NOTE

RETURN ON POLITICAL INVESTMENT: THE PUZZLE OF EX ANTE INVESTMENT IN ARTICLES 3 AND 4 OF THE U.C.C.

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[*] J.D. May 2006, University of Virginia School of Law. I would like to thank my parents, John and Mary Termini, and sister, Angela, for taking an unmitigated interest in my legal studies. I also thank Dean Robert Scott, Professor George Triantis, my peers on the Virginia Law Review, and the students of the 2004–05 Business Transactions and the Scholarly Process seminar. This Note would not have been possible without their support and assistance. All errors are mine.

INTRODUCTION

The influence of interest group lobbying activities on federal, state, and local law is well known. Polls reveal that most Americans believe the government is run not for the public good, but for special interests.[1] But contrary to the popular public sentiment, some economists and political scientists have argued that interest group political investment is a necessary lubricant to the information transmission process fundamental to the U.S. governmental system.[2] Without the facts reflected by interest groups, legislators may possess inadequate or miscalculated information regarding specialized political issues in which only a few societal institutions take interest.

Despite the value of interest group lobbying, there exists in the United States a shared sentiment among public choice theorists

[1] Fred S. McChesney, Money for Nothing 1 (1997).
[2] See infra notes 45–47 and accompanying text.

that interest group influence on the political process is fundamentally at odds with the principle of one man, one vote.[3] Consumers and small businesses are frequently identified as the victims of this process, as they possess fewer resources and weak political clout. The belief of consumer exploitation particularly thrives in the context of Articles 3 and 4 of the Uniform Commercial Code ("U.C.C."), the uniform, state-enacted bodies of law that govern negotiable instruments and check collection, respectively.[4] Large banking institutions and industry groups invested heavily in efforts to dictate the substance and uniform passage of these two Articles. Though academic criticism of the U.C.C. lawmaking process dates to its original promulgation in the 1940s,[5] only recently have scholars examined how interest group influence adversely affected the *substance* of the U.C.C.[6] In doing so, the legal academy has drawn primarily on principles of law and economics to criticize Articles 3 and 4 as economically inefficient. The bank-friendly provisions, it is argued, merely redistribute the bargaining surplus from consumers to commercial banks, imposing a permanent cost upon consumers.[7]

[3] The criticism against interest groups can be traced back to James Madison, who argued in *The Federalist Papers* that "factions" were inherently bad as working against the community as a whole. The Federalist No. 10 (James Madison). Madison used this very concept to support the constitutional premise of checks and balances among the government branches. The Federalist No. 51 (James Madison).

[4] See, e.g., Frederick K. Beutel, The Proposed Uniform [?] Commercial Code Should Not Be Adopted, 61 Yale L.J. 334 (1952); Grant Gilmore, The Uniform Commercial Code: A Reply to Professor Beutel, 61 Yale L.J. 364 (1952); see also Robert D. Cooter & Edward L. Rubin, A Theory of Loss Allocation for Consumer Payments, 66 Tex. L. Rev. 63 (1987); Homer Kripke, The Principles Underlying the Drafting of the Uniform Commercial Code, 1962 U. Ill. L.F. 321; Edward Rubin, Efficiency, Equity and the Proposed Revision of Articles 3 and 4, 42 Ala. L. Rev. 551 (1991) [hereinafter Rubin 1991]; Edward L. Rubin, Policies and Issues in the Proposed Revision of Articles 3 and 4 of the UCC, 43 Bus. Law. 621 (1988) [hereinafter Rubin 1988]; Edward L. Rubin, Thinking Like a Lawyer, Acting Like a Lobbyist: Some Notes on the Process of Revising UCC Articles 3 and 4, 26 Loy. L.A. L. Rev. 743 (1993) [hereinafter Rubin 1993]; Norman I. Silber, Substance Abuse at UCC Drafting Sessions, 75 Wash. U. L.Q. 225 (1997).

[5] See, e.g., Beutel, supra note 4; Gilmore, supra note 4; Kripke, supra note 4.

[6] See, e.g., Cooter & Rubin, supra note 4; Larry E. Ribstein & Bruce H. Kobayashi, An Economic Analysis of Uniform State Laws, 25 J. Legal Stud. 131 (1996); Alan Schwartz & Robert E. Scott, The Political Economy of Private Legislatures, 143 U. Pa. L. Rev. 595 (1995); Robert E. Scott, The Politics of Article 9, 80 Va. L. Rev. 1783 (1994); see also Clayton P. Gillette, Politics and Revision: A Comment on Scott, 80 Va. L. Rev. 1853 (1994).

[7] See, e.g., Cooter & Rubin, supra note 4; Ribstein & Kobayashi, supra note 6.

A puzzle emerges, however, when one considers the fact that the rules of Articles 3 and 4 are merely default in nature. In short, parties are free to bargain around the non-mandatory rules, underscoring a major loophole through which consumers or market competitors could potentially contract for efficiency, and thereby regain the surplus allegedly usurped by banking interests. As Professor George Triantis has noted, there is seemingly little reason to believe that firms could capture a permanent return from their lobbying activities. Microeconomic theory, coupled with the unmitigated right to contract, suggests the ultimate terms of Articles 3 and 4 will achieve general equilibrium—that is, socially optimal provisions are inevitable. This puzzle is both specific to the U.C.C. and general to any context in which firms politically invest in mere default law with weak durability. Furthermore, this observation places serious doubt on the issue of whether commercial banking interest groups are even able to capture a permanent positive return from their lobbying investment. Short of market failure, the right to contract should produce ex post efficiency.

