



interest both in the crop (as the original collateral, because Worth Gin did not take free of the Bank's security interest) and in the debtor's account receivable from Worth Gin (as proceeds of the crop). As an account debtor, Worth Gin was permitted to set off even against a secured party amounts that the debtor owed it on transactions arising before it received notification of the Bank's security interest in the account. § 9-404(a). This would not permit Worth Gin to set off amounts the debtor owed to an affiliate unless that right was expressly granted in a contract with the debtor, but it does mean that Worth Gin was probably entitled to set off amounts the debtor owed to it. The court did not discuss or even cite to § 9-404.

In short, Worth Gin could have converted the *crop*, but it could not have converted the *unpaid portion of the purchase price*. Moreover, its liability for converting the crop would be for the value of the crop, not merely the amount withheld. Presumably, the Bank could at least argue that it is entitled to retain the amounts paid as proceeds plus get the crop or its value back. Whether Worth Gin would be entitled to a partial defense or claim in restitution for the amount paid is an interesting question – one likely to be discussed at a program entitled *What Every Commercial Lawyer Needs to Know about the Restatement (Third) of Restitution and Unjust Enrichment*, scheduled for Saturday April 18, 2009 at 1:00pm during the Spring meeting of the ABA Business Law Section – but it is a separate issue. In any event, because the Bank was apparently seeking nothing more than the amount Worth Gin had withheld, the court's ultimate conclusion was correct.

***In re Baker,***  
**2008 WL 2358592 (Bankr. D. Del. 2008)**

This case involved the efficacy of a default-on-bankruptcy clause in a consumer loan contract. With very little analysis, the court invalidated the *ipso facto* clause in this case and stated that such clauses are generally unenforceable. In the process, it cast such clauses into question in all loan agreements, commercial as well as consumer.

The debtors had a four-year car loan from Ford Motor Credit Company ("FMCC"). They were current on their loan payments when they filed for Chapter 7 bankruptcy relief. They then sought to reaffirm the debt but the bankruptcy court declined to approve the reaffirmation agreement. After the debtors received their discharge and the bankruptcy case was closed, FMCC repossessed the car. The debtors sought sanctions for violation of the discharge injunction.

There was some question whether FMCC's actions were based on the failure of the court to approve the reaffirmation agreement or an *ipso facto* clause in the security agreement, but the court seemed to assume that FMCC was in fact relying on the latter. The court then stated – without discussion or citation to any authority – that such clauses "are generally unenforceable against debtors," subject to some limited exceptions. The court then analyzed § 521(d), which was part of the BAPCPA amendments to the Bankruptcy Code. Section 521(d) provides that, if the debtor fails to comply with § 521(a)(6), nothing in the Bankruptcy Code shall prevent or limit the application of an *ipso facto* clause.

The court seized on this limitation and concluded that, since the debtors had met their obligations under § 521(a)(6):

the Court need not determine whether an *ipso facto* clause is enforceable under Delaware law because the exception in section 521(d) allowing for limited enforcement of such clauses is not met in this case. In short, [FMCC] had no right under state law to repossess the vehicle.

This analysis is extremely confusing. The court seems at first to be concluding that the *ipso facto* clause is unenforceable as a matter of bankruptcy law. Yet it then states that the clause is unenforceable under state law. Either way, the court's analysis is flawed

The Bankruptcy Code says very little about *ipso facto* clauses. It does provide that an *ipso facto* clause will not prevent property from coming into the bankruptcy estate. § 541(c)(1). It also provides that such a clause will not impair the ability of the trustee or debtor in possession to assume and assign an executory contract or unexpired lease. § 365(e)(1). Other than that, however, the Bankruptcy Code was silent about *ipso facto* clauses until the 2005 amendments.

The court in this case relied on § 521(d). But, as the court itself noted, that provision never invalidates *ipso facto* clauses, it merely provides that nothing in the Bankruptcy Code interferes with them if the debtor fails to comply with § 521(a)(6). The court seemed to rely on a negative inference and concluded that, because the debtors had complied with § 521(a)(6), the Bankruptcy Code invalidated the *ipso facto* clause. Yet the last sentence of § 521(d) belies that negative inference. It provides that “[n]othing in this subsection shall be deemed to justify limiting such a provision in any other circumstance.” Thus, the court did not have an adequate basis for concluding that federal law invalidates these clauses.

Admittedly, a number of courts have shown hostility to *ipso facto* clauses. Before enactment of § 521(2) in 1984, the two circuit courts that had ruled were divided on the issue. *In re Bell*, 700 F.2d 1053, 1058 (6th Cir. 1983), ruled that an *ipso facto* clause did create a default on a contract once the trustee had abandoned the collateral to the debtor. *Riggs Nat’l Bank v. Perry*, 729 F.2d 982, 984-85 (4th Cir. 1984), held that an *ipso facto* clause was unenforceable as contrary to the fresh start policy of the Code. Since enactment of § 521, courts have had little to say on this issue. The Second Circuit suggested in a footnote that such clauses are unenforceable, *In re Boodrow*, 126 F.3d 43, 49 & n.6 (2d Cir. 1997) (referring to a default on bankruptcy as a “technical” default); the First Circuit BAP suggested the opposite. *In re Burr*, 218 B.R. 267, 272 & n.5 (1st Cir. BAP), *rev’d on other grounds*, 160 F.3d 843 (1st Cir. 1998). *See also In re Sokolowski*, 227 B.R. 16, 18-20 (Bankr. D. Conn. 1998) (canvassing the cases on the issue and concluding such clauses are unenforceable). If the Bankruptcy Court for the District of Delaware was going to weigh in on this issue, it should have canvassed the law and analyzed the prior decisions.

Certainly, state law might render *ipso facto* clauses unenforceable, particularly in a consumer contract. *See, e.g., In re Rowe*, 342 B.R. 341, 350 (Bankr. D. Kan. 2006) (ruling that an *ipso facto* clause was unenforceable because, under the Kansas version of Uniform Consumer Credit Code



