1995

Some Comments on Bowers

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What are you gonna do now, Leander? The feds have got the atom bomb.¹

Times change. Thirty years ago, law professors took a benign, not to say irenic, view of the possibilities of government intervention. Not everyone endorsed the bomb-throwing excesses of the Great Society, but there was more or less general agreement that good people with good hearts could put matters right through good law. Today, no one would admit that sort of thing unless he or she wants to be thought of as hopelessly behind the times. The beau ideal of the new elite of legal academics is not as much John Marshall or Benjamin Cardozo as it is Milo Minderbinder, the hero of Catch-22 who bought eggs for seven cents apiece and sold them for five cents at a six cent profit.² Jim Bowers thus operates in the establishment mainstream when he proposes abolishing the filing system under Article 9 of the Uniform Commercial Code as a means of achieving the goals of Article 9.³

Precisely because the notion of economic efficiency is so popular, we need to be extra careful not to get swept up in our own enthusiasms. Although we will surely fail, we must try to detect and eradicate our own metaphysical blind spots. Start with the dichotomy of government, or public, versus private. We need to remember that our opponent is not the government, per se. Our opponent is the idea of rent seeking.⁴ For example, we might

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¹. Bill Rose, Louisiana Family’s Feud Shatters 50-Year Dynasty: The Perez Dictatorship is Losing Grip on Parish, MIAMI HERALD, Jan. 20, 1983, at 1A (quoting Louisiana Governor Earl Long in a conversation with Plaquemines County patriarch, Leander Perez, on principles of sovereignty and the separation of powers).


⁴. Rent seeking is “the opportunit[y] to exploit informational asymmetries,” which leads to economic inefficiency. Robert E. Scott, The Politics of Arti-
blindly assume that although both the government and Citibank are rent seekers, life under the dominion of the Citibank workout department would be sweeter and more fulfilling. That is not, however, necessarily so. The question of who is in fact the better rent seeker remains an empirical question.\(^5\)

Privatization presents a similar problem. Economic rhetoric pays listless lip service to the notion that deadweight costs might afflict nongovernment transactions.\(^6\) Any defense of

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\(^5\) A related approach to this problem is to ask who is the government. For example, we can imagine a world in which the Citibank workout department acquires its own Air Force and the power to exact taxes while eschewing any explicit claim to government power. Something of this sort seems to be happening in post-communist Russia, where investors are finding that they must equip themselves with paramilitary forces to support private investment goals. One United States firm, for example, pays $12,000 a year to a British company for protection from local racketeers. Lee Hockstader, *A Time of Thieves: Organized Crime in Post-Soviet Russia* (pts. 1 & 2), WASH. POST, Feb. 26, 1995, at A1, WASH. POST, Feb. 27, 1995, at A1, A13. Of course, we might define all successful rent seekers as the government, but this robs the notion of any useful analytical content.

\(^6\) Economists have argued that private transactions are not always as efficient as they could be. See, e.g., R.G. Lipsey & Kelvin Lancaster, *The General Theory of Second Best*, 63 Rev. Econ. Stud. 11, 11 (1956) (providing a general theory of second best). Lipsey and Lancaster argue that “if there is introduced into a general equilibrium system a constraint which prevents the attainment of one of the Paretn conditions, the other Paretn conditions, although still attainable, are, in general, no longer desirable.” *Id.* In other words, private actors will settle for a state of equilibrium that is “second best” from the standpoint of economic efficiency. As a result, “an imperfectly competitive economy may well diminish both the general productive efficiency of the economy and the welfare of its members.” *Id.*
privatization as a means of avoiding the costs of rent seeking, however, requires an explication as to precisely why that particular privatization, rather than privatization in general, serves to reduce the net social cost of the governmental scheme.

Within the framework of requiring justification for specific privatization schemes, let me suggest three parts of Bowers's plan that seem to require more thought. First, Bowers needs to state explicitly his understanding of the function of an Article 9 filing system. Second, Bowers needs to clarify his description of the state of nature absent an Article 9 filing system, or, more precisely, why he assumes the existence of the particular state of nature that he does. And third, Bowers's proposal would profit from a more comprehensive analysis of the different means through which to eliminate rent seeking. I will discuss these in sequence.

