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Brandeis, Progressivism, and Commercial Law: Rethinking Benedict v. Ratner

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BRANDEIS, PROGRESSIVISM, AND COMMERCIAL LAW: RETHINKING *BENEDICT V. RATNER*

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I. INTRODUCTION

President Franklin D. Roosevelt frequently referred to then-Justice Brandeis as old Isaiah—the prophet. Dissenting with Holmes in *Abrams v. United States*[1] and *Gitlow v. New York*[2] and concurring in *Whitney v. California*,[3] Brandeis helped reshape First Amendment jurisprudence. His ideas about constitutional law and about public and private accountability were well ahead of his time and helped shape modern corporate law,[4] antitrust law,[5] and securities law,[6] among others. He began as a voice in the wilderness, and famously, his ideas and opinions have been justified by history.

Except one: *Benedict v. Ratner*.[7] *Benedict* is a famous case but not because Brandeis wrote it. That fact is generally ignored. *Benedict* is often taught at the beginning of law school courses in secured credit[8] for the

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[1] 250 U.S. 616 (1919).

[2] 268 U.S. 652 (1925).

[3] 274 U.S. 357 (1927). Roosevelt was not the only one to describe Brandeis in biblical terms. *See* HARRY KALVEN, JR., A WORTHY TRADITION: FREEDOM OF SPEECH IN AMERICA 158 (1988) ("Like Twin Moses come down from Mount Sinai bearing the true Commandment, [Holmes and Brandeis] see little need to argue that the [clear and present danger] formula is rightly derived from the First Amendment, merely that it is.").

[4] Brandeis's views about interlocking corporate directorates were articulated in his book, *Other People's Money*. *See* LOUIS DEMBITZ BRANDEIS, OTHER PEOPLE'S MONEY (1914).

[5] As a private lawyer, Brandeis developed a reputation as a "trust buster," taking on the New Haven Railroad and the United Shoe Company. *See also* Board of Trade of Chicago v. United States, 246 U.S. 231 (1918) (Brandeis, J.).

[6] *See* BRUCE ALLEN MURPHY, THE BRANDEIS/FRANKFURTER CONNECTION: THE SECRET POLITICAL ACTIVITIES OF TWO SUPREME COURT JUSTICES 131-38 (1982); PHILIPPA STRUM, LOUIS D. BRANDEIS: JUSTICE FOR THE PEOPLE 383-84 (1984).

[7] 268 U.S. 353 (1925).

[8] *See, e.g.*, DOUGLAS G. BAIRD & THOMAS H. JACKSON, SECURITY INTERESTS IN PERSONAL PROPERTY 52 (2d ed. 1987); DOUGLAS J. WHALEY, PROBLEMS AND MATERIALS IN SECURED

propositions that it is wrong, both as a legal and a policy matter, and has been rejected by the drafters of the Uniform Commercial Code. It is generally presented as a last gasp of the quixotic historic judicial hostility to non-possessory security interests in personal property and, more particularly, of judicial hostility to the floating charge on accounts receivable. To the extent that commercial law professors mention Brandeis's role in the case, it is to point out with a certain self-aggrandizing satisfaction that the great Brandeis even got the law wrong. By 1925, the New York law of accounts receivable financing had moved beyond the position Brandeis espoused.[9]

Benedict suggests a paradox. Is it the fate of the prophet to be deemed right by history when he is vilified in his own time, but to be judged harshly by history when he writes for a unanimous court? In this essay, I seek first to show that *Benedict* is not a product of shoddy legal craftsmanship but is instead, like *Abrams* and *Gitlow*, an outgrowth of Brandeis's progressive vision and part of his broader effort to reshape the law. Second, I seek to rehabilitate Brandeis as a commercial law judge, suggesting Brandeis, writing in *Benedict*, may have had a better grasp than even the drafters of the current Revision to the UCC how best to facilitate accounts receivable financing and other forms of secured credit.[10]

II. THE PUZZLE OF *BENEDICT V. RATNER*

Benedict v. Ratner[11] is a familiar, if somewhat forbidding, story to students of commercial law. In early 1921, the Hub Carpet Company found

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TRANSACTIONS 5 (3d ed. 1993).

[9] *See In re* Michigan Furniture Co., 249 F. 978 (S.D.N.Y. 1918) (Learned Hand, D.J.); Stackhouse v. Holden, 73 N.Y.S. 203 (App. Div. 1901); GRANT GILMORE, 1 SECURITY INTERESTS IN PERSONAL PROPERTY 255 (1965).

[10] Cases like *Benedict v. Ratner* have enjoyed something of a renaissance in certain circles, as scholars have recognized some of the costs that secured transactions impose on non-adjusting and non-consensual creditors. *See* Edward J. Janger, *Predicting When the Uniform Law Process Will Fail: Article 9, Capture, and the Race to the Bottom*, 83 IOWA L. REV. 569 (1998); Lynn M. LoPucki, *The Unsecured Creditor's Bargain*, 80 VA. L. REV. 1887, 1890 (1994); Paul M. Shupack, *Solving the Puzzle of Secured Transactions*, 41 RUTGERS L. REV. 1067, 1074-75 (1989). Brandeis's analysis, however, does not derive from a hostility to secured credit, per se. Nor does it appear to derive principally from a concern about the "externalities" of secured credit. Instead, Brandeis appears to be doing something more sophisticated. *See infra* text accompanying note 58.

