RECHARACTERIZING CONTRACTS: THE SALE-VERSUS-LOAN PROBLEM OF RECEIVABLES FINANCING

by

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This article addresses a complex and critically important issue that lies at the intersection of contract, property, commercial, and bankruptcy law and is crucial to corporate wealth production: what constitutes the sale of intangible rights to payment, or "receivables." Courts often recharacterize contracts that purport to sell such rights if, notwithstanding being designated a sale, some of the substantive terms of the transfer are indicative of a loan.

The jurisprudence on this sale-versus-loan problem is muddled and inconsistent. The confusion is compounded by the intangibility of receivables, subverting the old adage that "possession is nine-tenths of the law." About the only well-established legal principle is that a court may sometimes, though it is unclear when, recharacterize a transaction that parties deem a sale to be a secured loan.

The resulting uncertainty has serious real-world consequences. A recharacterization means that a purported buyer would not own, but merely would have a security interest in, the receivables and their collections, with the relatively limited rights and remedies associated with that interest. The risk of recharacterization thereby impairs receivables financing as a tool to unlock the growing segment of the world's money—currently estimated at trillions of dollars—and, in developed countries, the bulk of corporate wealth that is locked up in receivables. To reduce that uncertainty and mitigate its costs, this article seeks to build a rational, consistent, and cost-effective legal framework for resolving the sale-versus-loan problem.

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I. Introduction

This article addresses a complex and critically important issue that lies at the intersection of contract, property, commercial, and bankruptcy law and is crucial to corporate wealth production: what constitutes the sale of intangible rights to payment (hereinafter, "receivables"). Courts often recharacterize contracts that purport to sell such rights if, notwithstanding being designated a sale, some of the substantive terms of the transfer are indicative of a loan.

As a highly simplified example, assume that Party A (the transferor/purported seller) contracts to sell $1,000 of receivables to Party B (the transferee/purported buyer) for $950. If the collections on the receivables are less than $975, or if collections are made later than 180 days (when expected), the contract requires Party A to compensate Party B for the loss or delay. If the collections are more than $985, the contract requires Party B to turn over the surplus collections to Party A.

As a business matter, this sales contract is sensible because it voluntarily and deliberately allocates the transaction's risk of loss and the time value of money between (typically) sophisticated business parties.[1] Even for this simple example, however, judges struggle whether the recourse of Party B, the transferee, against Party A, the transferor, coupled with the transferor's right to any surplus collections, permits or even constrains them to recharacterize the contract as creating a loan secured by, as opposed to a sale of, the receivables.[2] Furthermore, most receivables sale contracts are much more complicated.[3]

Absent clear guidelines, judges as well as lawyers face "difficult problems of distinguishing between transactions in which a receivable secures an obligation and those in which the receivable has been sold outright. In many commercial financing transactions the distinction is blurred."[4] These problems

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[1] *See, e.g.*, *Using Contractual Risk Allocation Provisions to Minimize Risk and Maximize Reward*, PRACTICAL LAW (2025) (stating that "allocation of risk is central to all commercial contract negotiations" and describing typical provisions used to allocate this risk). *Cf. infra* note 32 and accompanying text (observing that in the context of receivables financing, the parties normally are sophisticated businesses).

[2] *Cf.* Nickey Gregory Co., LLC v. AgriCap, LLC, 597 F.3d 591 (4th Cir. 2010) (illustrating how even when superficial indicators may support a sale, courts attempt to focus on the economic reality of the transaction to determine its true character); *In re* Com. Loan Corp., 316 B.R. 690, 700 (Bankr. N.D. Ill. 2004) ("The absence of any set legal analysis, along with the annoying tendency of decisions to turn on their facts, makes predicting the outcome of a loan/true sale dispute nearly impossible.").

[3] *Cf. infra* note 4 and accompanying text (noting the difficult problems of distinguishing whether receivables financing contracts create sales or secured loans).

[4] Off. Cmt. No. 4 to U.C.C. § 9-109. Note that receivables financing is a subset of

are compounded by the intangibility of receivables, subverting the old adage that "possession is nine-tenths of the law."[5] About the only well-established legal principle is that a court may sometimes, though it is unclear when, recharacterize a transaction that parties deem a sale to be a secured loan.[6]

A. Uncertainty and Costs

The resulting uncertainty has serious real-world consequences. A recharacterization means that Party B would not own, but merely would have a security interest in, the receivables and their collections, with the relatively limited rights and remedies associated with such an interest.

For example, assume that Party A, needing cash but not wanting to take on more debt, transfers its receivables to Party B and the parties formally document the transfer as a sale. Further assume that Party A subsequently files for bankruptcy. If Party B moves to collect the receivables, Party A (not being estopped[7]) may well argue that, notwithstanding the sale contract, the transaction is in substance a secured loan. If the bankruptcy court concurs—and bankruptcy courts sometimes can favor debtors in arguments about creditor remedies[8]—the receivables and collections thereon would remain the property

commercial financing, a term that—as Official Comment No. 4 observes—can refer both to loans and sales to raise the financing. *See also, e.g.*, American Express, *The Ins and Outs of Accounts Receivable Financing* (https://www.americanexpress.com/en-us/business/trends-and-insights/articles/the-ins-and-outs-of-accounts-receivable-financing/) ("[A]ccounts receivable financing effectively allows companies to access additional payments and funds by borrowing against their outstanding invoices or selling these assets to third parties at a discounted rate[.]").

[5] *See, e.g.*, BLACK'S LAW DICTIONARY 1164 (6th ed. 1990) (defining "possession is nine-tenths of the law" as "this adage is not to be taken as true to its full extent, so as to mean that the person in possession can only be ousted by one whose title is nine times better than his, but it places in a strong light the legal truth that every claimant must succeed by the strength of his own title, and not by the weakness of his antagonist's").

[6] *See infra* notes 84–87 and accompanying text.

[7] Even though Parties A and B ex ante may both want the transaction to be a sale in order to reduce financing costs, Party A (the transferor) is likely, in bankruptcy, to want to recharacterize that transaction as a loan in order to advance its rights over the receivables and their collections. Because the transferor in bankruptcy is technically a different legal entity (a "debtor-in-possession") than it was prior to bankruptcy, it would not be estopped from taking a different position. *But cf.* N.L.R.B. v. Bildisco & Bildisco, 465 U.S. 513 (1984) (questioning the different legal entity theory).

[8] *Cf.* Keith Sharfman, *Judicial Valuation Behavior: Some Evidence From Bankruptcy*, 32 FLA. ST. U. L. REV. 387, 387 (2005) (finding that in valuation disputes, bankruptcy judges on

of Party A notwithstanding the transfer. Party B would then merely have a security interest in that property; accordingly, its rights and remedies would be limited, and any enforcement thereof would be subject to the automatic stay in bankruptcy.[9]

The risk of recharacterization can discourage receivables financing and make it more expensive.[10] This is especially true for securitization, one of the primary modes of receivables financing and a major source of business funding[11]:

> Perhaps the most critical issue in a securitization is whether the [transferee's] investors[12] will continue to be

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average were nearly three times as likely to allocate most of the value to debtors); DAVID SKEEL, DEBT'S DOMINION: A HISTORY OF BANKRUPTCY LAW IN AMERICA 47 (2002) (discussing how pro-debtor ideologies were influential in forming modern bankruptcy law).

[9] *See* 11 U.S.C. § 362(a). A recharacterization also might affect financings of future-arising receivables. If a sale is recharacterized as a secured loan, the financier's security interest could be limited by § 552 of the federal Bankruptcy Code, which cuts off prepetition liens on postpetition arising receivables except to the extent such receivables constitute proceeds of prepetition collateral. Section 552 might not apply, however, if that financing is characterized as a sale. *See* Steven L. Schwarcz, *Preventing Windfalls: A Model for Harmonizing State and Federal Laws on Floating Liens*, 75 N.C. L. REV. 403, 457–58 (1997) (explaining why § 552 should not apply to true sales of receivables). Section 552 also should not apply to true sales of receivables because, even if a receivables purchase agreement were deemed to be a "security agreement" for § 552 purposes, it should not create a "lien." Section 101(37) of the Bankruptcy Code defines "lien" as "charge against or interest in property to secure payment of a debt or performance of an obligation." That is not an ownership interest in property.

[10] *See, e.g.*, Dan S. Schecter, *Judicial Lien Creditors Versus Prior Unrecorded Transferees of Real Property: Rethinking the Goals of the Recording System and Their Consequences*, 62 S. CAL. L. REV. 105, 125–26 (1988) (observing that creditor behavior is "necessarily influenced by the general reliability of the debt collection remedies which will be available in the event of default" and that collection risk "will be passed along to all debtors because there is no way to tell whether any individual debtor will trigger these sorts of systemic problems"); John C. McCoid, II, *Bankruptcy, Preferences, and Efficiency: An Expression of Doubt*, 67 VA. L. REV. 249, 267–68 (1981) (observing that uncertainty whether creditors who receive a potentially preferential transfer may have to return it imposes "costs to their debtor-customers by increasing the cost of credit").

[11] *2024: Securitization's Surprisingly, Very Good Year*, STRUCTURED FINANCE ASSOCIATION (2024), https://structuredfinance.org/wp-content/uploads/2024/12/SFA-Research-Corner_2024_Securitizations-Surprisingly-Very-Good-Year.pdf (noting that the securitization market experienced significant growth in 2024. ABS issuance rose 19% to $304 billion, CLO issuance jumped 53% to $178 billion, non-agency RMBS surged 81% to $143 billion, and non-agency CMBS climbed 120% to $101 billion).

[12] The transferee in a securitization is a special-purpose vehicle, or SPV, which sells securities to institutional investors.

> repaid in the event of the [transferor's] bankruptcy.[13] If the [transferee] owns the [receivables], its investors will continue to be repaid; if not, their rights to be repaid will be suspended and subject to possible impairment. The [transferee] will own the [receivables] only if the transfer of those assets from the [transferor] to the [transferee] constitutes a sale . . . .[14]

There is little doubt that uncertainty can materially increase costs. The National Bureau of Economic Research has found, for example, that "uncertainty has a direct effect on investment" and that "greater uncertainty tends to make investment less desirable"[15] and "exerts a strong negative influence on investment."[16] Studies have demonstrated that greater legal uncertainty leads to higher interest rates and reduced investment.[17] Similarly, an examination of court outcomes found that in debtor-friendly jurisdictions where recharacterization risk may be higher, interest rates are also higher.[18] That examination concluded that legal uncertainty reduces the size of credit markets, likely because lenders exercise greater caution.[19]

Courts also have expressed concern about uncertainty. The Southern District of New York has observed that uncertainty "would both impair bank financing and increase the costs of obtaining such financing."[20] The Seventh

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[13] The transferor in a securitization is the company that originates the receivables, often called the originator.

[14] Steven L. Schwarcz, *Securitization Post-Enron*, 25 CARDOZO L. REV. 1539, 1543 (2004).

[15] John V. Leahy & Toni M. Whited, *The Effect of Uncertainty on Investment: Some Stylized Facts* 2 (Nat'l Bureau of Econ. Rsch., Working Paper No. 4986, 1995).

[16] *Id.* at 3.

[17] Bruno Funchal, Fernando Caio Galdi & Paulo C. Coimbra, *Corporate Governance, Bankruptcy Law, and Firms' Financing Under Uncertainty*, 6 CORP. OWNERSHIP AND CONTROL 47, 47 (2008).

[18] Jiwon Lee, et al., *The Economics of Legal Uncertainty* (Euro. Corp. Gov. Inst., Law Working Paper No. 669/2022, 2024).

[19] *Id*. A more indirect cost is that legal uncertainty can incentivize forum shopping. Forum shopping could occur, for example, if a debtor chooses to file in a bankruptcy court that would resolve the sale-versus-loan problem in the debtor's favor. Some bankruptcy courts, such as those in the Southern District of Texas and the District of Delaware, have been recognized as particularly debtor-friendly. Ellen Bardash, *Texas Can't Touch Delaware on Corporate Bankruptcies,* LAW.COM (Oct. 3, 2024), https://www.law.com/delbizcourt/2024/10/03/texas-cant-touch-delaware-on-corporate-bankruptcies/?slreturn=20260319160439.

[20] Worldwide Sugar Co. v. Royal Bank of Canada, 609 F. Supp. 19, 22, 27 (S.D.N.Y.), *aff'd*, Worldwide Sugar Co. v. Royal Bank of Canada, 751 F.2d 272 (2d Cir. 1984) (ruling that

Circuit likewise has observed that investors influenced by the uncertainty of debt recovery might prefer not "to lend or invest in the future," causing "the cost of credit [to] rise for all."[21]

In contrast, scholars have found that in jurisdictions that had adopted anti-recharacterization laws, which reduce legal uncertainty, firms experience improved access to debt financing and engage in less precautionary behavior—thereby mitigating those costs of uncertainty.[22] The same study also showed that strengthening creditor rights through clearer recharacterization rules fosters greater investment in intangible capital and innovation.[23]

By discouraging receivables financing and making it more expensive, the uncertainty caused by recharacterization risk can impair the real economy.[24] Receivables currently represent trillions of dollars of investments in the United States.[25] More broadly, a "growing segment of the world's money" and in "developed countries, the bulk of corporate wealth" is locked up in receivables.[26] Receivables financing is the tool for unlocking that wealth. Using that tool effectively requires that courts and lawyers can realistically determine if a receivables financing constitutes a sale of, or a loan secured by, the receivables (uncertainty in making that determination hereinafter being the

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allowing "recovery from an advising bank on the basis of a terminated letter-of-credit arrangement would" impose uncertainty and increase financing costs).

[21] *In re* Lifschultz Fast Freight, 132 F.3d 339, 347 (7th Cir. 1997).

[22] Giovanni Favara, Janet Gao & Marassunta Giannetti, *Uncertainty, Access to Debt, and Firm Precautionary Behavior*, 141 J. FIN. ECON. 436, 438 (2021).

[23] *Id.*

[24] The real economy is "the part of a country's economy that produces goods and services." CAMBRIDGE.ORG DICTIONARY.

[25] *See Release Tables: Owned and Managed Receivables Outstanding,* FED. RSRV. BANK OF ST. LOUIS, https://fred.stlouisfed.org/release/tables?rid=316&eid=8791 (St. Louis Federal Reserve Bank reporting that, as of January 2025, finance companies alone held almost $2 trillion of receivables).

[26] Spiros V. Bazinas, *An International Legal Regime for Receivables Financing: UNCITRAL's Contribution*, 8 DUKE J. COMP. & INT'L L. 315 (1998); Steven L. Schwarcz, *The Universal Language of International Securitization*, 12 DUKE J. COMPAR. & INT'L L. 285, 289 (2002). *Cf.* Sanjeev Ganjoo & Kunal Bist, *The Rise of Receivables Finance*, CITI, https://www.citibank.com/tts/articles/article185.html (estimating global receivables financing at $3–3.5 trillion, and indicating significant opportunity for growth); *AR in 2024: Expectations, Technology, Opportunities*, BLACKLINE, https://cdn.prod.website-files.com/6432b294a7aa23676dfb1b63/675b292c5561fd6561f2823b_ar-in-2024-expectations-technology opportunities.pdf (a 2023 survey by Blackline found that 71% of the companies it surveyed planned to increase the role of its receivables financing teams, indicating that receivables financing is an area of increasing importance).

