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Laura B. Bartell
Wayne State University, l.bartell@wayne.edu

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THE LEASE OF MONEY IN BANKRUPTCY: TIME FOR CONSISTENCY?

Laura B. Bartell*

Money answereth all things
– Ecclesiastes 10:19

Bankruptcy is about money—the allocation of the limited resources of the bankrupt estate to the claims against the estate made by prepetition creditors. But in the case of one class of creditors, the lenders, not only is the claim against the estate one for money, but the commodity involved in the original prepetition transaction is also money.¹

¹ “Money” is defined narrowly in the Uniform Commercial Code (U.C.C.) as “a medium of exchange authorized or adopted by a domestic or foreign government . . . .” U.C.C. § 1-201(24) (1995) (except as otherwise indicated, all references herein to the U.C.C. will be to the 1995 Official Text, which does not reflect the proposed revisions approved by the National Conference of Commissioners on Uniform State Laws in July, 1998). This view of money as legal tender has its critics, who see money in a more functional role as the purpose of payments. To the extent physical currency is replaced by bank credits, money transfers become a system of novation of bank liabilities, which represent a contract right to a judgment for money. See Joseph H. Sommer, Where is a Bank Account?, 57 Md. L. Rev. 1, 7, 11-12 (1998).

Although I tend to lean toward what Mr. Sommer would characterize as “currency fundamentalism” (i.e., the belief that a claim to “real” money underlies the intangible bank money with which most commercial transactions are made), see id. at 12, in this Article, I use the term in its narrow sense. When appropriate, I discuss how a more functional definition...
The Bankruptcy Code\(^2\) has apparently accepted as an article of faith that the nature of this prepetition commodity justifies treatment of the relationship between lender and debtor in a way that differs from that afforded any other creditor who provides a commodity to the lender for a set period, receives interim payments in respect thereof, and expects to receive that commodity back at the end of the term (i.e., a lessor). This Article begins by looking at the differing statutory treatment of personal property leases and money leases (more commonly known as loans) under the Bankruptcy Code. The great disparity between the provisions applicable to the two types of lending transactions can be traced, I argue, to the state law linkage between physical possession of currency and ownership of the value represented thereby.

Having found the modern source of the distinction, I then examine potential justifications for the differing treatment, ranging from history to the demands of a mercantile economy dependent on the free transferability of a medium of exchange. I conclude that none of these purported justifications warrant treating a lending transaction involving money in such a dramatically different fashion from a lending transaction involving other personal property.

After looking at how a lending transaction would be characterized if the common law linkage between possession of funds and ownership were severed, I look at how such a recharacterized transaction—a true lease of money—would be treated in a bankruptcy case. Finally, I propose that this approach, which treats all personal property lessors uniformly, better balances the competing goals of bankruptcy—equitable treatment of creditors and rehabilitation for debtors—than the current vestigial bifurcation between lessors of money and those of other personal property.

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I. STATUTORY TREATMENT

A. Personal Property Leases

The statutory provisions dealing with leases are some of the Code's most elaborate. When a petition for protection is filed under the Code, an "estate" is created, which comprises of, among other things, "all legal or equitable interests of the debtor in property as of the commencement of the case." If the debtor is a lessee under an unexpired lease, the interest of the debtor in the underlying property subject to the lease is limited to a leasehold interest, that is, the right to possession and use of the property for the lease term, subject to the terms of the lease. Courts have consistently recognized that leasehold interests are included in the bankrupt estate.

The lessor (like all other "entities") is subject to the automatic stay described in § 362. A lessor is precluded from, among other things, commencing or continuing any action or proceeding against the debtor, enforcing any judgment, or acting to obtain possession of property from the estate (including the leased property) without obtaining relief from the stay. The lessor may seek relief from the

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4 If the lease is one of nonresidential real property and has terminated at the conclusion of its stated term prior to the commencement of the bankruptcy case, the Code explicitly excludes it from the scope of property of the estate. See id. § 541(b)(2). However, even in the absence of an explicit exclusion, if a lease has expired, as a result of which the debtor/lessee no longer has a leasehold interest cognizable as a matter of state property law, there is no "legal or equitable interest[]" of the debtor to include in the estate under § 541(a)(1).
5 Cf. U.C.C. § 2A-103(1)(n) (defining "lessee" as "a person who acquires the right to possession and use of goods under a lease"). A "lease" means "a transfer of the right to possession and use of goods for a term in return for consideration, but a sale, including a sale on approval or a sale or return, or retention or creation of a security interest is not a lease." Id. § 2A-103(1)(j). "Leasehold interest" is defined as "the interest of the... lessee under a lease contract." Id. § 2A-103(1)(m).
stay under § 362(d), but will be successful only if the debtor cannot adequately protect the lessor's interest in the leased property or if the debtor has no equity in the leasehold interest and the property is not necessary to an effective reorganization.

Generally, as discussed infra, the bankruptcy trustee (or debtor-in-possession exercising the powers of the trustee under § 1107(a)) is given the right under § 365 to assume or reject any unexpired lease of the debtor, subject to certain limitations and exceptions. Until a decision is made with respect to assumption or rejection, the trustee may continue to use the leased property in the ordinary course of business, subject to the right of the lessor to request that such use be conditioned on the provision of adequate protection of the lessor's interest in the property. Adequate protection may take

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8 For property of the estate that is not single asset real estate, § 362(d) provides two bases for lifting the stay. The first is "for cause, including the lack of adequate protection of an interest in property" of the party seeking relief. 11 U.S.C. § 362(d)(1). The second requires the moving party to demonstrate that "(A) the debtor does not have an equity in such property; and (B) such property is not necessary to an effective reorganization." Id. § 362(d)(2).


10 See 11 U.S.C. § 363(c)(1) (1994) (permitting use of "property of the estate in the ordinary course of business without notice or a hearing" unless the court orders otherwise).

11 See id. § 363(e). Section 363(e) provides:

Notwithstanding any other provision of this section, at any time, on request of an entity that has an interest in property used, sold, or leased, or proposed to be used, sold, or leased, by the trustee, the court, with or without a hearing, shall prohibit or condition such use, sale, or lease as is necessary to provide adequate protection of such interest. This subsection also applies to property that is subject to any unexpired lease of personal property. . . .

the form of a one-time cash payment, periodic cash payments, or any other relief that will result in the realization by the lessor of "the indubitable equivalent" of its interest in the property.12

Until the debtor makes its decision on assumption or rejection, the lease presumably remains enforceable against the lessee.13 Thus, the lessor must continue to provide the leased property to the debtor and must provide any additional services or supplies specified in the lease, but the lessor cannot take any action to enforce the lessee's obligations against the debtor.14

Certain lessors are provided statutory protection against prolonged periods of limbo while the debtor reaches a decision on assumption. Pursuant to § 365(d)(1), a trustee in a case under chapter 7 of the Code must generally assume or reject an unexpired lease of residential real property or personal property of a debtor within sixty days after the order for relief or the lease is deemed rejected.15 The same rule applies to unexpired leases of nonresidential real property under which the debtor is the lessee in

12 11 U.S.C. § 361; see also, e.g., Wyatt, 173 B.R. at 703 (monthly lease payments and adequate insurance); In re Pavco Enters., Inc., 172 B.R. 114, 118-19 (Bankr. M.D. Fla. 1994) (curing arrearages and making monthly rent payments); In re Borbidge, 66 B.R. 998, 1004 (Bankr. E.D. Pa. 1986) (payment of all postpetition rent); Nexus Communications, 55 B.R. at 599 (payment of monthly rent); Dabney, 45 B.R. at 314 (compliance with provisions of lease); A.L.S., 3 B.R. at 109 (payment of all rent and charges and security deposit of three months rent).

13 In NLRB v. Bildisco & Bildisco, the Supreme Court, dealing with a collective bargaining agreement which the NLRB sought to enforce against the debtor in possession, stated emphatically that "from the filing of a petition in bankruptcy until formal acceptance, the collective-bargaining agreement is not an enforceable contract." 465 U.S. 513, 532 (1984) This conclusion was mandated by the need to provide a debtor adequate breathing space to ascertain whether assumption or rejection of the contract under § 365 was in its best interests. However, even if the contract is unenforceable against the debtor, there is nothing in the Code that purports to relieve the nondebtor of its legal obligations. See Douglas W. Bordewieck, The Postpetition, Pre-Rejection, Pre-Assumption Status of an Executory Contract, 59 AM. BANKR. L.J. 197, 200 (1985).

14 When a nondebtor lessor provides supplies or services prior to assumption or rejection of an unexpired lease, the lessor is entitled to compensation pursuant to the lease terms. See 11 U.S.C. § 365(b)(4). In all other cases, the nondebtor party to an executory contract or lease during the limbo period between filing and assumption or rejection is entitled only to an administrative expense priority under § 503(a) at the end of the case for the reasonable value of the benefits conferred on the estate during the case. See Bildisco, 465 U.S. at 531.

15 The bankruptcy judge may grant additional time "for cause." See 11 U.S.C. § 365(d)(1); see also, e.g., In re Telemark Management Co., 51 B.R. 623 (Bankr. W.D. Wis. 1984).
a case under any chapter of the Code. By contrast, the trustee is given until the confirmation of a plan in any case under chapter 9, 11, 12, or 13 to assume or reject any unexpired lease of residential real property or of personal property of the debtor. Even in those cases, however, the lessor may move for a court order providing a shorter specified period in which the trustee must act.

For leases of nonresidential real property, the trustee must timely perform all obligations of the debtor until assumption or rejection. The trustee must also timely perform all obligations of the debtor under leases of personal property (other than consumer leases) arising from and after sixty days after the order for relief in a chapter 11 case until the lease is assumed or rejected, unless the court orders otherwise based on the equities of the case.

Section 365 provides the trustee three explicit options with respect to an unexpired lease: assumption, assumption and assignment, or rejection. In order to assume such a lease, the trustee must meet three conditions set forth in § 365(b). First, the

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17 See 11 U.S.C. § 365(d)(2); see also, e.g., General American Transp. Corp. v. Martin (In re Mid Region Petroleum, Inc.), 1 F.3d 1130, 1132 (10th Cir. 1993). The Supreme Court has explained this distinction as reflecting "the considered judgment of Congress that a debtor-in-possession seeking to reorganize should be granted more latitude in deciding whether to reject a contract than should a trustee in liquidation." Bildisco, 465 U.S. at 529.

18 See 11 U.S.C. § 365(d)(2) (providing that "the court, on the request of any party to such . . . lease, may order the trustee to determine within a specified period of time whether to assume or reject such . . . lease"). In these circumstances, the court is not likely to shorten the period for decision-making absent a showing of hardship to the lessor outweighing the risks to the estate of an improvident decision. See, e.g., In re Dunes Casino Hotel, 63 B.R. 939, 949 (D.N.J. 1986); Sumitomo Trust & Banking Co. v. Holly's, Inc. (In re Holly's, Inc.), 140 B.R. 643, 682 (Bankr. W.D. Mich. 1992); In re Monroe Well Serv., Inc., 83 B.R. 317, 323 (Bankr. E.D. Pa. 1988) (denying motion to shorten period); cf. Theatre Holding Corp. v. Mauro, 681 F.2d 102, 106 (2d Cir. 1982) (suggesting that the bankruptcy court abused discretion by shortening the period to assume or reject the lease to 30 days, but affirming the decision because debtor had shown no evidence of developing a plan during the following year).

19 See 11 U.S.C. § 365(d)(3). There is no comparable provision applicable to unexpired leases of personal property or other executory contracts.

20 See id. § 365(d)(10).

21 See id. § 365(a) (providing that "the trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor"). If the trustee assumes the lease in accordance with § 365(a), the trustee is then empowered to assign such lease pursuant to § 365(f)(2).
trustee must cure, or provide "adequate assurance" that the trustee will promptly cure, any default in the lease. Second, the trustee must compensate, or provide adequate assurance that the trustee will promptly compensate, any nondebtor party to such lease for any actual pecuniary loss attributable to such default. Third, the trustee must provide adequate assurance of future performance under such lease.

If the trustee meets the requirements for assumption, elects to assume, and the court approves that election, the estate becomes a

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22 The concept of "adequate assurance" is borrowed from Article 2 – Sales of the U.C.C. With respect to a contract of sale, when reasonable grounds for insecurity arise with respect to the performance of one party, the other party may demand in writing "adequate assurance of due performance" and may suspend his or her own performance until receiving such assurance. U.C.C. § 2-609(1) (1995). The concept of "adequate assurance" was intended to be determined "according to commercial standards" rather than legal norms. See id. § 2-609(2) & cmt.3; see also, e.g., In re Luce Indus., Inc., 14 B.R. 529 (S.D.N.Y. 1981); In re Alipat, Inc., 36 B.R. 274 (Bankr. E.D. Mo. 1984); Allied Technology, Inc. v. R.B. Brunemann & Sons, Inc., 25 B.R. 484 (Bankr. S.D. Ohio 1982).

23 Courts differ widely in their opinions on how long the debtor may take to cure a default without running afoul of the statutory requirement that such cure be made "promptly." Compare In re R/P Int’l Techs., Inc., 57 B.R. 869 (Bankr. S.D. Ohio 1985) (60 months is not "promptly") with In re R.H. Neil, Inc., 58 B.R. 969 (Bankr. S.D.N.Y. 1986) (three months is "promptly").

24 Certain defaults are excepted from the cure requirement. Under the Code, the debtor need not cure a default relating to:

(A) the insolvency or financial condition of the debtor at any time before the closing of the case;

(B) the commencement of a case under this title;

(C) the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement;

(D) the satisfaction of any penalty rate or provision relating to a default arising from any failure by the debtor to perform nonmonetary obligations under the executory contract or unexpired lease.


27 Although the Code recognizes the possibility of deemed rejection without court
party to the lease to the same extent as the debtor was a party prior to bankruptcy. The lease thereby becomes enforceable against the estate, and the obligations of the estate (both prepetition obligations assumed by the trustee and postpetition obligations incurred directly by the estate) are transformed into administrative expenses entitled to first priority under § 507(a)(1).28

If the estate does not wish to shoulder the liability associated with an unexpired lease, but instead wishes to realize the value inherent in its provisions, the trustee may assume the lease29 and then assign the lease to a third party who is willing to take on the obligations thereunder.30 The assignee must provide adequate assurance of future performance of the lease, even if there has been no default on the lease.31 Upon any assignment, the trustee and the estate are relieved from any liability for any breach of the lease occurring after the assignment.32

When neither assumption nor assumption and assignment are beneficial to the estate, the trustee may opt to reject the unexpired

approval merely by trustee inaction prior to the date by which a decision with respect to assumption must be made, see id. § 365(d)(1), (4), § 365(a) does not permit an implicit assumption of an executory contract or unexpired lease, even when the trustee knowingly performs the contract during the case and accepts the benefits thereof, or stipulates to his intent to assume, see, e.g., In re Fuzzy Thurston's Eau Claire Left Guard, Inc., 33 B.R. 579 (Bankr. W.D. Wis. 1983); In re Kelly Lyn Franchise Co., 26 B.R. 441, 444 (Bankr. M.D. Tenn. 1983).


See 11 U.S.C. § 365(f)(2)(A) (providing that the assumption of the lease in accordance with the other provisions of § 365 is a prerequisite to valid assignment).

See id. § 365(f)(1). Moreover, the Code renders unenforceable contractual provisions that preclude assignment. Section 365(f)(1) provides:

Except as provided in subsection (c) of this section [dealing with nonassumable and nonassignable contracts and leases], notwithstanding a provision in an executory contract or unexpired lease of the debtor, or in applicable law, that prohibits, restricts, or conditions the assignment of such contract or lease, the trustee may assign such contract or lease under paragraph (2) of this subsection;

Id. § 365(f)(1).

See id. § 365(f)(2)(B). If the assignee is replacing the debtor as lessee under the lease, such assurance may take the form of a deposit or other security for performance of future obligations under the lease. See id. § 365(f).

See id. § 365(k).
lease, or in certain cases may be deemed to have made such an
election.\footnote{See id. § 365(g)(1). In a chapter 7 case, if the trustee does not assume or reject an unexpired lease of residential real property or of personal property of the debtor within 60 days after the order for relief (or within such additional time as the court provides), the lease is deemed rejected. See id. § 365(d)(1). In a case under any chapter, if the debtor is a lessee of nonresidential real property and the trustee does not assume or reject the unexpired lease within 60 days after the order for relief (or within such additional time as the court fixes), such lease is deemed rejected. See id. § 365(d)(4).} Some consequences of rejection are clear: § 365(g)(1) provides that such rejection of an unexpired lease which has not previously been assumed constitutes a "breach" of the lease immediately before the date of the filing of the petition.\footnote{If the rejected lease had previously been assumed, the breach is deemed to occur at the time of the rejection (so long as the case had not previously been converted to a chapter 7 case), meaning that the damages occasioned by the breach will be entitled to administrative expense priority. See id. § 365(g)(2).} The claim arising from such breach is treated as is any other claim arising prior to the filing of the bankruptcy petition; that is, it is considered a prepetition claim subject to discharge.\footnote{See id. § 502(g).} If the claim results from termination of a lease of real property, there are statutory limits imposed on the amount of an allowable claim.\footnote{See id. § 502(b)(6) (providing for disallowance of a rejection claim in respect of a lease of real property to the extent that it exceeds the sum of the rent payable for the greater of one year or 15% of the remaining term of the lease, but not to exceed three years, plus unpaid rent).} Less clear, however, is what happens to the leased property once the lease has been rejected. If the debtor is the lessor of real property, the Code gives the nondebtor lessee a right to terminate a rejected lease (if rejection creates a breach that would entitle the lessee to terminate the lease under nonbankruptcy law) or, alternatively, to retain its rights under the lease that are "appurtenant to the real property" for the balance of the lease term.\footnote{See id. § 365(h)(1)(A).} Thus, possession of leased real property may remain unaffected by a lessor's rejection of the lease. Congress has adopted comparable provisions in § 365 to (1) protect the rights of nondebtor timeshare interest purchasers when a debtor who is a timeshare interest seller rejects a timeshare interest under a timeshare plan;\footnote{See id. § 365(h)(1)(A).} (2) protect the interests of purchasers in possession of real property under a rejected executory contract for
the sale of real property, or of a timeshare interest by the debtor; and (3) protect licensees of rights to intellectual property from the debtor under a rejected executory contract of license. No statutory guidance is provided with respect to personal property subject to an unexpired lease on which the debtor is the lessor; thus, the impact of rejection on possession of that property is unclear.

On the other hand, if the debtor is a lessee of nonresidential real property and the unexpired lease is deemed rejected by the failure of the trustee to assume or reject it on a timely basis, the trustee is directed to "immediately surrender such nonresidential real property to the lessor." Although the Code does not so provide, courts have assumed that immediate surrender of the property must occur whenever the debtor-lessee rejects an unexpired lease of nonresidential real property, even if the rejection is completely volitional. The Code gives no mandate to lessees of property other than nonresidential real property. However, because the statutory obligation of the trustee to perform the lease obligations pending the decision on assumption or rejection terminates when the decision is made, Congress must

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9 See id. § 365(i)(1).
10 See id. § 365(n)(1).
13 See id. § 365(d)(4).
15 Under the Code, the trustee must "timely perform all the obligations of the debtor . . . under any unexpired lease of nonresidential real property, until such lease is assumed or rejected." 11 U.S.C. § 365(d)(3) (emphasis added). Similarly, the trustee must "timely perform all of
have assumed that rejection of the lease would result in immediate surrender of the leased property, thereby terminating any administrative expense liability for rent.\textsuperscript{46}

To summarize, if the debtor is the lessee of personal property under an unexpired lease, then pursuant to § 365 the trustee may make one of three elections. First, the trustee may elect to assume the lease, thereby making the estate liable under the lease and retaining the benefit of the property for the lease term. Second, the trustee may elect to assume the lease and assign it to another, thereby capturing the economic benefit of the lease without incurring the long-term liability associated therewith. Finally, the trustee may elect to reject the lease, thereby creating a breach of the lease, which is treated as a prepetition claim, and relinquish the property to the lessor.