[11] See GILMORE, *supra* note 9, at 253-57 for a wonderful retelling of the history and influence of *Benedict v. Ratner*.

itself in financial difficulty.[12] To stay in business, the corporation borrowed $30,000 in two installments from Aaron Ratner, the father of the corporation's vice-president.[13] As a condition of the loan, Ratner demanded Hub secure the advances with "all accounts receivable then outstanding and all which should thereafter accrue in the ordinary course of business."[14]

This assignment was intended to create a "floating lien" or "floating charge" on Hub's book accounts. The so-called "floating lien" on accounts was rare at that time,[15] but was designed to eliminate one of the difficulties of using receivables as collateral for debt. One of the most important assets of a textile manufacturer is the right to be paid by its customers for textiles purchased (Hub, for example, had between $90,000 and $120,000 in accounts receivable outstanding in any given month between May and September of 1921).[16] The corporation assigned (transferred title to) this asset to Ratner in return for and as security for his $30,000 loan.[17] The advantage of such an arrangement, had it worked, would have been to eliminate any risk of non-payment, as the value of Ratner's collateral was at all times well in excess of the debt owed to him.[18]

In taking book accounts as collateral, Ratner faced the difficulty that, in an ongoing business, old customers constantly pay for the goods purchased while new customers receive credit. Though the aggregate value of the accounts receivable may remain relatively constant over time, the identity of the various account debtors necessarily changes: Again, in this case, between May 23 and September 17[19] Hub collected approximately $150,000 in assigned accounts, while at all times keeping the value of the outstanding balance above $90,000.[20] For obvious practical reasons, Hub and Ratner had no desire to enter into a separate assignment each time a new account was created. Neither did Ratner want to take the trouble to collect the accounts, so long as Hub was current on its loan and the aggregate value of the accounts receivable was sufficient to repay him. To accomplish their deal, Hub and

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[12] *See Benedict*, 268 U.S. at 357.

[13] *See id.* at 359.

[14] *Id.*

[15] *See* BAIRD & JACKSON, *supra* note 8, at 52.

[16] *See Benedict*, 268 U.S. at 359.

[17] *See id.*

[18] *See id.* at 360.

[19] On September 17, Ratner apparently grew worried about the financial state of Hub and exercised his right to have the accounts delivered directly to him. *See id.*

[20] *See id.*

Ratner entered into an arrangement whereby, toward the end of each month, Ratner would receive a list of the accounts securing his loan.[21] Through this device, Ratner could satisfy himself that the value of the collateral exceeded the amount owed to him. In the meantime, Hub would continue to sell carpets and to collect the purchase price from its customers, and the lien would "float" from account to account.[22] Because Ratner apparently trusted his son, Hub was left free to use the proceeds of these accounts as it saw fit.[23] (It was this last aspect of the deal that was apparently fatal.)[24]

The loan from Ratner was not sufficient to solve Hub's difficulties, and, in September of 1921, Hub's creditors had Benedict appointed as receiver to take control of Hub's assets.[25] A bankruptcy proceeding was commenced shortly thereafter.[26] Benedict, now the bankruptcy trustee, proceeded to collect the book accounts owed to Hub.[27]

Ratner then petitioned the court to have the proceeds of the accounts paid to him pursuant to the assignment.[28] Benedict resisted, arguing the original transfer was void under the law of New York as a fraudulent conveyance and further asked Ratner to relinquish to the estate the proceeds of certain accounts that had been collected by Hub and turned over to Ratner prior to the bankruptcy.[29] In challenging the assignment to Ratner as fraudulent, Benedict relied on New York's version of the Statute of 13 Elizabeth that rendered void any transfers made with the intent to hinder, delay, or defraud creditors.[30]

Although Brandeis and his colleagues were unanimous in their conclusion that the arrangement with Ratner was fraudulent, their reason is not obvious on the face of the transaction. The difficulty faced by Brandeis and by later readers of the *Benedict* opinion is explaining, both as a practical and a legal

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[21] *See id.*

[22] *See id.*

[23] *See id.*

[24] Though it had not yet received the name, this form of transaction later became known as non-notification, recourse, accounts receivable financing.

[25] *See id.* at 357.

[26] *See id.*

[27] *See id.*

[28] *See id.*

[29] *See id.* at 358. As noted above, on September 17, 1921, Ratner apparently became worried and instructed Hub to deliver the proceeds of accounts directly to him, to pay down the debt. *See supra* note 19.