Surprisingly, there is limited scholarship on whether interest groups can harness a positive return from their political investment in Articles 3 and 4 of the U.C.C. Rather, most literature simply assumes that commercial banks are able to do so. But the implications of a finding that banking interests cannot realize a permanent return from lobbying for the content of the Code are significant. If they are not in fact able to do so, the academic criticism regarding Articles 3 and 4 is misplaced, and the marketplace may in fact feature a legal regime governing payments systems far more socially optimal than the default rules provided by the U.C.C. However, if commercial banks can, in fact, capture a positive return from their political investment, the question evolves into just how this is accomplished in light of the default nature of the governing Articles. Furthermore, what exactly *are* the returns from political investment that the commercial banking interests capture?

This Note is the first attempt to answer these puzzling, yet unanswered questions. In doing so, it will rely on the robust findings in behavioral psychology that, contrary to the central assumption of rational-choice economics, individuals do not always act fully rationally in the decision-making process.[8] Rather, they rely on heuristics and succumb to biases to simplify complex decisions. The discussion that follows will center on the notion that consumers are boundedly rational when asked to understand and interpret their commercial banking agreements. Bounded rationality should be properly understood as more than simply the failure of consumers to possess adequate information to understand their banking agreements. The mere inability to access information because of transaction costs can be easily reconciled with rational-choice theory economics. Bounded rationality, on the other hand, cannot, and represents a cognitive limitation that disables consumers from fully incorporating all known and relevant information into their purchasing decisions.

The implications of drawing this line between public-choice theory and behavioral economics help explain why interest groups care enough to lobby for rules that consumers can easily contract around: private interest groups can still profit from investment in non-mandatory default rules because consumers suffer from the cognitive shortcoming of bounded rationality. The premise is broad, though the specific application here relates directly to Articles 3 and 4 of the U.C.C. It is likely that this explanation extends to any legal regime in which private interests invest in default rules. As this Note will demonstrate, neither marketplace competition nor consumer education will resolve the problem of consumers' bounded rationality, and critics of interest group influence on Articles 3 and 4 can now lean on the additional explanations provided by behavioral economics in their assault on the redistributive and exploitative terms found in the U.C.C.

[8] The literature regarding behavioral economics and the law is vast, as both legal scholars and behavioral psychologists have examined the behavioral shortcomings that undermine the rational-choice assumption in law and economics. See, e.g., Behavioral Law and Economics (Cass R. Sunstein ed., 2000); Christine Jolls et al., A Behavioral Approach to Law and Economics, 50 Stan. L. Rev. 1471 (1998); Russell Korobkin, The Status Quo Bias and Contract Default Rules, 83 Cornell L. Rev. 608 (1998); Jeffrey J. Rachlinski, A Positive Psychological Theory of Judging in Hindsight, 65 U. Chi. L. Rev. 571 (1998); Thomas S. Ulen, The Growing Pains of Behavioral Law and Economics, 51 Vand. L. Rev. 1747 (1998); Jennifer Arlen, Comment: The Future of Behavioral Economic Analysis of Law, 51 Vand. L. Rev. 1765 (1998). But see Richard A. Posner, Rational Choice, Behavioral Economics, and the Law, 50 Stan. L. Rev. 1551 (1998) (defending the rational-choice model against the findings of behavioral psychology).

Part I will examine the distinction between public legislatures and private legislatures, and will recount the current public choice theory literature that criticizes the U.C.C. as socially suboptimal. This Part will also examine several provisions within Articles 3 and 4 to illustrate their alleged inefficiency.

Part II will identify the circumstances under which a firm will choose to commit resources to political investment. This Part will then introduce the four stages of inquiry a firm will enter before choosing to invest politically. These questions, which this Note terms the Political Investment Threshold Inquiries ("PITI"), require the interest group to understand the nature of the proposal, the probability of passage without further influence, the degree of information possessed by the legislature, and the likelihood of reaping a positive Return on Political Investment ("ROPI"). Section II.B will deconstruct ROPI and assert that a firm will likely capture a positive ROPI when the following conditions exist: (1) few or no competing interests, (2) little or no disclosure of proprietary information, (3) low coalition costs, and (4) strong durability of the resulting law. In applying these factors to the context of the U.C.C., Section II.C will posit that a priori, there is little reason to believe the ex ante inefficient terms in Articles 3 and 4 will have any ex post legal durability. More important is the conclusion that lack of durability implies a probable negative ROPI, which conflicts with both conventional criticism of interest group influence on the U.C.C., as well as empirical evidence that such activity occurs.