I. THE FUNCTION OF AN ARTICLE 9 FILING SYSTEM

Bowers asserts that Article 9 filing serves a notice purpose only in that it merely provides a source of information for those who believe they need it. He may be right. I suggest, however, that Article 9 also serves a validation function, which is a rather different matter and requires separate analysis to determine whether its filing system is desirable or efficient. Consider the following case:

S2 is considering lending $100,000 to Debtor, to be secured by a widget. On review of information furnished by Debtor, S2 learns that Debtor previously granted a security interest in the same widget to S1. Debtor also reports that she signed a financing statement containing a description of that collateral. A search reveals, however, that the financing statement was never put on file. S2 then undertakes to complete the transaction with Debtor. Debtor signs a new financing statement describing the collateral, which S2 files. In a subsequent priority conflict between S1 and S2, who prevails?

If S2 is bound by S1's unfiled security interest because he knew about it, then Article 9 filing is a notice mechanism only. If S2 wins regardless of his knowledge, then Article 9 serves a validation function independent from its notice function. Article 9 filing thus is a formal mechanism in the sense that it is meaningful in determining the substantive rights of S1 and S2 but it does not change the content of their respective agreements with

7. Bowers, supra note 3, at 725 ("The Article 9 filing system provides nothing other than a simple commodity—information.") (citation omitted).
Debtor. As Lon Fuller suggests, the interminable tension between function and form means that neither will ever triumph completely over the other.

Although Article 9 is a formal rule mandating that S2 has priority over S1 in spite of his knowledge, it is entirely likely that judges will treat Article 9 filing as a notice mechanism and grant priority to S1 by employing trumping doctrines (perhaps they are counterrules) such as estoppel or, heaven help us, bad faith. Many judges who decide Article 9 cases have never been exposed to commercial law, and their knowledge on the point comprises at best a creative misreading of James White.

Bowers does not explicitly state which of these possibilities he embraces. My impression is that he vacillates somewhat. He implies that the prior creditor is required to file to protect his interest, which suggests a validation function. He also spends some energy, however, discussing the availability of alternate information sources and the possibility of competitive markets, which seems to presuppose a regime of reliance. The distinc-

8. Form and substance are two important factors in assessing the enforceability of a promise. See Lon L. Fuller, Consideration and Form, 41 COLUM. L. REV. 799, 799 (1941) (discussing the “formal” and “substantive” aspects of consideration). Gratuitous promises, for example, are not enforced because “such promises are often made impulsively and without proper deliberation.” Id. Because this objection is based on the form of the agreement, it disappears if the promise is accompanied by “some formality or ceremony.” Id. Yet, many argue that enforcing gratuitous promises is not sufficiently important “to our social and economic order to justify the expenditure of the time and energy necessary to accomplish it.” Id. “Here the objection is one of ‘substance’ since it touches the significance of the promise made and not merely the circumstances surrounding the making of it.” Id. at 799-800. Reliance is another important element in the enforceability of a promise. See, e.g., Charles L. Knapp, Reliance in the Revised Restatement: The Proliferation of Promissory Estoppel, 81 COLUM. L. REV. 58, 59 (1981) (“In light of the important policies underlying consideration and form, a court might well require . . . that the plaintiff seeking enforcement demonstrate reliance that is both definite and substantial.”). See generally E. Rabel, The Statute of Frauds And Comparative Legal History, 63 LAW Q. REV. 174 (1947) (discussing the evolution of the Statute of Frauds).

9. See Fuller, supra note 8, at 799 (explaining the relation of form to the substantive basis of contract liability).

10. Now, I must confess that I am not certain on this point, at least not certain enough that I would be willing to sign an opinion letter on it.

11. See James J. White, Revising Article 9 to Reduce Wasteful Litigation, 26 LOY. L.A. L. REV. 823, 824 (1993) (proposing the repeal of § 9-301(1)(b), which grants priority to the first to file).

12. Bowers, supra note 3, at 726 (“Transacting parties must file before they can make the benefits of their dealings enforceable against strangers.”).

13. See generally id. at 725-33 (explaining that the function of Article 9 is to provide information and that an efficient market would provide the same services if they were truly valuable). Perhaps Bowers visualizes shifting from a
tion is important. If the goal is to eliminate the filing system, the rationale for doing so will vary depending on the function of the system. Indeed, recognizing the distinction might make it possible to achieve more analytical precision as to whether the function of the system is validation or notice.