"sale-versus-loan problem").[27] This has become both a domestic and a worldwide problem.[28]

B. Legal Challenges

To reduce that uncertainty and mitigate its costs, this article seeks to build a rational, consistent, and cost-effective legal framework for resolving the sale-versus-loan problem. Building such a framework faces a host of challenges, including answering fundamental questions about the sale of receivables and other intangible rights.[29] The fact that at least four separate bodies of law—contract, property, commercial, and bankruptcy law—apply to receivables financing adds to the challenges.

For example, contract law applies to receivables financing because the analysis starts with the financing contract itself. As observed, courts sometimes recharacterize these contracts, finding that they merely evidence loans secured by the receivables. This recharacterization directly confronts the principle of freedom of contract.[30]

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[27] *Cf*. *supra* notes 8–9 and accompanying text (discussing the different consequences of the receivables financing being a sale of, or a loan secured by, the receivables).

[28] *See, e.g.*, BAKER MCKENZIE, A GLOBAL GUIDE TO LEGAL ISSUES IN SECURITISATION (Philippe Steffens, ed., 2021), available at https://www.bakermckenzie.com/-/media/files/insight/guides/2021/securitisation-guide-2021_29092021.pdf (explaining that "at the heart of a traditionally structured securitisation transaction will be the . . . true sale of the [receivables] being used by the [transferor] to raise the financ[ing]. . . . Accordingly, the legal analysis for sale treatment is of paramount importance. [M]ost legal regimes' requirements typically relate to either the form taken by the transaction documents (e.g., whether they are expressed to be sale documents) or the substance (i.e., whether the transaction is consistent with a sale on closer analysis).").

[29] *See supra* note 5 and accompanying text.

[30] Other examples of recharacterization include distinguishing between debt and equity investments (*In re* AutoStyle Plastics, Inc., 269 F.3d 726, 747–48 (6th Cir. 2001)) and between leases and secured financing (United Airlines, Inc. v. HSBC Bank USA, N.A, 416 F.3d 609, 612 (7th Cir. 2005)), as well as collapsing corporate structures (Steven L. Schwarcz, *Collapsing Corporate Structures: Resolving the Tension Between Form and Substance*, 60 BUS. LAW. 109 (Nov. 2004)). These examples illustrate how courts sometimes favor substance over form, notwithstanding freedom of contract. Courts also have recharacterized repo transactions—evidenced by agreements to sell securities for cash and repurchase them later for a higher price—as secured loans. Harold S. Novikoff, *Chapter 11 Business Reorganizations (Re)Characterization in Bankruptcy of Transactions Affecting the Public Markets: The Treatment of Repurchase Agreements and its Implications*, ALI-ABA COURSE OF STUDY MATERIALS (2004). This recharacterization has become less relevant, however, because the Bankruptcy Code's so-called safe harbors (11 U.S.C. §§ 555, 559) now would permit the

There are three general limitations to freedom of contract: paternalism, externalities, and statutory policies.[31] In the context of receivables financing, the parties normally are sophisticated businesses, so paternalism generally should not apply.[32] The limitations based on externalities and statutory policies, however, are not well developed, contributing to the uncertainty.[33] Part IV.B of this article examines these limitations.

Property law applies to receivables financing because the ultimate question is whether the purported sale contract effectively transfers ownership of the receivables. As mentioned, the intangibility of receivables complicates the analysis.[34] Part IV.A of this article focuses on property law.

Commercial law also applies because the Uniform Commercial Code ("UCC") covers both sales of receivables and loans secured by receivables.[35] Although intended to allow UCC Article 9's notice-filing perfection and priority provisions to protect both types of transfers,[36] that dual coverage

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enforcement of repos recharacterized as secured loans. J.R. Smith, Anthony Pijerov & Justin Paget, *Sailing Without A Headwind: Structured Lending Market Embraces Bankruptcy Safe-Harbor Provisions*, Hunton & Williams 2 (undated), HTTPS://WWW.HUNTON.COM/MEDIA/PUBLICATION/3354_SAILING_WITHOUT_A_HEADWIND.PDF. In contrast, receivables financings recharacterized as secured loans could not be enforced in a bankruptcy case. *See supra* note 9 and accompanying text.

[31] Steven L. Schwarcz, *Rethinking Freedom of Contract: A Bankruptcy Paradigm*, 77 TEX. L. REV. 515 (1999).

[32] Paternalism, or the refusal to apply it, may help to differentiate this article's focus on recharacterization cases from cases in which courts reform, or refuse to reform, particular contracts ex post. For example, in Metro. Life Ins. Co. v. RJR Nabisco, Inc., 716 F. Supp. 1504 (S.D.N.Y. 1989), the court refused to "imply a covenant to prevent the recent LBO and thereby create an indenture term that, while bargained for in other contexts, was not bargained for here." *Id.* at 1508. The court nonetheless noted that "[i]t is not necessary to decide that indentures like those at issue could never support a finding of additional benefits, under different circumstances with different parties [that is, parties other than sophisticated investors]." *Id.* at 1519. The court distinguished its holding from "the classic sort of form contract or contract of adhesion often frowned upon by courts. In those cases, what motivates a court is the strikingly inequitable nature of the parties' respective bargaining positions." *Id.* at 1521.

[33] *See supra* notes 5–27 and accompanying text.

[34] *See supra* note 5 and accompanying text.

[35] U.C.C. § 9-109(a). *Cf.* U.C.C. § 1-201(b)(35) (defining "Security interest" as including "any interest of. . . a buyer of" receivables "in a transaction that is subject to Article 9").

[36] *See* Off. Cmt. 5 to U.C.C. § 9-109. *Cf.* U.C.C. § 9-317 (providing that if a buyer does not perfect its interest in accounts or chattel paper, other parties who perfect or obtain a lien will have priority over the buyer's claim to the collateral); Off. Cmt. to old U.C.C. § 9-103 (observing that Article 9 applies to both sales and secured loans to import the filing system for perfection and priority); Rollins Commc'ns, Inc. v. Georgia Inst. of Real Estate, Inc., 140 Ga. App. 448, 451 (Ga. Ct. App. 1976) (holding that presence of a UCC filing does not, by itself,

muddies the sale analysis by using nomenclature that treats sales of receivables as secured transactions—a treatment that has confused numerous courts, including federal courts of appeal.[37] PEB Commentary No. 14 has now mitigated this confusion, however, by clarifying that "[t]he reason for subjecting both sales and secured transactions to Article 9 was to inform third parties of existing interests in a debtor's receivables and to provide protection for all types of assignments of receivables." Moreover, an Official Comment to the UCC now further explains that commercial law should not undermine sale treatment; it directs courts to look to non-commercial law to differentiate sales of, from loans secured by, receivables.[38] Some confusion nonetheless remains.[39]

Bankruptcy law applies to receivables financing because courts most often are asked to recharacterize receivables financing contracts when the purported seller of the receivables (in bankruptcy, the "debtor") has become subject to bankruptcy.[40] The equitable power of bankruptcy judges then compounds the uncertainty.[41] Although that equitable power is sometimes exercised unpredictably,[42] Part IV.B of this article seeks to provide bankruptcy

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determine the character of the transaction).

[37] In Octagon Gas Sys., Inc. v. Rimmer, 995 F.2d 948 (10th Cir. 1993), for example, the Tenth Circuit Court of Appeals erroneously held that certain receivables, "accounts," could not be sold because U.C.C. Article 9 treats sales of receivables as secured transactions.

[38] *See* Off. Cmt. 4 to U.C.C. § 9-109 (stating that "neither this [UCC] Article [9] nor the definition of 'security interest' . . . delineates how a particular [receivables-transfer] transaction is to be classified").

[39] *Cf. infra* notes 71–77 and accompanying text (observing that although the UCC now directs courts to look to non-commercial law to differentiate sales of, from loans secured by, receivables, courts sometimes consider a transferor's rights and obligations under the UCC in making a sale-versus-loan determination). *Also cf. infra* notes 198–199 and accompanying text (discussing that confusion in the recent *In re* Shoot the Moon case).

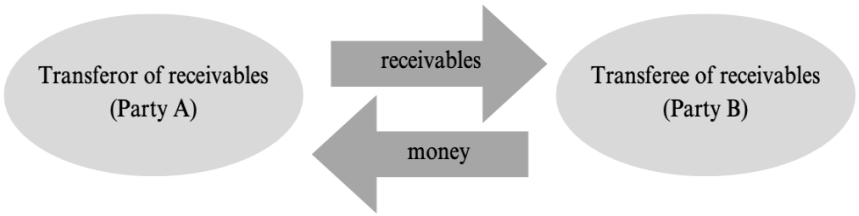
[40] Other contexts involving recharacterization of receivables financing contracts include usury, where courts may treat a transaction as a disguised loan charging illegally high interest, and equity of redemption, where courts may recharacterize an arrangement to preserve a borrower's right to reclaim mortgaged property by repaying the full debt before disclosure. *See, e.g.*, Kenneth C. Kettering, *True Sale of Receivables: A Purposive Analysis*, 16 AM. BANKR. INST. L. REV. 511, 543–44, 546–48 (2008).

[41] *See, e.g.*, Jonathan Seymour, *Against Bankruptcy Exceptionalism*, 89 U. CHI. L. REV. 1925 (2022) (critiquing the supposedly exceptional equitable power of bankruptcy judges under 11 U.S.C. § 105).

[42] *See, e.g.*, Diane Lourdes Dick, *Equitable Powers and Judicial Discretion: A Survey of U.S. Bankruptcy Judges*, 94 AM. BANKR. L.J. 265, 279 (2020) (noting that the tendency of bankruptcy judges to exercise too much judicial discretion can threaten legal certainty and predictability); Rafael Ignacio Pardo, *Beyond the Limits of Equity Jurisprudence: No-Fault*

judges with insights as to how they should apply bankruptcy policies to the sale-versus-loan problem.

Another challenge to characterizing receivables financings is that both sales of receivables and loans secured by receivables superficially look the same. As illustrated below, they both involve the transfer of receivables from one party (Party A) to another party (Party B) and the concurrent transfer, in exchange, of money from Party B to Party A.



That similarity may lead courts to conflate sales and loans involving receivables, creating all the more reason for judges to exercise caution.

A further challenge is the confusion arising from the classic asymmetric information problem of selling property.[43] Because the timing and amount of collections on the receivables cannot always be accurately predicted at the time of the transfer, and the transferor inherently knows more about the receivables than the transferee, the agreement governing the transfer—whether denominated a sale agreement or a loan agreement—normally provides for recourse in the form of an adjustment of payments (as illustrated in this article's earlier example[44]). That recourse simply reflects the transferor's assurances about the quality of the receivables being transferred. Courts often view the existence of recourse, however, as inconsistent with a sale.[45]

Equitable Subordination, 75 N.Y.U. L. REV. 1489, 1493 (2000) (arguing that with non-fault equitable subordination, balancing of the equities becomes a mere pretext).

[43] *See, e.g.*, George A. Akerlof, *The Market for "Lemons": Quality Uncertainty and the Market Mechanism*, 84 Q.J. ECON. 488, 489–94 (1970) (discussing that problem in the context of selling used cars).

[44] *See supra* text accompanying note 2.

[45] *See infra* notes 63–70 and accompanying text.

That view ignores the reality that in order to reduce the information asymmetry, sellers generally make representations and warranties ("R&Ws") or other assurances about the quality of the property being sold. This recourse helps to solve the "lemons" problem discussed by Nobel-Prize-winning economist George Akerlof, describing how information asymmetry can lead to market inefficiencies.[46] If buyers cannot differentiate between high-quality and low-quality goods, they may be unwilling to pay a premium for quality, resulting in a market dominated by low-quality goods ("lemons").[47] To address this market failure, sellers typically provide R&Ws, giving buyers assurances about the quality of the goods.[48] This need for sellers to provide recourse to buyers regarding the quality of the property sold is as important for the sale of receivables as for the sale of goods.[49]

The failure to view the sale-versus-loan problem within the larger context of selling property presents yet another challenge. A sale generally is determined by the transfer not only of risks but also of benefits of the transferred property.[50] Due to path dependence, however, courts considering the sale-versus-loan problem have almost completely ignored the transfer of benefits as a sale criterion.[51] Although a sale of property, including receivables, should give the buyer the right to further alienate and otherwise benefit from the property,[52] most sale-versus-loan cases focus almost entirely on the transfer of risks, typically in the form of recourse.[53] Part IV.A of this article analyzes the sale-versus-loan problem in that larger context of selling property.

Finally, a more prosaic challenge is correcting the widespread judicial reliance on a 1991 article by two practitioners (hereinafter, the "1991

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[46] Akerlof, *supra* note 43, at 490.

[47] *Id.*

[48] R&Ws incentivize sellers to provide accurate disclosures because buyers will have claims for R&W breaches. *See, e.g.*, Frederick L. Klein & Kevin L. Shepherd, *Feature, By the Way, What About the Post-Closing Credit Enhancement*, 30 PROBATE & PROPERTY 35, 36 (2016).

[49] *Cf.* ADAM B. ASHCRAFT & TIL SCHUERMANN, UNDERSTANDING THE SECURITIZATION OF SUBPRIME MORTGAGE CREDIT 7 (Fed. Rsrv. Bank N.Y. Staff Reps. No. 318 2008) ("[T]he information advantage of the arranger creates a standard lemons problem."); Kathleen C. Engel & Patricia A. McCoy, *Turning a Blind Eye: Wall Street Finance of Predatory Lending*, 75 FORDHAM L. REV. 2039, 2057 (2007) (describing securitizations as possessing a "lemons problem").

[50] Route 231, LLC v. Comm'r, 810 F.3d 247, 260 (4th Cir. 2016).

[51] *See infra* notes 89–93 and accompanying text.

[52] *See infra* notes 125–126 and accompanying text.

[53] *Cf. supra* note 45 and accompanying text.

article"),[54] which purports to list factors considered by courts in analyzing the sale-versus-loan problem. Although attempting to catalog those factors, that article failed to differentiate their contexts (e.g., bankruptcy, usury, equity of redemption[55]), nor did it critique the relevance or reasonableness of those factors. For example, that article conflated usury-related factors, which focus on excessive interest charged to consumers—a serious social concern that strongly favors recharacterization[56]—with corporate bankruptcy-related factors, which have no relevance to consumers or interest rates.[57] Furthermore, a usury remedy would not stop at recharacterization; it would lead to invalidating the usurious loan.[58]

C. Goals and Direction

This article has mixed normative and positive goals. As mentioned, its normative goals are to derive a rational, consistent, and cost-effective legal framework to resolve the sale-versus-loan problem.[59] To that end, the article seeks to reduce, if not eliminate, the confusion and uncertainty associated with the sale-versus-loan problem, including addressing the challenges discussed in

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[54] Robert D. Aicher & William J. Fellerhoff, *Characterization of a Transfer of Receivables as a Sale or a Secured Loan Upon Bankruptcy of the Transferor*, 65 AM. BANKR. L.J. 181 (1991).