Part III will attempt to resolve this puzzle of legal durability. After briefly describing the nature of default rules, this Part will examine why the commercial banking marketplace should reach general equilibrium of contract terms, notwithstanding inefficient default provisions. It will then explore the predominant source of market failure likely to affect the banking industry: asymmetric information. Part III will observe that because the terms of Articles 3 and 4 are complex and contemplate risks uncommon to the marginal commercial banking customer, consumers as a class are incapable of integrating the appropriate information to bargain for an efficient contract. Section III.D will suggest that the default rules function as quasi-mandatory rules. This analysis is unique in its marriage of behavioral economics with public choice theory—an application yet to be identified in the academy. It also supports the notion that banking interest groups can harness a positive ROPI, and lends credence to the conventional public choice theory criticism of Articles 3 and 4 on grounds of economic inefficiency.

Part IV will identify the substantive returns that banking interest groups seek to harness through political investment in default rules. First, firms hope to realize favorable terms that consumers will not bargain around. Second, banking firms hope to gain additional market power by fixing non-price terms. Third, by clarifying the law, firms hope to restrain judicial interpretation adverse to their economic interests. Finally, banks politically invest simply to prevent the legislation of consumer-friendly federal law.

I. INTEREST GROUP INFLUENCE ON ARTICLES 3 AND 4

A. Private Legislatures and Criticism of Interest Group Influence

The discussion—particularly as it relates to Articles 3 and 4 of the U.C.C.—must begin with an understanding of a *private* legislature relative to a *public* legislature. Contrary to most federal and state statutory law, the U.C.C. is not promulgated by publicly elected legislators who conduct their own research and hearings to arrive at socially optimal law. Rather, two private lawmaking bodies, the American Law Institute ("ALI") and the National Conference of Commissioners on Uniform State Laws ("NCCUSL") are responsible for the substance of the U.C.C. Although the memberships of both groups consist of lawyers, judges, and academics, the ALI is primarily responsible for producing restatements of the law, while the NCCUSL is responsible for creating uniform law statutes that it then recommends to state legislatures. The two groups jointly create and revise the U.C.C.

With this framework, it is now possible to define the term "interest group" in the U.C.C. context. Consensus among political scientists and economists regarding the precise definition of a special interest group is fleeting.[9] However, the distinct character of the U.C.C. as a product of private legislation permits a degree of clarity in arriving at a working definition. The predominant "influence" on the U.C.C. is intrinsic to the composition of the ALI and

[9] Gene M. Grossman & Elhanan Helpman, Special Interest Politics 1 (2001).

NCCUSL, and begins with its members. Private lawyers and general counsel for the largest financial institutions and industry groups—the principal members of the ALI and NCCUSL—played an integral part in both the substance and style of the U.C.C.[10] Thus, contrary to the notion of special interest groups as an *exogenous* influence upon the lawmaking process, Articles 3 and 4 of the U.C.C. were drafted largely under the *endogenous* influence of bank attorneys, corporate attorneys, private firm attorneys representing banking corporations, and banking trade associations such as the American Bankers Association.[11] The "interest group influence" under the instant microscope is therefore somewhat unconventional, but the following analysis nevertheless identifies these endogenous interest groups as primarily responsible for influencing the substance of Articles 3 and 4.

The reasons for employing a private, rather than public, legislature to promulgate law are threefold. First, private legislators may possess significant expertise and experience in the regulated subject matter.[12] Second, private legislators arguably possess a narrow mandate to address "technical issues that legal expertise can resolve, not matters whose resolution requires controversial value choices or would be aided by social science or philosophical skills."[13] Finally, and most importantly for the purposes of this Note, is the belief that private legislature deliberations are apoliti-

[10] Schwartz & Scott, supra note 6, at 602 ("Academics commonly are reporters for these [NCCUSL] committees, but 'real lawyers' are in charge; that is, the lawyer commissioners and reporters have the final say concerning the content of any proposal . . . .").

[11] Rubin 1993, supra note 4, at 747–48.

[12] See Kathleen Patchel, Interest Group Politics, Federalism, and the Uniform Laws Process: Some Lessons from the Uniform Commercial Code, 78 Minn. L. Rev. 83, 92 (1993) ("Uniform laws are the product of a neutral group of experts, whose solutions will represent the 'best' way in which to regulate the particular subject matter involved, rather than the product of political compromise."); Schwartz & Scott, supra note 6, at 597 (ascribing the lack of academic attention to the ALI and NCCUSL to the perception that the two institutions are "thought to be [composed of] disinterested legal experts who pursue only the public good"); see also George G. Triantis, Private Law-making and the Uniform Commercial Code, *in* 3 The New Palgrave Dictionary of Economics and the Law 117, 118 (Peter Newman ed., 1998) (attributing state legislative deference to the U.C.C. to the "recognized experience of the sponsoring organizations").

