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Making Policy with Imperfect Information: The Article 9 Full Priority Debates

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MAKING POLICY WITH IMPERFECT INFORMATION: THE ARTICLE 9 FULL PRIORITY DEBATES

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INTRODUCTION

A logical construction for the Symposium on the Priority of Secured Debt would have been an introduction to highlight the issues, followed by a panel of commentators supporting full priority, a panel opposing full priority, and a panel discussing the optimal implementation for any constraints on priority. The difficulty, however, is that while the attack on full priority is quite spirited, the defense of full priority is hedged in qualifications. Commercial lenders and their lawyers are willing to come out foursquare for full priority for secured creditors, but the academic analysis has been very different in tone. Most academic supporters carefully note the limited evidence on which a conclusion can be based, often describing themselves as agnostic or waiting for the empirical studies before they commit to a position on full priority.[1]

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1 *See, e.g.*, Douglas G. Baird, *The Importance of Priority*, 82 CORNELL L. REV. 1420, 1420-21 (1997) (urging caution because of the indirectness of priority rights' benefits); Theodore Eisenberg & Stefan Sundgren, *Is Chapter 11 Too Favorable to Debtors? Evidence from Abroad*, 82 CORNELL L. REV. 1532, 1533-36 (1997) (comparing evidence between reorganizations in Finland and in the United States); Robert E. Scott, *The Truth About Secured Financing*, 82 CORNELL L. REV. 1436, 1437-38 (1997) (displaying ambivalence about whether a priority regime *does* enhance social welfare); William J. Woodward, Jr., *The Realist and*

Does this mean that partial priority has triumphed and secured creditors will not be permitted to expand their reach under the next version of Article 9? Not quite. As Professors Harris and Mooney state in the opening paragraph of their Article, "As of yet, however, none of the subordination proponents has addressed [the empirical] questions in any detail."[2] Until that lucky day, the revision process evidently proceeds apace to make Article 9 safer for secured creditors, ensuring that secured creditors sweep in more of the debtors' assets and leave less for the unsecured creditors.[3]

Academics who ply their scholarly trade in the field of commercial law often debate in two simultaneous worlds: the abstract world of ideas where theoretical dominance spells success, and the very real world of law reform, where debates result in code provisions that govern billions of transactions. This Symposium provides a wonderful example of what happens when those worlds collide.

In the past few months, three events have occurred simultaneously: the lack of theoretical consensus for full priority has become prominently exposed, the absence of empirical data has obviated the ability to make any concrete evaluation of the costs and benefits of secured credit, and the headlong push to enlarge on every scintilla of priority for secured creditors has intensified. The confluence of these events creates the focus of my Article—policy decisions in a world of disputed theories and imperfect information.

I
Baseline Rules and Private Deals

UCC priority questions involve an easily understood transaction. Whether the discussion is about abstract letters, as in Professor Schwartz's work, or specifically identified groups who cannot adjust their lending practices, as in Mr. Klee's work, the deal under scrutiny is the same. In its baldest terms, contractual priority permits the

Secured Credit: Grant Gilmore, Common Law Courts, and the Article 9 Reform Process, 82 CORNELL L. REV. 1511, 1529-30 (1997) (raising issues of distributive fairness).

Some academics are supporters of full priority. *See, e.g.*, David Gray Carlson, *On the Efficiency of Secured Lending*, 80 VA. L. REV. 2179, 2179-80 (1994) ("[I]t is easy to show that secured lending has at least the potential to create social good."); 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) (arguing that "[t]he law should not impair 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"); Steven L. Schwarcz, *The Easy Case for the Priority of Secured Claims in Bankruptcy*, 47 DUKE L.J. (forthcoming Dec. 1997).

2 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).

3 The carve out, Professor Harris announced at the Symposium, is "dead in the water."

debtor and one lender to get together and agree that, in the event of complete collapse, a third party will bear the biggest share of the losses.

This legal arrangement differs dramatically from the two schemes imposed elsewhere in collection law—the state-law scheme that fosters a one-at-a-time collection process which rewards the diligent creditor, and the bankruptcy system that embraces the ideal of equity-is-equality. Article 9 is the best-known example of permitting two parties to agree by contract not only to change their own collection rights, but to change the collection rights of third parties who are not present.

Ordinarily, when two parties try to alter the rights of third parties who are absent from the negotiations and who are unable to refuse such altered treatment, the law says "no." Parties may barter away their own rights, but they cannot give away the rights of those who do not consent to such treatment. In the case of personal property, it was not until the sweeping reforms of Article 9 were adopted in the 1960s that parties could reliably and inexpensively negotiate for the reduced collection rights of third parties in the event of a financial collapse.[4]

Why would the law take such an extraordinary step to permit two parties to negotiate away the rights of a third party that was not present at the negotiation table? The proposed answers have differed,[5]

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4 *See generally* Charles A. Bane, *From Holt and Mansfield to Story to Llewellyn and Mentschikoff: The Progressive Development of Commercial Law*, 37 U. MIAMI L. REV. 351, 374-75 (1983) (describing the confused state of the law prior to Article 9).

5 *See* DOUGLAS G. BAIRD & THOMAS H. JACKSON, CASES, PROBLEMS, AND MATERIALS ON SECURITY INTERESTS IN PERSONAL PROPERTY 316-29 (2d ed. 1987) (criticizing as too simplistic the conventional justification—facilitating the borrowing of money—for granting priority to secured claims); Barry E. Adler, *An Equity-Agency Solution to the Bankruptcy-Priority Puzzle*, 22 J. LEGAL STUD. 73, 93 (1993) (concluding that current theories show how secured credit efficiently reduces management's opportunity to take excessive risks with a debtor's assets); Richard L. Barnes, *The Efficiency Justification for Secured Transactions: Foxes with Soxes and Other Fanciful Stuff*, 42 U. KAN. L. REV. 13, 33 (1993) (asserting that creating greater efficiency for only one of the participants in a transaction does not justify secured credit); Lucian Arye Bebchuk & Jesse M. Fried, *The Uneasy Case for the Priority of Secured Claims in Bankruptcy*, 105 YALE L.J. 857, 934 (1996) (demonstrating that the rule of full priority "causes excessive use of security interests, reduces the incentive of firms to take adequate precautions and choose appropriate investments, and distorts the monitoring arrangements chosen by firms and their creditors"); James W. Bowers, *Whither What Hits the Fan?: Murphy's Law, Bankruptcy Theory, and the Elementary Economics of Loss Distribution*, 26 GA. L. REV. 27, 64-67 (1991) (addressing the costs of security in light of debtor misbehavior); Carlson, *supra* note 1, at 2213 (arguing that the rationality of secured lending is established by ordinary price theory—security interests reduce risk and make credit available that would otherwise not be extended); Harris & Mooney, *supra* note 1, at 2047-66 (proposing that secured creditors have property interests in their security interests); John Hudson, *The Case Against Secured Lending*, 15 INT'L REV. L. & ECON. 47, 53-55 (1995) (taking the position that full priority allows a firm to continue to operate inefficiently); Thomas H. Jackson & Anthony T. Kronman, *Secured Financing and Priorities Among Creditors*, 88 YALE L.J. 1143, 1158 (1979) (arguing that "the economic utility of secured credit rests upon the assumption that total monitoring costs can sometimes be reduced by giving certain creditors priority over others"); Thomas H. Jackson & Robert E. Scott, *On the Nature of Bankruptcy: An*

and the debate continues apace, as this Symposium shows. The justification for contractual priority remains, at best disputed, and at worst, thoroughly debunked. Nonetheless, the real-world aspect of the debate rears its head from time to time, and the world of reform and modernization efforts does not leave time for the luxury of waiting for a resolution to the theoretical debate. Article 9 is in use, the UCC revision process is upon us, and it is imperative to decide how to decide.