B. Leases of Money

When the contractual arrangement between debtor and nondebtor involves the lending of money rather than another type of personal property, the Code treats the relationship very differently. First, as discussed in Part II of this Article, the Code does not view the money provided by a lender to a borrower as "belonging" to the lender. Therefore, the lender may not seek adequate protection of its interest in the money by reason of the debtor’s continued use or disposition of the money as could the owner of other personal property.\textsuperscript{47} Moreover, the continued use of

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\textsuperscript{46} Indeed, in many cases of rejection, the debtor/lessee has already vacated the premises prior to making the motion, and the court may allow retroactive rejection at least to the date the debtor files its motion in order to avoid administrative expense priority for increased rents owed by the debtor between the date the motion is filed and the date the court approves the rejection. \textit{See, e.g., In re Amber's Stores, Inc.}, 193 B.R. 819 (Bankr. N.D. Tex. 1996); \textit{In re Joseph C. Spiess Co.}, 145 B.R. 597, 606 (Bankr. N.D. Ill. 1992).

\textsuperscript{47} Section 363(e) of the Code reads as follows:

\textit{Notwithstanding any other provision of this section, at any time, on request of an entity that has an interest in property used, sold, or leased, or proposed to be used, sold, or leased, by the trustee, the court, with or without a hearing, shall prohibit or condition such use, sale, or lease as is necessary to provide adequate protection of such interest. This subsection also applies to property that is subject to any unexpired lease of personal property (to the exclusion of such property being...}
that money during a bankruptcy case does not give rise to an administrative expense claim, as does use of other personal property belonging to a creditor, nor does the debtor have to comply with the terms of the loan contract until it is assumed or rejected.

Second, a contract "to make a loan, or extend other debt financing or financial accommodations, to or for the benefit of the debtor" is not subject to assumption or assignment. With respect to such contracts, the only choice left to the debtor is to reject. Therefore, the debtor is unable to reap the financial benefits inherent in such a contract, even with the consent of the lender.

subject to an order to grant relief from the stay under section 362).

The final sentence of § 363(e) was added by Congress as part of the Bankruptcy Reform Act of 1994. See Pub. L. No. 103-394, 108 Stat. 4106 (1994). At the same time Congress added § 365(d)(10), which requires the debtor/lessee to begin timely performance of all obligations (including payment of rents) under a personal property lease (other than one of consumer goods to a consumer) within 60 days after the order for relief in a chapter 11 case. See supra note 45. The new sentence in § 363(e) provides a remedy to a lessor who does not receive such payment even if the lessor cannot show that use of the leased property benefited the estate, which is the requirement necessary to establish an administrative expense claim under § 503(b)(1)(A). See generally In re Ernst Home Ctr., Inc., 209 B.R. 955, 965 (Bankr. W.D. Wash. 1997); In re Elder-Beerman Stores Corp., 201 B.R. 759, 762-63 (Bankr. S.D. Ohio 1996).


Cf. 11 U.S.C. § 365(d)(10) (requiring the trustee to timely perform all of the obligations of the debtor arising from and after 60 days after the order for relief in a chapter 11 case under an unexpired lease of nonconsumer personal property until the lease is assumed or rejected).

See id. § 365(c)(2). Congress apparently believed that a nondebtor should not be compelled to lend money to a debtor, even if loans incurred during the case would be entitled to administrative expense priority. See H.R. REP. NO. 95-595, at 348 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6304 ("The purpose of this subsection ... is to prevent the trustee from requiring new advances of money or other property."). These financial accommodations were distinguished from "ordinary leases or contracts to provide goods or services with payments to be made over time." 124 Cong. Rec. H 11089 (Sept. 28, 1978), reprinted in 1978 U.S.C.C.A.N. 5963, 6447 (statement of Rep. Edwards); see also In re Placid Oil Co., 72 B.R. 135, 139 (Bankr. N.D. Tex. 1987). Instead, Congress provided a statutory mechanism for the incurrence of credit after the filing of a petition, either in the ordinary course of business or otherwise. See 11 U.S.C. § 364.

See Transamerica Commercial Fin. Corp. v. Citibank, N.A. (In re Sun Runner Marine,
and is precluded from substituting for itself as borrower under the unexpired lease (loan agreement) a more creditworthy customer who would be willing to pay the debtor to receive money from the lender on the terms provided therein.

However, upon rejection of such a contract, the debtor is not expected to return the underlying property (the money) previously lent. Instead, the rejection is deemed a prepetition breach of the contract under § 365(g), and the lender is given a claim for damages occasioned by the breach under § 502(g), which will be equal to the value of the property retained, that is, the principal amount of the loan, plus the unpaid rental for such property (interest) for the period before the filing of the petition. Unlike postpetition rent (which is an administrative expense claim with respect to leased personal property), postpetition interest is not even an allowable claim unless the claim is secured and the property securing the claim has a value greater than the amount of the claim.\textsuperscript{52} Therefore, the lender of money, unlike the lender of other personal property, often receives no compensation for use of the underlying property during the bankruptcy case, and instead of getting back his property to redeploy with another party, receives a claim against the bankrupt estate that will likely result in his receiving a small percentage of the value of the property lent.\textsuperscript{53}

\textsuperscript{52} See 11 U.S.C. §§ 506(b) (allowing postpetition interest, fees, costs and charges provided for under the agreement to the oversecured creditor), 502(b)(2) (disallowing other claims for unmatured interest).

\textsuperscript{53} See, e.g., Steven L. Schwarcz, The Easy Case for the Priority of Secured Claims in Bankruptcy, 47 DUKE L.J. 425, 455 & n.130 ("perhaps 5 to 20 cents on the dollar"); Lucian Arye Bebchuk & Jesse M. Fried, The Uneasy Case for the Priority of Secured Claims in Bankruptcy, 105 YALE L.J. 857, 862 & n.18 (1996) ("only a few cents on the dollar"); Lynn M. LoPucki & William C. Whitford, Bargaining Over Equity's Share in the Bankruptcy Reorganization of Large, Publicly Held Companies, 139 U. PA. L. REV. 125, 142 (1990) (showing recoveries of 0.5% to 81.6% among 30 large publicly-traded companies that were insolvent and filed for bankruptcy after October 1, 1979 and had plans confirmed by March 31, 1988).
II. STATE LAW AND THE TREATMENT OF MONEY TRANSFERS

A. The Significance of State Law—Property of the Estate

When a debtor becomes the subject of a bankruptcy case, either by a voluntary filing or by the commencement of an involuntary case, an "estate" is created, which includes, among other things, "all legal or equitable interests of the debtor in property as of the commencement of the case." Whether something constitutes "property" within the meaning of the Code is a matter of federal law. However, the Supreme Court has noted, "[p]roperty interests are created and defined by state law. Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding." Therefore, the determination of whether the debtor has a "legal or equitable interest" in the federally-defined property is a matter of state law.

54 The filing of a petition under the applicable chapter of the Code by an eligible debtor initiates a voluntary bankruptcy case. See 11 U.S.C. § 301.

55 See id. § 303 (contemplating involuntary cases only under chapters 7 and 11 of the Code, and only against certain types of eligible debtors).

56 See id. § 541 (a) (l).

57 See, e.g., Board of Trade v. Johnson, 264 U.S. 1, 10-11 (1924) (finding that the debtor's seat on the Chicago Board of Trade constituted 'property' in bankruptcy, even if it was not 'property' under Illinois law). Congress intended the term to be read broadly. Section 541 "includes all kinds of property, including tangible or intangible property, causes of action, and all other forms of property currently specified in Section 70a of the Bankruptcy Act." H.R. REP. NO. 595, at 367 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6323. Section 70a of the Bankruptcy Act vested in the trustee title to the following:

(1) documents relating to [the debtor's] property; (2) interests in patents, patent rights, copyrights, and trade-marks, and in applications therefore . . . ; (3) powers which [the debtor] might have exercised solely for some other person; (4) property transferred by [the debtor] in fraud of his creditors; (5) property, including rights of action, which prior to the filing of the petition [the debtor] could by any means have transferred or which might have been levied upon and sold under judicial process against him, or otherwise seized, impounded or sequestered . . . ; (6) rights of action arising upon contracts, or usury, or the unlawful taking or detention of or injury to [the debtor's] property; (7) contingent remainders, executory devises and limitations, rights of entry for condition broken, rights or possibilities of reverted, and like interests in real property . . . ; and (8) property held by an assignee for the benefit of creditors appointed under an assignment which constituted an act of bankruptcy . . .


Without question, money (cash, currency, funds in hand) constitutes "property" within the meaning of the Code. When there is a unity of possession and ownership of money in the debtor, the inclusion of the funds in the estate is self-evident. Bankruptcy courts have been troubled, however, when ownership of money has allegedly been separated from possession thereof.

For example, if the debtor physically holds funds that are claimed by another, courts have looked to § 541(d) and tried to interpret whether under state law a party other than the debtor has an "equitable interest" in the funds so held. Conversely, if a party...
other than the debtor holds funds to which the debtor makes a claim, the court must decide whether, under state law, the debtor's rights to those funds rise to the level of an equitable interest. Most of these cases turn on whether state law would find an express escrow, express or constructive trust, or agency relationship allowing the court to conclude that the possessor of funds did not possess the funds in its own capacity but instead acted as possessor for the benefit of another, thereby creating a unity of ownership and possession once again.

These questions are difficult in bankruptcy only because of the way state law treats title to money, for only money, which under state law in some sense belongs to the debtor, will become part of the connection with real estate transaction); In re Summit Airlines, Inc., 94 B.R. 367, 370-371 (Bankr. E.D. Pa. 1988), aff'd, 102 B.R. 32 (E.D. Pa. 1989) (funds deposited in escrow for proposed purchase of aircraft from debtor).

See, e.g., Denczyk, 126 F.3d at 827 (a refundable commitment fee paid to a lender); Sherman, 52 F.3d at 550-51 (commissions earned by debtor but retained by employer pending resolution of law suit brought by third party); First Indemnity Ins. Co. v. Modular Structures, Inc. (In re Modular Structures, Inc.), 27 F.3d 72, 76-77 (3d Cir. 1994) (funds retained by project owner until performance completed by debtor/contractor); In re Braniff Int'l Airlines, Inc., 164 B.R. 820, 825-27 (Bankr. E.D.N.Y. 1994), aff'd, 101 F.3d 686 (2d Cir. 1996) (unpublished) (uneearned prepaid premiums and refunds owed bankrupt airline); O'Neil v. Shipman (In re Pratt & Whitney Co., Inc.), 143 B.R. 19, 22-23 (Bankr. D. Conn. 1992) (funds transferred by debtor to attorney to be held in escrow for defense of claims against debtor's officers, directors, employees, and agents); Weissing v. Gerring (In re G & R Builders, Inc.), 123 B.R. 654, 658-59 (Bankr. M.D. Fla. 1990) (funds withheld by owners from final payment to contractor/debtor to satisfy subcontractor claims).


Compare Kitchen, 229 B.R. at 705 (finding debtor to be mere agent), and Almar Communications, 205 B.R. at 542-44 (finding genuine issue of fact as to whether debtor was agent), with Foothill Capital, 113 F.3d at 1099, and Pan Am. World Airways, Inc. v. Shulman Transport Enters., Inc. (In re Shulman Transport Enters., Inc.), 744 F.2d 293, 295-96 (2d Cir. 1984) (finding no agency relationship).
bankrupt estate and be administered in accordance with the Code. As discussed infra, under state law, money is treated like other personal property only until possession of it passes to someone else.

B. Ownership and Money at State Law

Establishing title to personal property of any kind is always problematic. With the exception of motor vehicles, for which state laws provide a system of titling by certificate, personal property is generally not covered by a deed or certificate of the sort that provides evidence of ownership of real property. Even if one can establish that one purchased personal property from a seller by saving the sales slip, there is no public registry of subsequent transfers of ownership.

With respect to real property, a deed to a person is prima facie evidence of that person’s ownership of the property, see, e.g., Zieben v. Krakower, 346 S.W.2d 401, 405 (Tex. Civ. App. 1961); Wunderlich v. Cates, 212 S.W.2d 556, 559 (Ark. 1948), and, under the best evidence rule, the deed itself must be produced to establish ownership unless there is sufficient justification for its absence, see, e.g., Olsen v. Olsen (In re Estate of Olsen), 579 N.W.2d 529, 531-32 (Neb. 1998); Viccaro v. Fort Wayne, 449 N.E.2d 1161, 1164 (Ind. Ct. App. 1983). See generally 29A AM. JUR. 2D Evidence § 1077 (1994).

The U.C.C., in Article 9, provides for a public filing to perfect transfers of security interests in most types of personal property, but not transfers of ownership of any personal property other than accounts or chattel paper. See U.C.C. § 9-102 (1995) (stating that Article 9 applies to any transaction “which is intended to create a security interest in personal property or fixtures” or “to any sale of accounts or chattel paper”).

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To provide some guidance in determining ownership rights to personal property, the common law created the presumption that the possessor of personal property was the owner thereof. As a corollary to that presumption, the transfer of possession of personal property is presumed to transfer ownership to the recipient. Of course, one can rebut the presumption by showing that the transfer of possession was not intended to transfer title. If the loss of possession has been nonconsensual, as by theft, the thief acquires no ownership interest in the property and cannot transfer good title to another. Intent of the parties is the touchstone of property rights.

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72 See, e.g., Kondik, 208 B.R. at 167 (equipment owned by another that the debtor had permission to use in his business); Hunt's Pier, 143 B.R. at 43 (amusement rides owned by partnership and operated by corporation formed to run amusement park); Hinkle, 752 S.W.2d at 269 (Ark. 1988) (automobile in possession of prospective purchaser); Greene v. Carmichael, 140 P. 45, 46 (Cal. Ct. App. 1914) (automobile of which proposed purchaser had possession under conditional sale contract); Aircraft Acceptance Corp. v. Jolly, 230 N.E.2d 446, 449 (Ind. Ct. App. 1967) (aircraft delivered to dealer for sale).


As a matter of state law, money is one type of personal property. As is the case for other types of personal property, possession of money creates a presumption of ownership in the possessor. Yet the sort of showings that suffice to rebut the presumption and compel turnover of other types of personal property by the possessor to the true owner (e.g., that the property was leased or loaned rather than delivered with intent to transfer title, that the property was converted, or that the property was

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stolen\textsuperscript{79} are generally insufficient to establish ownership in one who does not possess money.

1. Loans

When personal property is transferred ostensibly pursuant to a lease, whether the transaction truly involved a leasing of property by the owner to the possessor/lessee or was instead a secured sale in which possession and ownership are united may be important as a matter of tax law\textsuperscript{80} or the law of secured transactions or bankruptcy.\textsuperscript{81} However, when the personal property consists of money, the issue never presents itself for a very simple reason. As a matter of long-standing state law, when money is loaned by a creditor to a debtor,\textsuperscript{82}


\textsuperscript{80} If property is leased, the lessor/owner of the property may depreciate the property for tax purposes, see I.R.C. §167 (1994), and the lessee may deduct the lease payments as ordinary business expenses, see id. §162(a)(3). If the transaction is really a sale disguised as a lease, the 'lessee' is the owner entitled to claim depreciation for tax purposes, and the 'rental' payments will be deemed either installment purchase price payments or amortization of a loan made to enable the lessee to purchase the property. See generally Frank Lyon Co. v. United States, 485 U.S. 561, 574 (1978); M & W Gear Co. v. Commissioner, 446 F.2d 841 (7th Cir. 1971); Transamerica Corp. v. United States, 15 Cl. Ct. 420, 436-43 (1988), aff'd, 902 F.2d 1540 (Fed. Cir. 1990).

\textsuperscript{81} The definition of "security interest" in §1-201(37) of the U.C.C. was amended in 1987 at the time Article 2A was promulgated as an amendment to the U.C.C. The revisions to the definition were intended to codify the factors that had developed to distinguish between a lease and a security interest. As stated in the Official Comment to the conforming amendments to §1-201(37), "[i]f a transaction creates a lease and not a security interest, the lessee's interest in the goods is limited to its leasehold estate; the residual interest in the goods belongs to the lessor. This has significant implications to the lessee's creditors." Compare In re Owen, 221 B.R. 56, 60-64 (Bankr. N.D.N.Y. 1998); In re Yarbrough, 211 B.R. 654, 656-59 (Bankr. W.D. Tenn. 1997), and In re Larson, 128 B.R. 257, 260-61 (Bankr. D.N.D. 1990) (finding transaction a true lease), with In re Kim, 232 B.R. 524, 328-32 (Bankr. E.D. Pa. 1999); HPSC, Inc. v. Wakefield (In re Wakefield), 217 B.R. 967, 970-71 (Bankr. M.D. Ga. 1998); Peoples Bank & Trust Co. v. Applewhite (In re 20th Century Enter., Inc.), 152 B.R. 119, 122 (Bankr. N.D. Miss. 1992); Banda Negra Int'l, Inc. v. Circle Business Credit, Inc. (In re Flores de New Mexico, Inc.), 134 B.R. 433, 436 (Bankr. D.N.M. 1991), and In re Village Import Enters., Inc., 126 B.R. 307, 308 (Bankr. E.D. Tenn. 1991) (finding transaction a secured sale).

\textsuperscript{82} A "loan" of money has been defined as "a contract by which one delivers a sum of money to another and the latter agrees to return at a future time a sum equivalent to that
the actual intent of the parties is never considered. Instead, title to the money passes to the debtor, and the creditor has nothing more than a claim against the debtor—a chose in action—for an amount equal to the amount lent.35

One could argue that, even if the intent of the parties is never examined, when a lender extends credit to a borrower the intent to transfer ownership of the funds is clear. Indeed, the purpose of such a loan is, in most cases, to enable the borrower to use the money as the borrower’s own funds, to purchase goods or services, to pay employees, or to repay other debt, for example. Once physical possession of funds is transferred to the borrower or to a third party on the borrower’s behalf, ownership transfers with it.

