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The Politics of Article 9

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THE POLITICS OF ARTICLE 9

Robert E. Scott*

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* Dean and Lewis F. Powell, Jr. Professor of Law, University of Virginia. I am thankful to Barry Adler, Clay Gillette, Tom Jackson, Saul Levmore, Fred Miller, Don Rapson, Steve Walt and Jim White for their helpful comments on prior drafts. Many of the ideas leading to this article were formed during my service as a member of the Permanent Editorial Board Study Group on Article 9. My colleagues on the Study Group will all concur with my judgment that the experience was enormously satisfying as a debate among experts over how best to implement the fundamental goals of Article 9. Few, if any, share my view that the fundamental norms themselves have been insufficiently vetted in the legislative process. In any case, as my argument suggests, the reason for this omission is structural and does not reflect any failure of effort or good will on the part of the Study Group membership.
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INTRODUCTION

In the ongoing debate concerning the efficiency and social value of Article 9 of the Uniform Commercial Code, two points are beyond dispute. First, asset-based financing has undergone an enormous transformation since the enactment of Article 9. The most vivid illustration of this is the dramatic increase in the number and size of firms that rely on secured credit as their principal means of financing both ongoing operations and growth opportunities. Previously, with a few exceptions (such as factoring and trust receipts), secured financing principally had served second-class markets as the “poor man’s” means of obtaining credit. Now, it
has become the linchpin of private financing, prompting even large firms to employ leveraged buyouts as a means of fleeing public equity markets for the safe harbors of Article 9. When viewed in these terms, Article 9 can only be seen as a blazing success.¹

No less debatable is that financial institutions, and those sympathetic to their needs, played a significant role in the drafting and ratification of Article 9. Grant Gilmore has described how conservatives in the legal establishment decided in the 1960s to throw their support behind the same U.C.C. they had considered overly radical ten years before.² Earlier, when the U.C.C. project had just gotten underway after World War II, Homer Kripke, then associated with C.I.T. Financial Corporation, served as a key advisor to Gilmore and the other drafters of what eventually became Article 9.³ In addition, Kripke served as the principal drafter for what became the 1972 revision of Article 9.⁴ And, in the campaign to pass the U.C.C. in the 1960s, William Schnader, a strong proponent of the Code, was hesitant to incorporate amendments suggested by academics, but, as Robert Braucher humorously noted, “was quite sympathetic with people who were suggesting amendments, where [they] were people who had power to keep the Code from getting enactment.”⁵

All this is not to impugn the motives of the managers of financial institutions, or the business lawyers who represent their interests, or to accuse either group of a conspiracy to infiltrate the lawmaking process and shape the Code to their advantage. Indeed, while recognizing the significant role played by financial institutions and their representatives in the Article 9 drafting process, Gilmore

¹ Small businesses show a particularly keen preference for secured credit. One survey of about 500,000 small firms showed that 62% of the respondents’ debt was secured for the years in question. Alan Schwartz & Robert E. Scott, Commercial Transactions: Principles and Policies 547 (2d ed. 1991).


³ Grant Gilmore, Dedication to Professor Homer Kripke, 56 N.Y.U. L. Rev. 9, 11 (1981); Patchel, supra note 2, at 130 n.207.

⁴ Gilmore, supra note 3, at 14.

recalled that they acted honestly and in good faith.\textsuperscript{6} And it is quite clear that Homer Kripke indeed believes that "the legal structure of secured credit developed to make possible mass production and the distribution of goods" and "that these developments have increased human welfare."\textsuperscript{7} Nonetheless, the enthusiasm that secured lenders showed for Article 9 begs the question of why they found it so attractive.

Two partial explanations emerge. First, Article 9 imposed certainty and uniformity onto a field previously characterized by quirky, indeterminate, and widely varying rules. As Grant Gilmore wrote, "[p]re-Code personal property security law may be described as closely resembling that obscure wood in which Dante discovered the gates of hell."\textsuperscript{8} The emergence of Article 9's scheme of bright-line rules to regulate asset-based financing let both prospective creditors and debtors feel secure that the new system provided laws superior not only to the quagmire of regulations that previously governed the field, but to other entirely different methods of financing as well. There is an undoubted core of truth to this explanation. The preexisting regime of pigeonholed classifications, each with its own filing system and/or special sets of rules, created unnecessary costs as well as traps for the unwary, and left—under virtually any rationale—odd holes in coverage and scope.

The second explanation, also undoubtedly true in part, is that Article 9 unabashedly promotes the institutionalization of secured credit; it not only regularized what was there but vastly expanded it, both in explicit coverage and in a dramatic lowering of costs. The "floating lien" (especially in the protection provided to future

\textsuperscript{6} Grant Gilmore, The Good Faith Purchase Idea and the Uniform Commercial Code: Confessions of a Repentant Draftsman, 15 Ga. L. Rev. 605, 626 (1981) ("The finance companies and banks were effectively represented in the drafting of article 9. It may be tempting to conclude that article 9 was a sell-out to these predatory interests. So far as my own memory goes, nothing of the sort took place.").

\textsuperscript{7} Homer Kripke, Law and Economics: Measuring the Economic Efficiency of Commercial Law in a Vacuum of Fact, 133 U. Pa. L. Rev. 929, 931 n.14 (1985). In the same article, Kripke wrote: "I confess to a prejudice in favor of secured chattel financing going beyond that of most conventional teachers of commercial law. I have a vested intellectual interest . . . ." Id. at 933 n.21.

\textsuperscript{8} Gilmore, supra note 6, at 620.
advances financing) and, to a lesser extent, the purchase money security interest ("PMSI") serve as key evidence for this point. Both essentially exempt certain secured creditors from important features of Article 9's general "first-in-time" priority rule, giving such creditors a favored status compared to other secured and unsecured creditors. Moreover, both classes of creditors are afforded relatively lenient filing requirements for preserving their priority claims to the debtor's assets.

When one views Article 9's dual characteristics of certainty in results and partiality towards some secured creditors, the reason for the enthusiasm of financial institutions becomes clear. The new scheme provided secured lenders a regulatory system that not only reduced uncertainty in general, but settled many of the longstanding doubts in their favor.

The term "floating lien" is a shorthand reference to a series of Article 9 provisions including U.C.C. § 9-201 (1990) (concerning general validity of security interest), id. § 9-204(3) (authorizing future advances financing), id. § 9-205 (use or disposition of collateral without accounting), id. § 9-306 (concerning secured party's rights on disposition of collateral), and id. § 9-312(7) (giving future advances priority as of the date of original filing).

U.C.C. § 9-204(1), the main provision that governs the floating lien, states: "Except as provided in subsection (2), a security agreement may provide that any or all obligations covered by the security agreement are to be secured by after-acquired collateral."

U.C.C. § 9-107 defines a PMSI, § 9-312 sets out the PMSI "superpriority" status, and §§ 9-301(2) and 9-302(1)(d) govern PMSI filing regulations.

The floating lien permits a creditor to take a blanket security interest in all of the debtor's collateral, whether presently held or after-acquired, to serve as security for both present as well as future uncommitted advances. Moreover, the financing statement that the creditor files to insulate this blanket security from third parties needs to contain only a bare description of the collateral. U.C.C. §§ 9-110, -402. Thus, the floating lien essentially gives the secured creditor the opportunity to gain exclusive control over all a debtor's financing opportunities; he is exempted from Article 9's basic "first-in-time" priority system.

The PMSI provisions function in a similar manner. These rules guarantee that purchase money lenders will, generally, receive favored treatment in relation to all other creditors, secured or unsecured, during insolvency proceedings. See, e.g., 11 U.S.C. § 547(c)(3) (1988). Again, PMSI creditors need not submit to the limitations of the general first-in-time rule. U.C.C. § 9-312.

The history of the floating lien illustrates this point well. The judiciary in the nineteenth century substantially resisted granting of priority in advance of the debtor's ownership of particular collateral, reasoning that was justified in part (at least at the turn of the century) by the notion that certain parts of a business, notably inventory and receivables, should be left available for general creditors. Thus, in Zartman v. First National Bank, 82 N.E. 127, 128 (N.Y. 1907), the New York Court of Appeals stated that a court of equity "will not [enforce] a contract to give a mortgage upon a subject to come
It is not my purpose in this essay to revisit the debate over whether the legal regulation of secured financing promotes efficiency,\textsuperscript{13} for that debate has proven inconclusive.\textsuperscript{14} Rather, I aim to broaden the terms of the debate by investigating how such a statute came to exist, focusing on the lawmaking process that cre-

\textsuperscript{13} The bulk of the literature examining the efficiencies of Article 9 has appeared in the last 15 years. For a review of the initial debate, see Thomas H. Jackson & Anthony T. Kronman, Secured Financing and Priorities Among Creditors, 88 Yale L.J. 1143 (1979); Saul Levmore, Monitors and Freeriders in Commercial and Corporate Settings, 92 Yale L.J. 49 (1982); Alan Schwartz, A Theory of Loan Priorities, 18 J. Legal Stud. 209 (1989) [hereinafter Schwartz, Theory of Loan Priorities]; Alan Schwartz, Security Interests and Bankruptcy Priorities: A Review of Current Theories, 10 J. Legal Stud. 1 (1981) [hereinafter Schwartz, Security Interests]; Robert E. Scott, A Relational Theory of Secured Financing, 86 Colum. L. Rev. 901 (1986). A comprehensive rebuttal to Schwartz’s criticism is provided by Professor Kripke. See Kripke, supra note 7. For a response to these arguments, see Thomas H. Jackson & Alan Schwartz, Vacuum of Fact or Vacuous Theory: A Reply to Professor Kripke, 133 U. Pa. L. Rev. 987 (1985). The debate continues, virtually unabated, to this day. See the articles in this Symposium and the articles cited infra note 57. I summarize the substance of this debate infra Part I.

\textsuperscript{14} It is worth noting that this debate derives from the famous “irrelevance theorem” of Franco Modigliani & Merton H. Miller, The Cost of Capital, Corporation Finance and the Theory of Investment, 48 Am. Econ. Rev. 261 (1958). The irrelevance theorem holds, in short, that the cost of capital is independent of a firm’s capital structure and that the level of investment will be unaffected by the type of security used to finance the investment. See id. at 268–69, 288. Thus, absent taxes or bankruptcy costs, the particular mix of debt or equity held by a firm has no effect on the firm’s value. From this it follows that with homogeneous, risk neutral creditors possessed of perfect information, a system of secured credit operates as a zero sum game. Under these conditions, the benefits to one creditor from taking security are exactly offset by the increased cost imposed on unsecured creditors whose claim to the debtor’s pool of assets has been correspondingly diminished. Scott, supra note 13, at 902. This suggests that any benefits that one group of creditors derive from Article 9 must come with associated losses to another group. Id. However, the formulation of the irrelevance theorem followed the drafting and general enactment of Article 9. Whatever the views of those working on Article 9, they were not informed by a particular view of how secured credit survives the challenge of the irrelevance theorem.
ated and later amended the U.C.C. In doing so, I hope to reveal connections between the institutional framework of the U.C.C. and the substantive provisions of Article 9.

This exercise seems particularly worthwhile because the U.C.C. Article 9 Study Group has recently completed its report of suggested revisions, and a Drafting Committee has been appointed to craft suggested revisions into statutory form. The Study Group Report will provide the blueprint for the revisions that will ultimately be proposed to state legislatures for ratification. Before this process continues, it is important to understand how the U.C.C.'s peculiar institutional framework has produced the salient features of Article 9, and how those features are likely to be affected by forthcoming revisions.

The results of the current revision process constitute the logical extension of a fundamental dichotomy in Article 9. On the one hand, the filing system has been celebrated as the fulcrum of Article 9, acting essentially as a certificate of good faith. It signals to less informed creditors that they may engage in secured financing on a level playing field with better informed creditors, because each must abide by the strictures of the filing system. On the other hand, Article 9 contains provisions, such as those institutionalizing the floating lien and PMSI priority, that allow certain classes of creditors to escape many of the constraints of a first-in-time filing system. Not surprisingly, as the filing system has become increasingly cumbersome, informed financers have become less willing to tolerate it. Thus, the institutional structure that produced Article 9's celebrated success contains the seeds of its own disintegration.

In Part I of this Article, I review the institutional forces that shape the regulation of secured financing. I identify the salient features of Article 9 and explore the underlying tension between the interests of informed creditors and other financial "insiders" and the interests of less informed or occasional participants in credit arrangements. This tension manifests itself most vividly in the filing rules and their exceptions.

Part II analyzes the nature and effects of the private lawmaking process that has produced Article 9 and its revisions. I develop an informal model for analyzing the political economy of the private law reform groups that have created the U.C.C. The model identifies the conditions under which this private lawmaking process may
be susceptible to disproportionate influence from affected interest groups. Interest group activity will have varying effects on proposed legal rules depending upon the presence or absence of competition among the interest groups. When only a single, dominant interest group participates in the lawmaking process, such a group will have a greater influence on the outcomes of these private lawmaking bodies than it would have on ordinary legislative outcomes.\footnote{This analysis of the effect of interest group activity developed in this paper is consistent with a formal model of private law reform groups that I have developed in collaboration with Alan Schwartz. See Alan Schwartz & Robert E. Scott, The Political Economy of Private Legislatures 143 U. Pa. L. Rev. (forthcoming 1994) (on file with the Virginia Law Review Association).}

Part III tests the model against the revisions to Article 9 proposed by the Study Group Report. I argue that the expansion of purchase money security interests, the expanded conception of proceeds, and the erosion of the filing system, as well as other key proposals, substantially support the interest group analysis. The effects of industry influence on the Study Group are twofold. First, the influence of a single, cohesive interest group generates a statutory commitment to normative objectives that benefit the affected group. Second, this consensus produces statutory provisions characterized by admirably clear and precise bright-line rules.

To conclude that the revisions proposed by the Article 9 Study Group represent the preferences of asset-based financers and banks is not to condemn the efforts of those deliberations. So long as the interests of those groups are sufficiently aligned with the public interest, interest group influence is benign. By producing bright-line rules and increasing certainty, such products can help promote the common good. But if the private lawmaking bodies that ultimately promulgate the Article 9 revisions are more susceptible to influence than ordinary legislatures, then it follows that their products are also more likely to result in special interest legislation.\footnote{Again, the irrelevance theorem does not suggest that secured credit is socially bad, except that it may introduce unnecessary transaction costs into the system. See Schwartz, Security Interests, supra note 13, at 33. Additional explanations of why secured credit should be reformed or eliminated (such as corrective justice rationales) have, like the positive case for secured credit, proven inconclusive. Id. at 34-36.}
I. THE INSTITUTIONAL STRUCTURE OF ARTICLE 9

A. The Legal Regulation of Secured Financing

A starting question is why the legal regulation of secured credit, beyond the rules of basic contract law, is necessary in the first place. Even assuming that secured credit is efficient, and thus should be allowed, why is it necessary to regulate it at all? The answers to these questions suggest the contours of a legal regime that is designed to minimize the inefficiencies of secured credit.

Virtually all explanations for the contours of the legal regime focus on controlling misbehavior. The most common explanation for the legal regulation of secured credit, ultimately unsatisfactory by itself, looks to the filing system as providing information to other creditors to control a self-interested debtor's incentive to lie concerning the extent of prior existing claims. But what is in the files is of little benefit to general creditors (who can be trumped by subsequent filings). Thus, the justification for the filing system must come from the efficient provision of information about secured creditors to other secured creditors.17

A more detailed focus on the precise forms of debtor misbehavior suggests that the benefits of the general rules of Article 9 are designed as much to protect the secured party itself from misbehavior as they are to protect it from other secured parties.18 Four main types of misbehavior by a debtor can be identified. Perhaps the most widely recognized is "asset substitution," which occurs when a debtor, having issued secured debt for a business venture of a certain risk, proceeds to engage in a riskier project. Having negotiated a fixed price loan contract, the debtor is essentially free to gamble with the creditor's funds, so that the debtor alone reaps any rewards from a successful wager, but shares any loss with the creditor.19 A second and more blatant form of misbehavior occurs

18 The following discussion of relational theory and debtor misbehavior is derived from Scott, supra note 13. The article's argument, in sum, is that blanket security interests function as relational contracts akin to licensing or franchising contracts, and secured credit provides the secured party with sufficient leverage to exert control over the debtor's investment decisions prior to bankruptcy.
19 Levmore, supra note 13, at 52.
when a debtor converts business assets to private use. Third, a debtor may dilute the creditor's claim. This occurs when a debtor issues additional debt on the same collateral that, upon default, will compete with the initial creditor's claim.

These first three forms of misbehavior can occur in all debt contracts, and a variety of legal rules (such as fraudulent conveyance law) exist to respond to them. A final type of misbehavior, underinvestment, is peculiar to exclusive financing arrangements and is much harder to thwart through traditional legal regimes. Underinvestment occurs when a debtor, having recouped a portion of its investment in a joint venture with a creditor, siphons off its resources to other projects from which it will reap more of the gain. The debtor will act in this manner even if further effort in the joint venture would enhance the firm's net worth. Traditional legal remedies are difficult to employ against this type of behavior.