[30] New York had previously adopted a version of the Statute of 13 Elizabeth. *See* Sturtevant v. Ballard, 9 Johns. 337 (N.Y. 1812) (Kent, C.J.) (citing Sess. 10, c. 44).

matter, why the assignment of accounts to Ratner was fraudulent and to whom. First, the legal puzzle: to wit, was the transaction fraudulent under the law of New York? The answer was not obvious. Non-possessory security interests in personal property had historically been found to be fraudulent because they created an "ostensible ownership" problem. Physical possession of an asset was such a strong indication of ownership that creditors and other investors would assume the debtor owned an asset that was in fact owned by another. As a result, creditors were likely to lend in reliance on that asset, only to find later it could not be reached. As a corollary to that view, a number of courts had also held a conveyance was fraudulent if the debtor reserved the right to sell the collateral for his or her own benefit.[31] Neither rule, however, had been applied to book accounts.[32] Brandeis, nonetheless, reached out to find a fraud.

The route he followed was somewhat involved. In 1925, New York personal property lien law was in disarray. Until recently, the above-mentioned doctrine of ostensible ownership governed the area of inventory financing and invalidated floating liens on inventory.[33] That case law, however, appears to have been overruled, at least in part, in 1911 when New York enacted the so-called Factors Lien Act,[34] which permitted the perfection of a lien on after-acquired inventory (and proceeds of inventory) and allowed the debtor to sell the property for its own benefit as long as a filing was made and notice of the lien was given by posting a sign at the debtor's place of business.[35] This statute did not directly control the *Benedict* case,[36] and the statute had not, in any event, been complied with. The second area of difficulty was that the doctrine of ostensible ownership did not apply comfortably to accounts. Accounts have no physical existence and no one possesses them. Therefore, no inference of ownership arises from possession.[37] Third, to the extent New York case law existed, it was case law relating to assignment of choses in action and intangible property. Courts had

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[31] *See, e.g.*, Zartman v. First Nat'l Bank, 82 N.E. 127 (N.Y. 1907).

[32] *See Benedict*, 268 U.S. at 362. *See also infra* note 38.

[33] *See id.*

[34] N.Y. PERS. PROP. LAW § 45 (1911); 1911 N.Y. Laws c. 626.

[35] *See id.*

[36] New York's Factors Lien Act covered inventory and accounts as *proceeds* of inventory, but it was not clear whether it covered accounts alone.

[37] A similar problem might arise if the accounts were listed on the books, but not Ratner's ownership interest. That, however, was not the issue in this case and clearly would have been found to be fraudulent.

not, to that point, applied the doctrine of ostensible ownership to such assignments.[38] Indeed, the one case decided by a New York state court went precisely in the opposite direction, upholding an arrangement virtually identical to that at issue in *Benedict*.[39] That decision had been followed by

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[38] *See* Brown v. Leo, 12 F.2d 350, 351 (2d Cir. 1926). Learned Hand noted

> It has been the law of New York since 1837, at least, that a chattel mortgage, under which the mortgagor not only remains in possession, but is authorized to sell the goods and use the proceeds on his own behalf is a fraud on creditors . . . . We had held [that doctrine] a part only of the general doctrine of reputed or ostensible ownership, and therefore inapplicable to intangibles. But the court [in *Benedict v. Ratner*] said no . . . .

Id. *See also* Grant Gilmore, *The Good Faith Purchase Idea and the Uniform Commercial Code: Confessions of a Repentant Draftsman*, 15 GA. L. REV. 605, 622 (1981) (arguing Brandeis should have looked at assignment cases instead of inventory cases) [hereinafter *Repentant Draftsman*].

[39] *See* Stackhouse v. Holden, 73 N.Y.S. 203 (App. Div. 1901). In *Stackhouse*, the debtors assigned their accounts to secure an overdraft at their bank. The plaintiff argued the assignment was invalid because "it tied up their property, while at the same time it gave them absolute dominion over it, thereby creating a secret lien, and therefore a fraud upon creditors." *Id.* at 205. The court dismissed the fraud argument saying

> The result of the exercise of dominion over the assigned accounts by Humphrey & Holdridge and the mingling of the moneys derived therefrom with that received in trade, so far as creditors are concerned, is the same as if the identity of the money which came to their hands from the assigned accounts had been preserved. If the latter method had been pursued, – the proceeds of the accounts would have been paid into the bank, and the credit set off against the overdraft, – the money borrowed at the bank by means of the overdraft would have been separately used in their business, new customers' accounts would have been made, and these in return assigned, and the process repeated to the end. In that case the identity of the money received from the accounts and the business would have been preserved, but the total amount would have been the same, whether kept separate or mingled together in one account.

Id. Significantly, a dissent that prefigured Brandeis's opinion stated

> The fraud which vitiates the transfer does not consist in the failure to deliver possession of the assigned accounts to the defendant, for choses in action are not the "goods and chattels" covered by the statutes condemning sales unaccompanied by delivery over of the property . . . . The vice here is that there was in fact no real transfer–no real vesting–of title in the assignee. It was an arrangement whereby the title and authority of Humphrey & Holdridge were to be unrestricted as long as they were able to shunt along their business, but, whenever the inevitable crash came, then by some sort of legerdemain the written assignment was to be stimulated into life to prefer the overdraft of the defendant.

