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Asset Securitization: How Remote Is Bankruptcy Remote?

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NOTE

ASSET SECURITIZATION:
HOW REMOTE IS BANKRUPTCY REMOTE?

I. INTRODUCTION

A relatively new method of corporate finance known as asset securitization1 ("securitization") has emerged as one of the major forces in the United States's financial markets.2 At its most simplistic level, securitization is the issuance of a debt instrument backed by a revenue-producing asset of the issuing company.3 In common parlance these are known as "asset-backed securities."4 Outstanding financings of these asset-backed securities have reached levels of almost two trillion dollars in the United States alone.5 As securitization represents such a significant form of financing, its effects on, and importance to, the economy as a whole should not be underestimated.6 Indeed, by the turn of the century, securitization may represent more than three quarters of all financ-

1. "The terms 'securitization,' 'asset securitization,' and 'structured finance' are used interchangeably" to refer "to a company's use of cash flows from its assets to raise funding. The term 'securitization' specifically refers to the issuance of securities backed by such cash flows." Steven L. Schwarcz, The Alchemy of Asset Securitization, 1 STAN. J.L. BUS. & FDN. 133, 133 n.1 (1994).

2. See Schwarcz, supra note 1, at 133; see also Committee on Bankruptcy, supra note 1, at 528 (suggesting that the possibilities of asset-backed financing "seem limitless"). According to the SEC, securitization is "becoming one of the dominant means of capital formation in the United States." Lynn A. Soukup, When Assets Become Securities: The ABC's of Asset Securitization, BUS. L. TODAY, Nov.-Dec. 1996, at 20.

3. See Schwarcz, supra note 1, at 135.

4. Committee on Bankruptcy, supra note 1, at 529.

5. See id. at 528.

6. See Jason H.P. Kravitt, The Nature of Securitization, in 1 SECURITIZATION OF FINANCIAL ASSETS, supra note 1, at 1-1, 1-14 ("Clearly, only the imagination and credit requirements of the parties to any securitization place limits on what one may securitize.").
Securitization enables companies to obtain needed capital and adds to the overall health of the economy. As such, in the absence of compelling considerations, the judiciary should avoid rendering decisions that have an adverse economic impact on these transactions.

The law is currently unequipped to effectively handle the myriad of legal issues that will inevitably arise as a result of the ever-increasing application of securitization methods. Since securitization is essentially a new and innovative technique, application of existing legal doctrine, not conceived with securitization in mind, is the legal equivalent of trying to put a square peg in a round hole. A superficial view of securitization reveals nothing more than a company issuing debt instruments to the public. However, a more discerning view of the manner in which securitization is accomplished reveals a twist on old concepts necessitating a new set of rules, not rules borrowed from a generation passed.

This Note continues in Part II with a general discussion of the securitization process. Part III discusses how companies benefit from securitization and concludes that it is beneficial for the economy. Part IV analyzes In re Kingston Square Associates in terms of the negative precedent it sets for the future of securitizations vis-à-vis a court applying traditional doctrines to new legal issues arising out of securitization techniques. Part V offers a preemptive strike against the application of two specific traditional legal doctrines in the context of securitization:

1. the questionable wisdom of applying standard corporate governance doctrine to corporations formed for the purpose of achieving securitization, and
2. the impropriety of utilizing the policy against prepetition

7. “By the year 2000, it is expected that 80 percent of all financings will be some form of [asset securitization].” Sheryl A. Gussert, Bankruptcy Remote Entities in Structured Financings, AM. BANKR. INST. J., Mar. 15, 1996, at 14.
8. But see Lois R. Lupica, Asset Securitization: The Unsecured Creditor’s Perspective, 76 TEX. L. REV. 595, 598 (1998) (arguing that securitization is an inefficient transaction). Professor Lupica notes that most of the literature regarding securitization implicitly assumes that securitization is an efficient transaction. See id. at 597 & n.5.

Securitization has permeated a large variety of markets such as “commercial mortgage loans, health care receivables, insurance premiums, mutual fund fees, municipal tax liens, franchise loans, aircraft leases, airline ticket receivables, [and] prescription receivables.” Soukup, supra note 2, at 20.
11. As one commentator recently noted: “[T]hese transactions are likely to be challenged. The courts have not thoroughly analyzed the risk allocation attributes of asset securitizations, but challenges to the transactions will become more likely as the device increases in popularity.” Christopher W. Frost, Asset Securitization and Corporate Risk Allocation, 72 TUL. L. REV. 101, 107 (1997).
bankruptcy waivers to deny the enforcement of corporate charter provisions designed to effectuate a securitization. Finally, the Note concludes with an assertion that the economy will ultimately be healthier if the judiciary will pause and consider that it is dealing with a financial innovation that raises its own unique set of legal issues and policy concerns which are not properly analyzed under existing doctrinal schemes.

II. HOW ASSET SECURITIZATION IS ACCOMPLISHED: THE QUEST TO BECOME BANKRUPTCY REMOTE

The main goal of a company utilizing asset securitization techniques is simple: to obtain access to low-cost capital that is otherwise unavailable through conventional means.\(^\text{12}\) The company desiring to effectuate a securitization must begin by identifying assets that generate a relatively predictable stream of payments.\(^\text{13}\) These assets are "receivables."\(^\text{14}\) The company seeking to securitize the receivables is known as the "originator."\(^\text{15}\)

One of the primary goals of securitization is to isolate the receivables from the group of assets held by the originator in the event of the originator's bankruptcy.\(^\text{16}\) In order to adequately shield the receivables from the originator's bankruptcy estate and from the reach of the originator generally, it is necessary to set up what is known as a special purpose vehicle ("SPV").\(^\text{17}\) The SPV will purchase the receivables from the originator and issue securities backed by the receivables.\(^\text{18}\) It is important that the SPV purchase the assets in what bankruptcy law refers to as a "true sale."\(^\text{19}\) That means that the assets will not become a part of the originator's bankruptcy estate should the originator become the subject of a bankruptcy proceeding.\(^\text{20}\)

