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# THE REALIST AND SECURED CREDIT: GRANT GILMORE, COMMON-LAW COURTS, AND THE ARTICLE 9 REFORM PROCESS

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## INTRODUCTION

One of the central, defining features of secured debt is its priority. Yet, the policy support for first priority for secured creditors is, at best, unclear and, at worst, shaky.<sup>1</sup> What is, perhaps, more remarkable is that the central policy question—whether secured creditors *ought* to enjoy the broad first priority in debtors' assets—has escaped thorough consideration both in the original process that led to the development of Article 9 of the Uniform Commercial Code and, more recently, in the process now underway to reform it.

Professor Elizabeth Warren invited such discussions in April 1996 by submitting to the American Law Institute a "Carve-out Proposal" to be included within a new Article 9.<sup>2</sup> This Proposal, in essence, provided that secured lenders could obtain only 80% of the value of personal property collateral against which they loaned; the first 20% of the value of the collateral was "carved out" for unsecured creditors. The Proposal was an amendment to the provision in Article 9 addressing priority conflicts between perfected, secured parties and lien creditors.<sup>3</sup> If implemented, a levying creditor could obtain 20% of the value of Article 9 collateral through levy and execution under state law. Accordingly, in bankruptcy, a trustee using her "strong arm" power<sup>4</sup> could "carve out" 20% of the value of all of a debtor's encumbered personal property for the benefit of the estate.

The Warren Proposal was an attempt to confront directly the distributional issues implicit in secured creditors' priority and thus, the

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† Professor of Law, Temple University. Thanks to Amy Boss, Jean Braucher, Dick Cappalli, Nathalie Martin, David Skeel, Elizabeth Warren, and Candace Zierdt for comments on earlier drafts of this Article and to Kalimah White for her research assistance.

<sup>1</sup> See, e.g., Lucian Arye Bebchuk & Jesse M. Fried, *The Uneasy Case for the Priority of Secured Claims in Bankruptcy*, 105 YALE L.J. 857 (1996) (generally discussing efficiency and incentives for priority); Lynn M. LoPucki, *The Unsecured Creditor's Bargain*, 80 VA. L. REV. 1887, 1947-63 (1994) (discussing "three theories and one not so bad" in support of subordination). For a more comprehensive listing of recent work, see Bebchuk & Fried, *supra*, at 862 n.23.

<sup>2</sup> Memorandum from Elizabeth Warren, Leo Gottlieb Professor of Law, Harvard Law School, to Council of the American Law Institute (Apr. 25, 1996) (on file with author).

<sup>3</sup> U.C.C. § 9-301 (1995).

<sup>4</sup> See 11 U.S.C. § 544(a) (1994).

Proposal invited those currently making secured credit policy to focus directly on the basic policy question at the center of their enterprise. However, despite the central nature of priority in the institution of secured credit, the Warren Proposal received a hostile reception within the Article 9 reform process. There was, perhaps predictably, a flurry of letters and short articles decrying either the details of the Proposal or what it would do to deserving borrowers.<sup>5</sup> Subsequently, the Article 9 Drafting Committee unanimously rejected it, apparently, without any voice in its support.<sup>6</sup> The low esteem in which the reform process held the Warren Proposal is strikingly similar to the regard reformers (both in the original Article 9 process and now) have given to those judicial decisions which, like the Warren Proposal, would tend to limit secured credit.

In 1981, a year before his death, Grant Gilmore confessed that those involved in the original, creative process that led to Article 9 did not pay adequate attention to the messages the common-law courts had been sending them.<sup>7</sup> Gilmore's observations about the original development of Article 9 seem to apply to the revision process as well. The tendency of the Article 9 development process (then and now) to reject common-law decisions, together with the current reformers' one-sided consideration of the Warren Proposal and the core issue it raised,<sup>8</sup> suggest that the revision process may be flawed or, at least,

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<sup>5</sup> See Letter from Brian Hulse, Esq. to Steven O. Weise, Esq. (June 6, 1996) (on file with author); Letter from Howard Ruda, Esq. to Geoffrey C. Hazard, Jr. (May 22, 1996) (on file with author); Letter from James J. White, Robert A. Sullivan Professor of Law, University of Michigan Law School, to Edwin E. Smith, Esq. (June 3, 1996) (on file with author). For short articles that criticize the proposal, see, for example, Lisa M. Bossetti & Mette H. Kurth, *Professor Elizabeth Warren's Article 9 Carve-Out Proposal: A Strategic Analysis*, 30 UCC L.J. 3 (1997); Hugh Ray, *Bankruptcy Law*, TEX. LAW., June 10, 1996, at 26-28; Memorandum from Jeffrey S. Turner to the Article 9 Drafting Committee (June 1, 1996), reprinted as *The Broad Scope of Revised Article 9 Is Justified*, 50 CONSUMER FIN. L.Q. REP. 328 (1996).

Professor James J. White, for example, challenged the Proposal's sequential levy feature—the possibility that a junior secured creditor would defeat a senior secured creditor by getting a judgment and levying rather than foreclosing under Article 9—and argued that the senior secured creditor might not be able to put the debtor into involuntary bankruptcy, that the Proposal would malfunction under the preference section of the Bankruptcy Code, that trustees might claim more than 20% under their “strong arm” power, and that the I.R.S. might get excessive priority over the senior secured creditor. Letter from James J. White to Edwin E. Smith, *supra*.

<sup>6</sup> A description of the Drafting Committee meeting that resulted in the rejection of the Warren Proposal can be found in Alvin C. Harrell, *Article 9 Drafting Committee Considers Consumer Issues Subcommittee Report*, 50 CONSUMER FIN. L.Q. REP. 189, 193-94 (1996).

<sup>7</sup> Grant Gilmore, *The Good Faith Purchase Idea and the Uniform Commercial Code: Confessions of a Repentant Draftsman*, 15 GA. L. REV. 605, 625 (1981).

<sup>8</sup> Many of those who reacted to the Proposal would, no doubt, characterize their reactions as anything but “one-sided,” and my characterization is not meant to disparage those efforts to offer expertise on the question raised by the Proposal. Curiously, however, despite considerable prompting, the Drafting Committee appeared simply unwilling even to consider the question whether secured credit ought to be limited in the interests of unsecured creditors. It made no effort to draft a proposal of any kind on its own. When

severely limited in what it can consider and evaluate. The Warren Proposal—or, rather, the unabashedly negative reaction to it—thus provides an occasion to examine the “private legislature” that develops and revises the UCC.<sup>9</sup>

This effort will consider the UCC revision process in a larger context that includes the superficially similar process by which Restatements of Law are created by the American Law Institute, and will examine the relationship of both of these processes to common-law decisions. The conclusions that one draws from juxtaposing the Article 9 process with the Restatement process and common-law decision-making seem striking: regardless of the proposal and regardless of whether it was Gilmore’s Committee, the current Drafting Committee, or some future Drafting Committee, the approach we currently use for developing secured credit policy in Article 9 *cannot* give serious, considered attention to the priority question at the core of the institution of secured credit. The problem is largely structural. It does not depend on the personal views, backgrounds, or expertise of those involved in the reform process<sup>10</sup> or on the quality of empirical or other research that might be developed on the question.

There are several implications to the analysis. The first is retrospective. If the Article 9 process *cannot* develop sound, fundamental policy on the core issue of secured creditor priority, then little significance should be attached to the Article 9 Drafting Committee’s rejection of the Warren Proposal. The analysis here would suggest that the Committee could do little other than reject the Proposal.

The other implications of the analysis are prospective. First, if the core issue of secured creditor priority *cannot* be addressed in the Article 9 process, where should it be addressed? Historically, the an-

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Professor Warren did it for them, they made no apparent efforts at, among other things, constructive criticism, at reworking it to make it more palatable, or at considering alternatives to limit directly priority for secured creditors. This lack of interest in the question, and the unison of negative reaction on what seems a very controversial and central question in secured credit, beg for an explanation.

