November, 1994

The Unsecured Creditor's Bargain: An Essay in Reply, Reprisal, or Support?

F. Stephen Knippenberg, *University of Oklahoma College of Law*

THE UNSECURED CREDITOR'S BARGAIN: AN ESSAY IN REPLY, REPRISAL, OR SUPPORT?

*Steve Knippenberg**

PROFESSOR Lynn M. LoPucki's claim in *The Unsecured Creditor's Bargain*[1] is a bold one. The question of importance for him is not whether secured credit is justifiable on grounds of economic efficiency, although he takes up that question and concludes it is not. Rather, the question is whether secured credit is evil, a blight on credit markets. He concludes that it is.[2] One can quibble with Professor LoPucki's conclusions and recommendations for legal reform,[3] and I do so in this essay. What one cannot do is dismiss some important and perhaps disturbing implications inherent in his analysis. LoPucki closely and critically examines the prevailing metaphors that define secured credit and set the boundaries of doctrine and scholarly discourse.[4] LoPucki forces self-conscious scrutiny of the metaphor of the secured transaction as a bargain

---

* Professor of Law, University of Oklahoma College of Law. I would like to express my appreciation to the participants in the University of Virginia School of Law Conference on the Revision of Article 9, all of whom contributed in one way or another to the development of this Commentary. In particular, I wish to express my gratitude to Lynn M. LoPucki for the many hours of truly interesting, long-distance discussion of his article and my Commentary thereon.

1 Lynn M. LoPucki, The Unsecured Creditor's Bargain, 80 Va. L. Rev. 1887 (1994).

2 I grant this may be something of an overstatement, but not by much. The term "evil" is mine, but the characterization of security as a blight is Professor LoPucki's. Id. at 1914 n.104. The kindest thing he has to say about security is that it "is so ingrained in the legal and popular culture that it may not be worth uprooting." Id. at 1947.

3 Elsewhere in this Symposium, Susan Block-Lieb undertakes a thoughtful point-by-point treatment. See Susan Block-Lieb, The Unsecured Creditor's Bargain: A Reply, 80 Va. L. Rev. 1989 (1994). In this Commentary, I explore what I believe to be some engaging theoretical implications of Professor LoPucki's article.

4 I do not use the term "metaphor" in the literary sense. Rather, I use it in the technical sense assigned to it in recent scholarship in human cognitive theory. Metaphor is simply "understanding and experiencing one kind of thing in terms of another." George Lakoff & Mark Johnson, Metaphors We Live By 5 (1980) (emphasis omitted). See generally Mark Johnson, The Body in the Mind: The Bodily Basis of Meaning, Imagination, and Reason (1987) (identifying metaphor as an essential structure of human comprehension); George Lakoff, Women, Fire, and Dangerous Things: What Categories Reveal About the Mind (1987) (explaining the primacy of metaphor and categorization in human conceptual systems).

among debtor, secured creditors, and unsecured creditors ("Bargain Model"), and the metaphor of the creation of a security interest as a conveyance of property ("Conveyance Model"). These metaphors are the conceptual referents according to which we have come to understand security. *The Unsecured Creditor's Bargain* is the most direct assault in the literature on those basic notions themselves.[5]

I. The Metaphors of the Bargain Model and Conveyance Model

The Bargain Model[6] supposes a contract by which creditors exchange risk and return on investment. Secured creditors trade away higher return (by lending at lower secured rates) for reduced risk of nonpayment whereas unsecured creditors assume greater risk in exchange for higher return. The Bargain Model is a principal vehicle for discourse about the "puzzle of secured credit."[7]

---

5 In recent years, there has emerged a cognitive theory, experientialism, which makes the case that metaphor may be the single most pervasive cognitive mechanism of all complex thought. See, e.g., Lakoff & Johnson, supra note 4. The experientialist insight that metaphor is central to cognitive operations has important implications for legal discourse. See infra note 33 and accompanying text. In concluding that our concepts are largely metaphoric, experientialism refutes the epistemological notion that concepts mirror some objectively verifiable state of affairs in experience. Our concepts are mainly imaginative and metaphoric, the result of drawing analogies among concepts that reflect nothing more than their own ntility. They do not represent slices of reality. See, e.g., Lakoff & Johnson, supra note 4, at 214-15. Models are metaphors that indulge in analogies among concepts to make them manageable. For instance, to state that the creation of a security interest is a transfer of property is not to state some objective truth about the nature of security. Rather, to understand security *in terms of* the property concept of conveyancing is to employ a metaphor: *the value of assets hypothecated is property that can be conveyed in the manner of other property.* The metaphor or model states no truth but has proved a useful way of conceptualizing security for some purposes.

Professor LoPucki's article is consistent with experientialist postulates. *The Unsecured Creditor's Bargain* shows how a commitment to the Conveyance Model, as though it were the conceptual incarnation of some absolute truth, can lead to a dysfunctional view of credit relationships and nnwelcome ontological consequences. This analytical feature of the article is, in my estimation, important to the debate whether secured credit is worth having.

6 The Bargain Model refers to the contract-based justifications of secured credit. See Thomas H. Jackson & Anthony T. Kronman, Secured Financing and Priorities Among Creditors, 88 Yale L.J. 1143, 1147-49 (1979).

7 The reference, of course, is to the longstanding debate in the literature over whether security can be justified on efficiency grounds—the so-called "puzzle" of secured credit.

In Professor LoPucki's view, the Bargain Model proceeds from two false assumptions.[8] First, it assumes unsecured creditors willingly subordinate their claims to the debtor's property upon default to the claims of secured creditors—that is, that unsecured creditors consent to unsecured status.[9] Second, the Bargain Model assumes unsecured creditors agree to a subordinate position knowing the exact levels to which their risk of nonpayment is elevated, owing to the presence of security.[10]

The Unsecured Creditor's Bargain tells a story of two kinds of unsecured creditors that challenges both assumptions, and thereby the descriptive prowess of the Bargain Model. The two kinds of creditors are involuntary creditors,[11] who do not willingly embrace unsecured status, and creditors who contract for unsecured status voluntarily but in ignorance of security's threat.[12] Creditors of the latter kind consent to unsecured status, but consent is not meaningful because they are unsophisticated lenders ("Bubbas")[13] and do not appreciate the risks of the bargain they strike.