\(^\text{12}\) See Jason H.P. Kravitt & Jeffrey Seifman, Identifying Legal, Accounting & Related Issues, in 1 SECURITIZATION OF FINANCIAL ASSETS, supra note 1, at 3-1, 3-9, 3-14; Schwarcz, supra note 1, at 133.
\(^\text{13}\) See Committee on Bankruptcy, supra note 1, at 532 ("In theory, any asset that provides a predictable stream of cash flow or that can be converted into a predictable amount of cash can be securitized.").
\(^\text{14}\) See Schwarcz, supra note 1, at 135.
\(^\text{15}\) See id.
\(^\text{16}\) See Committee on Bankruptcy, supra note 1, at 533.
\(^\text{17}\) See Schwarcz, supra note 1, at 1-2. For purposes of simplicity, the discussion in this section assumes that the SPV is a corporation. The SPV, however, may take a variety of different forms. In general, the basic principles are the same.
\(^\text{18}\) See id.
\(^\text{19}\) Schwarcz, supra note 1, at 135.
\(^\text{20}\) See id. A court may view an improperly executed sale as a secured loan instead of a "true sale." Essentially, a true sale occurs when the originator has completely relinquished any
Another way to shield the SPV from the originator is through the observance of all necessary formalities consistent with existing as a completely separate entity.21 This should prevent the bankruptcy court from substantively consolidating the assets and liabilities of the originator with that of the SPV,22 in much the same way that a court may pierce the corporate veil when a company acts as the alter ego of another.23

Although it is important to keep the SPV and its receivables out of the originator's bankruptcy estate, it is also necessary to implement a structure that prevents the SPV from voluntarily filing its own bankruptcy petition. To that end, SPVs have one or more "independent directors."24 The independent director, "when considering whether or not to cause the SPV to enter a bankruptcy or insolvency proceeding, will owe his or her fiduciary duties not to the shareholders, but to the [SPV] itself (including, expressly, its [investors])."25 The organizational documents of the SPV will normally require the unanimous consent of the directors in order to file a bankruptcy petition.26 With this procedural safeguard in

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21. See Thomas S. Kiriakos et al., Bankruptcy, in 1 Securitization of Financial Assets, supra note 1, at 5-1, 5-172.3 to -184; Schwaerz, supra note 1, at 136.
22. Substantive consolidation is an equitable doctrine whereby the bankruptcy court consolidates two or more separate entities for purposes of treating them as one in bankruptcy. In the context of securitization, the SPV will become, for bankruptcy purposes, indistinguishable from the originator if the court applies substantive consolidation. See Frost, supra note 11, at 111; see also SCHWARCZ, supra note 1, at 24-26; Committee on Bankruptcy, supra note 1, at 558-60 (discussing how to structure an SPV that will avoid substantive consolidation).

The court reserves substantive consolidation as an extraordinary remedy for cases where the creditors/investors did not rely on the separation of the originator and the SPV or where the two entities are so entangled that regarding them as separate is not feasible. See Kiriakos et al., supra note 21, at 5-171 to -172. Where investors in an SPV specifically relied on the separate nature of the originator and the SPV, the balance of whether to apply substantive consolidation weighs heavily in favor of the investor. See id. at 5-172. It is therefore unlikely that the court will apply substantive consolidation in this context, and following all of the structural formalities of maintaining separate identities will further reduce the likelihood that the court will employ the doctrine. See id. at 5-172 to -172.1.
23. See Committee on Bankruptcy, supra note 1, at 559 (noting that some courts discuss substantive consolidation in terms of whether an entity is acting as a "mere instrumentality" or "alter ego" of another).
24. See Kiriakos et al., supra note 21, at 5-177; Schwaerz, supra note 1, at 136.
25. Kiriakos et al., supra note 21, at 5-177.
place, the risk that a voluntary bankruptcy petition will be filed by the SPV is fleeting.

Finally, the structure of the SPV should prevent it from engaging in any activities outside of its "special purpose." The SPV's only purpose should be to hold the assets that provide the basis for its securities. It is counter to the purpose of the SPV if it can operate in such a way that it regularly creates or keeps creditors other than those holding its securities. The existence of creditors other than the SPV's investors gives rise to the possibility of an involuntary bankruptcy petition. The successful commencement of an involuntary bankruptcy case undermines a primary purpose of any securitization: the avoidance of bankruptcy.

The obvious reason for this design is that bankruptcy is often destructive to the interests of unsecured creditors such as those holding the securities issued by the SPV. Therefore, the SPV needs procedural protections against bankruptcy to maintain the desirability of its securities. As such, all of the procedures outlined above allow the SPV to achieve the status of "bankruptcy remote"—a rating company's indication of a reduced risk that the SPV will be strapped into a bankruptcy of the originator or made the debtor in its own bankruptcy proceeding. The SPV's ability to attain the status of bankruptcy remote is a cornerstone of any securitization as it allows the SPV to issue debt securities at a lower rate of interest than the originator.

III. THE BENEFITS OF ASSET SECURITIZATION

The underlying force which drives the securitization process is the desire of the originator to obtain access to low-cost capital through the issuance of debt securities by the SPV. When a company decides to is-

27. See Peter V. Darrow et al., Rating Agency Requirements, in 1 SECURITIZATION OF FINANCIAL ASSETS, supra note 1, at 7-1, 7-61.

28. See id.

29. See In re Kingston Square Assocs., 214 B.R. 713 (Bankr. S.D.N.Y. 1997) (demonstrating how an SPV can become the subject of an involuntary bankruptcy petition due to the existence of outside creditors of the SPV); see also infra Part IV (analyzing and criticizing Kingston Square).

30. See Darrow et al., supra note 27, at 7-61 to -62; Schwarcz, supra note 1, at 135-37.

31. The SPV's structure also helps protect the receivables from risks associated with the originator other than bankruptcy, but such risks are beyond the scope of this Note.

32. The following discussion concerning the benefits of asset securitization assumes that the cost of effectuating the securitization does not outweigh the benefit received. As Steven Schwarcz aptly points out:

To determine whether an originator will achieve an overall cost savings from securitization, one must assess the interest savings possible . . . against the costs of the securitization transaction. A company considering securitization should compare (i) the ex-
sue debt securities to the public, various private rating agencies rate the securities. Since there is an inverse relationship between the rating on the security and the rate of interest that the issuer will have to pay to the investor, companies naturally seek to have their securities rated as highly as possible.

Take, for example, Company X which has a large pool of fairly reliable receivables as part of its total assets but little in the way of needed capital. If Company X were to offer securities such as bonds to the public backed by any part of its pool of receivables, the rating on those securities would reflect the fact that the receivables are within the zone of danger generated by a possible bankruptcy of X. Therefore, Company X's ability to issue low-interest debt securities to the public is seriously diminished. The company may also have difficulty obtaining capital through other methods as a result of the same circumstances which cause the rating on its securities to be low in the first place. Even if the company can obtain some other form of direct capital infusion (e.g., a bank loan), the risks attendant to dealing directly with the company will result in increased costs to the company that could ultimately make the transaction economically unfeasible. This inability to obtain a cost-effective capital infusion presents a serious problem which asset securitization, in some cases, is able to solve.