Id. at 209 (Spring, J., dissenting).

New York federal courts in bankruptcy cases.[40] With the law in this state, the easier result would have clearly been to affirm the decisions of the lower courts and to side with Ratner.

Instead of taking the easy route, Brandeis made an intriguing, if controversial, move. He adopted the reasoning of the dissent in the one New York state case on point.[41] As noted above, a corollary to the doctrine of ostensible ownership, at least in inventory cases, was that an assignment that allowed the debtor to use the proceeds of the sale of collateral for his or her own benefit was void. This rule had been expressly *rejected* in assignment cases and had recently been overruled by statute in inventory cases by the Factors Lien Act, but Brandeis used it anyway. He focused on the link between dominion and title rather than on disclosure, saying the fraud rests

> not upon seeming ownership because of possession retained, but upon a lack of ownership because of dominion reserved. It does not raise a presumption of fraud. It imputes fraud conclusively because of the reservation of dominion inconsistent with the effective disposition of title and creation of a lien.[42]

This was a rule of broad application and not necessarily limited in scope to accounts receivable. According to Brandeis, any time the debtor retained the right to sell collateral for its own account, rather than delivering the proceeds directly to the secured creditor, the creditor was not "exercising dominion" and did not have title.[43] This would be true where the lien was unrecorded, unfiled, or secret, but it would also be true if notice was given, as under the New York inventory financing statute.

This peculiar focus on title presents the practical puzzle of *Benedict* squarely. Where is the fraud? If the fraud was that the lien was secret, then the "Rule of *Benedict v. Ratner*" does nothing to solve that problem. Brandeis

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[40] *See In re* Michigan Furniture Co., 249 F. 978, 980 (1918) (L. Hand, D.J.) ("[T]he rule based upon the possessor's power of disposal in New York arose as an application of the doctrine of reputed ownership of a stock in goods, and should be as much so confined as that doctrine in its other applications.").

[41] *See* Benedict v. Ratner, 268 U.S. 353, 365 (1925) (citing Stackhouse v. Holden, 73 N.Y.S. 203 (App. Div. 1901)). This argument had been made and rejected in *Stackhouse*. The Brandeis view was taken up instead by the dissent, where the dissenting judge argued "the vice here is that there was in fact no real transfer–no real vesting–of title in the assignee." *Stackhouse*, 73 N.Y.S. at 209 (Spring, J., dissenting).

[42] *Id.* at 363.

[43] *See Benedict*, 268 U.S. at 364-65.

and his colleagues were apparently willing to view the transaction as valid, even in the absence of a filing, so long as the creditor "exercised dominion" —that is to say so long as the account debtor and perhaps the debtor had an obligation to deliver the account debtor's payment directly to the assignee. Moreover, the absence of dominion would render the assignment invalid even if notice of the transaction was given. Curiously, the existence of "dominion" does not appear likely to affect the amount of cash available to the debtor. In either case, the creditor will determine how much to lend based on the shifting value of the collateral.[44] The lack of dominion hurts, if anyone, the secured creditor, who has given the debtor the power to liquidate his or her collateral at will. But Ratner would not seem to need protection here; he went into the transaction with open eyes. He trusted his son and was willing to proceed on the basis of monthly statements of account that assured him his debt was secured by a comfortable cushion of collateral.

What then was at stake? Brandeis did not take this opinion lightly. The *Benedict* file in the Brandeis papers at the Harvard Law School library contains multiple drafts of the opinion and demonstrates that Brandeis "devoted a great deal of time and thought to the case."[45] Why was Brandeis willing to torture the New York law of accounts receivable financing to reach this seemingly incongruous result? To answer this question, one needs to look not at the law of accounts receivable financing, but at Brandeis himself. Brandeis's decision in *Benedict v. Ratner* can and should be seen as an extension of Brandeis's progressive vision of American law. Only then is it possible to see what Brandeis was likely trying to do and what the drafters of Article 9 of the UCC have since missed.[46]

III. BRANDEIS THE PROGRESSIVE

Brandeis was a progressive, and, although this "commercial law" decision would not appear to be politically driven, the decision can best be understood as an expression of this ideology. A central focus of Brandeis's progressive vision was accountability in both the public and private spheres. Brandeis was probably a mugwump before such a term existed. As Allon Gal has noted,

> when [Brandeis] was ten years old . . . [h]e leveled against the treasurer of

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[44] The *Stackhouse* court made precisely this point. *See supra* note 39.

[45] GILMORE, *supra* note 9, at 258 n.2.

[46] Gilmore grew to appreciate the wisdom of *Benedict v. Ratner*. *See* GILMORE, *supra* note 9, at 257-71; *Repentant Draftsman*, *supra* note 38, at 623.

