 407 (Bankr. D. Minn. 1997); U.C.C. §§ 9-102(a)(64)(A), (C), 9-315(a)(2), (c), (d).

56. U.C.C. § 9-204(a).

57. See U.C.C. §§ 9-102(a)(42), 9-204.

58. 11 U.S.C. § 552(a) (2012).

59. *Id.*

60. *Id.* § 552(b).

61. U.C.C. § 9-315(c).

62. In *DBSD I*, the bankruptcy court permitted secured creditors to make a “gift” of the distributions to which they were entitled to junior classes of creditors. See *In re DBSD N. Am., Inc.*, 419 B.R. 179, 212 (Bankr. S.D.N.Y. 2009), *aff’d*, No. 09 Civ. 10156 (LAK), 2010 WL 1223109 (S.D.N.Y. Mar. 24, 2010), *aff’d in part, rev’d in part*, 627 F.3d 496 (2d Cir. 2010). The Second Circuit reversed the bankruptcy court’s finding and held that “the bankruptcy court erred in confirming the plan of reorganization” which included the gift. *In re DBSD N. Am., Inc.*, 634 F.3d 79, 100–01 (2d Cir. 2011). The Second Circuit specifically noted “Congress . . . did not create any exception for ‘gifts’ like the one at issue [in *DBSD I*].” *Id.* See also *Jacoby & Janger, supra* note 13, at 923–24.

63. The argument that the employee was paid with cash collateral does not help. The algorithm would be property acquired by the debtor when created. The employee would be paid in arrears, well after the algorithm was created. Similarly, cases involving restaurants distinguish the extent to which food sold is product of inventory, and the extent to which it is a product of services.

value contributed by the line cooks and wait staff is not proceeds of inventory, even though a customer technically pays for a meal.<sup>64</sup> Section 552 of the Code recognizes this limitation on proceeds when it says that the proceeds can be limited as required by the “equities of the case.”<sup>65</sup> Again, the secured party is entitled to the collateral value that they had as of the petition date, and that value may be traced through multiple forms, but that does not eliminate the fact that there is no such thing as “proceeds in the air.” Proceeds must be traceable to prepetition collateral in order for the secured party to be entitled to the value to be attributable to those proceeds/that collateral.<sup>66</sup> In short, even if the debtor and secured creditor intend to create a blanket lien, the lien holder may not “own” all of the firm’s value. For better or for worse, this has significant governance implications. If the secured creditor is not the sole owner of the insolvent firm, then it does not have a unilateral right to decide what to do with the firm’s assets. It also sets up a conflict of interest between the secured creditor and the other claimants. The secured creditor has an incentive to maximize the value of assets (and to increase the allocation of firm value to lien-ed assets) while the other claimants have an incentive to maximize the value of the firm as a whole.

### III. THE LIMITS OF STATE LAW REMEDIES AND THE CONCEPT OF BANKRUPTCY-CREATED VALUE

Bankruptcy law is replete with verbal formulations that mandate the protection of a secured creditor’s interest in its collateral: “adequate protection,” “indubitable equivalence,” and “value of such interest.”<sup>67</sup> The common thread is that bankruptcy law respects the secured creditor’s property right. But what does that mean? Is the secured creditor entitled to the monetary value of its lien, or to the full bundle of state law entitlements, subject only to the automatic stay? One might view secured credit solely as a remedy; the secured creditor has chosen secured credit to ensure an alternate source of recovery. They are therefore entitled to at least what they would have recovered had they exercised their rights outside of bankruptcy. Alternatively, one might view the bundle of rights embodied in the security interest as including the “hostage value.”<sup>68</sup> State law allows a secured creditor to seize and dispose of the collateral (regardless of the value) in a manner that might impose costs on the debtor

---

64. *In re Cafeteria Operators, L.P.*, 299 B.R. 400, 410 (Bankr. N.D. Tex. 2003). Some courts conclude that the food is not proceeds at all. *In re Inman*, 95 B.R. 479, 480 (Bankr. W.D. Ky. 1988) (“[T]he degree of service is not the significant factor for our consideration. Rather, the meritorious fact we should note is that the restaurant industry, in general, is a service-oriented industry.”).

65. 11 U.S.C. § 552(b).

66. *See supra* note 55.

67. 11 U.S.C. §§ 361, 506(a).

68. Ronald J. Mann, *Strategy and Force in the Liquidation of Secured Debt*, 96 MICH. L. REV. 159, 235 (1997).

far in excess of the value of the collateral itself.<sup>69</sup> A consumer debtor might lose her house. An automobile factory might need to shut down because it cannot operate without the use of a specialized piece of equipment.

That question was posed squarely in the recent *RadLAX* case, where the Supreme Court concluded that a secured creditor did not receive the “indubitable equivalent” of the value of its collateral for the purposes of section 1129(b)(2)(A) when the creditor was deprived of the right to credit bid in a sale of its collateral pursuant to a plan of reorganization.<sup>70</sup> In *RadLAX*, the Supreme Court appeared to endorse the second approach—the right to credit bid was deemed an essential part of the secured creditor’s bundle of rights, embodied in the concept of “indubitable equivalence” required by the statute.<sup>71</sup> Credit bidding, though, does not affect a secured creditor’s distributional priority—it simply increases the creditors’ leverage at the foreclosure sale. For reasons I will discuss below, I believe this to reflect a fundamental misunderstanding of Congress’ approach to liens in the Code, and, more importantly, an approach that is likely to create significant inefficiencies.