Now assume Company X, currently unable to obtain needed capital, decides to create an SPV and sell the receivables to it. The SPV will obtain the cash to buy the receivables by issuing debt instruments (for purposes of this example, assume the instrument is a bond), backed by the receivables, to the public. Most importantly, the separation of the assets from the risks associated with Company X, the originator, causes the bonds to receive a higher rating which permits the SPV to issue the bonds at a lower rate of interest. It is this lower rate of interest which enables the SPV to raise more capital than the originator would have been able to with the same set of receivables.

33. Rating agencies are private organizations that assign grades to a particular class of securities based on their assessment of the overall quality of the particular security being offered. The investing public in turn relies on the grades when making investment decisions. The primary rating agencies are Moody's, Standard & Poor's, Fitch Investors, Duff & Phelps, IBCA Banking Analysis, and Thomas Bankwatch. See Lupica, supra note 8, at 607-08 n.52.

For an overview of rating agencies and their rating systems, see Darrow et al., supra note 27, at 7-1.
A simple example demonstrates the SPV’s ability to raise more capital than the originator with the same set of receivables. Assume the receivables generate $10,000,000 in revenue over the course of a single year. This is true regardless of whether the originator or the SPV utilizes them. Also assume that both the originator and the SPV will use only the revenues generated by the receivables to pay the bond holders. If the originator issues the bonds at a ten percent rate of interest, it will incur a higher cost of financing than an SPV that only has to pay interest at a rate of nine percent. As a result, the SPV will be able to support a larger debt issuance (i.e., raise more capital). This benefit funnels back to the originator in the form of a higher purchase price for the receivables. In general, Company X is unable to unilaterally transform the receivables into the amount of cash that the SPV will ultimately raise and pay to the originator as the purchase price for the receivables.

Securitization can be analogized to a concept in physics known as potential energy: When a spring is fully compressed, the energy it possesses is known as potential because it will not move unless the force holding it back is removed. As the force holding back the spring is removed, the potential energy is immediately transformed into kinetic energy. A company’s receivables also possess a similar type of potential energy. The receivables are unable to do more than produce a relatively long-term cash flow, but if the force restraining them is removed (i.e., the originator), they are convertible into an immediate cash infusion for the company. However, that “energy” remains untapped so long as the receivables are tied up in the complex environment of the originator. Securitizing the assets through the use of an SPV, where assets are supposed to be safe from bankruptcy, releases the potential energy, and the originator can harness that energy stored in the receivables. As is the case with the spring, a company must remove the forces on its receivables in order to maximize their utility.

Where a company wants to expand, a predictable stream of cash flow from its receivables may not be enough to further the desired goal. By liquidating the asset, which is the essential result of securitization, a company empowers itself to further develop its operations. Ostensibly, this creates jobs, or at least prevents their loss, and strengthens the economy. Moreover, there are instances where a company is not trying to improve upon its current good fortune, but is instead trying to prevent its own demise. In such a case, securitization may offer a distressed company the chance to continue to operate as a going concern. There is

34. See Schwarcz, supra note 1, at 136.
little dispute that a company’s ability to continue as a going concern, in the long term, maintains the overall health of the economy. In either case, securitization releases the potential energy of an asset which may otherwise languish on the company’s books and slowly produce a cash flow insufficient to meet the originator’s current needs.

IV. AN INFLUENTIAL COURT STRIKES A SWIFT BLOW AGAINST ASSET SECURITIZATION

The recently decided case of In re Kingston Square Associates, where an influential bankruptcy court held that a debtor may orchestrate an involuntary bankruptcy petition for the purpose of avoiding bankruptcy remote bylaw provisions, gave the financial world reason to pause and reconsider the integrity of its various securitization transactions. If the court that decided this case infrequently dealt with these types of transactions and was unlikely to see one again anytime soon, it is unlikely that it would have created such a stir. However, the Chief Judge of the Bankruptcy Court for the Southern District of New York, which sits in Manhattan—the world’s financial center—decided this case. Consequently, this case has raised more than a few eyebrows. Although the case arises in the context of a “mortgage-backed securitization,” the issues raised and the holding of the court apply in most, if not all, securitizations.

Kingston Square involved a securitization technique known as a mortgage-backed securitization. Conceptually, this is the same basic transaction described in Parts II and III: a company issuing debt instruments backed by a reliable and predictable receivable. In mortgage-backed securitizations, a mortgage on real estate secures the stream of payments. The transaction in Kingston Square raises issues common to most mortgage-backed securitizations, which represent billions of dollars worth of securitizations. It is for precisely these reasons that the Kingston Square holding is so troubling.

The significant parties in Kingston Square included two trustees, eleven debtors (all eleven debtors were controlled by the same person, the “principal”), and seven creditors who each filed an involuntary

35. A company’s ability to continue operating as a going concern is one of the primary policy justifications for the existence of Chapter 11 of the Bankruptcy Code. Securitization, in some cases, achieves the same result, thus avoiding bankruptcy altogether.
37. Id. at 714.
38. See Committee on Bankruptcy, supra note 1, at 528.
bankruptcy petition against the debtors. The trustees represented investors who were the beneficiaries of mortgage pass-through certificates issued by the debtors in a securitization transaction. The mortgage certificates were similar to debentures in that they entitled the beneficiaries to a stream of future payments. For the purpose of securing the approximately $277,000,000 the trustees spent purchasing the pass-through certificates, they took a mortgage on various properties owned by the debtors. As part of the securitization, the debtors inserted “bankruptcy remote” provisions in their bylaws. The provisions required a unanimous vote of the directors in order to file a voluntary bankruptcy petition. In conjunction with the unanimity requirement, the provisions also called for an independent director whose purpose was, in part, to prevent the required unanimous agreement for the filing of a voluntary bankruptcy petition, thereby making the likelihood of a filing virtually nonexistent.

As the result of a default on the pass-through certificates, the trustees instituted foreclosure proceedings on all of the properties securing the certificates. The only way that the debtors were able to halt the foreclosures was through the filing of a bankruptcy petition and availing themselves of the protections of the Bankruptcy Code’s automatic stay. Due to the bankruptcy remote provisions in the bylaws, the principal had to consider methods other than a voluntary petition to get each of the debtors into bankruptcy. In spite of the fact that the parties to the transaction specifically structured the securitization to avoid bankruptcy and did so at the behest of the principal, the principal gathered a group of “friendly” creditors for the purpose of orchestrating an involuntary petition against each of the debtors whom he controlled.

