

The Legal Anomaly of Non-Recourse Financing

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ABSTRACT

Section 1111(b) is one of the Bankruptcy Code's most complex and challenging provisions. The existing scholarship focuses on the so-called 1111(b)(2) election, in which an undersecured creditor, in order to protect against undervaluation of collateral, can sometimes opt to have its claim treated in Chapter 11 as fully secured. This article, in contrast, focuses on what can happen if that election is not made. Absent that election, § 1111(b)(1) automatically converts debt claims that are non-recourse under state law into full recourse claims. The consequence of this lobbied conversion is that non-recourse claims are no longer limited to the value of the collateral, creating unbargained and unfair benefits for non-recourse lenders to the detriment of debtors and unsecured creditors. This problem is important: domestic finance companies engage in roughly half a billion dollars of non-recourse financing yearly, non-recourse loans make up a significant portion of commercial real estate financing, and virtually all securitization and other structured financing is made on a non-recourse basis. The article explains the questionable origin of the § 1111(b)(1) non-recourse-to-recourse debt conversion and analyzes how that section should be amended to fairly protect non-recourse lenders without harming third parties or impairing bankruptcy policies.