The most striking examples of involuntary creditors are tort victims, such as persons injured as a result of the debtor's business activities.[14] Involuntary creditors do not bargain for unsecured sta-

---

Professor LoPucki provides an overview of the evolution of the puzzle literature and discusses it insofar as it is relevant to his theses. LoPucki, supra note 1, at 1890-95.

8 Id. at 1893.

9 Id.

10 Id.

11 Id. at 1896.

12 Id. at 1916.

13 These are Professor LoPucki's "uninformed creditors." Id. I had assumed the term "Bubba" was universally understood, and so was mildly astonished to learn from Professor LoPucki that this may not be the case. Bubbas are members of a class, the "good ole boys." They may be smart, even savvy in some areas, but are generally presumed to be underinformed and guileless. Although Bubbas have a number of readily identifiable, distinctive features—e.g., they drive pickups equipped with gun racks, drink a great deal of Coors or Lonestar, and dip snuff—they are not, so far as I know, a suspect class. Accordingly, I refer to them with little fear of political correction, and, in any event, I take my lifelong membership in the group to be a license to deploy the term here.

14 Other involuntary creditors listed include former spouses and children with unsecured claims for support, government agencies, educational lending agencies, health care providers, tax authorities, landlords, and utilities. Id. at 1896. They are the "reluctant creditors" of Elizabeth Warren and Jay Westbrook's study of consumer bankruptcies. See Teresa A. Sullivan, Elizabeth Warren, & Jay L. Westbrook, As We Forgive Our Debtors 293-301 (1989) (containing Warren and Westbrook's discussion of consumer bankruptcies). Actually, as Professor Block-Lieb points out in her reply to *The Unsecured Creditor's*

tus at all, rendering the first assumption of the Bargain Model silly as to them. Because they are unwilling creditors from the outset, involuntary creditors cannot contract for a premium to offset the increased risk of nonpayment associated with unsecured status in the presence of security. Credit from the unwilling is thus bought cheaply, with the inefficient result that secured creditors and the debtor are better off at the expense of those unsecured creditors who cannot react to security. Where the involuntary creditor is the victim of the debtor's tortious activities, the windfall to the secured lender and debtor is all the more odious. In that case, security permits the debtor and secured party to externalize the risks of irresponsible management and behavior, foisting them upon the debtor's tort victims.[15]

Bubbas challenge the second assumption of the Bargain Model, that creditors contract for unsecured status knowing the consequences of being an unsecured creditor in the presence of security. Unschooled in the esoterica of Article 9,[16] Bubbas systematically underestimate the risk that they will not be paid, and so do not charge enough for assuming it.[17] An unsophisticated trade creditor, for instance, is surprised and dismayed to learn that the value of the inventory sold to the debtor on short-term credit was automatically transferred to the coffers of a secured creditor through the simple and costless expedient of an after-acquired collateral clause in the security agreement.[18] This is a result that Bubbas could not have thought possible under any set of rules governing security they might have imagined and is therefore one that they would not take into account in bargaining with the debtor.

Bargain, the involuntary creditors that really seem to matter to Professor LoPucki are tort victims. Block-Lieb, supra note 3, at 1993. Indeed, Professor LoPucki indicates that not all reluctant creditors should be considered involuntary creditors for purposes of the legal reform he proposes. LoPucki, supra note 1, at 1896 n.38.

15 LoPucki, supra note 1, at 1897-98.

16 Id. at 1917 ("Article 9 is highly complex, unintuitive, and notoriously deceptive. In order to protect secured creditors, it rejects what are, for anyone other than an expert in Article 9, basic principles of justice.").

17 See id. at 1916-20.

18 Id. at 1917-18. Other counterintuitive Article 9 concepts include the priority of future advances made by a secured party with knowledge of a competing claim, id. at 1917, and the near abolition of "the equitable doctrines by which courts have traditionally protected unsecured creditors against the harshest effects of security," id. at 1919.

The Unsecured Creditor's Bargain also makes the claim that involuntary creditors and Bubbas exist in far greater numbers than has previously been supposed.[19] The misallocation of resources and the inefficiency resulting from security are therefore considerable—so considerable as to suggest that the Bargain Model is only marginally descriptive and mainly a thought experiment. How is it, then, that security exists at all if it generates large-scale inefficiency and insufferably unfair results for involuntary creditors and Bubbas? It is certainly not in the interest of the sophisticated lenders and borrowers at high levels who Professor LoPucki asserts deal in unsecured credit and do not need security.[20]

Professor LoPucki's claim is that creditors and debtors in modest credit markets deal in security for the very purpose of capturing the subsidies it enables: externalizing risk, grabbing cheap unsecured credit from involuntary creditors who cannot react to security, and, perhaps, exploiting Bubbas who do not know enough to react to security.[21] What motivates that result is, of course, flawlessly rational greed. What commissions it, if I read Professor LoPucki correctly, is the theoretically useful but insidious concept by which we have come to understand the grant of security as a transfer of part ownership of the debtor's assets—the Conveyance Model. The Conveyance Model is the centerpiece of the property-based theory of security advocated by Professors Steven Harris and

---

19 As to involuntary creditors, they may represent 23% of unsecured credit. Id. at 1896. As to Bubbas, Professor LoPucki states that "[m]any more businesses operate and much more credit is extended at [a low] level of sophistication than at the virtually perfect levels of sophistication assumed in economic modeling." Id. at 1919. It is interesting to note the striking differences in the professional experience of lawyers. In Professor LoPucki's experience, clients were Bubbas; their lawyers were relatively more sophisticated. Id. In my experience, clients were mainly sophisticated, and their lawyers were often Bubbas.

20 Professor LoPucki states: "That some 55% of all lending by commercial banks is unsecured demonstrates that this kind of unsecured lending not only exists, but is common. The borrowers who receive asset-based unsecured loans tend to be the largest, financially strongest companies." Id. at 1925 (footnote omitted). Accordingly, "[t]hat most sophisticated lenders and borrowers eschew security ought to bother commentators who consider security efficient." Id. at 1930.