<sup>9</sup> Professors Schwartz and Scott have examined the “private legislature” in this context. Alan Schwartz & Robert E. Scott, *The Political Economy of Private Legislatures*, 143 U. PA. L. REV. 595 (1995); Robert E. Scott, *The Politics of Article 9*, 80 VA. L. REV. 1783 (1994). See also Steve H. Nickles, *Consider Process Before Substance, Commercial Law Consequences of the Bankruptcy System: Urging the Merger of the Article 9 Drafting Committee and the Bankruptcy Commission*, 69 AM. BANKR. L.J. 589, 595-96 (1995) (discussing the “federal legislative process”); Edward L. Rubin, *Thinking Like a Lawyer, Acting Like a Lobbyist: Some Notes on the Process of Revising UCC Articles 3 and 4*, 26 LOY. L.A. L. REV. 743 (1993).

<sup>10</sup> In this respect, the analysis is different from that developed by Professors Schwartz and Scott. Schwartz & Scott, *supra* note 9, and Scott, *supra* note 9. The analysis would therefore suggest that the defects are immune to correction by inviting more persons to participate in the process, however important that may be in its own right.

swer has been in the bankruptcy law,<sup>11</sup> but such a solution may have problems of its own.<sup>12</sup> Second, does the historic process for developing secured credit policy—state law expansion followed by bankruptcy law contraction—make sense any longer? Such a *tit-for-tat* process seems itself inefficient and unlikely to generate optimal policy. This Article's analysis thus may offer additional reasons for reexamining the process through which we make policy in the field of secured credit.

The discussion will begin with a brief visit to the common law to observe another core attribute of secured credit—the judicial hostility historically accorded to it. Several centuries of case law suggest strong discomfort in the courts with the distributional consequences of secured credit. The Legal Realist might well conclude that wisdom can be found in the distributional results of such common-law decisions regardless of the often strained legal mechanics of reaching the result. It was partly because he ignored these distributional results that Gilmore ultimately “repented.”<sup>13</sup>

The discussion will then turn to the American Law Institute (“ALI”)/National Conference of Commissioners on Uniform State Laws (“NCCUSL”) process<sup>14</sup> for developing the UCC and briefly compare it with the ALI process for developing a Restatement of Law. At their core, both processes commission a group of experts to study the law and develop a set of rules for the area to be covered. Beyond obvious differences in sponsoring bodies and the need for state enactment of the UCC, there is a very basic difference in the relationship between each of these processes and common-law decisions in the area under review: judicial decisions both limit and anchor the Restatement process; they perform no such necessary functions in the development of the UCC.

The next section will turn to the comparable system constraints on the development of the UCC and, specifically, Article 9 of the UCC.<sup>15</sup> Here, the need for state enactment structurally constrains the

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<sup>11</sup> Professor Nickles has proposed merging the Article 9 effort with the Bankruptcy Review Commission's efforts to propose changes to the bankruptcy law. See Nickles, *supra* note 9.

<sup>12</sup> See Lynn M. LoPucki, *Should the Secured Credit Carve-Out Apply Only in Bankruptcy? A Systems/Strategic Analysis*, 82 CORNELL L. REV. 1483, 1483-88 (1997).

<sup>13</sup> Gilmore, *supra* note 7, at 615, 627.

<sup>14</sup> The ALI and NCCUSL are the sponsoring organizations for the Uniform Commercial Code. For an extensive description of the ALI/NCCUSL process, see Scott, *supra* note 9, at 1803-10.

<sup>15</sup> Although similar dynamics might be observed in other areas covered by the UCC, secured credit may be unique because distributional issues are central to secured credit in a way they may not be in other UCC areas. Cf. Nickles, *supra* note 9, at 590 (explaining that “[b]ankruptcy aims for distributive fairness”). I make no attempt to apply the observations about the Article 9 process to the broader UCC.

kinds of proposals the Article 9 process can entertain. As should become clear, *any* proposal to fundamentally alter the priority status of the Article 9 secured creditor must be rejected because of very legitimate concerns about "enactability." Even if there were compelling empirical data or an otherwise strong general consensus that limiting secured credit was sound policy, it seems that such a policy could not be implemented through the Article 9 reform process.

But while the need for state enactment constrains the Article 9 process, it does not—and cannot—offer it either direction for reform or benchmarks for decisions about reforms. What substitutes for the benchmark function of common-law decisions in the Article 9 process is the logic of secured credit itself, which produces a work product that, like common-law decisions and Restatements, purports to be free of the personal bias and judgment of the participants in the process. I hope to show that this logic both precludes serious consideration of a proposal as openly distributional as Professor Warren's and imposes its own distributional consequences which are likely at odds with the interests of many unsecured creditors.

I will conclude by suggesting that, in the final analysis, the priority of secured credit is at least as much a question of fair distribution as it is a matter of efficiency, however one defines it.<sup>16</sup> In that respect, the priority of secured credit shares much with better-known limits on creditors' rights such as limitations on wage garnishment and statutes creating debtors' exemptions. While these and other limitations on what creditors can do in the event of debtor default can be subjected to an efficiency analysis, efficiency analysis can supply only a part—and perhaps a very small part—of the determinants of sound policy. In many areas of debtor-creditor law such as these, distributional consequences are at least as important as "efficiency" (however defined) in setting sound policy. If distributional consequences are also inseparable in the setting of sound policy, then the analysis here would counsel a serious reexamination of the processes through which we create policy in the area of secured credit.

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<sup>16</sup> Most of the modern scholarship into the priority of secured credit has approached it from the perspective of "efficiency" and has, by making or relaxing one or more assumptions, asserted that secured creditor priority is either "efficient" or "inefficient." Although economic analysis has illuminated previously obscure areas of the subject, the point here is that, even if we could agree on the correct frame of reference for an efficiency analysis, our conclusions about the efficiency of secured creditor priority would not define sound policy. Rather, efficiency would be one factor in sound policy-setting and might well be outweighed by conclusions about distributional fairness, a point nearly all economists would concede. The near-exclusive dominance of economic analysis of the question, however, might lead one wrongly to conclude otherwise.

## I

## THE MEANING OF COMMON-LAW HOSTILITY

If the first priority of the secured creditor were not the defining characteristic of secured credit, judicial animosity towards the institution would be. This hostility may be unequaled in commercial law.<sup>17</sup> Even before the time of *Twyne's Case*,<sup>18</sup> the English courts of equity began protecting borrowers' equity of redemption from the mortgagee to whom the borrower had conveyed title.<sup>19</sup> Students of secured transactions routinely begin courses in the subject with *Twyne's Case* or comparable cases in which courts openly display their hostility to primitive attempts at creating security interests.<sup>20</sup> Professors Baird and Jackson begin their casebook treatment of the subject with the early case of *Clow v. Woods*.<sup>21</sup> There, the Pennsylvania Supreme Court conveniently found that the secured party's failure to particularize the items of collateral in the security agreement, structured as a sales contract, was "fatal."<sup>22</sup> The court said that "[i]n a case of this kind, the slightest neglect in any circumstance the nature of the case may admit of as an equivalent for actual possession, is unpardonable."<sup>23</sup> What the courts then said—that a "fraud" label attaches to one's display of apparent ownership despite a secret encumbrance—was wholeheartedly embraced by legislatures as they searched for ways to correct the problem and thereby expand secured lending.

