ARTICLES

CONTRIBUTION ARGUMENTS IN COMMERCIAL LAW

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Allocative decisions are the stuff of commercial law. This Article is concerned with the branch of commercial law that governs the rights of competing creditors, and specifically with priority claims to particular assets of a debtor. In this area, the function of legal rules might be characterized as an allocation of gains, insofar as the object is to divide a pool of assets among creditors. In another sense, priority rules are rules for allocation of losses resulting from a debtor’s default. Taking the initial credit transaction as a baseline, each creditor expects to be paid in full. When the debtor’s assets fall short of the sum of his or her obligations, priority rules come into play to allocate the shortfall, positioning creditors at varying points along the range from no loss to loss of the full amount of their claims. Accordingly, priority rules serve a loss allocation function within a larger body of commercial rules that allocate, or enable the parties to allocate, both expected gains from exchange and potential losses.

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Any allocative rule must identify and distinguish among classes of claimants. The choice of classification depends on the underlying goal of the rule. The underlying goal may be to promote efficient use of resources, to further some distributive ideal, or to vindicate a notion of rights. In the area of commercial credit one might expect efficiency to dominate, since parties are generally sophisticated, markets are well-functioning, and wealth maximization is a likely motive for action. Yet economic analyses in this field have been oddly inconclusive.

We propose that a particular allocative principle, which we call the "strong contribution principle," lies behind a number of seemingly diverse commercial rules. By a contribution principle, we mean a principle that distributes a debtor's assets on the basis of each creditor's contribution to the debtor's estate. The strong contribution principle is a form of contribution principle that gives particular weight to the connection between the claimant's contribution and specific assets available for distribution. More precisely, it favors creditors who can establish a transactional link between assets they contributed and identifiable components of the debtor's distributable estate. A creditor of this sort has a special proximity to certain of the debtor's assets, and therefore a special claim to those assets. We believe that contribution principles, and in particular the strong contribution

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1 A priority rule, for example, might rank creditors according to the claimants' particular attributes (e.g., age, virtue, relative need), characteristics of the transaction between claimant and debtor (e.g., voluntariness, contribution), or procedural criteria (e.g., first-to-file, the outcome of a lottery). For statutory uses of lotteries in allocating benefits, see 47 U.S.C. § 309(j)(1) (1988) (regarding certain broadcast licenses); 8 U.S.C. § 1153(c)(2) (1992) (visa numbers allocated to certain aliens). Cf. Willem K.B. Hofstee, Allocation by Lot: A Conceptual and Empirical Analysis, 29 SOC. SCI. INFO. 745 (1990) (regarding the experimental finding that perceptions of fairness in the allocation of benefits depend on its aleatory component).

principle, often serve as the basis for rules allocating commercial loss.

Some of the rules we associate with the strong contribution principle are familiar to lawyers as “tracing” rules. We prefer to call the principles at issue contribution principles for two reasons. First, while recovery of one’s contribution often involves a process of tracing assets through intermediate transactions, this is not always the case. The same principle may be at work, although the contributed asset has not changed in form. Second, the term “contribution” conveys a sense of the intuitive moral basis of the rules we discuss. In a competition for scarce assets, the claim of a creditor who has contributed to the pool, and can identify his or her contribution within the pool, is thought to be especially persuasive. As a result, the contributor prevails over a variety of competing claimants.3

We do not mean to suggest that contribution is the sole or even the dominant principle governing priorities among creditors. Nor do we claim that contribution explains every feature of the rules we discuss. It does not.4 We argue only that contribution plays a role in a significant number of the rules governing priority among creditors.

This leads us to ask why contribution affects priority in the ways we have observed. There is no economic justification for the strong contribution principle. In fact, many instances of the principle seem to contradict the predictions of economic theory. We suspect that the strong contribution principle reflects an intuitive notion of property rights as relations between persons and things, which in turn derives from several influential theories of private property. On close examination, however, we think these theories and the conception of property they generate are out of

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3 As against the debtor, the claim of a contributing creditor is at least in part a restitution claim, because the debtor has gained at the creditor’s expense. Fuller and Perdue, in their famous article on contract interests, described the special appeal of a restitution claim in this way:

If, following Aristotle, we regard the purpose of justice as the maintenance of an equilibrium of goods among members of society, the restitution interest presents twice as strong a claim to judicial intervention as the reliance interest, since if A not only causes B to lose one unit but appropriates that unit to himself, the resulting discrepancy between A and B is not one unit but two.

Lon L. Fuller & William R. Perdue, Jr., The Reliance Interest in Contract Damages: 1, 46 Yale L.J. 52, 56 (1936). The commercial rules we examine in this Article carry the intuition of justice associated with restitution a step further, into the area of priorities. In other words, the commercial rules dictate that other creditors should not be paid at the expense of the contributor. The question we address is whether there is any basis for this intuitive notion of justice.

4 See infra text accompanying notes 74-75.
place in commercial law. Our conclusion, then, is that the strong contribution principle should be eliminated from priority rules.

A possible alternative to the strong contribution principle is a weaker contribution principle based on a causal link between the claimant’s contribution to the debtor and the assets available for distribution. The weaker causal form of contribution principle, however, does not support a system of priorities anything like that of present law, because it makes no distinctions among those who have added to the debtor’s wealth. Moreover, we doubt that contribution can ever be a sound reason for favoring some claimants over others in a division of losses. Priorities among creditors, if they are to be justified at all, must be justified on other grounds.

This Article describes and assesses the operation of contribution principles in commercial law. Part I identifies a number of allocative rules that are importantly similar in structure. Part II analyzes the principle that appears to be at work in the rules identified in Part I. In Part III, we assess instrumental and non-instrumental arguments for contribution-based priority and conclude that both are indefensible. Part IV illustrates the consequences of our conclusion by reference to two judicial grants of priority. Part V briefly emphasizes the modesty of our normative case for abandoning contribution-based priority rules.

I. STRUCTURALLY SIMILAR DOCTRINES IN COMMERCIAL LAW

A number of discrete commercial rules appear to follow a common pattern. We have chosen four examples for close analysis: constructive trusts, subrogation rights accorded to construction contract sureties, priority for purchase money security interests under the Uniform Commercial Code, and sellers’ reclamation rights. Each of these rules affects the outcome of a competition for scarce assets of a defaulting debtor. Each takes the form of a contribution principle, awarding priority to creditors who have contributed an asset or productive labor to the debtor’s estate. Further, each is an expression of the strong contribution principle, which requires a connection between the claimant’s contribution and particular assets within the pool available for distribution. In Parts II and III, we will define the strong contribution principle more precisely and consider its sources and justifications. Here our task is a descriptive one: to show how the strong contribution principle appears as a frequent pattern in the allocation of commercial loss.
A. The First Case: Constructive Trusts

A constructive trust is an equitable remedy that has the effect of allocating priority among creditors. The remedy is restitutionary in nature, designed to correct unjust holdings when one party has obtained property from another by conversion, fraud, mistake, or some other inequitable means. It works by treating the wrongdoer as a trustee holding title for the benefit of the victim from the moment of the wrong. The fictitious trust allows the constructive trust claimant to claim not only property taken from the claimant, but also any traceable products or proceeds of that property. Further, the claimant, as the beneficiary of the trust, is considered to be the "equitable owner" of any assets subject to the trust. From this it follows that the constructive trust beneficiary's claim to those assets is prior to the claims of other creditors.

For example, suppose the claimant once owned a valuable machine. The wrongdoer fraudulently induced the claimant to trade the machine for some accounts receivable that turned out to be worthless. The wrongdoer then sold the machine and used the proceeds to purchase shares of stock, which he still owns. At this point, the claimant has no legal title to the machine or the stock: she is simply a creditor with a tort claim. Never-

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9 The types of claims to which a constructive trust remedy may apply are collected in Restatement of Restitution §§ 163-171 (1937) and Scott, supra note 5, §§ 465-473, at 482-506.

10 See Restatement of Restitution § 160 cmt. c (1957); Restatement (Second) of Restitution § 30 cmt. d (Tentative Draft No. 2, 1984); Scott, supra note 5, § 508, at 3573, § 521, at 3650. For criticism of the notion of equitable ownership, see Dawson, supra note 5, at 31-32 (asserting that courts have been "seduced"); and Palmer, supra note 5, §§ 1.4, 2.14(e), 2.15, at 90-91.

11 See Restatement of Restitution § 202 cmt. e (1937); Dawson, supra note 5, at 31; Dobbs, supra note 5, § 4.3, at 244; Palmer, supra note 5, § 2.14, at 182; Scott, supra note 5, § 508, at 3573, § 521, at 649-52. Bankruptcy cases taking this position are cited below. See infra note 13.
theless, as a remedy for the fraud practiced by the wrongdoer, the claimant is deemed to be the equitable owner of the machine, and later of the stock. The only limit on the remedy is that the claimant must trace her claim to an asset that is now in the hands of the wrongdoer, and which is linked by exchange to the property that once belonged to the claimant. If the wrongdoer sold the stock for cash and used the cash to pay rent, the claimant could not assert a constructive trust, because there would be no trust "res." 

Assume now that the wrongdoer is insolvent. He owes $50,000 to a tort creditor (an elderly woman he injured while driving recklessly) and $50,000 to several unsecured trade creditors. His only assets are the stock he bought with the proceeds of the machine and some personal property that is exempt from creditors’ claims. According to traditional constructive trust doctrine, the fraud claimant, as equitable owner of the stock, is entitled to claim it, while the other unsecured creditors receive nothing. In general, the same result follows in federal bankruptcy proceedings. A few bankruptcy courts have questioned and limited the priority rights of constructive trust claimants. Most, however, have treated the fraud victim’s

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11 See Restatement of Restitution § 160 cmt. i (1937); Restatement (Second) of Restitution § 32 cmt. c, at 50-51, cmt. e, at 57-58 (Tentative Draft No. 2, 1984); Dobb, supra note 5, § 4.3, at 242, § 5.16, at 426; Palmer, supra note 5, § 2.14, at 182-83; Scott, supra note 5, § 521, at 654-55; Oesterle, supra note 8, at 172-75.

12 See Restatement of Restitution § 160 cmt. i (1937); Ames, supra note 8, at 514.

13 One issue on which courts have disagreed is whether a constructive trust claim is subject to the strong arm powers of a bankruptcy trustee. Compare 11 U.S.C. § 541(d) (1993) (excluding from the bankruptcy estate property in which the debtor holds only equitable title) with 11 U.S.C. § 544(a)(3) (1993) (enabling the bankruptcy trustee to avoid interests that could be avoided under state law by a bona fide purchaser of real property or the holder of a judicial lien on personal property). See, e.g., National Bank of Alaska v. Erickson (In re Seaway Express Corp.), 912 F.2d 1125, 1127-30 (9th Cir. 1990) (holding that strong arm powers apply); Belisle v. Plunkett, 877 F.2d 512, 514-16 (7th Cir. 1989) (holding that strong arm powers apply); Sanyo Elec., Inc. v. Howard’s Appliance Corp. (In re Howard’s Appliance Corp.), 874 F.2d 88, 95 (2d Cir. 1989) (reserving judgment); City Nat’l Bank v. General Coffee Corp. (In re General Coffee Corp.), 828 F.2d 699, 704-07 (11th Cir. 1987) (reserving judgment), cert. denied, 485 U.S. 1007 (1988); Vineyard v. McKenzie (In re Quality Holstein Leasing), 752 F.2d 1009, 1013-14 (5th Cir. 1985) (holding that constructive trust property is excluded from the estate). Even if the bankruptcy trustee’s lien avoidance powers are applicable, it does not follow that the constructive trust is ineffective; rather, the outcome depends on relative priorities between a constructive trust claimant and a judicial lien creditor or a bona fide purchaser of real property, as determined by state law. See, e.g., Sanyo Elec., 874 F.2d at 93-95; City Nat’l Bank, 828 F.2d at 707; Elin v. Busche (In re Elin), 20 B.R. 1012, 1016-20 (Bankr. D.N.J. 1982), aff’d, 707 F.2d 1400 (3d Cir. 1983).

Several courts have expressed more general reservations about the justice of a constructive trust
constructive trust remedy as a state law entitlement that should be honored in bankruptcy. 14

Courts usually explain constructive trusts in terms of unjust enrichment: restoring the products of misappropriated property to the prior owner will prevent an unjust enrichment at her expense. 15 When the contest is between the claimant and the wrongdoer, this explanation is reasonable enough. Between these parties, a constructive trust on misappropriated property accomplishes corrective justice. 16 Further, a constructive trust remedy reduces incentives for misappropriation, by allocating all profits to the victim. 17

The picture changes in bankruptcy. Most bankruptcy proceedings involve a variety of creditors competing for limited assets. In this setting the

remedy in the context of bankruptcy. See National Bank of Alaska, 912 F.2d at 1129; Torres v. Eastlick (In re North American Coin & Currency, Ltd.), 767 F.2d 1573, 1574-78 (9th Cir.), modified in other respects, 774 F.2d 1390 (9th Cir. 1985), cert. denied, 475 U.S. 1083 (1986); Lane Bryant, Inc. v. Vichle Tops, Inc. (In re Vichle Tops, Inc.), 62 B.R. 788, 792 (Bankr. E.D.N.Y. 1986); see also Cunningham v. Brown, 265 U.S. 1, 11-13 (1923) (approving the recognition of constructive trusts, but suggesting that stricter trading rules should apply in bankruptcy). For a more detailed discussion of these issues, see Sherwin, supra note 5, at 318-29; and Thomas H. Jackson, Statutory Liens and Constructive Trusts in Bankruptcy: Undoing the Confusion, 61 Am. Bankr. L.J. 287 (1987).


15 See, e.g., Sanyo Elec., 874 F.2d at 94; City Nat'l Bank, 829 F.2d at 706; N.S. Garrott & Sons, 772 F.2d at 467; Beatty v. Guggenheim Exploration Co., 122 N.E. 378, 380 (N.Y. 1919); Restatement of Restitution § 160 & cmt. c, d (1937); Dawson, supra note 5, at 26-28; Scott, supra note 5, §§ 462, 462.2.


17 See Restatement of Restitution § 202 cmt. c (1937); Scott, supra note 5, § 508, at 556.
debtor, whose obligations will be discharged in any event, is not affected by a constructive trust. The impact of the remedy falls entirely on the creditors.\footnote{This statement assumes that the debtor's assets are not sufficient to pay his debts and that the property at issue is not exempt from creditors' claims under state or federal law. See 11 U.S.C. § 522 (1988) (exemptions).} This means—or ought to mean—that the inquiry into unjust enrichment must be expanded to take into account the relative positions of competing creditors. In other words, it must appear that other creditors would be unjustly enriched if they were permitted to share in the products of the misappropriated property.\footnote{The Restatement in the text is also true under English law. English law allows the imposition of a trust on funds advanced for a specified purpose, where the purpose remains unaccomplished at the debtor's bankruptcy and where the funds are identifiable. See, e.g., Barclays Bank Ltd. v. Quietclose Invs., 1970 App. Cas. 567 (appeal taken from A.C.); In re Kayford, Ltd., 1975 W.L.R. 279 (Ch.); Michael Bridge, The Quietcose Trust in a World of Secured Transactions, 12 Oxford J. Legal Stud. 333 (1992). Imposition of a trust reduces assets available to creditors of the debtor other than the beneficiary by the value of the trust.} Yet this does not explain why the constructive trust claimant

\footnote{The statement in the text is also true under English law. English law allows the imposition of a trust on funds advanced for a specified purpose, where the purpose remains unaccomplished at the debtor's bankruptcy and where the funds are identifiable. See, e.g., Barclays Bank Ltd. v. Quietcose Invs., 1970 App. Cas. 567 (appeal taken from A.C.); In re Kayford, Ltd., 1975 W.L.R. 279 (Ch.); Michael Bridge, The Quietcose Trust in a World of Secured Transactions, 12 Oxford J. Legal Stud. 333 (1992). Imposition of a trust reduces assets available to creditors of the debtor other than the beneficiary by the value of the trust.}

\footnote{Because constructive trust claims span a wide range of wrongdoing, including conversion, fraud, mistake, fiduciary misconduct, and occasionally breach of contract, the nature and extent of the claimant's dealings with the debtor vary from case to case. See Oesterle, supra note 8, at 177-79 nn.11-17 (materials listing bases of constructive trust claims). In most cases, however, there is at least a defect in the transaction between debtor and claimant, so that the claimant is not a fully voluntary creditor. Courts rarely impose constructive trusts as a remedy for simple breach of contract. See Palmer, supra note 5, § 4.10(a); John P. Dawson, Restitution or Damages?, 20 Ohio St. L.J. 175, 182 (1959). But see National Bank of Alaska, 912 F.2d at 1129 (holding a constructive trust to be a remedy for contract breach under Washington law).}
prevails over an accident victim (the elderly woman in our example).

A second possibility is that, unlike an auto accident, misappropriation adds value to the debtor's estate. This circumstance suggests that a contribution principle is at work. Even so, contribution is not a complete explanation for the constructive trust claimant's priority, because nearly every unpaid contract creditor has added something to the debtor's estate. 21

Even if we combine the elements of contribution and involuntary involvement with the debtor, these circumstances alone are not enough to ensure the claimant's priority. Constructive trust priority extends only to claimants who can trace their claims to specific products remaining in the debtor's pool of assets. If the debtor squandered the fraud victim's property rather than investing it, the victim must share with other creditors. 22 The key to the constructive trust claimant's priority, then, lies in the connection between his or her contribution and specific assets in the hands of the debtor. In other words, the constructive trust is an instance of the strong contribution principle: a creditor who has made an identifiable contribution to the pool of assets to be distributed among creditors is favored over others who have not.

B. The Second Case: Subrogation for Construction Sureties

Subrogation is another equitable remedy that can result in priority for particular creditors. 23 The remedy is available when one party has paid another's debt and is entitled to restitution from the debtor of the amount paid on behalf of the debtor. Subrogation permits the claimant (the party who paid) to assume the rights of the creditor who received the payment. 24

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21 In fact, even the tort claimant might argue that the debtor realized a gain by driving recklessly, because he avoided the costs of greater care. See Richard A. Posner, The Concept of Corrective Justice in Recent Theories of Tort Law, 10 J. LEGAL STUD. 187, 198 (1981).

22 See supra notes 11-12 and accompanying text.

23 For general discussions of subrogation, see DOBBS, supra note 5, § 4.3, at 250-52; DAWSON, supra note 5, at 36-37; PALMER, supra note 5, § 1.4(b); and SCOTT, supra note 5, § 464.