Essay on Bankruptcy Sharing and the Creditors' Bargain, 75 VA. L. REV. 155, 169-73 (1989) (concluding that full priority encourages secured creditor misbehavior on the eve of bankruptcy); Homer Kripke, *Law and Economics: Measuring the Economic Efficiency of Commercial Law in a Vacuum of Fact*, 133 U. PA. L. REV. 929, 941 (1985) (advocating a practical analysis which leads to the observation that security is desirable because it is quick and offers many procedural advantages); Saul Levmore, *Monitors and Freeriders in Commercial and Corporate Settings*, 92 YALE L.J. 49, 55-57 (1982) (asserting that the freeriding problem is solved when unique monitoring tasks are assigned to secured creditors); Lynn M. LoPucki, *The Unsecured Creditor's Bargain*, 80 VA. L. REV. 1887, 1952-54, 1965 (1994) (proposing that the "Article 9 filing system be redesigned to serve the information needs of all who are to be bound by the secured creditor's [agreement]"); James Steven Rogers, *The Impairment of Secured Creditors' Rights in Reorganization: A Study of the Relationship Between the Fifth Amendment and the Bankruptcy Clause*, 96 HARV. L. REV. 973, 977-79 (1983) (arguing that a secured creditor does not acquire property rights deserving greater constitutional protection than is accorded to contractual rights of an unsecured creditor); Alan Schwartz, *Security Interests and Bankruptcy Priorities: A Review of Current Theories*, 10 J. LEGAL STUD. 1, 9-28 (1981) [hereinafter Schwartz, *Security Interests*] (rejecting several common efficiency justifications for security, including: reduction of monitoring costs, the value of secured debt as a signal, the premise that properly staggered debt increases profits, the reduction of creditor uncertainty, and the ability of security interests to shift risks from more to less risk-averse creditors); Alan Schwartz, *The Continuing Puzzle of Secured Debt*, 37 VAND. L. REV. 1051, 1051 (1984) (reiterating that the law's favorable treatment of secured debt is without plausible support); James H. Scott, Jr., *Bankruptcy, Secured Debt, and Optimal Capital Structure: Reply*, 34 J. FIN. 253, 257-58 (1979) (arguing that issuing secured debt affects shareholder wealth); James H. Scott, Jr., *Bankruptcy, Secured Debt, and Optimal Capital Structure*, 32 J. FIN. 1, 9-12 (1977) (asserting that the issuance of secured debt can increase the total value of a firm); Robert E. Scott, *A Relational Theory of Secured Financing*, 86 COLUM. L. REV. 901, 967-70 (1986) [hereinafter Scott, *Relational Theory*] (asserting that Article 9's strength is that it has chosen certainty over equity); Paul M. Shupack, *Solving the Puzzle of Secured Transactions*, 41 RUTGERS L. REV. 1067, 1103-07 (1989) (arguing that there is a social gain from secured transactions); George G. Triantis, *Secured Debt Under Conditions of Imperfect Information*, 21 J. LEGAL STUD. 225, 227 (1992) (stating that security is unnecessary "in perfect capital markets where lenders are risk neutral"); James J. White, *Efficiency Justifications for Personal Property Security*, 37 VAND. L. REV. 473, 475 (1984) (concluding that the Article 9 position is "the most efficient, practical alternative under an economic system that recognizes and protects private rights of ownership"); James J. White, *The Recent Erosion of the Secured Creditor's Rights Through Cases, Rules and Statutory Changes in Bankruptcy Law*, 53 MISS. L.J. 389, 424-26 (1983) (outlining constitutional concerns raised by the spectre of effectively eliminating a creditor's existing rights in security); Michelle J. White, *Public Policy Toward Bankruptcy: Me-First and Other Priority Rules*, 11 BELL J. ECON. 550, 552-61 (1980) (pointing to the danger of continued inefficient operation by a firm in a full priority regime).

II
THE POWER AND LIMITS OF EFFICIENCY ANALYSIS

The rhetoric of the debate over security interests is couched largely in the language of economics. Will a priority scheme make lending more efficient? Will it promote more lending? Will it cause over-investment in risky projects? Will a modified priority scheme encourage greater internalization of risk? Do externalities caused by a full priority scheme undercut any efficiencies it might produce? There can be no doubt that economic analysis provides a valuable tool in analyzing the implications of any rule in commercial law, including a rule regarding the priority of secured debt.

Economists are, however, the first to note that using economic analysis as a tool for understanding policy choices has its limits. At many turns, the analysis depends heavily on empirical assumptions. Without knowing the accuracy of the underlying assertions of fact, it is impossible to know whether an abstract economic analysis is applicable or not. The agnosticism expressed by a number of commentators puts this limitation very much in plain sight.

Economists would point out a second constraint on the contribution an efficiency argument could make to policymaking decisions. Economic analysis is well-suited to contribute to debates over allocative efficiency, but the tools of economic analysis are not nearly as useful in dealing with questions of distributive efficiency. Methods to produce expansion or contraction of credit are good subjects for deductive debates; decisions to prefer banks over utility companies or tort victims are not. Economic analysis can help inform debates about distributive issues by pointing out, for example, that commercial lenders are able to spread risks in a way utility companies or tort victims cannot, or that reallocation would be unworkable. Nonetheless, the ultimate normative question about preference for one group over another in the distribution of limited assets is beyond the expertise these tools provide.

Debates over priority are not new. Professor Schwartz revived an old debate in the newly discovered language of law and economics by asking whether secured debt is efficient.[6] In quick order, a cottage industry of articles rising to the challenge or disputing its basic assumptions arose.[7]

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6 Schwartz, *Security Interests*, *supra* note 5, at 3. Schwartz states:

> [My] essay's principal conclusion, therefore, is that scholars and decision makers should no longer regard as settled the question which bankruptcy priority list is normatively preferable. Much more work must be done to make compelling the efficiency defense of current law, yet normative justifications for altering this law are also poorly developed.

Id.

7 *See supra* note 5 and accompanying text.

In his delightful introduction[8] to his *Virginia Law Review* article, Professor LoPucki noted that economists spend a great deal of time explaining why any rule that aims to redistribute wealth to the underdog would actually reduce wealth to everyone.[9] These economists explain the need for banks to be able to seize all the assets of a business while the tort victims limp away with nothing, as based on allocative efficiency. LoPucki comments: "Ah, to be exquisitely cruel but at the same time efficient—what more could an economist ask of an institution?"[10]

Although LoPucki does not identify it as such, he makes the point that the economic rationality arguments for the efficiency of a system that benefits those in power[11] often trump the distributional impulses that might affect policymakers. He notes that even noneconomically oriented scholars often give up the idea of protection for the losers in the priority game, as these scholars see how much good the secured credit system does.[12] These debaters often toss a bone to the underdogs through a warmed-over trickle-down theory, arguing that what is good for secured creditors is good for all of America.[13] In one form

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8 "Delightful" to those who enjoy seeing someone poke fun at the economists—although maybe not so delightful for the economists.