If filing serves a notice purpose only, then the issue involves the relative merits of different sorts of notice. One might say, for example, that it is easier, cheaper, or more expeditious to get information from county clerks than it is from Dun & Bradstreet, or the reverse. Empirical evidence dictates the truth of either assertion. Issues such as the potential economies of different sorts of notice systems and the possibility of contestable markets in information then become relevant.\textsuperscript{14}

On the other hand, if Article 9 filing serves a validation purpose, one must employ a different sort of analysis. One needs to show not merely that the private market is a more efficient information provider, but also that formalism itself is discredited and ought to be abandoned.

II. BOWERS'S STATE OF NATURE

Similarly, Bowers needs to clarify his view of the state of nature. He assumes that doing away with the filing system leaves us with a regime in which security interests are valid against competing claimants, whether or not the competing claimants knew, or could have known, about them. There may be such a state of nature, but I have not seen it. My reading of pre-UCC history suggests a far more complicated picture, and for Bowers, a more troublesome one. Specifically, the state of nature Article 9 addresses can be understood as a classic eternal triangle of economic interests. In such a scenario, two or more parties have claims against a third, and there is not enough collateral to go around. The reason this triangle is a problem in the absence of Article 9 is not, as Bowers's assumption suggests, that each side can deploy equally plausible state of nature rheto-

\textsuperscript{14} Although I may seem to suggest that formalism requires some degree of government monopoly, I would not go quite that far. I am aware, for example, that we accept many items as private money regardless of the government's effort to maintain a monopoly. Although it is possible to imagine a private market in which entrepreneurs both evidence and validate transactions, I cannot imagine exactly how it would work—nor does it seem that Bowers has done so. \textit{See infra} notes 20-21 and accompanying text (discussing the role of semiprivate filing systems).
ric to justify his claim. The prior creditor typically has the logic of property, contract, and priority on his side. On the other hand, the subsequent creditor may have a weaker case with regard to priority and property. The subsequent creditor, however, has an equally valid claim based on contract, and she has an additional and equally compelling argument based on ostensible ownership. Bowers can eliminate the filing system, but he cannot eliminate the ideological tension in competing claims that led to Article 9 in the first place.

Ironically, if the state of nature points in any direction here, it is probably points to the reverse of the one Bowers supposes. Traditionally, we associate the right of the prior claimant with the notion of a property right. She has ownership that no one can impair without her consent. The subsequent claimant can assert security of transaction. That is, a party ought to be able to make deals cheaply and depend on appearances in making them. This is the reason, for example, that we have a regime in which a store clerk does not demand two forms of identification before accepting a twenty dollar bill for payment.

Typically, the rhetoric in the nineteenth and early twentieth centuries asserted that the commerce position was modern and fashionable. The property interest position, on the other hand, was terminally retrograde, medieval. The drafters of Article 9 thus understood themselves as coming not to destroy but to fulfill a vision of private ordering, a vision free from extraneous interference.

III. ALTERNATIVE MEANS TO ELIMINATE RENT SEEKING

Bowers should consider the problem of rent seeking at a somewhat higher level of abstraction. In doing so, he would recognize that there are any number of means or devices through which to thwart or finesse rent seeking.

The campaign in support of Article 9 is a campaign to limit rent seeking. I am not saying that the proponents were correct in their appraisal of the world. They may have been badly mistaken. No one can deny, however, that the whole point of the Article 9 movement was to accomplish precisely the result that Bowers seeks here. Indeed everyone understood that the entrenched county clerks, who profited by exacting a toll for crossing the transactional bridge, would constitute the principal source of opposition. This is the reason Article 9 implements central filing and uncouples the financing statement from the
security agreement. Indeed, Bowers should recognize that the problem in Louisiana has not been the success of Article 9 but, rather, that Article 9 has not been successful enough.

The drafters of Article 9, of course, could have chosen to depend on private ordering for informational needs rather than creating a filing system. Before the UCC, plenty of case law sorting out the rights of competing claimants on the grounds of estoppel or ostensible ownership supported such a choice. Indeed, to a certain extent the drafters did depend on private ordering. Unlike today's version of Article 9, which favors a "race" system, the original version of Article 9 clearly favored a "race-notice" scheme of perfection in certain circumstances.