#### A. *Formal Rights v. Realizable Value*

As Melissa Jacoby and I have discussed elsewhere, putting aside whether the Code can or should be used to preserve jobs, protect equity, or otherwise preserve the value of a firm for noncreditor constituencies, bankruptcy law can create value for creditors in two distinct ways.<sup>72</sup> Most obviously, Chapter 11 seeks to preserve going concern value by allowing a firm to continue its business and reform its capital structure by shedding debt.<sup>73</sup> Chapter 11 provides a way to allocate this loss and distribute

---

69. *Id.* at 179–80.

70. *RadLAX Gateway Hotel, LLC. v. Amalgamated Bank*, 132 S. Ct. 2065, 2070 (2012). The right to credit bid seems, at first, to be a trivial question for both the creditor and debtor. A secured creditor who credit bids “pays” for the foreclosed collateral by cancelling the relevant amount of debt. This simply saves the creditor the trouble of writing a check to the foreclosure trustee and then being handed the money back as its distribution. While this right appears purely formal, it can significantly affect the dynamics of a foreclosure sale. Since the secured creditor need not put up cash, it need not arrange financing before bidding. Similarly, in cases where the deficiency is uncollectible, the secured creditor can use the threat to credit bid the full amount of the debt to deter possible bidders.

71. *Id.* at 2027.

72. Jacoby & Janger, *supra* note 13, at 920.

73. As the House Report to the Bankruptcy Reform Act of 1978 states: The purpose of a business reorganization case, unlike a liquidation case, is to restructure a business’s finances so that it may continue to operate, provide its employees with jobs, pay its creditors, and produce a return for its stockholders. The premise of a business reorganization is that assets that are used for production in the industry for which they were designed are more valuable than those same assets sold for scrap. Often, the return on assets that a business can produce is inadequate to compensate those who have invested in the business. Cash flow problems may develop, and require creditors of the business, both trade creditors and long-term lenders, to wait for payment of their claims. If the business can extend or reduce its debts, it often can be returned to a viable state. It is more economically efficient to reorganize than to liquidate, because it preserves jobs and assets.

H.R. REP. NO. 95-595, at 220 (1977) *reprinted in* 1978 U.S.C.C.A.N. 5963, 6179.

firm value across creditor constituencies through a mixed process of bargaining and compulsion. But Chapter 11 can preserve value in other ways as well. The value can be preserved by a going concern sale under a plan of reorganization.<sup>74</sup> Another value preserving aspect of Chapter 11 is that, in an emergency, it can be used to accomplish a hurry-up, all-asset sale.<sup>75</sup> Even these liquidations in Chapter 11 will often yield greater realizations than could be achieved under state law liquidation procedures.<sup>76</sup> Therefore, extending the package of state law rights embodied in “adequate protection,” or the “allowed secured claim,” beyond the concept of realizable value gives the holder of such a claim the power to bargain for a greater value than she would have achieved using her prebankruptcy state law rights.<sup>77</sup> To the extent that this encourages efficient resolutions, this is not a problem. To the extent that it allows the secured creditor to hold out, and exploit the hostage value of its collateral, however, it is quite problematic. As noted above, the secured creditor who does not own all of the firm’s value has an incentive to maximize the value of its collateral, rather than to maximize the value of the firm.

Many discussions of a secured creditor’s rights confuse the fact that a security interest is a “property” right with the fact that it is most emphatically not an ownership right in fee simple. Real property mortgage holders, holders of Article 9 security interests, loss payees on an insurance policy, consignees, and other holders of consensual liens cannot simply realize on their collateral as if they owned it. Their rights are only triggered by a default. Those rights must be exercised in compliance with the state’s rules for judicial or nonjudicial foreclosure. And, even after foreclosure, they must wait for the end of any redemption periods and jump through the appropriate state law hoops for transferring title.<sup>78</sup> These processes can be time consuming and are not calculated to, and rarely do, maximize value.<sup>79</sup> Bankruptcy law, however, allows the trustee in bankruptcy to conduct a sale in the manner best calculated to obtain full value, or if such a sale will not work to reorganize.<sup>80</sup> To the extent that this bankruptcy-created value exceeds what would have been obtainable under nonbankruptcy law, it is not by any means clear that the surplus is “owned” by the secured creditor.<sup>81</sup>

---

74. Jacoby & Janger, *supra* note 13, at 911–12, 919.

75. *Id.* at 931, 940–41.

76. *Id.* at 892–95.

77. See Mann, *supra* note 28, at 1008.

78. Jacoby & Janger, *supra* note 13, at 892–95.

79. *Id.*

80. See 11 U.S.C. § 363(b), (f) (2012).

81. This is not to say that Congress does not have the power to allocate that value to the secured creditor. However, in the absence of such an allocation, there is no *a priori* entitlement to that value.

### B. Realizable Value and Coordination Problems

The asset-by-asset nature of state law remedies may make it difficult to accomplish value-maximizing sales of collateral where the debtor is not cooperating. Loans secured by various assets may be held by diverse creditors, and loans against different types of assets may be subject to different procedures for foreclosing.<sup>82</sup> Indeed, where real estate is involved, entirely different state law processes with different deadlines may be used to effectuate an assignment of lease, as opposed to a real property mortgage.<sup>83</sup> Even when one is selling off a company's assets and ceasing operations, how one sells the company's assets may matter a lot. Two adjoining pieces of real property may be worth more sold together than separately. A building sold with everything in it, as well as all the tenants may be worth more than the same building sold empty (or vice versa).