The trustees moved for a dismissal pursuant to section 1112(b) of the Bankruptcy Code, arguing that each of the involuntary petitions was the result of collusion and therefore filed in bad faith. They argued

40. See id. at 716. A mortgage pass-through certificate gives the beneficiary the right to the proceeds (or a portion thereof) from the payments made on the mortgage. See SCHWARZ, supra note 1, at 45 & n.101.
41. See Kingston Square, 214 B.R. at 716.
42. See id.
43. See id.
44. See id. at 716-17.
45. See id. at 723-24.
46. See id. at 717-18.
48. See Kingston Square, 214 B.R. at 723.
that the principal "initiated, funded and identified seven friendly creditors to prosecute the involuntary petitions so each debtor could obtain improper leverage against the trustees by gaining access to the bankruptcy court without violating the bankruptcy restrictions in the bylaws of the various debtors."\textsuperscript{50} On the other hand, the petitioning creditors, in union with the debtors, claimed that seeking bankruptcy protection was their only means to

(i) preserve any chance of recovery on their claims ... before the trustees foreclosed on the assets of each debtor, (ii) challenge the validity of the trustees' claims, and (iii) find a third party to fund a plan of reorganization or purchase the properties, which would result in a greater recovery to all parties than would be obtained from the pending foreclosures.\textsuperscript{51}

These arguments made by the petitioners appear to have some merit on their face but should be viewed in light of the following: The seven creditors the principal assembled for the purpose of this orchestration consisted of two trade creditors and five professional organizations (such as law firms and a consulting firm) whose overall debt was not significant enough to cause them, on their own, to file an involuntary petition prior to the solicitation by the principal.\textsuperscript{52} In addition, the principal paid a law firm to do the work, and several of the creditors were only willing to join in the filing of the involuntary petitions on the condition that the principal would handle all legal fees and administrative matters.\textsuperscript{53} One of the creditors had already written off the debt as "uncollectible,"\textsuperscript{54} and only one of the creditors had taken any action beyond sending invoices to enforce its legal rights prior to the filing.\textsuperscript{55} Moreover, the assertion with respect to a greater recovery for all creditors excluded the largest body of creditors, the investors represented by the trustees, who had approximately $277,000,000 at stake. Finally, as the court noted: "Since these cases commenced, the Petitioning Creditors have exhibited no interest in what has been transpiring. And, of the seven individual creditors comprising the Petitioning Creditors, at least

\textsuperscript{50} Kingston Square, 214 B.R. at 723.
\textsuperscript{51} Id.
\textsuperscript{52} See id. at 718-19, 726.
\textsuperscript{53} See id. at 726 ("Those Petitioning Creditors who testified universally agreed that the absence of any responsibility for fees was a precondition to their joining the group.").
\textsuperscript{54} Id.
\textsuperscript{55} See id.
three had no knowledge of who was footing the bill for the legal expenses."56

On this set of facts, the court correctly noted that "[a]t first blush, these cases seem ripe for dismissal."57 However, that statement is the closest the court came to acknowledging the questionable tactics employed by the principal. Aside from the fact that the case appeared "ripe" for dismissal, the court noted that "within the boundaries of well-settled principles, a bankruptcy judge has wide discretion to determine if cause exists and how ultimately to dispose of the case."58 Although that observation is true and would seemingly help to facilitate a just result, the court's opinion did not analyze the forces underlying this type of transaction, nor did it consider how ill-suited the case may be for adjudication based on "well-settled principles." Under this approach, the court's ensuing analysis tried to solve a new problem with old solutions and reached what many will argue is an erroneous decision, a model of form over substance.

The standard in the Second Circuit (the circuit where Kingston Square arose) for dismissing a petition based on bad faith requires an inquiry into both the "objective futility of the reorganization process and [whether there was] subjective bad faith in filing the petition."59 The trustees, however, believed that a recent decision from the Second Circuit Court of Appeals, Federal Deposit Insurance Corp. v. Cortez,60 was dispositive with regard to the involuntary petitions filed in Kingston Square.61 The Cortez court held that a bankruptcy petition may be dismissed when the court determines that the filing was "collusive"62 because it is a "fraud upon the jurisdiction of the Bankruptcy Court."63

56. Id. at 726 (footnote omitted).
   During the eleven week period from early September to mid-November (when the last involuntary was filed), [the law firm for the petitioning creditors] met with [the principal] on ten separate occasions and conducted at least 49 telephone calls with either [the principal] or his assistant. During that same period, [the law firm] conducted only 12 telephone calls with the Petitioning Creditors and met only once with [one of them].
   Id. at 727.
57. Id. at 724.
58. Id.
59. Id. at 725 (emphasis omitted); see also Baker v. Latham Sparrowbush Assocs. (In re Cohoes Indus. Terminal, Inc.), 931 F.2d 222, 227 (2d Cir. 1991); In re RCM Global Long Term Capital Appreciation Fund, Ltd., 200 B.R. 514, 520 (Bankr. S.D.N.Y. 1996).
60. 96 F.3d 50 (2d Cir. 1996).
61. See Kingston Square, 214 B.R. at 723.
62. Cortez, 96 F.3d at 51.
63. Kingston Square, 214 B.R. at 723. The trustees also relied on two other cases, Cornwall Press, Inc. v. Ray Long & Richard R. Smith, Inc., 75 F.2d 276 (2d Cir. 1935), and Blumenthal v. Strat (In re Cohn), 227 F. 843 (3d Cir. 1915). These cases arose under the Bankruptcy Act of
Noting that earlier cases failed to identify what is required for collusion and that the Second Circuit and other jurisdictions have adopted the definition contained in Black's Law Dictionary, the court used the definition contained therein: "‘a secret combination, conspiracy, or concert of action between two or more persons for a fraudulent or deceitful purpose.’" 94

The trustees argued that it was not necessary to meet the two-prong bad faith test where collusion can be shown because of the ruling in Cortez.65 Specifically, they argued that Cortez obviates the need to inquire into the objective futility of the reorganization process because collusion, for the purpose of invoking the jurisdiction of the bankruptcy court, is itself bad faith and is enough to permit outright dismissal of the petitions. Since the trustees took the position that Cortez was controlling, they did not present any evidence to establish the objective futility of the reorganization process, and the case instead turned on whether the petitions were filed collusively.66

The court reviewed the case Cortez relied upon67 and considered an additional case not discussed in Cortez nor raised by the parties68 and concluded that "[i]n each of [those] cases, a debtor attempted to bypass a statutory or court-imposed restriction on filing a new bankruptcy case by arranging the filings of involuntary cases with friendly creditors." 69 Since the court viewed the specific facts of those cases as defining the outer limits of where a court may find collusion, the court declined to "extrapolate" a rule from those cases which would require dismissal un-


1898. They held that an order of adjudication based on an involuntary petition would not issue where access to the bankruptcy court was obtained through the debtor's admission that he could not pay his bills when it could be proven that the admission was the result of "fraud and collusion between the debtor and certain creditors, or in aid of a collusive scheme." Cornwall Press, 75 F.2d at 276-77 (citing Blumenthal, 227 F. at 845). The basic underpinning of these cases is that the "bankruptcy court is a court of equity [and] it will not participate in fraud and 'may refuse to...grant an adjudication...where to do so would be a fraud...upon the act.'" Kingston Square, 214 B.R. at 732 (quoting Cornwall Press, 75 F.2d at 277).