The drafters, however, added the device of filing. The justification for the device of filing was that it was more economical in social welfare terms than devices extant at the time. This rationale is even more persuasive if one views Article 9 as a validation instead of merely an informational statute. To the extent that Article 9 appeals to notions of formalism, it invokes all the conventional arguments in favor of formalism. These arguments are, in large part, arguments about the supposed economies of Article 9. To use familiar examples: if all money has to pass a formal test, then we save the time and cost of weighing and assaying; or, if all trains run on schedule, then fewer people miss trains.

Once again, I am not saying that any of these arguments were, in fact, true when the National Conference of Commissioners on Uniform State Laws created, and state legislatures adopted, Article 9, or that they remain true today. My point is only that Bowers's arguments in support of his proposal to abolish the filing requirement, however factually correct they might be, are not revolutionary in principle. Anyone who wants to weigh the evidence again should recall that the evidence has already been weighed before.

It is also proper to consider a variety of intermediate devices that the UCC may invoke to limit the social welfare cost of filing. The UCC already exempts some transactions from the filing requirement, such as security interests in consumer goods. In the same vein, the drafters of a special set of Article 2A rules gov-

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15. In other words, the first to file is first in right regardless of notice. U.C.C. §§ 9-301(1)(a), 9-312(5) (1990).

16. See, e.g., U.C.C. § 9-301(1)(b) (1962) (an unperfected security interest is subordinate to the rights of "a person who becomes a lien creditor without knowledge of the security interest and before it is perfected") (emphasis added).
erning equipment leasing might have intended to avoid the burden of a filing system. Presumably a conclusive defense of Article 2A would have to show that the savings in not filing outweigh any costs that arise from the lack of a filing requirement. I know of no attempt either to prove or disprove that reading of Article 2A. My own intuition is that the proponents of Article 2A could meet the burden of such a cost-benefit analysis. The Article 2A example is particularly instructive because exemption from the filing requirement is coupled with the option of filing for those seeking a comprehensive plan of self-protection. I do not know how widespread optional filing is, but do I believe that it is widespread. This would suggest that counsel for creditors believe that it is a cost-effective means of protecting their clients, or themselves, from a certain kind of risk.

Other modifications are possible. A number of critics have pointed out that the animating principle of Article 9 is the conflict between the secured creditor and the bankruptcy trustee. Critics have also asserted that present rules governing the conflict often seem to operate in an arbitrary or accidental way. Jim White has pointed out that we could obviate these problems by removing filing from the list of conditions necessary for a secured creditor to triumph over the trustee.

It is worth noting that White’s recommendation marks a radical departure in terms of the structure of the Bankruptcy Code as a whole. Compare the treatment of real property. Under the law of many states, an unrecorded security interest in real estate trumps a lien creditor and also will trump a bankruptcy trustee. In effect, that is White’s proposal. As bankruptcy lawyers know, however, it does not end there. With respect to the real estate claim, the bankruptcy trustee also has the power of a bona fide purchaser, which puts her effectively back in control. It is not at all clear why the Bankruptcy Code gives the trustee this kind of power. It is hard to conceive, how-

17. See John D. Ayer, An Unrepentant View of the Sale-Lease Distinction, 4 J. BANKR. L. & PRAC. 290 (1995). This does not mean the motive was to relieve clients of the expense of filing. More likely it was to relieve transactional lawyers of the embarrassment of failing to file. I am not certain that this was the primary motive for Article 2A. Another contender is the desire of law professionals to claim their place in the hall of fame of uniform lawmakers.

18. See White, supra note 11, at 824. White notes that “[t]he direct and most obvious effect” of his proposal “would be to subordinate a creditor who had procured a judicial lien—usually after judgment and levy—to an unperfected secured creditor who had a security interest in the personal property on which the lien creditor levied.” Id.
ever, that it could be the result of rent seeking by the lobby of Louisiana county clerks.\textsuperscript{19}