Because state law liens are "asset-by-asset," and because each lien represents a different bundle of sticks, idiosyncratic and inconsistent rights may make it difficult or impossible to combine assets and sell them in value-maximizing packages. While asset consolidation may create a legal inconvenience, coordination of creditors with claims against particular assets may be an even bigger problem. Where assets that would best be combined for sale are held by disparate creditors, holdout problems can arise and become devilishly complicated to resolve.<sup>84</sup>

The *RadLAX* holding provides an example of how such problems arise even with a seemingly innocuous procedural right, like the right to credit bid. In *RadLAX*, the Supreme Court held that a secured party that is denied the right to credit bid is not receiving the "indubitable equivalent" of its allowed secured claim under section 1129(b)(2)(A)(iii) of the Code.<sup>85</sup> On its face, this ruling seems inconsequential. Credit bidding allows a secured creditor to pay for its purchase at a foreclosure sale by crediting the price against the outstanding loan. Thus, instead of paying cash, the purchaser need only cancel debt. This simply relieves the creditor of the need to put up money that will then be returned immediately on completion of the sale. An absolute right to credit bid, however, could cause serious inefficiencies under certain circumstances.

For example, imagine a debtor that owns three adjoining pieces of real estate, purchased with the intention to join them together to build a large shopping mall. Each plot of land was purchased separately with a distinct lender and a separate mortgage. Further, imagine that the values are as follows. Parcel A would sell at foreclosure for \$25,000 as a stand-alone piece of property. It is encumbered by a mortgage debt of \$200,000. Parcel B would similarly sell for \$30,000, and is encumbered by a mortgage of \$150,000. Parcel C would sell for \$50,000, and is unencum-

---

82. See, e.g., Korobkin, *supra* note 4, at 726–27.

83. See RESTATEMENT OF PROP., *supra* note 22, at intro.

84. Mann, *supra* note 68, at 228 n.283.

85. *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 132 S. Ct. 2065, 2072 (2012).



bered. Assume further that the three properties, if sold as an assemblage, could be sold for \$135,000. In other words, the three properties are worth more when sold together than separately. \$135,000 is more than \$105,000. The value of the assemblage is also considerably more than what any of the three creditors would stand to receive if they were to liquidate their collateral under state or separately under bankruptcy law. However, there is no practical way to allow the creditors to bid the full amount of their debt against the assemblage. The property being sold is not all their collateral. If Creditor A is allowed to bid \$200,000, it would be able to purchase all three properties when it contributed assets worth less than twenty percent of the true value.

The problem arises because bankruptcy sales under section 363(b) are different from sales under Article 9 and real estate foreclosures. Under state law, the creditor only has the power to sell its own collateral. Therefore the right to credit bid is axiomatically limited to the right to bid at a sale of the creditor's own collateral. By contrast, in bankruptcy, the trustee may liquidate any or all of the debtor's property. Some of it may be encumbered, some not. The goal is to engineer a value maximizing sale regardless of the various claims against the assets. Therefore, some of the property up for sale may be the secured party's collateral, but other property may not. The problem is that the right to credit bid is inextricably linked to whether the property being sold is subject to the creditor's lien. At state law, or in a stand-alone liquidation under Chapter 7, the value of the credit bid would be limited to the realizable value of that piece of collateral.<sup>86</sup> The additional value of the assemblage is not something that any of the individual secured creditors could capture. It can be preserved, however, by the ability that exists under Chapter 11 to merge the properties and sell them together, free and clear of liens.<sup>87</sup> A broad reading of the *RadLAX* holding, that "indubitable equivalence" to the value of collateral under section 1129 includes the right to credit bid, would have the paradoxical effect of preventing such a value-maximizing sale.<sup>88</sup> This undercuts the fundamental goal of Chapter 11. This problem is not idiosyncratic or unusual. Any time a debtor has multiple secured lenders with claims on different assets, this problem arises—for example, where a debtor has separate inventory, receivables, and equipment lenders.

To untangle the knot created by *RadLAX*, it is necessary to examine carefully the source of the right to credit bid and to take the concept of "adequate protection" seriously. The broad reading of *RadLAX*—that the secured creditor is entitled to protection of the full panoply of its state created rights—cannot be correct. The question is: what right is protected and how? In the remainder of this Section, I will analyze the

---

86. Charles J. Tabb, *Credit Bidding, Security, and the Obsolescence of Chapter 11*, 2013 U. ILL. L. REV. 103, 107.

87. 11 U.S.C. § 363(b), (f) (2012).

88. *RadLAX*, 132 S. Ct. at 2067.

source and scope of the right to credit bid, and in the next Section, I will explore the limits of its protection in bankruptcy.

Most discussions of *RadLAX* treat the right to credit bid as if it is an incident of state law—a prebankruptcy right that is preserved by the concept of “indubitable equivalence” in section 1129(b). Nothing in the Supreme Court’s opinion undercuts this assumption, but the example above shows that this cannot be the case. If all of a secured creditor’s state law rights are protected, then each secured creditor will have an effective veto on a potentially value-maximizing sale or reorganization. While a right to credit bid does exist under state law, the right to credit bid at issue in *RadLAX* is a product of federal law, contained in section 363(k) of the Code.<sup>89</sup> Unlike the seemingly absolute right to credit bid under state law, the right under section 363(k) can be limited for cause (presumably including the need to conduct a going concern sale).<sup>90</sup>

In short, while the modern rhetoric of secured creditors’ rights focuses on formal rights under state law, the Code would appear to protect the value of that right, but not necessarily its formal attributes.