24 See RESTATEMENT OF RESTITUTION § 162 cmt. a, d-f (1937); DOBBS, supra note 5, § 4.3, at 251; PALMER, supra note 5, § 1.4(b); SCOTT, supra note 5, § 464. To qualify for subrogation, the plaintiff must not have acted officiously in paying the debt. There must be some justification for the payment, such as mistake, protection of the plaintiff's property, or a secondary legal obligation resting on the plaintiff. See RESTATEMENT OF RESTITUTION, supra, § 162 cmt. b; PALMER, supra note 5, § 22.1, at 332.
At least in its origins, subrogation is another instance of the strong contribution principle, though the contribution is somewhat harder to perceive in this case. The image of a subrogee stepping into the shoes of a creditor paid by the subrogee is shorthand for a more complex idea that incorporates the same tracing process found in constructive trust doctrine.\textsuperscript{25} The logic of subrogation is that any property that becomes available to the debtor as a result of the claimant's payment is a product of the assets the claimant expended in paying the debt. For example, if A pays B's home mortgage debt at B's request, the new equity B holds in his home is a product of the money A paid to B's mortgagee. In this sense, A has contributed the new equity to B. It follows, in the view of the courts, that B's other creditors would be unjustly enriched if they were permitted to share in the equity.\textsuperscript{26} In order to prevent such an enrichment, subrogation preserves the paid creditor's rights and priority for benefit of the subrogee. Of course this invites the same question as did the constructive trust: why is it unjust for other creditors to have a share? We will return to that question shortly.

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A simple example may be helpful. Assume the debtor obtained a loan from a bank, giving the bank a note and a mortgage on some land belonging to the debtor. The note was endorsed by a wealthy relative of the debtor. Later the debtor defaulted and the bank collected from the endorser. The endorser can sue the debtor for restitution of the amount paid on account of the debtor's default. In addition, the endorser has a right of subrogation, which allows the exercise of whatever rights the bank had on account of the debt, including the right to foreclose on the debtor's land. This right is especially important if the debtor has other creditors, because it attaches automatically upon payment and promotes the subrogee (the endorser) to the bank's priority.

\begin{itemize}
\item \textsuperscript{25} See Dawson, \textit{supra} note 5, at 37; Dobbs, \textit{supra} note 5, § 4.3, at 250; Palmer, \textit{supra} note 5, § 1.5(b), at 22.
\end{itemize}
Consider the use of subrogation doctrine to benefit construction contract sureties. In a typical case, the debtor is the project’s general contractor, and the assets in dispute are funds held as a retainage by the project owner. The retainage is governed by the agreement between the owner and the contractor, which permits the owner to withhold a certain percentage of each periodic progress payment until the project has been completed according to contract specifications. If the project is not completed as required, the owner has a right to set off its damage claims against the retained funds.

The owner’s agreement with the contractor also requires the contractor to furnish payment and performance bonds, in which an independent surety company undertakes to pay subcontractors and to complete construction of the project if the general contractor defaults. In a private construction project, the payment bond is especially important to the owner because it ensures that the project will be free of mechanics’ liens. Mechanics’ liens are a form of protection provided by statute to subcontractors who furnish labor or materials to the project. Typically, mechanics’ lien statutes give unpaid subcontractors a lien on the project itself, and sometimes on retainages held by the owner, to secure payment of sums owed to them by the general contractor. A payment bond reduces the


In practice, a construction surety’s subrogation rights will be affected by particular contract terms governing the parties in various funds at different stages of the project. Our description in the text makes some simplifying assumptions about contract terms, but it is fairly representative.

39 See Sweet, supra note 28, § 26.03; Withers, supra note 27, at 358.

40 See Sweet, supra note 28, § 22.04, at 486; Withers, supra note 27, at 359-60.

41 See Sweet, supra note 28, ch. 37; Withers, supra note 27, at 356-67.


Labor and material subcontractors may also have non-statutory equitable liens on the retainage if they are intended beneficiaries of the retainage agreement between the contractor and the owner. See
chance that liens of this kind will attach or be enforced.

The surety company that issues payment and performance bonds is engaged by the contractor, though its bonds run to the benefit of the owner. The consideration for the bonds is a fee paid by the contractor, and an agreement by the contractor to indemnify the surety for any costs it may incur if it is required to perform on the bonds. The contractor may also give the surety an assignment of its contingent interest in the owner's retainage, to secure the promise of indemnification.

It is important to notice that on paper, the surety is a creditor of the contractor only, and not of the project owner. According to the terms of the contract between owner and contractor, the retained funds become property of the contractor if and when the project is complete. Apart from subrogation, the surety has only an indemnity claim against the contractor, plus whatever security interest in the contractor's assets it has reserved by means of a conventional security agreement. Thus the surety has no claim on the retainage until it reaches the contractor.

Suppose now that the contractor defaults on its obligations to the owner and files a bankruptcy petition. It owes money to a number of creditors, including (1) employees who have not received their wages, (2) a tort claimant who was injured by debris left on the site by careless agents of the contractor, and (3) unsecured contract creditors who contributed indirectly to the project by providing such things as office space or telephone service. The contractor also owes indemnity to a surety company that issued payment and performance bonds, and has performed its bonds obligations by paying labor and material subcontractors and hiring a substitute contractor to complete the project. The project is now complete, and the contractor's principal asset is its matured contract right to funds retained by the project owner.

Subrogation places the surety in the position of creditors who previously had claims against the contractor, and whose claims were discharged by the surety's payment and performance. Again, the explanation for this

Sweet, supra note 28, § 32.07(h), at 652; Withers, supra note 27, at 360.
33 See Sweet, supra note 28, § 37.01, at 744; Smith & Covel, supra note 27, at 668-69; Withers, supra note 27, at 356-57.
34 See Smith & Covel, supra note 27, at 668-69; Withers, supra note 27, at 357.
remedy is that it traces and reclaims property the surety contributed to the
debtor's estate. In other words, any property that became available to the
contractor as a result of the surety's performance is viewed as a traceable
product of whatever assets the surety expended to perform. The surety
steps up to the priority of the claims it discharged in order to avoid en-
riching other creditors of the contractor at the surety's expense.

For example, if subcontractors held mechanics' liens on the retainage,
the surety takes their positions because its payment discharged their
claims and freed the retainage from their liens. The surety also takes the

Schlager, 267 N.E.2d 492, 496 (Mass. 1971); Smith & Covalt, supra note 27, at 672-73; Withers,
supra note 27, at 360-62. It is sometimes said that the surety is subrogated to the rights of
the contractor as well as to those of the creditors whose claims it has satisfied. See, e.g., Pearlman, 371
U.S. at 141; Canter, 267 N.E.2d at 496. This is, however, a misunderstanding of subrogation: the
surety's right against the contractor is simply a right of reimbursement, which is not prior to the
claims of other creditors unless it is secured by a properly perfected security interest. See Prairie State

38 See American Fire & Casualty Co. v. First Nat'l City Bank, 411 F.2d 755, 758 (1st Cir.
(M.D. Ga. 1977); Finance Co. of Am. v. United States Fidelity & Guar. Co., 353 A.2d 249, 255
(Md. 1976); Earl Dubey & Sons, Inc. v. Macomb Contracting Corp., 296 N.W.2d 582, 586 (Mich.

Funds or property that are not traceable to the surety's performance are not subject to the surety's
Cir. 1984) (funds due under a separate contract); Great Am. Ins. Co. v. Universal Builders, Inc. (In
re Universal Builders, Inc.), 53 B.R. 183, 185-88 (Bankr. M.D. Tenn. 1985) (distinguishing between
retainage and earned but unpaid progress payments); American States Ins. Co. v. Glover Constr. Co.
(In re Glover Constr. Co.), 30 B.R. 873, 875-82 (Bankr. W.D. Ky. 1983) (same); Leach, 438 F.
Accident & Indem. Co. v. Long, 245 A.2d 800, 805 (Del. Ch. 1968) (subrogation extends to earned
progress payments); Travelers Indem. Co. v. Clark, 254 So. 2d 741, 745 (Miss. 1971) (same). Subro-
gation also may not apply to money the owner has paid over to the contractor. See Pearlman, 371
U.S. at 143-44 (Clark, J., concurring); United Pac. Ins. Co. v. United States, 362 F.2d 805, 808 (Ct.
Cl. 1966).

37 See supra notes 25-26 and accompanying text.

38 Pearlman, 371 U.S. at 141; United States Fidelity & Guar. Co. v. First State Bank, 494 P.2d
1149, 1154-55 (Kan. 1972); Canter, 267 N.E.2d at 496; Clark, 254 So. 2d at 746; Stevlee Factors,
Co., 603 S.W.2d 730, 734 (Tenn. 1980); Withers, supra note 27, at 362-63. In Pearlman, 371 U.S.
at 141, a surety that paid subcontractors was held to be entitled to the retainage. The majority opinion
referred to rights of the owner, the subcontractors, and the contractor, but did not make clear what
rights the surety had assumed. The concurrence rightly pointed out that because federal law prevents
subcontractors from asserting mechanics' liens on federal projects, subrogation to the rights of subcon-
tractors was of no use to the surety. Id. at 142-43 (Clark, J., concurring). However, the surety was

position of the project owner, because its performance discharged the owner's damage claim against the contractor and ended the owner's right of set-off against the retainage. In both cases, the retainage is considered a traceable product of the surety's performance. As a result, the surety moves ahead of unsecured creditors. Whether or not the surety has reserved a consensual security interest in the retainage, it can claim the retained funds to the exclusion of competing unsecured tort and contract creditors. Subrogation also may place the surety ahead of creditors who hold consensual security interests in the retainage. For example, we might add to the list of creditors a bank that has extended a general line of credit to the contractor, secured by a floating lien on the contractor's assets. The bank's security interest covers all contract rights relating to the project, whenever acquired, and the bank has perfected its interest by filing a financing statement.

Without subrogation, the bank probably would prevail over the surety, at least if it were the first party to perfect a security interest. The surety is a creditor of the contractor and is subject to the normal rules governing also subrogated to the government's right to apply retained funds to payment of subcontractors. Id.; see also City Bank & Trust Co. v. Don's Elec., Inc. (In re Don's Elec., Inc.), 65 B.R. 399, 402 (Bankr. W.D. Wis. 1986) (holding that subcontractors had no rights to which surety could be subrogated in the absence of a trust fund in the subcontractor's favor).


Presumably the surety also would prevail over unpaid employees of the contractor. The Bankruptcy Code gives a limited priority to employee wage claims in the distribution of a debtor's assets. See 11 U.S.C. § 507(a)(3) (1992). But the surety assumes the position of the owner, who has a right to set off its claims against the retained funds before they become part of the contractor's distributable assets.
priority in the contractor’s assets.41 With a right of subrogation, however, the surety can climb ahead of the bank by asserting the owner’s right to damages for breach of contract. The owner’s right is a right to set off damages against the retainage before the retainage reaches the contractor, and thus before any rights of the bank can attach.42 As a remedy for unjust enrichment, subrogation duplicates that right for the surety. Thus, by an equitable magic trick, the surety prevails over the bank.43

A few courts have expressed dissatisfaction with this result. For example, a Florida appellate court held that the surety’s interest in retained funds was essentially a security interest that should be held to the priority rules of Article 9.44 It reasoned that in the context of a sophisticated construction project, both the bank and the surety are business parties extending credit, both have the opportunity to obtain and perfect consensual

41 See U.C.C. §§ 9-301(1), 9-312(5) (1992). It has been suggested that the surety might claim priority as the holder of a purchase money security interest, but even if it could characterize its interest in this way, it would have to comply with filing requirements. See id. §§ 9-107, 9-312(3)(c), (d); Smith & Covalt, supra note 27, at 678-79.

Most courts have held that the surety’s subrogation rights, and its priority over secured creditors of the contractor, are not preempted by Article 9 of the Uniform Commercial Code. See Michelson, 452 F.2d at 1221-25; Framingham Trust Co., 427 F.2d at 857; Home Indem. Co., 433 F.2d at 765; Don’s Elec., Inc., 65 B.R. at 403-04; In re Ward Land Clearing & Drainage Inc., 73 B.R. at 315-16; In re V. Pangori & Sons, Inc., 53 B.R. at 716-17; Alaska State Bank, 579 P.2d at 1364-68; Transamerica Ins. Co., 540 So. 2d at 116; Argonaut Ins. Co., 232 S.E.2d at 138-40; First State Bank, 494 P.2d at 1157-59; United States Fidelity & Guar. Co., 353 A.2d at 253-54; Canter, 267 N.E.2d at 494-96; Old Kent Bank-Southeast, 444 N.W. at 165; Clark, 254 So. 2d at 745-46; Stevlee Factors, Inc., 346 A.2d at 627-28; Jacobs, 206 A.2d at 54-55; Highlands Ins. Co., 603 S.W.2d at 733-34; cf. In re Kuhn Constr. Co., 11 B.R. 746, 748-50 (Bankr. S.D. W. Va. 1981) (holding that consensual assignment from contractor to surety was subject to Article 9 although subrogation rights were not).

security interests, and therefore both should be made to follow the rules governing commercial credit. The appellate court's decision seems a sensible one, but it was reversed on further appeal, and most courts have continued to favor the surety.

This brings us to the question: what is it about a surety's role in a construction project that distinguishes it from other creditors of the contractor? The surety added value to the pool of assets under dispute; but presumably any creditor who has provided goods and services to the debtor and has not been paid has enhanced the debtor's wealth. The difference between the surety and the various creditors it prevails over must lie in the fact that the surety added something that is still identifiable within the pool, and thus distinct from mere value. Specifically, it added the retainage, by rendering the performance that freed the retainage from the interests of the owner and subcontractors. Thus the priority the surety obtains through subrogation is another instance of the strong contribution principle: a creditor who adds to the debtor's wealth, and can locate the product of its contribution among the debtor's assets, is favored over other creditors whose contributions have been commingled or disbursed.

C. The Third Case: Direct Contribution Priority

In general, priority under Article 9 and elsewhere is determined temporally: the first in time is the first in right. Typically, under Article 9, security interests in personal property and fixtures are ranked in the order in which they are filed or perfected. The date a financing statement is filed or the date a security interest is perfected orders conflicting interests in the same collateral. Accordingly, in general, Article 9 gives priority in collateral to the first creditor to file or perfect a security interest in it. When or how the collateral is produced or becomes an asset of the debtor is irrelevant. Ignoring exceptions, Article 9 subordinates a creditor who contributes to the production of an asset of the debtor to a creditor with a

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46 Id. at 445-46; see also In re V. Pangori & Sons, Inc., 53 B.R. at 718-22 (holding that a trustee in bankruptcy of the contractor could avoid the surety's subrogation rights when the bankruptcy petition was filed before the surety performed its bond obligations); Macomb Contracting Corp., 296 N.W.2d at 584-88 (holding that a judicial lien established before the surety performed its bond obligations was superior to the surety's subrogation rights, but not to the perfected security interest of a bank).

48 See Transamerica Ins. Co., 540 So. 2d at 133; see also supra note 43.
floating lien who has previously filed a financing statement. In fact, the creditor is subordinated to the floating lien creditor even if the latter has not extended credit to the debtor or made a commitment to do so. Earlier filing is sufficient to give the floating lien creditor priority.

Article 9 contains a number of exceptions to its general ordering of priorities. The exceptions are based on the underlying nature of a secured claim, not on temporal considerations. In particular, they are based on the extension of credit directly contributing to the acquisition or production of the debtor’s asset. Secured claims arising from credit given to enable a debtor to acquire or produce an asset are accorded priority. Consider first the most well-known exception: purchase money security interests. A purchase money security interest is a security interest a creditor takes in an asset that the creditor’s loan enables the debtor to acquire. The creditor’s loan may take one of two forms. Either the creditor sells an asset and retains a security interest in it to secure the asset’s purchase price, or a loan is extended to enable the debtor to acquire the asset in which a security interest is taken. In both cases the extension of credit enables the debtor to acquire an asset. It contributes to the acquisition of an item of collateral. A properly perfected purchase money security interest has priority over a previously filed nonpurchase money security interest.

Tracing is required for a security interest to be a purchase money security interest. That is, the collateral must have been acquired as a direct result of the contribution in the form of credit. Section 9-107 imposes the tracing requirement definitionally:

A security interest is a “purchase money security interest” to the extent that it is (a) taken or retained by the seller of the collateral to secure all or part of its price; or (b) taken by a person who by making advances or incurring an obligation gives value to enable the debtor to acquire rights in or the use of collateral if such value is in fact so used.\(^\text{47}\)

Case law concerning the effect of refinancing on purchase money debt reinforces the requirement. In jurisdictions that treat refinancing of a debt secured by a purchase money security interest as destroying that interest, the conceptual impossibility of tracing is determinative. Debtor already owns collateral subject to a purchase money security interest. Creditor, by

refinancing, allows the debtor to retire the old debt, but the funds used to retire the old debt cannot be used to enable the debtor to acquire rights in the collateral. This is because the debtor already owns the collateral. Therefore the refinanced debt cannot be secured by a purchase money security interest.\textsuperscript{48} The conclusion follows only if a transactional connection between a loan and acquisition of an asset is required.

The nature of a purchase money security interest is worth noting. Any extension of credit enables a debtor to continue in business. Even the advance payment of a buyer often allows the seller-debtor to produce the asset being purchased. New value is given to a debtor in each case. All credit previously extended therefore indirectly enables the debtor to acquire or produce assets subsequently. Types of loans are indistinguishable on this basis. Also, all simultaneous extensions of equal credit equally enable a debtor to acquire or produce an asset. But only some of that credit is in fact used to acquire or produce a particular asset. That is, only some loans \textit{directly contribute} to the acquisition or production of a particular asset. They link the extension of the loan and the addition of the asset to the debtor's estate. By definition, only directly contributing loans are secured by a purchase money security interest. Hence only security interests arising from directly contributing loans are second in time but first in right.\textsuperscript{49}

Lesser-known exceptions to Article 9's general scheme of priorities are of the same sort. Take creditors C1 and C2, two sellers of component parts who have retained a security interest in their respective components to secure their respective purchase prices. Suppose that components sold by both C1 and C2 are commingled in the same product or mass during production. Suppose also that there is a floating lien creditor C3 with a security interest in the product or mass produced, and that C3 has filed an

\textsuperscript{48} A committee studying Article 9 has recommended that the definition of a purchase money security interest in section 9-107 be revised so that refinancing does not destroy the purchase money character of a security interest. See PEB Study Group Uniform Commercial Code Article 9, at 25 (1992) [hereinafter PEB Study Group]. The recommended revised definition still requires a transactional connection between the initial loan and the acquisition of the collateralized asset.