21 Professor LoPucki notes: "Two promising malignant explanations for the existence of secured debt were commonly noticed but rarely explored. Security might have flourished because it facilitates the exploitation of involuntary creditors or of voluntary creditors who failed to react to security." Id. at 1895 (footnotes omitted).

Charles Mooney elsewhere in this Symposium.[22] Thus, what authorizes disappointed expectations for involuntary creditors and Bubbas is nothing more than an idea.

The Conveyance Model is indifferent to the bargain into which the debtor and creditors are imaginatively projected under the Bargain Model.[23] Under the Conveyance Model, the grant of security is simply a transfer by which property of the debtor—some stick from the debtor's ownership bundle—is relocated in the secured creditor's. What the secured party gets might be characterized as a contingent future interest in the collateral, a future interest that becomes possessory upon the debtor's default. The stick transferred is value, which thereby is placed beyond the reach of other claimants inferior to the secured creditor.

The Conveyance Model conceptualizes the grant of security as a transfer of property from the debtor to secured party through the medium of the security agreement. The security agreement is thus a kind of deed, more an instrument of conveyance than an instrument of bargain outlining the rights and obligations of the parties.[24] Possession and management remain with the debtor, but value now belongs to the secured creditor.[25] The debtor who retains possession and management after value has been transferred away is perhaps a menace because assets without value have the same

---

22 Steven L. Harris & Charles W. Mooney, Jr., A Property-Based Theory of Security Interests: Taking Debtors' Choices Seriously, 80 Va. L. Rev. 2021, 2024 (1994). They examine "the creation of security interests under the law governing private property" and claim that "[t]he well-accepted rights of property owners—to use and freely and effectively to alienate their property and to be secure in their ownership—form the basis of our normative theory of secured transactions." Id. The notion that the creation of a security interest is a transfer of property is deeply rooted in doctrine and is clearly the dominant conceptualization of security. Professors Harris and Mooney, however, are perhaps the first to make the concept the explicit premise of a normative justification for secured credit and to organize a coherent, systematic theory of security around the concept.

23 Professor LoPucki states: "The bargain in Jackson and Kronman's economic model was a three-party bargain. Although the unsecured creditor's agreement was disingenuously inferred from the circumstances, it was nonetheless considered necessary. The property theory dispenses with even the pretense of unsecured creditor agreement." LoPucki, supra note 1, at 1952. On the other hand, the Bargain Model amounts to an attempt to justify the priority accorded secured claims that follows from the Conveyance Model.

24 See Harris & Mooney, supra note 22, at 2051-52.

25 The security transfer might also be thought of as an absolute transfer, with a return of possession and management to the debtor. Either way, security may amount to ownership of property without the accompanying responsibility.

appearance and potential for mischief after the security transfer as before. Involuntary creditors such as tort claimants simply take their debtors, or rather their debtors' assets, as they find them—namely, depleted of value by the conveyance. Bubbas are duped into lending on an unsecured basis in part on mistaken assumptions about what assets will be available to satisfy their claims.[26]

II. Protecting the Expectations of Involuntary Creditors and Bubbas: The Demise of the Conveyance Model

Professor LoPucki makes two proposals, one for involuntary creditors and one for Bubbas, to remedy what he sees as a dysfunctional set of rules under Article 9 in its present form. Involuntary creditors would simply be awarded priority over secured creditors.[27] Bubbas would be bound only by so much of their unsecured bargain as they understood or should have understood, such that counterintuitive terms implied by Article 9 would be exorcised from the bargain.[28] Professor LoPucki would thus substitute a

[26] I suppose involuntary creditors and Bubbas are in some respects not different categories but rather occupy different points along a continuum. Tort victims, for example, expect payment because they have been wronged or injured by the debtor's self-serving operations. Bubbas expect payment because they believe they bargained for it and are stupefied on learning of the implied-in-law terms of Article 9 (e.g., the floating lien) that will defeat that expectation. Involuntary creditors *cannot* bargain ex ante to take account of the added risk of nonpayment created by security. Bubbas are unaware of the added risk imposed by counterintuitive implied-in-law terms and so *do not* take account of it in bargaining for unsecured status. Either way, both kinds of unsecured creditors assume more than their share of the risk that they will not be paid in the presence of security, and they are not compensated for it. This is what Professor LoPucki calls a subsidy in the form of bargain-rate unsecured credit. See LoPucki, supra note 1, at 1920. It is what I might call a bird's nest on the ground.

[27] Professor LoPucki observes: "We are on the brink of recognizing that the priority of secured creditors over truly involuntary creditors is indefensible." Id. at 1908. He argues that "[t]he priority of secured creditors over involuntary unsecured creditors cannot be justified by any coherent theory and should be abolished. Involuntary creditors should have priority over voluntary creditors, whether secured or unsecured." Id. at 1963.

[28] Professor LoPucki specifically proposes

> that a security agreement should bind an unsecured creditor only if and to the extent that a reasonable person in the position of the unsecured creditor would have expected at the time that person extended credit. The unsecured creditor's bargain should be an express or implied agreement *in fact.*

Id. at 1947-48 (footnote omitted).

"Bargain in Fact" for the constructive bargain supposed by the Bargain Model.

Adopting the Bargain in Fact as to Bubbas entails overt rejection of the Conveyance Model. Although awarding priority to involuntary creditors is arguably possible within a property-based theory of security, in my view *The Unsecured Creditor's Bargain* implicitly calls for more than a reordering of priorities within existing conceptualizations. I believe the call is to abandon the Conveyance Model as the principal metaphor by which security is conceptualized as a transfer of property from the debtor to the secured party.[29] The proposal is a daring one with disconcerting implications, not the least of which may be that the creation of a security interest is not *innately* a conveyance, a contract, or anything else, for that matter.[30] In other words, understanding security *in terms of* a conveyance is not required but is simply a useful and sometimes convenient way to conceive of security for some purposes: "Just saying it's so doesn't make it so."[31]

---

[29] The property theory is one of the "three bad theories" justifying security. Id. at 1947-48, 1952-54. At several junctures, Professor LoPucki refuses to acknowledge that we are bound to think of the creation of a security interest according to the Conveyance Model. For instance, Professor LoPucki argues that the security interest might as easily be understood as a kind of spendthrift trust, a concept with which the security shares important dimensions. Id. at 1953-54. In addition, he argues convincingly that unsecured, negative covenant lending under some circumstances is indistinguishable from security—that the two differ only in "formal legal effect." Id. at 1926. To extrapolate, it would appear that the rights of negative covenant lenders might as easily be characterized as property, yet they are not. Security, it follows, is thought of as property, but might as easily be regarded as embodying a set of procedural contract rights on default.