### C. Adequate Protection of What?

This focus on the economic value of a lien rather than its formal incidents finds textual support in the Code’s related concepts of the “allowed secured claim,” and “adequate protection.” Under section 361, “adequate protection” protects the secured creditor to the extent that “the stay . . . , use, sale, or lease . . . , or any grant of a lien under section 364 of this title results in a decrease in the *value* of such entity’s interest in such property.”<sup>91</sup> This is the same verbal formulation as is used in section 506 and in section 1129(b)(1)(A).<sup>92</sup> It is also the baseline against which “indubitable equivalence” is measured. The question raised is, what is the relevant moment for valuing the claim? As a logical matter, the baseline for adequate protection should be measured based on what the secured creditor would get if the stay was lifted, and if the debtor was to abandon the collateral. In other words, the baseline entitlement is what the secured creditor would be able to obtain if the creditor pursued nonbankruptcy remedies.

There are, again, two ways of looking at what a creditor has under state law: formally and practically. As a formal matter, for example, the creditor has the absolute right to credit bid under state law. However, as a practical matter, this state law right to credit bid could only be exercised in a state law foreclosure. To put it another way, the formal rights under state law are only relevant to the extent that they allow a creditor to realize value under state law. The formal right to credit bid must be

---

89. 11 U.S.C. § 363(k).

90. *Id.*

91. 11 U.S.C. § 361(1) (emphasis added).

92. See 11 U.S.C. §§ 506, 1129(b)(1)(A).

balanced against what the creditor could *actually* obtain under state law processes that (1) are generally far more cumbersome than the Code, (2) preclude assembling the property in value maximizing packages, and (3) provide only the power to convey the title that the particular foreclosing creditor has the power to convey, with any title infirmities that may exist.<sup>93</sup> This is not to say that a secured creditor may not be able to obtain more in bankruptcy, or even that the statute might not allocate some bankruptcy created value to the secured creditor. It is only to say that when one considers the concept of “adequate protection,” and hence “indubitable equivalence,” one must start from the baseline of what the creditor could actually receive.<sup>94</sup>

Not only is this view of “adequate protection” rooted in the Code, it also finds support in a symmetric reading of Jackson and Baird’s “creditor’s bargain.”<sup>95</sup> As both Baird and Jackson have argued, bankruptcy is favored over state law when bankruptcy processes produce greater value for the estate as a whole than state law processes.<sup>96</sup> They argue, however, the law should not be structured to encourage one creditor constituency to file bankruptcy based on a group-specific bankruptcy priority.<sup>97</sup> The implication is that creditors’ entitlements are shaped by what they would have received under state law, but value created in and by bankruptcy processes should be shared, unless there is a good reason to reallocate it. Formal rights like credit bidding or rights to delay realization give the secured creditor the power to exercise hostage value with regard to its collateral *after* the case has been filed.<sup>98</sup>

#### D. Allocating Bankruptcy Created Value

After distinguishing the practical monetary value of a secured creditor’s collateral from the formal rights of a secured creditor under state law, it becomes possible to distinguish value that is created by procedures available only under bankruptcy law from value that is owned by the secured creditor prior to bankruptcy. As such, even when a secured creditor claims to have a blanket lien on all of a debtor’s assets, there may be value in the debtor firm that is not owned by the secured creditor.<sup>99</sup> There are assets that could not be efficiently realized under the state property law because of cumbersome remedies or assemblage problems.<sup>100</sup> There are assets that could not be reached at all under state law,

---

93. See, e.g., 735 ILCS 5/15 (2014); see also Jacoby & Janger, *supra* note 13, at 921.

94. Indeed, the right to credit bid that is discussed in *Radlax*, is not a state law right, but a right under federal law conferred by section 363(k) of the Code.

95. See generally Douglas G. Baird & Thomas H. Jackson, *Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy*, 51 U. CHI. L. REV. 97 (1984).

96. *Id.* at 126.

97. *Id.* at 100.

98. *Id.* at 117.

99. See *supra* Part I.

100. See *supra* Part II.

or whose value could only be realized in bankruptcy (such as software or government licenses).<sup>101</sup> Finally, there is going concern value that could only be realized in bankruptcy.<sup>102</sup> This going concern value inheres in *the firm*, rather than the assets themselves. However, it is a fair question to ask whether the value that the secured party should receive is the value that could be realized on sale, or the value to the debtor of the asset. The key point here is that the answer to that question does not turn on the secured party's state law rights. As a practical matter, that value is determined by the availability of substitutes, the cost of replacing the secured party's collateral, and so on. As a legal matter, allocating that value is a question of federal law under the Code.

### *E. Bankruptcy-Created Value and the Creditors' Bargain*

In *The Logic and Limits of Bankruptcy*, Jackson makes a normative argument against bankruptcy-specific priorities. Jackson argues that priorities for unsecured creditors or equity holders that exist only in bankruptcy will create an incentive for forum shopping into bankruptcy in order to favorably reallocate the debtor's value.<sup>103</sup> The realities of modern bankruptcy practice have turned Jackson's argument on its head. For a variety of reasons, secured creditors now often prefer to liquidate their assets in bankruptcy rather than relying on their state law remedies.<sup>104</sup> This preference derives from a number of the attributes of bankruptcy sales discussed above. First, there is the ability to sell the assets in value-maximizing packages.<sup>105</sup> In bankruptcy, a debtor can sell a whole division, or a group of buildings, in a way that is calculated to maximize value. Such a sale could not be compelled under state law. Second, bankruptcy law provides the ability to convey clear title through the power to sell free and clear of encumbrances under section 363(f).<sup>106</sup> This increases the value realizable by the estate and the secured party on its collateral, because the purchaser knows that she will take clear title and thus will not have to invest in dealing with junior liens and other encumbrances (some of which may be known, some of which may not be), all of which may be expensive. Third, bankruptcy law provides the ability to move quickly. Bankruptcy sales can be accomplished in a matter of days, where state