64. Kingston Square, 214 B.R. at 725 (quoting BLACK'S LAW DICTIONARY 264 (6th ed. 1990)).
65. See id.
66. See id. at 723, 725.

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der the Kingston Square facts.

The primary difference between those cases and Kingston Square is that the petitioner in Kingston Square were acting in concert with the debtor's principal for the purpose of circumventing the bankruptcy remote provisions of the corporate bylaws, and the Cortez cases deal with the circumvention of statutes or court-imposed orders. Although the corporate bylaws obviously do not carry the same legal authority as a court order or a statute, it would not be a major extension of Cortez or other similar cases for the court to say that where a debtor orchestrates an involuntary petition with its creditors for the purpose of avoiding the bankruptcy remote provisions of the corporate bylaws, the bankruptcy court will not sanction such activity by permitting invocation of its jurisdiction.

The Kingston court acknowledged that debtor orchestration of involuntary petitions is indicative of bad faith, but it held that orchestration standing alone is not enough for a bad faith dismissal based on collusion.70 As previously discussed, collusion requires concert of action and a fraudulent or deceitful purpose.71 According to the court, the orchestration of the petitions in this case satisfies the concert of action element of the test for collusion.72 However, since the concert of action was not for the purpose of avoiding a previous court order or in contravention of a statute, the court was unwilling to find the necessary fraudulent or deceitful purpose.73 The court interpreted "fraudulent or deceitful purpose" to mean "wrongful purpose."74 If a debtor-induced involuntary petition, aimed at circumventing the bankruptcy remote provisions agreed upon at the initiation of the transaction, is not "wrongful," what is it?

The court stated that the "[trustees] ask [it] to extrapolate a rule from [Cortez and similar cases] that a debtor-induced filing per se leads to a finding of bad faith, which in turn constitutes cause for dismiss[al]."75 What is not clear is why the court saw this as an all-or-nothing proposition. A per se rule was not necessary to adequately address the concerns of the trustees or those similarly situated. A rule which would prevent a principal (or a debtor), such as the one in Kingston Square, from orchestrating an involuntary bankruptcy filing where

70. See id. at 734.
71. See supra text accompanying note 64.
72. See Kingston Square, 214 B.R. at 734.
73. See id. at 733-34.
74. Id. at 725.
75. Id. at 733.
he could not have otherwise filed one directly would have been sufficient. For example, the holding could have been as follows: "Where a debtor or anyone acting on behalf of the debtor seeks to avoid the bankruptcy remote provisions of a corporate structure by orchestrating or causing another to orchestrate an involuntary bankruptcy petition, such petition shall be dismissed." This would have addressed the problem and protected the integrity of securitization transactions without creating a per se rule regarding all debtor-induced filings.

The court declined to extend Cortez but did not adequately explain why, other than to distinguish the Cortez principle on the facts. That is easy enough to do since the securitization issues are novel. The harder task would have been to determine how best to craft a rule that addresses the problem without creating a "per se rule." The court never adequately addressed the underlying concerns in this case and mechanically went through the facts of the case law to show how the cases did not factually support the trustees' argument. In an effort to avoid a per se rule, the court effectively adopted an alternative one: Unless the involuntary petition results from collusion and is aimed at avoiding a statutory mandate or a court order, the court will not dismiss the case for bad faith. Since dismissal is an equitable remedy demanding flexibility regarding the facts of each case, the per se rule adopted by the court is no better than the one it purported to avoid.\footnote{76}

76. The court also placed significance on two cases, In re Spanish Cay Co., 161 B.R. 715 (Bankr. S.D. Fla. 1993), and Management Technologies, Inc. v. Morris, 961 F. Supp. 640 (S.D.N.Y. 1997), where the court in each case permitted an insider (such as the principal in Kingston Square) to take unusual measures to place an entity into bankruptcy in the face of an unwillingness or an inability on the part of the management of the entity to take the necessary steps to seek bankruptcy relief where such relief was considered appropriate. See Kingston Square, 214 B.R. at 729-31. In Spanish Cay, insiders of a corporation filed involuntary petitions when the corporation's venture faltered. See Spanish Cay, 161 B.R. at 722-23. This case supported the proposition that absent a specific prohibition in the organizational documents or a statute, a party connected with the debtor may seek to have an involuntary petition filed if it is necessary to save the corporation. See Kingston Square, 214 B.R. at 729-30. In Management Technologies, the chief executive officer of a corporation, pursuant to his powers, adopted new articles of association (the English equivalent of a certificate of incorporation) wherein he gave himself the power to take the necessary steps to place entities under his control into administration (the English equivalent of Chapter 11 under the Bankruptcy Code). See Management Techs., 961 F. Supp. at 643-45. The court discussed this case in support of the proposition that "action taken by an insider without board or shareholder authority may later be found to have been appropriate in circumstances where the existence of the corporation is very much at risk." Kingston Square, 214 B.R. at 731.

Neither of these cases, however, arose in the context of securitization. As such, they are missing an important element that would make them useful in this context—the existence of agreed upon bankruptcy remote provisions. The court regarded these cases as factually similar to the problem faced by the principal in Kingston Square in that he was subject to the bankruptcy remote provisions of the debtors he controlled and therefore blocked from having a bankruptcy
The ability to dismiss a case is an equitable power possessed by the bankruptcy court and is appropriate whenever the particular facts of the case call for such relief. The court seemed to focus narrowly on the specific facts of the case law for the purpose of determining whether there should be a dismissal in this instance. However, there are many reasons to dismiss a petition beyond the scenario discussed by the court. Section 1112(b) of the Bankruptcy Code makes it clear that the determination of whether to dismiss is one properly left in the hands of the bankruptcy court. It only offers a small list of scenarios where dismissal is appropriate, but the language leaves the possibilities wide open: "[O]n request of a party in interest . . . the court may . . . dismiss a case under this chapter . . . for cause . . . ." The Code does not define "cause" for all purposes, thereby making it clear that there is no pre-determined set of parameters. The court's analysis does not seem to follow from its observation that "[d]etermining whether a petition has been filed in good faith is difficult because the very term itself, 'good faith,' is an amorphous notion that is largely defined by factual inquiry. . . . It is the totality of circumstances, rather than any single factor, that will determine whether good faith exists." That being the case, it is unclear why the court gave only minimal significance to the underlying elements of this transaction, namely, the bankruptcy remote provisions and the action of others that the provisions were designed to protect the investors from.