Article 9 helps to combat these problems. For instance, the floating lien serves as an efficient means of reducing the risk of underinvestment. The combination of exclusive financing and blanket security gives the creditor the power to "turn off the spigot" at any time, thereby threatening the viability of the business project. This "leverage" affords an exclusive financing creditor the means of combating the underinvestment problem, because once it discovers the debtor's inadequate efforts, it can credibly threaten to impose effective sanctions. The floating lien

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20 Id.
21 Scott, supra note 13, at 920; Robert E. Scott, Rethinking the Regulation of Coercive Creditor Remedies, 89 Colum. L. Rev. 730, 745 (1989).
22 Scott, supra note 13, at 920-25.
23 Id. at 926-27.
24 Here, "leverage" is used in its traditional sense; it is the power gained by using a lever to apply force at one point in order to exert greater force at a second point. Indeed, empirical evidence suggests that certain secured lenders value collateral almost exclusively for the leverage that it offers. According to one bank officer, "No bank I know would make a loan against a basket of gold bricks if there was a good chance it would have to sell the bricks." Id. at 944; see also Schwartz & Scott, supra note 1, at 682 ("[S]ecurity places the lender in a stronger negotiating position because the assets are usually necessary to operate the business . . . .").
25 The leverage provided by security, however, does not totally solve the problem, because the creditor must still monitor the debtor to see if the debtor is misdirecting its efforts. Such misbehavior can be exceedingly difficult to detect.
also aids the creditor in controlling any risky end-game strategies that the debtor might undertake when facing bankruptcy.

The legal regulation of secured debt is justified to the extent that it prevents the costs of these various forms of misbehavior from being imposed on third parties. One way of regulating misbehavior, common to most tort regimes, is to encourage optimal precautions by parties with the comparative advantages in reducing the regulated harm. Article 9 approaches the problem from a markedly different perspective. Instead of seeking to encourage optimal precautions at the margin, Article 9 seeks to regulate the information available to parties who are financing a particular debtor. Armed with full information, the parties themselves can make efficient debt contracts. Those creditors best able to monitor the debtor will be compensated for doing so with priority claims to the debtor's assets. This argument turns on the assumption that the debtor, who wishes to minimize the total credit bill, will issue debt contracts that give priority position to those creditors best able to control future misbehavior.

The role of the Article 9 scheme, under this conception, is to create the incentives necessary for efficient information exchange, and to specify default rules that mimic the priority ordering that most fully informed debtors would bargain for if they negotiated explicitly with all of their creditors. The most striking characteristic of the Article 9 scheme is its strong form of behavioral agnosticism. Unlike pre-Code regimes, a creditor is not disabled from

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26 See infra note 52 and accompanying text; see also Guido Calabresi & A. Douglas Melamed, Property Rules, Liability Rules, and Inalienability: One View of the Cathedral, 85 Harv. L. Rev. 1089, 1093-94 (1972) ("Economic efficiency asks for that combination of entitlements to engage in risky activities and to be free from harm from risky activities which will most likely lead to the lowest sum of accident costs and costs of avoiding accidents."); Richard A. Posner, A Theory of Negligence, 1 J. Legal Stud. 29, 32-33 (1972) ("If the cost of safety measures or of curtailment—whichever is lower—exceeds the benefit in accident avoidance to be gained by incurring that cost, ... a rational profit-maximizing enterprise will pay tort judgments to the accident victims rather than incur the larger cost of avoiding liability.").

27 See U.C.C. § 9-402(1) & cmt. 2 ("[N]otice itself indicates merely that the secured party ... may have a security interest in the collateral described."); Schwartz & Scott, supra note 1, at 580 ("The case law makes it abundantly clear that a financing statement is intended merely 'to put a searcher on notice that an underlying security agreement may be outstanding.'" (quoting Bramble Transp. v. Sam Senter Sales, 294 A.2d 97, 103 (Del. Super. Ct. 1971), aff'd, 294 A.2d 104 (Del. 1972))).

28 Schwartz & Scott, supra note 1, at 565-66.
asserting its priority merely because it knew of the debtor's prior commitments to other creditors and could plausibly take cost-minimizing precautions. To the contrary, Article 9 is essentially a pure "race" statute, one in which a subsequent creditor with notice can nonetheless prevail unless prior creditors have fixed their priority by public filing.  

B. The Salient Features of Article 9

One might thus view Article 9 as a means of institutionalizing creditors' incentives to guard against debtor misbehavior. Such a scheme may well have the effect of increasing the efficiency of secured credit. However, because the priority rules are premised on a first-in-time principle measured not from the time a debt contract is concluded but from the time that a property right is granted, they also provide a reason why Article 9 might be seen as favoring secured creditors over unsecured creditors. This is especially true if the premise of full information is challenged. The option given unsecured creditors under Article 9 is to increase their interest charges to compensate for the greater risks they bear that debtors will remove some or all of their assets from the common pool available for pro rata distribution. Even so, certain classes of creditors may still bear uncompensated risks. Specifically, when there are systematic and persistent information asymmetries between financial "insiders" and "occasional" creditors, then Article 9 is facilitating the redistribution of wealth from uninformed creditors to informed creditors (and debtors). With this analysis in mind, I can proceed to summarize the salient features of Article 9 that support and/or rebut the redistribution hypothesis.

29 See Douglas Baird & Thomas Jackson, Information, Uncertainty, and the Transfer of Property, 13 J. Legal Stud. 299, 312-18 (1984) (stating that some of the reasons for the pure race system, in which knowledge gained outside the filing system is irrelevant to creditor priority, derive from issues of circular priority and their attendant costs).

30 Schwartz, Security Interests, supra note 13, at 7; Schwartz, Theory of Loan Priorities, supra note 13, at 260-61; see also Jackson & Kronman, supra note 13, at 1147-48 (noting that unsecured creditors will insist on a premium for lending on an unsecured basis in order to secure their own claims).

31 Schwartz, Security Interests, supra note 13, at 30-33. This topic is discussed in more detail later in this Section.
1. Rules That Advantage Financing Insiders

Article 9 serves the interests of informed secured creditors and other financing insiders both structurally and substantively. The most unique structural characteristic of Article 9 is its devotion to bright-line rules, which serve to increase certainty of outcome in a host of situations. Secured creditors see this clarity as efficiency enhancing, especially when compared to the morass of regulatory provisions that governed secured transactions before Article 9.\textsuperscript{32} In addition, by providing a comprehensive set of default rules, Article 9 lowers the cost of secured transactions.\textsuperscript{33} Thus, even if the substantive provisions of the Article did not redistribute wealth to secured creditors, there would still be much for them to find attractive. However, many substantive provisions do indeed support the redistribution hypothesis.

This bias is most apparent in the exceptions that Article 9 establishes to its general “first-in-time” principle. The first-in-time priority system is based upon the acquisition and publication of a property right in the debtor’s assets.\textsuperscript{34} The general rule provides that parties secured with the same collateral take amongst themselves according to a first-in-time rule.\textsuperscript{35} This system aims to freeze a debtor’s creditworthiness—that is, it reduces the cost of secured credit by reducing the creditor’s risk of having its interest in the collateral subordinated to a subsequent creditor. Although this system might seem facially neutral, in fact it results in certain classes of secured creditors being granted specially protected priority claims.

Article 9’s three main departures from the first-in-time principle are instructive. The first exception is the extraordinary legal protection afforded the floating lien. By an appropriate filing, a gen-

\textsuperscript{32} Gilmore, supra note 6, at 620; see also Gilmore, supra note 3, at 14 (“The 1972 revision . . . clarified many unintended obscurities, corrected many simple mistakes, and provided guidelines for the solution of problems . . . .”); Kripke, supra note 7, at 931 & n.14 (asserting that Article 9 promotes mass production and distribution of goods); Schwartz & Scott, supra note 1, at 611-12 (“Article 9 contains a series of precise priority rules which . . . enable counsel often to give clients accurate advice about the legal consequences of their actions.”).

\textsuperscript{33} Schwartz & Scott, supra note 1, at 598-606.

\textsuperscript{34} U.C.C. §§ 9-203, -302; see also Schwartz & Scott, supra note 1, at 568 (discussing perfection).

\textsuperscript{35} U.C.C. §§ 9-301, -312(5).
eral financing creditor may claim a priority in any or all of the debtor's current and future assets, with the creditor's priority status fixed from the time of filing rather than from the time property rights in particular assets are acquired. Such a scheme makes sense with collateral, such as inventory, that is rapidly and constantly changing, because otherwise the filing requirements would become so cumbersome as to discourage secured financing. But when the collateral is assets that are in use over time, such as equipment, the burden of filing for each transaction is no more onerous than for other creditors bound by the general rules. In this case, encouraging competitive bidding for each financing transaction would seem likely to reduce the debtor's interest payments. Subsequent creditors would be relieved from having to negotiate with the primary lender prior to taking security in collateral that the primary lender had already encumbered. Nonetheless, Article 9 invites a dominant general financing creditor to encumber, with a single filing, all the existing and future assets of the debtor. Is such a scheme justifiable?

Two social benefits plausibly arise from the exclusive credit arrangement created by floating liens. First, exclusive financing arrangements essentially make the creditor a joint venturer in the business opportunity. Thereafter, the creditor has an incentive to provide financial counseling and management advice to the debtor firm and, just as importantly, has the leverage to ensure that the firm acts on that advice. This is a public good to the extent that it enhances the general business prospects of the debtor.

A second benefit may result from the monitoring activities of the general financing creditor. By entering into an exclusive financing arrangement, the primary creditor signals to other creditors that it is comprehensively policing the debtor's assets. This, in turn, permits other creditors to relax their monitoring activities. Reliance on a single monitor whose vantage point and position allow effective policing against all forms of misbehavior reduces duplicative

36 U.C.C. §§ 9-204(3), -312(7); see also Schwartz & Scott, supra note 1, at 637-39 (discussing functions of the first-in-time rules).
37 Schwartz & Scott, supra note 1, at 638, 680-82; Scott, supra note 13, at 931, 948-52.
monitoring costs resulting from the uncoordinated efforts of multiple creditors.\(^{38}\)

Thus, social welfare \textit{may} well be enhanced by institutionalizing the floating lien. This does not contradict the assertion that the floating lien benefits certain classes of secured creditors, but rather illustrates the point that a regulatory scheme that is desired by a particular interest group can still serve the public good, as long as the interests of that group do not conflict with the larger societal interests.\(^{39}\)

The second major exception to the "first-in-time" priority rule is the "superpriority" granted to PMSIs. A creditor with a properly perfected PMSI gains a superpriority status that trumps even prior creditors holding floating liens.\(^{40}\) The conventional defense of the PMSI superpriority holds that the priority rule allows debtors to bring new money to a faltering enterprise, and that the general financer should be unconcerned, because the PMSI is supported by new collateral.\(^{41}\) This explanation, however, is unconvincing. Jackson and Kronman have shown not only that a general financer would be disadvantaged by the second loan, but that it would be

\footnotesize

\(^{38}\) Schwartz & Scott, supra note 1, at 683; Scott, supra note 13, at 931-32; see also F. H. Buckley, The Bankruptcy Priority Puzzle, 72 Va. L. Rev. 1393, 1425 (1986) ("Secured lending also reduces total screening costs by allowing the parties to take advantage of any economies of specialization and scale associated with the screening function."); Levmore, supra note 13, at 55-56 (arguing that secured financing solves the freerider monitoring problem by compensating secured creditor for monitoring role).

\(^{39}\) Schwartz & Scott, supra note 1, at 637-39, 680-85. Grant Gilmore viewed the floating lien less charitably. He acerbically commented that it ensures that a "secured party can lock up all the property that his debtor now owns or ever will acquire, sit back and do nothing until bankruptcy day, and then . . . walk off with everything." Gilmore, supra note 6, at 625. This insight prompted Gilmore to ask rhetorically, "[W]hy on earth should the fruits of a known insolvent's labors feed the assignee while all the other creditors starve?" Id. at 627. Gilmore began questioning the usefulness of the floating lien some 20 years after he helped to draft Article 9. In his treatise on secured transactions, he limply defended the practice, stating that its legitimacy "rests not so much on the merits or the positive excellence of the floating lien as on an argument of fait accompli." 1 Gilmore, supra note 12, at 360; see also U.C.C. § 9-204 cmt. 2 ("This Article decisively rejects [the hostility to the floating lien] not on the ground that it was wrong in policy but on the ground that it was not effective."). This suggests that Gilmore's later-found doubts were shared previously by the drafters of the comments. The later Gilmore was probably remembering what the earlier Gilmore already knew.

\(^{40}\) U.C.C. § 9-312(3), (4).

\(^{41}\) Kripke, supra note 7, at 936; Scott, supra note 13, at 961.
able to finance the subsequent loan more cheaply than a second lender.\textsuperscript{42}

Relational theory offers two explanations to justify the PMSI superpriority. The first holds that the general financing creditor would willingly grant the debtor the opportunity to issue priority debt for PMSIs as a “bond” or “escape hatch” with which to guard against the general financer’s inherent conservatism and cautious view towards risky, but potentially profitable, ventures. The PMSI thus allows the debtor to develop projects on its own that the general creditor would probably veto.\textsuperscript{43} Second, purchase money lenders presumably have specialized skills in monitoring and policing inventory and equipment that the general financer lacks. Thus, the skills of the PMSI creditor complement those of the general financer, and may serve to reduce monitoring costs.\textsuperscript{44} In sum, the PMSI serves as yet another example of how a rule that unabashedly favors a discrete class of secured creditors may still be plausibly seen as efficient.\textsuperscript{45}

The third exception to consider concerns the priority of paperized assets, such as chattel paper and instruments. U.C.C. section 9-308 provides that a general financer who has perfected a security interest in a debtor’s chattel paper, either directly or as proceeds, will lose in a priority contest with a subsequent purchaser of the chattel paper who gives value and takes possession of the paper in the ordinary course of business.\textsuperscript{46} Two possible rationales exist for this exception to the first-in-time principle. First, by carving out an exception to the general first-in-time rule, Article 9 provides a means to give new money to a firm that may otherwise be denied the additional credit by the general financer because the firm is in

\textsuperscript{42} Jackson & Kronman, supra note 13, at 1167-71.
\textsuperscript{43} See Scott, supra note 13, at 962-63.
\textsuperscript{44} Id. at 963.
\textsuperscript{45} An argument can be made that Article 9’s PMSI superpriority is overbroad. When an initial financer and a purchase money financer both lend money based on the same class of collateral (that is, when the initial financer is a specialized creditor such as an equipment financer), then the purchase money creditor has no comparative advantage over the initial lender in policing and monitoring. Even so, Article 9 allows the purchase money lender in such a situation to retain its superpriority. See Schwartz & Scott, supra note 1, at 679. However, even in this situation, the escape hatch explanation retains its potency.
\textsuperscript{46} U.C.C. § 9-308(a).
economic distress. A second justification focuses on the "thinness" of credit markets. Credit markets are specialized, and therefore are not fully competitive. The main obstacle to the formation of "thick" markets is the information that creditors accumulate, mainly through repeated experience with debtors, which grants them comparative advantages over "distant," nonspecialized creditors. The priority granted to subsequent purchasers of chattel paper expands the "local" credit market and makes it thicker and more competitive. If the anticipated "gains from a thicker market exceed the costs to first-in-time creditors, then the Code priority rule would be justified."

If these assumptions are true, the priority exception for subsequent purchasers of chattel paper is another example of a rule preferred by a particular interest group, but which nonetheless serves larger societal interests.

2. The Filing System—Rules That Advantage Less Informed Creditors

One can tell either benign or malign stories to explain each of the key exceptions to Article 9's first-in-time rules. All of the benign stories, however, have one common feature: a dependence on the premise of full information that underlies the filing system. The filing system, then, is the counterweight to the claim that Article 9 systematically disadvantages certain creditors.

The filing system serves as the fulcrum of Article 9. Subject to the exceptions discussed above, a creditor's priority depends on the date that a financing statement was filed. Perhaps the most unique feature of Article 9's filing system is what I have earlier referred to as its "behavioral agnosticism." That is, the filing system does not address the problem of debtor misbehavior directly through the standard knowledge-based techniques for regulating primary behavior. Rather, Article 9's filing system seeks to regu-

47 Schwartz & Scott, supra note 1, at 658.
48 Id.
49 Id. at 658-59.
50 Id. at 659.
51 U.C.C. §§ 9-302, -402.
52 Schwartz & Scott, supra note 1, at 664. In contrast, the real property filing systems, which through the notice and race-notice filing systems protect only bona fide subsequent
late the provision of information, leaving the regulation of misbehavior to private ordering among the parties.

The assumption that supports this regime of behavioral agnosticism is that the debtor will bargain for credit with each of its consensual creditors. The debtor thus internalizes the costs of misbehavior as a function of its total interest bill. Rather than create default rules based on crude assumptions about which creditors are best able to guard against misbehavior, the Code invites the parties to structure their policing mechanisms individually. As long as all parties are fully informed, the debtor will have all the necessary incentives to precommit not to misbehave and to grant priority status to those firms that are best able to monitor against infractions of that commitment. Through such an arrangement, the debtor is able to minimize total interest charges. In this manner, for example, special priority status for floating lienors, PMSIs, and purchasers of paper can be tested in the market. If such special priority treatment does not efficiently reduce misbehavior risks, the risk premiums charged by subsequent informed creditors will rise. This will lead debtors, in turn, to opt out of the Code’s inefficient default priority rules.