Although commercial loans from a bank to a borrower may reflect a unity between ownership of funds and possession thereof because the parties to the loan so intend, in the case of the most common form of loan in our society—the loan that occurs when a person takes funds and deposits them in a bank—the intent of the parties is not so clear, but the consequences of the physical transfer of funds is the same. As a matter of state law, when a customer of a bank deposits funds into an account at the bank, the bank is generally not deemed a bailee or custodian of the deposited funds,36 but instead becomes indebted to the depositor for an equal amount.37 The funds themselves no longer belong to the depositor,
but become property of the bank and available to the bank for use in its business.86

As a result, if the bank wrongfully declines to pay a depositor an amount equal to the deposited funds, the bank is not guilty of conversion, which requires unlawful interference with the ownership rights of another in personalty, but instead mere breach of contract.87 Similarly, in some jurisdictions the right of the

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86 See, e.g., Marine Bank, 69 U.S. (1 Wall.) at 256; Mon ostr, 125 F.3d at 187; All Funds, 955 F. Supp. at 26; United States v. $3,000 in Cash, 906 F. Supp. 1061, 1066 (E.D. Va. 1995); Morse, 190 Cal. Rptr. at 842. See generally 5A MICHIE ON BANKS ch. 9, § 1, at 15 ("The money deposited becomes part of the general fund of the bank, to be dealt with by it as other moneys, to be lent to customers, and parted with at the will of the bank."); § 4b, at 46-50 ("The legal title to the money passes to the bank which has the right to mix it with its own funds and invest and use it as it pleases, for its own benefit in its usual financing operations.").

depositor with respect to the account generally cannot be reached by a creditor through execution and levy (as could the depositor’s interest in tangible personal property); a creditor must employ garnishment or supplemental proceedings that enable the creditor to reach choses in action. The depositor also cannot trace the funds paid out from the account into the hands of another, or object to the seizure of the account by the government. Possession becomes ownership because the law deems that to be the intent of the parties.

However well-settled this characterization, there is nothing self-evident about it. Any ordinary depositor, when asked about “his” or “her” bank account, would undoubtedly describe it as “his” or “her” money being held in the bank. If that depositor were informed that he or she had made a loan to the bank and held simply a chose in action, that is, a claim against the bank, the response would probably be a blank stare. Even if the ordinary depositor is not so naive as to believe that there is a little cubicle in the bank’s vault with the depositor’s name on it in which reposes a stack of dollar bills and coins, but realizes that the deposited funds are commingled with all other bank deposits made by other customers, the depositor probably assumes that he or she owns (in the true depositor’s money, held by the defendant bank as the depositor’s agent, “then the use of it by defendant would seem to be a conversion”); Owens v. Andrews Bank & Trust Co., 220 S.E.2d 116 (S.C. 1975) (holding that action for conversion would not lie if funds had been on general deposit, but account had been closed and bank issued check for balance, which it then refused to deliver to depositor, constituting conversion).

Even courts make this understandable error. For example, the Eleventh Circuit court stated that the only way under the U.C.C. “to obtain a perfected security interest in the bank account funds [of a debtor] was to take possession of them.” Henry Lee Co. v. Tobs, 157 F.3d 1290, 1292 (11th Cir. 1998) (citing U.C.C. § 9-304(1), which applies, among other things, to perfection of a security interest in “money”). In fact, not only is a bank account not the debtor’s “money,” but in most states security interests in “deposit accounts,” see U.C.C. § 9-105(1) (1995), are excluded from the scope of Article 9 of the U.C.C. except with respect to proceeds, see id. U.C.C. § 9-104(1).
property sense) a proportionate share of the funds held by the bank based on the ratio of his or her deposit to the total deposits of all customers.92

The presumption that the depositor intended to transfer ownership of the funds and receive, instead, a claim against the bank is thus, in most cases, a legal fiction. And unlike the presumption of ownership that arises from possession of other personal property, the true "owner" of the deposited cash cannot rebut the presumption. State law views the possession of loaned money and the ownership thereof as indissolubly linked.93

92 Indeed, this argument was made to the Supreme Court in Marine Bank, 69 U.S. (1 Wall.) 252. Between the time Fulton Bank had made a deposit with Marine Bank and the time it requested withdrawal of the funds, the value of Illinois currency had declined by 50 percent. Marine argued that it acted merely as the "agent" for Fulton in accepting the funds for deposit, and that Fulton and the other depositors "had an interest in common in the entire fund, in proportion to their respective shares." Id. at 254. The Court rejected this contention, noting that Marine had placed the funds with its other money, and used it in its business as its own, and could not now contend that it belonged to Fulton. "It being understood between the parties that, when the money was received, it was to be held as an ordinary bank deposit, it became by virtue of that understanding the money of the defendant the moment it was received." Id. at 256. Marine was ordered to pay Fulton the value of the money at the time it was deposited.

One commentator, in criticizing this proportionate property interest approach as it previously applied to purchasers of an interest in a fungible bulk of securities under the 1987 version of Article 8 of the U.C.C., suggested that no one would "support a law to the effect that bank account depositors have a property interest in money or other property of a bank." Charles W. Mooney, Jr., Beyond Negotiability: A New Model for Transfer and Pledge of Interests in Securities Controlled by Intermediaries, 12 CARDOZO L. REV. 305, 350 (1990). Professor Mooney did not explain why he considered this approach to deposits so untenable, other than to suggest later that application of tracing principles to resolve the rights of bank depositors among themselves would be unmanageable. See id. at 403; see also U.C.C. § 8-503(b) and the Official Comment thereto.

93 As a practical matter, modern commercial banking involves very little physical money capable of possession at all. Generally depositors do not arrive at a bank with a sack of cash. Instead, they receive a check in payment for their goods or services and deposit that check with their own bank. That check represents merely a claim against the bank on which it is drawn once it is accepted, see U.C.C. § 3-408, and a secondary claim against the drawer of the check, see id. § 3-414(b). Once the check is deposited, the depositor's bank gives the depositor a (provisional) claim against it instead. Although the depositor may request satisfaction of all or part of this claim in the form of cash, in many cases the depositor simply writes his or her own check on the account to which the deposit was made, thereby substituting as claimant against the depositor's bank the payee once the check is accepted by the depositor's bank.

Similarly, bank loans are no longer made by turning over a suitcase full of crisp, new bills or even in most cases by delivering a check payable to the borrower. Instead, the bank provides the borrower or a third party "which may be another bank at which the borrower has an account," a claim against the bank for the amount of the loan. See id. § 4A-104(1) & cmt. 1. Such loans are then repaid by crediting against them the assigned benefit of claims against
2. Conversion

Conversion lies when a defendant has wrongfully exercised dominion over a plaintiff's personalty. The roots of this modern tort rest in the ancient common law form of action for trover, a remedy afforded an owner of lost goods against the finder thereof who refused to return them. Because only specifically identifiable goods could be the subject of an action for trover, courts have consistently required that the personalty subject to conversion be specifically identifiable.

When applied to money, this principle severely limits the availability of conversion to remedy the unauthorized appropriation of a plaintiff's funds. Essentially, an original owner of money may others under deposited checks or wire transfers.

The increasing obsolescence of "real" money makes the presumption linking possession and ownership of money all the less relevant and should result in its abandonment in law. Commentators have criticized the use of simplistic property concepts that link possession with ownership as applied to a monetary system in which money is no longer reified (in the form of physical currency) but is instead transferred by transfer of bank credits. See, e.g., James Steven Rogers, The Irrelevance of Negotiable Instruments Concepts in the Law of the Check-Based Payment System, 65 Tex. L. Rev. 929, 934 (1987).

See generally 18 Am.Jur. 2d Conversion § 2 (1994); Restatement (Second) of Torts § 222A (1965).


But see U.S. Metal & Coin Co. v. Burlock, 652 F. Supp. 37, 39 (E.D.N.Y. 1986) (rejecting assertion that conversion will not lie for gold and silver combined with like metals of other customers because "[t]his result...impl[ies] that two conversions may be better than one").

See generally 55A Am.Jur. Money § 21 (1996) ("An action may lie for the conversion of money, where there is an obligation to keep intact or deliver the specific money in question, and where such money can be identified or described."); H.D. Warren, Annotation, Nature of Property or Rights other than Tangible Chattels which may be Subject of Conversion, 44 A.L.R.2d 927, 938 (1955) ("Money can be the subject of conversion and a conversion action only when it..."
rebut the presumption that title passed to the possessing converter only if the funds were segregated from the converter's other money and are thus identifiable. Yet the fact patterns of cases in which claims of conversion are raised with respect to money demonstrate the confusion that the "identifiable" requirement engenders.

First, a plaintiff may have given the defendant property that was not cash, with the expectation that, through some action on defendant's part, it would turn into cash for the plaintiff's account. When the defendant does not turn over the resulting cash, the plaintiff sues for conversion. In this case, neither the original property (as it was voluntarily entrusted to the defendant) nor the resulting cash could be converted, unless it was placed in a separate account by the defendant (making it identifiable) and only thereafter misappropriated. When examining these cases, courts focus specifically on identifiability of the cash at the time of conversion, when it is in the hands of the defendant.99

Second, assume the same situation as in the first case, but the original noncash property of the plaintiff is taken by the defendant without plaintiff's consent and then transformed into cash. In this case, the defendant has not converted the cash but rather the original identifiable property and is liable to return it or its value (the cash, although not identifiable). Therefore, identifiability should not be an issue because it is not the cash that is converted but the original noncash property.100 Yet plaintiffs fail to distinguish

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100 See, e.g., Dayton Constr. Co. v. Meinhardt, 882 S.W.2d 206, 209 (Mo. Ct. App. 1994) (affirming judgment for conversion of checks wrongfully deposited in defendant's account); Kansas City Casualty Co. v. Westport Ave. Bank, 177 S.W. 1092, 1094 (Mo. Ct. App. 1915) (affirming award of damages for conversion of checks); Davin v. Dowling, 262 P. 123, 125 (Wash. 1927) (holding bank that received payment on loan from party who converted plaintiff's crop did not convert plaintiff's money).
between the original converted property and the cash it has become and mistakenly allege conversion of the retained cash, leading courts to dismiss their complaints because the cash is not identifiable.101

In the third case, the original property voluntarily given by the plaintiff to the defendant is itself cash, and defendant refuses to return it or misuses it. As in the first case, unless the cash in the defendant’s possession has been placed in a separate, segregated account (or is otherwise identifiable in defendant’s hands) at the time the defendant refuses to return it, a cause of action for conversion will not lie.102 Here the focus is appropriately on the ability of the plaintiff to identify the cash at the moment of conversion, when it is in the defendant's hands. The identifiability of the original property in plaintiff's hands is not an issue, because it was not converted by the defendant.

101 See, e.g., Kubin v. Miller, 801 F. Supp. 1101, 1118 n.16 (S.D.N.Y. 1992) (dismissing conversion claim with respect to net income received by defendant who converted plaintiff's stock because no allegation that funds were identifiable); Hutton v. Klabal, 726 F. Supp. 67, 72 (S.D.N.Y. 1989) (dismissing conversion count relating to purchase price of etchings, with leave to replead to allege conversion of etchings themselves); United States Fidelity & Guar. Co. v. Mississippi Valley Trust Co., 153 S.W.2d 752, 756 (Mo. Ct. App. 1941) (finding no cause of action for conversion of money collected on misappropriated checks); Anderson Elec. Car Co. v. Savings Trust Co., 212 S.W. 60 (Mo. Ct. App. 1919) (dismissing conversion claim of money collected on checks by improper endorsement); cf. Bel-Bel Int'l Corp. v. Community Bank of Homestead, 162 F.3d 1101, 1108-09 (11th Cir. 1998) (finding cash received upon collection of converted accounts receivable constituted "specific fund" and conversion could be established).

102 See, e.g., The High View Fund, L.P v. Hall, 27 F. Supp. 2d 420, 429 (S.D.N.Y. 1998) (finding no conversion of $1 million investment in corporation to manage golf properties misappropriated by defendant from corporate accounts); Horbach v. Kaczmarek, 934 F. Supp. 981, 986 (N.D. Ill. 1996) (finding no conversion of advance payment for equipment made by plaintiff to defendant which was not identifiable); Massive Paper Mills v. Two-Ten Corp., 669 F. Supp. 94, 96 (S.D.N.Y. 1987) (finding no conversion of prepayment for paper shipment wired into commingled account); United Merchants & Mfrs., Inc. v. Sanders, 508 So. 2d 689, 692 (Ala. 1987) (finding no conversion of erroneous double payment of invoice deposited in general corporate account); Johnson v. Life Ins. Co., 581 So. 2d 438, 442-43 (Ala. 1991) (finding no conversion of money paid to insurance company for purchase of policies which was not segregated); General Motors Corp. v. Douglass, 565 N.E.2d 93, 100 (Ill. 1990) (finding no conversion of amount overpaid by car manufacturer to dealer and not segregated by dealer); DeChristofaro v. Machala, 685 A.2d 258, 263 (R.I. 1996) (finding no conversion of money paid contractor used for his own purposes rather than to build plaintiffs' house); Larson v. Dawson, 53 A. 93, 94 (R.I. 1902) (finding no conversion of money entrusted to defendant, which defendant mingled with own funds and refused to return); cf. Walker v. Hanke, 992 S.W.2d 925 (Mo. Ct. App. 1999) (finding proceeds of settlement deposited in joint account with plaintiff's daughter sufficiently identifiable).
Finally, if the original property is cash and is misappropriated by the defendant from the plaintiff, no cause of action for conversion lies unless the cash was segregated and identifiable at the time of the misappropriation. This requirement is not difficult to satisfy if the cash was originally in the possession of the plaintiff and was wrongfully taken by the defendant from the plaintiff's possession. However, if the cash comes into the defendant's hands from a third party, allegedly for the account of the plaintiff, conversion can seldom be established because the defendant is not likely to segregate the funds he intends to convert, and unless he does so, the plaintiff's portion will not be identifiable.

Even if the owner of the money is able to establish a cause of action for conversion against the party who took his funds in the first instance, he is likely to lose his cause of action if the miscreant has disposed of the funds to a third party. This is not generally true of converted personal property. As is true for holders of stolen goods, the acquirer of goods that have been converted obtains no

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103 See, e.g., Limbaugh v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 732 F.2d 859, 862 (11th Cir. 1984) (holding funds transferred from mutual fund account without owner's consent were identifiable); Crown Life Ins. Co. v. Smith, 657 So. 2d 821, 823-824 (Ala. 1994) (finding conversion when insurance agent forged insureds' names onto premium refund checks and loan applications against cash value of whole life insurance policies, thereby converting identifiable cash); Greene County Bd. of Educ. v. Bailey, 586 So. 2d 899, 899-900 (Ala. 1991) (holding funds originally in special account were converted by scheme of sending false invoices that were paid by plaintiff and funds were then diverted by defendant); Carter v. Hornsby, 29 S.E.2d 95, 97 (Ga. 1942) (holding package of money delivered to defendant by party to whom plaintiff entrusted it and held separate from all other funds of defendant was converted); cf. Lewis v. Fowler, 479 So. 2d 725, 726 (Ala. 1985) (finding no conversion when funds were legally garnished, but were not segregated although never paid by employer to garnishing creditor before employer went bankrupt).

104 See, e.g., Mitchell Energy Corp. v. Samson Resources Co., 80 F.3d 976, 984 (5th Cir. 1996) (no conversion for failure to turn over gas royalties owed under a lease for gas sold); Shaffer & Max, Inc. v. JM Eng'g, Inc., Civ. A. No. 93-518P, 1994 WL 774682 (D.R.I. Oct. 18, 1994) (commissions owing to sales agent could not be converted when sale proceeds received from purchasers were deposited in seller's general account); cf. Carpenters' Pension Trust Fund Detroit & Vicinity v. Laminate Creations, 803 F.2d 718 (6th Cir 1986) (table) (vacation pay trust fund payments never placed into trust by employer were not converted because there was no identifiable fund). But see Lopresti v. Terwilliger, 126 F.3d 34, 42 (2d Cir. 1997) (union dues withheld from workers' paychecks and never turned over to union held sufficiently identifiable although deposited in general corporate account); Weiss v. Marcus, 124 Cal. Rptr. 297, 303 (Cal. Ct. App. 1975) (when plaintiff specified portion of settlement payment that was subject to his lien, allegation sufficiently identified fund); Bank of India v. Weg & Myers, P.C., 691 N.Y.S.2d 439, 445 (N.Y. App. Div. 1999) (law firm converted insurance proceeds covered by bank's security interest when it deducted its fee and paid remainder to debtor; fund was identifiable).
better title to the goods than his transferor, and the true owner may reclaim the goods even from the hands of a good faith purchaser for value. But if the subject of the conversion is money or negotiable instruments, a bona fide purchaser or holder in due course cannot be held liable. Again, "possession . . . is ten-tenths of the law."  

3. Theft

The development of the criminal law of theft is also replete with examples of distinctions between stolen goods and stolen money stemming from the linkage between possession and ownership of money. The early law of theft required, as a condition to guilt, a showing that the defendant had engaged in trespass—that is, a showing that the defendant had wrongfully removed a chattel from the possession of another. This created theoretical difficulties when the party engaging in the allegedly wrongful conduct had obtained possession of the property in a voluntary transaction with the owner before treating it in a way not contemplated by the parties (as by converting goods bailed with the wrongdoer). The earliest solution to this conceptual quandary was to deem the act of breaking open the bailed containers in order to sell the goods ("breaking bulk") as terminating the bailment, so that possession reverted to the original bailor as a matter of law. This

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105 See generally Restatement (Second) of Torts § 229 (1965) ("One who receives possession of a chattel from another with the intent to acquire for himself or for a third person a proprietary interest in the chattel which the other has not the power to transfer is subject to liability for conversion to a third person then entitled to the immediate possession of the chattel.").


107 Rogers, supra note 93, at 932.


109 See Hall, supra note 108, at 4-10 (discussing Carrier's Case, Y. B. 13 Edw. IV. F. 9 pl.5).
solution merely redefined as "possession" by the owner against whom the bailee had trespassed what to the casual observer might seem to be actual possession by the bailee.

The concept of "possession" was also central to cases in which the wrongdoer obtained possession of the goods through fraud. The earliest case involved a man, Pear, who was accused of stealing a horse he had hired. The jury concluded that Pear's intent at the time he hired the horse was to sell it for his own account. On appeal, the court concluded that this sufficed for larceny, because "the parting with the property [i.e., the hire of the horse by Pear] had not changed the nature of the possession, but that it remained unaltered in the [owner] at the time of the conversion." This case was the basis of the crime of larceny by trick, which required the parting of possession without an intent to part with title to property. If the intent of the owner was to transfer to another party not merely custody of the goods, but also title to the property, even if the property was obtained through fraud, larceny could not be charged because there was no trespass against the owner's possession. Indeed, only in very limited circumstances was such an act criminal at all. The justification for denying criminal sanctions was that the injured party had suffered loss merely because he relied on a lie, and simple prudence would have prevented the wrong.

The earliest statute criminalizing the obtaining of property by fraudulent means required the use of a "counterfeit letter or privy token to receive money or goods in other names" as the instrument of the fraud to be actionable. The cause of action was expanded to delete the requirement of the seal or letter, yet the statute was not broadly interpreted, perhaps because the significance of the change from prior law was not appreciated. However, in 1789, four

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112 As stated in the Queen v. Jones, Salk. 379, 91 Eng. Rep. 330 (1704), "we are not to indict one man for making a fool of another."
113 Statute of 33 Hen. VIII, c. 1 (1541).
114 30 Geo. II, ch. 24 (1757). The statute provided that "all persons who knowingly and designedly, by false pretence or pretences, shall obtain from any person or persons, money, goods, wares, or merchandizes, with intent to cheat or defraud any person or persons of the same...shall be deemed offenders."
judges of the King's Bench unanimously concluded that the statute should be read literally and found that several defendants, who had falsely stated that a certain race was to be run on which they had themselves placed bets and thereby induced the complainant to give them money to place his own bet, were properly prosecuted under its terms.115 After 1789, the crime of obtaining property by false pretenses provided an available basis for criminal prosecution when trespass against possession, necessary for larceny, could not be shown.116

Even these two species of theft failed to cover the situation in which possession of the misappropriated goods or funds was obtained not by fraud but by legitimate and honest means with the wrongful act occurring thereafter. In 1799, a bank teller, Joseph Bazeley, was prosecuted for larceny on the theory that he took for his own use a note for one hundred pounds deposited by a customer with the bank.117 The court concluded that Bazeley had not trespassed against the bank's possession of the note because the bank never obtained possession of the note (Bazeley had pocketed the note rather than delivered it to the bank). Furthermore, the court declined to attribute Bazeley's own possession of the note to his employer under these circumstances. Thus, it was concluded, Bazeley had to be discharged from prosecution.