\section*{CONCLUSION}

The tenor of these remarks may seem to cast doubt on the substantive merit of Bowers's proposal. But, in fact, I am more agnostic. It is easy to conjure up lines of inquiry that support, rather than oppose, his suggestion. For example, Bowers has suggested that the rent seeking clerks at the courthouse are a powerful constituency helping to maintain a filing system that lines their own pockets. Another constituency that, in principal, also stands to gain from a filing system is the constituency of attorneys who plan transactions for institutional creditors. After all, it is the attorneys, not their clients, who draft reform statutes. In additionally, the interests of lawyers and clients often diverge on important issues. A likely justification for Article 2A is that it relieves lawyers of the embarrassment of nonfiling. It could, however, be the other way around. It may be that the virtue of the filing system is that it gives lawyers the assurance they need to write opinion letters validating transactions. Under these circumstances, the attorney can pass the cost back to the client. It is entirely consistent to suppose that both of these seemingly opposite propositions are true. That is, lawyers like filing when it makes it easier to validate opinion letters and dislike it where the costs of mistakes are too high.

In a somewhat different vein, I assume Bowers would acknowledge that not all filing systems are alike. If one were assessing the relative costs and benefits of a filing system, one would want to know which filing systems are most cost-effective and why.\textsuperscript{20} This is particularly interesting in view of Bowers's Louisiana example, in which clerks keep records centrally but secured parties file locally. An uninformed individual might guess that such a system was more competitive and therefore

\textsuperscript{19} A superficially attractive reason for the pro-trustee bias is that some of the high priests in the church of bankruptcy have a settled populist distrust of professional institutional creditors. I think this is probably true in fact, but it explains nothing. It does not say why this settled populist distrust existed, nor does it explain how the bank came in conflict with the rent seekers.

\textsuperscript{20} See Lynn M. LoPucki, \emph{Why the Debtor's State of Incorporation Should Be the Proper Place for Article 9 Filing: A Systems Analysis}, 79 Minn. L. Rev. 577, 585-88 (1995) (discussing the costs and benefits of various filing systems); see also Edward S. Adams et al., \emph{A Revised Filing System: Recommendations and Innovations}, 79 Minn. L. Rev. 877, 889-910 (1995) (discussing the same, particularly with respect to the technological aspects of filing).
more cost-effective than a system with a sole provider. Apparently, however, nothing of the sort is the case. Evidently the county clerks have done an effective job of drawing wagons into a circle around their tents. Why this holds true, and what it will take to break it up, is a line of inquiry all its own.

As a corollary, one would do well to consider the role of semiprivate filing systems elsewhere. Bowers himself speaks of commercial providers like Dun & Bradstreet. There is some discouraging evidence about the role of private credit reporting agencies. The bond rating agencies are currently taking heat for not blowing the whistle on Orange County, which is in bankruptcy as a result of bad luck with a high risk investment policy. A widely held belief exists that conventional bond rating agencies downgrade bond issues only after the market has assimilated the information on which the downgrading is based. In California, for example, the business of processing land titles remains almost exclusively the province of private title insurance companies. These companies maintain their own elaborate title plants on which they base their opinions. I realize that the example is not precisely parallel to Bowers's. The title companies are not totally independent. They distribute information at retail that the state furnishes both at wholesale and at retail. Knowing more about the relation between the public and private land title processors, including the extent of the stake title companies hold in maintaining an inefficient state system so that customers will embrace the private providers, would be worthwhile.

Finally, to know whether we should do away with a filing system, we would need to know to what extent lawyers and clients actually rely on filing today. If the cost of filing is unacceptably high, one can attempt to structure transactions around it by, for example, leasing instead of using direct collateral security. One can also ignore it and choose to either police collateral and debtors more carefully, consciously choose to assimilate the risk as a cost of doing business through self-insurance, or some combination thereof.

I offer these thoughts in a positive and largely sympathetic frame of mind. Bowers and I share a large common ground here. We both serve as acolytes of First Church of Transactional and Social Welfare Efficiency. It is important to remember who is the enemy. It is not the government; rather, it is inefficiency in

21. See Nell Henderson, Orange County Planning to Sue Three Brokerages, WASH. POST, Dec. 9, 1994, at F2 (discussing Orange County's fiscal crisis).
the form of rent seeking. If we oppose the government when the government is in fact the more efficient provider of a desired service, we increase, rather than reduce, the amount of inefficiency in the world. My purpose here is only to outline some lines of inquiry that we should pursue before concluding that the government is, in fact, the target.