[55] *Cf. supra* note 40 (observing the different contexts in which a sale-versus-loan problem can arise).

[56] *See, e.g.*, Home Bond Co. v. McChesney, 239 U.S. 568 (1916) (holding that a contract in the form of a sale with an option or agreement to repurchase will be treated as a loan under usury law; such a contract is simply covering up a scheme to collect usurious interest on a loan).

[57] In a usury context, the lender offers consumers loans at usuriously high rates and, in what amounts to an adhesion contract, denominates the loan agreement as a sale agreement to attempt to avoid the application of usury law. *Cf.* Kara Bruce, *The Murky Process of Characterizing Merchant Cash Advance Agreements*, 42 BANKR. L. LTR. 4 (2022) ("Most notably for our purposes, the characterization of an MCA transaction as a sale of receivables, rather than a loan, limits the application of usury laws."). Usury law only applies to loans in order to protect borrowers from excessive interest and prevent predatory lending. *See id.* (observing that characterizing MCA transactions as sales may enable MCA financiers to take advantage of desperate borrowers).

[58] Bruce, *supra* note 57. Merchant cash advance cases are just usury cases; therefore, they have fundamentally different policies, and their jurisprudence should be kept separate. However, recent MCA cases cite to the 1991 article's factors. *See, e.g.*, CapCall, LLC v. Foster (*In re* Shoot the Moon, LLC), 635 B.R. 797 (Bankr. D. Mont. 2021) and *In re* R&J Pizza Corp., 2014 Bankr. LEXIS 5461 (Bankr. E.D.N.Y. 2014).

[59] *See supra* text accompanying notes 27–29.

the preceding subpart B. The 1991 article, for example, is problematic[60] and a third of a century old. Since then, there have been major changes in the economy and financing landscape, including significant increases in the volume of receivables financing and the growth of securitization.[61] Judges, lawyers, investors, and scholars alike need a fresh perspective.

To these ends, Part II of this article describes the current jurisprudence, discussing the factors that courts have been considering when addressing the sale-versus-loan problem. Part III of the article critiques that jurisprudence, identifying and discussing its serious flaws. Part IV derives a legal framework for resolving the sale-versus-loan problem. Subpart A of Part IV analyzes what broadly constitutes the sale of property; it shows that the determinants of a sale include not only the intentions of the parties but also the transfer of the risks and benefits of the transferred property. Subpart B applies that analysis to receivables financing, deriving a specific framework for determining what should constitute a sale of receivables. Finally, Part V of the article tests that framework by applying it to hypothetical and actual examples of receivables financings.

II. The Current Jurisprudence

The jurisprudence on the sale-versus-loan problem is muddled and inconsistent. Courts analyzing the problem claim to apply a holistic framework, rather than relying on a single determinative factor. However, they differ in the factors they consider, and the weight given to each.[62] Four factors nonetheless dominate: risk allocation, or "recourse"; rights and obligations regarding surplus and deficiency; control over receivables and collections; and contractual language.

A. Recourse

By far the most significant factor that courts consider is recourse: the

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[60] *See, e.g.*, *supra* notes 55–59 and accompanying text (observing that although the 1991 article attempted to catalog the sale-versus-loan factors considered by courts, it failed to differentiate their contexts and did not purport to critique their relevance or reasonableness).

[61] JULIAN B. MCDONNELL & JAMES P. NEHF, SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE, § 34.05 (2019) (discussing the 1999 revision of Article 9 and the 2008 financial crisis leading to tightened requirements for true sale accounting treatment).

[62] *See, e.g.*, *In re* Com. Loan Corp., *supra* note 2, at 700 (noting that "different courts consider different factors and give those factors different weight").

extent to which the transferor bears a risk of loss on the transferred receivables.[63] Courts generally recharacterize receivables financings as secured loans if the transferor bears substantial risk.

This risk allocation is clear at the extremes. For example, courts will recharacterize a receivables financing as a secured loan if the transferor bears the entire risk of non-payment of the receivables.[64] Similarly, they will find the financing to be a sale if the transferee assumes the full risk of non-payment.[65]

In between these extremes, there is considerable ambiguity. Courts tend to find a receivables financing to be a loan if the purchase price is retroactively adjusted to address shortfalls in expected collections.[66] Some courts find a receivables financing to be a loan if the transferor is obligated to repurchase defaulted receivables.[67] In contrast, if the transferor's obligations arise in limited circumstances, a court might find the financing to be a sale.[68]

To complicate matters, courts tend to view a transferee's right to collect interest after the completion of the transaction as recourse. Absent the transferee's right to collect interest, some courts find a sale because the risk has been passed to the transferee.[69] But courts tend to find a loan where the transferor is required to pay a fixed amount in interest regardless of whether the accounts were paid, arguing that the transferor has retained much of the risk.[70]

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[63] *See, e.g.*, *In re* Dryden Advisory Grp., 534 B.R. 612, 620 (Bankr. M.D. Pa. 2015) ("To classify a transaction accurately, several attributes must be examined, primarily the allocation of risk.").

[64] *See, e.g.*, Endico Potatoes, Inc. v. CIT Group/Factoring, Inc., 67 F.3d 1063, 1069 (2d Cir. 1995); *In re* Watchmen Sec. LLC, 2024 Bankr. LEXIS 2871, 16 (Bankr. S.D. Ind. 2024); Lange v. Inova Cap Funding, LLC (*In re* Qualia Clinical Serv. Inc.), 441 B.R. 325, 330 (B.A.P. 8th Cir.), *aff'd*, 652 F.3d 933 (8th Cir. 2011).

[65] *See, e.g.*, Paloian v. LaSalle Bank Nat'l Ass'n (*In re* Doctors Hosp. of Hyde Park, Inc.), 507 B.R. 558, 712 (Bankr. N.D. Ill. 2013); Off. Comm. of Unsecured Creditors v. EBF Partners, LLC (*In re* Cornerstone Tower Servs., Inc.), 2019 Bankr. LEXIS 6, 17 (Bankr. D. Neb. 2019) (finding sales because the transferee had no recourse to the transferor if the receivables were uncollectible).

[66] *See, e.g.*, Classic Harvest LLC v. Freshworks LLC, 158 F. Supp.3d 1317, 1327 (N.D. Ga. 2015), *modified on reconsideration*, 204 F. Supp. 3d 1377 (N.D. Ga. 2016).

[67] *See* Nickey Gregory Co., LLC v. AgriCap, LLC, 597 F.3d 591, 602 (4th Cir. 2010); CF Motor Freight v. Schwartz (*In re* De-Pen Line), 215 B.R. 947, 951 (Bankr. E.D. Pa. 1997).

[68] *See, e.g.*, *In re* Dryden Advisory Grp., 534 B.R. 612, 623 (Bankr. M.D. Pa. 2015); Cornerstone Tower, *supra* note 65, at 17 (ruling that because the transferor's obligations only arose in limited circumstances, a majority of the risk was transferred to the transferee, consistent with a sale).

[69] R&J Pizza, *supra* note 58, at 11–12.

[70] *See In re* Woodson, Co., 813 F.2d 266, 271–72 (9th Cir. 1987); Netbank, FSB v. Kipperman (*In re* Com. Money Ctr., Inc.), 350 B.R. 465, 483–84 (B.A.P. 9th Cir. 2006); *In re*

B. Surplus/Deficiency

Courts sometimes consider a transferor's right to surplus collections or its obligation to cover deficient collections as evidencing a secured loan.[71] Correlatively, absent these rights and obligations, they may find the receivables financing to be a sale.[72]

These rights and obligations are connected to other sale-versus-loan factors discussed in this article. The extent to which a transferor is obligated to cover deficient collections would constitute recourse, as above and subsequently discussed.[73] The extent to which a transferor lacks the right to surplus collections inversely corresponds to the transferee gaining that right, which would constitute the transfer of benefits as later discussed.[74]

Nonetheless, courts do not appear to recognize, or at least acknowledge, those connections. Rather, they tie these rights and obligations to the provisions of commercial law that require a secured lender to return surplus collateral value to the borrower[75] and that obligate the borrower to pay the loan to the extent the collateral is insufficient.[76] The implicit logic is that a receivables financing that has rights and/or obligations that somewhat parallel these commercial law provisions must be a loan.

The problem, however, with resolving the sale-versus-loan problem by looking to commercial law is that the UCC now explicitly directs courts to look to non-commercial law to differentiate sales of, from loans secured by,

Carolina Utils. Supply Co., Inc. 118 B.R. 412, 416 (Bankr. D.S.C. 1990).

[71] *See, e.g.*, *In re* Evergreen Valley Resort, Inc., 23 B.R. 659, 662 (Bankr. D. Me. 1982); Endico Potatoes, Inc. v. CIT Grp./Factoring Inc., 67 F.3d 1063, 1069 (2d Cir. 1995); and *In re* Carolina Utilities Supply Co., Inc. 118 B.R. 412, 416 (Bankr. D.S.C. 1990) (all recharacterizing a receivables financing as a secured loan where the transferor had to pay the balance if the transfer of receivables did not provide sufficient funds). *See also In re* Joseph Kanner Hat Co., Inc., 482 F.2d 937, 940 (2d Cir. 1973); SPS Tech., Inc. v. Baker Material Handling Corp., 153 B.R. 148,153 (E.D. Pa. 1993) (recharacterizing a receivables financing as a secured loan where the transferor was entitled to surplus collections on the receivables).

[72] *See, e.g.*, Paloian v. La Salle Bank Nat'l Ass'n (*In re* Doctors Hosp. of Hyde Park, Inc.), 507 B.R. 558, 712 (Bankr. N.D. III. 2013) (finding a sale because the transferor had no obligation to cover shortfalls in collections of the transferred receivables).

[73] *See supra* notes 63–70, and *infra* notes 89–97, and accompanying text.

[74] *See infra* notes 98–103 and accompanying text.

[75] *See, e.g.*, U.C.C. § 9-615(d)(1) ("the secured party shall account to and pay a [borrower] for any surplus" collateral value).

[76] *See, e.g.*, U.C.C. § 9-615(d)(2) ("the [borrower] is liable for any deficiency" in collateral value).

receivables.[77]

C. Control over Receivables and Collections

Another factor that courts consider is which party has control over the transferred receivables and collections. Control refers to the servicing of the receivables—that is, the right to collect amounts due from the obligors of the receivables—and whether the proceeds, or cash collections, of the receivables are commingled with the transferor's other property.[78] Control by the transferee would be consistent with a sale, whereas control by the transferor would be more consistent with a loan.[79]

Although some courts rule that it is consistent with a sale for a transferee of the receivables to pay the transferor a fee to service the receivables,[80] others hold that the absence of such a fee would be consistent with a loan.[81] Other courts consider a receivables financing to be a sale where the transferee has the right to collect amounts due from the obligors of the receivables, even if it does not exercise that right.[82] Courts also consider a receivables financing to be a sale where the obligors of the receivables are notified of the transfer.[83]

In general, though, courts are inconsistent in how they view control as a factor.

D. Contractual Language

Courts often begin analyzing the sale-versus-loan problem by examining the express terms used by the contracting parties, including the title

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[77] *See supra* note 38 and accompanying text (quoting Official Comment 4 to UCC § 9-109: "neither this [UCC] Article [9] nor the definition of 'security interest' . . . delineates how a particular [receivables-transfer] transaction is to be classified").

[78] *See* Paloian v. LaSalle Bank Nat'l Ass'n (*In re* Doctors Hosp. of Hyde Park, Inc.), 507 B.R. 558, 713 (Bankr. N.D. III. 2013).

[79] *See, e.g.*, *In re* Dryden Advisory Grp., 534 B.R. 612, 622 (Bankr. M.D. Pa. 2015) (holding the transaction was a sale because the buyer had the right to demand that it receive payment directly from the account debtors and the receivables were held in trust as property of the buyer).

[80] Paloian v. LaSalle Bank Nat'l Ass'n (*In re* Drs. Hosp. of Hyde Park, Inc.), 507 B.R. 558, 713 (Bankr. N.D. III. 2013).

[81] Netbank, FSB v. Kipperman (*In re* Com. Money Ctr., Inc.), 350 B.R. 465, 483–84 (B.A.P. 9th Cir.).

[82] *In re* Dryden Advisory Grp., 534 B.R. 612, 626 (Bankr. M.D. Pa. 2015).

[83] Paloian v. LaSalle Bank Nat'l Ass'n (*In re* Drs. Hosp. of Hyde Park, Inc.), 507 B.R. 558, 713 (Bankr. N.D. III. 2013).

of the contract. Ironically, most courts then go on to say that labels and terminology do not matter.[84] In other words, "Simply calling transactions 'sales' does not make them so."[85]

Nonetheless, some courts state that they will respect clear and unambiguous sale language. For example, in *Goldstein*, the court indicated that if the language clearly expresses an absolute sale, that interpretation should be upheld unless there is compelling, contrary evidence.[86] Nonetheless, most courts tend to disregard labels and to focus on more substantive factors, like the allocation of risk, if there is contradictory terminology or if other factors suggest a loan structure.[87]

III. Critiquing the Current Jurisprudence

The current jurisprudence on the sale-versus-loan problem is seriously flawed as well as inconsistently applied. The inconsistencies alone would be troublesome, inviting forum shopping.[88] Set forth below are critiques of the more serious flaws.

A. Overreliance on Recourse

Perhaps the most serious flaw is the overemphasis on recourse. The transfer of risk, however, is only one of several key factors characterizing a sale. This overemphasis appears to be path-dependent, stemming from the precedent set by the seminal *Major's* case.[89]

The question before the *Major's* court was which party—the transferor

[84] *See, e.g.*, *In re* Dryden Advisory Grp., 534 B.R. 612, 621–22 (Bankr. M.D. Pa. 2015) (stating that the terms "sale" and "purchase" were of little value); European Am. Bank v. Sackman Mortg. Corp. (*In re* Sackman Mortgage Corp.), 158 B.R. 926, 932 (Bankr. S.D.N.Y. 1993) (noting terminology is insufficient); *In re* Carolina Utils. Supply Co., Inc. 118 B.R. 412, 415 (Bankr. D.S.C. 1990) (stating that the court was not bound by how parties labeled their relationship).

[85] *In re* Woodson, Co., 813 F.2d 266, 272 (9th Cir. 1987).