In response to the Bazeley case, the first general embezzlement statute was passed in 1799.118 The statute criminalized the Bazeley facts, by making liable for a felony:

any servant or clerk... to any person... [who] by virtue of such employment, receive[s] or take[s] into his possession any money, goods, bond, bill, note, banker's draft or other valuable security, or effects, for or in the name or on the account of his master or masters,

116 See, e.g., People v. Ashley, 267 P.2d 271, 279 (Cal. 1954); People v. Niver, 152 N.W.2d 714, 716-17 (Mich. Ct. App. 1967); Kellogg v. Ohio, 26 Ohio St. 15, 18-19 (1874). The common law crime required a false representation with respect to fact, and a mere promise to do something that the promisor had no intention to do was insufficient. See, e.g., State v. Robington, 75 A.2d 394, 396 (Conn. 1950); Churchill, 390 N.E.2d at 1149.
118 39 Geo. III, c. 85.
or employer or employers, and ... fraudulently embezzle[s] ... the same.\textsuperscript{19}

In essence, it expanded the common law of larceny to create a trespass against deemed possession, even when actual possession had never been obtained.

The importance of possession (or deemed possession) for larceny or embezzlement\textsuperscript{20} prosecution has particular significance when the property involved is money. If one party has possession of money and it is physically taken from him, as by highway robbery, that constitutes larceny under all state statutes to the same extent as would the theft of his gold watch because both involve trespass against personality of another.\textsuperscript{21} However, if the money and the gold watch were voluntarily placed in the possession of another by reason of fraud, and that person then converted them to his own use, larceny by trick would surely lie for theft of the watch but would be more difficult to establish for the money. Why the distinction? Possession (in the sense of ownership) of the gold watch is not deemed to transfer when physical possession is given to the other, but title to money is presumed to transfer with its delivery. Larceny by trick is of little use in connection with money transfers, even when money is obtained by trick or device, unless the transfer of money was intended to be for a specified and limited purpose rather than for the unrestricted use of the transferee, thus rendering the transferee the functional equivalent of a bailee and rebutting the presumption that title transferred.\textsuperscript{22}

\textsuperscript{19} \textit{Id.}
If neither larceny nor larceny by trick can be established because the presumption that title to money passes with its possession cannot be rebutted, then the only criminal actions available against the recipient of money are embezzlement (if the recipient received the funds in a fiduciary capacity for a third party, and then only because the deemed possession of the third party was violated) or obtaining property by false pretenses.

Quite apart from the difficulties inherent in establishing a case of theft for money that is not physically and involuntarily taken from the owner, the remedies for the owner once theft is established are far more limited in the case of money than for other stolen personal property. In the case of most personal property, a thief acquires no title and therefore has no power to transfer good title to a third party, even if that party is a good faith purchaser for value. As a result, the owner of stolen goods can always obtain their return, even from the hands of an innocent third party.

1902) (upholding conviction when money transferred for specific purpose).


124 Even these might not be available, depending on the statutory language of the criminal code. A stark example of this paradox is the Oregon case of State v. Tauscher, 360 P.2d 764 (Ore. 1961). Ms. Tauscher was the executive secretary of the Douglas County Tuberculosis & Health Association. In that capacity, she was authorized to draw checks on the Association’s bank account by instrument signed jointly by her and by a Mrs. Petrequin. Mrs. Petroquin had an unfortunate practice of signing several checks in blank and turning them over to Ms. Tauscher for completion of the payment information and for her signature. Over a long period of time Ms. Tauscher used some of these checks to pay her private electric bills. Ms. Tauscher was charged with embezzlement, but the trial court sustained a demurrer to the indictment on the grounds that the indictment failed to allege that Ms. Tauscher embezzled or fraudulently converted property. The supreme court affirmed, noting that the Oregon statute on embezzlement required that the embezzled money or property ‘come into his possession or is under his care’, and that the funds on which Ms. Tauscher drew never came into her possession or her care, but were transmitted directly by the bank to the electric company. The court further concluded that the acts committed by Ms. Tauscher did not fall within the statutory definition of larceny or false pretenses, because the property affected was not tangible but rather an intangible chose in action and the statute did not list ‘credits’ as property subject to larceny.


126 See, e.g., Autocephalous, 717 F. Supp. at 1399; Naftzger, 49 Cal. Rptr. 2d at 788; Weaver, 816 P.2d at 1134.
However, once money is transferred by a thief to a third party who gives value and takes possession without knowledge of the theft, the third party takes title to the money free and clear of any claim of the original victim of the crime. The linkage between possession and ownership becomes nonseverable, even if the crime victim can specifically trace his funds into the hands of the current possessor.

III. JUSTIFICATIONS FOR POSSESSION/OWNERSHIP LINK

The consistent alignment between possession of money and ownership of that commodity in state law is clear. Thus, the Code, which incorporates state concepts of an "interest in property" in the definition of the estate in Section 541, reflects that connection. Less clear is the rationale for this seemingly inextricable linkage. This Part suggests some possible justifications for the link between possession and ownership of money and demonstrates that none of the justifications either does, or should, lead to the conclusion that money in the possession of another cannot belong to the original owner.

A. Historical Treatment

At least as early as Roman times, the transaction in which one party provided another with money for the other's use, with the expectation that an equivalent sum would be returned, was recognized as a discrete form of contract. Mutuum, or loan for consumption, was applicable not only to loans of money, but also to loans of any res quae mutua vice funguntur, readily interchangeable or

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128 See, e.g., Hatch v. Fourth Nat'l Bank, 41 N.E. 403, 404 (N.Y. 1895); Portland, 739 P.2d at 1043-44; cf. Burtch, 227 B.R. at 256 (holding that chapter 7 trustee could not trace funds misappropriated from estate through commingled bank account into hands of third parties).
fungible goods. The delivery of the res to the recipient created the binding obligation to return the amount, and the lender could bring an action—a condictio or (in the case of money) an actio certae pecuniae creditae—to recover it. Indeed, the development of mutuum can be seen as a more formal recognition of the general equitable principle that one who receives property from another with the understanding that it was not a gift has been unjustly enriched and must return the amount of such enrichment. Thus, the identical remedy ("condictio") was available for return of money wrongfully entrusted to another or provided for a limited purpose that was not accomplished, and similar cases in which the money was not "consumed" by the recipient.

Mutuum was always gratuitous. The contract gave rise to a single remedy: the condictio for return of an equal sum (or equivalent kind, quantity, and quality in the case of other goods). It was originally intended to be a transaction between friends or neighbors, rather than a commercial transaction. If the lender wished to receive recompense for the loan in the form of interest, the parties would have to supplement the loan (the mutuum) with a stipulatio, a formal, oral agreement made with certain legal formalities. The stipulatio was defined by its form, not its

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129 See W.W. Buckland, A Text-Book of Roman Law from Augustus to Justinian 462-63 (3d ed. 1963) [hereinafter Buckland, Text-Book]. Such fungible goods included grain, wine, oil, bronze, silver, and gold, or "any things commonly dealt with by number, weight or measure." Id. at 463. See also Reinhard Zimmermann, The Law of Obligations 153 (1990); W. H. Buckler, The Origin and History of Contract in Roman Law Down to the End of the Republican Period 180 (1983). It is unclear whether mutuum applied originally to money and was later extended to cover other commodities, or whether always applied to all fungible things. See generally David Locke Hall & F. Douglas Raymond, Economic Analysis of Legal Institutions: Explaining an 'Inexplicable' Rule of Roman Law, 61 Ind. L.J. 401, 406 (1986).

130 See H.F. Jolowicz & Barry Nicholas, Historical Introduction to the Study of Roman Law 284 (3d ed. 1979); see also Buckland, Text-Book, supra note 129, at 463; Buckler, supra note 129, at 182.

131 See Jolowicz & Nicholas, supra note 130, at 284; see also W.W. Buckland, A Manual of Roman Private Law 272 (2d ed. 1957) [hereinafter Buckland, Private Law].

132 See Jolowicz & Nicholas, supra note 130, at 285.

133 See Buckland, Text-Book, supra note 129, at 464; Rudolph Sohm, The Institutes 375 (3d ed. 1907).

134 See Zimmermann, supra note 129, at 153.

135 See Alan Watson, The Evolution of Law 10 (1985); Zimmermann, supra note 129, at 156; Buckler, supra note 129, at 180.

136 When interest was charged, the transaction was sometimes called a fenus. See Buckland, Private Law, supra note 131, at 273.

137 This verbal agreement arose from the use of certain words, in the form of question by
the parties were free to impose on the party to be bound whatever obligations they wished, as long as they did so with the requisite formality.

In order to have a mutuum, ownership of the money or other thing provided by lender to borrower had to transfer. However, if ownership of the property could not be transferred (because, for example, the lender did not own the property or did not have the authority to alienate it), although there was no mutuum, the true owner could recover the property itself from the recipient by vindicatio, or if it had been consumed or alienated in good faith, the owner could recover its equivalent by condictio.

The loan of an object for use, accomplished by a contract denominated "commodatum," did not transfer ownership of the subject matter of the loan but only temporary possession. As for a mutuum, the contract was gratuitous, created by the handing over of the object to be loaned. At the end of the loan the res itself had to be returned to the lender in specie. Failure to return the res would give rise to an actio commodati. The key distinction between mutuum and commodatum was that for the latter the actual object lent had to be returned. However, the object itself might be fungible, as when a sum of money was lent to serve as security (via pledge) to a third party by the borrower thereof, or to be spread out on a

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the creditor and answer by the debtor. For example, if the stipulatio was for the payment of interest, the creditor would ask the debtor, "do you solemnly promise (spondesne) to pay me interest at such-and-such a rate every month?" and the debtor would response, "I solemnly promise (spondeo)," thereby creating the binding stipulatio. SOHM, supra note 133, at 382-83; see also BARRY NICHOLAS, AN INTRODUCTION TO ROMAN LAW 159 (1962); WATSON, supra note 135, at 8.

See Hall & Raymond, supra note 129, at 404; WATSON, supra note 135, at 7-8.

See, e.g., BUCKLAND, PRIVATE LAW, supra note 131, at 273; BUCKLAND, TEXT-BOOK, supra note 129, at 463-64; PATRICK MAC CHOMBAICH DE COLQUHOUN, A SUMMARY OF THE ROMAN CIVIL LAW, Vol. II, § 1537, at 469 (1988); SOHM, supra note 133, at 375; ZIMMERMANN, supra note 129, at 158.

See BUCKLAND, TEXT-BOOK, supra note 129, at 464; DE COLQUHOUN, supra note 139, § 1539, at 471.

See DE COLQUHOUN, supra note 139, § 1554, at 480; ZIMMERMANN, supra note 129, at 190.

See DE COLQUHOUN, supra note 139, § 1551, at 479; BUCKLAND, PRIVATE LAW, supra note 131, at 276; SOHM, supra note 133, at 376; WATSON, supra note 135, at 17.

See ZIMMERMANN, supra note 129, at 188.

See DE COLQUHOUN, supra note 139, § 1551, at 479.

See ZIMMERMANN, supra note 129, at 189; SOHM, supra note 133, at 376.
moneylender's table for show. Such a loan of money would be a commodatum despite the "fungible" nature of the subject matter.\footnote{See Zimmerman, supra note 129, at 188.}

Fungible goods, including money,\footnote{A depositum involving money is sometimes referred to as a depositum irregulare, although this is not a Roman term. See Buckland, Text-Book, supra note 129, at 469 n.13; Sohm, supra note 133, at 377; Zimmerman, supra note 129, at 215-16.} could be handed over to a third party without an intent to transfer ownership pursuant to a depositum.\footnote{See Buckland, Text-Book, supra note 129, at 467; Jolowicz & Nicholas, supra note 130, at 287.} The depositee received the subject of the deposit, the res, without compensation, to care for it until the res was handed back to the depositor or to a third party.\footnote{See De Colquhoun, supra note 139, § 1565, at 488; Buckland, Text-Book, supra note 129, at 467.} Failure to do so would give rise to an actio depositi directa.\footnote{See De Colquhoun, supra note 139, § 1565, at 488; Buckland, Text-Book, supra note 129, at 467; Watson, supra note 135, at 11; Zimmerman, supra note 129, at 205.} The depositee was forbidden to use the res,\footnote{See Buckland, Text-Book, supra note 129, at 470; Buckland, Private Law, supra note 131, at 276; Zimmerman, supra note 129, at 216.} but in the case of money it might be agreed that the depositee could use it, thereby effectively transforming the depositum into a mutuum at any time.\footnote{A "real" contract was one formed by the delivery of the subject matter of the contract by one party thereto rather than by executory promises. See De Colquhoun, supra note 139, § 1535, at 468.}

By the middle ages, the distinctions between the genres of real contracts\footnote{See M.M. Postan, Medieval Trade and Finance 11-16 (1973). Usury having been prohibited by the Catholic Church and vigorously attacked beginning in about the middle of the twelfth century, see generally David J. Gerber, Prometheus Bound: The High Middle Ages and the Relationship Between Law and Economic Conduct, 38 St. Louis U. L.J. 673, 706 (1994), the objective of many of these disguised loans was to conceal the charging of interest, see id. at 11.} were fast eroding. Loans were extended in a variety of forms, ranging from loans of money disguised as sales and repurchases of goods, to sales of rents.\footnote{See 2 Frederick Pollack & Frederic William Maitland, The History of English Law, 169-70 (2d ed. 1898); Zimmerman, supra note 129, at 204.} The transfer of movable goods to a third party was said to be a "bailment" whether the goods were being pledged, gratuitously lent for use, deposited for safe keeping, delivered for transportation, or hired, so long as title did not pass and the goods were to be returned (in their original form or as modified by the bailee) to the bailor.\footnote{See 2 Frederick Pollack & Frederic William Maitland, The History of English Law, 169-70 (2d ed. 1898); Zimmerman, supra note 129, at 204.} In modern times, the terminology of lending has almost completely lost the Roman
distinctions. Instead, commentators and courts have sought to distinguish bailments from "sales," and have placed all transactions which would have been covered by a *mutuum* under Roman law in the latter category because title transferred.

But to the Romans, this would have made no sense. Although loans of money or other fungible goods for consumption, loans of goods (including fungible goods) for use, and deposits of goods (including money) were distinguished by the location of ownership of the *res* at Roman law, the location of ownership did not transform the transaction into a sale. Roman contracts of sale were consensual and based on mutual agreement, rather than premised on the delivery of a *res*.

Legal history always informs our understanding of modern legal concepts, but the fact that a Roman *mutuum* transferred ownership does not establish that modern law must treat a loan agreement as a sale of funds. A *mutuum* was also gratuitous; a loan

156 See Pollack & Maitland, supra note 155, at 170 n.1 ("To this day we Englishmen are without words which neatly mark the distinction [between *mutuum* and *commodatum*]. We lend books and half-crowns to borrowers; we hope to see the same books again, but not the same half-crowns; still in either case there is a loan.").

157 See, e.g., Armistead M. Dobie, *Handbook on the Law of Bailments and Carriers* 9-11 (1914) ("since title to the goods in such cases [of *mutuum*] would immediately vest in the recipient, such a transaction would in no sense be a bailment, but is a sale or exchange"); William F. Elliott, *A Treatise on the Law of Bailments and Carriers* 43 (1914) ("Under the common law this [*mutuum*] would not be a bailment, but a sale."); Edwin C. Goddard, *Outlines of the Law of Bailments and Carriers* 9 (1928) (*mutuum* "is considered a sale and not a bailment"); Joseph Story, *Commentaries on the Law of Bailments* 193 (2d ed. 1840) (in *mutuum* "the absolute property passes to the borrower, it being a loan for consumption"); Philip T. Van Zile, *Elements of the Law of Bailments and Carriers* 4 (1902) (*mutuum* "at common law, was considered to be a sale of the property").

158 See, e.g., O'Keefe v. Equitable Trust Co., 103 F.2d 904, 906 (3d Cir. 1939); Rahilly v. Wilson, 20 F. Cas. 179, 181 (C.C.D. Minn. 1873) (No. 11,532); Energy Coop., Inc. v. Permian Corp. (In re Energy Coop., Inc.), 94 B.R. 975, 979 (N.D. Ill. 1988); Provost v. United States, 60 Ct. Cl. 49 (1924), aff'd, 269 U.S. 443 (1926); De Jaramillo v. United States, 37 Ct. Cl. 208 (1909); *In re Ellis*, 6 A.2d 609, 611-13 (Del. Super. Ct. & Orphans' Ct. 1939); New Domain Oil & Gas Co. v. Hayes, 259 S.W. 715, 716 (Ky. 1924); State v. Karri, 149 P. 956, 958 (Mont. 1915); Fosdick v. Greene, 27 Ohio St. 484, 488-89 (1875); Chase v. Washburn, 1 Ohio St. 244, 249 (1853).


159 The consensual contract of sale was called *emptio venditio* and required that the parties agree on both the object of the sale and the fixed price. See Jolowicz & Nicholas, supra note 130, at 289.
agreement almost invariably provides for interest. A *mutuum* was intended to be between friends or neighbors; a loan agreement is often between a professional lender and a borrower with no other relationship. A *mutuum* was not a sale; yet the common law treats a loan as one. In short, a loan as we know it is not a Roman *mutuum*. The argument that it must result in transfer of ownership because that was required for a *mutuum* is not persuasive.

B. Medium of Exchange

Money, it is argued, cannot be treated as other personalty because money is not a commodity but is currency—that is, a medium of exchange, constituting a measure of value for all other property in our society. This special characteristic of money has been used to justify the need to treat the possessor thereof as the owner in all but limited circumstances.

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The U.C.C. has always treated money as something different from all other personalty. Section 1-201(24) of the U.C.C. defines “money” as “a medium of exchange authorized or adopted by a domestic or foreign government and includes a monetary unit of account established by an intergovernmental organization or by agreement between two or more nations.” Money is explicitly excluded from the definition of “goods” in U.C.C. § 9-105(1)(h), but is also excluded from the definition of “general intangibles” in U.C.C. § 9-106. Therefore, although money is not excluded from the scope of Article 9, which (except as provided in U.C.C. § 9-104 on excluded transactions, which does not exclude money) applies “to any transaction (regardless of its form) which is intended to create a security interest in personal property,” U.C.C. § 9-102(1)(a), it is not treated as any other category of personal property, nor can money be the subject of a “lease” pursuant to Article 2A of the U.C.C. A “lease” is defined to be “a transfer of the right to possession and use of goods,” U.C.C. § 2A-103(1)(j), and the definition of “goods” explicitly excludes money, see U.C.C. § 2A-103(1)(h). Article 2 of the U.C.C., which is applicable to “transactions in goods,” U.C.C. § 2-102, defines “goods” to exclude “the money in which the price is to be paid,” U.C.C. § 2-105(1), but may include money within the definition of goods “when money is being treated as a commodity” as opposed to “the medium of payment.” U.C.C. § 2-105 cmt. 1. Thus Article 2 is applicable to foreign exchange transactions, when foreign currency is the commodity being traded. See, e.g., Saboundjian v. Bank Audi (USA), 556 N.Y.S.2d 258, 262 n.2 (N.Y. App. Div. 1990).