The information exchange contemplated by Article 9 is premised on a bargaining game stimulated by “notification” filing. Section 9-402 does not require the reproduction of the documentary basis for the secured creditor’s claims against the debtor’s assets. Rather, it calls for the filing of financing statements, containing only limited information, including general descriptions of encumbered collateral. The comment to section 9-402 explains that the purpose of this type of filing system is limited. “The notice itself indicates merely that the secured party who has filed may have a security interest in the collateral described.” This approach, as with so many of the rules already discussed, has the advantage of

purchasers, and the good faith requirement in the U.C.C.’s Article 2 are examples of schemes that seek to regulate behavior, as opposed to solely regulating information production.

53 See Schwartz, Theory of Loan Priorities, supra note 13, at 220 (“Good debtors could avoid paying the high interest rates that uninformed lenders would charge by informing the lenders that they had little or no prior debt.”).

54 U.C.C. § 9-402 cmt. 2.
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clarity. It also vividly demonstrates Article 9's indifference to optimal precautionary behavior.

Understandably, creditors will not display similar indifference. Article 9 invites individual creditors to discover privately whether the collateral in question has already been encumbered. Creditors can gain this information by assuming first that all potential collateral is encumbered, and proposing to charge an interest rate that approaches the market rate for unsecured credit. Debtors, seeking to reduce the price of credit, are thus encouraged to show that the potential collateral is indeed unencumbered. Simply put, an effective filing system ensures that it is in the debtor's best interest to establish its honesty.55

Thus, the filing system serves as a critically important counterbalance to the floating lien, the PMSI, and the priority of paperized rights. It permits a proponent of Article 9 to defend the maintenance of a rule structure that clearly advantages certain classes of creditors, by plausibly claiming that these advantages are nevertheless consistent with social welfare; for if they were not, the effects would be observable in the form of frequent opting-out behavior by debtors and creditors.

However, the premise of full information is at best empirically untested. The mythology of Article 9 asserts that informed creditors use the filing system to signal less informed creditors, and that this signaling function justifies the unique priority position certain creditors enjoy.56 The information provided in the filing system is principally for the benefit of those creditors who are subject to the limitations of the first-in-time principle. Absent a successful and fully functioning filing system, rent-seeking and other opportuni-

55 Alan Schwartz has suggested that such private disclosure is in fact so efficacious that the public filing system should be abolished. See Schwartz, Theory of Loan Priorities, supra note 13, at 218-19 (advocating an expansion of first-in-time priority, to create a system in which initial financers are given senior rank in liquidation whether or not their claims are secured or public); see also Schwartz & Scott, supra note 1, at 609-11 (summarizing Schwartz' argument).

56 Much of the scholarly literature on Article 9 has focused on systemwide efficiency justifications for the priority position of secured creditors. See, e.g., Buckley, supra note 38, at 1426 (arguing that secured credit reduces net screening costs); Jackson & Kronman, supra note 13, at 1156-57 (arguing that secured credit reduces total monitoring costs); Levmore, supra note 13, at 56 (arguing that secured credit solves the freerider problem).
ties to exploit informational asymmetries would emerge as a severe problem.

The preceding discussion underscores the critical importance of the efficiency debate that has dominated the theoretical scholarship on secured financing over the past fifteen years. The debate may not have established a general theory of secured debt, but it has at least served to explode the conventional wisdom that has long supported the Article 9 scheme—the wisdom that, on its face, secured credit serves to lower the interest rate for debtors. The irrelevance theorem suggests that, without other explanations, any gains to secured creditors are offset by losses to other creditors. In turn, the anticipation of losses by unsecured creditors will be reflected in higher interest rate charges that presumably will erase any benefits derived from the lower rates charged by secured creditors.

In response to this zero-sum hypothesis, scholars have sought to find other social benefits that justify statutory protection of secured creditor interests. Even with the additional contributions of the participants in this symposium, the debate continues to prove

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57 See, e.g., Buckley, supra note 38, at 1426, 1464 (arguing that secured credit both reduces the lenders' net screening costs in determining a debtor firm's creditworthiness and minimizes adverse incentive costs); Jackson & Kronman, supra note 13, at 1156-58 (arguing that the preference for secured creditors can reduce total monitoring costs and avoid significant transaction costs); Kripke, supra note 7, at 940, 946, 950 (rejecting the argument that secured credit is a zero-sum game, and arguing that it allows consummation of credit sales and enables the secured party to act quickly when trouble is discovered); Levmore, supra note 13, at 56-57 (stating that granting priority to secured creditors gives them incentives to function as the monitor of debtor misbehavior, solving the freerider problem); Scott, supra note 13, at 503 (noting that secured financing allows parties to achieve their mutually beneficial objectives, which they could not do through conventional contractual relationships); Paul M. Shupack, Solving the Puzzle of Secured Transactions, 41 Rutgers L. Rev. 1067, 1122-24 (1989) (contending that Article 9 seems to increase transactional efficiencies, but calling for more empirical research); James J. White, Efficiency Justifications for Personal Property Security, 37 Vand. L. Rev. 473, 508 (1984) (arguing that secured credit expands available credit to risky debtors and cures the inefficiencies of heterogeneous risk aversion by employees and firms). But see Jackson & Schwartz, supra note 13, at 994 (rejecting Professor Kripke's argument that secured credit is not a zero-sum game); Schwartz, Security Interests, supra note 13, at 10, 15, 33 (rejecting monitoring and signaling explanations of secured credit's efficiency); Alan Schwartz, The Continuing Puzzle of Secured Debt, 37 Vand. L. Rev. 1051, 1066-67 (1984) (arguing that no convincing explanation for the present pattern of secured lending has emerged).
inconclusive. I now propose to advance the debate by investigating the political forces and institutional framework that shape the Article 9 lawmaking process.

II. THE POLITICAL ECONOMY OF ARTICLE 9

It seems to be standard scholarly practice to treat the U.C.C. and similar laws as if they were created by rule-generating "black boxes." Although academics have not hesitated to critique the resultant laws, until recently they have paid scant attention to the internal workings of the institutions that produce such laws, and thus have failed to debate whether those processes themselves are desirable. I hope to contribute to the beginnings of such a debate by examining the Article 9 lawmaking process in much the same way that political scientists study legislatures.

A. The Nature and Function of the U.C.C. Lawmaking Process

1. The ALI and NCCUSL

The U.C.C. is a joint product of the American Law Institute ("ALI") and the National Conference of Commissioners of Uniform State Laws ("NCCUSL"), two private bodies that formulate private law rules in the form of restatements that are ultimately


59 Other uniform codes and restatements are promulgated by the American Law Institute, the National Conference of Commissioners on Uniform State Laws ("NCCUSL"), the National Bankruptcy Conference, and the American Bar Association.

60 For projects that have begun such an investigation, see Patchel, supra note 2 (giving a historical analysis of how the structure of the U.C.C. drafting process, since the U.C.C.'s inception, has affected the substantive product); 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) (discussing the inner workings of the American Bar Association committee as it reviewed recommendations to Articles 3 and 4 of the U.C.C.); Larry E. Ribstein & Bruce H. Kobayashi, A Theory of Uniform Laws (Jan. 30, 1994) (unpublished manuscript, on file with the Virginia Law Review Association) (focusing on the NCCUSL's efforts towards uniformity in American law, the role that interest groups play in drafting NCCUSL proposals, and the formidable weight that those NCCUSL proposals carry in state legislatures considering enactment of the proposals); Schwartz & Scott, supra note 15 (analyzing the ALI and NCCUSL's institutional structures, using the techniques of "structure induced equilibrium").
offered to courts and model uniform laws that are offered to legislatures.\textsuperscript{61}

The ALI is a private law reform group that chooses its own members, all from the legal profession, including practitioners, legal academics, and judges. The ALI creates restatements of law, does special law reform projects, and assists in creating and revising the U.C.C. Its general membership meets annually for one week, although typically no more than a day or two is devoted to any one subject.\textsuperscript{62}

The NCCUSL drafts uniform laws in various fields that it then proposes to state legislatures for ratification. The membership consists of over 200 Commissioners—practitioners, judges, and academics—appointed on a nonpolitical basis for three-year terms by the governors of their states. Each state, the District of Columbia, and Puerto Rico have approximately four members each; however, each state gets only one vote during balloting on proposed uniform laws, which are approved with the votes of a majority of the states represented at the meeting. The Conference meets annually to review the laws and model acts that its committees create.\textsuperscript{63}

The U.C.C. project combines elements from both the ALI and the NCCUSL. This marriage, with the U.C.C. as the intended offspring, was arranged in the 1940s by William Schnader, an attorney who held office in both organizations.\textsuperscript{64} A Permanent Editorial Board ("PEB") for the Code, composed of members of the NCCUSL and the ALI, with the ALI Director ex officio, periodically sends recommendations to the NCCUSL and the ALI for revisions to the Code. If the two groups agree to prepare a report, the ALI President appoints a study group, the membership of which the ALI Director clears with the ALI Council after consult-

\textsuperscript{61} Much of the following discussion draws on Schwartz & Scott, supra note 15.

\textsuperscript{62} Schwartz & Scott, supra note 15 (manuscript at 6-7); see also Patchel, supra note 2, at 84 n.2 (discussing the ALI).

\textsuperscript{63} National Conference of Comm'rs on Uniform State Laws, 1993-94 Reference Book 3-4 (1993); Ribstein & Kobayashi, supra note 60, at 5; see also Walter P. Armstrong, Jr., A Century of Service: A Centennial History of the National Conference of Commissioners on Uniform State Laws (1991) (discussing the history of the NCCUSL); Patchel, supra note 2, at 88-93 (discussing the NCCUSL).

\textsuperscript{64} Gilmore, supra note 2, at 84; see also Patchel, supra note 2, at 93-98 (discussing the early history of the U.C.C.).
ing with the NCCUSL. Study groups tend to have academics serving as chief reporters, with other academics and practitioners serving as members. In addition, study groups seek out advice from groups or individuals who have some interest or stake in the revisions at hand. The study group as a whole has the final say as to the draft report's contents. After completing their reports, study groups, which tend to meet two to three times a year, send their products on to both the ALI and the NCCUSL.

The NCCUSL (in consultation with the ALI) then appoints drafting committees, which reformulate the reports into statutory language. As with the study group, a mix of academics and practitioners serve on the drafting committees, but the "real lawyers" tend to hold sway. The NCCUSL, at the same time, routinely approves reports from the study groups, and must also approve any proposed changes to the Code. Thereafter, the NCCUSL tries to sell the new statutory provisions to the state legislatures.

In addition to understanding the operational structure of the lawmaking process responsible for the U.C.C., it is important to understand something about the members who participate in the process, and the impact that the structure of the process has on them. In general, the members may be characterized as public-spirited lawyers who volunteer their time and energy to resolve important legal issues in technically correct and politically uncontroversial ways. Both the ALI and the NCCUSL believe that their function is to deal with technical problems that can be


66 Schwartz & Scott, supra note 15 (manuscript at 6-7).

67 Patchel, supra note 2, at 100.


70 Patchel, supra note 2, at 92; see also Ribstein & Kobayashi, supra note 60, at 5-6 (providing historical context).

71 Schwartz & Scott, supra note 15 (manuscript at 10-12); see also Patchel, supra note 2, at 141 (discussing legislative delegation of the task of codifying complex areas of law to lawyers with technical and specialized knowledge of the issues).
resolved by legal expertise and to avoid issues whose resolution requires controversial value choices. Thus, their efforts result in restatements that courts should follow or proposed uniform laws that state legislatures should enact as written. This belief has prevailed for the U.C.C.; consequently, the overwhelming majority of states have adopted the Code and its subsequent revisions as developed by the ALI and the NCCUSL.  

2. The Interests Affected by Article 9 and Its Revisions

In the discussion that follows, I propose to evaluate the effects of this traditional conception of the role of the ALI and the NCCUSL on the deliberations of the Article 9 Study Group. Before proceeding, however, it is important to identify the parties whose interests are affected by Article 9, and explain how these parties are represented, if at all, in the revision process. The interests that are most affected by the legal regulation of secured credit, not surprisingly, are specialized asset-based financers (factoring companies and commercial finance companies) and commercial banks that commonly issue secured debt as a part of their portfolio of loans. These groups, because they make such extensive use of Article 9, are well-informed financing insiders. Their repeated occasions to observe the effects of particular regulatory provisions produce a reservoir of private information concerning the actual function of different asset-based financing regimes. Moreover, their interests tend to be cohesive, at least insofar as their views are aligned on the salient features of Article 9.

Unsecured creditors and debtors are also affected by Article 9. These groups have less cohesive interests, however, than do informed secured creditor interests. Many unsecured creditors and debtors and some “occasional” secured creditors are less informed parties; their participation in transactions involving secured credit does not occur with sufficient frequency to justify the costs of becoming fully informed about the effects of the Article 9 regulatory regime. Certain trade creditors and other suppliers, consumer or small business debtors, nonconsensual tort claimants, and war-

73 See Rubin, supra note 60, at 748-53 (discussing the reasons for this shared perspective).
ranty claim holders would all fall in this category.\(^\text{74}\) Some unsecured creditor interests are repeat players, particularly large institutional trade creditors, such as agricultural suppliers, and certain classes of institutional debtors, such as single entity real estate developers. The heterogeneity of unsecured creditors and debtors increases their costs in forming effective coalitions to share information about the effects of Article 9 rules.\(^\text{75}\)

The last group of interested parties are the business lawyers and legal academics for whom Article 9 is an important practice or research specialty. The academics in this group may be distinct from the other lawyers in that they do not necessarily have pecuniary interests that can be affected by changes in Article 9. Nevertheless, the academics might be said to have an interest in the continued existence of the statute, as it serves as the basis for at least a nontrivial proportion of their work, and also as a means for augmenting their reputations.\(^\text{76}\)

Business lawyers have both economic and reputational interests at stake. Changes in Article 9 can affect their practice directly. Moreover, success in law reform projects enlarges a lawyer's reputation for good judgment and serves as an important credential, denoting expertise and experience in representing secured creditor interests.

3. The Study Group Process

The Article 9 Study Group, typical of U.C.C. projects, was comprised of two academic reporters and sixteen members—three legal academics and thirteen practicing lawyers (one of whom was appointed a bankruptcy judge after the Group was formed). The Study Group met two or three times a year over nearly a three-year period.\(^\text{77}\) Prior to each meeting, the reporters distributed an

\(^{74}\) Lynn M. LoPucki, The Unsecured Creditor's Bargain, 80 Va. L. Rev. 1887 (1994), provides a more comprehensive analysis of the treatment of such creditors under Article 9.

\(^{75}\) See Patchel, supra note 2, at 127 (arguing that "broad-based interests find it difficult to organize to secure collective benefits"). See generally Mancur Olson, The Logic of Collective Action: Public Goods and the Theory of Groups 43-65 (1971) (discussing interest group theory generally and the advantages and disadvantages with larger versus smaller interest groups).

\(^{76}\) See Ribstein & Kobayashi, supra note 60, at 21-22 (discussing the interests of lawyers in other independent lawmaking procedures).

\(^{77}\) Final Report, supra note 68, at 4.
agenda and accompanying working papers. Topics for working papers and the agenda were determined by the reporters and the chair, after consultation with interested parties. Typically, the working papers analyzed particular issues seriatim and recommended appropriate courses of action. At each meeting, the Study Group discussed the specific topics in turn and sought, where possible, to reach a consensus about how each issue should be addressed in any future revision of Article 9. On a number of technically complex issues, the reporters and chair sought recommendations from advisory groups of "experts.

The structure and conduct of the Study Group is entirely consistent with the underlying intellectual premise of the ALI and the NCCUSL. If Article 9 rules can be derived from uncontroversial moral premises and constructed with traditional legal skills, then a small group of "experts" can create and propose useful sets of reforms, and larger groups of less informed practitioners and judges, meeting occasionally, can choose the best ones.

The principal currency in the Study Group, therefore, is technical expertise. Moreover, all expertise is not equally valued. Although academic insights into the structure and social effects of Article 9 are recognized as important, encyclopedic knowledge of how the rules have been interpreted by different courts is valued more highly, and the greatest asset is knowledge of how the rules "really work" in practice. This hierarchy of expertise is not irrational, given the operating assumptions of the ALI and NCCUSL approach.

On the other hand, the privileged status of "hands on" working knowledge of Article 9 rules has dramatic effects on the dynamics of Study Group deliberations. Most significantly, in-house counsel for banks and finance companies and private commercial lawyers whose practice involves representation of those interests provide the most important source of expertise concerning the nature and effects of proposed revisions to Article 9. Because operational

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78 Id.
79 Id. at 4-6.
80 See Patchel, supra note 2, at 100 ("[S]olicitation of interest group participation ... provided the drafters with technical information and understanding of business practices . . . ."); id. at 120-21 ("Interest groups [are] a primary source of information about the operation and needs of the industries affected by the Code.").
expertise is the relevant criterion, it is unsurprising that eight members of the Study Group (including the chair) were commercial lawyers and house counsel whose practice specialty was the representation of secured creditors. These lawyers are the most knowledgeable concerning the questions the Study Group is asked to resolve, and they properly emerge as the most influential members of the group (other than the academic reporters). Their influence is further elevated because key members of this group also occupy prominent roles on the U.C.C. Permanent Editorial Board.

The impact of these structural forces on the deliberations of the Study Group is striking. Efforts by the academic members to place on the agenda a discussion of the broader implications of the proposed changes in Article 9, including their cumulative effects on other societal interests, were uniformly unsuccessful. The several practicing lawyers who were seen as representatives of other interests were similarly marginalized by the focus on the technical task of “fixing” Article 9. Ultimately, these members participated only sporadically in the discussions that led to the final report.