[86] Goldstein v. Madison Nat. Bank of Washington, D.C., 89 B.R. 274, 277 (D.D.C. 1988). *See also In re* Firestar Diamond, Inc., 643 B.R. 528, 554 (Bankr. S.D.N.Y. 2022), *aff'd*, 734 F. Supp. 3d 272 (S.D.N.Y. 2024) (rejecting extrinsic evidence when a greement was unambiguous and finding the language to be decisive); Lyon v. Ty-Wood, Corp., 212 Pa. Super. 69, 73 (1968) (holding the language clearly indicated a sale).

[87] Netbank, FSB v. Kipperman (*In re* Com. Money Ctr., Inc.), 350 B.R. 465, 481 (B.A.P. 9th Cir. 2006).

[88] *See supra* note 19.

[89] Major's Furniture Mart, Inc. v. Castle Credit Corp., 602 F.2d 538 (3d Cir. 1979).

or the transferee of receivables—should be entitled to the so-called equity of redemption, representing the surplus value of collections. Although the receivables financing was evidenced by a "sale" contract, the court found that protecting a borrower's equity of redemption should override the contract's formal designation. If the receivables financing was a sale, the transferee (Credit Castle Corporation) would have been entitled to the surplus; if a loan, the transferor (Major's Furniture Mart) would have been entitled to the surplus.[90] The court examined the substantive terms of the contract and found that the transferor retained virtually all of the risks associated with the transferred receivables.[91] It ruled that the contract created a loan because a sale would have shifted all or a substantial part of those risks to the transferee.[92]

The emphasis of the *Major's* court on recourse, however, was fact-specific and should not serve as precedent for resolving the sale-versus-loan problem. Although the broader test of what should constitute the sale of property looks to the transfer not only of risks but also of benefits of the transferred property,[93] the *Major's* court could not look to the transfer of benefits as a factor; that would have been circular because the question before the court was which party should be entitled to those benefits. In other words, the court was bound by the facts to look only to the transfer of risks.

B. Failure to Differentiate Types of Recourse

Another flaw in the current jurisprudence on the sale-versus-loan problem is its failure to differentiate the nature of the recourse. As discussed, virtually every sale of property requires the transferor to bear some recourse, often in the form of R&Ws as to the quality of the transferred property, in order to reduce information asymmetry.[94] The *Major's* court effectively recognized this distinction: "Guaranties of quality alone, or even guarantees of collectibility alone, might be consistent with a true sale."[95]

A group of prominent commercial law and bankruptcy scholars further developed this distinction, differentiating recourse for collectibility—essentially the equivalent of R&Ws on the sale of goods—and economic recourse, which more closely represents the type of recourse that should

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[90] *Id.* at 541.
[91] *Id.* at 545–46.
[92] *Id.* at 546.
[93] *See infra* notes 134–45 and accompanying text.
[94] *See supra* notes 46–48 and accompanying text.
[95] Major's Furniture Mart, Inc. v. Castle Credit Corp., 602 F.2d 538, 545 (3d Cir. 1979).

characterize a loan.[96] Full economic recourse would provide the transferee of receivables with a specific guaranteed rate of return regardless of losses or delays in collections. That type of recourse would be inconsistent with a sale because "a true buyer, unlike a lender, cannot adjust its return after the purchase to ensure a market return at all times."[97]

To date, however, few courts have followed that distinction, possibly reflecting the difficulty of differentiating those forms of recourse.

C. Underreliance on the Transfer of Benefits

As courts are overrelying on the transfer of risk (recourse),[98] they are under-relying on, and often ignoring, the transfer of benefits in analyzing the sale-versus-loan problem. As will be shown, however, determining whether property—whether tangible property or receivables—has been sold turns significantly on whether the benefits associated with the property have sufficiently shifted from the transferor to the transferee.[99]

This analytical gap stems, as discussed, from the very particular and fact-specific opinion in the *Major's* case.[100] That court could not look to the transfer of benefits as a sale-versus-loan factor because its inquiry was limited to which party should be entitled to those benefits.[101]

Some courts have considered the right to surplus collections as a type of benefit and its transfer, or lack thereof, as a relevant sale-versus-loan factor. In principle, surplus value is a type of benefit whose transfer should be a relevant factor.[102] Even in those cases, however, many of the courts have tied their analysis to a borrower's right to the return of surplus collateral value under the UCC. As discussed, the UCC now directs courts to look to non-commercial law to differentiate sales of, from loans secured by, receivables.[103]

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[96] Peter C. Pantaleo & Steven L. Schwarcz, *Rethinking the Role of Recourse in the Sale of Financial Assets*, 52 THE BUS. LAW. 159, 162–63 (1996).

[97] *Id.* at 171.

[98] *See supra* note 89–93 and accompanying text.

[99] *See infra* notes 136–45 and accompanying text.

[100] *See supra* note 89 and accompanying text.

[101] *See supra* note 93 and accompanying text.

[102] *See infra* notes 136–45 and accompanying text.

[103] *See supra* note 77 and accompanying text.

D. Dismissing the Parties' Intentions

The current jurisprudence dismisses, or pays little attention to, the parties' intentions.[104] As a matter of freedom of contract, those intentions should govern the characterization of a receivables financing absent limitations imposed by externalities or statutory policies. Part IV.B of this article later discusses why those limitations should not apply to the characterization of a receivables financing.

E. Considering Irrelevant Factors

Another serious flaw in the current jurisprudence is that it considers what should be completely irrelevant factors. For example, the 1991 article lists, and some courts follow, that a transferor's continued servicing of transferred receivables—that is, collecting those receivables and dealing with delinquent and defaulted payments—would be indicative of a loan.[105] This ignores the practical realities of receivables financings. Because transferors, including sellers, typically have longstanding familiarity and expertise in servicing their receivables, transferees, including buyers, often find it efficient to retain the seller as a servicer, typically paying them an arm's-length fee to do this work.[106]

The 1991 article also states that the lack of an independent credit investigation of the obligors of the receivables may be indicative of a loan. Again, this ignores market practicalities. Making such an independent credit investigation would be extremely expensive and time-consuming.[107] Buyers

[104] *See supra* notes 84–87 and accompanying text.

[105] Netbank, FSB v. Kipperman (*In re* Com. Money Ctr., Inc.), 350 B.R. 465, 483–84 (B.A.P. 9th Cir. 2006).

[106] Paloian v. LaSalle Bank Nat'l Ass'n (*In re* Drs. Hosp. of Hyde Park, Inc.), 507 B.R. 558, 714 (Bankr. N.D. Ill. 2013) (quoting Kenneth N. Klee & Brendt C. Butler, *Asset-Backed Securitization, Special Purpose Vehicles and Other Securitization Issues,* ALI-ABA COURSE OF STUDY MATERIALS SJ082 (June 2004)) (recognizing that "because the Originator [transferor] initially generated or held the assets [receivables], the Originator is in the best position to understand the nature of the assets and how to best service them. Appointing a new servicer could result in increased expense and inefficiency").

[107] In the experience of one of this article's authors (Prof. Schwarcz), such an investigation could cost as much as $500–$1000 per obligor. *Cf.* NATIONAL ASSOCIATION OF CREDIT MANAGEMENT, CREDIT INVESTIGATIONS 11–19, available at http://web.nacm.org/pdfs/educ_presentations/Principles_Ch11_v3.pdf (explaining that "gathering credit information directly can be time consuming and costly in terms

therefore normally rely on the seller's R&Ws about the quality of the receivables.[108] This reliance reflects the buyer's confidence in the seller's reliability and financial ability to pay for any R&W breaches.[109] Given that confidence, a transferee's decision whether or not to make such an independent credit investigation should be irrelevant to whether the transfer of the receivables is a sale or a loan.

Some lawyers also have considered the absence of a legal opinion stating that a receivables financing is a sale as supporting recharacterization of the financing as a loan.[110] That again is unrealistic; because a legal opinion is expensive, parties to a receivables financing may decide to forego requiring such an opinion.[111] Furthermore, the presence or absence of a legal opinion would not change the underlying structure or terms of the receivables financing.

Considering these critiques, this article next derives a normative

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of labor"); Emily Strauss, *Crisis Construction in Contract Boilerplate*, 82 L. & CONTEMP. PROBS. 163, 171 n.39 (2019) ("The cost and difficulties of re-underwriting [the loans underlying] a portfolio of MBS [can be] immense. . . .").

[108] *See, e.g.*, Metro. Coal Co. v. Howard, 155 F.2d 780, 784 (2d Cir. 1946) ("A warranty is an assurance by one party to a contract of the existence of a fact upon which the other party may rely. It is intended precisely to relieve the promisee of any duty to ascertain the fact for himself."). *Cf.* TINA L. STARK, NEGOTIATING AND DRAFTING CONTRACT BOILERPLATE § 10.08(2)(b) (1st ed. 2003) (discussing R&Ws as contractual tools of risk allocation); Sean J. Griffith, *Deal Insurance: Representation and Warranty Insurance in Mergers and Acquisitions*, 104 MINN. L. REV. 1839, 1840 (2020) (discussing R&Ws as a contractual solution to information asymmetry between sellers and buyers).

[109] *See, e.g.*, Patricia A. McCoy & Susan Wachter, *Representations and Warranties: Why They Did Not Stop the Crisis*, *in* EVIDENCE AND INNOVATION IN HOUSING LAW AND POLICY 289, 290 (Lee Anne Fennell & Benjamin J. Keys eds., 2017) (observing that R&Ws provide investors in securitizations with the needed assurances about the quality of the loans underlying the transactions).

[110] This observation is based on the experience of one of the authors (Prof. Schwarcz).

[111] Although the buyer would receive such a third-party legal opinion, the seller normally would be required to pay for it. Steven L. Schwarcz, *The Limits of Lawyering: Legal Opinions in Structured Finance*, 84 TEX. L. REV. 1, 9 (2005). Therefore, the parties to a receivables financing typically negotiate whether such an opinion would be required. *Cf.* Leslie L. Gardner, *Attorney Liability to Third Parties for Corporate Opinion Letters,* 64 B.U. L. REV. 415, 419 n.34 (1984) ("[T]he general content of the legal opinion is usually negotiated prior to its issuance."); Committee on Legal Opinions, *Guidelines for the Preparation of Closing Opinions*, 57 BUS. LAW. 875, 877 (2002) (outlining the negotiating process between opposing lawyers to determine which opinions the recipient wishes to receive); TriBar Op. Comm., *Third-Party "Closing" Opinions*, 53 BUS. LAW. 591, 599 (1998) (explaining that all transactions are unique and, as such, require a certain amount of negotiation between opinion givers and opinion recipients).

framework for resolving the sale-versus-loan problem.

IV. Deriving a Legal Framework for Resolving the Sale-versus-Loan Problem

A. Analyzing What Should Constitute a Sale of Property

1. *Governing Law*. State law governs what should constitute a sale of property, even in a bankruptcy case—the typical scenario in which courts are asked to recharacterize receivables financing contracts.[112] In the *Butner* case,[113] the U.S. Supreme Court held that state law property rights[114] apply in bankruptcy unless "some federal interest requires a different result."[115] This article later examines whether any federal bankruptcy policies should require a different result than would be applicable under state property law.[116]

2. *General Principles*. An inquiry into what should constitute the sale of receivables, an intangible form of property, should start with a more general understanding of what constitutes the sale of tangible property under state law. This approach admittedly grafts a normative analysis (what should constitute the sale of receivables) onto a positive observation (what constitutes the sale of tangible property).[117] The scholarly practice of basing normative analyses on positive observations has strong precedent, though.[118] The law should be tethered to reality.[119]

To determine what constitutes the sale of tangible property under state law, the most important factors are the expressed intention of the parties and

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[112] *See supra* note 40 and accompanying text.

[113] Butner v. United States, 440 U.S. 48 (1979).

[114] Under *Butner*, therefore, commercial law and the UCC should not govern the sale-versus-loan problem. Furthermore, as observed, the UCC itself directs courts to differentiate sales of, from loans secured by, receivables under other law. *See supra* note 38 and accompanying text.

[115] *Butner*, 440 U.S. at 55.

[116] *See infra* notes 164–77 and accompanying text.

[117] *Cf*. G.E. MOORE, PRINCIPIA ETHICA, 59–63 (Thomas Baldwin ed., 2d ed. 1971) (distinguishing positive observations of what exist from normative analysis of what should be).

[118] *See*, *e.g.*, Lucian Arye Bebchuk, *A New Approach to Corporate Reorganizations*, 101 HARV. L. REV. 775, 776–77 (1988) (grafting a normative analysis onto a positive assumption, in this case taking the existence of corporate reorganizations in bankruptcy law as a given to put forth a suggestion to improve the reorganization process).

[119] *See, e.g.*, ISAIAH BERLIN, PERSONAL IMPRESSIONS xxi (Henry Hardy, ed., 2001) (arguing that norms are and should be factually based and tethered to reality).

the transfer of the risks and benefits associated with the property.[120] Assuming the parties intend a sale, ownership of the property is transferred when those risks and benefits sufficiently shift from the transferor to the transferee of the property.[121] This is reasonable, reflecting a substance-over-form approach that focuses on which party bears the economic consequences rather than solely relying on formal documents like title or deeds.[122]

Determining when risks sufficiently shift from the transferor to the transferee of the property usually depends on who would suffer the loss if the property were damaged or destroyed.[123] This can be tricky. For the sale of goods, for example, the law allocates that risk of loss based on commercial realities, such as who would be expected to insure the goods at the time of their loss, not ownership.[124]

In determining when benefits sufficiently shift from the transferor to the transferee of the property, courts look to which party has the right to use, control, or profit from the property, including profiting by reselling (that is, alienating) the property.[125] Alienability is a fundamental aspect of property

[120] *See, e.g.*, Taylor v. Daynes, 118 Utah 61, 67 (Utah 1950) (stating that whether a sale has occurred depends on what the parties intend); Route 231, LLC v. Comm'r, 810 F.3d 247, 260 (4th Cir. 2016) (stating that ownership is dependent on which party possesses the benefits and burdens of the property).

[121] *See, e.g.*, Grodt & McKay Realty, Inc. v. Comm'r, 77 T.C. 1221, 1237–38 (Tax 1981) (holding that ownership transfers when the benefits and burdens shift based on such factors as possession, risk of loss, and right to profit).

[122] *See, e.g.*, Frank Lyon Co. v. United States, 435 U.S. 561, 573 (1978) (stating "in applying this doctrine of substance over form the Court has looked to the objective economic realities of a transaction rather than to the particular form the parties employed"). *Cf.* Stephen J. Lubben, *Derivatives and Bankruptcy: The Flawed Case for Special Treatment*, 12 U. PA. J. BUS. L. 61, 80 (2009) (arguing that in applying bankruptcy law's derivatives "safe harbor," courts should be empowered to examine the economic reality of transactions rather than merely deferring to contractual designations created to exploit statutory definitions).