> a debating society to which he belonged the charge of inaccurate accounting: the amount involved was forty cents. Only after an explanatory interview given by the treasurer did [Brandeis] agree to drop the investigation.[47]

Throughout his career as the "People's Lawyer," a common theme was his demand that public officials and business people account accurately and publicly for their use of funds. In his battles with the New Haven Railroad, Brandeis fought tirelessly to force the Morgan interests to provide accurate disclosure of the state of the railroad's finances.[48] Not long before the decision in *Benedict*, Brandeis engaged in a brutal and angry battle with Chaim Weizmann over the accurate disclosure of the Zionist organization's use of funds.[49] Most important, however, Brandeis had a vision for the appropriate shape of American business law. And, just as he waged guerilla warfare for his view of the First Amendment,[50] he fought for his ideas about private law. *Benedict v. Ratner* can be viewed as a small piece of this larger Brandeisian agenda.

IV. DISCLOSURE AND ACCOUNTABILITY

A few vignettes illustrate the outlines of Brandeis's vision. Brandeis had a passion for facts. As he saw it, accurate disclosure of financial information by public and private actors was essential for citizens to exercise their franchise in an informed fashion and for shareholders to provide effective supervision to corporate managers. For example, early in his career as the "People's Lawyer," as he gathered information about the New Haven Railroad in connection with his efforts to force the divestiture of the Boston & Maine Railroad, Brandeis discovered the financial information made public by the New Haven Railroad to its investors was seriously inaccurate.[51] Brandeis wrote his brother Alfred: "I think, before we get through, the estimable gentlemen who scrambled for the chance of exchanging their B&M stock for New Haven will find that they have been served a gold brick."[52] When the New Haven Railroad's annual report came out, Brandeis went to work. His admiring early biographer, Alpheus T. Mason, wrote:

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[47] ALLON GAL, BRANDEIS OF BOSTON 22 (1980).

[48] *See* ALPHEUS THOMAS MASON, BRANDEIS: A FREE MAN'S LIFE 177-79 (1946).

[49] *See* Edward J. Janger & Michael Berkowitz, Brandeis, Zionism and Other People's Money 36 (1998) (unpublished manuscript) (on file with the *Brandeis Law Journal*).

[50] *See infra* text accompanying note 84.

[51] *See* MASON, *supra* note 48, at 182.

[52] *Id.*

> When [the report] appeared in the fall of 1907, he was very surprised. He knew the company's fixed charges had increased tremendously, yet the report failed to reveal this. The balance sheet listing contingent liabilities did not include certain items which he knew existed. What startled him most was the absence of a full statement of resources—a conspicuous departure from accounting practices.[53]

Indeed, Brandeis wrote the chairman of the Massachusetts Board of Railroad Commissioners:

> One might study the report filed with your board from end to end and never know that the New Haven held any interest in the Boston & Maine railroad stock, or in the Rhode Island Railway System, or in any of the Massachusetts Street Railways controlled by the New England Investment Security Company.[54]

The shortcomings in the New Haven's annual report led Brandeis to write a pamphlet:

> Brandeis's chief point . . . was that the New Haven's "change from financial strength to weakness has been accomplished in an extraordinarily short period of time; the published reports of the company have been so framed as not to disclose its real condition." For example, Brandeis could find no provision for maintenance. On the other hand, he found the ordinary expenditure of about ten million dollars for rolling stock, repairs, etc., charged not to operating expenses in the regular way but to profit and loss. If the amount had been charged in the conventional way, he pointed out, the New Haven would have fallen $1,171,550.82 short of paying its 8 per cent dividend.[55]

The battle went on for nine years, until James C. McReynolds, Woodrow Wilson's attorney general and later Brandeis's colleague on the Supreme Court, filed suit against the New Haven on behalf of the United States, and the railroad capitulated by divesting itself of the Boston & Maine Railroad.[56]

This demand for accurate disclosure also showed up in Brandeis's early police power opinions on the Court and might be described simply as a belief in truth-in-advertising. For example, in a 1916 decision concerning, of all

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[53] *Id.* at 182-83.
[54] *Id.* at 183.
[55] *Id.* at 185.
[56] *See id.* at 212.

things, ice cream,[57] Brandeis wrote the Court's opinion upholding Iowa and Pennsylvania statutes that said a frozen dessert could not be called "ice cream" unless it contained at least twelve percent butterfat.[58] He declared:

> The ice cream of commerce is not iced or frozen cream. It is a frozen confection–a compound. The ingredients of this compound may vary widely in character, in the number used and in the proportions in which they are used. These variations are dependent upon the ingenuity, skill and judgment of the maker, the relative cost at a particular time or at a particular place of the possible ingredients, and the requirements of the market in respect to taste or selling price. Thus, some Philadelphia Ice Cream is made of only cream, sugar and a vanilla flavor. In making other Philadelphia Ice Cream the whites of eggs are added; and according to some formulas Vanilla Ice Cream may be made without any cream or milk whatsoever; for instance by proper manipulation of the yolks of eggs, the whites of eggs, sugar, syrup and the vanilla bean. All of these different compounds are commonly sold as ice cream; and none of them is necessarily unwholesome.
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> The facts show that in the absence of legislative regulation the ordinary purchaser at retail does not and cannot know exactly what he is getting when he purchases ice cream. He presumably believes that cream or at least rich milk is among the important ingredients; and he may make his purchase with a knowledge that butter-fat is the principal food value in cream or milk. Laws designed to prevent persons from being misled in respect to the weight, measurement, quality or ingredients of an article of general consumption are a common exercise of the police power.[59]