In his excellent article on the Fifth Amendment and the Bankruptcy Clause, Professor James Rogers observes:

> The notion that the secured creditor's remedial right is a "property" right may derive much of its intuitive force from the perception of the mortgage on Blackacre as the paradigm of secured financing. Secured financing law, however, has become far more complex. One of the most significant forms of modern secured financing . . . is financing on the security of the inventory or accounts receivable of an enterprise. The collateral in such arrangements is more of an accounting concept than a specific piece of property. Once we move from a mortgage on Blackacre to a floating lien, . . . the "property rights" perspective becomes blurred.

James S. Rogers, The Impairment of Secured Creditors' Rights in Reorganization: A Study of the Relationship Between the Fifth Amendment and the Bankruptcy Clause, 96 Harv. L. Rev. 973, 992 n.74 (1983) (citation omitted).

[30] See supra note 5.

[31] Professor Jeanne Schroeder made this challenge to Professors Harris and Mooney in the question-and-answer session following their presentation of their property-based

The idea that concepts like the Conveyance Model do not capture and describe some reality but are metaphors that identify and report perceived analogies and correspondences among concepts, is not new,[32] but it is new in the literature of commercial law.[33] The importance of acknowledging this possibility is its potential effect on the way we go about doctrinal critique. Where analysis begins and ends with the endeavor to find a single *correct* model, one that captures and embalms reality for all times and places, principled analysis is supplanted by the logical entailments[34] of the model itself. For example, once it is concluded that the creation of a security interest *is* (rather than shares certain dimensions with) a conveyance of property, the entailments of that conclusion are themselves a justification for the subordination of unsecured claims to secured claims. There is simply no value remaining for unsecured creditors because it has been conveyed away in the security agreement.[35] A profound, if implicit, premise of *The*

---

theory of secured credit at the University of Virginia School of Law Symposium on Revision of Article 9 of the Uniform Commercial Code, which occurred on October 15-16, 1993. She is at once right and wrong. Inherent in the challenge is the notion that the Conveyance Model captures no metaphysical reality, no objective truth, but is simply one metaphor by which security may be profitably understood. In that, she is right.

On the other hand, there is a strong consensus that security is property. The conveyance metaphor pervades doctrine and the literature. Professors Harris and Mooney note: "It seems clear enough that security interests, under Article 9 and real estate law alike, are interests in property." Harris & Mooney, supra note 22, at 2051. Doubtless, they are correct for the most part. So long as those drafting, applying, and critiquing the set of rules governing priority concur in the metaphor, the creation of a security is, as a practical matter, a conveyance. *The Unsecured Creditor's Bargain* challenges the metaphor itself, and that is why it is a disturbing piece.

32 See supra note 5.

33 It is not, however, new to legal analysis. See, e.g., Steven L. Winter, The Metaphor of Standing and the Problem of Self-Goveruance, 40 Stan. L. Rev. 1371 (1988) [hereinafter Winter, The Metaphor of Standing]; Steven L. Winter, Transcendental Nonsense, Metaphoric Reasoning, and the Cognitive Stakes for Law, 137 U. Pa. L. Rev. 1105 (1989). In deploying new scholarship from the cognitive sciences on the role of metaphor in human cognition, Professor Winter conclusively demonstrates its value to legal discourse. He notes: "The law is committed to the use of reason. New discoveries about the nature of reason, therefore, have a natural and necessary place in legal scholarship. To fail to recognize them ultimately would be to deny the role of reason in law." Winter, The Metaphor of Standing, supra, at 1382.

34 Entailments are the propositional consequences that follow from understanding one concept in terms of another. That is the essence of modeling. See Johnson, supra note 4, at 22.

35 Conventional legal analysis is deeply rooted in the propositional tradition. Its methodology involves coaxing abstract principles from cases and other authority,

Unsecured Creditor's Bargain is that the logical consequence of conceiving of the security interest as a conveyance of value is not a justification for the subordination of involuntary creditors or Bubbas; rather, it is a rationale. Acknowledging the Conveyance Model to be nothing more than a metaphor by which security may be understood for some purposes clears the way for normative scrutiny of the result.

III. Priority for Involuntary Creditors

Proposals to subordinate secured claims to the unsecured claims of tort victims can be found here and there in the literature.[36] Abandoning the Conveyance Model as to involuntary creditors in particular is a notion with considerable appeal, at least in the context of the right story. Consider the following illustration. A debtor owns and operates a small, private zoo. Several of the animals kept there are dangerous, including a lion with an insatiable appetite. The debtor keeps dangerous animals, like the lion, because they are more spectacular than the others and tend to draw more patrons, who are awed by them. The hungrier and more irritated the lion, the more it roars, and the more it roars, the bigger the crowd. But at some point, the lion's hunger, and so its rage, may become so great that it becomes impossible to contain and is therefore a menace to zoo patrons.

Assume further that the debtor has issued no secured debt but has complete and unencumbered ownership of all assets of the business, the most valuable of which happens to be the lion. If the lion, half mad with hunger, escapes into the crowd and seriously injures an onlooker, it becomes an attractive asset out of which to satisfy the claim of the injured victim. So long as the debtor has equity in the lion, there is some incentive (apart from obvious humanitarian motivations) not to starve it to the point that it poses an unacceptable risk to patrons. To be sure, the hungrier the lion, the greater its appeal and the greater the return to the debtor. Yet,

---

instituting the principles abstracted as propositions, then instantiating propositions derived in succeeding cases.