[13] Schwartz & Scott, supra note 6, at 603.

cal and not vulnerable to special interest group influence.[14] As Professor Patchel notes, "[u]niform laws obtain their legitimacy, not from the political accountability of those promulgating them, but from the supposed neutrality and expertise of these individuals."[15] These justifications have afforded private legislatures, such as the ALI and NCCUSL, significant deference from state legislatures and the courts.[16]

These traditional arguments in support of private legislature deference may in fact be insufficient. While the second justification has been questioned to some extent,[17] the latter justification has generated the most criticism from the legal academy, particularly in the context of the U.C.C.[18] Since the original promulgation of Articles 3 and 4, scholars have criticized the resulting product as pro-bank and anti-consumer.[19] Fundamental to this Note's premise is an understanding that financial institutions, banking industry groups, and the lawyers that represent them in fact played an ac-

[14] Id. at 597. See also Walter P. Armstrong, Jr., A Century of Service: A Centennial History of the National Conference of Commissioners on Uniform State Laws 113 (1991) (quoting former NCCUSL President George C. Keely, who stated that the NCCUSL is unique because of its independence and absence of self-interest and most political pressures); Triantis, supra note 12, at 118 ("The Code has received a very high degree of deference from state legislatures and courts, due at least in part to the recognized experience of the sponsoring organizations and the immunity they are believed to enjoy from the interest group politics that affects legislatures."); Patchel, supra note 12, at 92 ("Conference supporters have pointed to this lack of political accountability as one of the Conference's best features. Their theory is that the lack of accountability insulates the laws the Conference promulgates from political pressure.").

[15] Patchel, supra note 12, at 92–93.

[16] Triantis, supra note 12, at 118.

[17] See, e.g., Schwartz & Scott, supra note 6, at 604 ("These institutions do venture into areas where values conflict and traditional legal expertise is insufficient to generate effective solutions to the problems at hand.").

[18] See supra note 4.

[19] In response to banking interest influence at the original drafting of Article 4, Professor Beutel dismissed the new Article as an unfair piece of class legislation tailored specifically for pressure groups favoring the banks over consumers. Beutel, supra note 4, at 362–63. Professor Gilmore, an influential defender of the Code, agreed with Professor Beutel regarding Article 4, stating that it had made too many concessions to special interest groups. Gilmore, supra note 4, at 377. In a private letter, Professor Gilmore confessed that the bank industry's involvement in drafting Article 4 was like "appointing a committee of dogs to draw up a protective ordinance for cats . . . ." Donald J. Rapson, Book Review, 41 Bus. Law. 675, 677 (1986) (reviewing Fred H. Miller and Alvin C. Harrell, The Law of Modern Payment Systems and Notes (1985)).

tive role in the promulgation and revision of Articles 3 and 4. The empirical evidence of interest group influence recounted in the literature satisfies a necessary precondition for the remainder of this Note, answering the threshold question of whether interest groups politically invest in the commercial law that governs their transactions. In light of the evidence that firms do, the next question concerns the *effects* of such influence. After all, while it may in fact be the case that banking interests shape the legal content of Articles 3 and 4, it does not necessarily follow that this influence adversely affects consumers.[20] The following Section examines several provisions of Articles 3 and 4 that illustrate the economically inefficient rules favoring financial institutions at the expense of consumers.

B. Interest Group Influence: Illustrating Economic Inefficiency

1. Economic Efficiency as the Proper Barometer

Most scholars who have criticized the process by which Articles 3 and 4 were created and revised have done so on the grounds that the resulting substantive law does not provide economically efficient terms to banking contracts.[21] Of course, this criticism presupposes that the drafters of Articles 3 and 4 recognized the need for economically efficient terms during the promulgation of the law. A significant amount of evidence refutes this presupposition—it is possible, if not probable, that the lawyers drafting Articles 3 and 4 did not even contemplate the efficiency of the resulting provisions.[22] The original purpose of the U.C.C. was not to promote

[20] For a defense of the U.C.C. revision process and the influence of private interest groups thereon, see Fred H. Miller, The Future of Uniform State Legislation in the Private Law Area, 79 Minn. L. Rev. 861 (1995); A. Brooke Overby, Modeling UCC Drafting, 29 Loy. L.A. L. Rev. 645 (1996); Carlyle C. Ring, Jr., The UCC Process—Consensus and Balance, 28 Loy. L.A. L. Rev. 287 (1994).

[21] See, e.g., Cooter & Rubin, supra note 4, at 66 (developing an analytic framework for loss allocation in the payment system based predominantly on economic efficiency, and using that framework to offer rules for changes in current provision of legislation governing commercial payment systems); Patchel, supra note 12, at 117–18 (criticizing the revised definition of "ordinary care" as economically inefficient). "Economic efficiency," in the context of payment systems, may be achieved by minimizing the net costs of payment systems transactions. Rubin 1991, supra note 4, at 561.

[22] Professor Rubin notes that from his own experience with the revision of Articles 3 and 4, "the committee members [responsible for the revision] were impervious to law

economically efficient transactions, but rather to facilitate economic activity.[23] To do this, the Code had to reflect actual business practice, which may very well conflict with the law and economics emphasis on efficiency. Customary business practices may or may not be efficient.[24] More explicitly, the drafters advocated a law that favored continuity, flexibility, and clarity—not efficiency. In her response to critics of the U.C.C., Professor Overby states:

> To claim . . . that [U.C.C.] rules and standards ought to be efficient or pro-consumer, and to fault the NCCUSL and ALI should the Code come up short in that regard, relies upon a mistaken assumption that agreement exists among Code practitioners and scholars on the proper substantive goals of the revisions.[25]

She concludes that calls for reform to promote efficiency in payment system transactions are without merit, particularly when viewed in the context of the history of the U.C.C.[26]

Critics of Articles 3 and 4 at least recognize the absence of economic efficiency as a guiding policy of the Code.[27] In this light, the criticism directed at Articles 3 and 4 represents a normative claim in favor of a new *policy* governing future revisions.[28] The question

and economics . . . law and economics analysis was greeted by most of the committee members with complete incomprehension." Rubin 1993, supra note 4, at 768.