101. Lord Mansfield, Chief Justice of the King’s Bench, in *Miller v. Race*, rejecting the notion that inability to trace money was the reason a bona fide purchaser took title to a stolen Bank of England note, stated, “The true reason is, upon account of the currency of it: it can not be recovered after it has passed in currency.” 97 Eng. Rep. 398, 401 (1758). Bank notes, he observed, “are not goods, not securities, nor documents for debts, nor are so esteemed: but are treated as money, as cash, in the ordinary course and transaction of business, by the general consent of mankind; which gives them the credit and currency of money, to all intents and purposes.” *Id.*
While money certainly does, at least in a particular geographic region, constitute currency, that alone cannot justify the special treatment afforded possession of money when money is loaned by a true owner to a borrower. If a medium of exchange by its nature always had to belong to its possessor, the law would not countenance a separation between possession and ownership of money. Yet, as already suggested, it clearly does.

For example, it is universally accepted that when possession of money is transferred by an owner to a bailee, with directions that the bailee should hold the money for safekeeping and return the same money at a later date, title to the money remains with the owner rather than transferring to the bailee. A specific example of this principle is the special account created by a bank for a depositor. With respect to special accounts, as opposed to general accounts, ownership of the deposited funds remains with the depositor rather than passing to the bank, and the relationship between the depositor and bank becomes that between bailor and bailee. If the bailee misappropriates the funds or commingles them with its own, the bailor may sue for conversion.

Similarly, when the money involved is unique coins or money in a bag or package, or is otherwise readily identifiable from other currency, the money is treated as a commodity and the usual rules no longer apply. Thus, an owner may recover such identifiable

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See, e.g., Carlyon v. Fitzhenry, 15 P. 273, 275 (Ariz. 1887); Hargis v. Spencer, 71 S.W.2d 666, 669-70 (Ky. 1944); Caldwell v. Hall, 60 Miss. 330, 334 (1882); Knapp v. Knapp, 96 S.W. 295, 297 (Mo. Ct. App. 1906).

See cases cited in note 83 supra.


The issue of whether money should be treated as something unique or as another commodity or type of good is played out in other contexts. For example, although loans are generally not governed by Article 2 of the U.C.C., if the money is being treated as a commodity (such as foreign exchange), the transaction is deemed a sale of goods and is subject to Article 2. See U.C.C. § 2-105 cmt. 1 (1995) ("Goods is intended to cover the sale of money when money is being treated as a commodity but not to include it when money is the medium of payment"); see also, e.g., Compania Sud-Americana de Vapores, S.A. v. IBJ Schroder Bank & Trust Co., 785 F. Supp. 411, 431 n.19 (S.D.N.Y. 1992). Courts interpreting statutes that apply to "sales of goods" or "commodities" differ over whether a loan of money is covered. Compare United States v. Investors Diversified Servs., Inc., 102 F. Supp. 645, 647 (D. Minn. 1951) (loan of money is not lease, sale, or contract for sale of goods or a commodity
money from the holder thereof, even if the holder is a bona fide purchaser, because the purchaser acquires no more interest than that held by his seller. As is true for misappropriation of a special account, suit may be brought for conversion of such money, although, generally, money is not specifically identifiable and thus conversion does not lie. If the mere fact that money constitutes a medium of exchange were all that is necessary to mandate an unalterable linkage between possession and ownership, these cases—which certainly involve money—would perforce be decided differently.


See, e.g., Sharon v. Nunan, 63 Cal. 234 (1883); Skidmore v. Taylor, 29 Cal. 619, 622 (1866); Eddings v. Boner, 38 S.W. 1110, 1111 (Indian Terr. 1887); Hamilton v. Clark, 25 Mo. App. 428, 433 (1887); Graves v. Dudley, 20 N.Y. 76 (1859); Knapp v. Springmeier, 7 Ohio Dec. Reprint 570 (1878); see also Williams Management Enters., Inc. v. Buonauro, 489 So.2d 160, 164 (Fla. Dist. Ct. App. 1986) ("When specific bills and coins are identifiable because of serial numbers or special markings, or because they are located uncommingled at a special exclusive place or contained within a [sic] identifiable container, the bills and coins, so identifiable, can be replevied.") (dictum).


See, e.g., Hunnicutt v. Higginbotham, 35 So. 469, 470 (Ala. 1903); Moody v. Keener, 7 Port. 218, 231-32 (Ala. 1838); Bolton v. Souter, 872 P.2d 758, 761 (Kan. Ct. App. 1993); Royce v. Oakes, 38 A. 371, 372 (R.I. 1897). See generally supra Part B.2. This concept of identifiability has been expanded from money contained in a "bag or chest," see Holiday v. Hicks, 78 Eng. Rep. 878, 900 (1599), to any money "with identified or segregated sources from which money has come or types of accounts into which money has been deposited," Lewis v. Fowler, 479 So.2d 725, 726 (Ala. 1985).
C. Impact on Commerce

The argument has long been made that commercial transactions could not function if the recipient of money had to investigate the provenance of that money to ensure that it belonged to the party from whom it was received, free and clear of claims of others.\(^{169}\) While this argument certainly has a degree of appeal, it

\(^{169}\) See, e.g., Ohio Cas. Ins. Co. v. Smith, 297 F.2d 265, 266 (7th Cir. 1962) (it is “a recognized public policy that money must be permitted to flow freely in our economy”); Transamerica Ins. Co. v. Long, 318 F. Supp. 156, 160 (W.D. Pa. 1970) (“it is absolutely necessary for commerce and business to continue that one who receives money, cashier’s checks or money orders is not put on inquiry as to the source from which the funds have been derived”); Tanner v. Lee, 49 S.E. 592, 593 (Ga. 1904) (allowing money to be reclaimed by the true owner “would be utterly destructive of the quality of currency which has been attached by law as an incident peculiar to money and negotiable paper, alone, of all other property”); Depew v. Robards, 17 Mo. 580, 582 (1853) (rule that owner of money and bills cannot recover from bona fide holder “is founded on the necessity of sustaining the credit of that which is used as the medium of exchange in commercial transactions”); Brown v. Perera, 176 N.Y.S. 215, 219 (N.Y. Sup. Ct. 1918) (“In this system of rules, which sprung into existence and has been perpetuated for the sole purpose of facilitating trade and rendering commercial transactions certain and secure, we may naturally except [sic] to find that the very corner stone of the structure is the rule which guarantees the untrammeled transferability of money.”); Stephens v. Board of Education, 79 N.Y. 183, 187 (1879) (“It is absolutely necessary for practical business transactions that the payee of money in due course of business shall not be put upon inquiry at his peril as to the title of the payor... It would introduce great confusion into commercial dealings if the creditor who receives money in payment of a debt is subject to the risk of accounting therefore to a third person who may be able to show that the debtor obtained it from him by felony or fraud. The law wisely, from considerations of public policy and convenience, and to give security and certainty to business transactions, adjudges that the possession of money vests the title in the holder as to third persons dealing with him and receiving it in due course of business.”); Hatch v. Fourth Nat’l Bank, 41 N.E. 403, 404 (N.Y. 1895) (“to permit, in every case of the payment of a debt, an inquiry as to the source from which the debtor derived the money, and a recovery if shown to have been dishonestly acquired, would disorganize all business operations, and entail an amount of risk and uncertainty which no enterprise could bear”); see also Hanson v. Mead-Haskell Co., 100 P.2d 1117, 1119 (Cal. App. Dep’t Super. Ct. 1940); Sanborn v. First Nat’l Bank, 90 S.W. 1033, 1034-35 (Mo. Ct. App. 1905); Yoder v. Sybmania Sav. Bank, No. L. 82-281, 1982 WL 6695, at *1 (Ohio Ct. App. Dec. 25, 1982); Portland v. Berry, 739 P.2d 1041, 1044 (Or. Ct. App. 1987); cf. Shaw v. Railroad Co., 101 U.S. 557, 564 (1879) (rule applicable to bills of exchange or bank notes, justified by “the interests of trade,” not applicable to lost or stolen bill of lading which is “not a representative of money”); Tucker v. New Hampshire Sav. Bank, 58 N.H. 83 (1877) (negotiability “is founded in the policy of sustaining the credit and circulation of negotiable paper. Freedom and safety in the negotiation of such paper are a practical necessity.”).

While the importance of negotiability has been challenged as it applies to negotiable instruments, see, e.g., Grant Gilmore, Formalism and the Law of Negotiable Instruments, 13 CREIGHTON L. REV. 441 (1979); Rogers, supra note 93; James Stephen Rogers, The Myth of Negotiability, 51 B.C. L. REV. 265 (1990); Albert J. Rosenthal, Negotiability—Who Needs It?, 71 COLUM. L. REV. 375 (1971), the commercial need for negotiability of money has not been questioned.
The Lease of Money in Bankruptcy

...does not justify a system that not only presumptively equates possession of money with ownership, but makes a loan of money without a transfer of ownership impossible.

In fact, the law does recognize situations in which a party other than the possessor of money has a cognizable interest in it, even in a commercial situation. For example, if a debtor grants a creditor a security interest in debtor's money, that security interest is valid as between the debtor and creditor upon attachment, even if the debtor continues to have possession of the money. Of course, the only means to perfect a security interest (making it valid against a third party) in money as such, not constituting proceeds of another type of collateral, is to possess it. But if the secured creditor takes possession of the money to perfect its security interest, ownership of the money remains with the debtor, despite the secured creditor's possession thereof. A third party, even one with no knowledge of the debtor's interest, who extends credit to the creditor in reliance on his possession of debtor's money, can get no claim to the funds because, in this situation, ownership does not follow possession.

If the money is collateral only because it constitutes proceeds of another type of collateral, the Uniform Commercial Code...
provides that the secured creditor continues to have a security interest in those proceeds even in the possession of the debtor if they are “identifiable.” That security interest also continues to be perfected to the extent that the security interest in the original collateral was perfected if a filed financing statement covers the original collateral (or the original collateral was investment property) and the proceeds are “identifiable cash proceeds.” This security interest is valid against third parties, despite the difficulty of ascertaining that the nonpossessor has any interest in the funds.

In the context of secured financing, therefore, the separation of possession of money from legally enforceable interests therein actually facilitates commerce rather than undermining it. Without the ability to obtain security interests in cash proceeds in the hands of a debtor, lenders would be virtually unwilling to finance inventory (which is sold for cash or on account) or accounts receivable (which by their nature turn into cash upon collection) because they would lose their collateral in the ordinary course of business. And debtors would be unable to utilize their cash assets not constituting proceeds as security if the very act necessary to perfect a security interest therein (delivery to the secured party) divested them of ownership of the money. Commercial transactions thrive despite the fact that money in these circumstances is subject to the claims of someone not in possession of it.

Even beyond the evidence provided by the law of secured transactions, it is not likely that our commercial system would be unable to function effectively if true claims of ownership could be asserted against those in possession of money. Although discussing the issue in the context of negotiable investment securities, Professor Rogers has made several cogent arguments against what he calls “the conventional wisdom that negotiability is essential to marketability.”

First, he points out that physical paper subject to negotiation by delivery is gradually giving way to electronic commerce and the

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174 See id. § 9-306(2).
176 James Steven Rogers, Negotiability, Property, and Identity, 12 CARDozo L. REV. 471, 479 (1990) [hereinafter Rogers, Negotiability].
recording of financial relationships by computer entry.\textsuperscript{177} While this development has been more accelerated for the securities markets than for money, the volume of cashless credit or debit transactions continues to rise at a phenomenal rate,\textsuperscript{178} and it is not at all inconceivable that cash in the form we now know it will disappear, as have treasury securities in bearer form. When all money transactions occur not in the form of currency but in the form of debits and credits of computer accounts (which can easily record any competing claims to credits), negotiability has little significance.\textsuperscript{179}

Second, he notes that protecting bona fide purchasers for value of negotiable paper does not necessarily facilitate the operation of the marketplace, because the rule harms true owners who are less willing to place their paper at risk.\textsuperscript{180} If true owners do not carry cash because of the risks connected with negotiability, the rule hinders commercial transactions rather than promoting them.

Third, Rogers notes that “[a]ny instrument that can be transferred by mere delivery is an instrument that can be transferred without any paper trail,”\textsuperscript{181} making enforcement of criminal and tax laws more difficult. Indeed, the federal government has statutorily limited the rule of negotiability of money by creating tracing rules to follow cash into the hands of third parties.\textsuperscript{182} Yet there is no

\textsuperscript{177} Rogers, Negotiability, supra note 176, at 479-80.

\textsuperscript{178} A recent study by Mentis Corporation indicated that consumer credit card payments will increase from 25% of all United States consumer payments made in 1997 to nearly one-third of such payments by 2000. According to the study, credit card transactions are increasing at a rate of 15% per year, and debit card transactions are exploding at an annual growth rate of 46%. The study found that debit card payments generally replace those previously made with checks and cash; only 6% of debit card purchases replace credit card purchases. See PR Newswire (Sept. 16, 1998) (available in NEXIS-LEXIS, News Library, PR Newswire File).

\textsuperscript{179} Cf. Charles W. Mooney, Jr., Beyond Negotiability: A New Model for Transfer and Pledge of Interests in Securities Controlled by Intermediaries, 12 Cardozo L. Rev. 305 (1990) (rejecting application of property law concepts such as tracing, first-in-time and bona fide purchase to transfers of interests in fungible bulks of securities controlled by intermediaries).

\textsuperscript{180} The simple example he uses relates to cash: “I never carry very much cash in the seat of my pants precisely because I know that if I lose it, it’s gone.” Rogers, Negotiability, supra note 176, at 480. In the absence of an alternative means of purchasing goods and services (such as a check, or debit or credit card), less money in the pants (or purse) means less economic activity. In this way negotiability, which Rogers equates with “vulnerability to theft,” makes commerce more risky. Id.

\textsuperscript{181} Rogers, Negotiability, supra note 176, at 480.

\textsuperscript{182} See Part III.E. infra.
evidence that the commercial markets are functioning less efficiently as a result.

Fourth, although there is no empirical study of the practice, "people do buy things even though they are not legally protected against adverse claims." Most goods purchased in good faith are not stolen or subject to a security interest in a third party. Even if there is a defect in the chain of title, the chances of the true owner having the inclination and the wherewithal to trace his or her goods are remote. Therefore, people simply engage in their ordinary commercial transactions without too much concern about competing claims to the goods they purchase. Similarly, most funds involved in commercial transactions are not subject to the claim of one not in possession of them. There is no reason to believe that commercial actors would search for a new medium of exchange if true owners who could trace their ownership interest were able to retrieve the money to which they had a claim. People do not currently decline to accept cash merely because there is a possibility that some of it might be counterfeit. The risk would simply be factored into the market, or people would be more selective about those with whom they do business so that they would be more likely to have a remedy against the party who transferred to them the tainted money in the event their rights to the money itself were defeated.

Finally, even if one believes that commerce requires that a bona fide holder of money who acquires it without notice of any deficiency in the title of the transferor and who gives value take free of all claims of a true owner, this principle does not justify treating the borrower of money (who has complete knowledge of the source of the funds and its own obligation to return them or their equivalent to the true owner) as the owner thereof. The negotiability principle is not needed to protect the party who borrows directly from a lender, any more than it is needed to

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183 Rogers, Negotiability, supra note 176, at 481.
184 Cf. Bankhaus Hermann Lampe KG v. Mercantile-Safe Deposit & Trust Co., 466 F. Supp. 1133, 1145 n.26 (S.D.N.Y. 1979) (imposing loss on good faith possessor of improperly issued certificate "accords with the imposition of loss upon a person who in good faith comes into possession of counterfeit currency").
185 Rogers uses the example of the market in art and antiques, where extremely expensive items trade frequently and are often stolen and subject to return to the true owner. Although purchasers may do some investigation of the title to the artwork, they generally rely on the reputation and solvency of their dealer. See Rogers, Negotiability, supra note 176, at 482.
protect a thief or person who converts funds of another who knows of the superior interest of the true owner of money.186

D. Intent of the Parties

When one party transfers property to another, whether that transfer is one of title to the transferred res or of mere possession is generally determined by the intent of the parties.187 Thus, one is not deemed to have relinquished ownership of one’s property unless there is evidence that one intended such alienation.188

186 When a thief or converter is not required to return money, it is not because the money is negotiable, but because the money is no longer identifiable. See supra Parts II.B.2. & II.B.3.

Grant Gilmore supported this point indirectly when he reflected on the decision of the drafters of Article 9 to allow assignments of intangible collateral free of the underlying contract defenses between assignor and obligor. See U.C.C. § 9-318(4) (1995). Gilmore noted:

The basic flaw in our analysis was our failure to perceive that the twentieth-century financing assignee was not in the least like the stranger who, one hundred and fifty years earlier, had bought goods, commercial paper, and other property in an open market without being able to find out about the prior history of whatever he bought. The financing assignee, who serves a useful function in providing working-capital loans, is not an ignorant stranger. He is in a position to find out—and, before putting up his money, does find out—all there is to know about the operations of his borrowers. He has a close and continuing relationship with them. He can, if he chooses, require the strictest accounting from them. He does not need to be insulated, as a matter of law, from the risks of the transactions in which they engage. Because he can investigate, supervise, and control, he should be encouraged to do so and penalized if he has not done so.


While a borrower may not have the same degree of control over a potential lender as a financing assignee has over its assignor, borrowers are no more “ignorant stranger[s]” who need protection from the claims of their lenders and their lenders’ creditors. See id. 187 See, e.g., Gulf Oil Corp. v. Banque de Paris et des Pays-Bas (In re Fuel Oil Supply & Terminaling, Inc.), 72 B.R. 752, 758 (S.D. Tex. 1987), rev’d on other grounds, 837 F.2d 224 (5th Cir. 1988); Goldstein v. Aleet Leasing Assocs. II (In re Spangler), 56 B.R. 990, 992 (D. Md. 1986); In re Taylor, 130 B.R. 849, 853 (Bankr. E.D. Ark. 1991); D.M. Ferry & Co. v. Forquer, 202 P. 193, 194 (Mont. 1921); Johnson v. Loewen, 272 N.W. 217, 218 (Neb. 1937); Estate of Gritzan, 523 A.2d 776, 778 (Pa. Super. Ct. 1987).

188 See generally Grant Gilmore, The Commercial Doctrine of Good Faith Purchase, 63 YALE L.J. 1057, 1057 (1954) (“The initial common law position was that equities of ownership are to be protected at all costs: an owner may never be deprived of his property rights without his consent.”). I do not deal here with the good faith purchaser for value without notice of a competing claim to property. See supra Part II.C. The commercial factors that have supported giving such a purchaser greater rights in certain property than its transferor have no bearing on a transaction between a single transferor and a single transferee dealing directly with one another.
Such evidence may be provided by the express language of the parties' agreement. If a contract is designated a "sale agreement" rather than a "lease," it can be assumed that the parties intended a transfer of ownership of the property subject to the agreement. Operative language that states that one party transfers and the other takes "all right, title and interest in and to" certain property would also provide direct evidence of the parties' intent that title was transferred. Alternatively, language that states that a party is "leasing" or "renting" property to another, or that the transferee "agrees to hold for the benefit of the transferor" and to return the property at a specified date or upon satisfaction of certain conditions, or that the transferor conveys the property "for security purposes only" or grants a lien on or security interest in property, would all suggest that ownership is not intended to be alienated.