In the context of securitization, it is difficult to think of many scenarios that could serve as a better model for collusion than the Kingston Square facts, even though they do not fit neatly into any existing case law. The Kingston transactions were specifically structured to avoid petition filed through normal channels. See id.

The fundamental difference between Kingston Square and these cases is that in Kingston Square, the impediment to filing bankruptcy was an agreed upon mechanism (agreed upon by the insider) used for the purpose of consummating a transaction that would in all likelihood never have occurred without the impediment in place. The court did not consider this fact in its comparison of these cases to Kingston Square. It merely considered the operation of the bankruptcy remote provisions as analogous to a situation where a board of directors in a typical corporation is unable to reach a consensus on whether or not to file bankruptcy. Absent bankruptcy remote provisions, these are simply not the same situations.

78. See id. ¶ 2.15[3] n.15 (listing different types of cases dismissed for bad faith filings).
79. 11 U.S.C. § 1112(b) (1994). The statute also offers a non-exhaustive list of what may constitute "for cause."
81. But see infra notes 87-89 and accompanying text.
bankruptcy, and courts should not allow debtors to utilize what is essentially a creditor’s protective tool, an involuntary petition, for the purpose of achieving what the debtor could not legitimately achieve on its own.

The Kingston court stated in dicta that “[t]he [trustees] may feel bruised because the [principal] outmaneuvered what the [trustees] thought was an iron-clad provision in the corporate by-laws preventing a bankruptcy filing, but this does not mean that, without more, the petitions must be dismissed.” The court’s statement that the trustees were “outmaneuvered” was occasioned by the court’s decision which allowed the outmaneuvering. Indeed, the decision indirectly sanctions a patently unfair method of avoiding the terms of an agreement relied upon by investors in making a decision to invest approximately $277,000,000. This case would have made much more sense if the creditors had taken this action out of their own interest in protecting their claims, but as the court points out, “[s]ince these cases commenced, the [petitioning creditors] ... exhibited no interest in what ha[d] been transpiring.”

A complete prohibition on the ability of creditors to file an involuntary petition in the context of securitization is not necessary, but debtor-induced involuntary petitions in this context are a clear example of petitions that courts should dismiss for bad faith. Essentially, the debtors invoked the bankruptcy court’s jurisdiction for the sole purpose of halting the foreclosure proceedings, the investor’s last line of defense. The principal agreed to structure the transaction to avoid bankruptcy, but when it became advantageous to seek bankruptcy protection, he orchestrated a series of involuntary petitions to the detriment of the investors. Therefore, this is not a case of an honest debtor in need of a fresh start through the protection of the bankruptcy laws. These orchestrated petitions were “ripe” for dismissal.

A review of the case law on dismissals reveals cases which strongly suggest that the petitions should have been dismissed. The case law suggests that the Kingston Square court’s mechanistic application of the existing case law was not necessary in light of the highly discretionary nature of the bankruptcy judge’s power to dismiss. Although the court recognized its own discretionary power, it chose to analyze the facts under existing law that it deemed factually distinguishable and did not adequately address the forces underlying the transaction which made the petitions worthy of dismissal. This approach belies the court’s

82. Kingston Square, 214 B.R. at 736.
83. Id. at 726.
recognition of its own wide discretion as well as the role of the bankruptcy judge in protecting the court from invocation of its jurisdiction by someone other than an honest debtor in need of a fresh start.  

The discretionary nature of the courts in this area is clear. For example, the bankruptcy court in the Eastern District of New York stated:

The precise perimeters of "cause" [for dismissal] are intentionally omitted from the [Code] so as to afford maximum flexibility and, among other things, to enable a bankruptcy court to dismiss a Chapter 11 case for any reason cognizable to the equity power and conscience of the court as constituting an abuse of the bankruptcy reorganization process.

Other courts have also clearly stated that bankruptcy judges have wide discretion in the application of their powers of dismissal. It makes sense, therefore, that there can be no all-purpose test for determining whether a particular filing is in bad faith and therefore requires dismissal. Certainly it is desirable to be able to look to existing case law for guidance, but expectations of finding the answers in existing case law, without also factoring in the forces underlying securitization, are misplaced. The *Kingston Square* court’s steadfast reliance on easily distinguishable case law does not utilize the discretionary powers of the bankruptcy judge. If, however, the answers can be found within existing case law not dealing with securitization, at least one other case appears relevant.

The Southern District of New York, which is where *Kingston Square* arose, in the case of *Carteret Savings Bank v. Nastasi-White, Inc. (In re East-West Associates)* identified a list of factors which "would support a dismissal for lack of a good faith filing," and they are

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84. Certainly not every debtor fits this paradigm of the honest debtor in need of a fresh start. It may be difficult to adequately define who that debtor is, but it seems that the facts of *Kingston Square* offer at least one scenario where there is no such debtor.


86. *See, e.g.*, Trident Assocs. Ltd. Partnership v. Metro. Life Ins. Co. (*In re Trident Assocs. Ltd. Partnership*), 52 F.3d 127, 131 (6th Cir. 1995) (suggesting that a bankruptcy court should exercise its discretion based on the peculiar facts present in each case); Industrial Ins. Servs., Inc. v. Zick (*In re Zick*), 931 F.2d 1124, 1129 (6th Cir. 1991) ("Dismissal based on lack of good faith must be undertaken on an *ad hoc* basis."); *In re Bingham*, 68 B.R. 933, 935 (Bankr. M.D. Pa. 1987) ("The facts required to mandate dismissal based upon a lack of good faith are as varied as the number of cases."). The *Kingston Square* court also recognized this when it said that "a bankruptcy judge has wide discretion to determine if cause exists and how ultimately to dispose of [a] case." *Kingston Square*, 214 B.R. at 724.


88. *Id.* at 771.
virtually identical to the facts in Kingston Square. The factors are as follows:

(1) the debtor has only one asset, the property; (2) the debtor has few unsecured creditors whose claims are small in relation to the claims of the secured creditors; (3) the debtor has few employees; (4) the property is the subject of a foreclosure action as a result of arrearages on the debt; (5) the timing of the debtor's filing evidences an intent to delay or frustrate the legitimate efforts of the debtor's secured creditors to enforce their rights.  

Applying the facts of Kingston Square to these guidelines reveals an unmistakable match. Yet, the Kingston Square court did not address this case in any meaningful way. It is unclear why that is, considering the similarity between the factors identified and the facts of Kingston Square. The Kingston Square court, had it utilized these factors, may not have reached a different conclusion, but the absence of even a brief discussion of those factors in the court's analysis is an omission that is difficult to explain.

The bankruptcy court in In re Cohen took a commonsense approach and dismissed the case, stating that "the facts do not show that the Debtor is a poor, unfortunate, debtor in need of a 'fresh start.'" The same could easily be said for the debtors in Kingston Square.