\textsuperscript{49} See, \textit{e.g.}, Kripke, \textit{supra} note 2, at 936 ("[O]ne who contributes new assets to the debtor is entitled to be paid for them and should not be required to give up a hold on the assets until paid."); Robert M. Lloyd, \textit{Refinancing Purchase Money Security Interests}, 53 TENN. L. REV. 1, 11 (1985) (noting the "inherent fairness" of allowing first claim on assets to those whose funds made possible their acquisition).
appropriate financing statement before C1 or C2 have done so. C1 and C2 have priority in the product or mass, either under section 9-315 or section 9-312(3). Assuming that the identity of the commingled collateral is lost, section 9-315 determines priority in the product or mass as between C1 and C2. Under section 9-315(2), C1 and C2 are of equal priority and therefore each has a pro rata share in the product or mass. The rank of C3's interest is left open under Article 9.\footnote{See David Frisch, UCC Section 9-315: A Historical and Modern Perspective, 70 MINN. L. REV. 1, 53-57 (1985); 2 GRANT GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 31.5 (1965).} Section 9-315(2) may apply, because C3 has a security interest in the product or mass. If so, C3 shares ratably in it. Alternatively, section 9-315(2) may have no application, because by its terms it applies only when section 9-315(1) applies, and section 9-315(1) is relevant only when a security interest in component parts is taken. C3's security interest arguably is in the produced product or mass alone. If section 9-315(2) has no application, section 9-312 determines C3's priority. Both C1 and C2 have obtained purchase money security interests in their respective collateral, probably inventory. Under section 9-312(3), C1 and C2 enjoy complete priority over C3 if section 9-312(3)'s notice requirements are satisfied. Therefore, section 9-315 sometimes treats the priority of C1 and C2 as functionally equivalent to purchase money security priority, and section 9-312(3) treats their priority as purchase money priority proper.

Analyzed under either section 9-315 or section 9-312, the status of C1 and C2 is that of directly contributing creditors. The collateral of C1 and C2 is in fact used to produce the product or mass. Their collateral enabled the acquisition of, and in fact was used to acquire, rights in that product or mass. In everything but name, under section 9-315, C1 and C2 have purchase money security interests in the outcome of production. C1 and C2 are directly contributing creditors. Under section 9-315(2), as directly contributing creditors, C1 and C2 share ratably in the product or mass produced. C3, the nonpurchase money creditor, at best shares ratably, again via application of 9-315(2). Hence, analyzed under section 9-315, C3 is first in time but only ratably first in right. Analyzed under section 9-312, C1 and C2 have purchase money security interests, probably in inventory. Again, they are directly contributing creditors—this time in name as well. As such, C1 and C2 have priority over C3, a nonpurchase
money secured creditor in inventory. Analyzed under section 9-312, therefore, C3 is first in time but last in right. Nonetheless, under both analyses, the status of C1 and C2 as directly contributing creditors gives them at least parity with C3, an indirectly contributing creditor.61

Consider finally two other exceptions to Article 9's general scheme of priorities. Both exceptions involve statutory mechanic's liens. Section 9-310 gives priority to a statutorily recognized possessory mechanic's lien over a prior perfected security interest in the same collateral. The converse ordering occurs only when the statute expressly provides for it. Nonpossessory mechanic's liens are outside the scope of Article 9. Priority rules other than those contained in the Code therefore are required to order conflicts between nonpossessory mechanic's liens and Article 9 security interests. Statute and decisional law generally treat the nonpossessory mechanic's lien as superior to a prior perfected Article 9 security interest. Whether invoking contractual or agency considerations, benefit in the form of increasing the value of an asset is the crucial element.62 Nonpossessory mechanic's liens are awarded priority because provided goods or services enhanced the value of debtor's property. The presence of a direct contribution is decisive. A prior perfected security interest in the same collateral enables the debtor to retain the contested asset. The creditor's loan may even have enhanced the asset's value. The prior perfected creditor therefore at least contributes to the debtor's retention of the asset. Nevertheless, the mechanic's contribution is direct: The connection between the mechanic's provision of goods or services and the asset's enhanced value is traceable.63 Section 9-310 and its extra-Code complemen-

61 See Steve H. Nickles, Setting Farmers Free: Righting the Unintended Anomaly of UCC Section 9-312(2), 71 Minn. L. Rev. 1135, 1202-03 (1987). Code treatment of contests between construction mortgagee and fixture creditor does not provide an exception to direct contribution priority. Section 9-313(6) gives priority to the construction mortgagee under most circumstances, even if the fixture creditor has a purchase money security interest. See U.C.C. § 9-313(6). This ordering of claims is consistent with direct contribution priority because the fixture creditor is a directly contributing creditor. But so too is the construction mortgagee. Both contribute assets which make possible the construction project. See Gilmore, supra note 50, § 30.6, at 830-31; Peter F. Coogan, The New UCC Article 9, 86 Harv. L. Rev. 477, 494-99 (1973). Therefore, the contest is between two directly contributing creditors. That one contributing creditor is given priority over another such creditor is consistent with both creditors being given priority over indirectly contributing creditors.


63 See Robert Mfg. Co. v. South Bay Corp., 368 N.Y.S.2d 413, 415 (1975) (holding that manufacturer is deemed a "materialman" within the meaning of lien law where manufacturer constructed
tary rule give priority to the directly contributing creditor. The priority
given is an instance of the operation of the contribution principle.\textsuperscript{54}

\textbf{D. The Fourth Case: Sellers' Reclamation Rights}

Reclamation rights provide instances of the contribution principle. A
seller's right to reclaim and regain possession of a delivered asset secures
payment of the purchase price. The buyer who fails to tender the
purchase price obviously contributes nothing to the acquisition or pro-
duction of an asset. Select classes of the buyer's creditors other than the seller
may have added to the buyer's assets, but they did not directly contribute
to the buyer's acquisition of the asset delivered by the seller. They there-
fore have no right to the asset the seller delivered to the buyer. A recla-
imation right, by securing the seller's interest in the purchase price, subordi-
nates other creditors' interests to the seller's interest in the delivered asset.
Ignoring labels such as "seller's lien," "title," and "replevin," the conse-
quence of recognizing a reclamation right is the same: The seller is given
priority over select classes of buyer's creditors based on direct
contribution.

The sellers' Article 2 rights of reclamation are evidence of the contribu-
tion principle. Section 2-702(2) codifies and alters the seller's pre-Code
right to reclaim goods delivered subject to a credit sale. A buyer need not
fraudulently misrepresent her ability or willingness to pay. It is enough
that the goods were received while the buyer is insolvent in the Code sense
of the term. Given the buyer's insolvency, the credit seller, upon timely
demand, may reclaim the goods delivered. Sections 2-507(2) and 2-511(3),
with judicial interpretation, codify a seller's right to reclaim goods deliv-
ered subject to a cash sale. Section 2-507(2) states that when payment is
due on delivery, the buyer's right to retain the goods delivered as against
the seller is conditioned on making payment. Section 2-511(3) provides

\textsuperscript{54} See, e.g., \textit{In re Dutcher Constr. Corp.}, 378 F.2d 866, 870 (2d Cir. 1967); \textit{In re Alliance
Properties, Inc.}, 104 B.R. 306, 311 (Bankr. S.D. Cal. 1989) (regarding both materialmen's priority
over general creditors on the basis of contribution to performance of the contract). For application of
\S 9-310 to agricultural liens, see Steven C. Turner et al., \textit{Agricultural Liens and the U.C.C.: A
that payment by check is conditional and is defeated when the check is dishonored. Neither section 2-507(2) nor section 2-511(3) contain an express statutory entitlement to reclamation, but the right is a logical consequence of the two sections. If the buyer’s right to retain goods delivered as against the seller is conditioned on making payment and payment is not made, then the buyer’s right to retain the goods is extinguished. It follows that the cash seller has the right to reclaim the goods from the nonpaying buyer, and courts have so held. Bankruptcy alters, but does not eliminate, the reclamation rights of both credit and cash sellers.66

The strong contribution principle is apparent in Article 2’s treatment of the effect of third party claims on reclamation rights. Under section 2-702(3), a credit seller’s reclamation right “is subject to the rights of . . . [a] good faith purchaser under this Article (section 2-403).”67 The pre-1966 version of section 2-702(3), still in force in a number of jurisdictions, also subjects the credit seller’s right to claims of a “lien creditor.”68 Since the cash seller’s reclamation right is not given express statutory recognition, the bearing of third party claims on that right remains statutorily unrecognized. But revised comment 3 to section 2-507 states that “[i]f third parties are involved, section 2-403(1) protects good faith purchasers.”69 Consider now three classes of third party claimants, respectively: unsecured creditors, lien creditors, and secured creditors. Neither unsecured creditors nor lien creditors of the buyer are “purchasers” under the Code. Hence the credit and cash sellers’ reclamation rights survive as against unsecured creditors. A credit seller’s reclamation right survives as against lien creditors in jurisdictions which have adopted the 1966 amendment to section 2-702(3), and a cash seller’s reclamation right prevails as against a lien creditor under section 2-403. Comment 3 to section 2-702 explicitly recognizes the consequence of the survival of the credit seller’s reclamation right: the reclaiming seller is preferred as against at least some classes of buyer’s creditors. Because a cash seller is given a reclamation right, the

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67 Id. § 2-702(3) (1966).
68 Id. § 2-507 cmt. 3 (1992).
same consequence results. The Bankruptcy Code restricts, but does not eliminate, this preference. Because the reclaiming seller is preferred as against unsecured and lien creditors, the preference is consistent with the contribution principle.

Matters are more complicated when secured creditors are considered. Reclamation rights are limited by competing secured claims. They are subject to the rights of a secured creditor with a security interest in the repossessed asset. Under pre-Code law, a cash seller's reclamation rights were not similarly limited. The reason is concisely stated by the court in *Guckeen Farmers Elevator Co. v. Cargill, Inc.*: “Since the ‘cash sale’ doctrine affords protection to those who by their toil, effort, skill, and risk have produced the marketable commodities involved . . . we feel that ‘concepts of social policy and business convenience’ compel and justify our adherence to this doctrine.”58 The court's justification contains a statement of the contribution principle. Code provisions and judicial construction provide otherwise. This is because reclamation rights are subject to the rights of good faith purchasers under section 2-403. Secured creditors can be good faith purchasers under section 2-403. Hence a judicially supported strict reading of Articles 1 and 2 has a reclaiming seller losing to a secured party.

To assess consistency with the contribution principle, two subclasses of secured creditors require identification. One class of secured creditors consists of those whose credit directly contributes to the buyer’s acquisition or production of the reclaimed asset. This is the class of directly contributing creditors discussed in Part I.B. Another class of secured creditors consists of those whose credit does not directly contribute to the buyer’s acquisition or production of the reclaimed asset. We shall refer to this group as the class of nondirectly contributing creditors. A contribution principle is consistent with giving priority to directly contributing creditors over reclaiming sellers. This is because both claimants directly contribute to the reclaimed asset. The contribution principle alone cannot assign priority between such claimants. It is inconsistent with giving priority to nondirectly contributing creditors over reclaiming sellers. Section 2-702(3) expressly and section 2-507(2) by implication give such a priority. *In re*
Samuels, a notorious case, is typical. There, a financier with an after-acquired secured interest in the buyer's inventory prevailed over unpaid cash sellers of cattle. Direct contributors lost to a nondirectly contributing creditor.

Sections 2-702(3) and 2-507(2) nevertheless are consistent with the contribution principle. Consistency is preserved when those sections are considered in conjunction with Article 9's provisions. Such consideration is required because an unpaid seller is both an Article 2 seller and an Article 9 creditor, and the value of the seller's interest in the purchase price can be protected under either Article. Hence the priority of a directly contributing creditor can be preserved either under Article 2 or under Article 9. Since a seller is a direct contributor to the buyer's acquisition or production of an asset, the seller can obtain a purchase money security interest in the asset delivered to the buyer and thereby obtain a directly contributing security interest. As a purchase money secured creditor, the seller can enjoy priority over a prior perfected nonpurchase money security interest. Alternatively, section 9-113 can be invoked. Here an unpaid seller's reclamation right arguably can be viewed as a security interest "arising solely under Article 2," and a buyer's failure to make payment under a sale can amount to the buyer "not lawfully obtain[ing] possession of the goods." If so, section 9-113 gives the reclaiming seller a perfected purchase money security interest without the need to conform to the Article 9 requirements for perfection. Section 9-113 is silent on the matter of priority. Presumably, Article 9's priority rules therefore also apply to a

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security interest created via section 9-113.\textsuperscript{63} Hence the reclaiming seller, as a purchase money secured creditor via section 9-113, again enjoys priority over a prior perfected nonpurchase money secured creditor. Both alternatives preserve a directly contributing party’s priority as against a nondirectly contributing party. Whether characterized as a “right of reclamation” or a “security interest,” a reclaiming seller’s interest is protected under either Article 2 or Article 9.\textsuperscript{64} The contribution principle therefore underwrites a seller’s Article 2 reclamation rights.

A final point evidences the presence of the contribution principle. Extra-Code statute and nonuniform Code amendments restrict even the scope of sections 2-702(3) and 2-507(2). An amendment to the Packers and Stockyards Act reverses the result of \textit{In re Samuels}.\textsuperscript{65} The amendment places all livestock and the proceeds received from unpaid cash sellers of livestock in trust for their benefit.\textsuperscript{66} Because the livestock of unpaid cash sellers is held in trust, it never becomes part of the buyer’s assets and is therefore not subject to the inventory financier’s security interest. Imposing a trust operates to subordinate secured inventory lenders with after-acquired security interests to unpaid cash sellers’ claims.\textsuperscript{67} Nonuniform Code amendments operate differently but to the same effect.\textsuperscript{68} The House

\textsuperscript{63} \textit{Contra} Wiseman, \textit{supra} note 62, at 115.

\textsuperscript{64} \textit{Cf. In re} Federal’s Inc., 402 F. Supp. 1357, 1367 (E.D. Mich. 1975) (“But on the other hand it must be recognized that § 2-702 is a powerful and effective security device which benefits sellers to the detriment, and possible exclusion, of other creditors.”).

A seller’s interest also may prevail over a secured party’s interest in the delivered asset under equitable principles (\textit{cf. U.C.C.} § 1-103). In particular, a seller can recover the unpaid purchase price from a secured creditor with an after-acquired security interest based on unjust enrichment. See, \textit{e.g.}, Producers Cotton Oil Co. v. Am Star Corp., 197 Cal. App. 3d 638 (1988); Ed Duggan, Inc. v. Ninth Dist. Prod. Credit Ass’n, 795 P.2d 1347 (Colo. Ct. App. 1990) (holding that seller is entitled to recover from buyer’s secured creditor the unpaid purchase price of corn delivered to the buyer and basing recovery on unjust enrichment); Borg-Warner Acceptance Corp. v. Valentine Assoc. Ltd., 384 S.E.2d 223 (Ga. Ct. App. 1989).


\textsuperscript{68} \textit{See id.} § 196(b). The similarity of the statutory treatment of proceeds of livestock to a constructive trust remedy should be apparent. \textit{See also id.} § 197(b) (establishing statutory trust in favor of unpaid cash sellers and “growers” of poultry); \textit{id.} § 499e(c) (1988 & Supp. 1992) (same for sellers of perishable agricultural commodities).


\textsuperscript{68} \textit{See, e.g., Cal. Food & Agric. Code} § 55702 (Deering 1993) (establishing that unpaid seller of livestock has lien on livestock and its proceeds which takes priority over competing liens or security interests); \textit{Colo. Rev. Stat.} § 4-2-403(1.5) (1992) (establishing that buyer lacks power to transfer good title to livestock to a good faith purchaser when purchase price is unpaid); \textit{Fla. Stat.}
Report accompanying the amendment to the Packers and Stockyards Act justifies the amendment in terms similar to those of the Guckeen court:

[L]ivestock producers occupy a position of unique national importance. No individual is engaged in a riskier endeavor or one more vital to the national interest than the producer. . . . We would be derelict in our responsibilities to the American people if we failed to address the evils which have inflicted heavy losses upon the very producers upon whom the Nation depends for such an important part of its basic food supply. 69

The justification is of the same sort as that given by the In re Samuels court in a judgment reversed en banc: "We believe it inequitable to deny the claims of stock farmers who produced and delivered the cattle, in favor of the mortgagee who refused to advance the money before bankruptcy." 70 Both statements indicate the presence of the strong contribution principle at work in allowing a seller reclamation rights. Livestock and its proceeds become part of the debtor’s assets, but reclaiming sellers have a superior right to both based on their contribution of livestock to the debtor’s estate.

II. Strong and Weak Contribution Principles

The various doctrines we have described follow a common pattern. In each case priority depends on the claimant’s previous contribution to the debtor’s wealth. Further, priority is asset-specific, and the asset at issue must be a product of the claimant’s contribution. This Part defines more precisely the principle at work in the doctrines described in Part I, which we call the strong contribution principle. The underlying sources and justifications of the principle are assessed in Part III.