Brandeis's demand for candor applied to government officials as well. During the Ballinger-Pinchot hearings, he took then-President Taft (like McReynolds, later a colleague on the Supreme Court) to task for presenting a post-dated report as the basis for his decision to fire an official in the Department of the Interior.[60] Just as with the New Haven Railroad and with

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[57] *See* Hutchinson Ice Cream Co. v. Iowa, 242 U.S. 153 (1916) (Brandeis, J.).

[58] *See id.* at 157-58.

[59] *Id.* at 158-59.

[60] MASON, *supra* note 48, at 254-82. Brandeis, during his investigation, asked Norman Hapwood:

> [W]hether Hapwood had noticed anything suspicious in the Wickersham "Summary and Report" to Taft, dated September 11, 1909, which the President later submitted as part of the record to support his firing of Glavis. . . . The problem concerned two dates—September 6 and September 11, 1909. Accepting the dates as stated, Wickersham would have had less than a week to study the record of the case, which

the Pennsylvania and Iowa laws regarding the butterfat content of ice cream, to Brandeis, if investors, consumers, and/or voters were likely to be deceived—were not likely to know the ingredients contained in the carton of ice cream—it was the appropriate role of the law to require complete and accurate disclosure.

V. THE EFFECT OF *BENEDICT V. RATNER*: RELATIONAL CONTRACTING AND THE SECURED CREDITOR'S BURDEN

Brandeis's progressive desire for complete and accurate disclosure provides the missing piece of the *Benedict v. Ratner* puzzle. Brandeis demanded Hub be required to account to Ratner.[61] Indeed, what Brandeis really said was Ratner would be *required* to compel Hub to account to him—otherwise he was not acting like an "owner" of the accounts. The rule in *Benedict* thus required Ratner to monitor Hub, even if he thought it was not necessary. Brandeis never explains why this was important. Only by viewing the opinion in light of its practical effect and Brandeis's broader "progressive" passion for financial accountability does the requirement of "dominion" make sense.

This account of *Benedict*, as part of Brandeis's progressive program, is perhaps easiest to understand when one looks at the effect the requirement of "dominion" actually had on the shape of accounts receivable financing in the post-*Benedict* period. At the time that *Benedict* was decided, accounts receivable financing was a rarity.[62] During the course of the next ten years, however, it became an important form of asset-based lending.[63] The decision that shaped the institution of accounts receivable financing was *Benedict*. Brandeis's decision was used as a road map for professional lenders, who developed various devices for "policing" their debtors to comply with Brandeis's requirement of "dominion."[64] The result was to cement a form of relational lending, where the lender actively monitored the affairs of its

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> was more than half a million words, and then write a well-documented opinion covering seventy-four closely printed pages. Brandeis knew only one man who could have done that job in that time, and his name was not Wickersham.

Id. at 261-62.

[61] *See* Benedict v. Ratner, 268 U.S. 353, 365 (1925).

[62] *See* BAIRD & JACKSON, *supra* note 8 at 57; GILMORE, *supra* note 9, at 250-53.

[63] *See* BAIRD & JACKSON, *supra* note 8, at 57.

[64] *See* GILMORE, *supra* note 9, at 260-61.

debtor.[65] As Grant Gilmore has explained, the result appears to have been that lenders secured by accounts receivable became aware of their debtor's difficulties much earlier.[66] The only way for creditors to protect themselves in this situation was to tighten the credit they extended to these debtors. As a secondary effect, other creditors would become aware of the debtor's difficulties as well. Therefore, the secured creditor monitoring would benefit even unsecured creditors by giving these other creditors notice of the debtor's difficulties before matters became hopeless.[67] Gilmore described the process well:

> [T]hus the *Benedict*-style assignee knew from day to day the state of his debtor's business health. He would recognize–or at all events be in a position to recognize–the symptoms of the last fatal plunge toward bankruptcy. At that point he might be expected, in his own self-interest, to intervene: if there still seemed to be hope, he might undertake a salvage operation in cooperation with other creditors; if all hope had vanished, he would call his loan, which in the usual case, would bring the debtor's operation to a halt. The assignee's self-interest in this context ran parallel with the interest of his debtor's other creditors. They benefitted from the fact that a professional with a substantial stake in the enterprise was acting as their policeman. It is reasonable to assume that in many cases shaky enterprises were preserved as a result of a timely intervention and that in many others the final disastrous ballooning of the unsecured debt just before

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[65] *See id.* Indeed, Brandeis may have been seeking to impose the pattern that had historically existed in textile factoring. As Gilmore notes, "[i]n textile factoring, the relationship between factor and borrower has always been close, and the control exercised by the factor over borrower's affairs considerable." *Id.* at 136.