[36] An early and oft-cited example is Christopher M.E. Painter, Note, Tort Creditor Priority in the Secured Credit System: Asbestos Times, the Worst of Times, 36 Stan. L. Rev. 1045 (1984).

the debtor, with something at stake—that is, the lion—has a financial incentive to stop short of immoderate underfeeding.

Suppose now that the same debtor has granted a security interest in all of the assets of the business, including the lion. If the secured transaction is analyzed under the Conveyance Model, the debtor has transferred away the value of the lion while retaining possession and management. With no equity in the lion, the debtor is induced to maximize her return and so adopts a riskier feeding regime. The secured creditor, to whom all the value in the lion has already been transferred, has no incentive to monitor the debtor in this scenario because its secured claim will trump the unsecured claims of involuntary creditors.[37]

Assume again that a patron is seriously injured, sues to judgment, and is now an involuntary creditor. The victim looks to the value of the lion to satisfy the judgment, but the Conveyance Model, taken as the only right conception of security, indicates that this dimension of the property belongs to the secured creditor. Recourse may be had only to such property as belonged to the debtor at the time the involuntary creditor had the misfortune of "dealing" with her. Because the debtor has transferred away value through the security conveyance, the victim may not satisfy her judgment with the lion as she previously could have when the debtor issued no secured debt and owned the lion outright.

So it is that the Conveyance Model ensures the primacy of the secured claim against the lion with no more normative justification than the logical entailments that follow from conceiving of security exclusively as the transfer of partial ownership. The result is both startling and questionable on efficiency grounds. It is startling because to deny the expectations of the tort victim under the circumstances seems counterintuitive. The result is inefficient because the debtor realizes an unearned subsidy in the form of credit at lower secured rates at the expense of the involuntary cred-

[37] Indeed, active participation in the business affairs of the debtor might lead to lender liability. Secured creditors are thus motivated to remain aloof, and debtors, particularly corporate debtors whose owners are shielded by the limited liability resulting from entification, are induced to issue excessive secured debt. The likelihood of disregarding the entity to reach the assets of corporate owners on that ground alone seems remote. LoPucki, supra note 1, at 1904.

itor.[38] The secured party leaves only title and management of the asset with the debtor, thereby avoiding the risks associated with those features of ownership, while enjoying the value feature. The tort risk is successfully externalized, to be borne by the involuntary creditor without compensation.[39]

The Conveyance Model offers a conceptually acceptable *rationale* for leaving the tort victim uncompensated: Security, understood as a transfer of property, necessarily leads to that result. The Conveyance Model does not, however, offer a normative justification for the resulting inefficiency, arguable unfairness, and externalities that attend subordination of the tort victim. The rationale becomes a normative justification only if we grant that the Conveyance Model correctly mirrors some state of affairs external to the model and not merely postulated by the model itself.[40] That is, it must be accepted that the creation of a security interest *is* a transfer of property and so cannot seriously be thought of in any other way. Any other characterization or conceptualization denies reality and is simply wrong headed.

As earlier indicated, Professor LoPucki counsels that involuntary creditors typically exist in substantial numbers so that misallo-

---

38 Id. at 1897-98.

39 See id. at 1901-02. It is a result that can be accommodated in only the most attenuated fashion by the Bargain Model because the involuntary creditor did not bargain—and could not have bargained—for unsecured status.

40 Professors Harris and Mooney offer a convincing justification for private property and its free alienability: "The right to own private property is the bedrock of capitalism and an essential component of a market economy." Harris & Mooney, supra note 22, at 2047-48. Moreover, private property enhances "political freedom and liberty," id. at 2048, and the centerpiece of private property, alienability, promotes efficiency because without it, "resources could not find their way to users who value them more," id. at 2049. Once security is conceptualized as property, the normative justifications for the latter become the normative justifications for the former.

Although I sympathize with much of what Professors Harris and Mooney have to say, the question raised in *The Unsecured Creditor's Bargain* is not whether private property and alienability are justified but whether the Conveyance Model, by which security is in all regards understood with reference to property concepts, is justified. In particular, Professor LoPucki seems to question whether the limited restraints on alienation of property, such as fraudulent conveyance law, are appropriate for security. Regardless of whether one is convinced that something more is required for security than for, say, absolute transfers, the question is worth asking. The tacit assertion in *The Unsecured Creditor's Bargain* that security need not be thought of with exclusive reference to the Conveyance Model is an analytical step that permits the question to be asked.

cation and unearned subsidy from security are significant.[41] If so, our insistence that advocates of the Conveyance Model offer some normative explanation might fairly be all the more urgent.

I endorse what I would characterize as a profound insight in *The Unsecured Creditor's Bargain*—that is, the idea that the Conveyance Model holds no conceptual monopoly on security. It is an insight that opens the way for fresh analysis. What remains to be considered, however, is Professor LoPucki's deployment of that insight in calling for surrender of the Conveyance Model as to involuntary creditors.

In its criticism, and what I read to be general repudiation, of the Conveyance Model, *The Unsecured Creditor's Bargain* implies that there is little difference between the debtor and secured creditor. In any event, a much closer conceptual association of the secured party and debtor than currently exists would necessarily follow the reconceptualization of security free of the Conveyance Model. Where the debtor owns assets outright, involuntary creditors may use those assets to satisfy claims arising from the debtor's management—or rather, mismanagement—of them. Where the grant of a security interest is conceived as a conveyance of property to the secured party, the assets are freed of that liability. On refiguring security as something other than a conveyance, the secured party is, as a practical matter, liable to involuntary creditors for the debtor's management of the assets.[42] The imposition of liability on the secured creditor through the collateral collapses the conven-

---

41 At the same time, the figure may be misleading. That is, some of those designated as involuntary, and so hapless, creditors in *The Unsecured Creditor's Bargain* have been recognized as exceptional and receive exceptional treatment in one way or another. For instance, tax claims, claims based on educational loans, the support claims of spouses and children, and even some tort claims all receive special treatment in bankruptcy. Utilities take deposits, as do landlords, who can also obtain liens, and health care providers have access to insurance.