Two preliminary points about the scope of contribution principles are worth making. First, we have characterized the principle at work as a

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70 510 F.2d 139, 153 (5th Cir. 1975), rev’d, 526 F.2d 1238 (5th Cir.) (en banc), cert. denied, 429 U.S. 834 (1976); cf. John F. Dolan, Section 9-307(1): The U.C.C.’s Obstacle to Agricultural Commerce in the Open Market, 72 Nw. U. L. Rev. 706 (1977) (on special treatment given to financiers of farm products under § 9-307(1)).
contribution principle rather than a production principle because not all the examples we have given involve productive use of assets. For example, the priority of a constructive trust claimant or a reclaiming seller requires only that the claimant must have transferred an asset to the debtor. It is not necessary that the debtor has used or transformed the asset in any way.\footnote{This can be true, for example, in cases of fraud. See Restatement of Restitution § 166 (1937); cf. 11 U.S.C. § 507(a)(6) (1988) (giving priority in bankruptcy to unsecured depositor’s claim for deposits up to $900 over other unsecured claims, whether or not the debtor used the deposit).} On the other hand, contribution is present in all cases, even those that involve a productive use of assets by the debtor, because the asset must be contributed before it can be used. For example, a purchase money security interest arises only when the debtor uses a loan to obtain rights in collateral.\footnote{See U.C.C. § 9-107(a) (1993); supra part I.C.} Here, priority depends on a productive use of assets, but production in turn depends on a prior contribution. In other words, production entails contribution, although contribution need not entail production. The principle that accounts for the priorities we have identified, therefore, is contribution rather than production.\footnote{Amartya Sen, in a different context, identifies a principle he calls a “personal production view” of economic justice. The personal production view “argues for the right of the producer to enjoy the fruits” of production. Amartya Sen, The Moral Standing of the Market, 2 Soc. Phil. & Pol’Y 1, 14 (1985) [hereinafter Moral Standing]; see also N. Scott Arnold, Capitalists and the Ethics of Contribution, 15 Can. J. Phil. 87, 99-100 (1985); G.A. Cohen, The Labor Theory of Value and the Concept of Exploitation, 8 Phil. & Pub. Affs. 338, 355 (1979); Amartya Sen, Just Deserts, 29 N.Y. Rev. Books, March 4, 1982, at 3 (reviewing P.T. Bauer, Equality, The Third World, and Economic Delusion (1981)). Sen’s production principle is a type of contribution principle, within the meaning we have given to contribution. Other refinements of production principles are possible (for example, distinguishing productive activities from contribution of assets for use in a productive process). On our notion of contribution, all such refinements are instances of the contribution principle.}  

Second, we recognize that contribution does not explain every feature of the priority rules we have discussed. For example, a credit seller’s reclamation right attaches only when the debtor is insolvent and the seller has demanded return of the goods.\footnote{See U.C.C. § 2-702(2) (1993).} Both these conditions are independent of the seller’s contribution to the debtor’s assets, but the same is true of other principles. For example, a principle of efficiency might explain a purchase money secured creditor’s priority over intervening creditors, without explaining the time period during which priority obtains.\footnote{Compare id. § 9-301(2) (ten days between time buyer receives collateral and date of perfection of purchase money security interest) with Wis. Stat. § 409.301(2) (1989-90) (twenty days), U.C.C} Thus the fact
that a priority principle is indifferent to some features of a given rule does not disqualify it as the moving principle behind the rule.

A. Contribution Principles

Contribution principles, as we use the term, are methods for allocating loss or gain in which the primary criterion for allocation is the claimant’s contribution of labor or assets to the thing claimed. A more formal argument in support of a contribution principle might be stated as follows:

1. When a creditor contributes an asset to a pool of assets or to the production of assets, the contributed asset is contained in the pool or product.
2. If the final pool or product contains the contributed asset, the contributing creditor has an entitlement in the final pool or product, at least to the extent of the value of that creditor’s contribution.
3. If the contributing creditor has an entitlement in the final pool or product, no one may impair that entitlement.
4. Preventing the contributing creditor from retrieving its contribution or equivalent value from the final pool or product impairs the contributing creditor’s entitlement.
5. Therefore the contributing creditor has a right to retrieve its contribution or equivalent value from the final pool or product, which is prior to the claims of other creditors.

Locke’s defense of initial property rights is a familiar argument taking this form: One who labors to appropriate and use an unowned resource adds his or her labor to the resource and so becomes entitled to the product. When the same form of argument is extended to determine creditors’ rights, the “product” in question is the debtor’s estate or some part of the debtor’s estate. The claimant’s contribution is a transfer of property to the debtor or an improvement in the debtor’s assets brought by the claimant’s services. The resulting entitlement, according to this argument, is a claim of priority.

§ 9-312(4) (1993) (purchase money security interest in non-inventory has priority over competing security interest if perfected within ten days of debtor’s receipt of collateral), CAL. COMM. CODE § 9312(4) (Deering 1993) and WIS. STAT. § 409.312(4) (1989-90) (twenty days).

Judicial versions of contribution-based priority rules generally are phrased more informally, in terms of unjust enrichment.\textsuperscript{77} Between two parties, unjust enrichment means that one party has gained at the other’s expense in circumstances the court considers unfair.\textsuperscript{78} In multiparty disputes, courts extend the notion of unjust enrichment so that it takes the shape of a contribution principle: if the subject matter over which the parties are quarreling was contributed or generated by one of the competing parties, then the others will be unjustly enriched at the contributor’s expense if they are allowed a share.\textsuperscript{79}

**B. The Strong Contribution Principle**

The commercial rules we have described express a form of contribution principle, but they are narrower than the general contribution principle just described. In our examples, it is not enough that the claimant has contributed to the overall value of the debtor’s estate. Instead, the claimant must have contributed a particular asset. In other words, the debtor’s estate does not “contain” the claimant’s contribution in the way the rules require unless that contribution is discernible in the pool of assets at the time of distribution. For this reason, we call the principle we have observed the strong contribution principle.

The strong contribution principle, as it appears in commercial doctrine, does not always require that the claimant’s original contribution be present in the debtor’s estate.\textsuperscript{80} Yet the claimant’s contribution must be connected in a particular way to the final pool of assets. The necessary connection can be described in two steps. First, the claimant must have

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\textsuperscript{77} See Restatement of Restitution §§ 160, 162 (1937) (constructive trusts, subrogation).

\textsuperscript{78} See Restatement of Restitution § 1 cmt. a-c (1937); Dawson, supra note 5, at 1-26; Palmer, supra note 5, § 1.1.

\textsuperscript{79} See supra notes 26 & 37 and accompanying text.

\textsuperscript{80} The Code is silent as to whether a seller’s right of reclamation extends to proceeds of the goods delivered. See U.C.C. §§ 2-507, 2-702(2) (1993); compare In re Coast Trading, Inc., 744 F.2d 686 (9th Cir. 1984) and In re Diversified Food Serv. Distrib., Inc., 130 B.R. 427 (Bankr. S.D.N.Y. 1991) (holding that reclamation right does not extend to proceeds of goods) with United States v. Westside Bank, 732 F.2d 1258 (5th Cir. 1984) (holding that reclamation right extends to proceeds of goods). In other cases, however, the claimant is permitted to trace and assert a priority claim to identifiable products and proceeds of the claimant’s contribution. See U.C.C. § 9-312(3)-(4) (1993) (purchase money security interests extend to proceeds of collateral); id. § 9-306 (proceeds defined and explained); supra note 8 (tracing as an incident of constructive trusts); supra note 36 (subrogation as a tracing remedy treating the rights of a paid creditor as products of payment).
contributed a definable asset or labor product to the debtor. Second, the claimant must establish a transactional link—through a chain of exchange—between his or her initial contribution and a specific item of property within the pool of assets available to creditors.\textsuperscript{81} If the creditor's contribution is still present in its original form, there is no need to proceed through both steps, for the two collapse into one. If the contribution has changed in form, the creditor must establish the necessary transactional connection to present assets. Either way, a creditor who hopes to prevail under the various rules we have described must show that something among the debtor's assets—something that can be pointed to or named or counted—is that creditor's contribution, or is linked to that creditor's contribution by a demonstrable process of exchange.

It is important to understand that the link required by the strong contribution principle is not always a causal one. To illustrate this, we borrow an example from an article by Dale Oesterle on the effect of equitable tracing rules.\textsuperscript{82} Oesterle describes a debtor who steals two teapots, one from Owner-One and one from Owner-Two. The debtor exchanges Owner-One's teapot for a guitar and Owner-Two's teapot for some wine. Then the debtor drinks the wine, but keeps the guitar. Under prevailing tracing rules, Owner-One is entitled to a constructive trust on the guitar, while Owner-Two has only an unsecured claim for the value of the teapot. Notice, however, that if we assume the debtor preferred the guitar to the wine, then Owner-One's teapot may not have been a necessary condition for the presence of the guitar, because the debtor could have used either teapot to make the exchange. Alternatively, if the debtor preferred wine, then both teapots were necessary conditions for the presence of the guitar, because the debtor would not have traded Owner-One's teapot for the guitar if Owner-Two's teapot had not been available for the purchase of wine.\textsuperscript{83}

\textsuperscript{81} This is clearest in the materials on constructive trusts. See Restatement of Restitution § 160 cmt. i (1937); Palmer, supra note 5, § 2.14(c), at 182-83; Scott, supra note 5, § 521, at 654-55; Oesterle, supra note 8, at 172-75.

\textsuperscript{82} Oesterle, supra note 8, at 203-08.

\textsuperscript{83} Id. at 204-06. Oesterle seems to assume that the object of tracing rules is to provide evidence of a causal connection, and that they have simply failed in their purpose. See id. at 204. We suggest later in this Article that discrepancy between exchange tracing and causation is attributable to the influence of traditional theories of private property. See infra part III.B. We also argue that a weaker production principle, based on causation, would point toward a rule of equality among creditors. See infra part III.B.2.
At this point, we should set out our understanding of causation in the context of a competition between creditors. 84 If causation is to serve as a basis for distinguishing one creditor from others, it should mean that the preferred creditor’s contribution was a necessary condition for the debtor’s purchase or retention of a disputed asset, while the contributions of others who are not preferred were not. 85 When the debtor had only the asset contributed by the claimant, and exchanged it for the asset at stake, this standard is met. There are at least two cases, however, in which the strong contribution principle departs from the standard of causation we have described, if we vary our assumptions about the extent of the debtor’s wealth and his or her preferences among assets.

First suppose that at the time the debtor purchased the disputed asset, the debtor had more than enough assets to make the exchange and preferred the new asset to any of his or her existing assets. In these circumstances, use of the claimant’s contribution to make the exchange is fortuitous. Any existing asset would have done as well. Therefore the claimant’s contribution cannot be characterized as a necessary condition for the exchange.

Alternatively, the claimant’s contribution may be part of the cause, but not the only cause, for the exchange. This occurs whenever (1) the debtor has limited assets, (2) the debtor’s first preference is for consumption or

84 Causation is an unstable concept, and it is possible that under some standards of causation, Owner-One’s teapot caused the purchase of the guitar. But-for causation is not an adequate standard for legal or moral decisionmaking, since any event depends on an infinite number of antecedent conditions. See H.L.A. Hart & Tony Honore, Causation in the Law 68-69 (2d ed. 1985); O.W. Holmes, The Common Law 68-78 (Mark DeWolf Howe ed., 1963). To isolate causes that count, one must make a judgment about the significance of particular causes. See Hart & Honore, supra, at 62-83. This judgment often is expressed by narrowing or enlarging the definition of the transaction under consideration. See id. at 68, 70. In the case of creditors, if the inquiry is limited to the debtor’s exchange of the teapot for the guitar, then perhaps the teapot caused the purchase of the guitar. But if it covers a wider range of past and future transactions between the debtor and other claimants, the conclusion as to causation may differ.

85 For a discussion of this and other causal difficulties in tort law, see Larry A. Alexander, Causation and Corrective Justice: Does Tort Law Make Sense?, 6 L. & Phil. 1, 12-17 (1987).

86 See Alan Schwartz, Causation in Private Tort Law: A Comment on Kelman, 63 Chi.-Kent L. Rev. 639 (1987); Richard W. Wright, Causation in Tort Law, 73 Cal. L. Rev. 1735, 1775 (1985); cf. David Lewis, Causation, 70 J. Phil. 556, 563 (1973). The field of relevant but-for conditions can be narrowed by limiting the players to unpaid creditors of the debtor, and by limiting the time period under examination to the period in which any of these creditors made a contribution to the debtor that forms a part of the legal basis of the creditor’s current claim.
payment of operating expenses, (3) the debtor’s second preference is for the purchase of a new asset, (4) the debtor uses assets obtained from someone other than the claimant to satisfy the debtor’s first preference, and (5) the debtor uses the claimant’s asset to make the purchase. Because the debtor’s first preference was for consumption or payment of expenses, the debtor presumably would have used the claimant’s contribution for this purpose had other assets not been available. In these circumstances, the claimant’s contribution was a necessary condition for the purchase of the new asset, but so too were the assets the debtor expended on consumption or expenses.

Thus the transactional connection required by the strong contribution principle does not establish that the claimant’s contribution is causally connected to the asset at stake, or that other creditors’ contributions are not. There are cases in which neither contribution was a necessary condition, or both were. In either situation, causation cannot provide a basis for distinction among competing creditors. We stress this point because we refer to it again in the evaluative stage of our analysis.86

A more formal argument for the strong contribution principle can be stated as follows:

1. When a creditor contributes an asset to a pool of assets or to the production of assets, and the contributed asset is discernible in the pool or product or is linked by a process of exchange to the pool or product, the contributed asset is contained in the pool or product.
2. If the final pool or product contains the contributed asset, the contributing creditor has an entitlement in the final pool or product, at least to the extent of the value of that creditor’s contribution.
3. If the contributing creditor has an entitlement in the final pool or product, no one may impair that entitlement.
4. Preventing the contributing creditor from retrieving its contribution or equivalent value from the final pool or product impairs the contributing creditor’s entitlement.
5. Therefore the contributing creditor has a right to retrieve its contribution or equivalent value from the final pool or product, which is prior to the claims of other creditors.

86 See infra part III.B.1.-2.
C. The Weak Contribution Principle

One alternative to the strong contribution principle is a weaker form of contribution principle based on causal contributions to the asset pool. The reformulated principle would give contributing creditors first claim to assets of the debtor if and to the extent their contributions were causally necessary conditions for the current value of the debtor's assets. We will use the term "weak contribution principle" to refer to the form of contribution principle just described.\textsuperscript{87}

A more formal argument in support of the weak contribution principle can be stated as follows:

1. When a creditor contributes an asset to a pool of assets or to the production of assets, and the contributed asset is a causally necessary condition for the existence of some portion of the value of the final product, the contributed asset is contained in the pool or product.
2. If the final pool or product contains the contributed asset, the contributing creditor has an entitlement in the final pool or product, at least to the extent of the value of that creditor's contribution.
3. If the contributing creditor has entitlement in the final pool or product, no one may impair that entitlement.
4. Preventing the contributing creditor from retrieving its contribution or equivalent value from the final pool or product impairs the contributing creditor's entitlement.
5. Therefore, the contributing creditor has a right to retrieve its contribution or equivalent value from the final pool or product, which is prior to the claims of other creditors.

\textsuperscript{87} Causal versions are not the only possible type of weak contribution principle. For example, several forms of "swelled asset" theories have been proposed as alternatives to tracing. See Palmer, supra note 5, § 2.14(c), at 182-83 (advocating constructive trusts as a remedy against unjust enrichment); Scott, supra note 5, § 521, at 653-54 (criticizing "original augmentation" and "ultimate augmentation" theories); Ames, supra note 8, at 521-22. An acausal version of the weak contribution principle could employ a counterfactual notion of contribution: roughly, that an asset contributes to the final product if, and to the extent that, the product would be diminished absent the asset, holding other contributed assets constant. Marginal productivity theories of distribution can be characterized as instances of the weak contribution principle, construed counterfactually. See, e.g., John Bates Clark, The Distribution of Wealth (1899); L.S. Shapley, A Value for n-Person Games, in 2 Contributions to the Theory of Games 307 (H.W. Kuhn & A.W. Tucker eds., 1953). Other versions of the weak contribution principle could limit the types of contribution that would qualify for priority. See Jeremy Waldron, Producers' Entitlements, in Essays in Honour of Gwen Taylor 304, 324-25 (R.G. Durrant ed., 1982); Cohen, supra note 73, at 355.
The principal consequence of the weak contribution principle is to prefer creditors who have given value to the debtor over those who merely have suffered losses at the debtor’s hands. All creditors whose extensions of credit to the debtor played a necessary part in producing or supporting the debtor’s current wealth qualify as contributors, even if their contributions only served as background conditions for the debtor’s investment decisions. For example, a line of credit extended by a floating lien creditor to cover the debtor’s operating expenses may enable the debtor to retain an asset that is subject to a purchase money security interest. In such a case, both creditors—the floating lien creditor and the purchase money financier—have contributed to the presence of the asset in the final asset pool. There is no basis in the weak contribution principle for preferring one of these creditors over the other because all contributions, direct or indirect, have equal weight.

On the other hand, the weak contribution principle, as we have described it, does not give priority to all creditors who have furnished value to the debtor. Priority depends on a causal connection between the claimant’s contribution and the debtor’s present asset pool. For example, assume that some time before default, the debtor owns assets X, Y, and Z. Each of these three assets was contributed by an unpaid creditor. The debtor has an opportunity to purchase a luxury A, which he plans to consume with no addition to his wealth. He prefers A to X, but he also prefers Y and Z to A. Accordingly, he uses X to purchase A, though he would not have used Y or Z for this purpose. At the time of default, he owns a valuable asset B, which he obtained in exchange for Y and Z. In these circumstances, the creditors who contributed Y and Z have made causal contributions to the debtor’s present wealth, but the creditor who contributed A has not.

88 In this respect, the weak contribution principle (as well as the strong contribution principle) is in opposition to arguments in support of priority for involuntary tort creditors. See, e.g., Buckley, supra note 2, at 1415-19; Christopher M.E. Painter, Tort Creditor Priority in the Secured Credit System: Asbestos Times, the Worst of Times, 36 STAN. L. REV. 1045, 1048-49 (1984); Schwartz, A Theory of Loan Priorities, supra note 2, at 258-59. While some tort creditors would qualify as contributors, accident victims typically would not qualify to the full extent of their compensatory claims. Cf. Posner, supra note 21, at 198.

89 In practice, it will be extremely difficult to measure causal contributions to a debtor’s distributable estate. In causal terms, any exchange or investment of assets is likely to be the joint product of assets used in the exchange and other assets the debtor possessed at the time. The effect of a given contribution on the final pool of assets depends on the debtor’s total wealth and his or her preferences.
In Part III.B.2, we will assess the weak contribution principle as a principle of priority. Causal contribution, however, is not the basis for priority in current law. The commercial rules we have examined evince the stronger, asset-specific form of contribution principle. Our assessment, therefore, focuses initially on the strong contribution principle.

III. Assessing Contribution Principles in Commercial Law

The strong contribution principle accounts for the priorities assigned in the fact patterns identified in Part I. It is also in accordance with pre-theoretical moral intuition. Claimants whose resources have been used to acquire or produce an asset generally are felt to have a stronger claim on that asset than those whose resources have not been so used. Allocating loss to noncontributing claimants is a consequence of this pre-theoretical moral intuition. Contribution is a decisive moral fact in some commercial contexts, as it is in some noncommercial contexts. Hence extension of a moral intuition from noncommercial to commercial contexts can in turn account for the presence of contribution principles in commercial law.