One might be tempted to suggest that this impressionistic evidence supports the inference that secured creditor interests are disproportionately able to influence the outcome of the Article 9 revision process. But the mere fact that lawyers sympathetic to those interests were prominent and influential members of the Study Group does not necessarily imply the ability to secure favorable outcomes following the conclusion of the drafting and approval process. Moreover, even if the evidence suggests industry influence, it does not necessarily imply that the revisions will have a special interest bias.

Furthermore, the fact that prominent financial institutions are and were widely interested in the Article 9 enactment process is not, by itself, evidence of industry influence in the lawmaking process. Commercial banks, for example, issue both secured and unsecured debt. Thus, it might be counterproductive for such institutions to seek legal regulations that favor one form of credit over

81 Final Report, supra note 68, at 2 n.6 (listing members of the Study Group).
82 Members and advisors of the Study Group who were (or are) also on the PEB include William M. Burke, William D. Hawkland, William E. Hogan, Homer Kripke, Frederick H. Miller, and Donald J. Rapson. Id. at v-vi.
another. Why would commercial banks seek to expand the definition of proceeds when, by doing so, any wealth that is redistributed to holders of secured debt by the new legal rule would come at the expense of the portion of their portfolio that holds unsecured debt? This argument is not dispositive either, however, as it ignores the significant mediating role played by commercial lawyers, who are the principal participants in the private legislative process. Because of conflict of interest rules and because their expertise generates intellectual and institutional biases, business lawyers may well develop allegiances to particular creditor interests. If so, a filtering process may take place, in which the undifferentiated interests of large financial conglomerates become separated and linked to particular client representation.

What seems clear, in any case, is that the nature of interest group influence on the Article 9 revision process cannot be established either a priori or through impressionistic observations of individual participants. In the discussion that follows, therefore, I sketch an analytic model of the private legislative process that generates the U.C.C. in order to offer a more systematic framework for assessing both the product and the process of any future revisions to Article 9.

B. An Interest Group Model of Private Legislatures

The preceding discussion has suggested that the U.C.C. lawmaking process functions much like a "private legislature" ("PL"). Rules are first proposed in "committees" dominated by members with technical expertise. The initial committee process produces a blueprint for revision that is then delivered to a second "committee" that executes the blueprint in statutory form. The final product is then offered to the larger consultative bodies for their approval.

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83 I am indebted to Barry Adler for this insight.
84 Rubin, supra note 60, at 748-53.
85 This is another example of how lawyers themselves may be seen as a separate interest group, as discussed in Part II.A.2, supra.
86 This is not to say that the observations of Rubin and others are not useful, but only that the question deserves a more systematic analysis.
87 For a formal analysis and a more expansive treatment of the product of these "private legislatures," see Schwartz & Scott, supra note 15.
This suggests that PLs can be studied in the same way that political scientists study legislatures. The action in the law reform game takes place largely at the study group and drafting committee levels, and, to a lesser extent, on the floor where the membership rejects, approves, or suggests modifications to the proposed law. At least in the case of U.C.C. projects, the final stage in which the approved model law is proposed to legislatures for adoption is largely pro forma. Hence, an analyst can treat a study group as a legislative committee and the ALI or NCCUSL as the "legislature."

At least two central questions arise: What are we to make of the products of such private legislative efforts? And, are these products likely to be more congruent with societal interests than the products of ordinary legislatures? For several reasons, we should start by trying to answer the second question. Until we have some insight into the comparative question—does the U.C.C. private legislature perform better or worse than the ordinary legislative process (and in what respects)—we can hardly begin to address the larger normative questions. The currently privileged status of proposed revisions to the U.C.C. in the adopting state legislatures is based upon an implicit and heretofore unexamined assumption: that such private legislative processes yield a product superior to the product of the ordinary legislative process. If that assumption is unwarranted, it follows that the imprimatur of the ALI and NCCUSL should no longer count as an independent factor in favor of any proposed rule.

1. Baseline Assumptions

To clarify the analysis that follows, I begin by making the following assumptions about the relevant features of a private legislative process such as that which produces the U.C.C.

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88 See Patchel, supra note 2, at 136-43 (discussing state enactment and the U.C.C.).
89 This assumption is clearly reflected in the statements of a current Reporter: "[T]he principal argument that the Commissioners can make on behalf of a uniform law when it is considered by a state legislature is its technical and substantive superiority over a law born in the back room of a state legislature and sired by a lobbying organization." James J. White, Ex Proprio Vigore, 89 Mich. L. Rev. 2096, 2097 (1991).
90 For a formal model that generates similar conclusions, see Schwartz & Scott, supra note 15.
a. Logrolling Is Very Difficult

PL participants cannot typically resolve disputes by agreeing, for instance, to trade one Article 9 provision for another. Decisions thus tend to be reached by consensus. This is not to say that logrolling does not take place. Rather, it indicates that although trades between representatives may take place with respect to a single provision, such compromises will not involve agreements to exchange one provision for another.

The assumption that cross-subject trades do not occur seems easily justified. Study group members are recruited for particular projects and concentrate only on them. The projects are thus presented to the private legislature as independent entities. Moreover, logrolling is risky, because trades are hard to enforce. Study groups are asked to draft single projects and are dismissed when the projects are completed. Without the gatekeeping function served by standing committees and political parties in ordinary legislative bodies, a promise by one faction to another not to change a proposed uniform provision will not be credible.91

The size and lack of representative status of the PL works against trading as well. To be sure, ALI and NCCUSL drafting committees are small enough to make intrasubject trades. Drafting committee members, however, are chosen because they are "experts," not because they represent the larger bodies, and the

91 In ordinary legislative bodies, institutions have developed to enforce trades. Enforcement mechanisms are key, because otherwise a group that trades its vote will be concerned that once the recipient group gets what it wants, it may renege in later sessions. One of the most important such institutions is the political party, which has continuity over time, powers of discipline, and a reputational interest in constancy. The party-controlled legislative committee holds the most significant enforcement power because it has the exclusive power to propose alternatives to the status quo. Subsequent attempts to renege can be blocked because no amendments to existing programs can be considered by the larger body without the committee's consent. Because members of one committee know that they have this enforcement power, they are willing to trade with members of another committee. See Barry R. Weingast & William J. Marshall, The Industrial Organization of Congress; or, Why Legislatures, Like Firms, Are Not Organized as Markets, 96 J. Pol. Econ. 132, 143-44 (1988) ("The Committee system provides substantial protection against opportunistic behavior, thereby providing durability to policy bargains."); see also John D. Huber, Restrictive Legislative Procedures in France and the United States, 86 Am. Pol. Sci. Rev. 675, 678 (1992) (noting that both the package vote and the guillotine—in which a vote on a bill is tied to a censure vote on the government—have the institutional structure necessary to preserve gains from trade, and that the French government, as gatekeeper, acts as the functional equivalent of the committee).
larger bodies have almost no voice in selecting the committee members or the reporters.\(^2\) Thus, the larger body has no particular reason to accept any controversial compromise that the small group members may reach (unless they are persuaded to do so by successful lobbying by the interest group(s) that favor the compromise). Moreover, trades within subjects are virtually impossible to make by the membership as a group because the typical PL membership, such as the ALI or NCCUSL, is quite large,\(^3\) heterogeneous, and not organized in political parties, and meets only annually for a week.\(^4\)

**b. PL Members Act as Individuals and Have No Independent Political Power**

Participants in the PL act as individuals; they are not members of "U.C.C. parties" such as those that exist in most legislatures, and that can assert some sort of discipline over their members. ALI members, for example, are chosen by the existing membership. They do not have to lobby for votes to become or to stay as members, and they do not owe allegiance to any constituency for their positions. NCCUSL Commissioners are appointed by politicians, but because their offices are seen as nonpolitical, and because they are routinely reappointed, they also are rarely beholden to a constituency. Furthermore, control of either organization by a particular group is perceived as being antithetical to the purposes of ALI and NCCUSL; both organizations are supposed to create rules by consensus.\(^5\) As a result, neither group's membership has incentives to create and maintain political parties.

As a consequence of the absence of political parties, PLs have no independent political power and commonly need interest group support, or at least the absence of interest group opposition, to

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\(^3\) The ALI is three times the size of Congress and the NCCUSL has several hundred members. Schwartz & Scott, supra note 15 (manuscript at 9).

\(^4\) Id.

\(^5\) See Ribstein & Kobayashi, supra note 60, at 3-4 (describing the manner in which the NCCUSL and ALI used lobbying by bankers associations to ensure passage of the U.C.C.).
ensure the passage of their proposals by state legislators.96 Both the ALI and the NCCUSL seek to have their uniform laws adopted, but the evidence of their many failures, and of their strong efforts to enlist interest groups in the law creation process and to yield to them when necessary, also implies the absence of any independent power base.97

c. There Are Information Asymmetries Between PL Committees and Study Groups and the Membership at Large

The creators and drafters of the rules are “experts” in that particular field of law. As such, they have information that is too costly for the uninvolved PL “legislator” to discover.98 The actual membership of a PL consists primarily of either nonexperts or experts in other fields of law. Thus, the median PL member knows little about the subject matter of any particular drafting product.

Moreover, unlike members of a typical legislature, ALI and NCCUSL participants have little incentive to become more educated before voting, thus creating even greater information asymmetries. This assumption is supported by the premise that the typical uninformed PL member seeks to maximize the public good (as she conceives of it) subject to several constraints: (1) that her private interest—for example, her law practice—is not directly

96 See Rubin, supra note 60, at 781-87.

97 Of the more than 200 uniform acts proposed by the NCCUSL, 107 have been adopted in fewer than 10 states; 77 of these have not even been adopted in five states. White, supra note 89, at 2103. The Conference has had its greatest success in the commercial area. Of the 22 acts adopted in more than 40 states, nine have been commercial. Id. at 2103-04. Ribstein & Kobayashi, supra note 60, at 54-63, includes an appendix that lists the adoption rates of every NCCUSL product. See also Langbein & Waggoner, supra note 69, at 877 (suggesting that NCCUSL proposals are like “political orphans” in need of interest group support in order to gain enactment by state legislatures); Patchel, supra note 2, at 92, 120-23 (noting that legislation on which industry disagrees stands little chance of adoption).

98 The assumption of information asymmetries is justified by the following premise: the individual member of the general membership of a PL will act to maximize the public good (as she envisions it) subject to the constraint that the participant spends little time on PL business (except business that affects the participant’s private interest), because she has too little at stake and the costs are too high to overcome the information asymmetries. Cf. Olson, supra note 75, at 53 (“When the number of participants is large, the typical participant will know that his own efforts will probably not make much difference to the outcome . . . .”.)
impaired; (2) that her reputation for good judgment is not impaired; and (3) that she spends little time on PL business.\textsuperscript{99}

Taken together, these constraints imply that the uninformed PL member will respond in one of two ways to proposals from the study group “experts.” If only a single interest group is active, the proposal favored by the active group may influence the PL member’s vote. If the proposal favored by the interest group is sufficiently close to the preferences of the median PL members, the PL is likely to adopt it. This is because the uninformed participant wishes to do good and be seen as having good judgment, yet spends little time on PL business. It follows that the messages of a single expert will be taken as credible when they are not inconsistent with the uninformed preferences of the median PL members, because people of good judgment tend to heed such expert advice, especially when they are unable to inform themselves independently.\textsuperscript{100}

On the other hand, where interest groups compete, the constraints on becoming informed suggest that neither interest group will exercise much influence on the uninformed member’s vote. A person of good judgment does not favor one expert over another without becoming better informed. But if there are inadequate incentives to becoming informed, the member will prefer one of two alternatives: either to retain the status quo or to have the competing views accommodated in some fashion.\textsuperscript{101}

d. Members of the Drafting Committees and Study Groups Tend To Have Stronger Preferences for Revision than the Median PL Member.

Study group members have stronger preferences for “reform,” because in the usual case, committee members are either academics or interested participants. In general, these members will favor revisions more than the uninformed PL legislator. The preferences of “experts” for revision follow directly from their knowledge of the operational inefficiencies of the status quo, and from their interest in seeking rules that advance the interests of the industry

\textsuperscript{99} See Schwartz & Scott, supra note 15 (manuscript at 3, 20-21).
\textsuperscript{100} See id. (manuscript at 46-47) (discussing the reasons PL participants rely upon messages from credible interest groups).
\textsuperscript{101} See id. (manuscript at at 54-55).
they "represent." Thus, their preferences for targeted changes obviously differ from those of the median member.\textsuperscript{102} Academics, who make up the remainder of study groups and drafting committees, also are preference outliers; they have an institutional commitment to reform because most law professors earn reputations by writing articles about how the law can be improved, rather than by defending the status quo.\textsuperscript{103}

On the other hand, the constraints that typify the median uninformed PL member, such as information asymmetries and the costs of overcoming ignorance, imply a stronger commitment to the status quo. This suggests that a typical outcome of the PL process will be to reject significant reform, especially where the reform is seen as controversial, unless the median PL member is influenced by the preferences of the members of a particular study group or drafting committee.

2. Preliminary Observations: The Influence of Cohesive Interest Groups

The preceding assumptions suggest that the PL process is susceptible to influence by cohesive interest groups. The effects of interest group activity on the lawmaking process will depend principally on whether a single, dominant group is active or whether interest groups compete with one another.

When only a single, dominant group is active, the preceding assumptions imply that the dominant group will be able to influence the outcome of the PL process whenever their proposals are not inconsistent with the uninformed preferences of the median PL member. This influence increases the likelihood that the interest group will be able to secure revisions that favor its interests. A single, active interest group will be represented by experts who favor the proposed revisions and who have the largest influence on the deliberations of the study groups. As a consequence, interest group representatives will be able to make the most credible representations to uninformed members concerning the effects of reform. Without an organized opposition, PL members will have

\textsuperscript{102} See id. (manuscript at 18-21) (detailing the preferences and incentives that guide the different types of PL participants).

\textsuperscript{103} See id. (manuscript at 19).
little reason to vote against a reform proposal so long as the proposal (1) effects only marginal changes in the status quo and (2) is not facially inconsistent with the preferences of most PL participants.

Moreover, the ability of a single, cohesive group to influence the outcome of PL deliberations is likely to be greater than in the case of ordinary legislative bodies. The absence of political parties and clearly defined constituencies reduces the likelihood that alternative views will be presented to the PL member (or that she will have an incentive to seek them out). When considering whether to support the views of a single, active interest group, ordinary legislators must calculate the risk that the unforeseen effects of a proposed rule will cause competing groups to form, and that these new groups will "punish" the legislator for being insufficiently vigilant in protecting the "public" interest. Moreover, ordinary legislators have alternative methods—such as hearings and the like—of becoming informed about the effects of interest group proposals. In a PL, the absence of either party affiliation or constituency removes the threat of subsequent reprisals if an uninformed member supports interest group proposals, whereas the lack of other channels of information increases the cost of becoming informed.

On the other hand, when interest groups compete, the analysis suggests quite a different outcome. The inability to enforce trades and to logroll means that competing groups will tend to present contrasting views that require the uninformed participant to make explicit and controversial value choices. In turn, the incentives to do good without doing much work and to protect a reputation for good judgment, coupled with a belief that the PL is engaged in a technical, noncontroversial process, will cause the messages from competing groups to have less influence than in ordinary legislative bodies. If seeking additional information is too costly and if the uninformed preferences of the median members do not clearly favor one proposal over another, the only respectable alternative is to decline to support either proposal. Hence, in the presence of competing groups, the PL will tend to reject reform in favor of the status quo, unless the reform can be presented in a form that disguises the underlying value choices.\textsuperscript{104}

\textsuperscript{104} See generally id. (manuscript at 50-55) (analyzing why conflicting messages from interest groups lead PL participants to favor preservation of the status quo).
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a. The Effects of a Dominant Interest Group

When a proposed set of rules is both "confined" and unlikely to create public controversy, then a PL is susceptible to influence by a single, dominant interest group. Here, "confined" is defined as the situation that occurs when the costs or gains of the rules fall on a group or industry that has low coalition costs, and when other groups that the rules affect, such as consumers, cannot directly punish or influence the members involved in drafting or approving the rules. This suggests, inter alia, that an institution that functions as the ALI and NCCUSL do is sometimes easier to influence than ordinary legislatures; as a consequence, it will enact more special interest legislation.

The claim that a single, active group can influence both the substance and the form of PL model rules requires some further elaboration. It should be obvious that interest groups prefer rules in their favor. A dominant interest group with low coalition costs can effectively exercise its influence by "infiltrating" the lawmaking process; the group can cause some of its representatives to become members of the study group or drafting committee, because they can provide expertise otherwise unavailable to the uninformed PL members. Such an interest group can also exert significant pressure outside the committee process, lobbying for the passage of rules that favor the industry and the defeat of rules that do not.

Consequently, the PL has an incentive to comply with the industry's demands, or to supply it with what it wants. When the rules are confined and hidden from public controversy, an uninformed PL member has little incentive to oppose an industry position. Even those ideologically opposed seldom feel intensely about the issue, precisely because it is confined. Also, under these circumstances, the uninformed PL member will only be lobbied by the industry side. Those members who favor the proposal, or have

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105 The question of when an issue is publicly controversial—that is, how and when it appears on "the public agenda"—is not well understood. A helpful preliminary discussion is found in Michael E. Levine & Jennifer L. Forrence, Regulatory Capture, Public Interest, and the Public Agenda, 6 J.L. Econ. & Organization 167, 185-94 (1990).