The message from the Kingston Square court is clear: There is no reason to labor over the bankruptcy remote provisions in a corporation's bylaws because they are easily circumvented. All that is necessary for an issuer of asset-backed securities seeking to avoid the agreed upon bankruptcy remote provisions is a supply of "friendly" creditors. Therefore, be certain that there are unpaid lawyers' or accountants' bills sufficient to provide an available avenue for avoiding the bankruptcy remote provisions. The Bankruptcy Court of the Southern District of

89. Id. at 771-72; see also In re 801 South Wells St. Ltd. Partnership, 192 B.R. 718 (Bankr. N.D. Ill. 1996) (dealing with a similar fact scenario and relying on similar considerations).
91. Id. at 955.
92. It should be clear that it is crucial to ensure that the SPV avoid the existence of creditors other than the SPV investors. Naturally, it will usually be necessary that some creditors are created, but they should be paid as quickly as is reasonably possible. Additionally, it would be prudent for investors' counsel to set up mechanisms whereby the investors will have either the option to satisfy the debts of any existing creditors attempting to place the SPV in bankruptcy or that the SPV will be required to satisfy the debts of the unpaid creditors. Some protections in this regard may include: (1) requirements of adequate capitalization of the SPV such that creditors do not remain unpaid; (2) requirements for accounting of the payment of creditors; and (3) making failure to pay creditors an event of default on the SPV debt instruments which entitles the investors to pay
New York has made it clear that issuers of asset-backed securities are not required to honor the agreed upon structure of their bankruptcy remote transactions. In light of the court’s unwillingness to fashion a new rule of law or modify an existing one for this innovative financial transaction, can investors reasonably believe that bankruptcy remote actually means bankruptcy remote?\footnote{Perhaps cases such as \textit{Kingston Square} will continue to appear and ultimately cause the rating agencies to reduce the ratings on bonds issued by “bankruptcy remote” entities. If that happens and the average cost of such financing increases significantly as a result, one may expect Congress to become involved by offering more protection to companies attempting to employ securitization methods. Indeed, the significant economic interests at stake assure that continued hostility towards asset securitization will be met with an equal and opposing force.}

\section{V. Potential Problems Involving the Future Application of Traditional Doctrines to Asset Securitization}

This Note has addressed the issue of applying an older doctrinal scheme to securitization in a specific factual setting. In so doing, it attempted to demonstrate how the court in \textit{Kingston Square} reached a poor result by not factoring in the unique nature of securitization, which necessarily requires a fresh analysis. This section discusses additional problems which have not actually arisen as of this writing, but are likely to confront courts in the future. In the same way that the \textit{Kingston Square} facts required more meaningful consideration of the underlying transaction in order to reach the right result, so too will the following issues when they are before the courts.

\subsection{A. The Application of Standard Corporate Governance Law to the SPV’s Bankruptcy Remote Provisions}

Almost any law applying to the governance of a corporation has, at its roots, the concept that corporations are formed for the purpose of maximizing wealth for their shareholders. Laws requiring that directors of a corporation execute their duties with the utmost consideration for the well-being of the shareholders of the corporation have no place in an analysis involving an SPV.\footnote{Although an SPV may take many forms other than a corporation, this discussion assumes that the SPV is in the form of a corporation.} It is tempting to analyze the fiduciary duties of an SPV’s directors under traditional corporate governance principles because on the surface the SPV appears no different than any other corporation. Nothing could be further from the truth however. The only parallel between a typical corporation and a corporation that is the creditors and subsequently charge the SPV for the incurred expenses.
created for the purpose of acting as an SPV is that they are both corporations in terms of their formal structure. The similarities stop there.

Substantively, the SPV's structure aims at protecting those who invest in the securities. The purpose of the SPV should never be held out as wealth maximization for the shareholders. This is most obvious when the sole shareholder of the SPV is the originator, which frequently is the case. Protecting investors is the SPV's purpose. When the corporate form is utilized for the SPV, the parties to the transaction insert bankruptcy remote provisions in either the charter or the bylaws, or both. Typical provisions require unanimous consent of all of the directors, where at least one of the directors is independent. The independent director of the SPV is beholden (either explicitly or implicitly) to the creditors, not the shareholders. This design blocks the voluntary bankruptcy petition. This procedural roadblock is one of the primary conditions that enables the debt instruments to receive high ratings which entice investors to invest their money at a low rate of interest.

It seems likely that the bankruptcy remote provisions applying to directors will eventually face challenges in courts by SPV shareholders who determine that it is in their best interest to file a bankruptcy petition. For example, a petition may be filed without the consent of the independent director and then challenged for lacking the director's consent. Another way in which this issue could come before the courts is through a shareholder suit against an independent director for breach of fiduciary duty based on a refusal to sign a petition when it is in the best interest of the corporation, but not the SPV's creditors, to seek protection of the bankruptcy laws. There are two ways in which a shareholder suit of this nature could arise. The first is when the shareholder posing the challenge is the originator. In that case, it should be entirely clear that the originator is trying to have it both ways. On the one hand, the

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95. When the shareholder of the SPV is also the originator, technically the purpose of the SPV is to maximize the wealth of the shareholder. However, in the context of the SPV, the corporation is formed as a protection to the investor, and the fact that a shareholder-originator is benefiting from the SPV's existence is secondary.

96. The design also prevents fiduciary suits by shareholders against the directors for favoring bondholders.

97. See supra Parts II-III.


For a discussion of the tension between the creditors and the shareholders of a corporation, see Steven L. Schwarz, Rethinking a Corporation's Obligations to Creditors, 17 CARDOZO L. REV. 647 (1996). Schwarz suggests that Credit Lyonnais raises more questions regarding a director's duty to creditors than it answers. See id. at 650.
SPV’s bankruptcy remote provisions enable the originator to obtain low-cost financing. On the other hand, the originator seeks to invalidate the provisions that provided the benefit at the expense of the investors who relied on it. “Since the originator, as well as its share transferees, are cognizant of the unanimity and other charter provisions, and benefit from the financing made possible by them, they should be estopped from attacking the provision later.” The other case is when there are third-party shareholders. Although the answer does not seem as clear in the case of a third-party shareholder, courts should also hold them to have acted with some degree of knowledge of their decision to own part of an SPV. It would be no less unfair to allow third-party shareholders to enjoy benefits of the deal when the economics are beneficial to them as shareholders and then allow them to challenge the provisions which made their investment as shareholders possible in the first place.

Again, a successful challenge to these provisions would ultimately place the burden of the downside on the investors who relied on the provisions as a criteria to make their investment decision. In sophisticated business environments, parties presumably enter into a transaction with an understanding of its nature. If that assumption holds true, there is no reason to cling to principles of corporate governance that were instituted long before the practice of securitization was an issue.