---

101. On this analysis, one might conclude that proceeds of a software license might be "collateral" for the purpose of determining what is available to satisfy the secured creditors' claim, but might not be included in the "value of the creditor's interest in the debtor's interest in the collateral" for the purpose of calculating the allowed amount of the secured creditors claim. *In re Rowland*, 166 B.R. 172, 175 (Bankr. N.D. Fla. 1994).

102. See Jacoby & Janger, *supra* note 13, at 894–95.

103. JACKSON, *supra* note 1, at 21–22.

104. See, e.g., W.D. Adkins, *Definition of Liquidation Priority*, CHRON.COM (HOUST. CHRON.), <http://smallbusiness.chron.com/definition-liquidation-priority-36955.html> (last visited Nov. 13, 2014) (describing that secured creditors get paid before all unsecured creditors in a liquidation proceeding).

105. See Jacoby & Janger, *supra* note 13, at 892–95.

106. See 11 U.S.C. § 363(f) (2012).

law judicial foreclosures can take months or even years.<sup>107</sup> These various items are all value-creating, and are acceptable reasons for a secured creditor's decision to forum shop into them.

There are, however, other aspects of bankruptcy practice that allow the secured party to capture both bankruptcy-created value and value that may not actually have been theirs to begin with. The list is quite long, but a few of these include: defensive provisions in a debtor-in-possession financing order that may allow a secured party to take control over the liquidation and allocate all of the value to itself;<sup>108</sup> compelling a quick sale to maximize the effect of an information asymmetry or uncertainty about value; the concept of proceeds may be used in bankruptcy to realize on and capture value that was not accessible to the secured creditor outside of bankruptcy; and various asset partitioning strategies such as securitization may be used to grab control over a key asset and maintain control over the case.<sup>109</sup> Here the conflict of interest between the asset value maximization strategy of the secured creditor and the firm value maximizing goals of the Code are in conflict. This second group of bankruptcy-specific powers allows the secured party to undercut the value maximizing and equality oriented policies of the Code. When secured creditors forum shop into bankruptcy to appropriate value, the logic of lien priority breaks down.

#### IV. REALIZATION AND TIMING

In this Article so far, I have sought to show that the distributional baseline for secured creditors should be determined based on the value that could actually be realized if state law compulsory remedies were exercised. The approach is to recognize that with bankruptcy law or without it, the general default of a debtor constitutes a realization event for the secured creditor with regard to its collateral. This was the logic outside of bankruptcy of default on bankruptcy clauses, *ipso facto* clauses, acceleration provisions, and so on.<sup>110</sup> Bankruptcy law both crystalizes that moment of realization and respects the rights that existed as of that moment. It then replaces the state law first-in-time regime with a collective approach that seeks to maximize value while treating similarly situated creditors (as of the petition date) in the same manner. This snapshot is effectuated in a number of ways. For unsecured creditors, interest stops

---

107. See Jacoby & Janger, *supra* note 13, at 878–80.

108. Defensive provisions in debtor-in-possession financing orders were addressed in Shapiro v. Saybrook Mfg. Co. (*In re Saybrook Mfg. Co.*), 963 F.2d 1490, 1491–92 (11th Cir. 1992) and Lyondell Chem. Co. v. Center Point Energy Gas Servs. Inc. (*In re Lyondell Chem. Co.*), 402 B.R. 571, 594–95 (Bankr. S.D.N.Y. 2009).

109. See, e.g., Lois R. Lupica, *Revised Article 9, Securitization Transactions and the Bankruptcy Dynamic*, 9 AM. BANKR. INST. L. REV. 287, 288 (2001).

110. These provisions all make an act of bankruptcy or the debtor's financial condition a default under the contract, so that the creditor need not await a payment default to exercise its remedies and participate in the race to the courthouse.

accruing.<sup>111</sup> For secured creditors, the allowed secured claim can now be calculated under section 506, and the baseline for adequate protection is established.<sup>112</sup> I have already explained why adequate protection is based on the amount recoverable on the petition date. A second underappreciated concept that establishes the distributional baseline is the concept of the equities under section 552 of the Code, and the “no moving up” rule for lien avoidance under section 551, discussed in the next Section.<sup>113</sup>

### A. *Preserving Relative Creditor Positions*

Sections 551 and 552 freeze the relative positions of creditors as of the bankruptcy petition date.<sup>114</sup> The concept is not perfectly honored, but exceptions are clearly that, exceptions. First, section 551 of the Code that preserves avoided liens for the benefit of the estate.<sup>115</sup> This freezes the relative position of secured creditors and the estate by preventing “moving up.” Second, section 552 prevents collateral expansion.<sup>116</sup> That section recognizes that if floating liens were allowed to continue to float, as the case continued, all of the property would run through the floating lien, and floating lien creditors would improve their lien positions over time.<sup>117</sup> To protect secured creditors whose collateral is sold, however, section 552 also attaches the lien to any proceeds of sale, thereby preserving the value of the lien, even if the identity of the collateral changes.<sup>118</sup>

This concept of proceeds has become one of the major pressure points for secured creditors. As noted above, the UCC allows security interests to attach to property that could not be liquidated under state law, but then if the property is sold, the UCC seeks to capture the proceeds.<sup>119</sup> In addition, as a debtor operates, cash collateral may turn into inventory, which turns into even more cash, which turns into even more inventory and other items. The result is that proceeds can expand in much the same way as floating liens. This is where the bankruptcy lawyers have failed to respond to the challenge of secured creditors. They miss the importance of the last sentence of section 552(b), that allows the judge to limit the interest in proceeds as the “equities” require.<sup>120</sup> This is a reference not just to vague concepts of equity, but also to equitable tracing rules, and the idea that the secured creditor’s position *vis a vis*

---

111. 11 U.S.C. § 502(b)(2).