[123] *See, e.g.*, W. Am. Ins. Co. v. Pro-Com Prods., Inc., 2024 U.S. Dist. LEXIS 88896, 4 (C.D. Cal. 2024) and Cent. Transp., LLC v. Balram Trucking, Ltd., 746 Fed. App'x. 508, 510 (6th Cir. 2018) (both referring to property damage or destruction in the disputed "risk of loss" provisions).

[124] U.C.C. § 2-509. *Cf.* Off. Cmt. No. 1 to § 2-509 ("The underlying theory of these sections on risk of loss is the adoption of the contractual approach rather than an arbitrary shifting of the risk with the 'property' in the goods.").

[125] These rights can be broken down more specifically to include the right to possess, referring to the ability to physically hold or control the property; the right to use, allowing the owner to exercise control over how the property is utilized (which depends on the nature of the item; for example, with an automobile, the owner has the right to drive it; with a hat, the owner has the right to wear it); the right to exclude, preventing others from using or interfering with

rights, ensuring that property can be freely exchanged in the market, promoting economic efficiency and stability.[126] These rights are not absolute, however; they can be disaggregated and reorganized. For example, someone may lease or loan their property to another, retaining some ownership rights while temporarily transferring others.[127] This flexibility allows owners to structure transactions to meet their particular needs, providing great autonomy, but it also makes the concept of ownership more complex.

Although documents of title can be important in showing the parties' intentions,[128] they are not necessarily controlling. In *Peoples Bank v. Sanders*, the court emphasized that while title "is an important indicator of ownership, it is not the only factor to be considered," focusing more on authorization to encumber.[129] Similarly, the court in *Gingrich v. Unigard Sec. Ins. Co*. found other indicia of ownership to be more important than title, including possession, right of control, and the nature of the transaction.[130]

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the property without permission (such as the doctrine of trespass); the right to profits, meaning the right to derive income from the property, whether through leasing equipment or selling goods or benefiting from the appreciation of the property's value over time; the right to destroy, allowing the owner to alter or discard the property how they choose; and the right to transfer/alienate, referring to the ability to sell, gift, lease, or otherwise transfer ownership of the property. *See* JOSEPH WILLIAM SINGER, BETHANY R. BERGER, NESTOR M. DAVIDSON & EDUARDO MOISES PEÑALVER, PROPERTY LAW: RULES, POLICIES, AND PRACTICES xxxii (8th ed. 2021).

[126] *Cf*. RESTATEMENT (FIRST) OF PROP. IV II Intro. Note (A.L.I. 1944) ("The underlying principle which operates throughout the field of property law is that freedom to alienate property interests which one may own is essential to the welfare of society."); *In re* Spaulding's Est., 22 Misc. 420, 422 (Sur. 1898), *aff'd*, 49 A.D. 541 (App. Div. 1900), *aff'd*, 163 N.Y. 607 (1900) ("It must not be forgotten that alienability is one of the essential qualities of property, and allows the owner to control its disposition, and freely give his property to whomsoever he pleases, limited, perhaps, to the right of creditors."). The law typically disfavors restraints on alienation because they can limit the marketability of property.

[127] SINGER ET AL., *supra* note 125, at xxxii.

[128] *See, e.g.*, West Valley Med. Partners, LLC, v. Shapow (*In re* Shapow), 599 B.R. 51, 79 (Bankr. C.D. Cal. 2019) ("[I]n the absence of any showing to the contrary, the status declared by the instrument through which the parties acquired title is controlling[.]"); Nat'l Union Fire Ins. Co., PA v. Eagle Aviation Acad., LLC, 2010 U.S. Dist. LEXIS 124415, 19–20 (M.D. Ala. 2010) ("Title documents also present strong evidence of ownership. Alabama, along with other jurisdictions, does not hold that title documents are conclusive evidence of ownership."); Spotts v. United States, 429 F.3d 248, 251 (6th Cir. 2005) ("[R]ecord title or legal title is an indicia sufficient to raise a presumption of true ownership[.]").

[129] Peoples Bank v. Sanders, 1984 Tenn. App. LEXIS 3383, *8–10 (Tenn. Ct. App. 1984).

[130] Gingrich v. Unigard Sec. Ins. Co., 57 Wn. App. 424, 431 (Wash. Ct. App. 1990). *See also, e.g.*, Kalway v. City of Berkeley, 151 Cal. App. 4th 827, 834 (2007) (holding title is only one indicator of ownership, other indicators including possession and control).

The importance of physically possessing tangible property is still real but diminishing. In *Gaass v. Hettinga*, for example, the court explained that although "a rebuttable presumption of ownership arises from the possession of property," "ownership is a collection of rights to use and enjoy property, including the rights to sell and transmit it" and possession is "only one of the incidents of ownership . . . ."[131] Possession may be even less important as an indicator of ownership in the modern business world.[132]

3. *Articulating a General Legal Framework for the Sale of Property*. A general legal framework for the sale of property under state law thus looks to the expressed intention of the parties and the transfer of the risks and benefits associated with the property as the most important factors. Assuming the parties intend a sale, it occurs when those risks and benefits have sufficiently shifted from the transferor to the transferee of the property. Determining when those risks have sufficiently shifted usually depends on who would suffer the loss if the property were damaged or destroyed. Determining when those benefits have sufficiently shifted depends on which party has the right to use, control, or profit from the property (including by reselling the property). Because state law allows these rights to be disaggregated and reorganized to provide flexibility, it may not always be obvious whether the benefits have sufficiently shifted.[133] Subpart B next derives a legal framework for the sale of receivables by applying this general framework to receivables financing.

B. Applying that Analysis to Derive a Legal Framework for Selling Receivables

1. *Intention of the Parties*. The threshold question for determining whether a transfer of receivables constitutes a sale therefore should be whether the parties intend a sale. This could be evidenced, for example, by how the parties label their contract. A contract labeled a receivables sale agreement—especially one that includes language expressing a sale of the receivables by the transferor and a purchase thereof by the transferee—should be sufficient.

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[131] Gaass v. Hettinga (*In re* the Est. of Hettinga), 514 N.W.2d 727, 729–30 (Iowa. Ct. App. 1994).

[132] *Cf. Book Reviews & Notices: Security Rights in Movable Property in European Private Law* ("[T]he traditional view that actual possession is an indication of ownership . . . has been rendered obsolete by the economic developments of recent decades[.]").

[133] Certain portions of the foregoing framework—holding documents of title and physically possessing the property—are completely irrelevant to selling receivables and thus not articulated above.

2. *Transfer of Risks*. The next question for determining whether a transfer of receivables constitutes a sale should be whether the risks associated with the receivables have sufficiently shifted from the transferor to the transferee. The test for the risk transfer of tangible property, who would suffer the loss if the property were damaged or destroyed, does not apply to receivables, which are intangible property. Rather, the risk of loss associated with receivables is that they will not be paid (default risk) or that they will be paid later than agreed (delinquency risk).

Default and delinquency risks depend on the quality of the receivables. As discussed, sellers of tangible property normally assume some portion of the quality risk associated with the property being sold, typically in the form of R&Ws, in order to reduce the information asymmetry between them and the buyers.[134] R&Ws or other forms of recourse serving this function for the sale of receivables—such as R&Ws protecting against default risk and delinquency risk due to misrepresentations about the quality of the receivables[135]—should be consistent with sale characterization. Part V of this article later examines, pragmatically, how lawyers and judges could distinguish that retention of risk as part of a broader inquiry into whether the risks associated with the receivables have sufficiently shifted from the transferor to the transferee to constitute a sale of the receivables.

3. *Transfer of Benefits*. Finally, consider whether the benefits associated with the receivables have sufficiently shifted from the transferor to the transferee to constitute a sale. Those benefits could include the monetary collections of the receivables as well as alienability—the transferee's right to resell the receivables.

In a pristine sale, the transferee would have the right to all of the monetary collections of the receivables.[136] Realistically, though, few if any receivables financings commercially provide that because transferees typically require significant overcollateralization to protect themselves.[137] Transferors

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[134] *See supra* notes 46–48 and accompanying text.

[135] R&Ws limited to the quality of the transferred receivables at the time of their transfer should conclusively be deemed as consistent with sale characterization. This reflects that those R&Ws would reduce actual information asymmetry and would not purport to address unrelated future risks. *Cf. supra* notes 46–49 (explaining that the theoretical justification of R&Ws is to reduce the information asymmetry between sellers and buyers).

[136] BLACK'S LAW DICTIONARY 1200 (5th ed. 1979) (defining "sale" as "implying the passing of the general and absolute title, as distinguished from a special interest falling short of complete ownership").

[137] *Cf.* Luize E. Zubrow, *Rethinking Article 9 Remedies: Economic and Fiduciary Perspectives*, 42 UCLA L. REV. 445, 454 (1994) (noting that "[*e*]*x ante* overcollateralization

and transferees customarily bargain over how surplus collections from the overcollateralization, or surplus value, will be divided between them.[138] That is sensible as a business matter because it voluntarily and deliberately allocates those collections between the parties.[139] Such a bargained-for allocation of benefits also is consistent with state law, which allows the benefits to be disaggregated and reorganized to provide flexibility.[140]

An arm's length bargain over how surplus value will be divided therefore generally should be consistent with a sale, notwithstanding that some courts have held that the transferor's right to receive surplus value suggests a loan.[141] Nonetheless, allocating the surplus value to the transferor could be inconsistent with a sale if that allocation coupled with the recourse[142] creates full economic recourse.[143]

A contractual restriction on alienability would be inconsistent with a sale, whereas a provision specifically contemplating alienability would suggest a sale. Silence, which tends to be the default in contracts for receivables

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protects against *ex post* under collateralization"). Although the term "overcollateralization" traditionally refers to the provision of collateral in excess of the principal advanced on a loan, its common use in securitization and other sophisticated receivables-financing contexts includes the excess value of receivables over the purchase price therefor. *See, e.g.*, *What is Overcollateralization in Finance*, https://www.thecoinzone.com/defi/what-is-overcollateralization (June 10, 2025) ("Overcollateralization is a financial strategy utilized primarily in the securitization of [receivables and other] assets, aimed at mitigating risk and providing security to lenders and investors. . . . This practice is prevalent in structured finance."); STANDARD & POOR'S, THE BASICS OF CREDIT ENHANCEMENT IN SECURITIZATIONS 2 (June 24, 2008) ("Under the overcollateralization method [of providing credit enhancement], the face value of the underlying [receivables] pool is larger than the par value of the issued bonds. So even if some of the payments from the underlying [receivables] are late or default, the transaction may still pay principal and interest payments on the bonds.").

[138] *Cf. infra* note 153 and accompanying text (observing that a transferee may have the right to retain only a portion of the overcollateralization).

[139] *Cf. supra* note 1 and accompanying text (observing this in the context of a simple example of a receivables financing). *Cf.* Steven L. Schwarcz, *The Alchemy of Asset Securitization*, 1 STAN. J.L. BUS. & FIN. 133, 137–39 (1994) (explaining that the cost of overcollateralization can be managed by returning excess receivables to the originator without disturbing the sale characterization); Benjamin M. Satterthwaite, *Nash Bargaining Theory and Intangible Property Transfer Pricing*, 164 TAX NOTES FED. 1947, 1948–49 (Sept. 27, 2019) (describing surplus utility maximization in bargaining theory, and noting that each party seeks to maximize its utility from a transaction relative to its alternatives).

[140] *See supra* note 133 and accompanying text.

[141] *See supra* notes 71–77 and accompanying text.

[142] *See* subpart 4(iii), *infra*.

[143] *See supra* notes 96–97 and accompanying text (discussing economic recourse).

financings,[144] would appear to be neutral. Parties wishing to more clearly document their transaction as a sale could consider inserting a provision into their contract specifically authorizing alienability of the transferred receivables. To be effective in evidencing a sale, any such provision would have to clearly provide that it applies to alienability of *ownership* of the transferred receivables, not merely to alienability of whatever lesser rights (e.g., secured transaction rights) the transferee has received in those receivables.[145]

4. *Articulating a Tentative Framework*. Based on the foregoing analysis, a receivables financing that satisfies these criteria should be characterized as a sale:

(i) The contract evidencing the financing is labeled a sale or it includes explicit language expressing a sale of the receivables by the transferor and a purchase thereof by the transferee; and the contract does not otherwise state that it is primarily intended[146] to create a secured loan rather than a sale.

(ii) The recourse is expressed through R&Ws or other provisions assuring the quality of the receivables, in order to reduce information asymmetry. R&Ws limited to the quality of the transferred receivables at the time of their transfer should conclusively be deemed to be consistent with sale characterization.[147]

(iii) The contract may freely allocate surplus value of the receivables between the transferor and the transferee, provided that allocation coupled with the recourse does not create full economic recourse.

(iv) The contract either gives the transferee the right to further transfer or sell the receivables or is silent on alienability restrictions.

5. *Taking into Account Externalities and Statutory Policies*. The analysis next stresses the foregoing tentative framework by taking into account externalities and statutory policies, which could limit freedom of contract.[148] First consider externalities, then statutory policies.[149]

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[144] This observation is based on Professor Schwarcz's experience.

[145] Such a provision also should clarify, as applicable, that it applies to alienability of ownership of the transferred receivables other than any portion thereof that constitutes overcollateralization that is allocated to the transferor. *Cf. supra* notes 138–41 and accompanying text (discussing the allocation of surplus value between the transferor and the transferee).

[146] This clarifies that many receivables financings contain a fallback provision stating that if the contract is recharacterized as creating a loan, that it be a perfected secured loan. Such a provision would not represent the intention, much less the primary intention, of the parties.

[147] *See supra* note 135 and accompanying text.

[148] *See supra* notes 31–33 and accompanying text.

[149] We also considered possibly analogous examples and how they might affect the derivation of a legal framework for the sale of receivables. Among other things, we searched

(i) Externalities should not limit the characterization of a receivables financing. The only third parties who potentially might be harmed by the financing would be the transferor's unsecured creditors.[150] Fundamentally, a receivables financing, whether characterized as a sale or a secured loan, transfers $(X+Δ) of receivables in exchange for $X of money. The $Δ represents what is customarily called overcollateralization—an excess of receivables value over the amount of money transferred.[151] The overcollateralization takes into account the risk of loss on the receivables and, because the receivables will be paid in the future, the time value of money.[152]

The amount of overcollateralization in an arm's length receivables financing—or at least the portion thereof that the transferee has the right to retain[153]—should be reasonable, otherwise sophisticated business parties[154] would not voluntarily bargain to exchange the relevant receivables and money. From the standpoint of the transferor, therefore, the $X of money received

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for any cases or secondary sources on sales of divisible tangible property, such as grain or fluids, in which the transferor has rights to take back some of the unutilized property with a retroactive adjustment of the purchase price. We found no such cases, though, several states have statutes that clarify whether the transfer of grain to a warehouse constitutes a sale or a bailment. These laws, however, would not appear, conceptually, to apply differently if the property at issue were not divisible. For example, Missouri's § 411.026 allows for "deferred pricing agreements," under which ownership of grain transfers if the statutory conditions of § 276.451 and § 411.325 are met. These statutes distinguish between (i) grain stored in a warehouse (bailment), so ownership remains with the seller; and (ii) grain sold to a buyer (sale), so ownership and risk pass to buyer. At the time of delivery of the grain, the deliverer/transferor will mark whether it is delivered for storage or sale. It will be deemed to be storage unless the transferee pays for the grain at that time or the deferred purchase price is established and documented at the time of delivery (in which case ownership and risk then pass to buyer). Those rules could apply equally, in concept, to an automobile or other particular tangible property.