106 See Schwartz & Scott, supra note 15, at 45-47 (describing the influence that non-reform interest group messages can have over the median PL participant).

107 See Jan Potters & Frans Van Winden, Lobbying and Asymmetric Information, 74 Pub. Choice 269 (1992) (discussing lobbying theory and incentives to lobby); see also
no strong preferences regarding it, will vote for adoption. As a consequence, uninformed members opposed to the industry stance will often find that the costs of opposition exceed the gain because uninformed members have no other readily available source of information and uninformed opposition not only is futile, but threatens the member's reputation for good judgment. Further, members have no constituents who mete out punishment for actions perceived to conflict with the public interest. The upshot is that the interest group will have substantial success in incorporating its views into the final product unless the proposal is inconsistent with the preferences of a broad number of PL participants.

In addition, a dominant interest group will influence the form as well as the substance of the rules adopted by the PL. When only a single dominant interest group is active, a PL will tend to adopt precise, clear, bright-line rules. The incentives for an influential interest group to favor precise, bright-line rules should be obvious—precise rules reduce the industry's costs of compliance with the rules, and, if they are rules that help the industry, give the interpreters of rules (i.e., judges) less ability to read the rule in a way contrary to the industry's interest. For this reason, a dominant group will tend to reach consensus in the study group around a set of clear rules. Thereafter, interest group representatives can lobby the members of the PL to take their preferences for reduced costs (i.e., greater clarity) into account. Ignoring such lobbying efforts can affect the private practice of an uninformed PL member, or cast doubt on her reputation for good judgment, thereby persuading her to take seriously the task of creating precise, bright-line rules.


108 Schwartz & Scott, supra note 15, at 48-49.

109 Describing just such a situation, in relation to a proposed amendment of U.C.C. Article 4A, one commentator wrote:

What is most notable is that it is the language of negotiated compromise. The provision is virtually a transcription of the point and counterpoint, the argument, objection, response and qualification that occurred during the subcommittee meetings. One can almost hear the bank attorneys and the corporate cash managers speak as one reads the provision.

Rubin, supra note 60, at 765.
The ability of a single dominant group to influence the form and substance of model laws is enhanced when the process focuses on the revisions to an existing statute. Revision of an existing statute is perceived as largely a technical exercise, correcting minor flaws or updating a statute, with most of the value judgments having already been made. As such, the revision is not as salient an event as the adoption of the statute originally. Therefore, the revision is less likely to spark opposition or much interest. In such a scenario, with a single, active interest group, its influence will be even greater. In sum, with only one interest group in the game, the noncontroversial nature of the revision process increases the probability that a single active interest group can influence the legislative process.

The possibility of special interest legislation is further increased by two other factors. First, the median PL member will generally act to implement policy that she considers beneficial to the common good. The common good requires the enactment of laws that reduce operational inefficiencies imposed on socially beneficial private transactions. Because of the influence of interest group "experts" on study group deliberations, many PL members will have public-spirited reasons for supporting proposals that clarify ambiguous rules and reduce transactional costs. Second, because of the political impotence of the PL, wide enactment of uniform laws often requires industry support, and is impossible to accomplish in the face of industry opposition. Because the PL

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110 See Patchel, supra note 2, at 109 (describing "modest goal[s]" of revision); Rubin, supra note 60, at 746 (noting that revision "would not attempt to unify payment law; it would simply update [it]").
111 I am indebted to Clay Gillette for this insight.
112 Schwartz & Scott, supra note 15 (manuscript at 3).
113 This proclivity can be attributed to the internalization of the industry's concerns by lawyers who serve that industry. This is not because of a failure by institute members to check their clients at the door, but, rather, has to do with the lawyers' conceptual framework being closely aligned with that of the industry, due to bonds of class, ethnicity, and friendship. Rubin, supra note 60, at 748-50; see also Kripke, supra note 7, at 933 & n.21 (illustrating that even academics have vested interests in the outcomes). Kripke had ample opportunity to help implement policies in favor of secured creditors that he felt increased general welfare. In addition to his influence on Article 9, Kripke also served on the National Bankruptcy Conference, of which he wrote, "I participated actively in the drafting of the new Bankruptcy Code, and resisted efforts to undo by that Code the support that the UCC gives to secured creditors." Id. at 933 n.21.
members want to be seen as both doing good and being effective, they will be predisposed to propose rules that can be enacted into law.

b. The Effects of Competing Interest Groups

The output of a PL may change dramatically when competing interest groups assert themselves or when the proposed revisions are publicly controversial. In this case, each competing interest group will want a bright-line rule in its favor. However, because of the lack of party discipline in the PL, and because of the difficulty in logrolling or trading provisions, the PL will experience great difficulty in choosing a set of rules; each group will want a bright-line rule in its favor, and no group will have an incentive to abandon its position.

Under these circumstances, there are two possible outcomes. Either the PL will reach agreement on a vague and nondirective compromise that appears to accomplish something, or the PL will fail to agree on any rule and will instead vote to retain the status quo.\(^{114}\) The failure to reach agreement is a function of competition and the absence of institutional structure. When two groups compete, neither is able to make fully credible representations to PL members about the consequences of their proposals. Where the value clash is not publicly controversial, the competing groups may prefer a vague delegation to courts over the status quo; uninformed members will accede to this because the appearance of action will preserve the members' reputations for public-spiritedness and good judgment. On the other hand, when strong groups have competing preferences, the uninformed PL member will prefer the status quo over controversial proposals. Thus, the result will be no agreement on revisions. In sum, when interest groups compete, the barriers to logrolling mean that the messages they send will be too noisy to influence the PL outcomes. Because of the assumptions of preference and information disparities between members of the

\(^{114}\) Schwartz & Scott, supra note 15 (manuscript at 54); see also Rubin, supra note 60, at 764-65 (describing the conflicting arguments regarding a proposed amendment of U.C.C. Article 4A).
drafting process and of the median participant, the general membership will hesitate to endorse either proposed alternative law.\footnote{It is important to note that this model should be equally applicable to private lawmaking bodies other than the ALI and NCCUSL. In fact, a plausible case can be made that secured creditors are able to exercise disproportionate influence over and have captured the Article 9 lawmaking process precisely because other potential interest groups—such as large institutional unsecured creditors and debtors—have tended to dominate the bankruptcy lawmaking process. Although a study of the interaction between competing private lawmaking bodies would likely yield fruitful results, this Article aims principally to study the dynamics and effects of interest group influence within the Article 9 process.}

c. Summary

The preceding analysis suggests that the products of the U.C.C. lawmaking process tend to fall into one of two broad categories. When competing interest groups arise and seek to influence the legislative process (either by joining study group committees or by lobbying the membership of the PL when proposals reach the floor), the tendency will be for the body to reject proposed reform or to approve only vague and nondirective rules that delegate substantial discretion to courts. On the other hand, when a single cohesive interest group is active, the group may be able to exercise disproportionate power. In this case, the PL deliberations are likely to produce precise, bright-line rules that operate in the interests of the dominant group.

Neither of these alternative outcomes, nor their underlying causes, support the assumption that the PL possesses superior legislative capacity to a public legislature—an assumption that has led to the uncritical adoption of U.C.C. provisions by state legislatures. Nevertheless, it is relevant to any normative judgments about the substantive rules of Article 9 to know whether the revision process conforms more to the first or the second of the prototypes developed above.

III. Testing the Interest Group Model

The earlier discussion of the Article 9 Study Group deliberations provides at least some impressionistic evidence that cohesive interest groups are active in the Article 9 revision process. This is confirmed by additional impressionistic data suggesting that the
original process that led to the Code’s adoption was also heavily influenced by particular industry groups. Anecdotal evidence abounds that commercial interests exercised considerable power and influence in the initial Article 9 drafting process.116

Furthermore, this influence can be traced to the resulting statutory scheme. Article 9 purports to promote the interests of those industries that helped create and lobby for it.117 Not only does it seek to lower the costs of asset-based financing, but the statute also creates rules (such as repossession) that many believe disadvantage

116 Perhaps the most striking example of this influence is the simple fact that the U.C.C. project was initially funded by grants from business, financial, and industrial concerns. See Armstrong, supra note 63, at 68. Also instructive is Homer Kripke’s description of how, even during the original deliberations of what became Article 9 of the U.C.C., creditors eliminated proposed clauses that would have had them bear some of the costs necessary to protect consumer interests. Homer Kripke, The Principles Underlying the Drafting of the Uniform Commercial Code, 1962 U. Ill. L. F. 321, 323-24. Kripke notes that the consumer protection provisions proposed by the academic drafters were based on the “farfetched” theory that “secured creditors [would] ruthlessly enforce their security interests to the detriment of unsecured creditors.” Id. at 324. The result, according to Kripke, is that whereas the academic drafters had attempted a “striking” revision of commercial law, the procedures through which the proposed code had to pass—both before and after the state legislatures began consideration of it—resulted in a fundamentally conservative document. Id. at 322, 326-28. Although Kripke claimed that “it was important not to arouse the opposition of banks or finance companies” in order to ensure passage, id. at 327, 10 years earlier, one critic stated that the entire U.C.C. was a “sell out” to the banking interests. Frederick K. Beutel, The Proposed Uniform [?] Commercial Code Should Not Be Adopted, 61 Yale L.J. 334, 357-63 (1952).

The banks have, not surprisingly, exerted their influence in many areas. See Armstrong, supra note 63, at 126 (describing how banks killed a proposed provision in the Uniform Controlled Substances Act that would have required forfeiture); Edward L. Rubin, Efficiency, Equity and the Proposed Revision of Articles 3 and 4, 42 Ala. L. Rev. 551, 554-55 (1991) [hereinafter Rubin, Efficiency and Equity] (describing how during the original drafting of Article 3, bankers exerted pressure on the drafters to shift liability to customers in certain places, and how, in response, Karl Llewellyn fired a reporter of a tentative draft of Article 4 who had proposed an anti-bank statute); Rubin, supra note 60 (detailing the role of bankers in the revision of U.C.C. Articles 3 and 4 and the drafting of Article 4A); Edward L. Rubin, Uniformity, Regulation, and the Federalization of State Law: Some Lessons from the Payment System, 49 Ohio St. L. Rev. 1251, 1256 1274 (1989) [hereinafter Rubin, Federalization] (discussing the influence of bankers on the U.C.C. in general); Peter Winship, Lawmaking and Article 6 of the Uniform Commercial Code, 41 Ala. L. Rev. 673, 683 n.33 (1990) (identifying the banking backgrounds of advisors appointed to assist in the revision of U.C.C. Article 6); see also Patchel, supra note 2, at 86, 120-23 (describing the banking industry’s pervasive influence over the U.C.C. throughout its history). See generally Gilmore, supra note 3, at 86 (listing other instances of the influence of the banking industry on the U.C.C. process).

consumer debtors. Indeed, a number of the rules of Article 9 (such as those that permit creditors to take blanket security interests in consumers' personal property and those that regulate secured creditor rights vis-à-vis general creditors) have been substantially altered by other laws once their subject matters became part of the public agenda.

Nevertheless, the degree to which the statute serves special interests, if at all, is difficult to determine from impressionistic observations alone. The interest group model developed above implies that the effects of interest group influence depend crucially on the presence or absence of competing groups. But it is difficult to determine the presence of competition merely by observing the behavior of study group and drafting committee members. Few of the experts who propose revisions are representatives of interest groups in any direct or classical sense. The mediating role played by the study group and drafting committee experts (commercial lawyers and involved academics) makes most ad hoc observations suspect.

The interest group model does suggest an alternative method of evaluation. The model predicts that precise, bright-line rules will

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118 For parallels outside Article 9, see, e.g., Robert D. Cooter & Edward L. Rubin, A Theory of Loss Allocation for Consumer Payments, 66 Tex. L. Rev. 63, 112-13 (1987) (describing cases in which the U.C.C. affords various protections to banks and creditors, but fails to afford similar safeguards to consumers); Rubin, Federalization, supra note 116, at 1256, 1274 (describing how the U.C.C.'s treatment of checks was influenced by banks); see also Patchel, supra note 2, at 86 (describing NCCUSL's general bias against consumers).

Interestingly, Homer Kripke claims that some of the disclosure provisions in the first version of Article 9 were deleted in order to prevent a confrontation between consumers and banking interests that could have blocked the enactment of the U.C.C. as a whole. Homer Kripke, Reflections of a Drafter, 43 Ohio St. L.J. 577, 582-83 (1982).

119 U.C.C. § 9-204.
120 Id. § 9-201.
121 See, e.g., Rubin, Federalization, supra note 116, at 1275-76 (describing how consumers agitated for federal control of the law of commercial paper and check collection in order to protect themselves from the perceived probanker bias in the U.C.C.); Rubin, Efficiency and Equity, supra note 116, at 560, 570-79 (describing the U.C.C.'s response, which still favors banks over consumers). Another example is the Federal Trade Commission Credit Practices Rule, which prohibits blanket security interests in household goods and contractual wage assignments. Scott, supra note 21, at 731. In addition, unsecured creditor interests may have captured the process that promulgates the Bankruptcy Code in a manner similar to the influence secured creditor interests have exerted on Article 9. See infra note 215 and accompanying text.
be observed where a dominant interest group is active. Alternatively, where several groups are in competition the process will tend to generate vague, imprecise rules and ambiguous standards. The striking contrast between the rules of Article 2 and those found in Articles 3, 4, and 9 provide a particularly salient illustration of this observation.\textsuperscript{122} In this Part, therefore, I attempt to augment the existing impressionistic evidence by examining the Article 9 Study Group Final Report\textsuperscript{123} to look for elements that either tend to confirm or refute the hypothesis that the Article 9 revision process is susceptible to influence by a dominant interest group.

I begin by discussing a relatively uncontroversial proposal, concerning choice-of-law, that is important only because the rules that are recommended by the Study Group illustrate the difficulties in drawing reliable inferences concerning the outcomes predicted by the interest group model. I then address areas of fundamental importance to Article 9—the filing system, PMSIs, proceeds, and the treatment of statutory liens. These examples tend to show: (1) that many of the key revisions seem to promote the interests of specific classes of secured creditors in contexts where competing interests may well be disadvantaged, and (2) that these effects are largely hidden from public view behind cosmetic efforts to main-

\textsuperscript{122} Most of the rules in Article 2 are vague and nondirective standards that delegate substantial discretion to courts. Unfortunately, these rules appear to have a normative content. This leaves parties to sales law contracts in the difficult position of seeking to opt out of rules whose effects are unclear and under circumstances where the freedom to negotiate alternatives is also unclear. In an important sense, then, the capture of the legislative process by a cohesive group with relatively low coalition costs solves an important lawmaking problem that otherwise plagues the U.C.C. revision process, namely the development of precise statutory language. Schwartz & Scott, supra note 15 (manuscript at 50-56).

\textsuperscript{123} Each of the 36 specific areas in the Final Report contains numerous proposals to amend either the statutory language or the official comments of Article 9. The areas of concern are grouped under five general headings: Scope of Article 9; Applicable Law; Perfection and Priority; Enforcement; and Other Topics. Final Report, supra note 68, at ix-xi.

The Final Report itself was the work of the Article 9 Study Group. That group, which was commissioned in 1990, met seven times during approximately three years, each meeting lasting for approximately a weekend. Id. at 4. It comprised 2 reporters (both academics), 16 members, and 4 advisors (these last two categories consisting of academics, practitioners, and one judge). Id. at n.6 (listing members). In addition, the Study Group sought the assistance of nearly a dozen advisory groups, and 75 members of a “consultative group.” Id. at vii-viii.
tain the efficacy of the filing system. Finally, the treatment of enforcement issues and corporate restructuring provide counter-examples that may suggest the presence of competition within the dominant "coalition."

One final caveat is in order. The conclusion that an interest group exercises disproportionate power in the private lawmaking process does not depend upon a finding that every participant represents the interests of the affected industry. To the contrary, interest group influence is facilitated precisely because many (if not most) of the formally neutral PL participants will regard themselves as having public spirited reasons for supporting industry proposals. Such participants, as previously mentioned, desire to do good and to preserve a reputation for effectiveness. This implies that the participants want to pass laws.\textsuperscript{124} Wide passage of a proposed uniform law often requires industry support and is impossible in the face of industry opposition. Thus, the PL participants will always have an incentive to supply laws that do much good for an industry if the laws do a little good for the public as well.

\textit{A. Choice of Law}

To summarize, the interest group model predicts that a PL will produce relatively precise, clear, bright-line rules only in limited circumstances, and that such an outcome will often be a signal of the influence of a dominant interest group. Affected industries prefer precise rules, because such rules reduce the industry’s costs of compliance with the rule. Moreover, a dominant interest group will also demand precise rules, because such rules best preserve the industry’s PL victory—the more precise the rule, the less discretion can be exercised in the rule’s application. The relative prominence of precise rules is thus an initial indication that a PL may have been influenced by a dominant interest group. Evidence for this proposition surfaces in many of the illustrations that follow, but a particularly clear example can be found in the recommendations concerning choice of law.

U.C.C. section 9-103 details how to choose the state whose law governs perfection of collateral by secured creditors. It states that when the collateral is of one sort, the law of the state in which the

\textsuperscript{124} Schwartz & Scott, supra note 15 (manuscript at 20-21).
collateral is located governs. However, when the collateral is of another sort, the law of the state in which the debtor is located governs. The Study Group Report recommends eliminating the "location of the collateral" rule. The reasons it offers for doing so are illuminating.