112. 11 U.S.C. §§ 506, 362.

113. 11 U.S.C. §§ 551, 552(b).

114. *See* 11 U.S.C. § 362.

115. *See* 11 U.S.C. § 551.

116. *See* 11 U.S.C. § 552. For unsecured creditors, this “snapshot” approach is given effect by the disallowance of claims for unmatured interest under 11 U.S.C. § 502(b).

117. *See id.* Indeed, If floating lines continued to float, then it would likely be possible for a secured creditor to lien all of the value of a debtor.

118. *Id.*

119. *See* U.C.C. § 9-315 (2014).

120. 11 U.S.C. § 552(b).

other claimants should affix to a mass of collateral of consistent value (even if its identity changes).<sup>121</sup> This principle is implicit in the concept articulated above, that filing for bankruptcy is a realization event for the secured creditor.

As I argued above, much value created postpetition is not properly traceable to prepetition collateral. Given, however, that collateral is used postpetition, sold, commingled and otherwise shifted in form, courts have struggled to allocate a commingled mass of proceeds that, while traceable, are no longer identifiable.<sup>122</sup> If the Code held firmly to a “filing is realization of value” line, the case law would be much simpler and clearer. Valuation and lien stripping would occur as of the petition date, and the secured claim would float over the floating mass of debtor collateral in a fixed amount (with or without interest, depending on whether the creditor was over or undersecured). This is not the approach that has been taken by all courts, however. Increases in value of items of collateral during the pendency of the stay may be allocated to the secured party.<sup>123</sup> In other cases, courts have struggled to allocate proceeds and nonproceeds components to the increased value of collateral. In one case, for example a court sought to determine how much of the value of a dairy farm’s milk was allocable to the cow (collateral) and to the pasturage, labor, food, and water (noncollateral).<sup>124</sup> The court concluded that the increase in value of the milk over its inputs would be shared pro rata between the secured creditor and the estate.<sup>125</sup> By contrast, in another case, the court allocated all of the increase in value to the secured party, and reserved to the estate only the cost of the inputs.<sup>126</sup>

### B. *Exceptions that Prove the Rule*

The preservation of relative creditor position is not uniform throughout the Code. There are a number of exceptions, but those exceptions prove the rule. The largest category is the “anti-lienstripping” rule contained in sections 1325(a) and 1111(b).<sup>127</sup> The general rule is that when an undersecured creditor’s claim is allowed, it is allowed at the value of the collateral, and the deficiency is fixed as of that moment.<sup>128</sup> The anti-lienstripping rules allow the secured creditor to capture increases in

---

121. *Id.*

122. *Id.*

123. *See, e.g.,* Janet McFarland & Jeff Gray, *Pensioners Take on Nortel Bondholders Over Division of Assets*, GLOBE AND MAIL (Apr. 29, 2014, 8:19 PM), <http://www.theglobeandmail.com/report-on-business/industry-news/the-law-page/creditors-take-on-nortel-over-underfunded-pension-plan/article18331459/>.

124. *In re Delbridge*, 61 B.R. 484, 490 (Bankr. E.D. Mich. 1986).

125. *Id.* at 491.

126. *In re Gunnison Ctr. Apartments, LP*, 320 B.R. 391, 405 (Bankr. D. Colo. 2005).

127. *See* 11 U.S.C. §§ 1111(b), 1325(a).

128. 11 U.S.C. § 506(a).

collateral value that occur during the life of a plan.<sup>129</sup> A second place where the value of a secured creditor's collateral can increase is where a single piece of encumbered collateral increases in value during the life of the case.<sup>130</sup> There is no inequity where the delay works to the creditor's benefit and the particular asset was never going to be available to other creditors.

### C. Conclusions

In sum, bankruptcy practice has lost sight of the fact that: (1) liens are property rights that are limited by the scope of the nonbankruptcy regimes that create them; (2) they attach to specific assets rather than providing a generalized distributional priority; (3) while creditors may wish to liquidate their collateral in bankruptcy for efficiency-based reasons, there is no reason to encourage them to use bankruptcy in order to reallocate value; (4) for this reason, the distributional baseline for secured creditors should be measured based on what could be obtained by the secured creditor exercising his nonbankruptcy rights, as of the petition date; and (5) deviations from this principle should be expressly stated in the statute.