[150] *Cf.* Lois R. Lupica, *Asset Securitization: The Unsecured Creditor's Perspective*, 76 TEX. L. REV. 595, 617 (1998) (noting that in securitizations, "the debtor's assets are . . . removed from the pool of assets available to unsecured creditors . . . . [I]n the absence of an avoidance of the transfer of or lien on these assets, they become unavailable to satisfy the unsecured creditors' claims").

[151] Jeffrey Stern, *Credit Enhancement in Securitizations*, LEXISNEXIS PRACTICAL GUIDANCE (2024).

[152] *See supra* note 1 and accompanying text.

[153] *Cf. supra* note 138 and accompanying text (observing that transferors and transferees customarily bargain over how collections from the overcollateralization will be divided between them).

[154] *See supra* note 32 and accompanying text (observing that the parties to receivables financings normally are sophisticated businesses).

should represent a fair exchange for the $(X+Δ) of receivables transferred.[155] Unsecured creditors of the transferor thus should have no compelling reason to oppose the receivables financing.

Empirical observations confirm this supposition, though with an interesting twist. Covenants restricting the sale of receivables are relatively rare in financing agreements, while covenants that restrict loans secured by receivables are much more prevalent.[156] In other words, to the extent a transferor's creditors oppose receivables financing, they are likely to oppose a loan secured by receivables and not a sale of receivables. This at least suggests that unsecured creditors do not generally see the sale of receivables as creating externalities.

(ii) Next stress the foregoing tentative framework by taking into account statutory policies that could limit freedom of contract. Theoretically, this limitation could apply in two contexts. First, it could constitute a generic state law limitation based on statutory policies as a limit to freedom of contracting.[157] Second, it could constitute a specific conflict-of-law limitation based on the Supreme Court's jurisprudence as to when the policies of federal bankruptcy law should override state law.[158]

For the receivables financings discussed in this article, however, these contexts merge. The only statutory policies that could limit freedom of contract are bankruptcy policies because, as discussed, courts adjudicate receivables financing recharacterization cases almost exclusively when a transferor becomes bankrupt and is advancing a recharacterization argument.[159]

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[155] A voluntary exchange presumably means that the transferor and the transferee each views the exchange as fair.

[156] *See, e.g.*, *Securitization Post-Enron*, *supra* note 14, at 1563–65; Victoria Ivashina & Boris Vallée, "Weak Credit Covenants" 14, 46 (2024), available at https://www.hbs.edu/ris/Publication%20Files/Ivashina_Vallee_Jan24_Weak%20Credit%20Covenants_7241c228-b3e3-405e-b8b7-c7a6f4cb8d32.pdf (finding that 92% of credit agreements in their sample restricted liens whereas only 73% restricted asset sales, and that 41.1% of those asset-sale restrictions exempted receivables sales; though noting that 38.5% of the lien restrictions had a carve-out for receivables financings). This disparity may be due to the transaction's effects on the lender's priority status. With a sale, the receivables are removed from the transferor's balance sheet, which should not affect the lender's collateral or priority interest. Additionally, creditors may like a sale as it lessens the likelihood of default, as money from the sale can be used to pay their existing debt. However, negative pledge covenants are likely common because a new secured loan creates a competing lien, which outwardly would dilute an unsecured creditor's priority.

[157] *See supra* note 31 and accompanying text.

[158] *See supra* notes 112–16 and accompanying text.

[159] *See supra* note 40 and accompanying text.

Furthermore, the only bankruptcy policies are federal bankruptcy policies because bankruptcy is governed by federal law.[160] The other potentially applicable statutory policies that could limit receivables financing contracts—usury and equity of redemption[161]—do not apply here. As previously explained, usury focuses on excessive interest charged to consumers, which has no relevance to business-related receivables financings.[162] And equity-of-redemption issues arise only in specific limited circumstances.[163]

The relevant inquiry, therefore, is whether bankruptcy policies should limit freedom of contract in order to sometimes justify recharacterization of a receivables financing contract.[164] The primary bankruptcy policies are equal treatment for creditors and debtor rehabilitation.[165] In another context, one of the authors of this article and others concluded that neither of those policies would be sufficiently "threatened by the concept of a true sale with recourse for collectibility as to require courts to create federal common law and ignore state law rights."[166] The more specific question for this article, though, is whether either of those policies should require or allow a court to recharacterize as a secured loan a receivables financing that, contractually, purports to be a sale.

Logically, a bankruptcy policy should require or allow that recharacterization only if the contractual characterization as a sale violates that policy. Contractually characterizing a receivables financing as a sale would not violate the policy of equal treatment for unsecured creditors. Although the transferee of the receivables would have greater rights to the receivables and their collections in a sale than in a secured loan,[167] both a sale and a secured loan would give the transferee rights therein that are superior to those of the

[160] Title 11 of the United States Code governs bankruptcy in the United States.

[161] *See supra* note 55 and accompanying text.

[162] *See supra* notes 56–57 and accompanying text.

[163] *Cf. supra* notes 93 and accompanying text (explaining why the equity-of-redemption *Major's* case was fact-specific and should not serve as precedent for resolving the sale-versus-loan problem).

[164] This might appear to create a degree of circularity because the Supreme Court has ruled that state-law property rights govern in bankruptcy. *See supra* notes 113–15 and accompanying text. The circularity is avoided, though, because the Court provided an exception where "some federal interest requires a different result." *See id.* Presumably, a receivables sale that violates a federal bankruptcy policy should require a different result.

[165] *Bankruptcy Basics: A Primer*, Cong. Rsch. Serv., R45137, at 1 (2022), https://www.congress.gov/crs-product/R45137.

[166] Pantaleo et al., *supra* note 96, at 185.

[167] *See supra* notes 8–9 and accompanying text.

transferor's unsecured creditors.[168] Therefore, the characterization of a receivables financing as a sale or a secured loan would be irrelevant to equal treatment of those creditors.

Contractually characterizing a receivables financing as a sale could impact debtor rehabilitation, however. As observed, a sale means that the transferee owns the receivables and collections, whereas a loan means that the transferor-debtor continues to own the receivables and collections and the transferee merely has a security interest therein.[169] Significantly for debtor rehabilitation, bankruptcy law would then allow the transferor-debtor to use the cash collections of the receivables for reorganization purposes if it provides the transferee with adequate protection of its security interest.[170]

Should that debtor-rehabilitation advantage, created by recharacterizing a receivables sale as a secured loan, be significant enough to "require[] a different result"[171] than what the parties contracted for? We think not because sale characterization would enable the transferor to obtain lower cost financing,[172] which should help it avoid bankruptcy in the first place. Bankruptcy law favors transfers that could help a firm try to avoid bankruptcy, even though the transfer could impair the firm's ability to reorganize if it subsequently enters bankruptcy. For example, bankruptcy law permits a financially distressed firm to grant a security interest in its assets as a quid pro quo to obtain default waivers that could help the firm avoid bankruptcy.[173] This grant of collateral, which could impede the firm's ability to reorganize in bankruptcy,[174] would remain valid even if those waivers ultimately fail to enable the firm to avoid bankruptcy.[175] Furthermore, although recharacterization would allow the firm to use the cash collections of the receivables for reorganization purposes,[176] bankruptcy law already separately

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[168] Even if the transferee has only a secured loan, its security interest in the transferred receivables and collections would have priority over claims of the transferor's unsecured creditors. U.C.C. § 9-322.

[169] *See supra* notes 8–9 and accompanying text.

[170] *See* 11 U.S.C. § 363.

[171] *Cf. supra* note 115 and accompanying text (quoting the Supreme Court in *Butner*).

[172] *See supra* notes 12–19 and accompanying text.

[173] *Cf.* 11 U.S.C. § 548(d)(2) (defining "value" as including the "securing of . . . an antecedent debt," thereby preventing a financially troubled firm's grant of collateral to a creditor from being avoided under § 548(a) in the firm's subsequent bankruptcy).

[174] This grant of collateral could restrict the firm's ability to grant adequate protection under 11 U.S.C. § 361.

[175] *See supra* note 173.

[176] *See supra* note 170 and accompanying text.

enables firms to obtain reorganization financing.[177]

On balance, therefore, bankruptcy policies should not justify recharacterization of a receivables financing contract.

6. *Articulating the Derived Framework*. As shown above, neither externalities nor statutory policies should limit the contractual freedom of sophisticated business parties to designate their receivables financing as a sale. Accordingly, this article proposes that the tentative framework[178] be the final derived framework (the "framework") for finding that a receivables financing constitutes a sale, namely that the following criteria are met:

(i) The contract evidencing the financing is labeled a sale or it includes explicit language expressing a sale of the receivables by the transferor and a purchase thereof by the transferee; and the contract does not otherwise state that it is primarily intended to create a secured loan rather than a sale.

(ii) The recourse is expressed through R&Ws or other provisions assuring the quality of the receivables, in order to reduce information asymmetry. R&Ws limited to the quality of the transferred receivables at the time of their transfer should conclusively be deemed to be consistent with sale characterization.

(iii) The contract may freely allocate surplus value of the receivables between the transferor and the transferee, provided that allocation coupled with the recourse does create full economic recourse.[179]

(iv) The contract either gives the transferee the right to further transfer or sell the receivables or is silent on alienability restrictions.

If all four of these criteria are met, the receivables financing should definitively be found to constitute a sale. In applying the framework, Part V will also consider how meeting certain criteria should be balanced with failing others.

V. Testing the Framework

The foregoing framework may appear sensible, but its raison d'être is

[177] *See* 11 U.S.C. § 364 (providing so-called debtor-in-possession or "DIP" financing). *But cf*. Kenneth C. Kettering, *Securitization and Its Discontents: The Dynamics of Financial Product Development*, 29 CARDOZO L. REV. 1553, 1575 (2008) (arguing that securitization undermines the policy of debtor rehabilitation because, by selling receivables to a bankruptcy-remote SPV, it deprives the transferor-debtor of the cash generated by those receivables).

[178] *See supra* Part IV.B.4.

[179] For a detailed explanation of how to determine if there is full economic recourse, *see infra* notes 183–89 and accompanying text.

to provide clear and pragmatic guidelines for judges, lawyers, and investors, thereby reducing uncertainty and cost and discouraging forum shopping. This Part V tests the framework by applying it to the simplified example in the Introduction and to other hypothetical and actual examples of receivables financings. These applications show that the framework should achieve those goals.

A. Application to Simplified Example

The simplified example in the Introduction[180] assumes that Party A (the transferor/purported seller) contracts to sell $1,000 of receivables to Party B (the transferee/purported buyer) for $950. If the collections on the receivables are less than $975, or if collections are made later than expected (180 days), the contract requires Party A to compensate Party B for the loss or delay. If those collections are more than $985, the contract requires Party B to turn over the surplus collections to Party A.

Subject to the discussion below,[181] that contract should constitute a sale of the receivables. Criterion (i) of the framework is met because the "contracts to sell" language explicitly expresses a sale of the receivables by the transferor and a purchase thereof by the transferee. The example does not suggest, and we therefore assume, that the contract does not otherwise state that it is primarily intended to create a secured loan rather than a sale.

Although less clear, criterion (ii) of the framework should be met. The contract requires Party A to compensate Party B if the collections on the receivables are less than $975 or if collections are made later than expected. These recourse provisions help to assure Party B about the quality of the receivables, thereby reducing the information asymmetry.

Criterion (iii) of the framework should be met because the contract allocates surplus value of the receivables between the transferor and the transferee; Party B retains any surplus value up to and including $985, and Party A is entitled to any surplus value exceeding that number.[182] That allocation of

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[180] *See supra* text accompanying note 1.

[181] *See infra* notes 183–89 and accompanying text.

[182] One anonymous reviewer of this article asked, "If this was a true sale, why would Party A be entitled to any surplus value at all? Party B is not enjoying the full benefits of its ownership." We explain this in detail, *supra* notes 136–40 and accompanying text: Although in "a pristine sale, the transferee would have the right to all of the monetary collections of the receivables, . . . few if any receivables financings commercially provide that because . . . [t]ransferors and transferees customarily bargain over how surplus collections from the overcollateralization, or surplus value, will be divided between them"; and that "is sensible as

surplus value coupled with the recourse would not create full economic recourse—defined as providing Party B, the transferee of receivables, with a specific guaranteed rate of return regardless of losses or delays in collections.[183]

The allocation of recourse and surplus value in the contract nonetheless provides Party B with a degree of economic recourse by assuring investment protection within a range of possible outcomes. In principle, that should be consistent with a sale; an arm's length sophisticated business party would not voluntarily make an investment, such as buying receivables for a specified purchase price, unless it reasonably expects its investment to be repaid with (or close to) a market rate of return.[184] For the simplified example, assume that receipt by Party B, the buyer, of $980 of collections of the receivables in 180 days would achieve a market rate of return on its $950 investment. The simplified example provides a degree of economic recourse because Party A, the seller, must compensate Party B if collections are less than $975 or if those collections are delayed beyond 180 days. Therefore, Party A contractually assures Party B that it will receive at least something close to a market rate of return. Party B's rate of return could be higher if it receives collections exceeding $980, but even that has an upper limit because Party A is entitled to any surplus value exceeding $985.[185]

The contract thus provides Party B with investment protection within a range of possible outcomes that are negotiated at arm's length at the time of the receivables transfer. Technically, that should not be full economic recourse because it does not guarantee a specific rate of return, as would be the case with a loan that bears an agreed interest rate.[186] Furthermore, it shifts at least some of the risk (up to $5 of risk if collections are between $975 and $980) and benefit (up to $5 of benefit if collections are between $980 and $985) from the transferor to the transferee.[187]

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a business matter [and] consistent with state law."

[183] *See supra* notes 96–97 and accompanying text.

[184] *Cf.* Miller v. ANConnect, LLC, 2022 Bankr. LEXIS 1373, 11 (Bankr. D. Del. 2022) (explaining that a transaction negotiated at arm's length normally should yield reasonably equivalent value for the parties).

[185] Party B nonetheless could increase that upper limit if it receives collections of the receivables earlier than 180 days.

[186] *See supra* notes 96–97 and accompanying text.