The Study Group Report addresses two issues: the benefits of having a uniform rule and the benefits of retaining only the "location of the debtor" rule. These two issues parallel the two main claims of the interest group model: that captured PLs will create "bright-line" rules, and that the substance of those rules will favor the capturing industry. I will treat each aspect in turn.

According to the Study Group Report, a uniform rule for choosing the state whose law will govern eliminates the need for confused secured creditors to "make multiple filings." A report written for the committee provided further evidence of the value that the Final Report placed in creating clear rules. It stated, "it does not matter what state's law applies. All that matters is that the UCC clearly specify that the law of a particular state apply, and that state should be chosen with reference to considerations of sound commercial practice."

This leads to the second claim. The Study Group's conception of "sound commercial practice" is to reduce costs for dominant classes of secured creditors such as general financers. Indeed, the

125 U.C.C. § 9-103(1)(a), (b) (ordinary (i.e., nonmobile) goods, instruments, and certain types of documents).
126 Id. § 9-103(3)(a), (b) (mobile goods, accounts, and general intangibles).
127 Id. at 75-77. The Study Group does recommend keeping the "location of the collateral" rule for perfection by possession. Id. at 77-78.
128 Id. at 75. The Final Report added that a uniform rule would also reduce priority disputes among secured parties. Id.
129 Memorandum from Professor Robert A. Sedler to Professors Steven L. Harris & Charles W. Mooney, Jr. (Oct. 16, 1991) [hereinafter Sedler Memorandum], in Permanent Editorial Board for the Uniform Commercial Code, PEB Study Group Uniform Commercial Code Article 9: Appendices to Report 137 (1992) [hereinafter Appendices]. Moreover, the Final Report states its preference for bright-line rules throughout the proposals. Indeed, in the Final Report's introduction, the first reason listed for the need for the current set of Article 9 revisions is "drafting imprecision." Final Report, supra note 68, at 2. In addition, several areas of the proposal list "clarification" as the main concern behind several specific proposals. See, e.g., id. at 97-134 (dealing with PMSIs and priorities).
130 Sedler Memorandum, supra note 130, at 144.
Study Group Report states that it prefers the "location of the debtor" rule essentially because it is cheaper for a primary lender. The Report concedes, however, that the location of the debtor rule has offsetting costs that must be borne by other creditors, such as purchase money financers of discrete goods, who must now file in the state where the debtor is located (which is a more problematic exercise than filing where the newly acquired collateral is located). Moreover, one could add to this example the increased costs to subsequent unsecured creditors and purchasers of such discrete goods who must now search in a potentially distant location for these filings.

The choice of law rules thus illustrate the difficulty any analyst confronts in seeking to evaluate the effects of the revision process. Even if precise rules are a good proxy for interest group influence, a rule created by a captured lawmaking process may still promote transactional efficiency. In the case of choice of law, for example, the proposed revisions plainly reduce the uncertainty and ambiguity that the prior rules perpetuate. Moreover, the new baseline rule is efficient if the increase in search costs imposed on subsequent creditors and purchasers under a location-of-the-debtor test will be less than the gain to primary lenders in being able to file in a single location. Whatever this calculus yields, it seems quite plausible that the gains in certainty from a uniform, bright-line rule are a principal consideration that drives the outcome. Nevertheless, the revision clearly carries distributional consequences for debtors and creditors. And, as with many of the examples that follow, the distributional effects clearly favor those classes of secured creditors—general financers, and other primary lenders—who have and continue to exercise the greatest influence over the Article 9 revision process.

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132 Final Report, supra note 68, at 76-77. The Final Report states, "For the perfected secured party, a change in the determinative fact requires a refiling, and refilings are costly. The costs include not only those of preparing and filing a new financing statement but also those attendant to determining that a refiling is needed (i.e., monitoring costs)." Id. at 76.

The report also mentions that the "location of the debtor" rule eliminates the need to create fictional locations that would be attendant if the "location of the collateral" rule were uniformly adopted, and also eliminates certain priority disputes. Id. at 76-77.

133 Id. at 77.
B. Filing, PMSIs, and Proceeds

1. Filing

In the words of the Study Group Report, "The filing system is the heart of Article 9." Therefore, the Code, at least theoretically, deals harshly with those who seek to bypass the filing system. The filing system purportedly serves as a seal of good faith, signaling less informed or occasional creditors that they may engage in asset-based financing on a level playing field with more experienced lenders.

However, according to a report sponsored by the Study Group, a number of "systemic" problems have emerged in the filing system. The problems include delay between the filing of a financing statement and its appearance in searches, improper rejections of financing statements, inaccuracy of search results, and the considerable costs of reliable searching. The filing system is further complicated, the Filing Report noted, by the different filing systems used by the states that have adopted the U.C.C. This is an especially vexing problem, because "[t]here appears to be no concerted effort to coordinate practices among the states or to even identify a unifying strategy for reform of the filing system."

In response to these concerns, the Filing Report recommended a series of revisions, ranging from wholesale technological reform, to keeping the current system while requiring more centralized filing practices, such as filing by taxpayer identification number, clarify-

134 Id. at 139.
135 U.C.C. § 9-301 essentially places unperfected security interests at the back of the queue of creditors. Section 9-201, however, rehabilitates an unperfected security interest vis-à-vis an unsecured creditor without a judicial lien. Also, the first-in-time priority arrangement among secured creditors in U.C.C. § 9-312 provides a strong incentive for prospective secured parties to conduct thorough searches and to file themselves.
136 Final Report, supra note 68, at 88. At the Study Group meetings, the understanding was that the various secretaries of state offices had "captured" the operation of the filing systems in their state, and used both central and local filing offices as a means of dispensing patronage at the expense of the efficiency and accuracy of the process. See Peter A. Alces & Robert M. Lloyd, An Agenda for Reform of the Article 9 Filing System, 44 Okla. L. Rev. 99, 105-08 (1991) (discussing the nature of the various filing system deficiencies).
137 Report of the Uniform Commercial Code Article 9 Filing System Task Force to the Permanent Editorial Board's Article 9 Study Committee (May 1, 1991) [hereinafter Filing Report], in Appendices, supra note 130, at 13, 20-24.
138 Id. at 18-19.
139 Id. at 19.
ing the debtor's name requirement, and imposing time limits on filing processing.\textsuperscript{140}

The Study Group Report does support some of the piecemeal reforms suggested in the Filing Report, such as indexing by tax number and making provisions for administrative regulation of aspects of the filing system.\textsuperscript{141} These suggestions seem to be largely cosmetic responses, however, especially given the Study Committee's statement that "solutions, or even improvements, in this area are beyond its expertise and resources."\textsuperscript{142}

Given the dismal state of the filing system, the Study Group Report could have recommended one of two polar alternatives. On the one hand, it could have reinforced the historic role purportedly served by the filing system, despite the increased costs imposed on primary secured creditors. This option would require the repeat players in the industry to subsidize a system that they find inefficient and cumbersome at best, and often redundant (given the alternative methods of private disclosure at their disposal) at worst. Alternatively, the Study Group Report could have recommended the elimination of a public notice filing system as the principal mechanism for providing information concerning the existence of competing claims, and in doing so, alerted less informed or occasional creditors to the need to resort to substitute methods of disclosure.

Instead of advocating either extreme, the Study Group Report recommends an intermediate option that the interest group analysis helps to explain: the proposed changes, if enacted, will further

\textsuperscript{140} Id. at 33-39. The Filing Report did not evaluate the extent to which these underlying concerns lead to significant problems. According to the Report, "We have not yet attempted to determine how borrowers, lenders and their counsel cope with these delays and whether these delays are merely irritations or whether they have a significant effect upon transactions." Id. at 18. Later, however, the Report indicates that "[a]n informal survey suggests that in spite of the time lag in the filing offices, experienced commercial lawyers seldom close important transactions without a search through the date of filing." Id. at 21. The report also noted that the "vast majority" of state filing systems turn up a new file within three days of its entry into the system. Id. at 20. It added that most states have "significantly improved their response time with respect to search requests." Id. at 21. In any case, neither the minutes nor the correspondence of the Study Group indicate that its members ever questioned the assumption that the concerns enumerated in the Filing Report cause real hardship for secured creditors.

\textsuperscript{141} Final Report, supra note 68, at 89.

\textsuperscript{142} Id. at 88.
erode the filing system's nominal function of providing useful information concerning the risk of prior claims against the debtor's assets. But at the same time, the Study Group Report perpetuates the mythology of the filing system, possibly because of an unwillingness to acknowledge publicly the failure of the proposed revisions to deal meaningfully with the filing problems.

The failure either to resolve the problems with filing or to abandon a system that has been captured by state interest groups is not, in itself, surprising. But the effect of this failure serves to underscore the tension that threatens the original "bargain" that led to Article 9: special treatment for important financial interests in exchange for the obligation to provide public notice of prior claims. Not surprisingly, as the costs of compliance with the filing rules increase, so also does the pressure to expand the exemptions for protected classes of creditors.

An increase in the costs of public filing, coupled with a reduction in reliability and accuracy, necessarily increases the relative attractiveness of substitutes. The principal substitute for public filing is private disclosure. Firms that believe they can better determine

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143 Id. Two suggestions in particular illustrate the continued erosion of the reliability of the filing system. First, the Study Group recommends an extension of the principle in U.C.C. § 9-402(a)(8) allowing filings to be effective despite "minor errors which are not seriously misleading." Id. at 90. Moreover, the Study Group omits from its specific recommendations a suggestion by the Filing Report that the official commentary specify that an error be classified as "seriously misleading if it would cause a party searching under the correct name in the relevant index to fail to find the financing statement." Filing Report, supra note 137, at 37-38. This suggestion would result in a bright-line rule of presumptive accuracy; one that would prevent a subsequent creditor from running a computer search under the correct name and relying on what is revealed. If it is the case that repeat players are increasingly dissatisfied with the filing system, they have fewer qualms about letting the accuracy of its contents deteriorate.

A second provision in the filing recommendations gives an indication of the pessimism concerning the prospect of correcting the flaws in the filing system:

In fashioning substantive rules, the Drafting Committee must take account of likely systemic delays and unreliability. For example, these systemic defects may make it impractical to impose greater responsibilities on enforcing secured parties to search and to give to junior claimants notice of dispositions (§ 9-504) or notice of proposals to retain collateral in satisfaction of indebtedness (§ 9-505).

Final Report, supra note 68, at 89 n.4.

144 Schwartz, Theory of Loan Priorities, supra note 13, at 218-24. Schwartz argues that the filing system is unnecessary to protect potential creditors. Id. at 220. He argues that in the absence of a filing system, a potential creditor would have to assign a probability to the chance that the debtor's assets were already encumbered. Id. The interest rate charged to
the nature and extent of prior claims through private disclosure have an incentive to escape the costs of filing. It is plausible, therefore, to expect an interest group initiative to expand the existing categories of exemptions from some or all of the filing rules so long as the benefits of the larger exemptions accrue to members of the affected coalition.

2. PMSIs

Within current Article 9 law, purchase money security interests are substantially exempt from the first-in-time priority rule. The Study Group Report suggests extending the favored priority status of PMSIs even further, while also expanding the reach of those interests that qualify as PMSIs. First, regarding the filing requirements for PMSIs, the Final Report recommends extending the ten-day temporary perfection window to twenty days.145 The Study Group is quite candid about its reasons, stating that "compliance with the ten-day requirement in the face of obstacles such as back-office backlogs and delays inherent in the filing systems may impose too great a burden on secured parties." The Report concludes that "[g]iven the relatively short period during which competing claimants would be at risk by virtue of the PMSI financer's 'secret lien,' the benefits of extending the period to 20 days well may outweigh the costs imposed on these competing claimants."147 Indeed, for the PMSI financer, the gains would far outweigh the

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145 Final Report, supra note 68, at 103.
146 Id.
147 Id.

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the debtor would reflect that probability. Id. Uninformed creditors could best protect themselves against prior liens by assigning a high probability to the chance that such liens exist. Id. Thus, debtors would bear the cost of creditor uncertainty. In consequence, a debtor with unencumbered assets would have an incentive to disclose that fact. Id. A public filing system is only justifiable, therefore, if it permits debtors to make disclosure of their prior credit history more cheaply than the private disclosure they would otherwise make. Id. at 222.

This argument logically leads to the inference that increases in the costs of public disclosure will produce incentives to substitute private disclosure alternatives. Such a move is most likely to be attractive to informed creditors and other financial insiders who engage in frequent and repeated financing arrangements, and who would realize economies of scale from private disclosure arrangements.
risk, because the superpriority would prevail in any resulting priority dispute.\textsuperscript{148}

Support for the PMSI priority is reinforced in the Final Report’s recommendation to expand the definition of a PMSI. The most significant of these proposals would revise the definition of PMSI to allow “dual status” PMSIs.\textsuperscript{149} According to the Final Report, “A security interest may be a PMSI notwithstanding (i) the fact that the collateral also secures other, non-purchase money debt and (ii) the fact that the purchase money debt is secured by additional collateral.”\textsuperscript{150}

The significance of this proposal turns on whether the PMSI superpriority can be justified. As mentioned above, the PMSI priority has two potential justifications.\textsuperscript{151} According to conventional wisdom, the PMSI allows a debtor to purchase more inventory or equipment to keep its business operating and thus to pay off other, non-PMSI creditors. Alternatively, according to revisionist views, the PMSI deserves a superpriority because of the benefits other creditors may enjoy from a focused monitoring of specific assets\textsuperscript{152} or because of the tendency of secured creditors to act conservatively in approving new projects.\textsuperscript{153} All of these explanations, however, hinge on the discrete nature of PMSI collateral. The broader the definition, the more the PMSI starts to look like general financing credit, and the weaker becomes the justification for defending the PMSI superpriority and resulting exemption from the normal filing rules.

Interestingly, the Study Group did not reach a consensus on whether to recommend a default formula for determining how pay-

\begin{quote}
\textsuperscript{148} Despite its assessment of the benefits of implementing the 20-day window, the Study Group recognized that for the 20-day window to have any effect, an amendment to 11 U.S.C. § 547(c)(3) (1988), which currently allows only for the 10-day window, is necessary. Id. at 103.
\textsuperscript{149} Id. at 97.
\textsuperscript{150} Id.
\textsuperscript{151} See supra Part I.B.1.
\textsuperscript{152} See Levmore, supra note 13, at 56-57 (stating that purchase money lenders may be more talented monitors); Scott, supra note 13, at 963 (suggesting that purchase money lenders may have specialized skills in monitoring and policing inventory and equipment that the general financer lacks, which may serve to reduce monitoring costs).
\textsuperscript{153} See Scott, supra note 13, at 962-63 (arguing that PMSI superpriority acts as an escape hatch to guard against the general financer’s aversion to risky, but potentially profitable ventures).
\end{quote}
ments should be allocated for the separate parts of the dual status PMSI.154 By leaving the line between the components indistinct, the Report invites secured creditors to claim that any particular dual status PMSI substantially or wholly deserves the special treatment.155

Similarly, the Final Report recommends an expansion of the obligations that PMSI collateral is meant to secure, including interest and collection expenses following default.156 These additional types of PMSI collateral would, of course, qualify for the same filing exemptions as current PMSIs. The Study Group also proposes a pro rata sharing rule to resolve priority disputes among PMSI creditors.157 This recommendation seems at odds with the standard first-in-time principle of Article 9, and, under the current version of Article 9, courts have typically applied a first-in-time rule.158 A sharing rule is, however, a simple means of resolving potential conflicts among coalition members.159

These expansions of the PMSI status, together with the proposed easing of the PMSI filing requirements, continue the trend towards exempting informed secured creditors from the first-in-time requirements that purportedly underlie the filing system.160 The

154 Final Report, supra note 68, at 99.
155 This comports with the prediction of the model, because the allocation of payments for the dual-status PMSI brings the competing interests of the various secured creditors to the surface. This issue generates competing interest groups within the study group, and thus a preference for a vague general standard rather than a precise bright-line rule.
156 Final Report, supra note 68, at 102.
157 Id. at 105.
158 Article 9 Study Committee Minutes: April 27-29, 1990, at 10 (unpublished memorandum, on file with the Virginia Law Review Association).
159 Another confirmation of the predictions of the model can be seen in the Study Group’s treatment of when a debtor “receives possession,” under U.C.C. §§ 9-301 and 9-312. The Study Group recommends that the phrase be clarified in the official comments to make clear that, generally, when two specified times could start the 10-day period, the latter should apply. Final Report, supra note 68, at 103-04. Again, we encounter a bright-line rule that favors PMSI creditors.
160 One provision of the PMSI recommendations might seem to cut against the interest group hypothesis:

The official comment to § 9-107 should be revised to make clear that a security interest does not qualify as a PMSI if: (i) a debtor buys property on unsecured credit and subsequently creates the security interest to secure the purchase price or (ii) a debtor buys property for cash and subsequently creates the security interest in the property to secure a borrowing of an amount equivalent to the purchase price.

Id. at 102.
effects are twofold. First, firms are likely to rely increasingly on private disclosure as a substitute method of policing against debtor misbehavior. Second, the costs of the filing system are increasingly externalized from primary or dominant creditors to less informed or "occasional" creditors.

3. Proceeds

The enhanced protection of purchase money financing finds its parallels in the treatment of proceeds. Here, the Study Group recommendations work to enhance the favorable position granted to general financing creditors by expanding their ability to maintain their first-in-time priority in proceeds.