## V. APPLICATIONS

The extent to which bankruptcy courts have forgotten that liens are asset-specific property rights, limited in scope by their state law origins, is illustrated by a number of recent cases. In the *Buffets Holdings Case*, the secured creditor had a lien on "all assets" except for some of the leases.<sup>131</sup> The lien included general intangibles.<sup>132</sup> The secured creditors claimed a right to all postpetition goodwill.<sup>133</sup> The creditors' committee argued that goodwill did not include goodwill attributable to the leases that were not collateral. The bankruptcy court agreed, however, with the secured creditor, stating that goodwill was a "general intangible" covered by the security agreement.<sup>134</sup> Even if one concedes that the secured creditors had a lien on all of the goodwill as of the petition date, postpetition goodwill is not necessarily proceeds of prepetition goodwill, nor is an increase in goodwill necessarily attributable to the prepetition goodwill. In sum, this opinion ignores the fundamental principle of proceeds—there cannot be a security interest in proceeds unless there is a security interest in the

---

129. See 11 U.S.C. § 1322(b)(2) (cannot modify rights of holders of secured claims secured by interest in real property used as a principal residence); *id.* § 1325(a)(5).

130. *Id.* § 1325(a)(5).

131. Order Granting in Part and Denying in Part Motion of Credit Suisse, Cayman Islands Branch, to Partially Dismiss Adversary Proceeding, OCB Rest. Co., v. Vlahakis (*In re Buffets Holdings, Inc.*), 397 B.R. 725 (Bankr. D. Del. 2008) (on file with author).

132. *Id.* at 2.

133. *Id.*

134. *Id.*



original collateral. Cases like this go well beyond what a secured creditor could obtain outside of bankruptcy. Because they allow the secured creditor to leverage a security interest in prepetition assets into ownership of enterprise value, they violate the fundamental principle of bankruptcy—equality of treatment—that would preserve the relative position of creditors as of the petition date.

*Buffets* is not unusual in this regard. In *Ridgely Communications*, the court held that the value of a broadcast license to which the security interest could not attach prepetition (it was before the enactment of 9-406 and 9-408), was nonetheless proceeds, and subject to the secured creditor's prepetition lien.<sup>135</sup> By contrast, in his recent *ResCap* opinion, discussed in more detail below, Judge Glenn held that the secured creditor had failed to meet its burden of proving the value of prepetition goodwill and was not entitled to goodwill acquired postpetition that was not proceeds.<sup>136</sup>

A second type of case where secured creditors have been able to leverage fictitious state law entitlements into valuable bankruptcy distributions is in the so-called “gifting” cases—the most prominent being the *Dish Network* case.<sup>137</sup> In that case, the senior secured lender asserted a blanket lien on all of the debtor's assets, and then sought to “gift” a portion of its distribution to former equity.<sup>138</sup> The creditors objected arguing that this violated the absolute priority rule by paying shareholders without paying unsecured creditors in full.<sup>139</sup> The secured lender said that this was not a violation because it was simply choosing what to do with its own property.<sup>140</sup> The bankruptcy court agreed with the secured lender and permitted the gift.<sup>141</sup> The Second Circuit reversed, however, and treated the gift as a violation of the absolute priority rule.<sup>142</sup>

Another example of the confusion I describe arises in the credit bidding context. I have already described how the Supreme Court's decision in *RadLAX* took an overly formal view of “indubitable equivalence.”<sup>143</sup> As I explained, protecting the right to credit bid can obstruct value-maximizing sales in various ways where a single creditor does not own all of the assets being sold. In *Fisker Automotive*, the court recognized this problem, and came up with a novel solution.<sup>144</sup> The court used section 363(k) to limit the right to credit bid.<sup>145</sup> As a statutory matter, this

135. *In re Ridgely Commc'ns, Inc.*, 139 B.R. 374, 376 (Bankr. D. Md. 1992).

136. *In re Residential Capital, LLC*, 501 B.R. 549, 616 (Bankr. S.D.N.Y. 2013).

137. *Dish Network Corp. v. DBSD N. Am., Inc. (In re DBSD N. Am., Inc.)*, 634 F.3d 79 (2d Cir. 2011).

138. *Id.* at 86–88.

139. *Id.* at 85.

140. *See id.* at 97.

141. *Id.* at 87; *see also In re DBSD N. Am., Inc. (DBSD I)*, 419 B.R. 179, 221 (Bankr. S.D.N.Y. 2009).

142. *Dish Network*, 634 F.3d at 108 (remanded in part).

143. *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 132 S. Ct. 2065, 2070–73 (2012).

144. *In re Fisker Auto. Holdings, Inc.*, 510 B.R. 55, 59 (Bankr. D. Del. 2014).

145. *Id.* at 59–60; *see also* 11 U.S.C. § 363(k) (2012).

makes sense. The tricky part is figuring out how to set the value for the limit on the credit bid. The court in *Fisker* used the amount that the holder of the debt had paid for the claim.<sup>146</sup> This has been criticized as arbitrary, and it appears to fly in the face of many earlier bankruptcy decisions that allow claims buyers to assert their full claim regardless of the purchase price.<sup>147</sup> On the other hand, the price paid for the claim does reflect a market valuation of the collateral.

In a later case, *Free-Lance Star Publishing*,<sup>148</sup> the court reached a similar result but did a better job of explaining its reasons for capping the secured creditor's bid. In that case, a creditor purchased a secured claim with the clear goal of acquiring the company. They engaged in a variety of practices, repetition, aimed at increasing the scope of their lien, and then used their control over the debtor to seek an accelerated sale process that would allow them to bid the full amount of their claim, while reducing the likelihood that other bidders might appear.<sup>149</sup> In response to this inequitable behavior, the court limited the right to credit bid to the value of the collateral.<sup>150</sup> While the secured creditor was ultimately able to purchase the company at the 363 sale, they were only able to credit bid a portion of the price and had to pay cash for the rest.<sup>151</sup>

Both *Fisker* and *Free-Lance Star* focus not on the claim, but on the lien. They recognize that a secured creditor only has the right to credit bid on his own collateral. Therefore, where there is property that the creditor does not own, the right to credit bid must either be allocated to his collateral or limited to the value of his collateral. In both of these cases, the court rested its decision, at least in part, on inequitable conduct by the secured creditor,<sup>152</sup> but the problem would have existed in any event.