Had policymakers at that time been Legal Realists, they might have wondered about this unabashed animosity towards security and whether there were distributional messages to be read in what the courts were doing. Instead, they listened to what the courts were *saying* and invented filing systems so that creditors could, in theory, discover the true state of the debtor's holdings.<sup>24</sup> They did this, of

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<sup>17</sup> Strong hostility of common-law courts to the work of business lawyers is also found in cases dealing with form contracts. Llewellyn's well-known description of common-law courts' use of "[c]overt tools" to address the problems of form contracts could just as easily describe the work of common-law courts in the secured credit area. K.N. Llewellyn, *Book Review*, 52 HARV. L. REV. 700, 703 (1939).

<sup>18</sup> 76 Eng. Rep. 809 (Star Chamber 1601).

<sup>19</sup> See LYNN M. LOPUCKI & ELIZABETH WARREN, *SECURED CREDIT: A SYSTEMS APPROACH* 27-30 (1995).

<sup>20</sup> *Twyne's Case* was, of course, a fraudulent conveyance case and has strong circumstantial evidence of actual fraud. One can, however, also understand its facts as an attempt at a primitive, albeit clumsy, secured transaction.

<sup>21</sup> DOUGLAS G. BAIRD & THOMAS H. JACKSON, *CASES, PROBLEMS, AND MATERIALS ON SECURITY INTERESTS IN PERSONAL PROPERTY* 8-23 (2d ed. 1987) (reprinting and discussing *Clow v. Woods*, 5 Serg. & Rawle 275 (Pa. 1819)).

<sup>22</sup> *Clow*, 5 Serg. & Rawle at 282.

<sup>23</sup> *Id.*

<sup>24</sup> The filing system's ability to cure the "ostensible ownership problem" has been a theoretical anchor for one view of secured credit. See generally Thomas H. Jackson & Anthony T. Kronman, *Secured Financing and Priorities Among Creditors*, 88 YALE L.J. 1143

course, without much thought to limiting the ambit of secured lending. There was probably no need: primitive notions of property (which included the notion that one could not convey what one did not own)<sup>25</sup> and the very cumbersome nature of secured lending made it likely that something would always remain for unsecured creditors in insolvency. The structure of the law itself “carved-out” assets for unsecured creditors.

Although courts embraced the legislatively-blessed secured credit regime at the core, at the periphery, they remained hostile. This hostility manifested itself in the courts’ demand that the documentation be letter perfect<sup>26</sup>—a tendency that extends to this day—and their resolute findings against secured credit as business lawyers pushed at the fringes with innovative transaction forms. In the period that preceded the revolution in secured lending that was Article 9, *Benedict v. Ratner*<sup>27</sup> stands out as perhaps the most famous of the cases reacting to business lawyer expansion of secured lending.<sup>28</sup>

Gilmore stated the case many times. Hub Carpet Company assigned its accounts receivable to Ratner on May 23 for an existing loan plus future advances.<sup>29</sup> The arrangement called for Hub to give Ratner a list of the accounts on the twenty-third day of each month. Hub was to collect the accounts and could use the money collected as it saw fit, although the documents gave Ratner the right, among other things, to collect the assigned accounts even though no default had occurred.<sup>30</sup> There were no requirements that Hub replace collected accounts nor that it account to Ratner.<sup>31</sup> Hub gave Ratner the last list on September 23, three days before it was put into involuntary bankruptcy.<sup>32</sup> *Benedict*, the trustee, collected the accounts and Ratner demanded them as assignee.<sup>33</sup> Justice Brandeis decided that the arrangement was fraudulent under New York law and, therefore, that Ratner had no rights to the accounts in bankruptcy.<sup>34</sup>

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(1979) (discussing notice filing). Professor LoPucki-challenged the theory conceptually. LoPucki, *supra* note 1. The fact that we permit the separation of possession and ownership in true leases under UCC Article 2A presents a substantial challenge to the ostensible ownership theory as well.

<sup>25</sup> See 1 GRANT GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY 228-29 (1965).

<sup>26</sup> See BAIRD & JACKSON, *supra* note 21, at 35.

<sup>27</sup> 268 U.S. 353 (1925).

<sup>28</sup> Grant Gilmore seems to have had a fascination with *Benedict*. He devoted an entire 36 page chapter of his treatise to the case and its implications, 1 GILMORE, *supra* note 25, at 250-86, and it formed the core of his secured credit discussion when he repented as a draftsman. Gilmore, *supra* note 7, at 621-27.

<sup>29</sup> See *Benedict*, 268 U.S. at 359.

<sup>30</sup> See *id.* at 359-60.

<sup>31</sup> See *id.* at 360.

<sup>32</sup> See *id.*

<sup>33</sup> See *id.*

<sup>34</sup> See *id.*



As Gilmore suggested, one must consider *Benedict* and these other cases from a realist perspective.<sup>35</sup> The *Benedict* analysis, as Gilmore has repeatedly pointed out, was unconvincing.<sup>36</sup> Justice Brandeis, a most gifted Supreme Court Justice and one not likely to miss alternative ways to resolve a hard case before him, misread New York law.<sup>37</sup> As Gilmore has noted, the decision directly affected this entire area of financing by forcing a monitoring of the debtor by the secured creditor.<sup>38</sup> By requiring the monitoring—a transaction cost—Brandeis both limited the ambit of secured financing by raising its price, and likely reduced insolvency problems by putting the secured party more firmly in charge of the debtor than before.<sup>39</sup> The legal reality of *Benedict* was distributive and probably “inefficient” in a narrow sense.<sup>40</sup> Its effects on the dynamic of secured financing were not unlike those that would be effected by a more direct limitation on secured lending such as found in the Warren Proposal.

True to the historic call of judicial decision and response of legislative countermeasure, Gilmore’s Article 9 effort rejected what Brandeis said in *Benedict v. Ratner*. But true to historic form as well, those

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<sup>35</sup> Dean Scott describes a tension in the common law between doing “present justice” and “future justice.” Robert E. Scott, *Chaos Theory and the Justice Paradox*, 35 WM. & MARY L. REV. 329, 331-34 (1993). His analysis might suggest that courts in the area of secured credit have been hard on secured creditors because they are faced with individual cases resulting in unsavory distributional consequences, and that those consequences override courts’ concern for longer-term policy implications of their decisions. We may or may not disagree. I agree with Dean Scott that courts are directly faced with the distributional implications of legal rules in individual cases. I believe, however, that if they fall prey to those implications on a regular basis, their decisions are signaling something about the rules themselves. Courts doing justice in individual cases is, arguably, the essence of the common law itself. See generally RICHARD B. CAPPALLI, *THE AMERICAN COMMON LAW METHOD* (1997) (offering “an account of how American judges, working in the common law tradition, create, interpret and apply precedents as law in the resolution of disputes before them”); KARL N. LLEWELLYN, *THE COMMON LAW TRADITION: DECIDING APPEALS* 23-24 (1960) (discussing courts’ “need, duty, and responsibility for bringing out a result which is just”).

<sup>36</sup> E.g., Gilmore, *supra* note 7, at 621-25.

<sup>37</sup> See 1 GILMORE, *supra* note 25, at 257-59; Gilmore, *supra* note 7, at 622-23.

<sup>38</sup> 1 GILMORE, *supra* note 25, at 260-61.

<sup>39</sup> See *id.* at 259-61. Although Gilmore did not state it in these terms, the *Benedict* decision was also “inefficient” in the way that was understood in the reform process both then and now. See *infra* Part III.B.