[187] *Cf. supra* note 121 and accompanying text (discussing the shifting of risk and benefit associated with a sale). *Also cf.* Steven L. Schwarcz, *The Parts Are Greater Than the Whole: How Securitization of Divisible Interests Can Revolutionize Structured Finance and Open the Capital Markets to Middle-Market Companies*, 1993 COLUM. BUS. L. REV. 139, 159–60 (1993) (arguing that because the transferee of receivables shares in the upside and downside of its

Even so, at what point should a court find that a contract has so narrowed the range of possible outcomes to create the de facto equivalent of a specific rate of return (and thus create full economic recourse)? Although the answer is not unequivocal, a reasonable response might be that a material range of variation for both risks and benefits should obviate a finding of full economic recourse. The rule of thumb for materiality is 5%.[188] The range of variation in the above simplified example for both risks and benefits exceeds 5%.[189] That range of variation should not create full economic recourse.

Finally, criterion (iv) of the framework would be met because the example does not suggest, and we therefore assume the contract does not impose (and hence is silent about), alienability restrictions. Because all the framework's criteria are met, the contract in the simplified example should create a sale of receivables.

B. Application to other Hypothetical Examples

The following applications stress the key variables in the framework.

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investment and is not merely guaranteed a fixed return, full economic recourse is not created).

[188] Generally accepted accounting principles (GAAP) tends to use 5% as a rule of thumb for materiality. *See, e.g.*, Nigel Sapp, *Minding the Gaps: How to Calculate Materiality Thresholds in Accounting*, NUMERIC (Sep. 17, 2024), available at https://www.numeric.io/blog/materiality-threshold. The Securities and Exchange Commission (SEC) is in accord: "The use of a percentage as a numerical threshold, such as 5%, may provide the basis for a preliminary assumption that–without considering all relevant circumstances–a deviation of less than the specified percentage with respect to a particular item on the registrant's financial statements is unlikely to be material. The staff has no objection to such a 'rule of thumb' as an initial step in assessing materiality." SEC Staff Acct. Bull. No. 99 – Materiality, 17 CFR Part 211 (Aug. 12, 1999).

[189] The simplified example posits that $980 of collections in 180 days on the $950 investment, or a $30 return in that half-year period, would achieve the specifically desired rate of return. *See* text following note 184, *supra*. That rate of return would equal 6.3% per annum [yearly rate of return = ($30 x 2)/$950 = 0.063]. The recourse for collections less than $975 assures a $25 return [$975–$950] in that half-year period, which would yield a rate of return of 5.3% per annum [yearly rate of return = ($25 x 2)/$950 = 0.053]. The range of risk variation would therefore equal 16% [(6.3%–5.3%)/6.3% = 16%], which would significantly exceed the 5% rule of thumb for materiality. Similarly in calculating the range of benefit variation, the obligation of the transferee to turn over collections exceeding $985 to the transferor limits the upside return to $35 [$985–$950] in that half-year period, which would yield a rate of return of 7.4% per annum [yearly rate of return = ($35 x 2)/$950 = 0.074]. The range of benefit variation would therefore equal 17% [(7.4%–6.3%)/6.3% = 17%], which again would significantly exceed the 5% rule of thumb for materiality. Note: If the above calculations did not round off the decimals, the range of variation would be identical for both risk and benefit because the absolute values of the variation (+$5 and -$5) are the same.

1. *Stressing the Framing of the Contract*. This could be stressed by including inconsistent framing language. For example, assume the contract is titled "Receivables Sale Agreement" but contains a provision stating "this Agreement is intended to provide [Transferee] with security for the obligations of [Transferor] hereunder." A court reasonably could find that this specific secured loan language expresses the primary intention of the parties, thereby outweighing the title itself. In contrast, many receivables financing agreements state that "if a court rules that it does not create a sale, this Agreement shall be deemed to provide [Transferee] with security for the obligations of [Transferor] hereunder." Such a backstop security interest would not contradict the primary intention of the parties, to create a sale, and therefore should be consistent with a sale.

2. *Stressing the Recourse*. This could be stressed by providing for full recourse that goes beyond assuring the quality of the transferred receivables. For example, assume the contract states that "if any receivable fails to be paid in full within 60 [or some other specified number of] days, [Transferor] shall promptly pay [Transferee] the amount of such payment deficiency." Although this type of full recourse for collectibility would be more consistent with a loan than a sale, a court should be able to find that the contract creates a sale if the framework's other criteria are met.[190]

3. *Stressing the Allocation of Surplus Value*. This could be stressed by allocating the surplus value to the transferee to the extent such allocation provides the transferee with a return of its investment plus an agreed rate of return. That alone would not provide full economic recourse—and thus it should be consistent with a sale—because the amount of the surplus could be insufficient to provide that rate of return. However, if that return of surplus were coupled with full recourse for collectibility, thereby guaranteeing that the transferee receives (either through collections or through the recourse) a return of its investment plus a specific rate of return, there would be full economic recourse, which would be inconsistent with a sale. A court therefore could recharacterize the contract as a secured loan, subject to the contract giving the transferee full alienability of the receivables.[191]

4. *Stressing Alienability*. This could be stressed by restricting alienability of the transferred receivables. For example, assume the contract states that "[Transferee] shall have no right to sell, assign, or otherwise transfer

[190] *Cf. supra* note 95 and accompanying text (observing that "even guarantees of collectibility alone[] might be consistent with a true sale").

[191] *See infra* note 192 and accompanying text.

the transferred receivables." That suggests that the transferee does not actually own those receivables but merely has a security interest therein. In contrast, a contractual provision giving the transferee the right to further sell the receivables and keep all the sale proceeds not only should be consistent with a sale but also, assuming the contract is framed as a sale, should outweigh the existence of full economic recourse. The rationale for this view is twofold: that full alienability (i) transfers all the benefits of the property and (ii) goes directly to the substance of property rights whereas recourse goes only to the economics of the transaction, and where the two conflict the former should govern ownership.[192]

C. Application to Actual Examples

1. *Examples where Courts Recharacterized a Receivables Financing to be a Secured Loan but where the Framework would justify a Sale*. Although there are certainly more examples, the following cases exemplify scenarios where courts recharacterized receivables financings to be secured loans but, under this article's framework, would be classified as sales.

(a) In *In re Shoot the Moon*,[193] the court recharacterized a receivables financing labeled as a "Merchant Agreement" to be a secured loan. Citing the 1991 article, the *Shoot the Moon* court said that it would follow "a holistic, multipart framework to examine a [receivables financing] transaction on the way to classifying it as a sale or a loan."[194] The court initially observed that the fact that the transferor of the receivables gave a "broad" security interest in its assets to the transferee, to secure the transferor's obligations under the contract, "is indicative of a loan, not a sale."[195] That observation, however, should be irrelevant to both the transfer of receivables and this article's framework. The

[192] *Cf*. Thomas W. Merrill & Henry E. Smith, *What Happened to Property in Law and Economics?*, 111 YALE L.J. 357, 359 (2001) (explaining that because property rights create duties that attach to "everyone else," they provide a basis of security that permits individuals to develop resources and plan for the future, highlighting the substantive nature of ownership beyond mere transactional rights); Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089, 1092–1104 (1972) (explaining that while liability rules may promote economic efficiency, protecting entitlements through property rules can be justified when necessary to preserve ownership rights, advance distributional objectives, or safeguard broader social values).

[193] CapCall, LLC v. Foster (*In re* Shoot the Moon, LLC), 635 B.R. 797 (Bankr. D. Mont. 2021). Although this case is an MCA case (*cf*. *supra* note 57 (discussing MCA cases)), the court—a bankruptcy court—does not distinguish its reasoning from that of bankruptcy cases.

[194] *Id*. at 813.

[195] *Id*. at 815.

security interest merely backed whatever obligations the transferor had; it is the nature and extent of those obligations (the recourse), not the transferor's creditworthiness to perform them, which should be relevant to sale-versus-loan characterization. Similarly, the court stated that the guaranty of the transferor's obligations by the principal of the transferor "weighs heavily in favor of characterizing the transactions as loans."[196] Again, a backing of the transferor's creditworthiness should be irrelevant to sale-versus-loan characterization.[197]

The court next observed that the UCC-1 "financing statements contain another revealing indicator that they relate to secured loans: they identify [the transferor] as a 'debtor.'"[198] This observation should be of no import because it conflates the UCC's application to both sales and secured loans, treating both as secured transactions for perfection and priority purposes,[199] with a substantive sale-versus-loan determination for bankruptcy law purposes. The model form of UCC-1 financing statement, which transferors of receivables must file for perfection and priority purposes, even officially identifies the transferor—whether a seller or a collateral debtor—as a "DEBTOR."[200]

Finally, the court applied certain other factors included in the 1991 article to its analysis, noting that

> three [such factors] weigh heavily in favor of classifying the transactions as loans. First, as contemplated in the first factor, [the transferee] retained a definite right of recourse against the [transferor] . . . . Second, as the second factor contemplates, the Shoot the Moon entities commingled funds from the [receivables] with other funds and specifically those used to operate the restaurants, with [the transferee's] approval to boot. Finally, as contemplated by the eighth factor, the language contained in the agreements and the conduct of the parties reveal an apparent debtor-creditor, rather than seller-buyer, relationship. Considered in conjunction with the overall economic substance and risk allocation that connects the factors, the court concludes that the

[196] *Id.* at 817.
[197] *See supra* notes 195–96 and accompanying text.
[198] *In re* Shoot the Moon, *supra* note 193, at 816.
[199] *See supra* notes 36–37 and accompanying text.
[200] U.C.C. § 9-521(a).

transactions are substantially similar to a loan.[201]

The first such factor, recourse, goes to criterion (ii) of this article's framework. Although the court does not describe the recourse in detail, it mentions "the absence of any provisions allowing the [transferee] . . . to alter the pricing terms."[202] This appears to indicate that the recourse was intended to assure the quality of the receivables, consistent with criterion (ii), and certainly not to create full economic recourse.[203] The second factor, commingling of proceeds, is not part of the framework not only because courts are inconsistent in how they view control over receivables collections as relevant to sale-versus-loan characterization[204] but also because sellers normally service the receivables.[205] The third factor, "the language contained in the agreements and the conduct of the parties," should be irrelevant. The "language contained in the agreements" should be irrelevant because the court only references that language in the financing statements which, as discussed above,[206] conflates the UCC's application to both sales and secured loans with a substantive sale-versus-loan determination. The "conduct of the parties" should be irrelevant because such conduct was limited to "business actors often discuss[ing] the transactions in vernacular reserved for debtor-creditor relationships."[207] The legal nature of a contract should not turn on the discussion of non-lawyers.[208]

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[201] *In re* Shoot the Moon, *supra* note 193, at 819.

[202] *Id.* at 820.

[203] Certain other descriptions of the recourse do not suggest full economic recourse. For example, this language—"[a]bsolute, broad, continuing guaranty of payment and performance, is a guaranty of payment and not merely a guaranty of collection"—is standard guarantee language, which merely states that the guarantee can be enforced immediately without exercising other remedies first. This language—"waivers such as any requirement that CapCall take any action against any security or collateral before demanding payment from the guarantor"—is additional language that reinforces our prior observation. And this language—"an affidavit of confession of judgment whereby both the Shoot the Moon entity and the personal guarantor confess to a generalized judgment in a fixed sum equal to the amount to be paid to CapCall plus legal fees and interest at the rate of 16% per annum"—merely provides a confession of judgment for any amount otherwise payable under the recourse.

[204] *See supra* notes 79–83 and accompanying text. In general, commercial law recognizes that parties may commingle cash collections. *Compare* U.C.C. § 9-207 (allowing such commingling) *with* U.C.C. § 9-315 (discussing when the transferee's interest in commingled cash should continue to be perfected).

[205] *See supra* note 106 and accompanying text.

[206] *See supra* notes 198–200 and accompanying text.

[207] *In re* Shoot the Moon, *supra* note 193, at 818.

[208] *Cf.* Invs. Ins. Co. of America v. Dorinco Reins. Co., 917 F.2d 100, 104 (2d Cir. 1990) (stating that extrinsic evidence cannot be introduced to vary the plain meaning of an unambiguous contract); Andrew Taylor, *A Comparative Analysis of U.S. and English Contract*

Applying the other criteria of this article's framework, criterion (i) would be met because the contract contained "lengthy provisions regarding how the central transaction 'is not intended to be, nor shall it be construed as a loan'."[209] Criterion (iii) would be met because the contract does not allocate surplus value.[210] Criterion (iv) would be met because the court does not observe any restrictions on, and thus we assume the contract was silent about, alienability. *Shoot the Moon* therefore exemplifies a case where the court recharacterized a receivables financing to be a secured loan but where this article's framework would classify the financing as a sale.

(b) The case of *CF Motor Freight v. Schwartz (*In re *De-Pen Line)*[211] exemplifies another scenario in which a court recharacterized a receivables financing to be a secured loan, whereas this article's framework would classify the financing as a sale. The contract was labeled a "Factoring Agreement," and the invoices evidencing the receivables were stamped with a statement that they have been "sold and assigned."[212] The court recognized that factoring involves "the purchase of accounts receivable . . . ."[213] The transferee advanced 86% of the face amount of each receivable at the time of its transfer, with an additional 10% if and when the receivable collected.[214] If a receivable failed to collect within 60 days, the transferee had recourse for repayment of the amount advanced.[215] As a result of this recourse, the court found "that the risks which are characteristic of a true sale are not accepted by [the transferee] in the Agreement."[216]

Applying this article's framework, criterion (i) would be met because

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Law Interpretation and Implied Terms, 9 INT'L IN-HOUSE COUNSEL J. 1 (2015) (concluding "where it is known that the contract has been drafted with the assistance of legal advisers, the Courts will seek to uphold the "four corners" of the written contractual instrument."). That is different from interpreting particular provisions of a commercial contract differently based on the parties' course of performance or dealing. *Cf.* U.C.C. § 1-303 (discussing course of performance and course of dealing).

[209] *In re* Shoot the Moon, *supra* note 193, at 819.

[210] *Cf. id.* at 820 (observing "the absence of any provisions allowing the [transferor] to repurchase the receivables").

[211] CF Motor Freight v. Schwartz (*In re* De-Pen Line), 215 B.R. 947, 951 (Bankr. E.D. Pa. 1997).

[212] *Id.* at 949.

[213] *Id.*

[214] *Id.* The transferee also charged a 4% factoring fee. *Id.*

[215] *Id.* (stating that the factoring fee was then also reversed).

[216] *Id.* at 951.

the contract clearly purported to create a sale of the receivables.[217] On balance, criterion (ii) should be met. Although full recourse for collectibility would be more consistent with a loan than a sale, a court should be able to find that the contract creates a sale if the framework's other criteria are met.[218] Criterion (iii) would be met because the contract does not allocate surplus value. Criterion (iv) would be met because the court does not observe any restrictions on, and thus we assume the contract was silent about, alienability. *CF Motor Freight* therefore again exemplifies a case where the court recharacterized a receivables financing to be a secured loan but where this article's framework would classify the financing as a sale.