The heart of the Study Group proposal promises to transform the treatment of proceeds. First, the Report proposes an expanded definition of proceeds. As a general principle, the Report recommends that proceeds not be limited to property "received" by the debtor, but extend to all property in which the debtor has any rights.

And, in a broader recommendation, the Study Group

The comments to the proposal state that PMSIs are meant to enable debtors without other assets to obtain capital to run their businesses. Id. Therefore, if a debtor has already obtained capital from an unsecured creditor or from retained earnings, the debtor has no need to grant a creditor a PMSI superpriority.

Doesn't this provision suggest a desire to restrict PMSI status? The answer is yes, but this conclusion nevertheless supports the predictions of the interest group analysis. The provision grants the PMSI superpriority only to financial interests that are able to engage in purchase money financing ex ante. These are precisely the large commercial finance companies that strongly support the Article 9 scheme. It is quite consistent with the hypothesis that the benefits of PMSI status should be denied to trade creditors, a group not well represented in Article 9 deliberations.

161 According to the U.C.C., "'Proceeds' includes whatever is received upon the sale, exchange, collection or other disposition of collateral or proceeds." U.C.C. § 9-306(1).

162 Final Report, supra note 68 at 106. The Study Group also recommends that U.C.C. § 9-318 be changed to make clear that this expanded universe of debtors carries the same obligations, particularly on torts and warranties, as current debtors. Id. at 113-14. Interestingly, the consensus to replace the "debtor in possession" approach with the "debtor with an interest" approach did not emerge immediately. Two Study Group members originally objected to the proposal. See Memorandum from Steve Nickles to Steven L. Harris & Charles W. Mooney, Jr. 1 (Aug. 28, 1990) [hereinafter Nickles Memorandum], in Permanent Editorial Board for the Uniform Commercial Code, PEB Study Group Uniform Commercial Code Article 9: Document Nos. 3-5 (Oct. 11, 1990) [hereinafter Document Nos. 3-5]; Letter from Fred H. Miller to Professor Charles W. Mooney, Jr. & Steven L. Harris 1 (Sept. 5, 1990) [hereinafter Miller Letter], in Document Nos. 3-5, supra. The Study Group reached a consensus on the proposal included in the Final Report at the Oct. 26-28, 1990 meeting in Philadelphia. Article 9 Study Committee
suggests a change in the conception of proceeds, from the "exchange" principle currently embodied in U.C.C. section 9-306(1) to a "close association" principle, which would include payments that do not involve an exchange.\textsuperscript{163} This expanded concept of proceeds in turn resolves a number of specific issues. For example, the Report recommends the classification of rent collections (and maybe royalties from licensing intellectual property), stock splits, and warranty and tort claims as proceeds.\textsuperscript{164} The Report also proposes making explicit that the logic of the proceeds concept necessarily implies that a secured party's interest in chattel paper should extend to the goods if the debtor reacquires a substantial interest in them.\textsuperscript{165}

It is necessary to understand the current treatment of proceeds in Article 9 in order to appreciate the impact of these proposals. According to U.C.C. section 9-306(3)(a), the security interest in proceeds is continuously perfected if the filing as to the original collateral is in the same office that a creditor would file as to the proceeds. This provision relieves creditors from providing current information regarding their claim to proceeds, assuming that the

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\textsuperscript{163} Final Report, supra note 68, at 110-11. Initially, the Study Group did not support this conception of proceeds. The first treatment of the issue assumed a Study Group preference for the exchange theory. Memorandum from Steven L. Harris & Charles W. Mooney, Jr., Reporters to P.E.B. Article 9 Study Committee 13 (July 31, 1990) [hereinafter Harris & Mooney Memorandum], in Permanent Editorial Board for the Uniform Commercial Code, PEB Study Group Uniform Commercial Code Article 9: Document Nos. 1-2 (Aug. 14, 1990). Some correspondence on the issue also indicated a preference for the exchange principle. Miller Letter, supra note 162. Miller stated, "It seems to me the 'exchange' idea has the benefit of fairness; it allows the secured party to make up what the secured party has lost." Id; see also Letter from Barkley Clark to Steven L. Harris & Charles W. Mooney, Jr. 1 (Sept. 20, 1990), in Document Nos. 3-5, supra note 162 ("My feeling is, 'if it ain't broke, don't fix it.' "). Indeed, the minutes of the Study Group meeting in Philadelphia from October 26-28, 1990, stated that the committee reached a consensus that "[t]here should be no basic change in § 9-306 that would impair the concept of 'exchange proceeds.' " October 26-28 Minutes, supra note 162, at 3. The Study Group subsequently adopted the "close association" principle.

\textsuperscript{164} Final Report, supra note 68, at 106.

\textsuperscript{165} Id. at 125. This recommendation suggests the repeal of § U.C.C. 9-306(5) and the substitution of a generic "proceeds theory" embodied in § 9-306(1) as the preferred means of resolving the series of vexing "returned goods" problems. See A. Eric Kauders, Jr., Note, Substitution of Proceeds Theory for U.C.C. § 9-306(5), or, the Expansive Life and Times of a Proceeds Security Interest, 80 Va. L. Rev. 787 (1994).
filing as to the original collateral can be found at the same location. By expanding the definition of proceeds, the necessary effect is to reduce marginally the quality and quantity of information about the claims of general financing creditors that can reasonably be obtained through a search of the files.

Other benefits accrue to secured creditors who claim collateral as proceeds. Specifically, Bankruptcy Code § 552 holds that after-acquired property clauses in security agreements cease to be effective after the debtor files a petition for bankruptcy. However, Bankruptcy Code § 552(b) provides an exception for "proceeds," which bankruptcy courts have often defined according to the terms of Article 9. Therefore, an expanded definition of proceeds further protects secured creditors against the claims of unsecured creditors in bankruptcy proceedings.

The Study Group also recommends other changes to exempt further from filing rules secured creditors whose claims extend to proceeds. It suggests that the ten-day period for temporary automatic perfection be lengthened to twenty days, and that if a secured party should fail to perfect its interest within the twenty-day period, the security interest becomes unperfected on the twenty-first day and the unperfected status does not relate back to the beginning of the twenty-day period.

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166 Final Report, supra note 68, at 109.
167 Id. The Study Group Report reflects the hesitancy to expand the definition of proceeds too far, for fear that bankruptcy courts would chose another definition of the term, thereby eliminating the current advantage. Id.
168 The Study Group Report states, "[T]he benefits to secured parties of classifying collateral as proceeds are relatively small." Id. Nevertheless, during the committee deliberations, some members noted the potential degradation of the filing system and subsequent harm that would result from the proceeds proposals. The original treatment of the proceeds issue in a working paper stated that the committee should try to "inhibit abuse and overreaching by some secured parties." Harris & Mooney Memorandum, supra note 163, at 2-3. More specifically, one Study Group member pointed out that the expansion of the definition of proceeds would lead to hidden liens. Memorandum from Darrell W. Pierce to Steven L. Harris & Charles W. Mooney, Jr. 4 (Sept. 12, 1990) [hereinafter Pierce Memorandum], in Document Nos. 3-5, supra note 162.
169 Final Report, supra note 68, at 118-19. The Study Group did not immediately adopt this provision. The Reporters' first mention of the issue left it up for debate. Harris & Mooney Memorandum, supra note 163, at 14. The available correspondence reveals split preferences. Compare Nickles Memorandum, supra note 162, at 2 (accepting retroactivity of unperfected status) with Memorandum from Ed Smith to Steven L. Harris & Charles W. Mooney, Jr. 3, in Document Nos. 3-5, supra note 163 (opposing retroactivity) and Pierce Memorandum, supra note 168, at 6 (same).
4. Summary

The recommended revisions in PMSI and proceeds rules generally confirm the prediction that special interest legislation is more likely to be adopted when the subject matter of the regulation is confined and invisible to the potentially opposed publics. Under these conditions, an uninformed PL member has little incentive to oppose an industry position, and even participants who are ideologically opposed will seldom feel intensely about the issues and they will not be punished for non-opposition. As a consequence, the costs to uninvolved participants of becoming informed will exceed the gains. Moreover, uninvolved PL participants may also see public-spirited reasons for supporting industry proposals.

Many, if not all, of these conditions seem to be present in the recommendations concerning PMSIs and proceeds. The proposed changes work to redistribute some of the costs of secured financing for a confined category of financial industries; specifically, costs are reduced for commercial finance companies engaged in large-scale purchase money financing and for commercial banks and other firms that engage in general financing of new business and growth opportunities. The cost reductions for these industries are, at one level, entirely justifiable responses to the perceived difficulties of maintaining an increasingly costly public notice system. But the effect of these changes is also distributional. The expansion of safe harbors for certain secured creditors necessarily increases the costs of secured financing for those who are not exempt from the filing rules and whose search burdens have been marginally increased. Finally, as long as the filing system remains intact, at least as a cosmetic matter, further expansion of safe harbors for privileged insiders is unlikely to attract public attention.

C. Agricultural Liens

The previous examples illustrate how the Study Group recommendations undermine the utility of the filing system as a meaningful source of information for important types of transactions currently within the scope of Article 9. At the same time, the system is formally preserved as the symbol of good faith for industry outsiders. This Section seeks to examine the implications of a seemingly unrelated initiative: the proposal to bring agricultural and other statutory liens within the Article 9 scheme.
For our purposes, we can describe agricultural liens as interests created by statute and held by certain otherwise unsecured creditors (usually suppliers of goods and products to ranchers and farmers), which give them the right to collect unpaid debt from farmers' assets, including crops, thereby avoiding the pro rata collection process. Obviously, these automatic liens are, in many respects, the functional equivalent of consensual security interests. However, they function outside of the Article 9 regulatory scheme. As such, they are exempt from the filing system, and essentially create a minefield of non-Article 9 liens into which primary secured parties might stumble. Any collateral in farm products that secured creditors hold stands a good chance of becoming encumbered by statutory liens. And, according to U.C.C. section 9-310, most statutory liens trump security interests in priority disputes.

Perhaps not surprisingly, the Study Group recognizes the importance of protecting primary secured creditors from this significant risk. Its recommendations seek to reduce the risk by bringing agricultural liens within Article 9, together with the attendant filing,


\[171\] Id. at 439.

\[172\] See, e.g., Thomas E. Salsbery & Gale E. Juhl, Chapter 570A Crop and Livestock Lien Law: A Panacea or Pandora's Box, 34 Drake L. Rev. 361, 378 (1985) (stating that "[e]ven though a chapter 570A [Iowa statutory] lien may not be superior to a security interest in all instances, it does possess the unique attribute of potentially being an equal lien," meaning the secured creditor and the lien holder will share pro rata); Steven C. Turner, Richard L. Barnes, Drew L. Kershen, Martha L. Noble & Brooke Schumm, Agricultural Liens and the U.C.C.: A Report on Present Status and Proposals for Change, 44 Okla. L. Rev. 9, 19-20 (1991) (discussing secured creditors' concerns about agricultural liens trumping security interests, especially "when the lien came into existence after the security interest was created").

\[173\] The provision reads:
When a person in the ordinary course of his business furnishes services or materials with respect to goods subject to a security interest, a lien upon goods in the possession of such person given by statute or rule of law for such materials or services takes priority over a perfected security interest unless the lien is statutory and the statute expressly provides otherwise.

U.C.C. § 9-310. For a description of one banker's adverse reaction to mechanic's liens, see Patchel, supra note 2, at 120-21 n.178.
perfection, and priority requirements.\textsuperscript{174} Not only would potential statutory encumbrances need to be filed, but statutory liens would also lose their automatic priority. Instead, the Agricultural Report, whose general recommendations were endorsed by the Study Group,\textsuperscript{175} recommends that priority disputes be resolved by a first-to-file rule.\textsuperscript{176} Indeed, the Study Group suggests imposing such requirements on statutory liens in general.\textsuperscript{177}

The Study Group then suggests a mechanism for production money financers to obtain a superpriority through the proposed creation of a "production money security interest" ("PrMSI"). The PrMSI would be defined as "a security interest . . . that is used in the production of crops."\textsuperscript{178} The PrMSI would give special priority to "one who gave new value that is actually used in the production of crops and would take priority over holders of conflicting non-PrMSI's who are given advance notice of the PrMSI."\textsuperscript{179} That is, the PrMSI, presumably a form of general financing, would trump existing security interests, including those that had qualified previously as statutory liens.

The method by which the Study Group proposed the PrMSI is instructive. The genesis for the PrMSI lies in the Agricultural Report, which referred to U.C.C. section 9-312(2)\textsuperscript{180} as "an effort to provide a purchase money security interest in crops" that, because the priority applies only against the earlier interests that are at least six months in default, left it with "little practical effect."\textsuperscript{181} However, the Agricultural Report also recommended

\textsuperscript{174} Final Report, supra note 68, at 181.
\textsuperscript{175} Id.
\textsuperscript{176} Agricultural Report, supra note 170, at 442-43.
\textsuperscript{177} Final Report, supra note 68, at 181.
\textsuperscript{178} Id.
\textsuperscript{179} Id. at 183.
\textsuperscript{180} The section reads:

A perfected security interest in crops for new value given to enable the debtor to produce the crops during the production season and given not more than three months before the crops become growing crops by planting or otherwise takes priority over an earlier perfected security interest to the extent that such earlier interest secures obligations due more than six months before the crops become growing crops by planting or otherwise, even though the person giving new value had knowledge of the earlier security interest.

U.C.C. § 9-312(2).
\textsuperscript{181} Agricultural Report, supra note 170, at 459. According to the report, "The general problem with 9-312(2) is the '6 months' and 'three months' requirements, which as a
the creation of a production money ag lien that would allow farm suppliers to retain priority so long as they supplied prenotification to secured creditors.\textsuperscript{182} Indeed, the Agricultural Report said such a production money ag lien would be necessary because "[i]t will be a 'hard sell' to convince Ag Liens to come into Article 9 given the basic first to file rule."\textsuperscript{183} The Study Group Report makes no mention of the production money ag lien, and instead recommends only the PrMSI.\textsuperscript{184}

The interest group analysis helps to make some sense of the agricultural lien recommendations. Under current law, agricultural liens, and statutory liens in general, constitute an ever-expanding aggregation of noncode liens that can trump an Article 9 security interest. Article 9 secured creditors would obviously prefer to bring such liens within Article 9, and, thus, the Study Group recommends extending the perfection, priority and enforcement provisions of Article 9 to agricultural liens. Moreover, the Report suggests that a similar strategy should be employed to extend the Article 9 regime to common-law liens generally.\textsuperscript{185} To blunt the opposition of suppliers and others who have already secured protected lien status through the legislative process in individual states, the Report invites the Agricultural Committee to join with production money financers in exploiting the expanded superpriority created by the PrMSI.\textsuperscript{186}

\textsuperscript{182} Id. at 443-44.

\textsuperscript{183} Id. at 444. The ag lien issue vividly illustrates the tension between the rights granted to secured creditors under Article 9 and the ability of agricultural suppliers and other unsecured creditors to persuade sympathetic legislatures to grant protection to these interests as statutory liens and thus escape the Code's priority rules.

\textsuperscript{184} If the Agricultural Report correctly predicted that it will be difficult to bring ag liens under the auspices of Article 9, the Study Group's decision not to recommend the purchase money ag lien makes the task even harder.

\textsuperscript{185} Final Report, supra note 68, at 181.

\textsuperscript{186} Id. at 183. One of the Agricultural Report's specific recommendations is to eliminate the requirement that creditors file a description of the real estate when collateral consists of crops or timber. Id. at 182. One credit institution, responding to the suggestion to drop the description requirement in real estate filings, commented: "We see the recommendation to eliminate the real estate description as a double edged sword. As much of a hassle as this description represents, it is predictable and allows us, as lenders, to assess who has a lien on the borrower's crops that are planted in a given location."
This analysis is supported by the current trends in legislative regulation of agricultural liens. The trend is toward notice requirements outside of Article 9 for such liens. Similarly, the trend is towards "first-in-time" rules, by statutory or judicial creation, in deciding priority contests involving nonpossessory liens over agricultural assets. Given the increase in the requirements that agricultural lienors give public notice and be subject to "first-in-time" priority rules, support of agricultural lienors for expanding the scope of Article 9 can be gained if their filing costs are reduced or their priority position is improved. The proposed treatment by the Study Group offers them both things: description requirements are reduced and superpriority is granted to PrMSIs.\(^{187}\)

The debate over the treatment of agricultural liens is a microcosm of the tensions that confront any process to revise Article 9. Social welfare is increased by the creation of a unified, clearly understood set of precise rules governing asset-based claims against agricultural debtors. Those benefits are purchased at the cost of enhancing the priority claims of politically powerful interest groups. Maintaining the "illusion" of the filing system as a level playing field is a necessary strategy to confine the issue and exclude the debate from the public agenda. Without those conditions, the "reform" never gets enacted and the institutional interests are likely to be increasingly balkanized in the state legislative process.

D. Enforcement and Corporate Restructuring

The preceding examples tend to confirm the claims of the interest group model that efficient default rules are unlikely to be produced in a PL except where they are the result of interest group influence. The model assumes that industries with low coalition costs can successfully infiltrate the PL and push for rules that are in the industries' interests. Interest group influence thus generates two conflicting normative results: the captured PL is more likely to produce transactionally efficient rules that can be defended as normatively desirable on those grounds, yet also more likely to produce rules that have unfavorable distributional consequences.