<sup>40</sup> I use “efficiency” here to connote the thrust of the reform process to create reforms that will facilitate and streamline the secured credit system. The economic underpinning is that secured credit with reduced transaction costs is more “efficient” than secured credit with greater transaction costs. Because such a view excludes the interests of many who can be affected by secured credit, policy generated through this narrow frame of reference may yield *inefficient* results in a larger economic frame of reference. See Bebchuk & Fried, *supra* note 1; LoPucki, *supra* note 1; *infra* Part III.B; cf. William J. Woodward, Jr., *New Judgment Liens on Personal Property: Does “Efficient” Mean “Better”?*, 27 HARV. J. ON LEGIS. 1 (1990) (assessing the benefits of increased “efficiency” of the judgment-collection system).

drafters did not capture the policy Brandeis was advancing with his decision: that secured lending required limits.<sup>41</sup>

It is well known that Article 9 was intended to make secured lending simpler, and to do away with technicalities seized on by courts to dislodge security interests. Most who know the present statute and its workings have great admiration for its elegance and for what it accomplished. Yet, over forty years of Article 9 have not convinced the courts of the substantive merits of complete secured creditor priority; judicial hostility remains.

*Dollar Bank v. Swartz*<sup>42</sup> is a modern display of this hostility. In *Dollar Bank*, the debtors gave the lender an Article 9 security interest in their business assets, personally guaranteed the debt, and backed up the guarantees with a mortgage on their residence.<sup>43</sup> The lender agreed to use reasonable efforts to foreclose on its Article 9 security interest before it moved against the personal assets.<sup>44</sup> Unfortunately, the lender filed its financing statements under several trade names for the debtor, none of which was the debtor's real name,<sup>45</sup> and, in the corporation's bankruptcy, abandoned any attempt to get the inventory.<sup>46</sup> When the lender attempted to foreclose on the residence, the debtors asserted that the bank had not used the contractually-required reasonable efforts to reach the inventory and, without doing so, it could not get the real estate.<sup>47</sup> The Pennsylvania Supreme Court agreed.<sup>48</sup> It easily could have held for the bank.<sup>49</sup>

Since Gilmore's original creation of Article 9, there have also been signs of *legislative* animosity towards full secured creditor prior-

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<sup>41</sup> See Gilmore, *supra* note 7, at 627; cf. 1 GILMORE, *supra* note 25, at 358-59 (discussing limitations).

<sup>42</sup> 657 A.2d 1242 (Pa. 1995).

<sup>43</sup> *Id.* at 1243.

<sup>44</sup> See *id.*

<sup>45</sup> Despite Article 9's attempt to give secured lenders leeway, cf. U.C.C. § 9-402(8) cmt. 9 (1995), most lawyers know that courts expect perfection of a security interest to be nearly "perfect." The *Dollar Bank* secured creditor gave up the Article 9 security interest without a fight: there is nothing in the opinion suggesting that the lender even attempted to assert that its misfiling should be forgiven under UCC § 9-402(8).

<sup>46</sup> See *Dollar Bank*, 657 A.2d at 1243.

<sup>47</sup> See *id.*

<sup>48</sup> *Id.* at 1245.

<sup>49</sup> The court disagreed with the trial court analysis that it was "unreasonable" for the bank to abandon its attempt to collect the business assets in the bankruptcy case. Instead, it reached to the period prior to the bank's collection efforts to find that the bank's failure to properly file made its efforts to reach the business assets first "unreasonable." *Id.* at 1244.

The bank also raised a causation issue: that it was improper for the trial court to render a summary judgment on the "reasonableness" issue without considering whether a proper security interest in the business assets would have fully protected the bank, making foreclosure on the residence unnecessary. Perhaps predictably, the court said the issue had not been raised below and, therefore, the bank was barred from subsequently raising it. *Id.* at 1244-45.

ity. State legislatures have increasingly created for constituents new statutory liens which often disrupt preexisting security interests. These new statutory liens have become sufficiently widespread that an American Bar Association Business Law Section Task Force has studied them and made recommendations aimed at reducing their impact on Article 9 security interests.<sup>50</sup> The cynic (or public choice theorist) might see the explosion in statutory liens<sup>51</sup> as state legislatures caving in to special interests;<sup>52</sup> the proliferation of statutory liens also may point to a developing consensus that secured credit requires limits.

## II

### THE PROCESS: THE UCC AND THE RESTATEMENTS

The UCC revision process is vaguely similar to the process for developing Restatements of Law. In both cases, a distinguished group is assembled to study the law and, through a Reporter, to propose formulations of black-letter rules. The proposed rules are brought before the appropriate bodies<sup>53</sup> for votes, are often amended, and are ultimately adopted. The Restatement process stops there; the UCC revision process is followed by promulgation of the revisions to the state legislatures for enactment. Besides this last obvious difference, a far more subtle, yet profound, difference lies in how these respective groups treat the common law.

Conventional wisdom holds that Restatements of Law gather common-law judicial decisions, distill their wisdom, and articulate that wisdom in a way that will yield more clarity and predictability in the law.<sup>54</sup> A traditionalist can view Restatement projects as Legal Realism in action—reformers study the cases to ascertain what courts actually *do* and then they reformulate the reasoning to give a better voice to those actions.<sup>55</sup> While Restatement projects often choose a “better” rule from conflicting decisions,<sup>56</sup> at a fundamental level, the enterprise is anchored in the judicial decisions. It is the direct and neces-

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<sup>50</sup> Report of the ABA Business Law Section Uniform Commercial Code Committee Subcommittee on Relation to Other Law Re: Inclusion of Nonpossessory Statutory Liens in Article 9, October 1996 (on file with author).

<sup>51</sup> The Task Force identified 107 statutory liens in California alone. *Id.* at 1.

<sup>52</sup> The “special interest” theory requires one to assume that the interests of (and lobbyists for) financial institutions can be trumped in state legislatures by opposing interests (and lobbyists). This is certainly not a self-evident proposition.

<sup>53</sup> The Restatement comes only before the ALI; the UCC comes both before the ALI and the NCCUSL.

<sup>54</sup> See Marshall S. Shapo, *In Search of the Law of Products Liability: The ALI Restatement Project*, 48 VAND. L. REV. 631, 633-34 (1995).

<sup>55</sup> Cf. G. Edward White, *The American Law Institute and the Triumph of Modernist Jurisprudence*, 15 L. & HIST. REV. 1 (1997) (recognizing the role of human creativity in judicial decisionmaking).

<sup>56</sup> Counting decisions and stating the “better” rule has a long history in the Restatement projects. See Shapo, *supra* note 54, at 634.

sary connection to those underlying judicial decisions that gives the Restatement process its legitimacy.<sup>57</sup>

Gilmore's 1981 "confession" hinted at how different the Article 9 process is from that just described. He wrote:

We were all "legal realists" and, as good realists, were committed to the propositions that legal rules have little or no predictive value and that what the courts do is infinitely more important than what the courts say. In this instance, however, we paid no attention to our precepts. The law review literature of the 1920's and 1930's is bursting at the seams with learned articles and faculty-inspired student notes deploring the short-sightedness and narrow-mindedness of the courts in failing to appreciate the beauty of what came to be called the "mercantile approach."<sup>58</sup>

The excessive focus on what the courts were *saying* may have been extreme in the original process of developing Article 9 of the UCC. There were no uniform statutory antecedents to Article 9 and the process of developing it involved perhaps the largest burst of legal creativity in modern commercial law. As Gilmore suggested, common-law cases that limited secured credit were perceived to be the *problem*, not a source to be considered in forging a solution. Yet one senses in the current reform process a comparable enterprise aimed at overruling or rendering moot judicial decisions that have tended to limit secured credit.<sup>59</sup> In the Article 9 process, then and now, judicial decisions clearly do not confine the reformers as they do in the Restatement process.

### III

#### LIMITS AND REFERENCE POINTS FOR ARTICLE 9 REFORM

##### A. "Enactability"

Limits do not come to the Article 9 reform process through judicial decisions, but through the need for widespread enactment in

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<sup>57</sup> See *id.* at 682. Grant Gilmore created one of the best (if slightly idealized) descriptions of the Restatement process. See generally GRANT GILMORE, *THE DEATH OF CONTRACT* (1974).