9 LoPucki, *supra* note 5, at 1888-89.

10 *Id.* at 1889.

11 *Id.* Note that this argument is different from the argument that Professor LoPucki advances in his piece, *The Death of Liability*, 106 YALE L.J. 1 (1996), and that Professor Baird echoes in his piece, *The Importance of Priority*, *supra* note 1. LoPucki argues that any form of liability can be avoided by a clever and well-advised party, LoPucki, *supra*, at 4-5, and Baird points out examples of ways that the debtor and one creditor could cut out a distribution to unsecured creditors even in a partial priority system, Baird, *supra* note 1, at 1423-25. The arguments are important and worth attention, and are addressed later in this Article. However, in any case, the arguments are not justifications for making normative decisions based on the inapplicable principles of allocative efficiency.

12 LoPucki, *supra* note 5, at 1888-89; *see also* Kripke, *supra* note 5, at 961. According to Kripke, "[D]ebtors and their suppliers are both advantaged by a system that permits the debtors' typically insufficient capital to be supplemented by financial lending practices based on security." *Id.*

13 *See* Jackson & Kronman, *supra* note 5, at 1156. The authors state:

> If we assume that the sum of all parties' monitoring costs depends on the priority of creditor claims, there are likely to be some situations in which everyone concerned, including the debtor, will be better off if the interests of certain creditors are subordinated to those of others than they would be if all creditors were given equal priority.

Id.; *see* Scott, *supra* note 1, at 1456. He states:

> In sum, it is fair to conclude that a regime that privileges secured credit *may* enhance social welfare and that the scheme of priorities institutionalized in Article 9 is roughly congruent with plausible explanations of the comparative advantages of secured financing over other financing alternatives.

Id.; *see also* Ronald J. Mann, *Explaining the Pattern of Secured Credit*, 110 HARV. L. REV. 625, 649 (1997) (stating that granting collateral enhances the lender's ability to restrain the borrower from engaging in risky conduct that decreases the borrower's ability to repay the loan); Triantis, *supra* note 5, at 235-36 (noting that issuing secured debt mitigates the negative effects of issuing new debt).

or another, the efficient answer must take precedence over any distributive concerns.

The conflict between efficient outcomes and distributive consequences goes well beyond the Article 9 debates, with warring camps looking at their opposing numbers with sneers of derision. The special contribution of Professor LoPucki, Professor Bebchuk, and Mr. Fried has been to establish that the theoretical debate needed a larger framework than simply figuring out why secured credit was efficient and why it should therefore always take precedence over distributional concerns. They forcefully point out that the heralded efficiencies of secured credit might themselves be suspect. Indeed, they push the point further, noting that there might be serious *inefficiencies* created by a full priority scheme for secured creditors. Their scholarship sets the stage for a heretical question: If the secured credit system might be both inefficient *and* distributionally suspect, perhaps the time has come to revisit its premier place in the commercial world.

III
Efficiency Arguments and Empirical Evidence

A. The Burden of Proof

Professors Harris and Mooney described Article 9 of the Uniform Commercial Code as "the most successful commercial statute ever [written]."[14] It is certainly well-loved, at least by those secured creditors who use it. But what makes it so great?

Professors Harris and Mooney admit that, without empirical evidence, it is hard to estimate the actual effects of a full priority system.[15] There are no studies of the efficiency, distributive consequences, or any other aspect of Article 9. No studies show who benefits and who loses. No studies show the consequences of highly leveraging businesses. No studies show larger economic effects of Article 9. Although a number of Article 9 missionaries carry the message of Article 9 to foreign countries, as Americans have actively pushed the adoption of a UCC-style full priority system throughout Europe, Asia, and South America,[16] the benefits of the system are asserted rather than proved.

According to Harris and Mooney, however, the absence of any empirical testing of the impact of Article 9 means that not only should secured creditors continue to enjoy full protection, but also that both Harris and Mooney should put their own efforts as reporters to the

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14 Harris & Mooney, *supra* note 1, at 2021.

15 Harris & Mooney, *supra*, note 2, at 1350.

16 *See* Peter Winship, *As the World Turns: Revisiting Rudolf Schlesinger's Study of the Uniform Commercial Code "In the Light of Comparative Law,"* 29 Loy. L.A. L. Rev. 1143, 1143-46 (1996).

Article 9 revision process—and the considerable resources and prestige of the American Law Institute and the National Conference of Commissioners on Uniform State Law—to the task of expanding the reach of secured creditors. Without evidence, Harris and Mooney assume they should work to make it even more difficult for unsecured creditors to challenge security interests, to leave fewer assets on the table for the unsecured creditors to divide, and, in short, to make the world a more comfortable place for the downtrodden class of asset-based lenders.

Evidently there has been some sort of burden shift in the past forty years regarding changes to the status quo. The first Article 9 Drafting Committee, headed by Professor Gilmore, devised the scheme that made security interests in personal property cheap and reliable. The first Committee brought order out of chaos, turning assets in which no security interest could reliably be enforced at state law into valuable collateral. For his efforts, Professor Gilmore was featured in *Time* magazine and achieved near-saint status in the world of commercial law.[17]

What about the empirical questions back in the 1960s? Gilmore's changes were heralded as "radical," "sweeping," and "monumental."[18] Everyone knew the changes would promote secured lending on personal property, but no one suggested that an empirical inquiry into the effects of such increased secured lending should precede such a powerful change. No one asked whether such easily available security devices would expand secured credit precipitously, foster the formation of risky businesses, dramatically increase the leverage of one class of lenders, or disadvantage the class of unsecured creditors. Why were these arguments not part of the debate?

Harris and Mooney remind us that those who offer change should bear the burden of offering evidence that change is needed. Where was the evidence just thirty-five years ago when the current system radically reformed the state law collection system? Why do Professors Harris and Mooney press further expansion of the priority rights in Article 9 with no empirical examination of its effects? Do only those who quarrel with the powerful bear the burden of produc-

17 *Teacher in out of the Cold*, TIME, Jan. 12, 1968, at 29. For an overview of Gilmore's accomplishments, see Anthony Jon Waters, *For Grant Gilmore*, 42 MD. L. REV. 865 (1983).

18 Grant Gilmore, *The Secured Transactions Article of the Commercial Code*, 16 LAW & CONTEMP. PROBS. 27, 27 (1951) (stating that "[n]o other Article of the Code proposes so radical a departure from prior law"); Richard L. Barnes, *Toward a Normative Framework for the Uniform Commercial Code*, 62 TEMP. L. REV. 117, 153 (1989) (descrihing changes in Article 9 mechanics as "sweeping"); Dan T. Coenen, *Priorities in Accounts: The Crazy Quilt of Current Law and a Proposal for Reform*, 45 VAND. L. REV. 1061, 1073 (1992) (describing Article 9 as "a project of monumental proportions compared to the accounts receivable statutes").

ing empirical evidence, while those who promote their interests get a free ride on empirical questions?