The next question is whether this extension is justified. Why does the pattern of priority rules identified exhibit the strong contribution principle? A detailed explanation of the presence of the strong contribution principle is required. And why should commercial loss be allocated on the basis of contribution at all? A justification of the use of contribution principles also is needed. If compelling explanations of the strong contribution

among various assets, from the time of contribution to the time of distribution. Since the information needed to make this determination is rarely available, the simplest way to administer a causal contribution principle is to assume that all contributing creditors are responsible for the final product. With this assumption, a causal contribution principle tends to produce a rule of equality among all contributing creditors. For such a proposed rule governing priority among agricultural financiers, based on the difficulty of measuring causal contribution, see Turner et al., supra note 54, at 47, 51.

90 See infra part III.B.2.


If, for example, we are asked to arbitrate between two children fighting over a wooden toy, which has been made unaided and with free wood by one of them, and if we know nothing more about the two children, then it would not be unreasonable to be swayed by the fact of “personal production” . . . . What is clear, and cannot be doubted, is that there is strong moral intuition in that direction.

Sen, Moral Standing, supra note 73, at 17.
principle are unavailable and if the use of contribution principles in commercial law is unjustified, then the case for retaining the pattern of priority rules identified is weakened. Part III.A argues that economic explanations of strong contribution priority are un compelling. Part III.B argues that property rights cannot justify use of contribution principles as priority principles.

A. Agnosticism About Economic Explanations

As noted, pre-theoretical moral intuition about the importance of contribution can account for the presence of the strong contribution principle in commercial law. There may be alternative explanations of the priorities identified. The alternative explanations are of two sorts. One sort appeals to different facts specific to the circumstances yielding the identified pattern of priorities. For instance, the comparative culpability of claimants in dealing with a debtor might be a fact which orders claims.\(^{92}\) A second sort of alternative explanation is instrumentalist: The identified pattern of priorities promotes a suitably specified goal under typically occurring conditions. Economic analyses are the most familiar examples of instrumentalist explanations. Maximization of allocative efficiency is sought: the largest excess of aggregate gains over aggregate costs. Since the pattern of priorities identified distributes loss, it is efficient only if the sum of the risks of loss is optimally reduced by such allocations. Positive economic explanations of priority provide accounts of the efficiency of the legal rules identified in Part I.

We are agnostic about the success of alternative explanations. Specifically, we suspend belief about the prospects of economic explanations of the identified pattern of priorities. Our agnosticism is based on the demands of explanatory adequacy. To explain the identified pattern of priorities by efficiency requires generalizations concerning the risk-reducing abilities among classes of creditors. Also required are estimations of the magnitude of prospective loss incurred by classes of claimants. Additionally, sound assumptions are needed concerning knowledge of creditors about each other and the debtor.\(^{93}\) As with any explanation, economic

\(^{92}\) See, e.g., David G. Carlson, Rationality, Accident, and Priority Under Article 9 of the Uniform Commercial Code, 71 Minn. L. Rev. 207 (1986); David M. Phillips, The Commercial Culpability Scale, 92 Yale L.J. 228 (1982).

\(^{93}\) Cf. Avery Katz, The Strategic Structure of Offer and Acceptance: Game Theory and the Law
explanations cannot be ad hoc: They must be capable of estimating the magnitudes just mentioned in advance of the priority rule to be explained. Finally, the explanation must be consistent with the strong contribution principle documented in Part I. This means that economic explanations must treat contribution as a factor, or as a proxy for factors, which optimally reduces aggregate costs.

Correspondingly, economic explanations can be inadequate in several ways. One sort of inadequacy is unsoundness: an explanation may lack a well-supported basis for believing that its premises are true. Over- or underinclusiveness is another sort of inadequacy: an explanation either can explain too much or not enough. If one phenomenon is explained by invoking a principle which would predict, contrary to fact, another phenomenon, the explanation is overinclusive. If one phenomenon is explained but not another phenomenon, the explanation is underinclusive. We suspend belief about the success of relevant economic explanations based on the explanatory inadequacies of unsoundness and inclusiveness. Brief consideration of some existing economic explanations of the identified pattern of priorities supports our agnosticism.

1. Constructive Trust Remedies

An explanation of constructive trust remedies can appeal to bargaining costs. Where bargaining costs are low, bargained-for exchanges are more likely to yield mutually preferred outcomes than unbargained-for exchanges. Costs associated with exchange are lower when bargaining occurs than by judicial determination of the values of items exchanged to the parties. Because imposing a constructive trust eliminates the gain from an unbargained-for exchange, bargaining is encouraged. Comparative costs associated with exchange therefore are minimized. The explanation does reasonably well in the two-person case involving unbargained-for ex-

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For a nice examination of the explanation in the case of recovery of unbargained-for benefits, see Saul Levmore, Explaining Restitution, 71 Va. L. Rev. 65 (1985). Our concern, unlike Levmore's, is with the recovery of unbargained-for benefits where two or more claimants have claims against a debtor whose assets are insufficient to satisfy both claims.
changes between Wrongdoer and Victim. Here, where Wrongdoer’s act involves fraud, theft, or conversion, Victim can trace the misappropriated asset into its product. The explanation does less well in two-person cases involving bargained-for exchanges.\textsuperscript{95} It fails in the three-person case involving Wrongdoer, Victim 1, and Victim 2, since in those cases Wrongdoer may have bargained with Victim 2 but not with Victim 1. For example, suppose Wrongdoer steals Victim 1’s asset, exchanges it for another asset, then fraudulently exchanges another asset for Victim 2’s asset. In addition, suppose Wrongdoer dissipates Victim 2’s asset, and Wrongdoer’s only remaining asset is the asset acquired by exchanging Victim 1’s asset. An appeal to bargaining costs may explain why Victim 1 prevails over Wrongdoer. It does not explain why Victim 1 prevails over Victim 2 by imposition of a constructive trust. After all, Victim 2 bargained with Wrongdoer and Victim 1 did not. To assume that aggregate bargaining costs are minimized by Victim 1 prevailing over Victim 2 is simply ad hoc.

Supplemental explanations are possible but unhelpful. A well-rehearsed possibility is an appeal to risk reduction. The prospect of Wrongdoer obtaining an unbargained-for benefit from Victim 1 is a risk of loss to Victim 1. The prospect of Wrongdoer obtaining an unbargained-for benefit from Victim 2 through fraud, mistake, conversion, and the like by using Victim 1’s asset is a risk of loss to Victim 2. Where the sum of risks of loss can be reduced at less cost than its expected value, risk is minimized when it is assigned to the party who can reduce its incidence at the least cost. Risk of loss can be reduced either by continued bargaining, by acquiring information about Wrongdoer or the assets exchanged from other sources, or by guarding one’s asset. Victim 1’s priority over Victim 2 is explained only if Victim 2 is the cheapest risk reducer as between Victim 1 and Victim 2. But here, as before, it simply is ad hoc to make that assumption.\textsuperscript{96} Put abstractly, the difficulty is this: A constructive trust

\textsuperscript{95} We say “reasonably well” because this explanation does not account for the imposition of constructive trusts on proceeds which are the result of bargained-for exchanges (e.g., some types of fraud or mistake). In the case in which exchange is involved, bargaining costs are low. Therefore, the explanation would predict that a constructive trust would not be imposed on the proceeds resulting from the exchange. The explanation mispredicts case outcomes.

\textsuperscript{96} Cf. Douglas Baird & Thomas H. Jackson, Information, Uncertainty, and the Transfer of Property, 13 J. LEGAL STUD. 299, 319 (1984) (“We find no particular reason to believe that either of the parties [i.e., a creditor who fails to properly file and a subsequent nonrelaying creditor] is better able to bear the risk, by preventing it from occurring or by insuring against it.”).
remedy is imposed in a wide range of circumstances, both contractual and noncontractual. Where there are two creditors of a debtor (e.g., Victims 1 and 2), four possible cases result: both creditors’ claims can be contractually based, both creditors claims can be noncontractually based, Creditor 1’s claim can contractually and Creditor 2’s claim noncontractually based, and Creditor 2’s claim can be contractually and Creditor 1’s claim noncontractually based. Generalizations about the comparative magnitude of bargaining costs or risk reduction might have some basis in the first and second cases. They are ad hoc in the third and fourth possibilities, where the nature of the parties and genesis of the claim matters. Tracing, by determining priorities on the basis of contribution, is blind to generalizations in all four cases.

2. Subrogation Rights of Construction Sureties

Subrogation operates to give the construction surety priority over a prior perfected general financier. Accounts of the priority given to the construction surety over the general financier are hard to come by. A grant of priority reduces the risk that a creditor will lose the value of its loan upon a debtor’s default. But here, as elsewhere, a corollary of the Modigliani-Miller irrelevance theorem applies: Given homogeneous, risk-neutral creditors with perfect information about the risk of debtor default, a debtor cannot reduce the cost of debt by altering its structure of debt. Benefits to the construction surety in the form of reduction in the risk of nonpayment upon default are exactly offset by increased cost to the general financier in the form of increased risk of nonpayment upon default. Subrogation, by operating as a priority, alters only the structure of debt. Hence a debtor’s debt bill cannot be reduced by allowing the construction surety to prevail over the general financier. The surety’s right of subrogation therefore cannot be explained under the assumptions required by the Modigliani-Miller irrelevance theorem.

Candidate explanations which relax those assumptions are inadequate. They are inadequate because they illegitimately transfer generalizations

97 See Jackson & Kronman, supra note 2, at 1154-64; Thomas H. Jackson & Alan Schwartz, Vacuum of Fact or Vacuous Theory: A Reply to Professor Kripke, 133 U. Pa. L. Rev. 987 (1985); Schwartz, Security Interests and Bankruptcy Priorities: A Review of Current Theories, supra note 2; Schwartz, The Continuing Puzzle of Secured Debt, supra note 2. For an informal review of the literature, see Shupack, supra note 2.
applying to subrogors to subrogees. Take explanations which appeal to the creditors' differential abilities to assess credit risk. Typically, subcontractors and suppliers may be less able than an owner to assess the risk of the general contractor's default. Again, the value of a subcontract may be so small and the associated risk so peculiar to the contract that investigating a general contractor may be impractical for the subcontractor. If so, debt costs are reduced by giving a subcontractor or supplier priority over an owner. The same need not be true of a surety as against a general financier, because the surety typically may be better able to assess a general contractor's credit risk than either an owner or a general financier. After all, sureties underwrite construction contracts on the basis of the construction firm's financial performance and credit ratings. If so, debt costs are reduced by giving priority to general financiers over sureties. The point is simply that the requisite generalizations upon which subrogation depends cannot be transferred between sets of competing parties.

The same point applies to another explanation which Levmore aptly calls wealth dependency. Given different tastes and wealth, a party may be unwilling to pay the market price of a benefit. An owner may require a surety to be engaged because the owner values the benefit of an uncompleted contract at less than its market price but more than its cost. The problem here is that generalizations pertaining to subrogors do not hold for subrogees. Owners typically may be subject to the phenomenon of wealth dependency. (Even here the generalization is rough at best. Where owners are profit-maximizing concerns, or where benefits are measurable in monetary terms, benefits usually can be measured by market price.) Sureties, on the other hand, typically are not subject to wealth dependency because they gauge both the risk of completing an uncompleted construction contract and the underwriting premium in dollars and cents. Their goal is profit maximization, not a plausibly idiosyncratic taste creating a divergence between benefit and market price. At most, therefore, wealth dependency can explain why an owner requires that a surety be engaged.

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98 Cf. Levmore, supra note 94, at 90 n.51 (setting forth, in passing, one such suggestion).  
100 Levmore, supra note 94, at 77. Levmore suggests in passing that the surety's right of subrogation is a "package" of considerations concerning credit risk and wealth dependency. See id. at 90 n.51. We are assessing the considerations individually. Our conclusions do not depend on such an assessment.
It does not account for the surety’s right of subrogation—a right which gives it priority over a prior perfected general financier.

3. Direct Contribution Priority

Security interests securing loans which directly contribute to the acquisition of an asset have priority over prior filed or perfected conflicting security interests.\(^{101}\) Three features of the Code’s scheme of direct contribution priorities are important. One feature concerns the undiscriminating nature of the contribution: Any traceable extension of credit which in fact contributes to the acquisition of collateral qualifies as a direct contribution. So, for example, the extender of funds, the seller of component parts of an asset, and the seller of the asset itself all can be direct contributors.\(^{102}\) Call this the undiscriminating feature. A second feature concerns the security interest acquired by direct contributors: The security interest given priority over conflicting security interests is limited to the asset acquired as a result of the loan. In other words, direct contribution priority is specific to the acquired asset. Call this the asset-specific feature. A third feature concerns the irrelevance of the debtor’s need for the direct contributing loan: There need be no showing that the debtor could not acquire the collateral without the particular extension of credit in question. Call this the irrelevance feature. The undiscriminating, asset-specific, and irrelevance features place constraints on adequate explanations of the Code’s scheme of direct contribution priority.

Existing economic accounts of direct contribution priority are inadequate because they violate one or more of the identified constraints. By violating these constraints, the explanations are either over- or underinclusive. None explains why the Code is as limited or as expansive as it is in granting direct contribution priority. Take the familiar explanations which appeal to avoidance of a situational monopoly in credit terms.\(^{103}\) Floating liens create a price advantage to the floating lien creditor: Given its lower costs in monitoring collateral, the floating lien creditor can charge uncompetitive rates for subsequent credit. Recognizing this, a debtor will offer to pay the floating lien creditor a premium to eliminate

\(^{101}\) See supra part II.C.

\(^{102}\) See, e.g., U.C.C. §§ 9-107(a)-(b), 9-315; supra parts I.C., II.C.

\(^{103}\) See Jackson & Kronman, supra note 2, at 1171.
its monopoly position. The size of the premium offered will be dependent on the debtor’s expectations concerning its need for subsequent loans. A purchase money security interest, on this account, is a device which prevents the floating lien creditor from obtaining a monopoly position in credit terms. The explanation violates the irrelevance constraint because it depends on the debtor’s expectations concerning the need for additional future loans. Such expectations are often absent in long-term financial ventures.¹⁰⁴ More importantly, the account hinges purchase money priority on a fact about a debtor’s financial condition: that it would be unable to acquire particular assets without the extension of additional credit. The Code treats this fact as irrelevant to purchase money priority.¹⁰⁵ Both creditors whose debtors expect to require loans and creditors whose debtors do not can become purchase money creditors. Since the irrelevance constraint is violated, the explanation is underinclusive.

One might deny that the explanation violates the irrelevance constraint. One also might contend that, as a well-supported generalization, most debtors grant purchase money security interests only when they are unable to acquire particular assets otherwise. The Code, one might argue, employs this generalization by not requiring such a showing. Assuming a debtor’s ignorance concerning its future financing needs, the debtor would agree ex ante to grant a creditor a floating lien while reserving purchase money security priority.¹⁰⁶ This denial is unconvincing. First, the generalization upon which it relies is questionable. Debtors may finance the acquisition of an asset for reasons unrelated to their inability to acquire the asset otherwise. They may do so to maintain dividend policy, for tax reasons, or to signal their view of their own prospects.¹⁰⁷ Given the range of circumstances in which purchase money security interests are granted, the asserted generalization is poorly founded. Second, even incorporating the asserted generalization, the above explanation still fails. To illustrate, note

¹⁰⁴ See Scott, supra note 2, at 962.

¹⁰⁵ Scott’s variant on the above explanation considers purchase money priority as an “escape hatch,” allowing a debtor to pursue high-risk, high-return projects when the creditor’s rate of return is fixed. See id. at 962-63. The point above applies to this variant too. Debtors may not know in advance the prospects of such risky projects; even if they do, they may be ignorant as to the likelihood of their need for secured credit.

¹⁰⁶ See Jackson & Kronman, supra note 2, at 1173.

¹⁰⁷ Cf. Schwartz, Security Interests and Bankruptcy Priorities: A Review of Current Theories, supra note 2, at 15; Schwartz, A Theory of Loan Priorities, supra note 2, at 245-47 (hypothesizing that security serves a signaling function; hypothesis is rejected).
that there are three possible priority rules to which a debtor could agree:

(1) A floating lien combined with no purchase money security priority.
(2) A floating lien combined with purchase money security priority.
(3) A floating lien combined with purchase money security priority, such priority being excluded by agreement when the debtor anticipates no need for future secured credit.\(^{108}\)

Given a debtor's ignorance concerning its future financing needs and negotiation costs associated with alternative (1), a debtor might prefer alternative (2) to (1). Nevertheless, given that some debtors may expect to have no future financing needs, certain borrowers may be better off excluding or limiting purchase money security priority. Hence these debtors would prefer alternative (3) to (2).\(^{109}\) Common clauses in loan contracts which limit the size of future purchase money debt are consistent with this preference.\(^{110}\) The Code, by not allowing a debtor to contract around purchase money security priority, ignores a debtor's expectations about its prospective financing needs.

Another explanation posits the existence of comparative advantages in repossessing and reselling particular collateral.\(^{111}\) Equipment and inventory financers, for instance, may have more knowledge about equipment and inventory than other sorts of creditors. Their comparatively greater knowledge may generate economies in policing collateral and reselling it upon default. In turn, the comparative advantage may yield benefits to the floating lien creditor that might agree to be subordinated to such compara-

\(^{108}\) Cf. Jackson & Kronman, supra note 2, at 1173 n.97.

\(^{109}\) The question, of course, is whether typical debtors prefer (3) to (2), not whether some debtors do. Two considerations suggest that they might prefer (3), or some version of (3), to (2). One consideration is the possibility that certain sorts of debtors, or debtors undertaking certain sorts of projects, might have that preference. If so, the desirability of a default rule which recognizes that preference turns on the costs associated with drafting and administering the rule. Another consideration is that common loan contracts often limit the amount of purchase money debt that can be incurred. See Schwartz, A Theory of Loan Priorities, supra note 2, at 243. The limitation, conjoined with the unenforceability of such a limitation against third parties under § 9-311, provides casual, indirect evidence that typical debtors have the preference noted.

\(^{110}\) See id. (asserting that a standard loan contracts clause limits purchase money debt to 5% of the value of debtor's assets).

tively skilled creditors. Such an explanation violates both the undiscriminating and asset-specific constraints. The undiscriminating constraint is violated because the account explains purchase money priority only for comparatively better monitors. The Code, however, grants such priority to all directly contributing creditors. Equipment financiers, for instance, arguably are better at policing a debtor and reselling equipment upon default than inventory financiers, but the Code allows a bank extending an enabling loan for equipment to have priority over a prior perfected floating lien creditor with a security interest in equipment. Is the bank even arguably a better overseer and liquidator of equipment than the equipment financier? Is a credit seller of a single piece of equipment a better overseer and liquidator of equipment than an equipment financier with a floating lien over all of the debtor's equipment?