<sup>58</sup> Gilmore, *supra* note 7, at 615-16 (footnote omitted).

<sup>59</sup> In numerous places in the new draft of Article 9, the Drafting Committee has implicitly rejected judicial decisions that interpret Article 9 in a way that tends to limit secured credit. For example, the expanded definition of "proceeds" in section 9-306 will redefine the term and thereby eliminate those decisions holding that the current "proceeds" definition does not include rental payments. See, e.g., *In re Cleary Bros. Constr. Co.*, 30 U.C.C. Rep. 1444 (Bankr. S.D. Fla. 1980). U.C.C. § 9-306 (Members Consultative Group Draft No. 1, Oct. 15, 1996) [hereinafter Consultative Draft U.C.C.]. For other examples, see Gail Hillebrand, *The Uniform Commercial Code Drafting Process: Will Articles 2, 2B and 9 Be Fair to Consumers?*, 75 WASH. U. L.Q. 69 (1997).

state legislatures.<sup>60</sup> The term “enactability” captures the reality that any revision to the UCC must be quickly enacted by state legislatures, each of which has its own political reality. Without “uniformity,” the UCC loses its great appeal as a commercial statute. Indeed, without it, the interstate nature of our commerce would quickly demand a *Federal Commercial Code*, something that those within the reform process usually consider undesirable.<sup>61</sup>

Enactability has confined the work product of the UCC revision process, and usually counsels restraint in moving too far from the perceived status quo.<sup>62</sup> Enactability operates as the great leveling agent in the reform process; the need for enactability means that nothing too controversial can be included in the UCC or some states will balk and thereby defeat the uniformity that is so central to the validity of this unusual legislative process.

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<sup>60</sup> James J. White makes the point that enactability constrains the UCC process in embracing consumer protection provisions in James J. White, *Comments at 1997 AALS Annual Meeting: Consumer Protection and the Uniform Commercial Code*, 75 WASH. U. L.Q. 219 (1997). In discussing one aspect of enactment of the original Article 9, Grant Gilmore's classic understatement leads one to the same conclusion: “The gentlemen [of the ALL and NCCUSL] were not, in their habits of thought or ways of living, revolutionaries. . . . The sponsors were, therefore, much happier when the [Article 9] project was described in terms of non-abolishment of anything—as introducing at most a slight change in terminology.” 1 GILMORE, *supra* note 25, at 298.

<sup>61</sup> See Fred H. Miller, *Is Karl's Kode Kaput?*, 26 LOY. L.A. L. REV. 703 (1993); Fred H. Miller, *The Future of Uniform State Legislation in the Private Law Area*, 79 MINN. L. REV. 861, 869-71 (1995).

The debate about whether the commercial code should be enacted at the federal level has been an ongoing one. See, e.g., Robert Braucher, *Federal Enactment of the Uniform Commercial Code*, 16 LAW & CONTEMP. PROBS. 100, 101-08 (1951); Frank R. Kennedy, *Federalism and the Uniform Commercial Code*, 29 BUS. LAW. 1225 (1974); F. Stephen Knippenberg & William J. Woodward, Jr., *Uniformity and Efficiency in the Uniform Commercial Code: A Partial Research Agenda*, 45 BUS. LAW. 2519, 2522-28 (1990); Charles W. Mooney, Jr., *Introduction to the Uniform Commercial Code Annual Survey: Some Observations on the Past, Present, and Future of the U.C.C.*, 41 BUS. LAW. 1343, 1358-60 (1986); William Schnader, *The Uniform Commercial Code—Today and Tomorrow*, 22 BUS. LAW. 229, 231-32 (1966); E. Hunter Taylor, Jr., *Recent Developments in Commercial Law—Forward: Federalism or Uniformity of Commercial Law*, 11 RUT.-CAM. L.J. 527, 546-52 (1980); E. Hunter Taylor, Jr., *Uniformity of Commercial Law and State-by-State Enactment: A Confluence of Contradictions*, 30 HASTINGS L.J. 337, 364-66 (1978).

<sup>62</sup> See Memorandum from Consumer Issues Subcommittee of Article 9 Drafting Committee to Article 9 Drafting Committee, Advisors, and Observers (May 29, 1996) (on file with author). The Memorandum reads, in part:

A major goal in the revision process is maintenance of uniformity and quick acceptance of revised Article 9 and the [ ] final decision regarding the extent of special consumer provisions in Article 9 must take into account enactability of the statute. At the 1995 annual meeting, both in the consideration of Article 2 and of Article 9, many commissioners expressed . . . the opinion that additional consumer related provisions would be important to enactability in their states. Therefore the Subcommittee is aware of the need for a balanced approach: the Drafting Committee should not summarily reject proposals for additional consumer provisions, but at the same time it should exercise caution in proposing such provisions.

This need for enactability is a fundamental<sup>63</sup> and structural limitation. It follows from the fact that the UCC is state legislation that the Code requires uniformity, and that we have no way of getting all our jurisdictions to enact it at once. Enactability explains why Warren's Proposal received a one-sided reaction within the reform process. The need for enactability prompts one to predict that *no* proposal to alter the first priority of the secured creditor would have a realistic chance of success in *any* ALI/NCCUSL process, irrespective of the soundness of empirical or other policy support.

Consider the prospect of including in a new proposed Article 9 the Warren Proposal or any other proposal materially altering the first priority of the secured creditor.<sup>64</sup> What state would be the first to enact it? Even if financial institutions had only average influence in state legislatures, state politicians would become fearful that, with the Proposal in place, financing would be driven out of state or that new businesses would migrate to states that permitted secured financing on 100% of a debtor's personal property under the old Article 9. There is no process—nor is one ever likely to be developed—that obtains simultaneous state enactments of the UCC.<sup>65</sup> The result of this

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<sup>63</sup> Professor Rubin has implied that the need for enactability worked its way into the very conception of the UCC Articles 3 and 4 project by confining its scope. Rubin, *supra* note 9, at 746.

<sup>64</sup> The dynamic hypothesized in the text would hold for any proposal to alter the secured creditor's first priority, including a "restatement-type" proposal (as yet to be developed) that might permit a court to avoid a security interest in whole or in part because of a predatory or negligent extension of credit, the inability of the competing claimant to protect himself, among other things, "when justice required." An example of this kind of provision is, of course, UCC § 2-302, permitting a court to avoid a contract or term on the basis of "unconscionability." U.C.C. § 2-302 (1995). Less obvious, perhaps, is UCC § 2-209, which did away with the "preexisting duty rule" in sales contracts but invited courts to address predatory contract modifications through the rubric of "good faith." See U.C.C. § 2-209 cmt. 1, 2 (1995).

<sup>65</sup> While extremely unlikely, states could develop a process for simultaneous enactment. If they were to do so, they could protect themselves from the perceived competitive disadvantage of being the first to embrace an idea like the carve-out proposal.

One method of simultaneous enactment was developed during the Great Depression. In *Steward Machine Co. v. Davis*, 301 U.S. 548 (1937), Justice Cardozo describes the reservations some states had in enacting state unemployment compensation statutes. "Many [states] held back through alarm lest, in laying such a toll upon their industries, they would place themselves in a position of economic disadvantage as compared with neighbors or competitors." *Id.* at 588. Massachusetts solved this problem by providing that its state legislation would not go into effect unless either the pending federal law were passed or eleven of twenty-one named states were to enact laws with burdens on their employers that were "substantially equivalent." *Id.* at 588 n.9. If such a mechanism were developed for UCC enactment, it would substantially reduce the constraints on policymaking imposed by the current need for uniform enactment.