B. How Creditors Use Priority

Professors Harris and Mooney assert that empirical studies will tell us about the costs and benefits of secured credit.[19] They suggest two approaches to such studies. The first is based on an analysis of current credit practices in "market segments in which anecdotal evidence and common knowledge indicate that secured credit plays an important role."[20] They suggest surveys and questionnaires,[21] but they do not explain what the questions are. "Do you like secured credit?" It is difficult to imagine a secured creditor dumb enough to say no, unless the question were framed in terms of whether the creditor could get even more protection. Nor is it possible to hypothesize an unsecured creditor who lost a fortune while the secured creditor walked away with all the assets of a business saying much more than no.

Perhaps there are other items to study in the Harris and Mooney survey, such as whether there were many failures in which the unsecured creditors took substantial losses. But again, the question lingers about what this inquiry would show. If the proportions of losses were small, would this mean that some constraint on full priority is unnecessary, or would it mean that some constraint would not be particularly disruptive to current business practices? Conversely, if the unsecured creditors' losses were high, would that support or undercut full priority? Until the hypothesis is clarified, such a study is useless.

Harris and Mooney's second empirical test is an abstract model that "reliable data [to] inform the example"[22] could fill in. Once again, the hypothesis to be tested remains unstated. Modest constriction might support either policy conclusion.

If we are to wait for law reform until these two studies are carried out, the wait will be long. Even if the lucky day comes when someone does these studies, it is unclear what they will tell us about the reform process. Here lies the crucial question as the debaters keep batting about unknown empirical assumptions: What can be learned about a restricted priority system by studying a full priority system?

A definitive test of a restricted priority system is virtually impossible within the regime of full priority. The behavior of the parties provides a crucial example. Some creditors will lend only on a secured basis. Does that mean that they would not lend in a "no-priority" sys-

19 Harris & Mooney, *supra* note 2, at 1355.

20 *Id.* at 1358.

21 *Id.*

22 *Id.* at 1360.

tem? Not necessarily. So long as a system exists that permits others to take priority over them, they will insist on defensive priority. In a priority system, many creditors will decide that even if they did not want to beat out others, they must make sure that no one can beat them. Some creditors might be satisfied with pro-rata priority, but that is unavailable in the current scheme. Defensive security interests are essential in a world that subordinates the unsecured.

This does not mean that efforts to frame empirical questions are worthless. They are enormously useful, if only to serve as a reminder about how little we know as we draft laws to govern billions of credit transactions. In the Article 9 reform process, three observations about empirical studies are important: 1) we cannot wait for the definitive study before we make policy decisions, 2) we have to acknowledge that any empirical evidence is likely to be indirect and only suggestive, and 3) we have to be more creative in our approaches to gathering empirical data.

C. Creative Alternatives

Professor Schwartz continues his efforts to give the definitive answer to the question he posed more than a decade ago: Why have secured credit?[23] In the latest incarnation of his answer, he focuses on the role of negative loan covenants and the creditor's paramount concern over debt dilution.[24] Admirably, he looks for—and even finds—empirical evidence consistent with his view. The creativity of his approach to looking for supporting evidence suggests that even if direct measures of priority systems do not yield much information, indirect measures may be quite revealing.

If Professor Schwartz is right in his view that the lender is trying to prevent the debtor from shifting investments toward higher risk-taking over time, and that secured debt priorities further this restriction, and if his evidence is adequate to support his interpretation, then another perspective on lending priorities might be in the offing. But Schwartz's view of the reasons for secured debt offers a very different perspective on the accompanying system of full priority.

If, as Schwartz suggests, secured creditors contract with reference to the intended acquisition of future trade debt, then perhaps an efficient priority system would provide a lower priority for subsequent creditors who are not ordinary course creditors. Instead, such a system should logically provide a first priority for routine trade credit.[25]

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23 Schwartz, *Security Interests*, *supra* note 5, at 1-3.

24 Alan Schwartz, *Priority Contracts and Priority in Bankruptcy*, 82 CORNELL L. REV. 1396, 1396-98 (1997).

25 Professor Schwartz draws a different conclusion from his hypothesis, placing trade debt distribution in an inferior status to secured debt. *Id.* at 1397-98, 1399-1401.

According to this view, the parties who would be bound by priorities would be those who put the first lender at risk—the creditors who offer out-of-the-ordinary financing that permits the debtors to shift investment strategies.[26] Incidentally, these are also the creditors who can best protect themselves by making informed lending decisions in the context of subordinated priority. For those who offer only the contemplated, routine trade debt that the secured creditor knows is essential to the survival of the business, and who have no hand in fostering subsequent risky investment decisions, perhaps first priority status would be in order. At a minimum, the Schwartz analysis raises the question why such trade debt should be subordinated to subsequent lenders who also take security interests and who finance the risky business operations that cause the trade creditors to lose out.

There is another implication from Professor Schwartz's argument: If creditors are mostly concerned about debt dilution, then it does not follow that these creditors should take priority over tort claimants.[27] Tort creditors have not contributed to the subsequent risky investments. They are, at worst, merely its co-victims. If the point of Schwartz's analysis is to try to control the post-lending, risk-taking decisions of debtors, there is no justification for the last-place treatment of the victims of that risky behavior.

D. Other Places to Look for Information

The work of Professors Eisenberg and Sundgren highlights a promising approach to the study of commercial law questions: comparative studies of other economies that do not use full priority rules.[28] In their study, they compare bankruptcy rules in Finland with those in the United States.[29] In an earlier work, Professors Eisenberg and Tagashira compared bankruptcy rules for Japan and the United States.[30] The approach is creative and yields a number of insights that raise questions about our own system.

Perhaps somewhat closer to the question of priorities for secured creditors would be comparisons between the United States's system and economic regimes in Europe that provide important priorities for parties not at the bargaining table. The French system has significant carve outs for unsecured creditors, and the Greek, German, and Italian systems do not provide for the kind of full priority that supporters

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26 These are the villains in Schwartz's analysis. *Id.* at 1399-1401.

27 Schwartz's only mention of tort creditors is found in footnote 2, which states that the Article "ignores involuntary creditors such as tort claimants." *Id.* at 1396 n.2. His conclusions apply only to legal relationships between borrowers and contractual creditors. *Id.*

28 Eisenberg & Sundgren, *supra* note 1.

29 *Id.*

30 Theodore Eisenberg & Shoichi Tagashira, *Should We Abolish Chapter 11? The Evidence from Japan*, 23 J. LEGAL STUD. 111 (1994).

of reform carefully protect in the Article 9 drafting process.[31] It is possible that the study of other economies that have not provided the same protection for the secured lender would yield some important insights about whether full priority is an essential feature of business lending.