(c) The decision in *Nickey Gregory Co. v. AgriCap LLC*[219] further exemplifies a case—notably, by a federal court of appeals—in which the court recharacterized a receivables financing to be a secured loan whereas this article's framework would classify the financing as a sale. The contract was labeled a "Factoring Agreement,"[220] which traditionally evidences a sale of receivables.[221] The transferor, Robison Farms, granted the transferee, AgriCap, a security interest in all of Robison Farms' assets to secure its obligations and also subordinated the claims of third parties to any future recourse claims of the transferee.[222] The president and owner of Robison Farms also personally guaranteed payment of any such future recourse claims.[223] The transferee had recourse against Robison Farms for receivables remaining unpaid past a specified period unless the obligor on the unpaid receivables had become bankrupt or insolvent.[224] The transferee also had recourse against Robison Farms for any unpaid receivables for which there was a R&W breach or an unsettled dispute.[225] Additionally, the filed UCC–1 financing statement referred to Robison Farms as "the Debtor."[226] As a result of the recourse, the credit support, and the UCC-1 financing statement, the court found the financing to be a secured loan.[227]

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[217] *See supra* notes 212–13 and accompanying text.

[218] *See supra* notes 95 & 190 and accompanying text.

[219] Nickey Gregory Co., LLC v. AgriCap, LLC, 597 F.3d 591 (4th Cir. 2010).

[220] *Id.* at 601 (also observing that the contract referred to the transferee of receivables as the "buyer," the transferor of receivables as the "seller," and to the transfer as a "purchase").

[221] *See supra* note 213 and accompanying text.

[222] 597 F.3d at 596, 602–03.

[223] *Id.* at 596.

[224] *Id.* at 602.

[225] *Id.*

[226] *Id.* at 603.

[227] The court also noted that the "Preliminary Term Sheet" for the receivables financing, which was "prepared before the transaction," described the financing as a "credit" facility. *Id.*

Applying this article's framework, criterion (i) would be met because the contract, a factoring agreement, purported to create a sale of the receivables. Criterion (ii) should be met because the recourse was limited and certainly did not constitute full economic recourse. The recourse resulting from R&W breaches simply assured the transferee/buyer about the quality of the receivables being sold.[228] The recourse for receivables that were subject to disputes was also quality-related because it related to the quality of the goods that were being sold to generate the receivables. The remaining recourse had an exception for unpaid receivables for which the obligor had become bankrupt or insolvent, the most likely reason generally for non-payment.[229] The court's observation that the "Factoring Agreement ensured that AgriCap had almost total recourse against Robison Farms if a receivable went unpaid"[230] was therefore unfounded—possibly because the court was influenced by the district court's "finding that the agreement between the parties in this case effectively insulated AgriCap from loss and was therefore a loan rather than a factoring sale."[231]

Criterion (iii) of this article's framework would be met because the contract allocated surplus value without creating full economic recourse. Criterion (iv) would be met because the court did not observe any restrictions on, and thus we assume the contract was silent about, alienability. Finally, the court's reliance on the existence of the credit support for Robison Farms' recourse obligations should be irrelevant because, as previously discussed,[232] it is the nature and extent of the recourse obligations, not the transferor's creditworthiness to perform them, which should be relevant to sale-versus-loan characterization. Similarly, the court's observation that the UCC-1 financing statement referred to Robison Farms as "the Debtor" should be irrelevant because, as previously discussed,[233] it conflated the UCC's application to both sales and secured loans with a substantive sale-versus-loan determination. This

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at 601. That term sheet did not govern the subsequent financing and thus should be irrelevant to its characterization.

[228] *See supra* notes 48–49 and accompanying text. *See also* 597 F.3d at 601 (stating that the contract "contained warranties that traditionally accompany the sale of an asset").

[229] *See, e.g.*, *Bad Debt*, WEX (2021) (defining "bad debt" as "a debt [that] cannot be recovered for a variety of reasons such as insolvent debtors").

[230] 597 F.3d at 602.

[231] *Id.* The policies of the Perishable Agriculture Commodities Act might also have indirectly influenced the court. *Cf. infra* note 234 (referencing that Act).

[232] *See supra* notes 195–96 and accompanying text.

[233] *See supra* notes 198–200 and accompanying text.

case yet again, therefore, exemplifies a court recharacterizing a receivables financing to be a secured loan where this article's framework would classify the financing as a sale.[234]

2. *Example where Court found a Receivables Financing to be a Sale and where the Framework would Concur*. In *Dryden Advisory*,[235] the court concluded that a receivables financing labeled as a "factoring agreement" constituted a sale. The framework would similarly recognize a sale. Consistent with criterion (i) of the framework, the agreement used language throughout expressing a sale, including "sale of accounts," "accounts purchased by," and "accounts offered for sale." Nothing in the agreement indicated that the financing was intended to create a secured loan. Consistent with criterion (ii), the recourse related to the quality of the receivables, and even that quality-related recourse was limited.[236] Consistent with criterion (iii), the contract did not allocate surplus value of the receivables. Finally, consistent with criterion (iv), the agreement was silent on alienability restrictions.

3. *Example where Court Recharacterized a Receivables Financing to be a Secured Loan and where the Framework does not provide a Clear Resolution*. In the *Lange* case,[237] the court recharacterized the receivables financing to be a secured loan. The contract was labeled an "Invoice Purchase Agreement." Under criterion (i), that labeling could be consistent with a sale,[238] but more information about the transfer language would be desirable. The contract was stated as being "full recourse," requiring the transferor to

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[234] Although this case involves the bankruptcy of a transferor whose activities are governed by the federal Perishable Agriculture Commodities Act (PACA), the court's analysis does not appear to be directly influenced by the policies of that Act. *Cf. id.* at 598 (emphasis in original): "[If] the conversion of accounts receivable into cash was part of a true factoring arrangement . . . , Robison Farms would have relinquished its interest in the accounts receivable and received the cash in lieu of them. . . . [U]nder this scenario, AgriCap [transferee] would own the accounts receivable and would be able to do with them what it wished. But if the accounts receivable were not *sold* but rather were given as *collateral* for a loan, then the accounts receivable would have remained trust assets [under PACA], subject to AgriCap's security interest." The court's analysis nonetheless might have been indirectly influenced by those policies. *See supra* note 231 and accompanying text.

[235] Dryden Advisory Grp., LLC v. Benef. Mut. Sav. Bank, 534 B.R. 612 (Bankr. M.D. Pa. 2015).

[236] The transferee accepted the risk of non-payment "due to the occurrence of an account debtor's financial inability to pay." The recourse for receivables that were subject to disputes is quality-related. *See supra* text following note 228.

[237] Lange v. Inova Cap. Funding, LLC, 441 B.R. 325 (B.A.P. 8th Cir.), *aff'd*, 652 F3d 933 (8th Cir. 2011).

[238] Invoices, which refer to bills for goods sold or services rendered, indirectly refer to receivables.

repurchase receivables if their full amount was not paid within a set number of days. Under criterion (ii), that full recourse could be consistent with a secured loan if, coupled with criterion (iii), the surplus, it constituted full economic recourse. The contract, however, appeared to be silent about surplus value. The contract also appeared to be silent about criterion (iv), alienability, which could be consistent with a sale. The factual background is therefore insufficient to enable the framework to provide a clear resolution. A court applying the framework to this case therefore would have to review the facts de novo to try to reach a clear outcome.

VI. Conclusion

Courts often recharacterize contracts that purport to sell receivables—intangible rights to payment—if some of the substantive terms of the transfer are indicative of a loan. The jurisprudence on recharacterizing these contracts is muddled and inconsistent. This uncertainty impairs receivables financing as a tool to unlock the trillions of dollars (and growing) segment of the world's wealth that is locked up in receivables.

This article builds a legal framework for reducing that uncertainty and mitigating its costs. This framework should give judges, lawyers, investors, and scholars a fresh perspective by correcting decades of judicial confusion, some of which stems from an outdated law journal article that was imprecise even when originally published.[239] The framework also should give contract-drafting guidance to lawyers, which could help to facilitate their clients' objectives and minimize the ambiguity and litigation relating to receivables financing.

Notwithstanding this article's framework, we caution that judicial confusion is not uncommon in inherently complex business, bankruptcy, financial, and other "commercial" cases. In another context, one of the authors studied erroneous court decisions involving the payment of checks, the honoring of letters of credit, the enforcement of assignment and anti-assignment clauses, and the sales of accounts.[240] That study suggested a possible way to improve the lawmaking process: to further develop, and then to steer relevant complex commercial cases to, business (sometimes called commercial) courts. In principle, these types of specialized courts—which

[239] *See supra* note 60 and accompanying text.

[240] Steven L. Schwarcz (with the Assistance of Nicole T. Phillips), *Adjudicating Business and Commercial Disputes: Fixing Failures*, chapter in VERBINDUNGLINIEN IM RECHT 629 (Festschrift for Prof. Christoph G. Paulus, 2022). This article already mentions the erroneous decision of the Tenth Circuit in connection with sales of accounts. *See supra* note 37.

generally operate either with specialized dockets that focus on commercial disputes, as separate divisions within existing court structures, or as separate courts entirely[241]—should be able to deal with the adjudication of complex commercial cases better than general jurisdiction courts.[242]

Although there has been an increased worldwide trend towards creating business courts,[243] there are no conclusive data on whether such courts are actually justified on a cost-benefit basis.[244] It also is unclear whether there are

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[241] Lee Applebaum et al., *Through the Decades: The Development of Business Courts in the United States of America*, 75 BUS. LAW. 2053, 2054 (2020). This article does not purport to resolve the many issues raised by business courts. For example, should business courts hear appeals from specialized bankruptcy courts and, if so, how? Although bankruptcy judges have (narrow) expertise in bankruptcy law, they may well lack expertise in commercial law. *See Adjudicating Business and Commercial Disputes*, *supra* note 240, at 5–7 (discussing *In re* Twist Cap and *In re* Woodbridge Group of Companies, cases wrongly decided by bankruptcy judges).

[242] *See, e.g.*, Applebaum et al. *supra* note 241, at 2054 (arguing that business courts can allow for efficient, just, and consistent resolution of disputes within bodies of business law). *Cf.* Frederick L. Trilling, *The Strategic Application of Business Methods to the Practice of Law*, 38 WASHBURN L.J. 13, 27 (1998) (observing that business-court judges normally have expertise and experience that allow them to understand and adjudicate complex business and commercial disputes).

[243] Pamela K. Bookman, *The Adjudication Business*, 45 YALE J. INT'L L. 227, 228 (2020). Twenty-seven U.S. states now utilize some form of business courts. Applebaum et al., *supra* note 241, at 2057–58. Although Applebaum et al. report 25 states as utilizing some form of business courts, two additional states—Texas and Utah—have recently begun utilizing business courts. *See* Benjamin Raymond Norman & Benjamin M. Burningham, *Recent Developments in Business Courts 2024* (2024), https://www.americanbar.org/groups/businesslaw/resources/business-law-today/2024-march/recent-developments-business-courts-2024/. Similar courts also have been, or are being, developed in Dubai, Qatar, Singapore, Abu Dhabi, Kazakhstan, China, Germany, and, in the post-Brexit era, elsewhere in Europe. *See* Bookman, *supra* note 243, at 228; Jenny Gesley, *Germany: New Law Establishes Commercial Courts and Allows English in Some Court Proceedings* (2024), https://www.loc.gov/item/global-legal-monitor/2024-10-20/germany-new-law-establishes-commercial-courts-and-allows-english-in-some-court-proceedings/.

[244] John F. Coyle, *Business Courts and Interstate Competition,* 53 WM. & MARY L. REV. 1915, 1975 (2012). Most U.S. states, for example, do not publish reports on the efficiency of business case resolution after the creation of a business court. *Id.* at 1980. Surveys of attorneys whose cases were heard in business courts showed high satisfaction levels, however. *Id.* at 1976. For example, a Philadelphia survey found that 97 percent of respondents would choose for their case to be heard by the business court if given the choice and 90 percent of the respondents were "very satisfied" with their treatment by the business court. *Id.* The Association of Corporate Counsel and individual attorneys have also stated that business courts improve the quality of dispositions in the cases they hear. *Id.* at 1977. Additionally, there is evidence that business courts can significantly improve the disposition rate of commercial cases. *Id.* at 1980.

more cost-effective alternatives to a formal business-court regime, such as arbitration or a requirement for litigants to retain specialized business-law counsel[245] in complex commercial cases.[246] As the complexity of those cases increases,[247] it will become progressively important to consider how these and other ways to improve the lawmaking process could enhance the adjudication of commercial disputes, including disputes involving the sale-versus-loan problem.

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[245] It is the job of counsel to identify and properly analyze the relevant business-law issues for the court. *Cf. Adjudicating Business and Commercial Disputes*, *supra* note 240, at 2 (observing that counsel for the litigants in Barnhill v. Johnson, 503 U.S. 393 (1992), completely ignored the fundamental commercial-law question of the case). This calls into question why litigants do not routinely retain specialized business-law counsel in these cases. One reason may be ego and elitism: top litigators sometimes convince themselves and their clients that they have, or will develop, the needed expertise. A somewhat related reason, raising scrutiny even outside of the business/commercial context, occurs in cases argued before the U.S. Supreme Court: the cases tend to be argued by members of an elite Supreme Court Bar who do not always have subject-matter expertise. *See, e.g.*, Joan Biskupic, Janet Roberts & John Shiffman, *At America's Court of Last Resort, a Handful of Lawyers now Dominates the Docket*, REUTERS SPECIAL REPORT (Dec. 8, 2014), available at https://www.reuters.com/investigates/special-report/scotus/ (reporting this "has turned the Supreme Court into an echo chamber—a place where an elite group of jurists embraces an elite group of lawyers who reinforce narrow views of how the law should be construed").

[246] Such counsel would be paid for by the litigants, but their duty could be to the court—to be independent, and perhaps even to try to mediate a fair and equitable resolution. For example, Prof. Schwarcz has served in a similar capacity for the U.K. High Court of Justice, testifying as an expert on American trust indenture law in the case later reported as Bank of New York v. Montana Bd. of Investments, [2008] E.W.H.C. 1594 (Ch.) and as an expert on American letter-of-credit law and bank-lending law in the Matter of CB&I UK Limited and in the matter of The Companies Act 2006. Even though expert witnesses normally do not testify on law, at least that of the court's jurisdiction, the aforesaid legal testimony should constitute an exception to that norm because the specialized business-law counsel are advising the court directly, not necessarily testifying as expert witnesses. Furthermore, even if testifying as expert witnesses, such counsel are advising on law that is so specialized and complex as to effectively be "foreign."

[247] *See, e.g.*, Steven L. Schwarcz, *Regulating Complexity in Financial Markets*, 87 WASH. U. L. REV. 211 (2009/2010) (discussing the increasing complexity of financial markets).