Whether such a mechanism could be adapted to a uniform state statute governing commercial law is beyond the scope of this Article. While the question is worth pursuing, it is not even clear at this point that the development of such a mechanism would be a good thing. The Article 9 process lacks the political constraints of the federal legislative process and the systemic constraints of the Restatement process. For all its faults in con-

variation of the collective action problem is that no state would be the first to enact Article 9 with the Proposal and, therefore, a new Code with the Proposal would be dead on arrival.<sup>66</sup>

The constraint of enactability is, however, fundamentally different from the constraint of common-law decisions on the Restatement process. The common-law limits on the Restatement process come from accumulated judicial decisions made in real cases over, perhaps, a long time. By contrast, the constraint of enactability is the collective perception of a relatively small number of people about what will be acceptable to a diverse group of state legislatures. Thus, unlike the case with Restatements, enactability exposes the UCC reform process to outside political pressure.<sup>67</sup>

Moreover, the political pressure that an interested entity or group might apply in the UCC reform process is probably leveraged pressure. This is because the threat of blocking a revision's enactment in even a few key states could effect a drafting change that the interest group might not be powerful enough to obtain at the Congressional level.<sup>68</sup> The effect of the need for enactability is to eliminate as not viable any provisions that might offend an organized group of participants.

That the end product of the revision process is targeted at state legislatures means that, in some sense, the drafters are performing legislative work.<sup>69</sup> Because the drafters or advisers must respond to

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straining the development of sound policy, the current limitations of enactability also constrain the influence any interest group can have on the development of the law. We may well be better off with enactability as a constraint on policymaking discretion than with no constraint at all.

<sup>66</sup> If the drafters included a carve-out provision but permitted states to "opt out" of the provision or if states thought they could do so on their own, the result would be that no state would enact the Proposal first.

<sup>67</sup> Some might argue that the development of a Restatement never has been and never can be apolitical and that politics has played an increasing role in the Restatement process in recent years. See, e.g., Shapo, *supra* note 54, at 645-46. Even if that were true, the political nature of the two processes is fundamentally different because of the necessity of state enactment for the UCC.

<sup>68</sup> If, for example, a group did not like the final product, they might block passage in a large state like California or New York and thereby effect change to the entire uniform statute.

Professor Rubin describes the efforts of individuals in several states who succeeded in blocking the enactment of Articles 3 and 4. Rubin, *supra* note 9, at 784. Had such persons been active in the drafting process then (as some of them are now), their threat of blocking enactment would have given them great leverage to effect a change in the draft. Cf. White, *supra* note 60, at 222 (describing bankers' opposition to Articles 3, 4, and 8 and their effect on the drafting process).

<sup>69</sup> Reliance on the state legislative processes for "political" checks is misplaced because the UCC comes to state legislatures as a package that carries the prestige of the sponsoring organizations and, perhaps, the implication that difficult policy choices have been resolved in a "neutral" fashion. Professor Rubin's experience in connection with the California legislature was that the legislature did not know what Articles 3 and 4 meant but

the pressures of effecting widespread state enactment, they are subject to political pressure not unlike that applied to elected legislators.<sup>70</sup> But since the reformers are neither elected officials nor philosophers or moralists, the constraints imposed by enactability and their insight into it do not anchor their work product in the same way that common-law decisions anchor the work product in the Restatement process.

### B. "Efficient" Secured Credit

In the case of Article 9, an internal logic of the institution of secured credit itself which is driven, perhaps, by the expertise of those in the process,<sup>71</sup> tends to anchor and steer decisions in much the same way that common-law decisions do in the Restatement process. The dominant enterprise is to make the system of secured credit as sleek and usable as the reformers can make it.<sup>72</sup> When articulated in "neutral" property terms, the idea is that "[t]he law should not impair

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assumed that policy choices had been well-resolved by the prestigious sponsoring organizations. Rubin, *supra* note 9 at 782. Cf. Scott, *supra* note 9, at 1814-16 (asserting that members tend to accept the judgment of the sponsoring organization if clear and unopposed, but generally favor the status quo because of information asymmetries and the costs of overcoming ignorance).

<sup>70</sup> To their substantial credit, those directly involved in the reform process made great strides in publicizing and exposing the UCC revision process to all interested parties. The reforms to the process have followed a barrage of criticism that it had effectively excluded those with consumer perspective. See generally Mark E. Budnitz, *The Revision of U.C.C. Articles Three and Four: A Process Which Excluded Consumer Protection Requires Federal Action*, 43 MERCER L. REV. 827 (1992) (criticizing the drafters of the 1990 revisions to Articles 3 and 4 for excluding consumer interests in the law of payment systems); Corinne Cooper, *The Madonnas Play Tug of War with the Whores or Who Is Saving the UCC?*, 26 LOY. L.A. L. REV. 563 (1993) (describing the battle between interest-group representatives and "law reform junkies" in the UCC drafting process); Gail Hillebrand, *The Redrafting of UCC Articles 2 and 9: Model Codes or Model Dinosaurs?*, 28 LOY. L.A. L. REV. 191 (1994) (discussing the deficiencies in Articles 2 and 9 as they relate to consumers primarily due to the UCC's basis as a commercial code); Donald B. King, *Major Problems With Article 2A: Unfairness, "Cutting Off" Consumer Defenses, Unfiled Interests, and Uneven Adoption*, 43 MERCER L. REV. 869 (1992) (explaining numerous problems with Article 2A); Fred H. Miller, *Consumer Issues and the Revision of U.C.C. Article 2*, 35 WM. & MARY L. REV. 1565 (1994) (discussing possible revisions to Article 2 necessitated by growth of the consumer movement); Yvonne W. Rosmarin, *Consumers-R-Us: A Reality in the UCC Article 2 Revision Process*, 35 WM. & MARY L. REV. 1593 (1994) (arguing that the revised Article 2 needs to address the unique characteristics and needs of consumer and commercial transactions).

Although these efforts have exposed the Drafting Committee to various kinds of political pressure described in the text, they have substantially opened the process and will probably improve the end result. If, however, I am correct that the problem in the Article 9 process is structural, then no amount of process or representation will correct it.

<sup>71</sup> Dean Scott has argued that the controlling expertise is that of those in the financing industry and that such expertise tends to bias the results. Scott, *supra* note 9, at 1806-07, 1850-51.

<sup>72</sup> See, e.g., Steven L. Harris & Charles W. Mooney, Jr., *A Property-Based Theory of Security Interests: Taking Debtors' Choices Seriously*, 80 VA. L. REV. 2021, 2021-22 (1994) (reviewing evolution of treatment of security interests).



the ability of debtors to secure as much or as little of their debts with as much or as little of their existing and future property as they deem appropriate."<sup>73</sup> Such goals can produce a work product that seems free of the personal biases or values of those who created it.<sup>74</sup> Ironically, this makes the language of Article 9 reform resemble the "neutral" language of judicial opinions rather than the often openly distributional language of legislatures.

Common-law courts do not often openly exercise their discretion in deciding commercial law cases.<sup>75</sup> The common law in the area of secured credit does not contain cases voiding security interests because, under the circumstances, to enforce the security interests would be "unfair" to unsecured claimants or to the debtor.<sup>76</sup> Similarly, outside Article 9, common-law courts do not commonly decide *how much* wage garnishment ought to be permissible<sup>77</sup> or *how much* property a debtor can keep from a judgment creditor.<sup>78</sup> More generally, common-law courts usually do not *directly* decide questions of distributional fairness; rather courts explain decisions that have distributional consequences by referring to neutral precedent and rules which "compelled" the decision at hand.<sup>79</sup> Common-law courts appeal to rules of law and precedent in order to anchor their decisions in "law" and distance them from the personal biases and discretion of the judge.

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This form of "efficiency" tends to exclude the impact of secured credit policy decisions on "outsiders" to the secured credit transactions whether they be tort creditors or other kinds of unsecured creditors.