[23] William Twining, Karl Llewellyn and the Realist Movement 307 (1973); Patchel, supra note 12, at 99 ("The primary purpose of a commercial code was to facilitate economic activity, and, in order to do this, that code should reflect actual practice.").

[24] Jody S. Kraus, Legal Design and the Evolution of Commercial Norms, 26 J. Legal Stud. 377, 377–78 (1997).

[25] Overby, supra note 20, at 647–48; see also Ring, supra note 20, at 303 (noting that the policy underlying the U.C.C. revision process is to promote steady improvements, not "ideal drafts").

[26] Overby, supra note 20, at 649–50.

[27] See Rubin 1988, supra note 4, at 629 ("Article 4 . . . has often been treated as embodying a policy of simple favoritism towards banks. More charitably, however, it can be seen as part of the general legal realist desire to adopt rules that codify the practices of the business community to which the rules apply.").

[28] Id. ("If one were to wipe the slate clear and begin again, one would presumably need to decide whether the purpose of [Articles 3 and 4] was to achieve economic efficiency, social equality, legal stability, or some other general goal."); see also Ribstein & Kobayashi, supra note 6, at 133 (1996) ("[T]he NCCUSL should at least significantly retrench its operations and focus its efforts on the relatively few areas in which uniform state laws are welfare-increasing."); Rubin 1991, supra note 4, at 552 (criticizing the newly revised Articles 3 and 4 as failing to adopt policies of economic effi-

thus boils down to whether economic efficiency is the appropriate policy that drafters should honor when revising the U.C.C. in the future. In their article examining how Articles 3 and 4 should look if cost-minimization were the driving principle, Professors Cooter and Rubin attempt to answer this question in the affirmative.[29] Although they acknowledge that economics as a central policy governing legal substance may not be a universally held sentiment, they conclude that "economic analysis intuitively seems to be an appropriate and promising place to start" for monetary regulation.[30] Additionally, they suggest that "applying economic analysis to loss allocation in the payment system leads to a set of recommended rules that are fairly close to legislation championed by consumer interests," which allays the risk that most opponents of economics-based policy assert: that purely economic considerations ignore concerns of social equity.[31] Thus, in the context of Articles 3 and 4, economic efficiency and social equity dovetail, suggesting the former is an appropriate policy on which to normatively critique the current legislation. It is on this framework that the examples in the following section rest.

More importantly, however, it is upon this assumption that the conventional criticism of Articles 3 and 4 rests. If scholars, practitioners, and lawmakers alike agree with the policy of continuity, flexibility, and operational stability upon which the supporters of Articles 3 and 4 rely, then the criticism from law and economics proponents may be unwarranted. But the amount of criticism directed at the current legal regime, as well as the quality of the scholars and sophistication of their analysis, suggests there is a great dissatisfaction with this policy. The current literature leans largely in favor of economic efficiency as the appropriate barometer of success in Articles 3 and 4.

ciency and social equality that are most relevant to consumers, and subsequently proposing the transfer of consumer transactions from the U.C.C. to the Electronic Fund Transfer Act).

[29] Cooter & Rubin, supra note 4, at 66.

[30] Id.

[31] Id.

2. An Illustration of Economically Inefficient Terms

The criticism that banking interests politically invested to create rules in Articles 3 and 4 that disproportionately redistribute the bargaining surplus in their favor relies on the notion that resulting Code terms are in fact economically inefficient. While this Note does not intend to offer an exhaustive assessment of the U.C.C. provisions that arguably fit this description, several examples may be instructive before continuing to the question whether and how these private interests can capture returns on their political investment in Articles 3 and 4. This Section briefly examines three provisions that scholars have questioned as socially wasteful and favorable to banking interests.

a. Negligence of Consumer as a Bar to Recovery

Contrary to the rule governing losses from credit card transactions that limit a consumer's risk to fifty dollars notwithstanding the cardholder's negligence,[32] Articles 3 and 4 effectively preclude a consumer from recovering losses on fraudulently signed or indorsed checks resulting from the consumer's negligence.[33] Although the consumer or cardholder might be in a better position ex ante to avoid the loss—he only need not be negligent—principles of economic efficiency militate in favor of capped liability as featured in the credit card context. The marginally declining consumer responsiveness to loss liability, as well as the concern for certainty and simplicity, favor capped liability for consumer negligence. At some point, the imposition of liability will not inspire consumers to engage in risk reduction. It is above this point that "financial institutions should absorb all losses because they can spread the losses and develop new technology to counteract their own carelessness, as well as that of the consumer."[34] This same principle governs

[32] 15 U.S.C. § 1643(a) (2000).

[33] U.C.C. § 3-406(a) provides that "[a] person whose failure to exercise ordinary care substantially contributes to an alteration of an instrument or to the making of a forged signature on an instrument is precluded from asserting the alteration or the forgery against a person who, in good faith, pays the instrument or takes it for value or for collection." U.C.C. § 3-406(a) (2005). U.C.C. §§ 4-406(c) and (d) preclude a customer from recovering on unauthorized payments if the customer fails to "exercise reasonable promptness" in examining the banking statement. Id. §§ 4-406(c)–(d).