If the parties' intent is not so clearly stated, it may be discernible from the substance of the transaction. For example, when the transferor provides the transferee complete control over the transferred property, with no requirement that it be returned, the transaction will be deemed a sale even if not so characterized by the parties. The substance of the transaction, rather than the language used by the parties, is seen as providing indirect or circumstantial evidence of the parties' intent.

In some cases, the parties' expressed intent will not be honored because it conflicts with the indirect evidence. Thus, even when the parties characterize a transfer of property as a "lease," if the consideration being paid by the transferee is an obligation for the term of the lease and is not subject to termination by the transferee and the full economic life of the property is being transferred in some way, the transfer will be deemed a sale with the supposed

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109 Indeed, for commercial law purposes such a transaction will be deemed a sale even when the transferor purports to retain title until the purchase price is fully paid. See U.C.C. § 2-401(1) (1995) ("Any retention or reservation by the seller of the title (property) in goods shipped or delivered to the buyer is limited in effect to a reservation of a security interest."). The security interest arising as a result of retention of title is treated like other security interests under Article 9, although for other purposes of state law title may indeed remain with the seller. In this situation, the demands of commercial practice may modify the intent of the parties with respect to title, but do not transform what is intended to be a sale into a lease.

100 Section 1-201(37) of the U.C.C. provides in the definition of "security interest" that: a transaction creates a security interest [and is thus a sale rather than a lease of property] if the consideration the lessee is to pay the lessor for the right to possession and use of the goods is an obligation for the term of the lease not
lessor (now recharacterized as a seller) retaining a security interest to secure the obligation to pay the lease payments (purchase price).\textsuperscript{191} A loan is generally not expressly called either a sale of money or a lease thereof by the parties, yet as we have seen, it is uniformly characterized to result in the transfer of ownership of the money loaned.\textsuperscript{192} As one possible justification for this characterization, it might be argued that such a transfer is consistent with the intent of the parties. Because the parties seldom expressly state in a loan agreement that they are transferring "title to" or "ownership of" the loaned funds,\textsuperscript{193} the intent of the parties must be discerned from other aspects of the transaction. To what factors should one look in trying to determine whether ownership of the funds has transferred?

If one were applying, by analogy, the factors distinguishing a lease from a secured sale of goods in the definition of "security interest" under section 1-201(37) of the Uniform Commercial Code,\textsuperscript{194} a loan does not obviously require characterization as a sale. The definition states that a transaction is a secured sale if the

subject to termination by the lessee, and

(a) the original term of the lease is equal to or greater than the remaining economic life of the goods,

(b) the lessee is bound to renew the lease for the remaining economic life of the goods or is bound to become the owner of the goods,

(c) the lessee has an option to renew the lease for the remaining economic life of the goods for no additional consideration or nominal additional consideration upon compliance with the lease agreement, or

(d) the lessee has an option to become the owner of the goods for no additional consideration or nominal additional consideration upon compliance with the lease agreement.

\textsuperscript{191} See, e.g., Western Enters., Inc. v. Arctic Office Machines, Inc., 667 P.2d 1232, 1234 (Alaska 1983).

\textsuperscript{192} See supra Part II.B.1.

\textsuperscript{193} A typical loan agreement speaks in terms of an agreement by the lender to "make a loan," "make advances," "lend," or "make available" a specified principal amount, and an obligation on the part of the borrower to "repay the unpaid principal amount" of such loan or advances on the specified date. See, e.g., AM. JUR. LEGAL FORMS 2d § 38:272 et seq. (1996).

\textsuperscript{194} Use of U.C.C. § 1-201(37) factors is, of course, not a perfect analogy. The language added to this definition in 1987 concurrently with the adoption of Article 2A was, in fact, designed to eliminate any search for the true 'intent' of the parties and instead analyze economic factors that would objectively indicate that ownership of goods had or had not been transferred. See U.C.C. § 1-201(37) Official Comment ("All of these tests [in the second paragraph of the definition] focus on economics, not the intent of the parties."). While economic analysis is somewhat more difficult for an asset like money that does not depreciate, the analogy can still be helpful.
obligation of the “lessee” to pay the “lessor” for possession and use of the goods is “not subject to termination by the lessee” “for the term of the lease” and one or more of four additional tests is met.\textsuperscript{195} Many loans, if not most, are prepayable at the option of the borrower;\textsuperscript{196} the obligation of the “lessee” to pay interest to the “lessor” is therefore subject to termination by the “lessee” at any time during the term of the loan and the first requirement for a secured sale is not met. The remaining four tests would be equally problematic, even if a loan is not prepayable at the borrower’s option. These tests focus on whether the full economic life of the leased property is being transferred to the lessee. Money has no finite economic life. Even if specific bills or coins wear out, they may be replaced for new ones. Money does not depreciate. Our currency is backed by the full faith and credit of the United States government; until there is no such government, or its credit loses substance, no transfer of money for a definite term will exhaust the economic life of the funds transferred.\textsuperscript{197} Therefore, none of these factors would militate in favor of characterizing a loan as a sale of funds, without regard to its term.

\textsuperscript{195} See supra note 190.

\textsuperscript{196} As a general matter, a borrower has no right to prepay a loan unless the contract so provides or the lender consents. See, e.g., C.C. Port, Ltd. v. Davis-Penn Mortgage Co., 61 F.3d 288, 289 (5th Cir. 1995) (applying Texas law); Ex parte Brannon, 683 So.2d 994, 996 (Ala. 1996); Wyckoff v. Anthony, 90 N.Y. 442, 448 (1882); Sound Stage Studios, Inc. v. Life Investors Ins. Co., No. 88-204-II, 1988 WL 138827, at *2 (Tenn. Ct. App. Dec. 30, 1988). However the common law rule has been reversed by case law and by statute in certain circumstances. See, e.g., Mahoney v. Furches, 468 A.2d 458, 461 (Pa. 1983); ALA. CODE § 5-19-4(c) (Supp. 1999); FLA. STAT. ANN. § 697.06 (West Supp. 2000); N.Y. BANKING LAW § 108(4)(e), (5)(d), (5-a)(6) (McKinney Supp. 2000); N.C. GEN. STAT. § 24-2.4 (1999).

\textsuperscript{197} The fourth test in paragraph (d) of the second paragraph of U.C.C. § 1-201(37) looks to whether the lessee “has an option to become the owner of the goods for no additional consideration or nominal additional consideration upon compliance with the lease agreement.” The consideration referred to must be the consideration paid during the term of the “lease,” which equates to interest and mandatory prepayments under a loan agreement. Although it is possible that one could characterize the final repayment of the unpaid principal amount of a loan as consideration paid by the borrower to become the “owner” of the money lent, such final repayment will almost never be “nominal.” In the case of a balloon loan (when no prepayments have been made during the term of the loan), it will be equal to the full amount originally borrowed. And the borrower is given no “option” to acquire ownership of the borrowed funds; either the borrower has such ownership from the inception of the relationship because the loan agreement transfers title, or the money is deemed leased and there is no end-of-term option.
Although some of the factors itemized in the third paragraph of section 1-201(37)\(^{198}\) may be present in the case of a loan,\(^{199}\) none of these factors compels recharacterization of a lease of goods into a secured sale; they should not, therefore, have any bearing on whether ownership of loaned money vests in the transferee.

Perhaps it could be argued that in the absence of any expressed intent with respect to title to the borrowed funds, it should be presumed that a transfer of ownership was intended because the recipient of the funds is given the ability to treat the funds as an owner would (i.e., the borrower may do with them as it likes). This sort of autonomy over property is one of the classic indicia of ownership.\(^{200}\)

\(^{198}\) The third paragraph in U.C.C. § 1-201(37) (1995) states:

A transaction does not create a security interest merely because it provides that

(a) the present value of the consideration the lessee is obligated to pay the lessor for the right to possession and use of the goods is substantially equal to or is greater than the fair market value of the goods at the time the lease is entered into,

(b) the lessee assumes risk of loss of the goods, or agrees to pay taxes, insurance, filing, recording, or registration fees, or service or maintenance costs with respect to the goods,

(c) the lessee has an option to renew the lease or to become the owner of the goods,

(d) the lessee has an option to renew the lease for a fixed rent that is equal to or greater than the reasonably predictable fair market rent for the use of the goods for the term of the renewal at the time the option is to be performed, or

(e) the lessee has an option to become the owner of the goods for a fixed price that is equal to or greater than the reasonably predictable fair market value of the goods at the time the option is to be performed.

With respect to clause (a), the consideration paid by a borrower will be substantially equal to the fair market value of the money at the time the loan agreement is entered into; any other pricing would make a lender non-competitive in the marketplace.

A borrower will assume the risk of any loss of money, and will pay any taxes, insurance, filing, recording or registration fees, or other costs with respect to the loan, as itemized in clause (b).

Although a loan agreement will not mention "ownership" of the money, it may be subject to extension or renewal, as mentioned in clause (c), and if it is, the pricing will again be the reasonably predictable fair market value interest rate at the time of renewal, as suggested by clause (d).

The borrower will never be deemed to have an "option" to become the owner of the borrowed funds as under clause (e); all amounts paid to the lender in respect of the funds (with the exception of optional prepayment fees) will be required by the loan agreement. See U.C.C. § 1-201(37).

\(^{200}\) See, e.g., Yonadi v. Commissioner, 21 F.3d 1292, 1297 (3d Cir. 1994) ("Control of property is no doubt an important indicia of ownership."); Sexton v. Graham, 4 N.W. 1090, 1096 (Iowa 1880) ("In case of a general bank deposit it is understood that the bank will use it.
But, in fact, lenders generally do not provide such autonomy to borrowers. Loans are usually made for specified purposes—to buy a house, to purchase a car, to finance the purchase of inventory, to pay off debt, to pay tuition—and the use of proceeds is likely to be specified in the loan agreement. Given the restrictions on the use of the transferred property, perhaps a loan looks more like a lease than a sale of the money. Although one can have control over property without ownership, as when the owner of property has delegated day-to-day management to an agent, general partner, or professional manager, ownership of property generally carries with it the unrestricted right to control.

On the other hand, at the point when the money is actually used for the specified purpose (i.e., paid to the seller of the home, car, or inventory; to the lender of the earlier debt; or to the educational institution), it has transferred to a good-faith holder for value and both lender and borrower must have intended that such holder take free of any claim of the lender. At least by this time, title to the money must have transferred from lender to borrower and from borrower to a third party. But this does not necessarily mean that the parties intended title to the money to transfer earlier, when the money is still in the hands of the borrower. Courts have recognized that a transaction originally structured as a bailment of money can turn into a loan. There is no reason a lease of money could not turn into a sale of money at the moment funds are applied by the borrower, if that were the intent of the parties.

But is that the intent of the parties? I have already suggested that, in the context of the most common loan of funds made by the deposit of money into a general account with a bank, the

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If a lender does not impose any restrictions on use of proceeds or specifies that the borrower may use the funds "for any legal purpose" or "for general corporate purposes," which is functionally equivalent to imposing no restrictions at all the lender has not retained autonomy over the funds and could be presumed to have intended to transfer such autonomy (and with it ownership of the funds) to the borrower. But, as suggested infra, if a lender's ownership of funds in the hands of a borrower were legally recognized if (and only if) the lender carefully specified the acceptable uses for such funds, all loan agreements would include such a provision.

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See, e.g., Hargis v. Spencer, 71 S.W.2d 666, 670 (Ky. 1934); Caldwell v. Hall, 60 Miss. 330, 334 (1882).
unsophisticated understanding of the depositor would likely be that the money in the bank "belonged" (in the state law property sense) to the depositor, although the bank would surely know that the "deposit" was merely a claim by the depositor against the bank (i.e., a liability of the bank) and that the bank itself owned the deposited funds until they are withdrawn. The intent of the more sophisticated party to a lending transaction is shaped by its understanding of the legal precepts governing that transaction. Given the consistent and long-standing legal treatment of a loan as a "sale" of money (in the sense of transferring ownership thereof) at the moment the loan is made, these parties naturally expect that this will be the consequence of their transaction. The borrowed cash is immediately recorded as an asset of the borrower, and the obligation to repay the lender is shown as a matching liability on the debtor's books. The lender no longer shows the lent funds as its own asset, but instead shows a promissory note from the borrower evidencing its obligation to repay the loan as an asset.

However, just because these expectations are shaped by the legal regime governing them, it makes no sense to justify the legal regime by the intent of the parties. Nor is it likely, in this "chicken-or-the-egg" scenario, that the intent of the parties is really driving the legal characterization. If it were, every lender would simply insert a provision in its loan agreement stating that all funds lent will remain the property of the lender. As in the case of the secured sale disguised as a lease, this so-called "loan" would likely still be deemed to transfer ownership of the money, without regard to the intention of the parties.

E. Tracing

The argument is made that ownership must transfer with possession of money because "money has no earmark" and therefore one generally cannot trace money into the hands of another. See supra at notes 91-92 and accompanying text.

203 See supra at notes 91-92 and accompanying text.

Of course, this argument is technically incorrect with respect to paper currency. All bills have a distinct serial number that is intended to, and does, permit tracing when needed. In that respect, currency is really no different from stock certificates or registered bonds, other than the quantity available in society. If one wished, one could trace a bill from printing to destruction.

Those who raise the specter of lack of earmark are not arguing that money cannot be traced, but that the burden of doing so in a society with so much money in circulation is not tolerable. Therefore, we should not only not require such tracing, but should positively preclude it.

Putting aside the technical feasibility of tracing, and recognizing that most loans are made not by a lender passing a suitcase of bills to a borrower, but by crediting the borrower's account with the loaned amount which has no identifying marks, the difficulties inherent in tracing money should still not lead ineluctably to the conclusion that the recipient of a loan becomes the owner of the funds. Money is not the only fungible property subject to transfer from one party to another, and, with respect to other property, the law has developed stratagems for maintaining source of money, and for this reason one who receives money in good faith for valuable consideration prevails over the victim.

See generally F.A. MANN, THE LEGAL ASPECT OF MONEY 9-10, 11-12 (5th ed. 1992) (describing "earmark" doctrine and suggesting that it "is today of little practical significance"). Sometimes this concept is somewhat carelessly expressed as "money is fungible," see, e.g., Estate of Newman v. Commissioner, 934 F.2d 426, 431 (2d Cir. 1991); Balcor Real Estate Holdings, Inc. v. Walentas-Phoenix Corp., No. 93C3065, 1996 WL 254286, at *2 (N.D. Ill. May 13, 1996); Williams Management Enters., Inc. v. Buonauro, 489 So.2d 160, 164 (Fla. Dist. Ct. App. 1986); State v. Endres, 741 S.W.2d 788, 790 (Mo. Ct. App. 1987), although "fungibility" really deals not with the ability to trace but instead describes items of property of a kind or quality such that one may be substituted for another in meeting an obligation, for example, the obligor has no right to particular items of such property, see, e.g., United States v. BCCI Holdings (Luxembourg), S.A., 941 F. Supp. 180, 185 (D.D.C. 1996); In re Purnel, 60 Cal. Rptr. 2d 667, 675 (Cal. Ct. App. 1997). Goods that are not capable of precise tracing will invariably be fungible, but fungible goods are not necessarily impossible to trace.

property rights in the nonpossessor of fungible property through the doctrine of confusion of goods.

Fungible goods, such as grain, oil, gas, or farm animals, can be commingled through wrongful or negligent conduct, by mistake or accident, or by the intent of the owners. When goods are commingled with the mutual consent of the owners, such that it is impossible to distinguish the particular goods owned by each, the general rule is that the owners become tenants in common of the entire mass in proportion to their respective contributions to that mass. This common law rule with respect to confusion of goods in the hands of warehousemen is now codified in section 7-207 of the Uniform Commercial Code.

See, e.g., Basin Elec. Power Coop. v. ANR W. Coal Dev. Co., 105 F.3d 417, 423 (8th Cir. 1997); Reeves v. Reeves, 92 So. 551 (Ala. 1922); Willard v. Cox, 63 So. 781, 782 (Ala. Ct. App. 1913); Arnold v. Producers' Fruit Co., 61 P. 283, 285 (Cal. App. Dep't Super. Ct. 1900); Drudge v. Leiter, 49 N.E. 34, 37 (Ind. App. 1898); In re Thompson, 145 N.W. 76, 79-80 (Iowa 1914); Inglebright v. Hammond, 19 Ohio 337, 343-44 (1850); Montgomery v. United States Nat'l Bank, 349 P.2d 464, 469 (Or. 1960); Ayre v. Hixson, 98 P. 515, 519 (Or. 1908); Manti City Sav. Bank v. Peterson, 86 P. 414, 415-16 (Utah 1906). Cf. Intermingled Cotton Cases, 92 U.S. 651, 653 (1875) (stating, with respect to funds realized upon sale of cotton seized from various Mississippi growers by Northern troops during Civil War, that "[e]ach owner of property intermingled with other property of the same kind and value, and stored in a common mass, becomes the owner as tenant in common of an interest in the mass proportionate to his contribution"). See generally 1 AM.JUR. 2D Accession and Confusion § 14, at 455 (1994) ("When goods of the same kind owned by different persons are, with the mutual consent of the owners, mixed and intermingled so that the portions or shares of the various owners are indistinguishable, the owners become tenants in common of the mixture, each having an interest in common in proportion to his respective share.").

Although this rule developed as a matter of equity, it was also codified for grain warehouses. Under the common law rule (based on the Roman mutuum), the transfer of a fungible good like grain to a warehouseman with the expectation that the identical property would never be redelivered results in a transfer of ownership to the grain warehouseman and the farmers would be relegated to a claim against the warehouseman for the value of the grain. See, e.g., Rahilly v. Wilson, 20 F. Cas. 179, 181 (C.C.D. Minn. 1873). Some state legislatures and courts rejected the common law rule and provided that the deposit of grain with a warehouseman would be treated as a bailment, despite the fungible nature of the grain. See, e.g., Zuber v. Minshall, 256 P. 806 (Kan. 1927); Ledyard v. Hibbard, 12 N.W. 637 (Mich. 1882); Hall v. Pillsbury, 44 N.W. 673 (Minn. 1890); National Exch. Bank v. Wilder, 24 N.W. 699, 701 (Minn. 1885); James v. Flank, 26 N.E. 1107, 1109 (Ohio 1891); Bretz v. Diehle, 11 A. 893 (Penn. 1888). See generally J.C. Knowlton, The American Mutuum, 1 Mich. L.J. 341 (1893); RAUSHENBUSH, supra note 85, at 237-44; Comment, On the Title to Grain in Public Warehouses, 6 AM. L. REV. 450 (1872).