It is unnecessary to stray so far from Philadelphia (home of the American Law Institute) to study systems of reversed priority. Admiralty law, for example, seems to support a commercially viable industry worldwide, and yet, under this system, neither wage claimants nor tort claimants wait behind secured lenders to recover for their injuries.[32] The inverted admiralty priority system is well known among all creditors, and there has been little cry that it causes either underinvestment in the industry or that it is unworkable. Lenders insist on adequate insurance and a sufficient showing of operating capital before they lend, thereby internalizing labor and injury costs. It appears that the markets have adjusted smoothly to this system.[33]

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31 *See generally* EUROPEAN CORPORATE INSOLVENCY 331 (Harry Rajak et al. eds. 1995) (Ireland) (stating that in France, employees' claims are given priority over those of secured creditors); Klaus Kamlah, *The New German Insolvency Act: Insolvenzordnung*, 70 AM. BANKR. L.J. 417, 434 (1996) (stating that "[t]here are no priority claims under Insolvenzordnung"); Jacob S. Ziegel, *Canada's Phased-In Bankruptcy Law Reform*, 70 AM. BANKR. L.J. 383, 409-10 (1996) (discussing the treatment of unpaid suppliers, farmers, and fishermen).

32 *See generally* 1 THOMAS J. SCHOENBAUM, ADMIRALTY AND MARITIME LAW §§ 9-1 to 9-9 (2d ed. 1994) (discussing maritime liens and mortgages). Under admiralty law, tort debt qualifies as a type of "maritime lien" which arises simultaneously with the service or occurrence that provides its basis. *Id.* § 9-1, at 484, 490. Other maritime liens include wages of the ship's master and crew, salvage operations, preferred ship mortgages, claims for breach of a charter party, claims under maritime contract for repairs, supplies, towage, pilotage, and a wide variety of other "necessaries," and pollution claims. *Id.* at 483-85. Maritime liens are nonconsensual and unrecorded. *See id.* at 490. The creditor has the right to seize the ship, have it sold, and seek repayment from the proceeds of the sale. *See id.*

Priorities among maritime liens assume significance in the event of a foreclosure and sale of a vessel accompanied by a lack of sufficient proceeds. The order of priorities is largely judge-made, "based on equitable considerations and the traditions of admiralty law." *Id.* § 9-6, at 507. According to Schoenbaum, the generally observed rankings are:

> 1. Expenses of justice while a vessel is *in custodia legis*. [Such expenses are held to be for the common benefit of the creditors.]. . .
> 2. Seamen's liens for wages, maintenance, and cure. . . .
> 3. Salvage and general average liens. [Their high ranking is based on the theory that the claimant's efforts have preserved the vessel.]. . .
> 4. Maritime tort liens. [The purpose is to protect innocent injured parties.]. . .
> 5. Contract liens.

Id. at 507-09. Other liens, including state created liens of a maritime nature, liens for forfeiture, perfected nonmaritime liens, including tax liens, are subordinated to the maritime liens. General creditors and other claimants are last. *See id.* at 509.

33 For a general description of lending in the shipping industry, see Mark M. Jaffe, *Chapter 11 Strategies and Techniques—Creditors Committees, Effective Use of Plan Provisions, Objections to Confirmation, Financing a Chapter 11 Case, "Cramdown" and How It Works*, 59 TUL. L. REV. 1298 (1985).

Causation is difficult to tease out of any empirical study. Comparisons across economies with hundreds of differences in both formal laws and operative rules governing the behavior of the economic actors make it particularly difficult to link different outcomes to particular differences in the legal system. Nonetheless, it is possible that American commercial law specialists can learn something from someone other than themselves. Other systems may have much to teach about laws that foster a thriving commercial system.

IV
WHEN THE EFFICIENCY ANSWER QUITS

There are a number of possible empirical questions that could inform the debate on full priority. Who are the creditors who profit from the current system, and who are those who lose? How much do the subordinate creditors lose? What are the effects of these losses on their businesses? What are the economy-wide effects of encouraging overleveraged businesses to continue operations? What are the effects of insulating secured creditors from the need to monitor the business operations of their debtors? The list grows quickly.

Nevertheless, one empirical question drives the debate. The question that arises again and again, both in the scholarly literature and public debates, is whether a partial priority system would reduce credit availability.[34] The empirical question quickly turns into the em-

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[34] It may be universally true that creditors will claim that any provision they oppose will cause a constriction of credit. E. Bruce Leonard, a noted Canadian practitioner and academic, gives the following account of the Canadian debates over changes in the bankruptcy laws:

> [T]here were massive changes to Canada's insolvency regime in 1992. We went from a system in which there wasn't even an automatic stay against secured creditors to a system that has moved toward a Chapter 11 position. In some respects . . . the Canadian system has additional disadvantages to secured creditors that are not found in Chapter 11. So, in a business and credit environment that is reasonably similar to that of the United States (largely common law, widespread acceptance of Article 9 concepts, etc.), there was a major shift in the position of secured creditors in reorganizations.
>
> We were all warned at the time that this would dramatically decrease the amount of credit available in Canada. Serious analyses were prepared to indicate that the multiplier effect in the contraction of credit would have a *major* influence on capital development and business formation in Canada. Did these predictions actually come true?
>
> My educated guess on the issue is that they did not. I would think that an analysis of statistics on credit availability and utilization would show a much higher availability of commercial credit in Canada now than before the 1992 changes. I would expect that the increase in capital availability out-paced economic growth in Canada during the same period . . . .
>
> If my suspicions are borne out by the evidence, the conclusion is pretty obvious. The change in the Canadian system in 1992 was much more profound and dramatic than the change that would be brought about by the carve out proposal. I think the answer may well be that suppliers of

pirical assertion that credit availability would diminish, thereby harming all business interests. The credit-constriction claim is the most forceful weapon in the arsenal of the proponents of full priority.[35]

While there may be no way of testing the credit-constriction assertion directly or measuring the magnitude or direction of the changes that would occur with partial priority, it is interesting to note how the assertion is treated as a debate stopper. If credit is reduced, the assumption runs, it will hurt commercial lenders and their borrowers, as well as their potential trade creditors. It will even threaten a robust economy.

The argument proves too much. If the only test of any part of a commercial law system were whether it promoted or constricted credit, then our system would look very different. Why not return to the days of debt servitude? There were efficiency concerns about servitude, but the bottom line was that servitude made credit available to people who otherwise could not obtain it. Nonetheless, it was gone by the early 1800s.[36]

If the goal of a commercial law system is expansion of credit, then perhaps the revisions of Article 9 should reflect changes in medical technology since the 1960s. Why not permit security interests in body parts? Any debtor who promised her liver or her heart would surely have strong incentives to perform on the loan. It would be possible to restrict security interests to body parts that leave the debtor diminished, but alive, such as offering a kidney, skin for a graft, a womb, or a cornea as collateral. It appears that the expansion of credit notion has not been embraced fully.

The idea here is not to give the current Article 9 drafters new ideas. Instead, the point is to note that even if a security device promotes lending, reasons not to support it may exist. Some of the reasons may be grounded in efficiency arguments. Some may be naked applications of paternalism. Some of the arguments may refer to community sensibilities and fairness. These concepts may be hard to

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> credit are able to thrive under virtually any system: they only need to have a fair and logical system of rules in place under which they can confidently operate.