The asset-specific constraint also is violated. Therefore, the explanation is overinclusive in that it accounts for purchase money priority by comparative advantage in policing and disposing of collateral upon default. The fact that a creditor has extended funds which the debtor uses to acquire an asset is by itself unimportant to the priority of the contributing creditor's security interest. Therefore, the explanation would predict that an equipment financier with a floating lien, enjoying economies in monitoring and disposing of debtor's equipment, is given priority over a bank extending an enabling loan in a piece of equipment. It also would predict that a creditor enjoying the same economies in equipment is given priority over a components seller who has taken a security interest in a component of equipment. The Code orders priorities differently. The bank is given priority in the piece of equipment the debtor has acquired with its funds. The components seller is given priority in the equipment which contains the component. Purchase money priority is asset-specific in both cases. Plausible generalizations about the advantages the equipment financier enjoys in policing or reselling the repossessed equipment are immaterial.

112 Cf. Stephen C. Diamond, Asset-Based Lending in a Changing Environment, 63 J. COMM. BANK LENDING 42, 46 (1981) ("If the machinery is so specialized that a liquidating appraisal cannot be obtained, the lender is not well advised to lend on that type of collateral. Thus, one has to know both the depth of the market for end users and the nature of the appraisal on which the valuation was determined."); Gerald D. Quill et al., Some Considerations About Secured Lending, 59 J. COMM. BANK LENDING 41 (1977).

113 The Code is silent, however, as to whether the components seller enjoys priority or the components seller and the equipment financier share pro rata in the equipment. See supra part II.C.
Hence, as above, the explanation is an inadequate account of the Code's treatment of direct contribution priority.

4. Seller's Reclamation Rights

Economic accounts of reclamation rights need to explain how such rights minimize the total cost of credit to the buyer-debtor.\textsuperscript{114} Since reclamation rights operate to give the reclaiming seller priority in the reclaimed asset,\textsuperscript{115} the likelihood of repayment to subordinated parties upon default is diminished. The diminished likelihood of repayment presumably is impounded in the interest rates charged by subordinated parties. Total credit charges are minimized when the claims of parties who can best reduce or bear the risk of the buyer-debtor's insolvency are subordinated. Comparative estimates of different parties' abilities to reduce or bear a buyer-debtor's risk of insolvency therefore are required. Under the Code, the rights of a lien creditor and a general creditor are defeated by those of a reclaiming credit or cash seller. Secured creditors, including financiers with after-acquired property interests, prevail over reclaiming sellers. The Bankruptcy Code preserves the reclaiming seller's priority, subject to additional restrictions.\textsuperscript{116} Hence, explanations of reclamation rights need to account for the order of priorities present under Code and extra-Code law: that subordinating lien creditors\textsuperscript{117} and general creditors to reclaiming sellers and reclaiming sellers to secured creditors minimizes total credit charges. Since subordination depends on a comparative assessment of insolvency risk-bearing abilities of the parties, generalizations concerning those abilities are required.

The requisite well-founded generalizations are unavailable. One problem concerns the considerable diversity among claimants. Cash sellers may deal with a buyer infrequently; credit sellers may deal with a buyer more frequently and have available information about the buyer's financial status. The claims of lien creditors and general creditors may be contractually or noncontractually based, and can arise before or after the buyer is

\textsuperscript{114} See Schwartz & Scott, supra note 111, at 524.
\textsuperscript{115} See supra part II.
\textsuperscript{117} This is true in jurisdictions which have adopted the 1966 amendment to U.C.C. § 2-702(3), which deleted "lien creditor" from the subsection. See U.C.C. § 2-702 (1993) (23 jurisdictions have deleted "or lien creditor" from § 2-702).
in possession of an asset subject to reclamation. Secured creditors may have after-acquired property interests or they may lend on the strength of a particular item of collateral, possibly subject to reclamation. It is implausible, even as a matter of rough generalization, to treat sellers, lien creditors and general creditors, and secured creditors as homogeneous classes with respect to a buyer-debtor’s risk of insolvency.\footnote{Pre-Code law in some jurisdictions drew distinctions among lien creditors. A reclaiming seller, for instance, prevailed over a lien creditor whose lien attached before the reclaimed goods were delivered but was subordinate to a lien creditor whose lien attached after the reclaimed goods were delivered. \textit{See, e.g., In re Federal's Inc.}, 402 F. Supp. 1357, 1361 (E.D. Mich. 1975).}

Similar comparisons between claimants present the same problem. Secured creditors with after-acquired property interests commonly have information about the debtor’s solvency as a byproduct of their administering loans. Sellers may or may not have as much relevant information about their buyer’s solvency. Again, a lien creditor’s interest in a debtor’s asset may arise from a nonconsensual transaction with the debtor—say, a tort claim. Alternatively, it may arise from a consensual transaction in which the lienor relied on the debtor’s possession of the asset subject to the lien—say, an unsecured loan made in reliance on the asset. Even as a rough generalization, are sellers less able to reduce or bear the risk of their buyer’s insolvency than the buyer-debtor’s secured creditors? Are sellers less able to reduce or bear the risk of their buyer’s insolvency than lien creditors? Absent some basis for making such comparisons, intra- and inter-class generalizations concerning claimants are ad hoc. Hence explanations which account for reclamation rights by their effect on total credit costs, without more, are weak.

\textbf{B. A Non-Instrumental Justification}

Priority requires justification. In the distribution of an insolvent debtor's assets, each creditor has a legal claim to be paid in full. Priority for one creditor means that the claims of other creditors will not be fully satisfied. Therefore, priority must be justified, and it cannot be justified simply by providing a reason why a particular creditor’s claim should be paid. The justification also must be one that supports the imposition of losses on competing claimants. It must show why one creditor should be paid while others are not. Any priority principle that does not satisfy this requirement is defective. Accordingly, contribution principles when used
as priority principles must justify why contributors are entitled to prevail over noncontributors.

If the strong contribution principle cannot be explained in economic terms, why does it persist as an element of many commercial law rules? One possible answer is that the principle appeals to a pre-theoretical notion of entitlement: a rule that favors creditors who can connect their claims to particular assets in the debtor's estate has the appearance of protecting property rights. Protection of property rights appears as a premise in the contribution arguments in Parts II.B and C. The Code also supports this explanation. Unperfected secured creditors prevail over unsecured creditors under sections 9-201 and 9-301, read in conjunction. Unsecured creditors lack a property right in a specific asset of the debtor; unperfected secured creditors have such a right. Hence secured creditors prevail. The Code therefore sometimes uses property rights to decide priority contests. In this section, we suggest that several theories of property rights may have made their way into commercial law in the form of contribution-based priority principles. We will argue that this is a mistake and that property theory is inapposite in a dispute among creditors.

1. Property Theory and the Strong Contribution Principle: Why Creditors Cannot Cite Locke or Hegel

One set of arguments in support of private property rights derives from Locke. Locke proposes that individuals can acquire ownership of previously unclaimed resources by taking possession of them and laboring on them. The Lockean argument begins with the premise that individuals have a natural property right in themselves, which encompasses body, personality, and labor. When an individual mixes labor with an unowned object, the product of the mixing contains that individual's labor. Once

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120 U.C.C. § 9-201 (providing that a security agreement is effective according to its terms between the creditor and debtor, and third parties, except as otherwise provided); id. § 9-301 (providing that a general creditor is not among the parties against whom an unperfected security interest is subordinated).
121 See also id. § 2-403(1) (providing that contests between an owner and a purchaser from a thief are determined on basis of purchaser acquiring no title to asset); John F. Dolan, The U.C.C. Framework: Conveyancing Principles and Property Interests, 59 B.U. L. Rev. 811 (1979) (describing conveyancing principles under the Code).
122 The principal statement of Locke's theory of property appears in LOCKE, supra note 76.
mixed, the product cannot be taken from the individual without also taking the labor contained in the product. Thus it follows that the individual is rightly entitled to the object.\footnote{Id. at 304-09. For explanation and criticism, see \textit{Lawrence C. Becker, Property Rights: Philosophical Foundations} 33-48 (1977); \textit{Robert Nozick, Anarchy, State and Utopia} 174-78 (1974); \textit{Alan Ryan, Property and Political Theory} ch. 1 (1984); A. \textit{John Simmons, The Lockean Theory of Rights} 242-43 (1992); \textit{Waldron, supra} note 76, at 137-252; Karl Olivecrona, \textit{Locke's Theory of Appropriation}, 24 Phil. Q. 220 (1974). Locke's labor theory of appropriation is distinct from his labor theory of value. The labor theory of appropriation justifies holdings in private property: why I have a claim to what I produce by my labor. The labor theory of value justifies ownership by reference to the value created by labor. The two theories are distinct because an asset may be the product of labor but have no value. Locke's "mixing" argument, sketched above, forms part of his labor theory of appropriation only.}

Philosophers have offered a variety of justifications for a Lockean principle of acquisition. Locke himself thought that an entitlement in the product of labor on an unowned object was necessary to protect the God-given right to one's self.\footnote{See Locke, \textit{supra} note 76, §§ 26-27, 34-35; Ryan, \textit{supra} note 123, at 31-32; Waldron, \textit{supra} note 76, at 176-83.} A slightly different justification invokes a notion of identification: an individual who labors on an unowned object sweeps that object into the sphere of his or her own personality and identifies it as his or her own. Once this is done, the individual cannot be deprived of the object without an injury to the integrity of his or her self.\footnote{See Olivecrona, \textit{supra} note 123, at 222-26.}

A third justification rests on desert. The argument from desert presupposes that the labor involved is good and should be rewarded; it then goes on to conclude that the product itself is an appropriate reward.\footnote{See Becker, \textit{supra} note 123, at 48-56; \textit{Stephen R. Munzer, A Theory of Property} 254-91 (1990); Ryan, \textit{supra} note 123, at 33-34 (skeptical); Waldron, \textit{supra} note 76, at 201-07 (skeptical).} This last step is a difficult one, particularly when awarding the product to the laborer means excluding others from it. At most one can say that if the purpose of the labor was to produce a certain product, the product is the most fitting reward.\footnote{See Becker, \textit{supra} note 123, at 52-54 (adding that the resulting entitlement should be subject to penalties, probably in the form of taxes, that reflect the negative desert arising from exclusion of others). \textit{But cf. George Sher, Desert} 54 (1987) (questioning whether desert underwrites any particular form of reward); \textit{Simmons, supra} note 123, at 246-47; John Christman, \textit{Can Ownership Be Justified by Natural Rights?}, 15 Phil. & Pub. Affs. 156 (1986).}
Another line of argument, sometimes described as personality theory, derives from Hegel.\textsuperscript{128} Like Locke, Hegel maintained that individuals who possess and use unowned resources acquire property rights in them. But for Hegel the justification of private property rested on the role of property in human moral development, rather than on a pre-existing natural right in one's labor. Interaction with material objects is part of the process by which individuals gain a sense of themselves as moral agents.\textsuperscript{129}

Now, there are serious and well-known objections to these accounts of property rights. The notion of "mixing" labor with resources is at best metaphorical and does not justify a claim to the product of one's labor. The Hegelian conception of property as a medium for moral development does not underwrite any particular scheme of property rights. Yet these theories have a central place in liberal philosophy and in the education of lawyers,\textsuperscript{130} and it is easy to see how they might have found their way into commercial law. A priority dispute appears to be a contest among conflicting claims to property, so property theory is a natural point of reference.

Initially, it is tempting to look for a direct connection between contribu-

\textsuperscript{128} The principal statement of Hegel's theory of property appears in G.W.F. Hegel, Hegel's Philosophy of Right \textsuperscript{\textregistered} 34-57 (Thomas M. Knox trans., 1952).

\textsuperscript{129} See id. \textsuperscript{\textregistered} 34-40, 66.

Hegel's argument, much abbreviated, is this: moral development entails the elaboration of one's free will. Initially, the will is "immediate," or unrealized. From this starting point the individual must externalize her will—that is, she must embody it in the external world by possessing material objects and applying them to her purposes. This process of embodiment assists the development of free will in several ways. Particularly when the individual alters an object for her own future use, the object comes to reflect her will, both in the changes she wrought and in the further purposes the product enables her to pursue. Control of property also brings stability and discipline to the will, because the individual must live with any changes she has made. Finally, recognition of the individual's property rights by others not only conforms her own will but also demonstrates its universality, as she comes to participate in a society of owners. For explanation and criticism of Hegel's theory of property, see Christopher J. Berry, Property and Possession: Two Replies to Locke — Hume and Hegel, in NOMOS XXII: Property 89, 95-99 (J. Roland Pennock & John W. Chapman eds., 1980); Ryan, supra note 123, ch. 5; Peter G. Stillman, Property, Freedom and Individuality in Hegel's and Marx's Political Thought, in NOMOS XXII: Property, supra, at 131-48; Waldron, supra note 76, at 343-89; Margaret J. Radin, Property and Personhood, 34 Stan. L. Rev. 957, 971-77 (1982); Peter G. Stillman, Hegel's Analysis of Property in the Philosophy of Right, 10 Cardozo L. Rev. 1031 (1989). See also Waldron, supra note 87, at 309-36 (moral development through production of objects for personal use); Alan Brudner, The Unity of Property Law, 4 Can. J.L. Juris. 3 (1991).

\textsuperscript{130} See Jesse Dukemnier & James E. Krier, Property 61-63 (1981). For examples of Lockean theory at work in a judicial opinion, see International News Serv. v. Associated Press, 248 U.S. 215, 238 (1918); Edwards v. Sims, 24 S.W.2d 619, 621-23 (Ky. 1929) (Logan, J., dissenting).
tion principles and Locke's defense of property rights, because they are so similar in form. Locke maintained that one who adds labor to a resource becomes entitled to the product. Contribution principles hold that one who adds assets to a debtor's estate has a special entitlement in the estate.

In substance, however, the Lockean argument has nothing to say about a contest among creditors. Locke's objective was to provide a moral foundation for the institution of private property, not to define the specific incidents of property rights. Moreover, his theory is a theory of acquisition, designed to explain how property rights might come into being through individual appropriation of unowned resources. This sets it apart from contribution principles, which are not principles of initial acquisition but principles of transfer that define the consequences of a failed exchange. Finally, Lockean theory cannot settle a priority dispute because it provides no basis for distinguishing among conflicting entitlements.

It is more likely that property theories of the Lockean and Hegelian type have had an indirect effect on priority rules, through the special sig-

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132 See Nozick, supra note 123, at 151-52 (acquisition and transfer within a theory of historical entitlement); Waldron, supra note 76, at 431-39 (transfer within "general right-based" theories).

Acquisition theories such as Locke's and Hegel's provide general support for a regime of exchange. Both Locke and Hegel contemplated that property rights would be transferable, and a plausible argument can be made that if the initial right is to be a meaningful one, it must entail a power of transfer. See Hegel, supra note 128, ¶¶ 46, 52, 57; Locke, supra note 76; Ryan, supra note 123, at 129-30; Waldron, supra note 76, at 218-25, 367-69, 431-34. But this means only that there must be some system of voluntary exchange. The need for meaningful private rights does not dictate what should happen when several property holders have transferred their rights to a debtor in return for promises that cannot be fulfilled.

133 This is illustrated by the facts of In re Samuels & Co., 510 F.2d 139 (5th Cir. 1975), rev'd, 526 F.2d 1238 (5th Cir.) (en banc), cert. denied, 429 U.S. 834 (1976), discussed in the text accompanying notes 60, 65-70. The debtor, Samuels & Co., was a meatpacking concern. A number of cattle ranchers had delivered cattle to Samuels, allegedly on a cash basis. A financier, C.I.T., had previously perfected a security interest in all of Samuels' assets, including its inventory. The issue was whether the ranchers, as cash sellers, or C.I.T., as a properly perfected secured creditor, had priority in the proceeds of the cattle sales. At least three parties had contributed to those proceeds: the ranchers, who furnished cattle; Samuels, which processed the cattle; and C.I.T., which extended funds for the operation of the meatpacking plant. On a Lockean account, at least the ranchers and Samuels "mixed" their labor and other assets with the cattle, so both must have acquired property rights in the cattle and its proceeds. Samuels then transferred its property right to C.I.T., to secure advances. Thus, as far as a Lockean account goes, both the ranchers and C.I.T. had property rights in the cattle proceeds. The Lockean account leaves unanswered the question of priority, which was the issue in the case.
nificance they attach to identifiable objects of "property." In both the Lockeian and the Hegelian arguments, property is conceived and defended as the relation between an individual and a thing. Locke's metaphor of "mixing" is a physical one.\textsuperscript{134} More importantly, the various justifications for his theory of acquisition all depend on the relationship between a person and a thing. The argument from self-ownership posits that the claimant's labor is present in an object the claimant has appropriated or produced. The argument from identification proposes that the claimant, through labor, has attached the external resources on which the claimant labored to the claimant's self. The argument from desert must assume a purposive relationship between the laborer and a finished product in order to say that the product is a fitting reward.\textsuperscript{135}

Hegel's argument for private property also envisions a relationship of persons to material things, or at least to identifiable property in which the efforts of the will can be recorded. An individual defines and develops free will by possessing and laboring on external objects. The property rights the individual needs for this purpose are rights that ensure the continuity of the individual's relation to the objects affected by the individual's possession and labor.\textsuperscript{136}

The picture of property that arises from these theories is one of a person exercising control over identifiable, and usually material, things.\textsuperscript{137}

\textsuperscript{134} See Locke, supra note 76, §§ 27-28 (acorns, for example); Waldron, supra note 76, at 160, 184.
\textsuperscript{135} See supra notes 126-27 and accompanying text.
\textsuperscript{136} Property in Hegel's theory is not necessarily limited to tangible objects. See Ryan, supra note 123, at 126-27 (extending the theory to intangible property such as stock). Further, property confirms the interdependence of individuals, and its ultimate function is a social one. See Hegel, supra note 128, §§ 182-208; Ryan, supra note 123, at 128-41; Stillman, Hegel's Analysis of Property in the Philosophy of Right, supra note 129, at 1047-1067. But property makes its first contribution to the development of personality through the relation of individuals to the external things of the world, and the image that illustrates this idea most vividly is that of a person adapting an object for personal use. See Hegel, supra note 128, §§ 54-64 (possession and use of things); Waldron, supra note 76, at 373-74; Radin, supra note 129, at 973-74, 986-88; Peter G. Stillman, Property, Freedom and Individuality in Hegel's and Marx's Political Thought, supra note 129, at 133-34; Waldron, supra note 87, at 326-27.
\textsuperscript{137} See Thomas C. Grey, The Disintegration of Property, in Nomos XXII: Property 69, 73-74, 77 (J. Roland Pennock & John W. Chapman eds., 1980); Waldron, supra note 87, at 160, 365-66; see also Waldron, supra note 76, at 33-39, 59-60 (stating that the concept of private property rests on "a single organizing idea—the idea that it is for a certain specified person (rather than for anyone else or for society as a whole) to determine how a specified resource is to be used").
Over time, the legal concept of property has enlarged to accommodate complex arrangements in which owners are far removed from the resources they control. Legal texts typically present the concept of property as a bundle of rights and duties among people, which relate more or less remotely to the use and disposition of things.\textsuperscript{138} Nevertheless, the image of property generated by Lockean and Hegelian theory is still a powerful one. At the mention of property, people tend to think of individuals exercising control over things, not of individuals ordering relations among themselves.\textsuperscript{139}

The same intuitive notion of property may explain the persistence of the strong contribution principle in commercial law. Priority under the strong contribution principle depends on the ability of claimants to connect their claims to specific assets of the debtor. If the necessary connection can be made, the claim takes on the appearance of a property claim and is accorded special treatment. It is difficult to explain the strong contribution principle in any other way.