Under U.C.C. § 7-207(2) (1995), "[f]ungible goods so commingled are owned in common by the persons entitled thereto and the warehouseman is severally liable to each owner for that owner's share." See also, e.g., Preston v. United States, 696 F.2d 528, 535 (7th Cir. 1982) (applying Wisconsin law); In re Woods Farmers Coop. Elevator Co., 107 B.R. 578, 684 (Bankr. D.N.D. 1989); Farmers Rice Milling Co. v. Hawkins (In re Bearhouse, Inc.), 84
The same rule is applicable to investment securities held by a securities intermediary under section 8-503(b) of the Uniform Commercial Code. Each person holding a property interest with respect to a financial asset identified on the books of the securities intermediary (such as a bank or broker who routinely maintains securities accounts for others) is deemed to have "a pro rata property interest in all interests in that financial asset held by the securities intermediary."\(^{208}\)

A similar doctrine governs perfected security interests in goods that are commingled with other goods in which a separate security interest has been granted. Under section 9-315 of the Uniform Commercial Code, if the goods in which there are multiple security interests become so commingled as part of a product or mass that their separate identity is lost, the security interests "rank equally according to the ratio that the cost of the goods to which each interest originally attached bears to the cost of the total product or mass."\(^{209}\)

The confusion of goods doctrine has been used even with respect to commingled money. In Boaz v. Ferrell,\(^{210}\) a county tax collector came into possession of both state and county tax collections. He commingled them in a single account and then embezzled an amount equal to the taxes due the state while paying over the rest to the county. The court held that dismissal of an action by the surety (which was subrogated to the rights of the state) against the county was improper. Both state and county owned both the embezzled funds and those transmitted to the county according to their proportionate share of the original deposit, and the surety therefore had the right to recover the state's share of the funds paid to the county.\(^{211}\)

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\(^{208}\) U.C.C. § 8-503(b)(a) (added by 1994 revisions).


\(^{211}\) It is not clear how much the court was relying on the doctrine of confusion of goods and how much on trust law. The court noted, "in the hands of any depository the taxes
Although Boaz is unusual in applying the confusion of goods rule to money, courts have employed other means to uphold ownership claims to fungible cash by parties not in possession of it. Trust law provides many examples of equitable tracing techniques. When trust funds are deposited with a trustee and that trustee wrongfully commingles the funds with his own, thereby creating an indistinguishable mass, the inability to distinguish the trust funds from the others should arguably lead to the conclusion that there is no longer an identifiable trust res, and the beneficiary of the trust should be relegated to a personal claim against the trustee. But the law of trusts rejects this conclusion and gives the beneficiary a constructive trust on the commingled property for an amount equal to the original value of the trust property.\(^2\) If the trust property is commingled not with the trustee's property, but with that of other trust beneficiaries, each beneficiary may enforce a constructive trust and share proportionately in the commingled mass, despite the inability to identify specific trust property.\(^3\)

Similarly, trust funds transferred out of a trust account and into the hands of a third party should lose their trust status if money cannot be traced. Instead, trust law allows the beneficiary to assert a claim to the funds wherever they may be found as long as the funds may be specifically traced into the hands of the holder and are not in the hands of a bona fide purchaser for value.\(^4\) If trust funds are constituted joint or trust funds, which, having become confused without fault of the cestuis que trust or real owners would be duly apportioned between such owners by courts of equity." Id. at 202 (emphasis supplied). The cases cited in support of this principle are a mixture of trust cases and cases involving confusion of goods. See id.


commingled with the trustee's own funds and disbursements are then made from the account that cannot be traced or recovered, under the lowest intermediate balance rule (LIBR) the disbursements are deemed to have come from nontrust property until such property is entirely depleted before the trustee will be deemed to have transferred any trust property. As a result, the beneficiary may assert a claim to the money remaining in the commingled account after any disbursements (up to the amount of the trust funds) but has no claim to any subsequent deposits of nontrust funds.

Statutes may also provide mechanisms for tracing the funds in which a nonpossessor has property rights even into a commingled mass of funds. The rules on proceeds under the Uniform Commercial Code were, in part, designed for that purpose. A secured creditor with a security interest in cash proceeds of other collateral does not lose its security interest merely because the debtor deposits that cash in a bank account where it is commingled with cash not subject to the security interest. Indeed, so long as the cash proceeds are "identifiable," the security interest continues in the cash proceeds indefinitely. Because the Uniform Commercial Code does not provide a means of identifying cash proceeds, courts have applied the equitable tracing rules discussed above to conclude


If a subsequent deposit were made with the intent to make restitution for the depleted trust funds, the beneficiary may claim the deposit as well. See, e.g., Columbia, 997 F.2d at 1061; Connecticut Gen. Life, 838 F.2d at 619; NBD Bank, 922 F. Supp. at 1243-44; Kepler v. Woods (In re Larson), 206 B.R. 945, 947 (Bankr. W.D. Wis. 1997); In re Drexel Burnham Lambert Group, Inc., 142 B.R. 633, 637 (S.D.N.Y. 1992); Bennett v. Glacier Gen. Assur. Co., 857 P.2d 683, 686 (Mont. 1993). See generally Restatement (Second) of Trusts § 202 cmt. j (1959); Restatement of Restitution § 212 cmt. a (1937).

U.C.C. § 9-306(2) (1995) provides, in part, "[e]xcept where this Article otherwise provides, a security interest... continues in any identifiable proceeds including collections received by the debtor." The concept of 'identifiable' proceeds also appears in U.C.C. § 9-114 (dealing with priority between a consignor and a secured creditor of the consignee) and in U.C.C. § 9-312(3) (covering conflicting security interests in inventory).
that cash proceeds are identifiable to the extent that they remain in the commingled account under LIBR.\textsuperscript{218}

If bankruptcy occurs, the Uniform Commercial Code provides a special tracing rule under which a secured creditor is deemed to have a perfected security interest even in commingled deposit accounts of the debtor into which cash proceeds have been placed, but this is limited to the amount of cash proceeds received by the debtor within ten days prior to the bankruptcy case, with certain deductions.\textsuperscript{219}


\textsuperscript{219} U.C.C. § 9-306(4)(d) gives the secured creditor a perfected security interest "in all cash and deposit accounts of the debtor in which proceeds have been commingled with other funds, but... limited to an amount not greater than the amount of any cash proceeds received by the debtor within ten days before the institution of the insolvency proceedings less the sum of (I) the payments to the secured party on account of cash proceeds received by the debtor during such period and (II) the cash proceeds received by the debtor during such period to which the secured party is entitled under paragraphs (a) through (c) of this subsection (4)." See also, e.g., United Jersey Bank/Central, N.A. v. Collated Products Corp. (In re Collated Products Corp.), 121 B.R. 195, 205-06 (D. Del. 1990), aff'd, 937 F.2d 596 (3d Cir. 1991) (unpublished); First Nat'l Bank v. Martin, 48 B.R. 317, 320-21 (N.D. Tex. 1985); In re Litamar, Inc., 157 B.R. 828, 832 (Bankr. N.D. Ohio 1993); In re Mark Twain Marine Indus., 115 B.R. 948, 952-54 (Bankr. N.D. Ill. 1990); Charter First Mortgage, Inc. v. Oregon Bank (In re Charter First Mortgage, Inc.), 56 B.R. 838, 848-51 (Bankr. D. Or. 1985); In re Datair Sys. Corp., 42 B.R. 241, 245 (Bankr. N.D Ill. 1984); Campbell v. SBA (In re Jameson's Foods, Inc.), 35 B.R. 493, 497 (Bankr. D.S.C. 1983).

The secured creditor's priority with respect to nonmonetary assets may also be dependent on its ability to trace money to the acquisition of those assets. A security interest constitutes a "purchase money security interest," entitled to the priority granted by section 9-312(3) and (4) of the UCC, only if the secured creditor "gives value to enable the debtor to acquire rights in or the use of collateral if such value is in fact so used." The definition requires tracing the proceeds of the loan directly to the acquisition of the collateral.

Tracing may be an issue in bankruptcy for parties other than secured creditors. For example, a seller who has a statutory right of reclamation does not lose that right merely because the goods it sold are fungible and are commingled with similar goods in the hands of the debtor. All that is required of a seller under these circumstances is that the seller trace the goods from its own possession into an identifiable mass in the hands of the debtor and show that the mass contains goods of like kind.

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U.C.C. § 9-312(3) affords priority to a perfected purchase money security interest in inventory over a prior perfected security interest in inventory if certain conditions are met. Purchase money security interests in all other types of collateral are given priority over conflicting security interests in the same collateral "if the purchase money security interest is perfected at the time the debtor receives possession of the collateral or within ten days thereafter." Id. § 9-312(4).

Id. § 9-107(b).


Under U.C.C. § 2-702(2), a seller of goods on credit may reclaim the goods "upon demand made within ten days after the receipt" if the seller discovers that the buyer has received the goods while insolvent. The ten day limitation does not apply where the seller has received a written misrepresentation as to the buyer's solvency within three months prior to delivery of the goods.

This state statutory reclamation right is modified in bankruptcy under 11 U.S.C. § 546(c) to require a written demand before 10 days after the buyer's receipt of the goods (or 20 days if the bankruptcy filing has intervened), and to permit the court to deny reclamation if the court grants the seller a priority administrative expense claim or a security interest to secure its claim for payment.

See, e.g., Conoco, Inc. v. Braniff, Inc. (In re Braniff, Inc.), 113 B.R. 745, 753-54 (Bankr.
A debtor in bankruptcy may also have the need to trace. In the same way that a secured creditor may have to trace loan proceeds to establish its entitlement to a purchase money security interest, the debtor may have to trace the same proceeds to establish that the security interest held by that creditor is subject to avoidance under § 522(f)(1)(B) of the Code. Certain exemptions, both those provided by the Code and those provided under state law, exempt not only particular categories of payments but also other property “traceable” to such payments. Even when the statutory exemption makes no reference to tracing, some exemptions have been interpreted to include amounts in a commingled bank account to the extent that the balance can be traced to exempt funds. In these cases, the debtor may trace the exempt cash, despite its lack of “ earmark,” to claim the exemption.


See supra notes 221-22 and accompanying text.

See 11 U.S.C. § 522(f)(1)(B) (allowing the debtor to avoid the fixing of a lien to the extent that it impairs an exemption if the lien is "a nonpossessory, nonpurchase-money security interest" in specified collateral).

Under 11 U.S.C. § 522(d)(11), a debtor may exempt his "right to receive, or property that is traceable to" certain compensatory payments, including some payments for wrongful death of a person of whom the debtor was a dependent, payments for loss of future earnings of the debtor or a person of whom the debtor was a dependent, certain personal bodily injury payments, and certain payments under a life insurance contract insuring the life of a person of whom the debtor was a dependent. Other exemptions provided by the Code do not include a concept of proceeds. See also, e.g., Makoroff v. Panza (In re Panza), 219 B.R. 95, 97 (Bankr. W.D. Penn. 1998) (exemption for debtor’s right to receive disability benefits in 11 U.S.C. § 522(d)(10)(C) did not include funds already received and deposited in a savings account). But see In re Frazier, 116 B.R. 675, 678 (Bankr. W.D. Wis. 1990) (finding funds in commingled bank account exempt to the extent traceable to disability benefits exempt under 11 U.S.C. § 522(d)(10)).


Statutory tracing rules exist outside the context of secured transactions and bankruptcy. Statutes providing for forfeiture of proceeds from illegal activity often require the government to show that the seized property can be traced to the wrongful conduct. Yet the fact that money has been commingled in a bank account with other funds unrelated to the criminal activity has not prevented tracing for purposes of these statutes using the equitable tracing techniques already discussed.
In all of these circumstances, parties are able—indeed, in some circumstances, required—to trace funds into a fungible mass in the possession of another. Therefore, the difficulties of tracing with respect to this fungible asset cannot alone justify treating borrowed funds in the hands of the debtor as necessarily being owned by the debtor rather than the lender who transferred them there.

IV. LOAN AS LEASE OF MONEY

Having concluded that the various justifications for automatically transferring ownership of money with the loan thereof cannot withstand scrutiny, the next question is whether the alternative can work. In other words, are there legal rules in place that would afford lenders equivalent rights to those given other lessors of personal property that do not undermine the values that have been proposed as the justification for linking possession of loaned funds with their ownership?

If a loan of money were treated in the same way as a lease of other personal property, the first consequence would be that a loan agreement would be treated as a lease agreement. Even before any loans are made under the loan agreement, the contractual arrangement between the lender and the debtor would be equivalent to that of any lessor and lessee who signed a binding contractual arrangement with respect to the lease of property prior to the delivery of actual possession of the res.\cite{footnote234}


\begin{footnotesize}
\textsuperscript{234} A "lease agreement" under U.C.C. § 2A-103(k) (1995) is "the bargain, with respect to the lease, of the lessor and the lessee in fact..." A "lease" means "a transfer of the right to possession and use of goods for a term in return for consideration." \textit{Id.} § 2A-103(j). The right to possession and use of goods "just like the right to borrow money" can transfer before actual possession is obtained by the lessee. Thus a loan agreement, containing a binding commitment to deliver funds to the borrower, transfers the right to use the funds even before any borrowing is made and, by analogy to Article 2A of the U.C.C., could be characterized as a lease agreement.
\end{footnotesize}
Once a loan was made, title to the loaned funds would remain in the lender when the money was transferred to the borrower.\(^\text{235}\) The fact that the borrower would have the right to alienate the funds should not affect the characterization of the transaction as a lease; although most leases preclude any sale or other disposition of the leased property by the lessee, the parties can contractually alter this understanding. \(^\text{226}\) By transferring leased funds to a third party,\(^\text{237}\) the borrower would, in essence, be purchasing the funds from the lender and simultaneously selling them.\(^\text{238}\) An option to purchase leased property (and thereafter transfer it to a third party) at any time during the lease term does not retroactively transform a lease into a sale.\(^\text{239}\)


\(^{226}\) See, e.g., Traction Cos. v. Collectors of Internal Revenue, 223 F. 984, 985-86 & n.1 (6th Cir. 1915); cf. Long v. Hammond, 145 P. 527, 528 (Cal. 1914); Mohawk Drilling Co. v. Wolf, 262 P.2d 892, 893 (Okla. 1953); Klaudt v. Bachtold, 188 P. 924, 926 (Wash. 1920) (finding no lease provision authorizing sale by lessee).

\(^{237}\) This transfer could, of course, be made simultaneously with the borrowing. For example, some loans take the form of deposits of loan proceeds to a “zero balance” account on which the debtor writes checks; the lender advances funds under the loan agreement in an amount just sufficient to permit the checks to be honored. In such a structure, the characterization of the lender/debtor transaction can become an issue in bankruptcy with respect to the loaned funds themselves only if the lender advances funds by depositing them into the account, but before the checks are honored the bankruptcy stay intervenes. Of course, the characterization of the loan agreement as a lease would continue to have serious implications for bankruptcy purposes. See infra Part V.

\(^{238}\) One could analogize such a transfer to a sale of collateral subject to a security interest with the consent of the secured lender. Under U.C.C. § 9-306(2) (1995), “a security interest continues in collateral notwithstanding sale, exchange or other disposition thereof unless the disposition was authorized by the secured party in the security agreement or otherwise.” The transferee takes free of the security interest only if the secured party authorized the disposition free and clear of the security interest. See id. § 9-306 cmt. 3; see also PEB Commentary No. 5 (1990). In the context of a secured transaction, the secured party generally relinquishes its security interest in the collateral itself in exchange for a security interest in the proceeds of the disposition, which may be applied to the secured obligation, remain in the possession of the debtor, or be used to acquire additional collateral. Rather than exchanging its interest in the loaned funds for an interest in whatever the borrower acquired with such funds, the lender would be authorizing the disposition of the loaned funds free of the lender’s ownership interest in exchange for a claim against the borrower for the value thereof.

\(^{239}\) U.C.C. § 1-201(37) has provided in the third paragraph thereof since its amendment in 1987 that a transaction purporting to be a lease is not in fact a sale “merely because it
If the loaned funds were maintained in a separate account before their use by the borrower, the lender's property could be readily identified at any time. But what if the funds were not kept in a separate account but instead were commingled with the borrower's other funds?²⁶⁰ Again, owners of fungible property intentionally commingled with that of another have long been able to claim a proportionate share of the commingled mass under the doctrine of confusion of goods.²⁴¹ The same principle could allow the lender of $1 million to a borrower, who then places the funds in an account with $2 million of its own funds, to claim one-third of the resulting mass.

Once disbursements are made from the commingled account, equitable tracing principles would take effect. Using as an example the commingled account with its $3 million balance, of which $1 million came from the lender and the remaining $2 million from the borrower's own funds, under LIBR all withdrawals would be deemed to come from the borrower's own funds (rather than the lender's funds), as long as the borrower had its own funds in the account.²⁴² Subsequent deposits to the account of the borrower's own funds would not increase the lender's interest in the commingled mass in the absence of evidence that the deposit was intended to accrue to the benefit of the lender.²⁴³ So long as the balance in the account never dropped below $1 million, the lender would always own $1 million of the funds in the account. If the balance dropped below $1 million, that lower balance would become the "lowest intermediate balance" and the lender's property interest in the commingled account would drop accordingly, without regard to subsequent deposits.

provides that *** (c) the lessee has an option... to become the owner of the goods." Even before its amendment U.C.C. § 1-201(37) specified that "the inclusion of an option to purchase did not itself make the lease one intended for security." U.C.C. § 1-201(37) (1978); see also, e.g., In re Marhoefer Packing Co., 674 F.2d 1139, 1143-44 (7th Cir. 1982); Ford Motor Credit Co. v. Sims, 743 P.2d 1012, 1014-15 (Kan. Ct. App. 1987).

²⁴⁰ This commingling problem would be present even if the loan agreement contemplated deposit of loan proceeds into the borrower's operating account (in which non-borrowed funds are also deposited) simultaneously with the presentation of checks drawn on the account by the borrower to pay its obligations. So long as the account includes any amounts not constituting loan proceeds, it is commingled as a matter of law and tracing becomes an issue despite the coincidence of the loan amount and the amount of the check.

²⁴¹ See supra notes 206-11 and accompanying text.

²⁴² See supra note 215.

²⁴³ See supra note 216.
There is no reason to believe that treating loans as leases would in any way undermine the concerns that underlie the current presumption that ownership passes with possession of the loaned funds. First, as previously suggested, there is historical precedent for the transfer of possession of funds without a transfer of ownership pursuant to a depositum, which could be transferred into a mutuum (loan for consumption) upon use of the funds by the borrower. Even if such a characterization did not fit into historical labels, there is no reason to allow the labels of Roman law to remain immutable. Mutuum was, after all, a gratuitous loan between family or friends; it was never intended to govern rights and liabilities in business transactions in a modern commercial age.

Treating loaned funds in the possession of the borrower as belonging to the lender would in no way be inconsistent with recognizing that money is a medium of exchange. As noted supra, money can be legally transferred without the transfer of ownership by depositing it in a special account at a bank or by entrusting it to a bailee. Indeed, once it is deposited in the borrower’s account, it is no longer even money but becomes a claim against the bank. When bank credits are increasingly treated as a medium of exchange in our society, the need to protect money as a medium of exchange is correspondingly diminished.

Because any third party taking the borrowed funds for value from the borrower would obtain good title, free of any claim of the lender, treating a loan as a lease of money would not undermine commercial transactions in the leased funds. The recipient of funds from the borrower would be under no obligation to ascertain whether the funds originated in a loan or in the borrower’s own operations. Money (to the extent that money remains a meaningful currency in the marketplace) would remain completely negotiable; commerce would continue to flourish as it now does.