42 A security interest is not made gratis but to secure an obligation arising out of credit or other value given the debtor. The value in the asset, in this regard, may be thought of as a substitute for whatever value the secured creditor passed along to the debtor. If liability attaches to the collateral notwithstanding the security interest because the creation of the security is no longer thought of as a conveyance, the substituted value is now vulnerable to the claims of involuntary creditors. On this view, the secured creditor is in effect liable for a debtor's management of the asset to the extent of its investment. To impose liability on the value of collateral is thus to assign liability for the debtor's obligations to the secured creditor. See also Harris & Mooney, supra note 22, at 2028-29 (arguing that a debtor's issuance of secured debt has no impact on the estate because the transfer of value from

tional distinction between debtor as manager and the secured party as creditor. Whatever the secured party's level of participation in a debtor enterprise, it is liable, through the collateral that was substituted for value given, to involuntary creditors for the debtor's management of the asset.[43] Presumably, with increased prospects for liability would come increased participation and monitoring on the part of the secured party.[44]

Specifically, dispensing with the distinction between the debtor and secured party necessarily means the return of some level of asset management to the secured creditor because the secured creditor will want to avoid the loss of its investment to involuntary creditors. The idea that lending and taking security, without more, justifies that kind of association of the secured creditor with the debtor is troubling. Before reordering matters to create an incentive for secured creditors to participate in asset management at levels higher than those under the current regime, Professor

creation of the security interest is offset by equal or greater value received from the secured creditor).

43 Consider again the zoo illustration under conditions where the creation of a security interest is not understood as a conveyance of value. The debtor had obtained financing for its operations by issuing secured debt, granting a security interest in the lion and other assets of the business. Assume again that the debtor did not feed the lion enough, and, on a rampage, it escaped to injure severely a zoo patron. Because (as to the tort victim) the value of the lion was not transferred to the secured creditor, the debtor must use the collateral, substituted for the credit extended, to repay the obligation as though it owned the lion outright. Through the collateral, the secured party is at risk for the debtor's management of the lion such that the identity of the secured party is to that extent lost in the identity of the debtor.

44 In the illustration, the secured creditor would take account of the risks of the debtor's business—keeping dangerous animals for display to the public—before lending.

It is interesting to contemplate the way incentives are aligned with respect to other types of risk that a debtor's business activities pose. Consider the risks that a venture built on a questionable idea or capital structure poses. Absent the Conveyance Model, the risks that such a venture creates would belong to secured creditors and could not be externalized. This would appear to be a powerful incentive that would inspire secured creditors to look carefully at a lending opportunity before seizing it—to make sure, that is, that the opportunity *is* an opportunity. Of course, it would also likely mean less secured lending, at least to risky ventures, whether risky because of the nature of the debtor's business as in the illustration, or risky in terms of the prospects for failure, as in the case of a business venture founded on a stupid idea or faulty capital structure. By contrast, in a world where the Conveyance Model rules, the secured creditor—perhaps the very party in the best position to evaluate investment risks ex ante—has little incentive to undertake that evaluation. See also infra notes 46-47 and accompanying text (questioning the imposition of either asset management or monitoring responsibilities upon secured creditors).

LoPucki must first make the case that a shift in management to the secured lender is justified on some normative basis. None is offered in *The Unsecured Creditor's Bargain*, which seems to take the position that, because assets are available to involuntary creditors in the absence of security, they ought to be available in its presence.[45]

That argument does not, in my judgment, go far enough in making the normative case for motivating secured creditors to become managers with or close monitors of the debtor.[46] It would seem that the very reason management is left with the debtor is that the debtor is a better manager of its assets. Presumably, the secured creditor in our zoo story is better at lending money than at feeding lions—that is why it is a lender instead of a zookeeper.[47] Beyond that, how far would a secured creditor have to go in the conceptual

---

45 This is by no means to say that the conflation of creditor and debtor cannot be justified; rather, it is merely to say that no justification is explicit in *The Unsecured Creditor's Bargain*. In fairness to Professor LoPucki, that is not what he set out to do.

46 Professor LoPucki approves of the new partnership his tort-first regime would create whereas he believes that I would "allow lenders to focus narrowly on being repaid and leave debtors to worry about the tort liability." LoPucki, supra note 1, at 1913. Although by no means declaring that secured creditors should continue to enjoy priority over tort claimants in all cases, I would point out that lenders not only worry about being repaid but also have the expertise to alleviate that worry to some degree. Under Professor LoPucki's tort-first regime, lenders would have to worry about tort liability, but worrying about tort liability is not the same as reducing the probabilities of tort from the debtor's activities. Professor LoPucki would compel lenders to acquire or purchase the expertise to monitor the debtor's activities in a meaningful way. The question is whether the attendant costs would justify any reduction in the probabilities of tort risk or whether there may be a less costly way to accomplish that reduction.

Professor LoPucki's analysis, under which he would force lenders to become experts in a debtor's enterprise, provokes a related observation that one might make about security and lender incentives. Although perhaps not as riveting as, say, personal injury resulting from a business debtor's activities, the financial failure of a firm, especially on a large scale, can certainly yield devastating results for commercial communities. Whereas lenders may know little about the risk of tort posed by a debtor's business activities, it seems safe to assume they know a great deal about the risk of financial failure at the time credit is extended. Where security relieves a lender of the fear of default to a significant degree, it would seem that the lender has less incentive to deploy its expertise. So it is that the party arguably in the best position to assess the financial worthiness of a debtor enterprise—and thus to avoid the consequences of the enterprise's failure—may decline to exercise that expertise to the fullest because of security.

47 Upon reading this Commentary, Professor LoPucki pointed out that I have ignored the possibility that the debtor was selected not because of its management expertise, but because it is judgment-proof. At the same time, I would speculate that debtors are more often chosen because they are good managers.

regime proposed by Professor LoPucki, and at what cost? Returning to the illustration, would it be enough that the secured creditor insist by covenant and on pain of default that the debtor feed the lion to safe levels, and then monitor for feeding? Should the secured creditor herself feed the lion? In the complete absence of the Conveyance Model, the liability of the collateral is absolute whatever measures the secured creditor takes because the debtor's management is the secured party's management. Liability follows strictly from the mere taking of security.