If the strong contribution principle expresses a notion of entitlement, it is based on an illusion. We have noted already that property theories such as Locke’s and Hegel’s have no direct bearing on questions of priority. They are arguments for initial acquisition of rights, not arguments for priority among rightholders.

Nor do the values associated with these arguments (self-ownership, identification, moral development, or desert) justify strong contribution as a criterion of priority.\textsuperscript{140} The first three of these considerations can be dismissed quickly. It may be that self-ownership, identification, or moral development lend some support to the contributing creditor’s initial enti-


\textsuperscript{139} See Ackerman, \textit{supra} note 138, at 97-100, 116-17 (layperson’s property); James S. Rogers, Negotiability, Property, and Identity, 12 Cardozo L. Rev. 471, 490-94 (1990); cf. Susan Rose-Ackerman, Against Ad Hocery: A Comment on Michelman, 88 Colum. L. Rev. 1697, 1702-03 (1988) (noting distinction in takings jurisprudence between physical and regulatory appropriation).

\textsuperscript{140} See \textit{supra} notes 124-29 and accompanying text.
tachment to the asset contributed, but they lose their force when the creditor consents to exchange the asset for a promise of payment with the attendant risk of default. Perhaps the contributed asset contained some trace of the creditor's self, as a remnant of labor applied long ago in the acquisition of a resource. But once the creditor trades the asset for a promise of future payment, the creditor's entitlement to the bit of self it contains is gone. Similarly, the contributed asset may once have been a part of the claimant's identity, but surely it is no longer a part of that identity after it is traded for a promise of cash. Finally, if property is thought to assist in moral development, as a medium for external embodiment of free will, it seems important that the owner should live with the bargain he or she made and the risks it entails. None of these arguments can support a strong contribution principle that gives the contributor priority in an asset parted with voluntarily, let alone its products and proceeds.

Even when the transaction between creditor and debtor is involuntary—for example, when the debtor has misappropriated the creditor's property and the court imposes a constructive trust—arguments from self-ownership, identification, or moral development cannot support tracing rules. If the debtor still has the creditor's property, the claimant's entitlement is intact. Arguments in support of the initial entitlement are diffi-

141 See Hegel, supra note 128, ¶ 65; Waldron, supra note 76, at 369-70 (withdrawing the will from the object).

142 If the wrongdoer stole the claimant's property and still retains possession, the claimant is deemed to have title, and her remedy is replevin. A constructive trust becomes necessary only when the wrongdoer has exchanged the claimant's property for another asset, or when the wrongdoer obtained title to the claimant's asset through fraud. See Restatement of Restitution §§ 4 cmt. c, 160 cmt. j (1937); Dobbs, supra note 5, § 4.7, at 285, § 5.13, at 399-402. In fraud cases, it is possible that the property subject to a constructive trust may be the same property the claimant once owned. However, the transaction between claimant and debtor is not wholly involuntary: the claimant has agreed, albeit under the influence of fraud, to part with her property.

In this respect, it is interesting to note that Oesterle, who generally rejects tracing rules, would honor the claim of an owner whose property was stolen but not exchanged. See Dale A. Oesterle, Restitution and Reform, 79 Mich. L. Rev. 336, 361 (1980) (book review). To illustrate: suppose the debtor steals two teapots, one belonging to Owner-One and one to Owner-Two. The debtor keeps Owner-One's teapot but trades Owner-Two's teapot for wine, which he drinks. We understand Oesterle to mean that Owner-One should recover, while Owner-Two should not. See Rogers, supra note 139, at 494 n.62 (discussing correspondence between Oesterle and author in which Oesterle justifies different treatment of claimants). This result draws some support from the arguments described in the text. When the debtor still holds Owner-One's teapot, then arguments from self-ownership, identification, and moral development—if indeed they have some moral force—continue to support Owner-One's claim.
cult to sustain, however, when the debtor has exchanged the claimant’s contribution for something new. At least, they cannot support a rule that favors a creditor whose property was stolen and exchanged over one whose property was stolen and dissipated.

The argument from desert holds more promise for a contributing creditor. With respect to initial acquisition of property rights, the argument from desert holds that one whose labor adds value to an unowned object deserves to be rewarded with property rights in the product.\textsuperscript{143} Extending the argument to the context of creditors’ rights, perhaps a contributing creditor could say that adding value to the debtor’s distributable estate is an act deserving of reward or compensation.\textsuperscript{144} Likewise, to the extent that notions of desert are informed by an underlying goal of maximizing social wealth, participation in commercial exchange and extension of commercial credit may count as deserving acts, because they normally produce net gains.\textsuperscript{145} If these arguments are valid, they are not defeated by the fact of a voluntary exchange, since they support the priority claim itself, rather than the claimant’s initial right to the contributed asset.

An argument from desert, however, cannot justify current priority rules. For it does not support a \textit{strong} contribution principle in which priority depends on identification of the claimant’s contribution in the pool of assets available for distribution. Typically, many creditors have contributed value to the debtor’s estate, but not all can trace their contributions to particular assets the debtor owns at the time of default. Some provide services that leave no tangible product but contribute to the debtor’s ability to generate income and purchase assets. Others furnish credit or assets that are used to pay debts the debtor must discharge in order to continue business. There is no plausible argument that those whose contributions are still discernible after a default are more deserving of reward than those whose contributions have blended into the mass of values that make up the debtor’s wealth.

\textsuperscript{143} \textit{See} Becker, \textit{supra} note 123, at 48-56.

\textsuperscript{144} \textit{Cf. id.} at 50-51 (adding value to the world through labor or innovation). One difficulty with this application of the argument is that priority enables the creditor to recover the full value of the creditor’s contribution. If desert rests on the gratitude or appreciation by others, full recovery would appear to negate the basis of desert. See Waldron, \textit{supra} note 76, at 205; \textit{see also} Joel Feinberg, \textit{Doing and Deserving} 67-70, 90-91 (1970) (on desert).

\textsuperscript{145} \textit{See} Waldron, \textit{supra} note 76, at 202, 204. \textit{But cf.} Feinberg, \textit{supra} note 144, at 80-82 (arguing that desert is logically distinct from utility).
This is especially easy to see if we return to a point we made earlier: the strong contribution principle does not depend on a unique causal connection between the claimant and the asset claimed. Under prevailing tracing rules, the presence of a certain asset in the debtor's estate may depend on the debtor's fortuitous choice to use certain assets to obtain services or consumables and exchange others for new assets. Thus, the fact that the debtor exchanged the claimant's asset for something new does not establish that the debtor's acquisition and retention of the new asset is attributable to the claimant's contribution alone. More likely, the new asset is a product of the confluence of many contributions by many creditors.

Thus, to the extent that the strong contribution principle incorporates Lockean or Hegelian notions of property, it is a misapplication of attractive philosophical arguments beyond their scope. Unless it serves instrumental purposes that we have been unable to identify, the strong contribution principle is a mistake.

2. The Weak Contribution Principle

Before we recommend that contribution principles, and unjust enrichment generally, should be excised from contests among creditors, we should consider whether a case can be made for the weak contribution principle as a method for determining creditor priorities. The weak contribution principle, as defined earlier, awards priority according to causal contributions to the debtor's wealth. In a distribution of assets, each claimant has a priority claim to the extent that the particular claimant's contribution of an asset or labor was a necessary condition for the existence of the present asset pool.

The weak contribution principle is more even-handed than the strong contribution principle, but it lacks the sort of justification necessary to support a principle of loss allocation. The best argument in favor of the weak contribution principle is that a causal contribution to something of value (such as a debtor's estate) deserves reward or compensation. If the issue were one of allocating gains, this argument might have some force:

148 See supra notes 84-86 and accompanying text.
147 See Oesterle, supra note 8, at 204-05.
146 See supra part II.C.
causation is a plausible basis of desert. But a contest among creditors is a process of loss allocation, in which priority for contributors means a greater loss for other, noncontributing creditors. Some of these other creditors have liens on the assets at stake, and all have legally recognized interests in receiving payment from those assets. To support a contribution-based priority, it is necessary to show not only why the contributor is entitled to a reward, but also what that reward should be and why it should come at the expense of other creditors. The fact of a causal contribution does not answer the last two of these questions. Thus, the weak contribution principle, like the strong contribution principle, is without adequate justification.

3. Summary

The strong contribution principle is unjustified: the notion of entitlement it reflects is out of place in a contest among creditors. The weaker form of contribution principle, based on claimants’ causal contributions to the debtor’s wealth, lacks a justificatory basis that will support the imposition of greater losses on other creditors. Neither provides a sound basis for priority.

IV. Abandoning Contribution Principles: The Consequences of Rejection

The rejection of contribution principles has consequences for preferred principles of priority. The consequences affect the rights of competing creditors. Two possible consequences can be identified. One possibility is that, given that contribution principles support the existing scheme of priorities and that such principles are indefensible, the existing scheme of priorities also is indefensible. Indefensibility transfers to priority princi-

140 Cf. Becker, supra note 123, at 50-56 (adding value through labor). In the course of his discussion of Lockean property rights, Becker proposes that an argument from desert is most persuasive as a “why not?” argument. Id. at 30, 41-48. When someone labors on an unowned object, she has a better claim to it than anyone else. When there are conflicting claims to the product, it becomes much harder to say that the product is an appropriate reward. On the difficulty of applying desert arguments in competitive settings, see id. at 42-43, 53-56; Feinberg, supra note 144, at 89-94 (on the difficulty of conceiving allocation of scarce resources as a form of reward).

ple themselves. A second possibility is more modest: Given that contribution principles support the existing scheme of priorities and that such principles are indefensible, an important justification for the existing priority scheme is removed. Indefensibility simply weakens support for the priority principles themselves. Since the former possible consequence follows only if no alternative plausible justifications exist, and since we have not shown that none exist, we do not claim that the former possibility is established. The existing scheme of priority principles still may be defensible. We instead claim that the latter possible consequence obtains: Rejection of contribution principles removes a justification for the existing scheme of priorities. Our claim is illustrated below by reference to two particular orderings of priorities.

A. Construction Sureties

Rejection of contribution principles eliminates an argument in favor of giving a construction surety priority over a construction lender in the same collateral. In particular, it eliminates a justification for giving a construction surety a right of equitable subrogation superior to a construction lender's security interest in retainage. Consider in this regard a typical priority contest between a construction surety and a contractor's lender. The construction contract between the owner and construction company calls for the owner to retain a portion of progress payments until completion of the project. A surety bond is issued in conformity with the construction contract naming the owner as beneficiary. As is common, the surety takes from the contractor an assignment of sums due under the construction contract. At some point, either before or after issuance of the surety bond, the contractor obtains a line of credit from a bank. The loan is secured at least by sums due under the construction contract. The bank duly files a financing statement covering the collateral; the surety files nothing. Later, the contractor defaults, and the surety fulfills the contractor's obligations of performance under the construction contract. Both the surety and the bank compete for rights in the retainage in the owner's possession.

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151 See supra part III.A.; infra part V.

152 This is frequently the case. See T. Scott Leo, The Financing Surety and the Chapter 11 Principal, 26 TORT & INS. L.J. 45, 52 (1990).
Three well-rehearsed issues are presented in this priority contest: (1) Is the contractual assignment to the surety of sums due under the construction contract an Article 9 security interest?; (2) If so, is the assignment nonetheless excluded from the scope of Article 9?; and (3) Does the surety have a right of equitable subrogation which gives it priority over the bank as to the retainage independently of Article 9? Issue (3) clearly is crucial because it addresses the relation between Code and extra-Code determined priority. Prevailing case law holds that the Code preserves a surety’s pre-Code right of equitable subrogation. The surety, by completing performance of the construction contract, is subrogated to the owner’s right to the retainage. A right of equitable subrogation gives the surety priority over the bank.\(^{153}\)

The right is difficult to justify, however. Doctrine aside, awarding priority to the surety is not inevitable. Simple references to the owner’s rights do not guarantee the surety’s priority, because different interpretations of the subrogator-owner’s rights are possible. Granted, the owner has a counterclaim for damages against the defaulting contractor. Granted too, the surety fulfills the contractor’s obligations to the owner under the construction contract. But there are two alternative characterizations of the owner’s rights in the retainage, given the surety’s performance. One characterization is standard: The owner’s counterclaim for damages extinguishes the defaulting contractor’s right to the retainage.\(^{154}\) Given this interpretation, the assignee-bank has no right to the funds in the owner’s possession because its defaulting assignor has no rights in them. An alternative characterization is that the owner’s counterclaim suspends the defaulting contractor’s right to the retainage. In other words, the contractor’s


\(^{154}\) See, e.g., National Shawmut Bank, 411 F.2d at 848.
right to the retainage is established when construction is completed by the surety. Given this interpretation, the assignee-bank has a right to the retainage because its assignor acquired a right in it upon the surety’s completion of performance. Under both characterizations the owner has a right to the retainage as against the contractor when there is a default. Similarly, the owner has no right to the retainage when the construction is completed according to the terms of the contract. But the surety has priority over the bank only under the former interpretation of the owner’s right: when the defaulting contractor’s right in the retainage is extinguished. Hence, a particular content of the owner’s rights needs to be asserted, not assumed.

Nor is the surety’s priority guaranteed, even when the owner’s rights in the retainage are fixed. By assignment of the contractor’s right to be paid upon completion, the bank succeeds to the contractor’s right in the retainage. The owner has a right to counterclaim for damages against the defaulting contractor and to offset that claim against the retainage. Therefore, the owner has a right to the retainage and a party hired by the owner to complete construction is entitled to be paid by the owner an amount equal to the cost of completion—an amount in turn equal to the owner’s counterclaim. Therefore, the party completing construction is entitled to the retainage. The surety who completes construction, however, is not such a party. The owner does not hire the surety; the contractor does. The surety undertakes to look to the contractor for indemnification, not to the owner for reimbursement. To measure the surety’s rights by those of a party hired by the owner to complete performance begs the question, which is whether the surety or the bank has priority in the retainage. As against a third party completing performance, the assignee-bank has no rights in the retainage. The question, of course, is whether the assignee-bank has rights in the retainage as against the surety when it completes performance. To measure the surety’s rights in the retainage by a third party’s rights is to predetermine the matter of priority. The decision requires justification, not an assumption.

Justifications which appeal to contribution principles do not give prior-

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165 Cf. Douglas G. Baird & Thomas H. Jackson, Security Interests in Personal Property 871-72 (2d ed. 1987). This assumes, of course, that the owner’s damages are equal to the cost of a completion by a third party. Where the owner’s damages are greater than the cost of completion, a third party is entitled only to the cost of completion.
ity to the surety, because such principles either are themselves indefensible as principles of priority or, if defensible, do not distinguish among contributing creditors. For instance, the surety may be said to have priority over the bank because its fulfillment of the contractor’s obligations eliminates the owner’s right to the retainage. The surety, in other words, may be said to have contributed to the retainage as an asset in the contractor’s estate. But the justification fails here because contribution principles are defective as priority principles. The strong contribution principle is indefensible for a reason noted before: The principle decides priority on the basis of contribution of a specific asset to the debtor’s estate, and its invocation in ordering competing creditors’ claims is unjustified. In performing the contractor’s obligations, the surety eliminates the owner’s right to the retainage. But it is inappropriate to base the surety’s entitlement to the retainage on desert, moral development, or rights to private property. Desert, moral development, or respect for property rights are questionable bases for deciding the entitlement of the modern surety’s historical predecessor: an individual who gratuitously agreed to guarantee the obligations of another. Such bases clearly have no proper role in deciding entitlements when a surety is a risk-calculating, sophisticated entity guaranteeing a contractor’s performance for a price under an existing regime of rules for the transfer of private property. The strong contribution principle is defective, therefore, as a principle for ordering creditor’s claims to a debtor’s assets.

The weak contribution principle also fails for a reason noted before: The principle decides priority on the basis of causal contribution to an asset in the debtor’s estate, and its application cannot order priorities

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186 See supra part I.B.; cf. Transamerica Ins. Co., 524 So. 2d at 434-44 (noting that rationale of federal cases granting priority to surety was that surety, by completing performance, directly helped the owner—United States).

187 See supra part III.


189 See supra part III.
among contributing creditors. All creditors’ contributions to a debtor’s asset are treated on par, as far as the weak principle goes. A surety’s performance extinguishes the owner’s right to the retainage, but the contractor’s use of the bank’s line of credit is a causal condition of the retainage being in the owner’s possession in the first place. Both the surety and the bank therefore causally contribute to the retainage in the debtor’s estate. Hence neither creditor can be given priority in the retainage. At best, the weak principle justifies giving the surety and the bank a pro rata share of the retainage. Because the weak contribution principle cannot distinguish among the causal conditions of a debtor’s acquisition of an asset, it fails to order contributing creditors’ claims. Whether a strong contribution principle fails because it is itself defective or a weak contribution principle fails because it cannot order priorities among contributing creditors, the consequence is the same: Contribution principles do not justify giving the performing surety priority over the bank with respect to retainage. Furthermore, justifications which appeal to the credit-cost reducing properties of a surety’s priority are unconvincing. 160 Hence there is no good argument for recognizing a surety’s right of equitable subrogation.