One might argue that commerce could be adversely affected by the proposed treatment because third parties who previously had a claim to the borrowed funds equal in priority to that of the lender would lose that claim entirely, because the funds would belong to the lender rather than the borrower. As a result, these third parties

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544 See supra notes 147-52 and accompanying text.
545 See supra notes 162-68 and accompanying text.
546 See supra notes 84-85 and accompanying text.
547 See supra text accompanying note 169.
The Lease of Money in Bankruptcy

would be unwilling to do business with a borrower. But creditors have long shown their willingness to deal with debtors who have prior claims to portions of their property, including claims of personal property lessors and claims of secured parties with security interests in property and its proceeds. Recognizing the lender's claim to the leased funds would in no way create a problem of "ostensible ownership" or "secret lien" when third parties are unable to ascertain whether there is a prior competing claim to property in the possession of the debtor. All loans are reflected on the financial statements of the borrower to the same extent as other leases of property. It would be imprudent of a competing creditor to extend credit to the borrower without looking at its balance sheet.

If the legal system allowed lenders to maintain their ownership interest in loaned funds, that would certainly become the intent of the parties to a loan. Parties' expectations are shaped by the relevant legal regime; as rules change, so do their intended objectives. If the parties desired a different legal result, such as a transfer of ownership of the funds, i.e., a sale of the funds, they could so stipulate.

Concerns about the fungibility of money would be addressed by utilization of the accepted equitable tracing principles. Money commingled in a single account would be deemed to belong to each owner in proportion to his respective deposit into the mass if no withdrawals have been made. Otherwise, the loaned money would

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248 Under U.C.C. § 2A-307(1) (1995), except in the case of certain statutory or common law liens for materials or services, a secured party with a security interest in leased property granted by the lessee "takes subject to the lease contract," meaning that such interest is subordinate to the ownership interest of the lessor.


251 Although individual borrowers may not have financial statements, a credit report or bank reference would serve the same function of giving notice to subsequent creditors.
be given the benefit of the presumption afforded by LIBR, and only until the borrower's own funds had been completely depleted from the commingled mass would the loaned funds be diminished. There is ample existing precedent for utilization of such equitable doctrines, and their extension to loaned funds would create no great change in the structure of the law.

V. LEASED MONEY IN BANKRUPTCY

Even if the common law rule were changed to recognize an ownership interest in the lender of funds, how would the treatment of loans in bankruptcy change if borrowers no longer owned the money they borrowed but instead merely had a leasehold interest in it? Some changes would be minor, but others would be quite dramatic for the debtor, for the lending institution, and for the other creditors.

When the debtor filed for bankruptcy protection, the debtor would continue to have an interest—the value of which would be determined by the equitable tracing principles outlined above—in the proceeds of the loan in its possession (a leasehold interest rather than an ownership interest). That interest would become property of the estate pursuant to Code § 541.252 As such, it would be protected by the automatic stay described in § 362 from the enforcement of any prepetition judgment, any act to obtain possession of the proceeds or to exercise control over them, and any act to create, perfect, or enforce any lien against them.253 In addition, the debtor would be protected by the stay against any action or proceeding to recover the loan proceeds or to enforce any other prepetition claim or judgment with respect to the loan.254

Notwithstanding the inability of the lender to enforce the loan agreement against the debtor, the trustee would continue to have the right to enjoy the benefits of the agreement, using the loaned money in the ordinary course of its business in the same way a trustee can continue to use any leased property under § 363(c)(1) of the Code.255 However, because the lender would have a legally

252 See supra note 6.
254 See id. § 362(a)(1), (2), (5), (6), (7).
255 See supra note 10.
protectible property interest in the loaned funds in the hands of the debtor (which it does not have under current law because title to the funds vests in the borrower), the loaned funds would constitute "cash collateral" within the meaning of the Code. Therefore, the trustee could use the funds only if either the lender consented or the court, after notice and a hearing, authorized the use. The lender could seek to condition the debtor's use of the funds on the provision of adequate protection of the lender's interest in the funds in the form of cash payments or other relief. Adequate protection could also be sought in connection with the motion to lift the stay to permit enforcement of the loan agreement.

The loan agreement, as a lease of money, would be subject to the options afforded the trustee in bankruptcy by § 365 of the Code to assume, assume and assign, or reject any lease. The trustee would have until confirmation of a plan to decide on its course of action in a case under chapter 9, 11, 12, or 13, but would have to

256 See 11 U.S.C. § 363(a) (defining cash collateral to include "cash . . . in which the estate and an entity other than the estate have an interest").
257 See id. § 363(c)(2).
258 See id. § 363(e). Illustrative types of adequate protection are itemized in § 361. In this context, adequate protection becomes more problematic than in the usual case, because use of the borrowed funds by the debtor decreases the value of the "cash collateral" by an equal amount. Therefore, the "indubitable equivalent" of the decline in value occasioned by the use would be property having an equal value to the cash spent. It is unlikely that the debtor would need to use the borrowed funds if the debtor had its own funds in an equal amount available to provide adequate protection to the lender. Therefore, the debtor would likely use the adequate protection hearing as a means of monetizing illiquid unencumbered assets by providing the lender a security interest in such assets to secure its obligation to return the leased funds being used.

Of course, the assets used to provide adequate protection would, under the existing legal structure, be available to satisfy the claims of other creditors on a pari passu basis with the lender. Therefore, as is true for other lessors, the lender would be given the benefit of the value of its property as of the filing date, whether in the form of the property itself or substitute assets, before other creditors would have any claim on property of the debtor.

259 See id. § 362(d)(1) (directing the court to grant relief from the stay upon request of a party in interest and after notice and a hearing "for cause, including the lack of adequate protection of an interest in property of such party in interest). A lender would be unlikely to obtain relief from the stay under § 362(d)(2). Although the debtor would have no equity in the loaned funds, the trustee would likely argue that the funds were "necessary to an effective reorganization." Id.
260 See supra text accompanying notes 21-46. Section 365(c)(2) implicitly recognizes that a loan agreement constitutes an executory contract or unexpired lease by explicitly excluding assumption or assignment of such a contract. The theoretical treatment of loans that I am positing would require deletion of this prohibition to treat leases of money consistently with leases of other personal property.
decide within sixty days after the order for relief in a chapter 7 case in order to assume or assume and assign. In a chapter 11 case, unless the loan were to a consumer primarily for personal, family, or household purposes, the trustee would be required to perform all obligations of the debtor under the loan agreement arising from or after sixty days after the order for relief until the loan agreement was assumed or rejected, unless the court ordered otherwise.

If the trustee wished to assume the loan agreement, the trustee would have to cure (or provide adequate assurance of prompt cure of) all defaults, provide compensation for actual pecuniary losses, and provide adequate assurance of future performance. For a loan agreement, this would probably entail an immediate payment of past-due interest and principal, as well as potential liens securing future performance. All obligations under the loan agreement would become administrative expense claims, as do claims under all other assumed leases.

If the trustee wished to assign the loan agreement (perhaps because the agreed interest rate was lower than the current market rate for comparable loans), it could do so without regard to any contractual restriction on assignment in the loan agreement, so long as it met the requirements for assumption of the loan agreement and in addition provided adequate assurance of future performance by the assignee.

Alternatively, it could reject the loan agreement (or allow it to be rejected as a matter of law), in which event the lender would have a claim for “breach” of the agreement deemed to have arisen prepetition. Although the Code does not so state, it is assumed that rejection of a lease of personal property by the debtor/lessee requires the immediate surrender of the leased property. Therefore, upon rejection of the loan agreement, the debtor would

262 See id. § 365(d)(1); see also supra text accompanying notes 15-18.
264 See supra text accompanying notes 22-24.
266 See 11 U.S.C. § 365(f); see also supra text accompanying notes 29-32.
267 See 11 U.S.C. § 365(d)(1) (providing in a chapter 7 case that any unexpired lease of personal property of the debtor that is not assumed or rejected by the trustee within 60 days after the order for relief (or within such additional time as the court allows) is deemed rejected).
268 See id. § 365(g)(1); see also supra text accompanying note 34.
269 See supra text accompanying notes 42-46.
be obliged to return the leased funds in its possession or their equivalent from a fungible mass as determined by equitable tracing techniques. To the extent that the funds were no longer in the possession of the borrower because they had been transferred to a third party and the lender had therefore relinquished ownership of the funds in exchange for a claim against the borrower (i.e., the lender had "sold" the funds to the borrower on credit), the lender would have an ordinary unsecured prepetition claim against the debtor subject to discharge, just as a lender now does.

VI. A BETTER SYSTEM, OR JUST A DIFFERENT ONE?

To this point I have examined the differing treatments of leases of money and leases of other personal property under the Code, identified the source of those differences in the common law of property, discussed the possible justifications for the common law distinction, and suggested that none of these justifications withstand careful scrutiny. I have also described how loans would be treated under the Code were they afforded treatment consistent with that of other leases of personal property. But the question remains whether such consistency—which would certainly be different in many respects from our current treatment of loans in bankruptcy—would contribute to a better bankruptcy system in any way, or simply a different one.

When I refer to a "better bankruptcy system" I am of course using a value-laden term. Better for whom? Better when judged by what standards? Although one can identify many values underlying our bankruptcy system, the most frequently mentioned are the twin pillars of equality of treatment of similarly-situated creditors.

Elizabeth Warren identifies four principal goals in her essay Bankruptcy Policymaking in an Imperfect World, those being "(1) to enhance the value of the failing debtor; (2) to distribute value according to multiple normative principles; (3) to internalize the costs of the business failure to the parties dealing with the debtor; and (4) to create reliance on private monitoring." 92 Mich. L. Rev. 336, 344 (1993).

and rehabilitation of debtors. Amending the Code to treat the lender of funds to the debtor as the owner of those funds, with all the rights given any other lessee with respect to the loan agreement (lease) and the underlying leased funds, could be justified only if the change promoted (or at least did not undermine) these values. I believe it would.

I have already established that lenders of money do not enjoy equality of treatment with lessors of other personal property. This violates the equality principle only if such lenders and lessors are similarly situated. The similarities between a loan and a lease of other personal property far outweigh the differences. In each case, an owner of an asset universally considered personal property as a matter of state law agrees to transfer possession or use of that asset for a specified term. During that term, the borrower must generally make periodic payments for use of the borrowed asset (characterized as "rent" in the usual lease, and "interest" in the loan agreement). At the end of the lease term, the borrower must return the leased property or its equivalent. In all these respects, leases of money and leases of other personal property share basic characteristics.

Of course, the underlying property subject to lease is different—money versus some other type of property. But various


See supra note 75.

To the extent that loans are generally made by book entry of credits rather than the delivery of currency, a loan cannot be seen as delivery of physical possession of anything. Rather, pursuant to the loan agreement the lender agrees to provide the borrower with use of credit, an intangible asset. Many statutes defining 'money' as personal property differ over whether it should be characterized as a tangible or intangible asset. Compare CAL. CIV. PROC. CODE § 481.225 (West Supp. 2000), and FLA. STAT. ANN. § 198.01 (10) (West 1999) (tangible), with GA. CODE ANN. §§ 48-1-2(13) (1998), and NEB. REV. STAT. § 77-105 (1996) (intangible).

The functional equivalence of interest to rent has been noted in other contexts. See, e.g., Michael J. McIntyre, An Inquiry into the Special Status of Interest Payments, 1981 DUKE L.J. 765 (characterizing interest as a type of rental payment "an amount paid for the use of borrowed money" and proposing that the use of loan proceeds, established by tracing, should determine the tax treatment of interest expense in the same way the character of leased property determines the tax treatment of rental expenses in respect thereof).
leases have different underlying property. A lease of livestock is
different from a lease of household furniture. A lease of an
automobile is different from a lease of construction equipment.
Those differences are factual, but not legal. Money is certainly
more akin to other personal property than personal property is to
real property, yet the Code treats leases of real and personal
property far more similarly than it does loans and other leases of
personal property.

Nevertheless, there are legal distinctions. Money is fungible,
but so are other types of leased property, like oil, gas, grain, and
securities. Money is a medium of exchange, but so is other leased
property, like coins in a coin collection or foreign currency. The
parties to a lease of money contemplate that the actual funds loaned
will not be the ones returned, but this is also true of some leases of
depreciating equipment, under which the parties establish a
mechanism for replacing worn out, missing, or destroyed leased
property with replacements having the same characteristics and
value. The parties to a loan agreement do not label their
transaction as a lease. But true leases need not be labeled as such by
the parties; the substance of the transaction determines its legal
characterization rather than terminology.

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270 See supra Part III.E.
277 See supra Part III.B.
278 For example, leases of airframes and engines customarily permit a lessee/airline to
replace the original lease engines with substitutes of comparable value, utility and condition.
This provision allows the lessee/airline to use the leased engines on any airframe in its fleet
without having to replace the leased engine on the leased airframe after every maintenance
procedure. It also permits the lease to continue without change if a leased engine is
destroyed in a crash, lost or damaged beyond repair, or reaches the end of its useful life. The
replacement engine is conveyed by the lessee to the lessor an thereupon becomes subject to
the terms of the lease as if it were an original leased engine. This mechanism does not compel
recharacterization of the original transaction between the parties as a sale of the engine. See,
e.g., Sunstream Jet Express, Inc. v. International Air Serv. Co., 734 F.2d 1258, 1264 (7th Cir.
Conn. 1998); In re Pan Am Corp. 124 B.R. 960, 972-973 (Bankr. S.D.N.Y.), aff'd, 130 B.R. 409
(S.D.N.Y. 1991); F/S Airlease II, Inc. v. Air Florida, Inc. (In re Air Florida, Inc.), 44 B.R. 798,
280 See, e.g., Liona Corp. v. PCH Assocs. (In re PCH Assocs.), 804 F.2d 193, 197 (2d Cir.
1986); Marriott Family Restaurants, Inc. v. Lunan Family Restaurants (In re Lunan Family
Restaurants), 194 B.R. 429, 450 (Bankr. N.D. Ill. 1996); Hotel Syracuse, Inc. v. City of Syracuse
Indus. Dev. Agency (In re Hotel Syracuse, Inc.), 155 B.R. 824, 838 (Bankr. N.D.N.Y. 1993); In
But, it may be argued, the parties to a loan intend that the borrower own the funds, and treating a loan as a sale is historically justified. But neither the Code nor state law truly treats a loan of money as a sale; a lender is not entitled to take a purchase money security interest in the "sold" funds, nor may a lender seek to reclaim the funds pursuant to § 546(c) of the Code and U.C.C. § 2-702(2). In essence, the current bankruptcy system recharacterizes a loan of money as a purchase of those funds for a purchase price equal to the principal amount of the loan, but does not give the lender the rights of other sellers of personal property to the debtor, and allows the debtor to satisfy the lender's claim for the "purchase price" with the "little tiny Bankruptcy Dollars" typically used to pay all claims upon a bankruptcy distribution.

A loan is thus sui generis, treated in a fashion unique among transactions in property under the Code. If there are competing bankruptcy values underlying this disparate treatment, they are difficult to discern. Certainly one cannot argue that the service provided by lenders is less valuable to society at large and to debtors in particular than the lease of other personal property. Indeed, access to money is generally far more valuable to a debtor than the...
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ability to lease goods, because goods can be acquired with the borrowed funds while generally lenders will not provide funds against the debtor's leasehold interest in goods.

As an economic matter, lenders of money are able to adjust to their treatment by pricing the risk of bankruptcy into their transactions. But lenders of money are not unique in this respect; a lessor of other personal property could do the same if bankruptcy precluded a lessor from recovering leased property in the possession of a debtor. And if the Code recognized the property rights of a lessor of money and provided such a lessor the same treatment as that given other lessors of personal property, perhaps the cost of funds to all borrowers would decrease, facilitating commerce and promoting economic growth.236

All this suggests that lenders of money and lessors of other personal property are indeed similarly situated, and treating them consistently under the Code would promote the goal of treating such creditors equally. But would such treatment undermine the goal of promoting rehabilitation of debtors? I would argue that it does not do so in an impermissible fashion.

First, if the debtor has already borrowed the full amount available under a loan agreement and has deployed the funds in its business by transferring them to a third party for value, the lender's position would be no different from that it holds under the Code. The lender would have a claim for the value of the leased funds, which would be satisfied as all claims are through distributions from the estate. That position is exactly the same as a lessor of personal property if the property subject to the lease has been sold by the debtor and is not traceable, or has been destroyed or rendered useless. The debtor has no further benefit from the loan or lease, and the needs of the debtor for rehabilitation are not implicated. Indeed, the debtor will reject the lease of personal property and would reject the loan agreement were it necessary to do so.237

236 Bank losses from bankruptcy filings rose from $1.75 billion to $11.32 billion from 1989 to 1996. See Darrell Dunham, Bankruptcy Court Jurisdiction, 67 UMKC L. REV. 229, 229 n.1 (1998) (quoting Sougata Mukherjee, Going for Broke: The Bankruptcy Game, AM. BUS. J. 34, 35 (1997)).

237 Section 365(c)(2) of the Code precludes the trustee from assuming or assigning any "contract to make a loan, or extend other debt financing or financial accommodations, to or for the benefit of the debtor." Although § 365(e)(1) generally makes unenforceable any provisions in executory contracts or leases allowing termination or modification of such contracts or leases after commencement of a case based solely on the insolvency or financial
But what if borrowed funds remain in the debtor’s possession, or the loan agreement provides for future advances after the date of the bankruptcy filing, or both circumstances exist? Currently a debtor may not draw down further funds under the loan agreement, but is able to retain all previously-borrowed funds at the cost of paying the lender’s claim for the principal amount thereof plus interest accrued and unpaid prior to the date of filing at the steep discount generally present in bankruptcy distributions. The approach suggested in this Article would permit the debtor to make further drawings and retain any borrowed funds it holds only if it chooses to assume the loan agreement, and would compel the debtor to return the funds in its possession if it chooses to reject.

There is no doubt that the debtor would prefer to be able to purchase the loaned funds at the price of a prebankruptcy claim for an equal amount. A debtor would also prefer to purchase leased personal property at that price, if the Code permitted the debtor to do so. But if the debtor needs the leased personal property in connection with its rehabilitation, the Code provides a legal mechanism for the debtor to retain it, even in the face of objections from the lessor, through assumption of the lease. There is a cost to assumption in the sense that cure payments and on-going rental obligations become administrative expenses and therefore are not generally paid at a discount. However, the debtor will not choose to assume unless the benefits derived from assumption outweigh the associated costs. Therefore, the goal of rehabilitation is furthered by the ability to assume unexpired leases.

Similarly, if the Code mandated the same treatment for unexpired leases of money, the goal of rehabilitation would be protected by the ability of the debtor to assume the loan agreement. Indeed, despite the cost of assumption, the debtor might be better off assuming an existing loan agreement that provides for future advances at prebankruptcy pricing than negotiating for a new one, because its negotiating leverage with respect to terms is significantly

condition of the debtor or the commencement of the case, this provision is not applicable to contracts to make a loan or extend other debt financing or financial accommodations. See 11 U.S.C. § 365(c)(2)(B).

diminished when it is in bankruptcy and has an urgent need of funds.

The treatment of loans that I am proposing would certainly be different from that to which we are accustomed. But it would also rectify a long history of discriminatory treatment towards lenders, whose relationship with the debtor is in all ways comparable to other creditors who convey to the debtor the right to use their property for a limited term at a set price. Consistency, in the context of creditors' rights in bankruptcy, is not "the hobgoblin of little minds" but is a fundamental goal of the statutory scheme. If we do not have consistent treatment of like creditors, we do not have a bankruptcy system that is fundamentally fair. If we do not have a bankruptcy system that is fundamentally fair, we should not have a system at all.

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290 Ralph Waldo Emerson, Self-Reliance.
291 See supra note 271.