Letter from E.B. Leonard, Cassels Brock & Blackwell, to the author, 1-2 (Apr. 4, 1997) (on file with author). Mr. Leonard then develops the thesis that one-lender models produce less lending and less capital investment than multiple-lender models. *Id.*

35 In defending their work, Harris and Mooney rely heavily on the purported diminution in financing. Harris & Mooney, *supra* note 2, at 1356-63. Although Baird does not argue in favor of full priority, he expresses concern that the costs of a project not begun because an entrepreneur could not get financing be included in any cost/benefit calculus. Baird, *supra* note 1, at 1420-21.

36 *See* PETER J. COLEMAN, DEBTORS AND CREDITORS IN AMERICA: INSOLVENCY, IMPRISONMENT FOR DEBT, AND BANKRUPTCY, 1607-1900, at 41, 77, 138, 147 n.11, 164-65, 218-19 (1974).

quantify in an equation full of sigmas and betas, but they have to do with our collective confidence in the commercial law system.

Even when the discussion is solely about money, the argument that full priority is justified whenever it promotes more lending still proves too much. Taxing authorities often take priority over secured lenders. For example, if property taxes are not paid, the government can foreclose on the property, hold a sale, and demand first distribution from the sale.[37] In other cases, the government agrees to come second behind perfected secured creditors,[38] even when such arrangements upset the priority scheme established in Article 9.[39] Surely such priority disturbances constrict credit extension. What lender would not claim that it would lend more, if only it did not risk being primed by a government authority?

In addition to the federal tax laws, state laws abound with priorities that permit certain protected groups to take priority over secured creditors. Statutory liens for everyone from automobile repair persons,[40] to launderers,[41] to cattle feed suppliers,[42] may trump the rights of the secured creditor. The full priority system gives full priority against only the unfavored groups who failed to persuade a legislature to pass a friendly statutory lien.

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37 *See* LYNN M. LOPUCKI & ELIZABETH WARREN, SECURED CREDIT: A SYSTEMS APPROACH 759-72 (1995).

38 *See generally* I.R.C. §§ 6321-6323 (1994) (providing the statutory framework for federal tax liens). Sections 6321 and 6322 govern the creation and duration of federal tax liens. Section 6323 provides exceptions to the "first in time, first in right" priority rules. Several of the provisions provide protection to those who lend money after the lien is filed. *See id.* § 6323(b) (granting some statutory liens priority over federal tax liens, even when those statutory liens arise after the federal tax lien is filed); *id.* § 6323(c)(2)(A), (C) (giving advances secured by commercial financing security, accounts, inventory, chattel paper, and mortgage paper made by the lender within 45 days after filing of the tax lien priority over the tax lien); *id.* § 6323(c)(4) (protecting lenders under obligatory disbursement agreements); *id.* § 6323(d) (protecting future advances made by secured creditors against federal tax liens); *id.* § 6323(e) (giving nonadvances equivalent protection against intervening tax liens).

39 *See* LOPUCKI & WARREN, *supra* note 37, at 776. The authors state:

> While this preexisting system of perfection and priority based on the principle of "first in time, first in right" is in most respects consistent and coherent, it is not entirely so. As our consideration of federal tax liens illustrates, the rules governing this system are made by different governing bodies and typically regulate competitions one by one. That is, they do not tell us the priority of *A* in relation to other liens. Instead, one rule tells us that *A* has priority over *B* and another, perhaps written and enacted by different bodies at different times, may tell us that *B* has priority over *C*. It is not safe to assume from these two rnles that *A* will have priority over *C*. The rules may simply be inconsistent.

Id.

40 *E.g.*, ME. REV. STAT. ANN. tit. 10, § 3801 (West 1964).

41 *E.g.*, ARIZ. REV. STAT. ANN. § 33-1021.01(A) (West Supp. 1996).

42 *E.g.*, FLA. STAT. ANN. §§ 713.50 - 713.65 (West 1988 & Supp. 1997).

Federal bankruptcy law is the ultimate partial priority system. The rights accorded the trustee in bankruptcy to stop foreclosure and repossession, to strip down security interests, and to distribute the debtor's remaining assets pro rata in contravention of a security agreement, create perhaps the most frequently encountered partial priority scheme in commercial law. A few scholars would like to see bankruptcy laws amended to permit parties to contract out of bankruptcy, and thereby contract into the full priority scheme of Article 9.[43] Nonetheless, the idea has attracted little attention outside the rarified atmosphere of academia.

The incursions on priority in tax law, in statutory liens, and in bankruptcy, make clear that fostering as much lending as possible is not the only goal of any commercial law system. The goal is always one of balance. Taxing authorities get priorities, in part because of a judgment that a business that cannot meet its tax obligations should not be operating. Cattle feed suppliers get a priority, in part because they add value in a way that makes it virtually impossible for them to take a protected interest through any other method. Employees may take priority because they are poor risk spreaders. And so on. Bankruptcy law takes precedence over contractual agreements, in part because the rights of third parties to pro rata distribution at liquidation cannot be negotiated away without consent.

The ultimate question is not whether a partial priority scheme might cause some constriction in lending. That empirical question remains open, although there are strong arguments both to refute and to support the idea that available total credit would remain the same. The real question is how the efficiency arguments, even if they were unambiguously true, stack up against other considerations.

V
Other Costs to Consider

Debates over the Carve Out Proposal have prompted a spirited dispute over who should bear the costs of full priority and whether those costs should be internalized to the operation of a business.[44] I will not repeat those arguments here, notwithstanding my own strong views on how they should influence the policy debates. I made my

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43 *See* Barry E. Adler, *Finance's Theoretical Divide and the Proper Role of Insolvency Rules*, 67 S. Cal. L. Rev. 1107 (1994); Robert K. Rasmussen & David A. Skeel, Jr., *The Economic Analysis of Corporate Bankruptcy Law*, 3 Am. Bankr. Inst. L. Rev. 85 (1995).

44 *See* Lisa M. Bossetti & Mette H. Kurth, *Professor Elizabeth Warren's Article 9 Carve-Out Proposal: A Strategic Analysis*, 30 UCC L.J. 3 (1997); Kenneth N. Klee, *Barbarians at the Trough: Riposte in Defense of the Warren Carve-Out Proposal*, 82 Cornell L. Rev. 1466 (1997); Jeffrey S. Turner, *The Broad Scope of Revised Article 9 Is Justified*, 50 Consumer Fin. L.Q. Rep. 328 (1996); Hugh Ray, *Losing 20 Percent of Your Lien—Automatically*, Tex. Law., June 10, 1996, at 26.

position unambiguously clear when I delivered a draft of a carve out provision to the Council of the American Law Institute after the Article 9 Drafting Committee refused to give the Council a model provision they might consider. Instead of repeating that debate here, I offer instead a few speculations about the consequences of the Article 9 priority system we have created.

Any legal rule will cause some redistribution of wealth. A rule of ownership, a rule of liability, or a rule of priority will relatively advantage or disadvantage competing parties. In Article 9, no one disputes that a rule of full priority will advantage commercial lenders and disadvantage tort creditors. Trade creditors are in a more ambiguous position. Some may be fully adjusting creditors, so that they are indifferent to the choice of priority systems. Others may be nonadjusting in short-run pricing, but more interested in seeing new businesses financed which will provide new markets for their goods. Still others may be nonadjusting and unable to survive the impact of overleveraged customers that fail without paying their bills. Employees may be in a similarly ambiguous position. They need capital formation to produce jobs, but they are generally unable to adjust to (or, in some cases, even to monitor) the extent of their employers' ability to make promised contributions to their pension funds and to meet other financial obligations. Thus, in a full-priority system, secured creditors win, trade creditors and employees may win or lose, and tort victims lose.