IV. SECURED CREDITORS AND BUBBAS: UNWILLING TUTORS OF STUDENTS WITHOUT PROMISE

Professor Lopucki warns that Bubbas exist in significant numbers.[48] He asserts that Bubbas systematically underestimate, and so undercharge for, the risks posed by secured credit because they could not have intuited those risks. Debtors who issue secured and unsecured debt can exploit the naïveté of Bubbas to realize a twofold windfall in the form of underpriced unsecured credit and lower secured rates. Bubbas suffer under the current rules governing secured credit for the same reason involuntary creditors do: their expectations are defeated because of the entailments of the Conveyance Model's transfer metaphor. Bubbas, like involuntary creditors, take their debtors' assets as they find them.

The answer for Professor LoPucki seems to be the rehabilitation of the Bargain Model as it currently exists in the literature. His criticism of the Bargain Model is that it supposes a bargain that does not exist in fact for Bubbas and so, to an important degree, does not describe reality. Rather than assume that Bubbas bargain with due regard for the set of rules governing security regardless of whether they actually do, a contract model should reflect the terms Bubbas actually take into account in agreeing to unsecured status.

Initially, it would seem that one could make a better normative case for conflating the debtor and secured creditor where the secured creditor is moved to exercise the sort of expertise that it is likely to possess. For instance, it would seem that a secured lender, if not in the best position to assess the tort risks associated with a debtor's business or asset management, might well be in a position to assess the financial risks presented. Perhaps more importantly, it may be that the combined prospects of liability aud monitoring costs to avoid it might move secured creditors to greater caution in extending credit in the first place. See supra note 44.

[48] See supra note 19 and accompanying text.

The Bargain Model should thus be reformed to become a Bargain in Fact rather than a bargain by supposition.[49] The substitution of a Bargain in Fact for the implied bargain supposed by the Bargain Model in the literature would apparently be accomplished with juries. Where an implied-in-law term—say, the priority afforded the floating lien—departs from the reasonable expectations of Bubbas as determined by a jury, that term is not binding.[50]

The Bargain in Fact thus substitutes a contract model for the Conveyance (property) Model, which it mainly ignores into oblivion. In that regard, the Bargain in Fact is perhaps more disruptive of present conceptions of secured credit than the solution Professor LoPucki offers for involuntary creditors. In any event, I am more troubled by the Bargain in Fact than by the proposed treatment of involuntary creditors. Importantly, the Bargain in Fact would create a duty on the part of secured creditors to warn Bubbas of the sinister possibilities of implied-in-law terms introduced into their bargains by Article 9.[51] Secured creditors would comply for fear Bubbas might thereafter take the matter to a jury likely to find the arcane terms supplied by Article 9 eccentric and outside the ken of unsophisticated bargainers.

As to warning Bubbas of the consequences of contracting for unsecured status in the presence of security, it would seem that this is the financing statement's purpose. Certainly, the financing statement neither explains its own significance nor schools those who read it in the relative priorities of creditors. But then it was never intended to be a lesson in Article 9. We might return to transaction filing—that is requiring the secured creditor to file the security agreement, which contains more information than the financing statement.[52] But would Bubbas learn anything from it? For exam-

---

49 See LoPucki, supra note 1, at 1950; supra notes 27-29 and accompanying text.

50 LoPucki, supra note 1, at 1964. The Bargain in Fact can thus be understood as the Bargain Model divested of fictional suppositions about what Bubbas know and take into account when they contract for unsecured status. The Bargain Model assumes that unsecured creditors are aware of implied-in-law terms and allows no mitigation in favor of Bubbas who are not. Id. at 1949. The Bargain in Fact looks to what Bubbas actually or should know about the bargain they strike. Id. at 1950.

51 See id. at 1958-59; cf. infra note 53 (explaining why it is rightly considered a "duty" despite LoPucki's differing characterization).

52 Professor Lopucki argues: "Under the scheme I propose, secured creditors who sought to bind unsecured creditors to a subordinate position would have to take whatever

ple, would unsecured creditors with no appreciation for the implications of a floating lien gain anything by simply observing the presence of a clause providing for one? If not, would the decision to lend unsecured be thereby more informed or meaningful?

A duty to explain to Bubbas the particulars and risks of the bargain they have struck would be unique, I think, in contract.[53] Certainly, that in itself is no reason not to impose a duty to warn on secured creditors. Still, before giving that sort of advantage to unsecured creditors, one must somehow distinguish them from bargainers in other contexts and show unsecured creditors to be more worthy of protection. If Bubbas are truly unaware of the risks created by secured credit, might they not hire a lawyer to explain those risks?[54] If the secured creditor must assume that role, it

steps were reasonable to communicate their intentions to those unsecured creditors. To facilitate that communication, I have proposed that the Article 9 filing system be redesigned . . . ." LoPucki, supra note 1, at 1964-65. Professor LoPucki's outline of his new information system is presented in id. at 1951-52.

[53] Absent a relationship of trust and confidence, the need to correct an earlier assertion that is no longer true, or a mistake in a basic assumption of fact, contracting parties are ordinarily under no duty to disclose even material *facts* to one another. E. Allan Farnsworth, Contracts § 4.11, at 253-55 (2d ed. 1990).

Professor LoPucki insists no duty to disclose would fall upon secured creditors under his regime: "Secured creditors would continue to have the option to disclose or not." LoPucki, supra note 1, at 1920 n.124. Of course, "the contents of the agreement implied between secured creditor and unsecured creditor would, under the rule I propose, be a function of what was in fact disclosed." Id. If there is a practical difference between imposing a duty to disclose the consequences of security that follow from terms implied by Article 9 and refusing to enforce them against the unsecured creditor unfamiliar with those terms, it escapes me.