[66] *See id.*

[67] As Gilmore noted,

> It is clear that a lender who scrupulously adhered to these *Benedict*-inspired practices –as all the professionals did–could not help but keep close watch over his debtor's affairs; the term that came into common use to describe the assignee's unremitting supervision of the assignor's enterprise was "policing." All the receivables passed through his hands. The amount of the loan was adjusted at frequent intervals. Furthermore, the loan agreement always gave the assignee the right to examine the assignor's books. In a large operation the assignee might put his own man in the assignor's office to maintain a continuous supervision; even if he did not do that, any suspicious fluctuation in the amount of receivables assigned would be the occasion for the assignee's men to make a check of the books.
>
> . . . We may conclude that the *Benedict* rule produced some exceedingly good results in forcing non-notification receivables financing into a desirable pattern.

Id. at 260-61.

bankruptcy was prevented by the assignee's cutting off the source of essential working capital.[68]

Gilmore has speculated that this creditor monitoring may have increased the stability of these businesses as they worked their way through the Depression.[69]

Thus, by requiring creditor monitoring, Brandeis, in effect, turned the institution of secured credit into a disclosure device. The creditor had to monitor, the debtor had to disclose, and all of the creditors benefitted. It is here that Brandeis's rule shows both remarkable prescience and underappreciated wisdom.

A number of modern law and economics scholars have recognized secured credit can create monitoring efficiencies.[70] Unsecured creditors face a collective action problem, i.e., no individual creditor has sufficient incentive to engage in anything but the most cursory monitoring of the debtor. Because of the collective action problem, no real monitoring occurs. Secured credit solves this problem to some extent. By identifying particular assets as collateral, creditors can divide the monitoring effort and focus their efforts on the one type of asset they are good at monitoring.[71] Dean Robert Scott has argued this type of monitoring is particularly helpful where accounts receivable and inventory financing are involved because (1) both provide, in effect, a snapshot of the debtor's cash flow, and it is the cash flow that provides payment to unsecured creditors[72] and (2) the relational guaranty allows the creditor to control the debtor's business decisions for the benefit of all creditors.[73]

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[68] *Id.* at 261.

[69] *See id.* While Gilmore appears to have recognized some of the merit in the *Benedict* rule, he also supported its repeal, arguing it was unworkable. *See id.* at 257-71.

[70] *See* Thomas H. Jackson & Anthony T. Kronman, *Secured Financing and Priorities Among Creditors*, 88 YALE L.J. 1143 (1979); Saul Levmore, *Monitors and Freeriders in Commercial and Corporate Settings*, 92 YALE L.J. 49 (1982); Robert E. Scott, *A Relational Theory of Secured Financing*, 86 COLUM. L. REV. 901, 933 (1986).

[71] *See* Jackson & Kronman, *supra* note 70; Levmore, *supra* note 70.

[72] *See* Scott, *supra* note 70, at 933. According to Scott, "the global monitoring required of the relational creditor releases other creditors from the focused monitoring tasks that they would undertake in the absence of a relational creditor. The resulting cost savings thus provides additional economies that are unlikely to be achieved where such security arrangements are not permitted." *Id.*

[73] *See id.* at 904. Scott points out:

> The leverage obtained by holding the debtor's assets hostage empowers the secured

Brandeis appears to have recognized the relational effect of accounts receivable financing. Indeed, his understanding may have been more sophisticated than even that of these modern law and economics scholars. The problem with the so-called "monitoring" justification for secured credit is the secured creditor will only monitor the debtor to make sure his or her *own* debt is not endangered.[74] *Benedict* is a case in point. At no point prior to Hub's bankruptcy did Ratner's collateral coverage ratio dip below three to one.[75] A secured creditor will have very little incentive to monitor when he is confident the value of the collateral exceeds the value of his claim. As it happened, Ratner appears to have intervened only once Hub's fate was sealed.[76] This is where Brandeis's rule differs from current practice under the UCC.[77] Brandeis's requirement of dominion forces even the oversecured creditor to monitor. Under Brandeis's approach, monitoring is simply part of the secured creditor's burden. Brandeis said, without "exercising dominion" over the collateral, the creditor was not acting like an "owner."[78] To put it another way, monitoring the collateral was part of the price the creditor paid for the right to receive an increased distribution if the business failed.

Now, let's return to Brandeis's progressivism. It is well known Brandeis's ideas formed the basis for what we now know as modern securities law. Indeed, Bruce Murphy has suggested that Brandeis, through Frankfurter, may have played a role in the drafting of these laws, even while he was on the bench.[79] The Securities Act of 1933 embodies Brandeis's vision of public disclosure of financial information.[80] To make securities markets work, the 1933 Act requires publicly traded companies to disclose material financial information so that investors can make informed decisions whether to invest in corporate securities. In 1925, however, the '33 Act was still years away

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> creditor to influence the debtor's business decisions, thus ensuring that new projects are properly developed. Most significantly, this relationship induces the creditor to provide valuable financial coordination and control, with resulting benefits accruing to all participants in the venture.