[34] Cooter & Rubin, supra note 4, at 90.

credit card losses, as well as losses in the insurance context where consumers are responsible for losses only up to some fixed amount equal to the deductible. Because Section 3-406 and Section 4-406 do not adopt capped liability, they are arguably inefficient and contrary to consumer interests.

b. Bank Exculpation from Acts of God

A second provision that fails to meet the principles of economic efficiency is found in Section 4-109, which excuses a bank from liability for losses that result from delay in the transmission of an item if "the delay is caused by interruption of communication or computer facilities, suspension of payments by another bank, war, emergency conditions, failure of equipment, or other circumstances beyond the control of the bank."[35] While this "Act of God" provision protects banks from losses where they have no operational culpability, and perhaps originates from the "policy of safeguarding the stability of financial institutions,"[36] it fails to minimize costs. The financial institutions, after all, are in a far superior position to avoid a technological meltdown—at least as compared to consumers. Consequently, Section 4-109 contains one of the most overt pro-bank, anti-consumer provisions, though consumers may not commonly feel its effects.

c. The Definition of "Ordinary Care"

A final example of inefficiency in Articles 3 and 4 resides in the revised definition of "ordinary care."[37] Prior to the revision, payor banks would frequently argue in court that the failure to examine each customer's check for a fraudulent signature did not constitute lack of ordinary care.[38] Rather, "they argued that the failure to check signatures on all checks was a general banking usage because most banks did not do so, and, thus, that this failure was in fact a

[35] U.C.C. § 4-109(b)(i) (2005).
[36] Cooter & Rubin, supra note 4, at 113.
[37] U.C.C. § 3-103(a)(9) (2005).
[38] The question of ordinary care is important to a bank's Section 4-406 contributory negligence defense. If a bank fails to exercise "ordinary care" in paying an item, and that failure substantially contributes to the loss, then the loss is allocated between the customer and the bank according to the extent of the failure. Id. § 4-406(e).

prima facie exercise of ordinary care."[39] To clarify the law (and arguably to reduce the risk of judicial interpretation adverse to the interests of financial interest groups), the drafters of revised Article 3 adopted a definition of ordinary care that embraces the financial institution perspective, explicitly stating that "reasonable commercial standards do not require the bank to examine the instrument if the failure to examine does not violate the bank's prescribed procedures and the bank's procedures do not vary unreasonably from general banking usage not disapproved by this Article or Article 4."[40] To the extent that this definition lowers the operational costs of commercial banks, the U.C.C. suggests this new definition "is designed to accommodate and facilitate efficiency, thus lowering costs and lowering expedited funds availability risks."[41]

However, when viewed in light of the economic principles offered by Professors Cooter and Rubin, this definition likely does not reduce the net costs of payment transactions. First, this definition does little to incentivize banks to employ technology that will prevent this risk, despite the fact that they are the party with the comparative advantage to implement such technology on behalf of consumers. Second, the bank can capitalize on its diversity of patronage to spread the loss resulting from a forged check; the customer certainly cannot diversify to this extent.[42] Finally, the Code provides neither motivation nor mandate that banks pass the resulting cost savings along to customers.[43] Thus, it is probable that the revised definition of "ordinary care" merely redistributes risk away from the bank and onto the consumer.

II. The Theory of Political Investment

Interest groups influence legislation in two ways: by providing campaign contributions and other tangible benefits to legislators or by distributing specialized information that legislators would not have otherwise had. Despite widespread cynicism regarding inter-

[39] Patchel, supra note 12, at 113.
[40] U.C.C. § 3-103(a)(9) (2005).
[41] U.C.C. art. 3 prefatory note at 359 (2005).
[42] Patchel, supra note 12, at 117.
[43] Id. at 118.

est group influence on the drafting of Articles 3 and 4,[44] there is neither evidence nor speculation that members of the ALI or NCCUSL drafting committees received any tangible benefits.[45] Consequently, lobbying in the context of Articles 3 and 4 is predominantly an information transmission process. The transmission of information has two effects. First, it enables the interest group to make important issues known to the legislature. Second, it facilitates the speedy and informed promulgation of law. In most legislatures, where time to create law is constrained, "information is welcome and can quickly be parsed for relevant and useful content."[46] Lobbyists facilitate this information processing by providing pertinent facts, rather than persuasive threats.[47] In this light, lobbying as an information transmission process may be a necessary lubricant to effective lawmaking. The question remains, however, as to when and why a firm will choose to fund lobbying activities. The following Section will identify those variables that motivate a firm's political investment.

A. Political Investment Threshold Inquiries ("PITI")

An interest group's decision to invest in lobbying activities can be mapped out in four stages. At each stage, the interest group will engage in one of four political investment threshold inquiries ("PITI") to ultimately decide whether investment in political activity makes sense. At Stage One, the interest group identifies the degree to which the legislative proposal at issue comports with its own interests.[48] Two possible answers to this inquiry exist: (a) the proposal may conflict with the interest group's interests (a "conflicting proposal"), or (b) the proposal may comply with the interest group's interests (a "favorable proposal").