Although there may be cases where a particular shareholder or group of shareholders would benefit from entering bankruptcy, courts should not elevate the typical corporate form over the substance of the transaction and therefore should not find that the bankruptcy remote provisions are invalid under a theory of public policy relating to fiduciary duties of directors of a corporation. After all, investors, who have agreed to receive a low rate of return on their investment, are the ones who will have to bear the burden. Courts should impute some degree of knowledge to shareholders of SPVs so that they are unable to challenge a practice upon which most securitizations rely. Faced with this issue, courts should be loathe to announce a rule like that in *Kingston Square*, which looks to other rules of law for an answer to the unique issues raised by securitization.


100. Of course this would not happen repeatedly because investors would eventually become aware of this problem and capital would naturally be diverted from the SPVs, preventing companies from utilizing securitization to raise capital.
B. Application of the Public Policy Against Prepetition Bankruptcy Waivers

Another means by which courts may seek to invalidate otherwise valid bankruptcy remote provisions is by falling back on the public policy against bankruptcy waivers. The most important issue in that regard is that the bankruptcy remote provisions do not amount to a waiver of the right to ever being placed in bankruptcy. Bankruptcy remote provisions serve merely as an internal structure implemented in order to prevent the SPV from filing a voluntary bankruptcy petition. There is little question that courts would hold an outright waiver of the ability to enter into bankruptcy as violative of public policy. The SPV’s bankruptcy remote provisions are specifically designed to avoid treading in those public policy waters.

Professor Marshall Tracht refers to structures designed to avoid bankruptcy without actually waiving the right to enter it as “bankruptcy avoidance techniques.” He notes that practitioners have become quite adept at structuring financing so as to avoid offending the law’s general hostility to waivers of the right to seek the protections of the bankruptcy laws. He argues that these techniques help skirt the real issue—the desire to make the SPV ineligible for bankruptcy. Professor Tracht would go so far as to allow waivers of eligibility for bankruptcy in many business contexts, an approach that would solve many of the issues addressed in this Note.

Even if the courts or legislators are unwilling to allow such waivers, they should not find that the bankruptcy remote provisions violate the public policy against prepetition waivers. Clearly, the bankruptcy remote provisions of the SPV would not prevent a creditor from filing an involuntary petition out of a desire to protect its financial interest. Nor would they prevent a voluntary bankruptcy filing if the directors deemed it to be in the best interest of the SPV. The purpose of the provisions is not to prevent a voluntary petition under all circumstances; instead they seek to prevent the SPV from filing bankruptcy solely to further the interests of the originator without regard to its own financial

101. Tracht, supra note 26, at 302.
102. See id.
103. See id. at 309-10.
104. He argues that courts fail to clearly identify the public policy at stake or how waivers in this limited context would violate it. If the policy against bankruptcy waivers grows out of the concept of providing the debtor with a fresh start, Professor Tracht believes that such reasoning is inapplicable in most business scenarios. See id. at 306-09.
105. See Kiriakos et al., supra note 21, at 5-178 to -179.
condition or the interests of its investors.\textsuperscript{106} If the directors, including the independent director(s), of the SPV determine that the best interests of the SPV require filing a voluntary bankruptcy petition, there is no reason to suggest that such a petition would be improper. Moreover, the SPV’s investors will lack grounds to challenge the filing of the voluntary petition so long as the decision by the board, including the independent director(s), is the result of sound business judgment.\textsuperscript{107} In short, the SPV still can become the subject of a bankruptcy filing, either voluntary or involuntary.

Consequently, the public policy against waivers of the right to enter bankruptcy should not manifest itself when courts are analyzing the validity of bankruptcy remote provisions. There is concern that the courts’ loyal adherence to the public policy\textsuperscript{108} will cause judges to find these provisions impermissible in that they are the closest thing to a waiver of bankruptcy eligibility. The provisions may come closer to the line than anything else (by design), but they do not cross it.

This section highlights only some of the problems that seem likely to arise. To see that the issues discussed in this section are probable securitization issues, consider the fact that the debtors in \textit{Kingston Square} challenged the bankruptcy remote provisions by asserting that they were void as against public policy.\textsuperscript{109} The court, however, never reached that issue. Nonetheless, the issue remains viable and will likely reappear. There are also certain to be other issues that will result from this twist on the standard corporate form. Consequently, courts must remain cognizant that “[securitization] in all its forms is a significant business phenomenon raising numerous legal issues that lie outside the present grasp

\begin{itemize}
\item \textsuperscript{106} See id. at 5-177 to -178.
\item \textsuperscript{107} See id. at 5-178 to -179.
\item \textsuperscript{108} Professor Tracht suggests that courts have accepted “almost as a matter of faith” that there can never be a waiver of the right to enter bankruptcy. Tracht, supra note 26, at 305. Some courts have apparently elevated this public policy to a constitutional level, a notion that Professor Tracht finds “patently incorrect.” Id.
\item He makes a compelling argument for permitting businesses to waive their right to enter bankruptcy. If allowed, it certainly would simplify most of the bankruptcy avoidance related problems that can arise from the implementation of securitization methods. Essentially, in order for companies to receive high ratings on their debt issuances, they would have to waive their right to enter bankruptcy or create an entity that could do so. This would be a much more cost effective and considerably less complex method of avoiding the risks of bankruptcy. Professor Tracht’s article is not only an strong argument for permitting the waivers in a limited context, it is also a good source for demonstrating why the “faith” the judiciary has placed in the policy against bankruptcy waivers will likely prevent the adoption of what is a commonsense business approach to securitization and other bankruptcy avoidance techniques.
\item \textsuperscript{109} See \textit{In re} Kingston Square Assoc., 214 B.R. 713, 737 (Bankr. S.D.N.Y. 1997).
\end{itemize}
VI. CONCLUSION

Asset securitization allows companies to improve upon their existing good fortune, or in some cases, it allows them to rebound from distressed financial times by tapping their receivables as a source of capital. By separating the risks of the originator from the revenue-producing asset, companies are able to compete for investors seeking long-term, low-risk investments. The problems addressed in this Note vary from a case recently before a bankruptcy court to problems that are likely to serve as flashpoints for the future of securitization. In future cases, it is imperative that the courts act prudently as they venture into the relatively new arena of securitization. The economy will suffer if they act with the same disregard for the transactional dynamics as did the Kingston Square court. The goal of maintaining or improving upon the health of businesses in America is one that will engender little controversy. As courts consider the issues arising from securitization, they must consider the underlying forces of the transaction, the importance of such transactions to the economy, and not just fine points of law.

Michael J. Cohn*

110. DeMott, supra note 9, at 1336.

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