Id.

[74] *See* LoPucki, *supra* note 10, at 1890; Shupack, *supra* note 10, at 1074-75.

[75] *See* Benedict v. Ratner, 268 U.S. 353, 359-60 (1925).

[76] *See id.*

[77] *See* U.C.C. § 9-205.

[78] *See id.*

[79] *See* MURPHY, *supra* note 6, at 131-38.

[80] *See, e.g.*, Securities Act of 1933 § 12, 15 U.S.C. § 77*l* (1994); Securities Exchange Act of 1934 § 10, 15 U.S.C. § 78j (1994). *Cf.* Rule 10b-5 of the Securities and Exchange Act of 1934, 17 C.F.R. § 240.10b-5 (1998).

(and it would not have applied to privately held companies like Hub anyway). From this perspective, *Benedict* is one small piece in a larger puzzle. Brandeis was merely practicing the techniques he learned as the "People's Lawyer"—taking one small doctrinal step at a time. Harry Kalven described Brandeis's method in the First Amendment context.[81] Brandeis had a vision. First, he found support on the Court for his vision by selling his ideas to Holmes.[82] They fought for that vision, piece by piece, in case after case:

> The stamina and tactics of these classic dissents are remarkable. In professional lawyering terms, the performance of Justices Holmes and Brandeis is outrageous. . . . Like Twin Moses come down from Mount Sinai bearing the true Commandment, they see little need to argue that the [clear and present danger] formula is rightly derived from the First Amendment, merely that it is.[83]

Similarly, *Benedict v. Ratner* can be viewed as part of Brandeis's broader "commercial" or "business" agenda. Brandeis appears to have been shaping commercial law to his progressive vision.

Thus, as a matter of legal reasoning, Brandeis probably stretched the precedents of New York State to find a fraudulent conveyance. As a matter of history, the rule of *Benedict v. Ratner* has been universally rejected. It became the subject matter of repealer statutes during the 1940s,[84] and it was ultimately repealed in all 50 states by the adoption of the UCC. As Gilmore notes,

> [n]o one can doubt that [UCC §9-205] does the job. *Twyne's* case is finally undone. Benedict is dead and Ratner is king. "Dominion" by the debtor is no longer "inconsistent" with the nature of security. So far as "the law" is concerned, the term loan without policing may replace the well-policed revolving credit. The repealer covers all types of collateral–chattels and intangibles alike. The long divorcement between financing on the security of fixed assets and financing on the security of a changing mass of inventory or receivables need no longer endure: everything, past, present, and future, tangible and intangible, can be swept up into one big security interest under one big security agreement.[85]

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[81] *See* KALVEN, *supra* note 3, at 158.

[82] *See id.* Brandeis and Holmes share parentage of the "clear and present danger" approach to the First Amendment. *See id.*

[83] *Id.*

[84] *See* GILMORE, *supra* note 9, at 354-59.

[85] *Id.* at 358-59.

Indeed, the Revision to Article 9 of the UCC recently approved by the American Law Institute and National Conference of Commissioners of Uniform State Laws carries the abandonment of *Benedict v. Ratner* to another level, self-consciously seeking to reduce the secured creditor's burden, both in perfecting and maintaining effective security interests in virtually all forms of collateral.[86] History, however, may be slowly moving towards recognizing Brandeis's contribution in *Benedict*. A number of scholars have posed the question whether secured credit is "efficient" or whether it merely allows debtors and their secured creditors to place an undue portion of the risk of business failure on non-consensual or non-adjusting creditors.[87] In this light, Brandeis appears to have captured something that many modern scholars, legislators, and judges continue to miss. There is nothing so radical in saying that the secured lender, as a price of its preferred position, *must* monitor. At least some of the benefit of this monitoring will redound to other creditors.

VI. BRANDEIS THE PROPHET

Thus, far from being an idiosyncratic case, *Benedict v. Ratner* can be viewed as an outgrowth of Brandeis's progressive views about business law. Moreover, his policy judgments, while currently in disfavor, may have been based on a subtle understanding of the role that a secured creditor could play in protecting the interests of other creditors. Although the rule in *Benedict v. Ratner* has not been revived, concern about the costs of secured credit has returned to the scholarly agenda and to policy debates. A time may very well come when Brandeis's opinion in *Benedict* will indeed be appreciated as prophetic.

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[86] *See* Steven L. Harris & Charles W. Mooney, Jr., *A Property-Based Theory of Security Interests: Taking Debtors' Choices Seriously*, 80 VA. L. REV. 2021 (1994).

[87] *See* Lucian Arye Bebchuk & Jesse M. Fried, *The Uneasy Case for the Priority of Secured Claims in Bankruptcy*, 105 YALE L.J. 857, 896-98 (1996); LoPucki, *supra* note 10, at 1890.