<sup>73</sup> *Id.* (footnote omitted). As to "future property," compare the older common-law wisdom that one could not convey what one did not "own." See *supra* text accompanying note 25.

<sup>74</sup> Dean Scott says that "[b]oth the ALI and the NCCUSL believe that their function is to deal with technical problems that can be resolved by legal expertise and to avoid issues whose resolution requires controversial value choices." Scott, *supra* note 9, at 1805-06.

<sup>75</sup> Cf. Llewellyn, *supra* note 17, at 702-03 (commenting on the reluctance of American courts to look closely at standard form contracts). While the UCC, particularly Llewellyn's Article 2 with its flexible concepts of good faith and unconscionability, has invited a greater use of judicial discretion, the situation has not changed much since Llewellyn's day. The major exception may lie in bankruptcy court decisions under the Bankruptcy Code.

<sup>76</sup> As examples, see the discussion of *Clow v. Woods*, *Benedict v. Ratner*, and *Dollar Bank v. Schwarz*, *supra* text accompanying notes 21-49.

<sup>77</sup> Cf. Consumers Credit Protection Act § 301, 15 U.S.C. § 1671 (1994) (stating the disadvantages of unrestricted garnishment and the need for Congressional regulation). In bankruptcy, however, they do decide how much of a debtor's total income constitutes "disposable income" and thus how much must be devoted to a Chapter 13 Plan. See 11 U.S.C. §§ 1325(b)(1)(B), 1325(b)(2) (1994).

<sup>78</sup> Cf. 11 U.S.C. § 522(d) (specifying property exempt during bankruptcy proceedings). Courts do decide, for example, "[i]s a bus a bus, or is it a car?" *In re Johnson*, 14 B.R. 14, 14 (Bankr. W.D. Ky. 1981), but do not directly decide whether motor vehicles *ought* to be exempted. It is rare to find overt policymaking at the trial court level.

<sup>79</sup> Cf. Llewellyn, *supra* note 17, at 702-03 (discussing several "semi-covert" techniques that courts use to balance bargains).

Like common-law judges, reformers in the Article 9 process require "neutral" principles on which to ground their judgments; they cannot directly articulate a policy decision by reference to distributional fairness. Like common-law courts, it is hazardous for Article 9 reformers to confront a distributional issue directly, much less to legislate a distributional consequence directly. Their process is, indeed, limited by logic and must be short on direct confrontations with values. This, of course, limits their work product to neutral-sounding provisions.<sup>80</sup>

A great many of the proposed changes, indeed, sound "neutral" and "logical." Two of the best examples are proposals to permit the phrase "all assets" to describe collateral in the security agreement and financing statement<sup>81</sup> and the proposed expansion of the definition of proceeds.<sup>82</sup> In both instances, some courts have strictly construed the current statute and avoided security interests for inadequate descriptions<sup>83</sup> or because what was claimed did not fit the definition of proceeds.<sup>84</sup> If the "true intent" in a secured lending transaction were to give a security interest in all the debtor had or will have, why would Article 9 simply not permit that without requiring more specificity?<sup>85</sup>

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<sup>80</sup> A different view of the revision process sees it as far more political. See generally Rubin, *supra* note 9 (describing how private attorneys' biases influence the revision process); Scott, *supra* note 9 (discussing the "politics" of Article 9). This is sometimes manifest in the consumer area where consumers have been said by some to be "taking over" and forcing their views into the drafts. See Norman I. Silber, *Substance Abuse at UCC Drafting Sessions*, 75 WASH. U. L.Q. 225 (1997). At times, the result is a political compromise of the negative sort: we will block enactment if X provision is included in the revision. Again, this dynamic tends to limit the statute to provisions that do not disturb the distributional preferences of any organized group. See Scott, *supra* note 9, at 1816-22.

<sup>81</sup> The proposal to permit "all assets" to suffice as a description of the collateral in the security agreement was a part of revised Article 9 (proposed § 9-111) but was eventually rejected by the Drafting Committee in November 1996. U.C.C. § 9-111, n.1 (Discussion Draft No. 2, Apr. 17, 1997). The logic of the "all assets" description is captured in an earlier comment to the draft, now deleted:

Some have questioned whether "all assets" or "all personal property" suffice as a description for purposes of a security agreement. (*Whether or not it should, arguably it does, inasmuch as it reasonably identifies the collateral.*)

Consultative Draft U.C.C. § 9-111 (emphasis added). The idea that "all assets" or "all personal property" is sufficient as a description remains within the proposed revision to the provision dealing with financing statements. See U.C.C. § 9-504 (Discussion Draft No. 2, Apr. 17, 1997).

<sup>82</sup> See Consultative Draft U.C.C. § 9-313.

<sup>83</sup> See, e.g., *Allis-Chalmers Corp. v. Staggs*, 453 N.E.2d 145, 148 (Ill. App. Ct. 1983); *Exchange Bank & Trust Co. v. Glenn's Marine, Inc.*, 579 S.W.2d 358, 359 (Ark. 1979).

<sup>84</sup> See, e.g., *In re Cleary Bros. Constr. Co.*, 30 U.C.C. Rep. 1444, 1445 (Bankr. S.D. Fla. 1980).

<sup>85</sup> A common answer has been that "all assets" would make it "too easy" to take a security interest. Indeed, it is common to understand judicial hostility to security interests as a statement that a secured creditor has to "earn" its security interest. Like its "logical" opposite, this too is a distributional statement.

To suggest that a secured creditor has to "earn" its collateral is to say that the secured creditor must work (in the form of increased transaction costs) to get its security interest.

Future creditors, finding the financing statement or security agreement, could not be deceived any more than at present and there would be transaction cost savings in reduced paperwork. What possibly could be wrong with such reforms?<sup>86</sup> Proposed changes like these will, no doubt, expand secured lending by, at worst, making it easier to accomplish.<sup>87</sup> If improvement of the secured credit system, *taken in isolation*, is the goal, such proposals improve the system. Case law to the contrary is not to be reconciled; it is to be rejected.

But an "efficient" Article 9, one that reduces the transaction costs of secured lending by improving the operation of the current statute and expanding its ambit, is anything but neutral in its distributional effects.<sup>88</sup> As with the long—and probably unending—lines of hostile judicial decisions in this area, distributional policy is being set in the revisions to Article 9 just as it was being set in the original enactment under cover of a veneer of efficiency. Those in the reform process tend to define efficiency as efficiency *within* the system of secured credit and, by so defining it, they tend to exclude any real focus on secured credit's externalities. Questions such as whether expansion of secured credit will contract other kinds of lending or impose costs on those in no position to avoid them largely go unasked and unanswered. In short, the predominantly narrow emphasis on "improving secured credit" within the reform process both makes distributional policy without acknowledging it and precludes consideration of whether secured credit *itself* might be inefficient—the precise focus of recent scholarship in this Symposium and elsewhere on the priority of secured debt.

At first blush, it seems obvious that a group of experts charged with developing comprehensive legislation about credit secured by personal property ought to be considering the basic priority question

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Consider substituting a tax for the transaction costs the secured creditor now must pay. To whom would the revenues go?

The value of security interests, avoided because the secured creditor did not "work hard enough," goes to unsecured creditors. Proponents of the "work harder" position would, no doubt, also assert that the substituted tax revenue ought to go to the unsecured creditors whose interests are displaced by the secured creditor. The Warren Proposal can be understood as a variation of this idea.

<sup>86</sup> Other proposed reforms simply expand the kinds of collateral that will be subject to Article 9. As currently proposed, the new statute will permit the creation of security interests in some deposit accounts, *see* Consultative Draft U.C.C. §§ 9-113(13), 9-113(14), 9-304, and some kinds of tort claims, *see* Consultative Draft U.C.C. § 9-112. On another front, an American Bar Association Task Force is attempting to have the Lanham, Patent, and Copyright Acts revised to make it clear that Article 9 will cover federal intellectual property. *See* Alice Haemmerli, *Insecurity Interests: Where Intellectual Property and Commercial Law Collide*, 96 COLUM. L. REV. 1645, 1725-29 (1996).