Stage Two predicts the likelihood that a favorable proposal will pass. If it appears as though the legislature will pass the proposal without any further influence or information, then the interest

[44] See supra Section I.B.
[45] Schwartz & Scott, supra note 6, at 619 n.52.
[46] Morten Bennedsen & Sven E. Feldmann, Lobbying and Legislative Organization: The Effect of the Vote of Confidence Procedure, 4 Bus. & Pol. 187, 188 (2002).
[47] Rubin 1991, supra note 4, at 589.
[48] Schwartz & Scott, supra note 6, at 624.

group will refrain from lobbying.[49] However, if the favorable proposal is unlikely to pass, or if a conflicting proposal from Stage One remains on the legislative table, then the interest group will proceed to the next inquiry.

At Stage Three, the interest group considers the quality of information possessed by the legislature. As noted above, in the context of the U.C.C., banking interests lobby for Articles 3 and 4 only to transmit information.[50] Thus, lobbying makes sense only to the extent that unknown information has not been transmitted. Where the legislature is fully informed and the legislators' preferences are fully exogenous—that is, their preferences cannot be influenced by endogenous factors such as tangible benefits—there will be no incentive to invest in political activity.[51] Lobbying solely to convey new information is fruitless in a market of perfectly informed participants. However, if the legislature is imperfectly informed and information asymmetries exist, the interest group will proceed to the final stage, Stage Four.

As a final pre-investment threshold inquiry, the interest group will predict the return on political investment, or ROPI. There is virtually no research regarding this figure. However, most economists recognize that firms engage in both market and nonmarket strategies to create value.[52] While market strategies refer to decisions such as product positioning and pricing, nonmarket strategies refer to actions in the "political, regulatory and social environments for the purpose of increasing firm value."[53] These latter nonmarket expenditures in the political arena have growing impor-

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[49] Id.

[50] See supra note 45 and accompanying text.

[51] Schwartz & Scott, supra note 6, at 619.

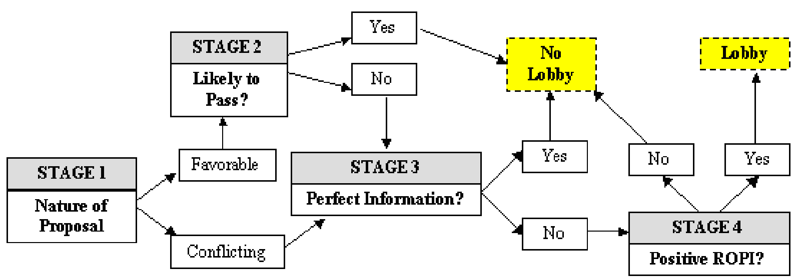
[52] See, e.g., Gary S. Becker, A Theory of Competition Among Pressure Groups for Political Influence, 98 Q.J. Econ. 371, 372 (1983) ("Political influence is not simply fixed by the political process, but can be expanded by expenditures of time and money on campaign contributions, political advertising, and in other ways that exert political pressure. Political equilibrium has the property that all groups maximize their incomes by spending their optimal amount on political pressure . . . ."); John M. de Figueiredo & Emerson H. Tiller, The Structure and Conduct of Corporate Lobbying: How Firms Lobby the Federal Communications Commission 3 (Nat'l Bureau of Econ. Research, Working Paper No. 7726, 2000), available at http://www.nber.org/papers/w7726 ("Firms engage in both market and 'nonmarket' strategies to create shareholder value.").

[53] See de Figueiredo & Tiller, supra note 52, at 3.

tance, and most firms now maximize their value only through investing in political influence. As Professor Becker has noted, "[p]olitical equilibrium has the property that all groups maximize their incomes by spending their optimal amount on political pressure, *given the productivity of their expenditures* . . . ."[54] Thus, firms will engage in political activities to maximize their individual profits to the extent that the lobbying itself is productive. Like any investment, the returns must exceed the opportunity cost. If the interest group is unable to capture a sustained and permanent net positive return from its lobbying investment, then it will refrain from lobbying. Conversely, an interest group may pursue political activity if its net present value exceeds its opportunity cost.[55]

Given these threshold considerations, the following decision tree can be constructed:

Exhibit 1: Political Investment Threshold Inquiries



As the final inquiry, Stage Four poses the most important question an interest group will ask before committing resources to political causes: what is the expected ROPI? As noted, the current academic literature is preoccupied with defining the scope[56] and substantive effects[57] of interest group prevalence in the promulga-

[54] Becker, supra note 52, at 372 (emphasis added).

[55] See Kevin B. Grier et al., The Determinants of Industry Political Activity, 1978–1986, 88 Am. Pol. Sci. Rev. 911, 913 (1994) (arguing that political activity is attractive if "its net present value is greater than zero").

[56] See generally Patchel, supra note 12; Rubin 1991, supra note 4.