\(^{187}\) Memorandum from Tom Moran to Steve Phelps & John Gunderson (Jan. 30, 1992), in Appendices, supra note 130, at 505.

\(^{187}\) Final Report, supra note 68, at 182-83.
Such rules will reduce the affected industry's costs of compliance with legal requirements (the efficiency assumption), and also preserve the industry's victory in the PL (the distributional assumption). In this Section, I examine the product of the Study Group process when those assumptions seem to fail.

1. Enforcement

Enforcement consists of the actions taken by the secured creditor to foreclose on collateral once a debtor has defaulted. When more than one secured creditor holds security interests in the same collateral, and one seeks to foreclose, their interests may conflict. The enforcing creditor wants to liquidate the collateral efficiently, whereas junior creditors prefer procedures that protect their residual interests in the collateral. The Study Group's recommendations on enforcement provisions embody this tension.

Section 30 of the Final Report contains nine provisions governing the relations between junior and senior creditors in enforcement proceedings.188 Each of these provisions reflects the Article 9 preference for precise, bright-line rules rather than the common Article 2 formulation of vague delegations to courts or multifactored standards. Of those nine provisions, three may be said to benefit the senior creditors, and five to benefit juniors.189

The proposals favoring the seniors include suggestions that: (1) they continue not to be required to search their files for possible junior creditors with claims in the same collateral, but only need to inform junior creditors from whom they have received written notice;190 (2) a senior who acts in good faith in paying out net proceeds from disposition of collateral not be held liable to other creditors who were entitled to payment;191 and (3) a senior have the right to take possession of collateral held by a junior if the senior has a right of possession as against the debtor.192

The proposals favoring the juniors include suggestions that: (1) juniors be entitled to excess proceeds from a senior's disposition of

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188 Id. at 214-24.
189 Recommendation F seems to be neutral. See id. at 218-20.
190 Id. at 214 (Recommendation A).
191 Id. at 216 (Recommendation C).
192 Id. at 220 (Recommendation G).
collateral;\(^1\text{93}\) (2) the rights of juniors to enforce a debt be clarified;\(^1\text{94}\) (3) a junior who disposes of collateral need give any excess funds to the debtor, and not directly to senior creditors;\(^1\text{95}\) (4) a junior who in good faith acts to infringe on the rights of a senior not be sanctioned;\(^1\text{96}\) and (5) the equitable doctrine of marshalling apply to enforcement.\(^1\text{97}\)

Section 30 thus reads essentially as a compromise measure; it appears to be a classic example of coalition members' logrolling.\(^1\text{98}\) This provision suggests that logrolling within a PL study group is not impossible so long as the trades occur within the "governing coalition" of interests.

The evidence of intra-interest group logrolling may, however, make more problematic any claim that bright-line study group recommendations reflect the influence of a single active interest group. First, the proposals do not favor one class of institutional interests over the larger group, but instead reflect a roughly equal division between competing interests. This suggests that where the legal regulation is not confined, and relatively cohesive interest groups form on either side, the participants in the Article 9 process can (and do) engage in trading. It follows that the composition of the interest group that succeeds in forming a governing coalition is a significant variable that may affect the output of the PL process. In particular, if the coalition is sufficiently broad-based, trading within the interest groups may produce outputs that are similar to those of ordinary legislative bodies.

2. Corporate Restructuring

A second assumption of the interest group model is that an uninformed PL member will have little incentive to oppose an industry position where the issue is confined and invisible to potentially opposed interests. Under these conditions, the rules do not affect a

\(^{193}\) Id. at 215 (Recommendation B).
\(^{194}\) Id. at 216 (Recommendation D).
\(^{195}\) Id. at 218 (Recommendation E).
\(^{196}\) Id. at 222 (Recommendation H).
\(^{197}\) Id. at 223 (Recommendation I).
\(^{198}\) Such logrolling is not wholly foreign to the drafting of U.C.C. rules. See Rubin, supra note 60, at 764-65 (describing a similar situation that took place during the drafting of Article 4A).
participant's own practice, nor will she be lobbied to oppose them. Such a situation seems to be reflected in the Study Group suggestions regarding a secured party's filing responsibilities following a debtor corporation's restructuring.

In the comments to Final Report section 17(E), the Study Group states:

When a new debtor becomes bound by the security agreement of the original debtor . . . Article 9 should indicate the circumstances, if any, under which the financing statement filed against the original debtor is effective to perfect a security interest in property acquired by the new debtor. In the view of the Committee, the current formulation in the second sentence of § 9-402(7) performs this task with insufficient clarity and should be revised.\textsuperscript{199}

The "new debtor" refers mainly to a new corporation that emerges through restructuring in which the old debtor, who signed the original financing statement, no longer survives.\textsuperscript{200} The Study Group, however, disagreed about exactly how to treat the issue. A minority of the Study Group\textsuperscript{201} recommends that the original party's secured creditors bear the burden of monitoring corporate restructuring, refileing with signatures of the officers of the restructured corporation, and forfeiting interest in the collateral upon failure to refile. The four-month grace period currently stated in U.C.C. section 9-402(7) would not apply to creditors resecuring debtors in this situation.\textsuperscript{202} The minority has a forthright reason for its position: "a financing statement should not be effective

\textsuperscript{199} Final Report, supra note 68, at 144. The second sentence of the provision reads: Where the debtor so changes his name or in the case of an organization its name, identity or corporate structure that a filed financing statement becomes seriously misleading, the filing is not effective to perfect a security interest in collateral acquired by the debtor more than four months after the change, unless a new appropriate financing statement is filed before the expiration of that time. U.C.C. § 9-402(7).

\textsuperscript{200} Final Report, supra note 68, at 144.

\textsuperscript{201} The Final Report refers to the advocates of the different positions as "Group A" and "Group B." Id. One of the preparatory documents implies that Group A was a minority. Memorandum from Steven L. Harris & Charles W. Mooney, Jr., to P.E.B. Article 9 Study Committee 2 (July 31, 1992), in Permanent Editorial Board for the Uniform Commercial Code, PEB Study Group Uniform Commercial Code Article 9: Document Nos. 57-60, First Set of Proposed Final Recommendations (Aug. 5, 1992).

\textsuperscript{202} Final Report, supra note 68, at 144.
against a person who did not sign it."\textsuperscript{203} The majority, although recognizing "that View A has the virtue of being relatively clear cut,"\textsuperscript{204} claims that secured creditors should have the advantage of the four-month grace period, because it is difficult for secured creditors to monitor their debtors closely enough to keep tabs on changes in corporate structure.\textsuperscript{205} In order to implement this view, the majority suggested a fairly complex set of implementing regulations.\textsuperscript{206}

This split among the Study Group members seems inconsistent with the claim that the Article 9 process is peculiarly susceptible to interest group influence. Here, the policy that best serves the interest of influential secured creditors is the one propounded by the majority. The model would thus predict that the Study Group would adopt it. That did not happen, because some Study Group members, specifically the two Reporters, dissented. This opposition is made clear in one of the preparatory documents where the two Reporters, Steven Harris and Charles Mooney, wrote that "we think that the costs of protecting original debtors' secured parties by complicated legal regulation are not justified by the few instances where those parties fail to protect themselves."\textsuperscript{207} This is perhaps the strongest example of how the academic reporters exercise independent influence in the Study Group deliberations.

It is worth noting the reasoning that the Reporters gave for opposing the interests of the majority. They did not protest merely at imposing the costs of secured creditors' sloppy monitoring on subsequent parties. Rather, they coupled that concern with the fact that the majority's position would require complicated accompanying regulation.\textsuperscript{208} That is, the minority preferred its own view, at least partially, because of its bright-line (i.e., efficient) quality that even the majority acknowledged. The resolution of the "double debtor" problem thus provides one of several illustrations

\textsuperscript{203} Id.
\textsuperscript{204} Id.
\textsuperscript{205} Id. at 144-45.
\textsuperscript{206} See id. at 146-48.
\textsuperscript{208} Id. at 1-2.
of the independent interests asserted by formally disinterested participants. The fact that these participants were the two Reporters rather than other, more casually informed, participants is instructive. One of the assumptions of the interest group model is that uninformed members will seldom oppose industry positions, because ignorant opposition commonly is futile and uninformed opposition threatens a participant's reputation for good judgment. These assumptions seem least likely to hold with regard to the Reporters, who have invested considerable human capital in developing expertise concerning the proposed regulations. Nevertheless, the evidence, fairly examined, suggests that formally neutral participants can exercise influence that blunts the initiatives of interest group representatives.

E. The Post-Study Group Process

It is important to note that the Study Group Report is only a legislative blueprint. Thereafter, the Report is forwarded to the NCCUSL, where it is given to a drafting committee to be reformulated into legislative language, and then offered to the state legislatures for enactment. In some cases, the NCCUSL drafting committees have limited their work to technical implementation, thus minimizing major substantive changes. However, there is some evidence that, at least for the Article 9 drafting committee, the drafting process will be more than a technical exercise, and that the members of the committee will be exposed to a wider range of voices from interest groups than was evident in the Study Group.

If the NCCUSL is indeed self-consciously attempting to broaden its constituency, then much of the risk of disproportionate interest group influence may be alleviated. But there is a fundamental par-

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210 See, e.g., Fred H. Miller, U.C.C. Articles 3, 4 and 4A: A Study in Process and Scope, 42 Ala. L. Rev. 405, 411 (1991) ("Articles 3 and 4 cover substantially the same ground that they covered in the former forms . . . ."); Patchel, supra note 2, at 109 (reporting that goal of revising Articles 3 and 4 was to clean up conflicting interpretations and to incorporate "desirable substantive improvements to take account of technological developments and changes in business practices"); Rubin, supra note 60, at 746 (stating that new revision process was simply to update the existing Articles 3 and 4 and would not alter the basic balance between banks and consumers that existed in the original Articles).
211 Comments of Professor Frederick H. Miller, Executive Director of NCCUSL, to author, in Charlottesville, Va. (Oct. 15, 1993).
adox to the U.C.C. lawmaking process. If the predictions of the model are valid, opening the NCCUSL process to a wider range of competing interest groups runs the risk of sacrificing the clarity of the Article 9 rule structure. Ironically, it is the clarity of the rules that makes the statute so attractive to all affected interests in the first place.\footnote{212}

To be sure, it is not yet clear that the tension between having a clear statute that promotes particular interests and a vague statute that accommodates interest group competition is inevitable. Arguably, the difference between the two statutory archetypes results not from interest group influence or its absence, but from the nature of the regulated industries themselves. Secured creditors are a relatively small and homogeneous group, who may have similar regulatory interests, and thus desire a clear statute. The buyers and sellers governed by Article 2, on the other hand, constitute relatively large and heterogeneous groups with sharply divergent interests, and might therefore prefer a more flexible statute that delegates broad discretion to courts.

Moreover, even if the interests of unsecured creditors are not fully reflected in the U.C.C. lawmaking process, these interests are not entirely ignored. Certain institutionalized unsecured creditors have powerful voices in the state legislatures that ultimately must decide whether to accept or reject the revisions.\footnote{213} Although state legislatures are unlikely to decline to adopt the revisions in toto, they are susceptible to ad hoc amendments that grant statutory liens and other exemptions to favored classes of unsecured creditors.\footnote{214} In addition, unsecured creditor interests may well seek to

\footnote{212}{Of course, it does not follow that a less precise and more ambiguous statute would be necessarily undesirable. See, for example, Rubin, Efficiency and Equity, supra note 116, at 579, 586-92. Moreover, although secured creditors may have played influential roles in both the promulgation and enactment of Article 9 and its revisions, it is not necessarily the case that influence at the PL level leads to enactment in state legislatures. Ribstein & Kobayashi, supra note 60, at 20. \footnote{213}{See, e.g., Salsbery & Juhl, supra note 172, at 363-64 & 363 n.14 (stating that legislature passed chapter 570A in response to farmers and their creditors during the farm debt crisis of the early 1980s). \footnote{214}{The influence of proposed U.C.C. revisions in state legislatures is generally very great, especially where the state legislators serve on a part-time basis. See Ribstein & Kobayashi, supra note 60, at 10-11 (arguing that uniform laws, theoretically, can be a better product than state legislative laws, because uniform lawmaking agencies are in a position}
influence the process by which the bankruptcy law is made in much the same way that secured creditors seem to have been able to influence the Article 9 process. Thus, the lack of competition in the Article 9 Study Group may say as much about the risk of special interest legislation from the Bankruptcy Conference as it does about the influence of secured creditors.\textsuperscript{215}

Finally, it is not clear how important any of this is to significant creditor interests. Because many (if not most) unsecured creditors to enlist experts in a particular field or in statutory drafting). Therefore, the final product of the NCCUSL stands a large chance of being enacted in full, at least in some states, without much informed discussion.

\textsuperscript{215} The 1978 Bankruptcy Code was based on an act proposed by the National Commission on the Bankruptcy Laws of the United States, which in turn was based in large part on work done by the National Bankruptcy Conference. Anthony T. Kronman, The Treatment of Security Interests in After-Acquired Property Under the Proposed Bankruptcy Act, 124 U. Pa. L. Rev. 110, 110 nn.1, 3 (1975). Any claims about the role played by interest groups, either directly or through the mediation of commercial lawyers, in the formulation of the Bankruptcy Code are necessarily speculative. Even so, there is at least impressionistic evidence that unsecured creditors, managers, and debtors had some role in molding the Bankruptcy Code to suit their needs, which were driven in large part by the sympathetic stance toward secured creditors evident in Article 9.

One salient example of this influence can be seen in the tug-of-war that occurred in the late 1960s and early 1970s concerning the validity of floating liens during insolvency. In 1969, two circuit courts held that floating liens did not constitute voidable preferences, and the priority of secured creditors was thus preserved in Bankruptcy. DuBay v. Williams, 417 F.2d 1277 (9th Cir. 1969); Grain Merchants v. Union Bank & Savings Co., 408 F.2d 209 (7th Cir.), cert. denied, 396 U.S. 827 (1969). These decisions prompted § 547(e)(3) of the 1978 Bankruptcy Code, which essentially created a presumption against the attachment of a floating lien during insolvency, unless certain exceptions applied. See Douglas G. Baird & Thomas H. Jackson, Cases, Problems, and Materials on Bankruptcy 478 (2d ed. 1990) (stating that § 547(e)(3) tries to postpone "the moment of transfer until the debtor acquires rights in the collateral"). The treatment of floating liens supports the inference that the Bankruptcy Conference is itself susceptible to interest group influence, and that interest groups seek to use the Bankruptcy Code in order to trump Article 9 concessions to secured creditors.

It is worth noting that the U.C.C. Article 9 Study Group and the National Bankruptcy Conference are not perfect mirror images of each other. The Bankruptcy Conference has experienced a modest decline of influence in recent years, and never enjoyed the official status of the U.C.C. Study Groups. Also, the Bankruptcy Conference is not the only PL on the bankruptcy side of the equation. Other organizations that merit investigation are the American Bankruptcy Institute, which has prodebtor sympathies, and the National Conference of Bankruptcy Judges. Finally, it is significant to note that, to my knowledge, none of these organizations have issued formal counterproposals to the current revisions to Article 9.

Of course, when the proposals from these bankruptcy-oriented private legislatures become law, they trump the state-enacted U.C.C. through the Supremacy Clause of the Constitution.
know in advance the priority position they occupy under the Article 9 default scheme, they are able to adjust by increasing interest rates to compensate for the heightened risk of default occasioned by rules that favor secured creditors.\textsuperscript{216}

**Conclusion**

Through an examination of the revision process of Article 9 of the U.C.C., I have sought to demonstrate that private law reform bodies have a political economy that influences the rules they produce in different and important ways. Where the legal regime regulates the interests of relatively cohesive industries, the U.C.C. lawmaking process is likely to function much differently than where the regulatory effects are diffused. Thus, the normative implications of a revision of Article 9 are likely to differ substantially from the implications of a revision to Article 2. Because Article 9 regulates asset-based financers, a paradigmatic example of well-organized and cohesive interests, the process is susceptible to disproportionate influence by a single active interest group representing particular financing interests. In such a case, I suggest that the law revision process will tend to propose rules that are both transactionally efficient and distributionally favorable to the dominating interests.

This situation does not necessarily lead to rules that work against the public interest. Indeed, when the interests of the dominant group are closely aligned with the public interest, a private legislative body such as the ALI and NCCUSL will recommend rules that serve the public admirably. In less ideal circumstances, however, the concerns of the dominant interest group and those of society do not coincide. In such a case, not only are the resulting rules distributionally suspect, but they risk externalizing costs onto dispersed and uninformed interests, thus undermining even the apparent efficiency of the rule structure.

This Article has attempted to explore whether one such situation exists in the case of Article 9 and the current set of suggested revisions. Whether the evidence fully supports the inference of inter-

\textsuperscript{216} But even if all of this is true, at least one group of unsecured creditors, most obviously the involuntary tort and warranty claimants, are unable to adjust ex ante and thus remain susceptible to exploitation in the private legislative process.
est group influence is not entirely clear. Nevertheless, one inference is clear. The revisions reflect a dramatic escalation of the tension between the twin goals of Article 9: the maintenance of public confidence through the use of a broad-based, facially neutral filing system and the development of rules that reduce costs for particular classes of secured creditors. The solution reflected in the Study Group report—to maintain the mythology of a filing system while expanding the exemptions available to dominant secured creditors—is unlikely to succeed in confining the issues sufficiently to forestall the ongoing public debate over the social value of Article 9.