The surety’s priority in retainage must be determined by contract, not contribution. Accordingly, the two well-rehearsed issues identified above become important: (1) Is the contractual assignment to the surety of the sum due under the construction contract an Article 9 security interest?; and (2) if so, is the assignment nonetheless excluded from the scope of Article 9? As a matter of Code interpretation, there is no reason not to treat the assignment to the surety as an Article 9 security interest. By issuing a performance or payment bond, the surety assumes a contingent liability: to fulfill the contractor’s obligations under the construction contract if the contractor defaults. This contingent liability is secured by an account receivable, the right to receive sums due under the construction contract. Therefore, the contractual assignment of an account receivable creates a security interest here. 161 The fact that the surety’s obligation is contingent does not affect the nature of the assignment any more than a lessor’s reservation of a residual interest in property, combined with a purchase or cancellation option in the lessee, affects the nature of the

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160 See supra part III.A.3.
transfer.\textsuperscript{163} Securing a contingent obligation, or reserving a residual interest in property transferred, does not, by itself, take such transfers outside the scope of Article 9. Case law to the contrary is simply unconvincing.

Nor is the assignment to the surety by the contractor excluded from the scope of Article 9 by section 9-104(f). Gilmore's point that the subsection excludes assignments of contracts, not assignments for security, is well-taken.\textsuperscript{164} An additional reason for the same conclusion, based on drafting history, is even stronger. The 1952 Official Draft of section 9-312 contained a subsection which explicitly altered pre-Code law and subordinated the surety's security interest to a later security interest of a secured lender.\textsuperscript{164} Courts have inferred from the subsection's deletion that the Code has preserved the surety's pre-Code priority as to retainages.\textsuperscript{165} But the deletion of a specific provision dealing with a surety's priority presupposes that the assignment of contract rights to the surety is within the scope of Article 9.\textsuperscript{166} Why else would a surety's priority under the Code even be relevant? Given that the interest in contract rights assigned to the surety by the contractor is an Article 9 security interest, the surety's priority as against the bank should be decided by the priority rules of Article 9.\textsuperscript{167}

\textsuperscript{163} See id. § 1-201(37).

\textsuperscript{164} 2 GILMORE, supra note 50, § 36.7, at 973-74; cf. Transamerica Ins. Co., 524 So. 2d at 439.


\textsuperscript{166} See Tecklenburg, supra note 153; GILMORE, supra note 50, § 36.7, at 973-74.

\textsuperscript{167} Cf. U.C.C. §§ 9-312(5), 9-312(4) (1992). Note that the surety to whom a right to payment due under a construction contract after those rights are assigned to the bank may still prevail as against the latter. This is because the surety may obtain a purchase money security interest from the contractor. U.C.C. § 9-107(b) (1992). The Code, however, does not define when a debtor acquires "rights in the collateral." Id.; cf. id. § 9-203(1)(c); Danning v. World Airways, Inc. (In re Holiday Airlines), 647 F.2d 977 (9th Cir. 1981), cert. denied, 454 U.S. 1146 (1982); Northwestern Bank v. First Virginia Bank, 585 F. Supp. 425, 428 (W.D. Va. 1984); Litwiller Machine & Mfg., Inc. v. NBD Alpena Bank, 457 N.W.2d 163 (Mich. Ct. App. 1990). Assuming that the contractor acquires a right to sums due under the contract upon complete performance at the time the construction contract is executed, a surety's guarantee could "enable the debtor to acquire rights in the collateral." U.C.C. § 9-102(b) (1992). (This would be true when Miller Act provisions and their state counterparts
B. *Priority in Commingled Proceeds*

Rejection of contribution principles has another consequence: it eliminates a justification for giving a secured creditor priority in commingled proceeds. To see this, begin by considering a secured party's security interest in proceeds of collateral. Under section 9-203(3), a security agreement gives a secured party rights in proceeds, unless otherwise provided. Section 9-306(2) gives the secured party something more: a security interest in "identifiable proceeds" of collateral. The section deems a security interest as continuing automatically in identifiable proceeds. Section 9-312(6) also treats the security interest in proceeds of collateral as having the same priority as the security interest in collateral. Therefore a secured creditor's priority carries over to commingled proceeds, if identifiable. The Code is silent as to when proceeds are "identifiable." Hence the possibility is left open that commingled proceeds should be treated as nonidentifiable.

Consider next five paradigmatic situations involving commingled proceeds of collateral:

(1) Creditor and Debtor agree, expressly or by implication, that Debtor can use, in any manner, assets in which Creditor has a security interest. This includes commingling them with unencumbered assets. Debtor commingles the proceeds of Creditor's assets in its possession with its own assets. No other creditors' assets are involved.

(2) The same as (1), except that Debtor commingles proceeds of Creditor's assets with other creditors' assets.

(3) Debtor uses assets in which Creditor has a security inter-

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require issuance of performance and payment bonds as a condition of being awarded a construction contract. If so, the surety would perfect a purchase money security interest in an account receivable if it duly filed a financing statement on or within ten days of the contractor being awarded the construction contract. As a purchase money secured creditor, the surety would enjoy retainage priority against the bank which had previously filed a financing statement covering the same collateral.

Filing here would determine priority. Of course, in public construction contracts, sureties are almost always required. Most private construction contracts do not involve a surety. At least with respect to public construction contracts, then, the contractor's creditors will expect that a surety has been or will be engaged. Filing in this case therefore is unnecessary to cure an ostensible ownership problem. But filing can reduce the litigation costs associated with determining priority. For it is an unambiguous and temporally identifiable act which can be proven at little cost. See Baird, supra note 2, at 64. Accordingly, filing may reduce the litigation costs involved in establishing priority more than the direct and indirect costs associated with filing.
est, either commingling them or the related proceeds. The agreement between Debtor and Creditor prohibited the use to which Debtor has put the encumbered asset. No other creditors' assets are involved.

(4) The same as (3), except that Debtor commingles proceeds of Creditor's asset with other creditors' assets.

(5) The same as (4), except that other creditors obtain from Debtor some of the commingled proceeds in violation of the express or implied terms of their agreement with Debtor.

Suppose that in each situation Debtor has insufficient funds to satisfy all outstanding claims against it. Now the relevant (and more frequent) commercial contexts do not involve situations (1), (3), (4), or (5). This is because relevant commercial contexts involve either competing creditors or no wrongdoing on the part of any party, even in the sense of a breach of the security agreement. The former context excludes situations (1) and the latter context excludes situations (3), (4), and (5). Therefore, commercial contexts involving situation (2) alone are relevant. Here, there is no wrongdoing on the part of Debtor or any other party and there are competing creditors with claims to the commingled assets. Situation (2) is a situation in which a loss is to be allocated among two or more creditors. The question in situation (2) is: What justifies giving Creditor or Creditor's competitors priority in commingled proceeds?

By itself, section 9-306(2) does not give Creditor priority. Read strictly, section 9-306(2) only gives Creditor a security interest in "identifiable proceeds." That is, it reads to say only that Creditor's security interest in proceeds remains valid. Section 9-306(2) does not give Creditor priority in those proceeds once they are commingled. It follows that an argument is needed for awarding Creditor priority over its competitors. Courts have awarded priority through use of tracing principles: proceeds are identifiable when collateral can be traced into the commingled funds.168 Invoca-

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tion of tracing principles usually is justified by recourse to pre-Code constructive trust law.\textsuperscript{169} The Debtor is treated as the counterpart of a trustee, and the commingling of proceeds is treated as the counterpart of a trustee’s breach of an implied contract with the beneficiary.

Invoking tracing principles here is unjustified. For one thing, recourse to constructive trust law is misplaced. Unlike the case of a trustee’s breach of contract, the paradigmatic commercial context does not involve the debtor’s breach of a security agreement. There is no breach at all by Debtor in situation (2), for instance. Hence the factual predicate for imposing a constructive trust on proceeds is missing.\textsuperscript{170} Another difficulty is the presence in a commingled fund of the proceeds of other creditors’ collateral. Allowing the tracing of proceeds into an undifferentiated fund in effect gives priority to one secured creditor’s security interest over other creditors’ claims. Contribution principles cannot justify that priority\textsuperscript{171} because application of the strong contribution principle depends on the existence of a transactional link between a creditor’s contribution and the

\textsuperscript{169} See supra part I.A.; Brown & Williamson Tobacco Corp. v. First Nat’l Bank, 504 F.2d 998, 1002 (7th Cir. 1974) ("Looking to Illinois law, it is clear in the different, but probably analogous, case of a fund impressed with a trust, such fund may be traced into a fund of commingled money."); Universal C.I.T. Credit Corp. v. Farmers Bank, 358 F. Supp. at 324; Debora L. Threedy, *Commingled Cash Proceeds and the Limits of Identity: The Misinterpretation of UCC Section 9-306*, 23 UCC L.J. 352, 361 (1991).

Courts also justify use of tracing principles by reference to the Code’s recognition of a debtor’s right to commingle proceeds of collateral without invalidating a security interest in the collateral. See U.C.C. §§ 9-206, 9-205 cmt. 1, 9-306 cmt. 4 (repealing rule of Bendict v. Ratner, 268 U.S. 353 (1925)); G.O. Funk & Sons, Inc. v. Sullivan Equip., Inc., 415 N.E.2d 1309 (Ill. App. Ct. 1981). The justification contains a non sequitur. It is one thing to preserve the validity of a security interest when collateral is commingled by the debtor. It is another matter to grant priority to a security interest in commingled proceeds when proceeds can be traced into a commingled fund. Nothing follows by way of priority from recognition of the continued validity of a security interest. Considerations present in a two-person transaction (debtor-creditor) may be absent in a three or more person transaction (debtor-creditors).

The committee established to study Article 9 justifies retention of extra-Code tracing principles by their innocuousness. Extra-Code tracing principles appear not to have “engendered serious practical problems.” See PEB Study Group, supra note 48, at 117. The committee’s justification is weak. Deeming a security interest in commingled proceeds lost also would not present serious practical problems. In fact, the litigation costs associated with tracing would be eliminated. Therefore, unless the use of tracing principles is independently justified, the absence of practical problems in their use does not provide a reason for retention. As argued below, contribution principles do not provide the requisite independent justification.

\textsuperscript{170} See supra note 168; Cesterle, supra note 142, at 351 (arguing that constructive trust doctrine originated in actions against fiduciaries).

\textsuperscript{171} See supra part III.B.1.-2.
commingled fund. The same link also exists between other creditor’s contributions and the commingled fund. Desert, moral development, or respect for property rights are inapposite here, as elsewhere. 172 Facts about the transactional link cannot distinguish, therefore, among claims to any particular part of an undifferentiated fund. Nor can the weak contribution principle justify tracing principles here: 173 the proceeds of each creditor’s collateral causally contributes to the size of the commingled fund. Each creditor’s contribution is a causal condition of the size of the fund. Thus, facts about the causal link cannot distinguish among claims to any particular part of an undifferentiated fund.

Suppose contribution principles were defensible bases of priority. Then a case of commingled proceeds of collateral would present only a difficulty of proof. There would be a transactional or causal link between collateral and some portion of the commingled funds. The secured creditor would have contributed to the fund in the requisite sense under some contribution principle. Accordingly, the contributing creditor would be entitled to priority with respect to some portion of the commingled fund. The question simply would be “which portion?” Tracing principles plausibly could operate as a supplementary device for answering the question. But contribution principles are defective principles of priority: they either cannot order claims among competing claimants or they do so without justification. 174 Hence contribution principles cannot justify invocation of tracing principles in the first place. Contribution principles provide no good argument for reading section 9-306(2) to treat commingled proceeds as “identifiable proceeds” of collateral. Gilmore rejected such a reading based on the drafting history of the section. 175 The indefensibility of contribution principles supply another reason for the rejection: A security interest in proceeds is lost when commingling occurs.

172 See supra parts III.B., IV.A.
173 See supra parts III.B.1.-2., IV.A.
174 See supra part III.
V. Conclusion

Contribution principles should be rejected as serviceable principles of priority within commercial law. They are either indefensible as priority principles or, if defensible, do not order a number of competing creditors' claims to a debtor's assets. In either case, contribution principles fail as justifiable devices for allocating losses among claimants. The instinct to rely on such principles is strong, dependent as it is on notions of property rights or other bases of entitlement out of place in the commercial contexts in which losses are to be allocated. Weaker versions of contribution principles do better, but fail to distinguish among contributing creditors. A significant range of commercial law rules appealing to contribution principles therefore lacks justification. Further, existing justifications which appeal to reduced cost of credit are not compelling. Defensible arguments for the present scheme of priority rules in commercial law are needed. Our argument is that contribution principles are indefensible.

We anticipate that the following objection to our conclusion will be made: One might argue that the conclusion shows, at most, that positive law reflects the presence of contribution principles. Nothing shown excludes the possibility that alternative principles can account for contribution principles themselves. Hence, the objection goes, contribution principles are consistent with alternative principles—say, efficiency principles. The objection fails, however, because it relies on consistency alone to question the soundness of contribution principles. Mere consistency with alternative principles is insufficient to do this. Obviously, alternative principles are possible, but the existence of consistent alternative principles does not impugn a candidate explanation or justification. For instance, explanations of heritable characteristics by reference to genes are not undermined by physiochemical explanations of the same phenomenon. Further, to adduce the possibility of alternative principles is not enough. The alternative principles also must exhibit the explanatory or justificatory virtues identified above: sound and non-ad hoc assumptions and estimates about relevant variables. Otherwise, different estimates of relevant variables can render any candidate principle consistent with contribution principles. Part III.A has argued that efficiency explanations of the pattern of priorities identified are inadequate. Thus, assuming that suitable

178 See supra part III.A.
relevant estimates may be derived, the fact that efficiency principles are consistent with contribution principles is not alone decisive.

A normative question remains concerning the bearing of our argument on the retention of the scheme of priorities identified. If contribution principles are indefensible, should that scheme be abandoned? Should a seller’s reclamation right or a construction surety’s priority as to retainage, for instance, be replaced by different allocative rules? In fact, the normative question remaining contains two questions: First, are the priority rules identified justified, notwithstanding the indefensibility of justifications based on contribution? Second, absent available and defensible justifications, should the scheme of priority rules discussed be abandoned? The questions are distinct. For it is one thing to find existing and initially plausible justifications for priority rules defective. It is another matter to recommend on that basis replacement of these rules. Credible proposals for abandonment have to answer both questions.

Our argument addresses only the first question: the question of the existence of justifications of the scheme of priority rules identified. We have argued that contribution principles and their competitors are indefensible. Should the priority rules identified therefore be abandoned? One possibility is to urge abandonment given the absence of defensible support for those rules. More modest proposals recognize the bearing of additional factors on the recommendation. They would require demonstration of at least two things. First, a showing is needed that abandonment of the existing set of priorities has fewer associated costs than its retention. Transition costs, here as elsewhere, require estimation. Second, a showing is needed that there is no good reason to believe that, although compelling justifications are unavailable, one or more exist. In particular, a demonstration is needed that there are no factors bearing on the price of credit which justify the existing scheme of priorities.\footnote{For example, the longevity of a priority rule may provide a reason for believing that a justification for it exists. Mooney implicitly invokes a reason of this sort, in the course of arguing against a filing requirement for leases of personal property: “Hundreds of years of respect for the ‘secret’ interest of a lessor, which survived intact during periods of intense judicial and legislative hostility toward non-possessory security devices, cannot be dismissed easily as an accident of history.” Charles W. Mooney, Jr., The Mystery and Myth of ‘Ostensible Ownership’ and Article 9 Filing: A Critique of Proposals to Extend Filing Requirements to Leases, 39 ALA. L. REV. 683, 737 (1988). Invariant rules among systems of commercial law or the success of particular types of justifications in related domains may provide other reasons for believing that convincing justifications will be forthcoming.} Without both showings,
more modest proposals would not recommend abandonment of the priority rules identified.

Our proposal is modest. We simply find that there is no good reason to believe that the required justification exists. Priority rules based on contribution apply broadly. They order different sorts of claims among different sorts of claimants, in both contractual and noncontractual settings. The range of claims, claimants, and settings seems to resist well-supported and non-ad hoc generalization necessary for a convincing justification. At the same time, we have given no reason to prefer particular alternative rules of priority, either for efficiency or other morally relevant reasons. Preferred priority rules plausibly have to satisfy at least three conditions: (1) they must be selected on the basis of a well-defined criterion for making allocative decisions within a domain; (2) the criterion must be morally acceptable; and (3) the criterion is applied to yield particular priority rules using well-supported generalizations about the domain. It is difficult to determine whether a particular priority rule satisfies all three conditions.

Take a criterion of selection based on the hypothetical choice of typical contracting parties. Confined to commercially sophisticated parties in contractual settings, a priority rule is preferred only if a typical debtor and its creditors would choose the rule. Priority, as with any contract term, should optimally allocate the risk of debtor’s default among the debtor’s creditors. The priority rules chosen here would be such that, by creditors paying for a senior ranking and being compensated for a junior ranking, the debtor’s total debt bill would be minimized. Suppose that all claims can be ranked according to this set of hypothetical contractual rules. The proposed criterion therefore satisfies condition (1). But it says nothing about the proper domain of decisions to which it applies. Nothing is said to justify treating priority as a permissible subject of contracting instead of as a mandatory default rule. Rather, the proper domain to which the criterion applies is presupposed. Moreover, because choice by typical parties states only a necessary condition for preferred priority rules, the criterion still may be morally objectionable. Both the proper domain of decisions and the criterion of selection are matters of moral acceptability: condition (2). Nor is it apparent that well-founded generalizations about typical debtors and creditors, in conjunction with that criterion, yield particular priority rules: condition (3). That is, not only are some of the rules to
apply in non-contractual settings (e.g., some constructive trust claims), they also are to apply to commercially unsophisticated debtors or creditors (e.g., some constructive trust claimants, some reclaiming sellers, and some purchase money secured creditors). In the former case, the criterion of selection is inapplicable. In the latter case, it may be morally objectionable. Hence, conditions (2) and (3) may or may not be satisfied. It is therefore unclear which particular priority rules are preferable to existing priority rules. Since we have argued that the scheme of priorities identified is unjustified, but have not proposed particular replacements, the normative case for changing current law is only half made.