Finally, and most importantly, there is Judge Glenn's recent opinion in the *ResCap* case.<sup>153</sup> That case appears to capture the approach to valuation articulated in this Article, in particular the focus on realizable value. In *ResCap*, the debtor had consented to the use of cash collateral in return for postpetition liens to secure their adequate protection claims.<sup>154</sup> They did not, however, agree in advance to a baseline value of the collateral for determining the diminution during the case.<sup>155</sup> Judge Glenn held

---

146. *Fisker*, 510 B.R. at 59–61.

147. See, e.g., Nelly Almeida, *A Recent Decision in the Fisker Case Brings New Life to the Credit Bidding Debate*, WEIL BANKR. BLOG (Jan. 27, 2014), <http://business-finance-restructuring.weil.com/asset-sales/a-recent-decision-in-the-fisker-case-brings-new-life-to-the-credit-bidding-debate/>; G. Ray Warner, *Slam Dunk for Credit Bid Cap*, GT RESTRUCTURING REV. (Feb. 19, 2014), <http://www.gt-restructuringreview.com/2014/02/slam-dunk-for-credit-bid-cap/>.

148. *In re The Free Lance–Star Publ'g Co.*, 512 B.R. 798, 806–07 (Bankr. E.D. Va. 2014).

149. *Id.*

150. *Id.* at 808.

151. *Id.* at 807–08.

152. *Id.* at 806; *In re Fisker Auto. Holdings, Inc.*, 510 B.R. 55, 61 (Bankr. D. Del. 2014).

153. Official Comm. of Unsecured Creditors v. UMB Bank, N.A. (*In re Residential Capital, LLC (ResCap)*), 501 B.R. 549, 556 (Bankr. S.D.N.Y. 2013).

154. *Id.* at 571.

155. *Id.* at 572.

a trial to determine that value, making clear that the relevant question was the value of the collateral at the commencement of the case, and that the burden was on the claimant to prove diminution in value.<sup>156</sup> Judge Glenn looked to the text of the section, and considered the “value” of the creditor’s interest in the collateral.<sup>157</sup>

The creditor pointed to the second sentence of 506(a) that says that the valuation inquiry should consider the “purpose of the valuation and the proposed disposition” of the collateral.<sup>158</sup> Some of the assets were being sold as a going concern, while others were being sold piecemeal. The argument was that the focus should be on the value to the debtor, and therefore the assets being sold as a going concern should be valued at fair market value.<sup>159</sup> While Judge Glenn accepted the argument that assets sold as a going concern should be valued differently, he also focused on the fact that the relevant going concern value was the value on the petition date, including the elements of financial distress that would have depressed their value had they been sold on the petition date.<sup>160</sup> As a result, Glenn concluded that the creditor had not met its burden of showing diminution in value.<sup>161</sup>

There is a small difference between the *ResCap* approach and the approach that I have advocated in this Article. I have suggested that the distributional baseline is the amount realizable under state law compulsory remedies. Glenn focuses instead on the value realizable by the debtor by any manner of sale as of the petition date, including a going concern sale.<sup>162</sup> Arguably, this is unrealistic, in that the only way to have realized this value as of the petition date would be through a consensual sale. If such a consensual sale had been possible, bankruptcy would not have been necessary. This is a small difference, however. The approach followed by Judge Glenn does recognize the distinction between the value of the lien and bankruptcy created value, and most importantly, focuses the inquiry on the question of realizable value.

## VI. CONCLUSION

In this Article, I have sought to fill in the half of the equation left unwritten by Jackson. While Jackson focused on the proper goals of bankruptcy law and the limits of its aspirations, he did not place any limits on the rights of secured creditors in bankruptcy. Jackson’s limiting principle for bankruptcy law—every claimant should get at least as much as she would get outside of bankruptcy—also establishes a limiting prin-

---

156. *Id.* at 577–78, 590–91.

157. *Id.* at 592.

158. *Id.* (quoting 11 U.S.C. § 506(a)(1) (2012)).

159. *Id.*

160. *Id.* at 595–597.

161. *Id.* at 595.

162. *Id.* at 597.

principle for secured creditor entitlements. Secured creditors “own” what they own outside of bankruptcy. If they get more through bankruptcy, either because the statute allocates value to them, or because of bankruptcy-created value, that is a *gift*, not property they are entitled to as a matter of right. This Article seeks to establish three key points, and develop their implications. The points are (1) an ownership rule, (2) a realization rule, and (3) an equitable tracing—or “no moving up”—rule. The ownership rule is that baseline entitlements in bankruptcy are established by what could have actually been realized outside of bankruptcy. The realization rule is that, unless the statute specifies otherwise, the baseline entitlement is valued as of the petition date. The equitable tracing rule uses a rigorous application of the concept of proceeds to freeze the relative position of creditors on the date of the bankruptcy filing, and limit the ability of secured creditors to use their property-based claims to “roll up” all of the bankruptcy-created value. These three rules, if applied consistently, should encourage efficient value-maximizing governance of the debtor firm and fair allocation of bankruptcy-created value among its creditors.