In support of his proposal that unsecured creditors be subject only to those implied-in-law terms that a jury would find reasonable, Professor LoPucki cites Calamari and Perillo to the effect that " '[a] party's intention will be held to be what a reasonable man in the position of the other party would conclude his manifestation to mean.' " Id. (quoting John D. Calamari & Joseph M. Perillo, The Law of Contracts § 2-2 (3d ed. 1987)). This says no more than that one contracting party may rely on what the other says and does and may safely ignore undisclosed intentions. There is nothing in the latter notion, however, to support Professor LoPucki's proposal that secured lenders "disclose" implied-in-law terms; indeed, they are disclosed in the provisions of Article 9 itself. In addition, I would point out that whatever obligations to disclose one contracting party owes another, there is no contractual relationship between the unsecured creditor and the secured lender. The contract for unsecured credit is created between the debtor and unsecured lender, and such complaints as the disappointed lender has would seem to be complaints against the debtor.

[54] Professor LoPucki observes that many of his clients could not afford lawyers for every deal. LoPucki, supra note 1, at 1919. If he is correct that much more business is conducted at low levels of sophistication and without lawyers than is sometimes supposed, he has

would seem Bubbas will contract at a discount, foist lawyering costs onto secured creditors, and pocket the difference. Bubbas could thus externalize their information costs while even tort victims, who I find inspire more sympathy in general than do Bubbas, must pay their lawyers.

Moreover, if a duty were imposed on secured creditors to warn Bubbas, in a competitive market the right to be warned and educated might well be routinely waived. If so, whatever the costs of finding, warning, and educating Bubbas might prove to be, they would have been incurred to capture only a cosmetic advantage.

As a practical matter, how might one fix the reasonable expectations of Bubbas? What is the lowest common denominator here? How simple must Article 9 become, and how much counseling and enlightening must a secured creditor undertake? Assuming consensus can be reached on the minimum level of competence that must finally be assigned to Bubbas, there will be those who would fall below the norm. If they are held to the standard anyway, the Bargain in Fact does not avoid the same fictional notion of agreement that is the basis for Professor LoPucki's criticism of the Bargain Model as it is presently articulated. Nothing more has been accomplished than to adjust to a lower level the point at which Bubbas will be held to implied-in-law terms. It remains to be shown that lowering the point at which Bubbas would be presumed to understand the terms of their bargain is a game worth the candle. The substitution of the Bargain in Fact, it will be recalled, is to be accomplished through the introduction of a jury, or at least the threat of a jury determination of the terms for which complaining Bubbas actually bargained. If a jury finds a term—really a priority rule in Article 9—counterintuitive, that term is out. But how much of the law in general must seem counterintuitive to juries as outside their reasonable, but untutored, expectations? Doubtless, the set

disclosed a significant difference between the Bargain Model and experience. If that makes a case against the descriptive powers of the Bargain Model, it does not, in my view, necessarily make a case for excusing unsophisticated creditors from hiring lawyers. Professor LoPucki's response, I believe, would be that expending competitive energies and resources in learning the intricacies of Article 9—"to master unnecessarily complex laws"—or paying someone who already understands them, are wasted. Id. Those energies and resources are always better spent improving services and products and making them cheaper. Id. But the same might be said of any ancillary costs of doing business, such as purchasing liability insurance.

of rules governing merchants, so far outside the experience of many juries, would prove the most mystical of all and so more vulnerable to being regarded as arcane for that reason alone.

The cases certainly show that some secured creditors have arguably abused the advantages afforded them in Article 9.[55] Still, if these cases constitute abuses, they should be regarded as extraordinary. And extraordinary cases might be handled effectively within existing conceptual frameworks.[56] To deconstruct existing conceptions by which security is understood and to construct a new body of doctrine around aberrations and presumed abuses seems excessive.

Conclusion

The Unsecured Creditor's Bargain does not simply debate the internal consistency or elegance of individual rules governing priority. Implicit in the article is the idea that although the creation of a security interest can be understood as a transfer of some aspects of ownership, there is nothing that requires it to be understood that way. To generalize from that implication, *The Unsecured Creditor's Bargain* challenges the very conceptual systems, contract and property, by which the institution of security has come to be understood. That is impertinence of a kind not likely to go unnoticed, and, although I disagree with some of the particulars for law reform proposed in the article, it is a significant departure from the usual analysis. Certainly, to analogize the creation of a security interest to the law of conveyancing, for instance, is not arbitrary—

---

[55] Professor LoPucki's favorites seem to be Ninth District Production Credit Ass'n v. Ed Duggan, Inc., 821 P.2d 788 (Colo. 1991), Chicago Limousine Serv. v. Hartigan Cadillac, 548 N.E.2d 386 (Ill. App. Ct. 1989), rev'd on other grounds, 564 N.E.2d 797 (Ill. 1990), and the classic In re Samuels & Co., 526 F.2d 1238 (5th Cir.), cert. denied, 429 U.S. 834 (1976).

[56] To illustrate, consider the case in which the secured creditor urges its debtor to purchase inventory on short-term unsecured credit, knowing the debtor is unlikely to satisfy the unsecured obligation, and planning to seize the inventory pursuant to a floating lien. The Conveyance and Bargain Models are themselves fruitful sources of doctrine with which to police such behavior. For example, where a secured creditor counsels a debtor to manage encumbered assets tortiously, or to purchase assets on short-term unsecured credit simply to capture more value for its secured claim, it is an easy conceptual step to understand the secured creditor as the transferee not just of value, but of some measure of management of the assets as well. In those cases, the association of debtor and secured party makes sense, and the liability of the secured party, in the form of loss of priority as to the collateral, naturally follows.

the concepts share certain dimensions, and the analogy is useful. But there is not a one-to-one correspondence—they are not the same concept. The danger of assuming otherwise is that principled analysis is reduced to considerations of the rationale behind the model itself.

To declare the creation of a security interest a conveyance of value to a secured creditor and therefore outside the reach of unsecured creditors is not to state some truth. Beyond a doubt, it is the entailment that follows from characterizing security according to the Conveyance Model, and it is an entailment that goes a long way toward making secured credit attractive, cheap, and more readily available. But entailments are not justifications. Nor is readily available secured credit a self-vindicating principle. Easy credit is not a justification for security; it is a consequence of security. A second important contribution of *The Unsecured Creditor's Bargain* is its insistence that readily available secured credit itself must be justified on some normative basis. Professor LoPucki demands that normative justifications for secured credit must come first, and that models employed to define security come after them.