What is remarkable about the Article 9 system is the consistent direction of the redistributive impulse. To the extent that the rules create any redistribution among creditors of a failing business, the system directs resources away from creditors who are involuntary, underrepresented, and least able to spread their losses. Instead, value is directed toward lenders who are entirely voluntary, best able to protect their rights, and best able to spread their risks among numerous projects. This is a remarkable step in American commercial law, made all the more remarkable by its support from such august institutions as the American Law Institute.

A second implication of the full priority system is also worth considering. The power of secured creditors is apparent even in the institutions that serve to equalize distributions among creditors. A full priority system of secured credit permits some creditors to make a partial opt out from the bankruptcy system. The impulse that equity-is-equality in bankruptcy takes shape in the analogy between failing businesses and sinking ships.[45] The impulse to salvage whatever can be

45 *See* Scott, *Relational Theory*, *supra* note 5, at 968 n.248. According to Scott:

> The basic principle underlying general average is that if a vessel loaded with valuable cargo should founder at sea, the captain may make necessary sacri-

salvaged is paramount, and the distribution of benefits and losses falls pro rata on all those who entrusted their cargo to the now-failing ship. Bankruptcy adopts this approach, but carves out a huge exception for the secured creditor.

Notwithstanding the features of bankruptcy that curtail the power of the secured creditor, the ability of the secured creditor to demand adequate protection and to insist on a priority repayment of assets effectively gives the secured creditor the power to block a reorganization.[46] If the creditors collectively might be better off with the business as a going concern, secured creditors can nonetheless insist on liquidation, unless they receive their statutorily protected treatment.[47] Every strengthening of the secured creditors' rights outside of bankruptcy redounds to a more lopsided distribution inside bankruptcy.

In bankruptcy, the warring nature of the creditors—secured versus unsecured—comes to the foreground. Secured creditors want their assets now, even if it means killing a going concern. They battle with unsecured creditors, who view the remaining assets as a last-ditch chance to recover something for the value they contributed to the business. Priority creates a conflict among the parties dealing with a failing debtor. It deflects the parties from the goal of reorganization—enhancing the total value of the business. With priority, the parties do not work together to make certain that whenever liquidation or reorganization could squeeze more value from a debtor business, the money is in fact squeezed out. If all creditors shared on a pro rata basis in bankruptcy, one can only speculate on how the focus of bankruptcy reform might be redirected.

A better, more effective Article 9 would simply favor secured creditors over unsecured creditors at the expense of a collective determination of what steps produce the greatest value for all creditors. The effects of this point are felt as much in negotiation as in formal law. To the extent that bankruptcy reorganizations proceed by agreement among claimants, every move to make the priority of security interests more complete, to insulate them from errors in filing or failures in documentation, and to enhance the scope of the property the agreement covers means that the parties negotiating in the combined shadow of Article 9 and bankruptcy will settle on arrangements that give more to secured creditors and less to the unsecured. This means, at the margin, fewer reorganizations or sales of going concerns will

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> fices of the cargo or the vessel to prevent the ship and cargo from sinking altogether. All parties involved in the voyage will contribute to the general average expense according to their percentages of ownership.

Id.

46 *See* 11 U.S.C. §§ 362(d), 506(c), 1129(a)(9) (1994).

47 *See* § 1129(a)(9).

occur, even when such approaches would yield the highest value to the creditors collectively.

There are other broad policy implications of full priority. When well-organized, amply-funded lenders can opt out of the baseline debtor-creditor system (the state-law "race of diligence"), there must be some effect on the development of that collection system. At a time when most creditors relied only on the ordinary state-law collection system, did the system offer a fair opportunity for creditors to be heard, for debtors to air their cases, and for judges to consider questions thoughtfully and fully? Some historical evidence suggests that the system did.[48] As the powerful players opted out of this system, and relied on priority agreements and self-help, what has become of the state collection system? Practices are arcane, costs are prohibitive, and much of the courts' business is the routine administration of confessions of judgments against unrepresented debtors, rather than the effective enforcement of creditors' rights.[49]

If the powerful players were forced to use the ordinary debt collection system, would the system look different? Would the *Wall Street Journal* write exposés of court delays and poor collection practices that a hopelessly outdated system fosters? Would the American Law Institute commit considerable resources to revising and streamlining the system? Would law professors put their enormous talents and creativity into creating models for the merchant courts that were the dreams of Karl Llewellyn? Maybe not, but the thought experiment is entertaining.

Another consequence of the full priority system is the frequent incursion of statutory liens that increasingly undercut it. As secured creditors grab more assets and finance more businesses that operate on ever-thinner margins, groups of unsecured creditors have organized for their own revenge. State laws are now choked with special-interest liens.[50] Sometimes the liens trump the Article 9 security interests, and sometimes they serve only to put the favored group ahead of the mob of unsecured creditors.[51] In any case, the new laws result from straight power politics. There is little principled guidance to explain why one group gets a lien and another does not. The effect, of course, is to undo the universal and facially neutral balance of the uniform commercial laws, substituting a grab bag of special inter-

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48 For a discussion about debt litigation in the colonial era and a description of the speed and responsiveness of the legal system, see generally BRUCE H. MANN, NEIGHBORS AND STRANGERS: LAW AND COMMUNITY IN EARLY CONNECTICUT 11-46 (1987).

49 *See* William J. Woodward, Jr., *New Judgment Liens on Personal Property: Does "Efficient" Mean "Better"?*, 27 HARV. J. ON LEGIS. 1, 1-2 (1990).

50 *See supra* notes 40-42 and accompanying text.

51 *See* LOPUCKI & WARREN, *supra* note 37, at 743-50 (discussing the relative priority of statutory liens and security interests).

ests.[52] In the world of every group for itself, the groups not represented decline in number and fall further and further behind the rest of the creditors as they are left to fight over the smaller and smaller bones that remain.

Partial priority would not eliminate the conflicts and concerns raised here, but adherents to a full priority system must pause to consider other ramifications of making creditors' conflicts with each other sharper than their conflicts with the debtor.