<sup>87</sup> It is debatable whether more financing will actually become available or whether these reforms will simply expand collateral at the margins.

<sup>88</sup> For development of this same point at greater length in connection with state statutes for execution on judgments, *see* Woodward, *supra* note 40.

at the core of the subject matter. State legislatures will probably assume they did.<sup>89</sup> The Warren Proposal, in effect, simply asked those in the process to actually confront the priority issue directly.

But when one considers the constraints on those within the ALI/NCCUSL process, it is apparent why they could not face the priority issue.<sup>90</sup> How would a neutral body developing neutral principles possibly evaluate or advance such an openly distributional proposal? How could a process, whose mission is "improved efficiency" of secured credit, accommodate a proposal that seemed not to expand but to contract secured lending and, by imposing monitoring costs that were not required before, make secured lending more—not less—cumbersome? How could a group of unelected private individuals resolve a core distributional question about the appropriate division of assets among secured and unsecured claimants? The questions the Warren Proposal raised are just too big, too direct, and too political for the revision process to handle.

#### CONCLUSION: WHERE DO WE GO FROM HERE?

If the core policy question of secured creditor priority will receive a hearing at all, it will have to be at the federal level.<sup>91</sup> And although conclusions of one sort or another about the efficiency of secured credit (broadly conceived) will no doubt be important, efficiency is only part of what should be involved in setting policy. The priority of secured credit is as much a question of distributional fairness as it is a question of efficiency. In insolvency situations, expanded secured creditor priority (or more "efficient" secured lending) takes assets that would otherwise go to unsecured creditors and gives them to secured creditors. Moreover, as Dean Baird has pointed out,<sup>92</sup> this redistribution may be very regressive: it may well take from injured tort creditors, employees, and divorced spouses (among others)<sup>93</sup> and give to financial institutions. Even if we were convinced that it were effi-

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<sup>89</sup> See Rubin, *supra* note 9, at 782-85.

<sup>90</sup> The political predispositions or backgrounds of those involved in the reform process are not central to the argument. The constraints on the process in this context would suggest that *any* group, whether composed of bankers or bankruptcy trustees, would be most reluctant to advance a proposal to openly alter the priority now given to secured creditors.

<sup>91</sup> The constraints I described above under the concept of "enactability," see *supra* Part III.A, will constrain states in independently deciding that there should be direct limits on secured creditor priority. It will not prevent individual states, however, from eroding the security interest through further proliferation of statutory liens, a piecemeal and non-uniform cure to all-encompassing security interests that may be worse than the disease.

<sup>92</sup> See Douglas G. Baird, *The Importance of Priority*, 82 CORNELL L. REV. 1420, 1426-29 (1997).

<sup>93</sup> See 11 U.S.C. § 507 (1994) (listing priority claimants paid in bankruptcy *after* secured creditors are fully paid).

cient (in the broad sense) to do that, we might decide that the distributional implications of such a decision are simply undesirable. If one were convinced that the distributional consequences were undesirable under present or expanded secured credit, one might address those consequences even in the absence of firm, empirical evidence on the efficiency question.<sup>94</sup>

We have made similar distributional determinations by outlawing imprisonment for debt, creating the personal bankruptcy discharge,<sup>95</sup> limiting wage garnishment,<sup>96</sup> and limiting broad non-purchase money security interests in consumer goods.<sup>97</sup> One can argue that any of these limitations is "inefficient." Each seems to drive up the cost of credit and benefit the very few who default on their obligations at the expense of the many who do what they promise. Each, arguably, keeps credit from honorable, but marginal, borrowers. But efficiency arguments have not prevailed: rather, in all these cases, policy decisions seem driven by distributional and fairness considerations. Indeed, history suggests that debtor-creditor law is largely *about* distributional fairness, first to debtors who promise but cannot deliver and, more recently, to outsiders to the secured credit transaction who, for one reason or another, do not take protective action.<sup>98</sup>

The analysis here has argued that the Article 9 reform process cannot (and probably should not) confront distributional fairness issues, yet, by setting secured credit policy, the process is making distributional decisions. Can sound policy in the area of secured credit be made without resolving the distributional implications of making secured credit "better"? Historically, we have muddled through with a *tit* of secured credit reform followed by a *tat* of bankruptcy reform.

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<sup>94</sup> Cf. Steven L. Harris & Charles W. Mooney, Jr., *Measuring the Social Costs and Benefits and Identifying the Victims of Subordinating Security Interests in Bankruptcy*, 82 CORNELL L. REV. 1349, 1349 (1997) (recommending "approaches for quantifying the major social costs and benefits likely to result from adoption of a subordination proposal").

<sup>95</sup> We have had the modern bankruptcy discharge in voluntary bankruptcy since the 1898 Act. Its most recent incarnation in Chapter 7 is 11 U.S.C. § 727 (1994).

<sup>96</sup> See Consumer Credit Protection Act, § 301, 15 U.S.C. § 1671 (1994).

<sup>97</sup> See Federal Trade Commission Trade Regulation Rules, 16 C.F.R. § 444.2(a)(4) (1997).

The Article 9 process has been decidedly "cool" about including within Article 9 a provision which would exempt from secured financing under Article 9 that which a debtor could otherwise exempt from execution under a state's exemption laws. This is despite the fact that both the Bankruptcy Code, 11 U.S.C. § 522(f)(3) (1994), and federal regulations, contain such restrictions on secured lending, and despite the fact that Article 9 is (arguably) the better place to include them.

<sup>98</sup> In business cases, the effects of insolvency are felt by a broader group than the debtor's "creditors," and an account of the distributional consequences of insolvency is incomplete without considering them. See Lawrence Ponoroff, *Enlarging the Bargaining Table: Some Implications of the Corporate Stakeholder Model for Federal Bankruptcy Proceedings*, 23 CAP. U. L. REV. 441, 468-71 (1994); Elizabeth Warren, *Bankruptcy Policy*, 54 U. CHI. L. REV. 775, 785-89 (1987).

But bankruptcy legislation may be problematic in this context,<sup>99</sup> and it offers little help to tort and other judgment creditors of a fully secured debtor outside of bankruptcy. Moreover, expansion of secured credit through the ALI/NCCUSL process, followed by its contraction through bankruptcy legislation, is, at best,<sup>100</sup> an extraordinarily inefficient way to make sound policy.

Congress, of course, provides no panacea and inspires little confidence that distributional questions in the area of secured credit will be addressed head-on in a way likely to produce policy results based on our cultural values. But whatever the prospects in Congress for a debate on the policy merits of broad, secured creditor priority, it seems clear that the distributional questions endemic to secured credit cannot be resolved in an ALI/NCCUSL process.

As a repentant draftsman, Grant Gilmore looked back and regretted that his process for developing the original Article 9 did not embrace what many of the common-law courts had been *doing* in the area of secured credit.<sup>101</sup> Inevitably, it is no different now than it was in Grant Gilmore's day and it will be no different in an ALI/NCCUSL process in the future. Gilmore did not need to repent; there was nothing he could have done about it.

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<sup>99</sup> See LoPucki, *supra* note 12, at 1486. In addition, financial institutions no doubt would argue before Congress that sound policy (including distributional policy) was already set by national experts in the Article 9 process and it would be wasteful to revisit the issues.

<sup>100</sup> If resolving distributional issues is central to—and inseparable from—the setting of secured credit policy, then our current two-step process will be neither efficient nor will it generate optimal policy results.

<sup>101</sup> See *supra* text accompanying note 7.