VI
BUT THE COSTS ARE UNAVOIDABLE

Professor Baird embraces the idea that policymakers should consider distributive considerations as well as efficiency concerns.[53] However, he expresses concern that any move to limit the rights of secured creditors might result in secured creditors' simply redoubling their efforts to move assets out of the reach of unsecured creditors through other means.[54] Professor LoPucki takes a stronger view of this position in his doomsday piece, *The Death of Liability*,[55] in which he concludes that the combination of computers, global communication, and creativity means that no company need subject itself to any liability if it merely structures its deals in such a way as to avoid paying unsecured creditors.[56]

The argument is a fair one. What is the point of changing the law if well-informed parties can slip around it with ease? The fact that some people may escape does not mean that policymakers should be indifferent between endorsing parties' ability to tie up all the assets of a business and indicating that the parties should count on some balanced distribution between secured and unsecured creditors. The failure to make this choice is to embrace, as a policy matter, one group of well-positioned creditors over all others. That policy statement is significant, both in the interpretation of case law and in the

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52 Secured creditors have begun to awaken to the fact that security interests can be threatened by statutory liens. They have enlisted the American Bar Association to recommend that statutory liens be brought within the ambit of Article 9. *See Inclusion of Nonpossessory Statutory Liens in Article 9*, 1996 A.B.A. BUS. L. SEC. 2 (draft copy, on file with author). To make the move politically palatable, they suggest such liens retain priority over all other unsecured creditors. *See id.* As for carve outs from the interests of secured creditors, however, they are clear: Article 9 priority remains triumphant. *See id.* A statutory lien should beat an Article 9 lien only if the creditor filed the interest ahead of the secured creditor—effectively transforming it into another Article 9 security interest. *See id.* The apparent intent of the move is to undercut the expansion of statutory liens into the territory dominated by secured creditors.

53 Baird, *supra* note 1, at 1420, 1426-28.

54 *Id.* at 1433-34.

55 LoPucki, *supra* note 11.

56 *Id.*

ultimate development of other laws governing commercial transactions.

The problem of shielding assets is a quickly emerging issue for the commercial-law world. Asset securitization, an unknown concept a few years ago, now flourishes as a tool in certain lending transactions to "bankruptcy-proof" security interests.[57] Commercial law may support such moves or may eventually conclude that these efforts are inappropriate. Similar to the manner by which the common law developed the doctrine of piercing the corporate veil when companies began to use the corporate form to foist losses onto their victims, both courts and legislatures may become more willing to consider enterprise liability to govern the activities of large business entities.[58]

This Article is not the place to replicate the vigorous debates elsewhere in business and corporate law about whether companies' ability to escape liability should be curtailed, and what are the best methods for curbing these efforts.[59] However, this Article is the place to say that the issue is one worthy of concern in determining how to draft a commercial law provision, but it should not be an argument for failing to do whatever a policymaker believes is right.

VII
How to Decide

For many years, commercial law has been as riven with the notion of "theory versus practice" as any other area of law. Conferences such as this one demonstrate that the dichotomy is false. Today, the theorists among us have begun to frame empirical questions, while the most practice-oriented argue the theoretical foundations of their positions.

Although today's commercial law debates are better than those of the past, they have not yet reached nirvana. Data are not available to inform the debates. The efficiency disputes remain unresolved. Law revision cannot wait for academics to resolve their disputes. In the face of deep conflicts and imperfect information, perhaps an approach based on a litigation model would be fruitful.

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57 *See generally* Marsha E. Simms, *Asset Securitization*, *in* Asset-Based Financing, at 321 (PLI Com. Law and Practice Course Handbook Series No. 739, 1996); Robert R. Veach, Jr., *Securitization of Assets*, 30 Bull. Bus. L. Sec. St. B. Tex. 23 (1993).

58 Professor Blumberg has been pushing for this move for several years. Phillip I. Blumberg, The Law of Corporate Groups, §§ 1.03, 2.01-2.14 (1985).

59 *See, e.g.*, Frank H. Easterbrook & Daniel R. Fischel, The Economic Structure of Corporate Law 61-62 (1991) (considering whether involuntary unsecured creditors should be able to sue management); Henry Hansmann & Reinier Kraakman, *Toward Unlimited Shareholder Liability for Corporate Torts*, 100 Yale L.J. 1879, 1933-34 (1991) (arguing that involuntary unsecured creditors should be permitted to pierce the corporate veil); S. Shavell, *The Judgment Proof Problem*, 6 Int'l Rev. L. & Econ. 45, 54 (1986) (requiring firms to provide adequate insurance to cover their tort victims).

The presumption underlying common-law decisionmaking is that the best outcome over time is likely to be reached when two well-informed parties who have a stake in the outcome make their best possible arguments to a neutral decisionmaker. No one case may be perfectly decided, but our system is founded on the belief that the two-disputants model will get us to the right decision more often than not.

That lesson is instructive here. Full priority rules have created two classes of interested parties—those who profit and those who lose from a full-priority regime. The group that profits from priority is well-funded and active, fully represented in all the policy debates and in the decisionmaking bodies. Their representatives are present at every drafting committee meeting and debate on the subject. If they—and all their academic supporters—make a persuasive case, they should win. But if they do not, then the party who has not had the opportunity to make its case should win. In the case of a tie, the unfunded, the unheard, and the unorganized should be declared the winners.

It is difficult to know what is missing from this debate about priority. The lawyers of commercial lenders ably explain their views about how a shift away from full priority will cause their clients to alter their lending practices and constrict credit, thereby hurting all businesses. They amass testimonial letters[60] and do not lack for supporters. Rhetorical devices flourish.[61] Professors Harris and Mooney even play a race card in the debates.[62]

If utility companies were equal partners in the debates, what might they say about their ability to adjust their prices to account for

60 In his role as the ABA Advisor to the Article 9 Drafting Committee, Steven O. Weise collected 25 responses to a request for comments on the Carve Out Proposal. Uniform Commercial Code Article 9 Revision: Comments on Professor Warren's Proposal, Collected by Steven O. Weise, Heller, Ehrman, White & McAuliffe 2 (on file with author). He sent a full set of those responses to the Drafting Committee and officials of the American Law Institute. With the exception of three lone academics—one who favored the Carve Out Proposal, one who criticized it, and one who did not draw a conclusion—all the authors who identified their professional affiliations said they worked with secured creditors. No one said they received their business from unsecured creditors, trade debt, employees, or tort victims.

61 One letter expressed the suspicion that there was "another agenda behind the proposal—such as plaintiff lawyer fees." But the author generously conceded that this response was "too cynical a view." Memorandum from Richard B. Smith to Steve O. Weise 1 (June 4, 1996) (on file with author). In the compendium of letters amassed by the Drafting Committee, there were not any letters from tort lawyers.

62 Harris and Mooney state: "For example, data may confirm that small businesses (and, accordingly, minority-owned businesses) would disproportionately comprise that group [that would face constriction of credit]." Harris & Mooney, *supra* note 2, at 1371. Their support? Anecdotal evidence. *Id.* n.95. This argument can be rephrased to say that banks want full priority to help their minority friends. Some critics may demand more than anecdotes to support this proposition.

their subordinate position when a debtor fails? What might suppliers say about their own business failures when their over-leveraged customers consume their goods and services, then hand over all their assets to commercial lenders when they collapse? What might employees say about their efforts to support a Chapter 11 reorganization that is thwarted by a commercial lender who has the right to sell off all the hard assets of an intact business? What might tort victims say about businesses that remained operational without adequate insurance or capital, producing the goods and providing the services that injured them?

Until we know all the stories from all sides, until all the empirical evidence is in, until one theoretical approach predominates, it might be appropriate to hesitate to expand the reach of commercial lenders. Only one party dominates the debate, but the case for full priority remains unproven. In such circumstances, it would not be precipitous to consider rebalancing the playing field to offer something to the unrepresented.