[57] See generally Gillette, supra note 6; Ribstein & Kobayashi, supra note 6; Schwartz & Scott, supra note 6.

tion and revision of Articles 3 and 4. There is no legal scholarship, however, regarding the *return* on political investment in the U.C.C. The existing literature seemingly assumes that political investment in Articles 3 and 4 yields a positive value for the commercial banking interests. Despite the fundamental, if not intuitive, assertion that firms will only lobby to the extent that their efforts generate a positive return, a significant gap exists in the literature addressing the extent to which firms actually obtain a positive ROPI.[58]

Two reasons may explain the absence of academic analysis on ROPI as it pertains to Articles 3 and 4 of the U.C.C. First, because the political participation of private banking interests is empirically observed and well documented, the available literature may take for granted the rationality of the banking interest groups. It is simply unlikely that an entire commercial banking industry is devoting significant resources to support Articles 3 and 4 if the individual firms therein are unable to capture a positive ROPI from doing so.

Second, and perhaps a better reason for this academic void, is the difficulty of performing meaningful research on ROPI. Economists have had a difficult time attempting to harness empirical evidence of lobbying returns.[59] Four major problems emerge in this arena. First, it is difficult to measure lobbying expenditures.[60] There is little systematic data on lobbying expenditures, and most economic reports on these figures rely on proxy measures, survey data, or dummy variable measures for lobbying, rather than direct measures of lobbying expenditures. Second, it is difficult, if not impossible, "to measure the monetary value of policy outcomes that

[58] For an essay posing the question and expressing doubt on whether banking interest groups can capture permanent returns from lobbying for U.C.C. provisions, specifically relating to Article 9, see Triantis, supra note 12, at 118–20.

[59] See, e.g., David M. Hart, Political Representation in Concentrated Industries: Revisiting the "Olsonian Hypothesis," 5 Bus. & Pol. 261, 283 (2003) (posing the following unanswered questions regarding dominant firms: "does their investment in political capabilities contribute to the maintenance of their market position? For those firms that entered politics before they achieved dominance, the question is even more pointed: did they achieve that position in part because of this investment?"); John M. de Figueiredo & Brian S. Silverman, Academic Earmarks and the Returns to Lobbying 1 (Nat'l Bureau of Econ. Research, Working Paper No. 9064, 2002), available at http://www.nber.org/papers/w9064 ("[R]emarkably little is known about the economic returns actually obtained by lobbying organizations.").

[60] See de Figueiredo & Silverman, supra note 59, at 8.

have been influenced by lobbying."[61] Most legal policies lack identifiable financial returns. For example, how might one measure the pecuniary benefits resulting from legislation that protects undeveloped land? Third, organizations typically employ multiple instruments to exert political influence, thereby frustrating the ability to isolate the returns of any single political activity.[62] Beyond lobbying, an interest group may devote resources to political action committee contributions and grassroots organizing. This dynamic interaction among different political instruments magnifies the difficulty of measuring an interest group's ROPI. Attributing policy outcomes to only one of these mechanisms when all three may be at work would be misleading.[63] Finally, it is difficult to control for the true optimality of the policy in question.[64] For example, in the context of Section 4-403 of the U.C.C., the Article 4 provision governing the customer's right to stop payments,[65] banking interests seemingly "prevailed" by shifting to the customer the initial burden of proving improper payment of an item subject to a proper stop payment order. Though critics of Section 4-403(c) find this result to be anti-consumer,[66] the possibility exists that it is in fact an optimal rule.[67] In short, it is not clear whether the resulting "banking victory" was a product of its lobby efforts, or rather a product of the

[61] Id. at 9.

[62] Id. at 10.

[63] Id.

[64] Id. at 10–11. Professors de Figueiredo and Silverman listed these measurement problems inherent to political investment returns in a working paper in which they measured and examined the returns of academic earmarks for U.S. universities. Their choice in studying political investment returns in the academic context was due in large part to their ability to circumvent the traditional problems of measurement listed above. See id. at 8–10.

[65] U.C.C. § 4-403(c) (2005). The section regarding burden of proof reads as follows:

> The burden of establishing the fact and amount of loss resulting from the payment of an item contrary to a stop-payment order or order to close an account is on the customer. The loss from payment of an item contrary to a stop-payment order may include damages for dishonor of subsequent items under Section 4-402.

Id.

[66] See, e.g., Patchel, supra note 12, at 133–34.

[67] See, e.g., Rubin 1993, supra note 4, at 751 (recounting the banking attorneys' argument to the drafting committee claiming "there was no need for a legal rule requiring banks to recredit the customer's account because that was standard practice anyway . . . [t]o codify this practice would only deny banks the flexibility they needed in these situations").

actual optimality of the rule, as the banking interests claimed. To measure ROPI, one must control for the true optimality of the policy relative to the alternatives.

Regardless of whether the dearth of literature on interest group ROPI is caused by an unacknowledged assumption of positive political investment returns or, rather, by the practical difficulty of harnessing empirical evidence of these returns, important questions remain. Do commercial banks expect positive returns on their political investment in Articles 3 and 4? If so, how do commercial banks forecast and measure the extent of these returns? Finally, what are the returns? While these questions have been left unanswered in the legal literature, they are important in understanding the questions already posed regarding interest group influence on the U.C.C. The implications are far-reaching. If banks cannot capture a permanent positive ROPI, it is unlikely that the banking interest groups are investing significant resources to exploit consumers. On the other hand, if banks can and do capture a positive ROPI, it is likely that banking interests will engage in political activity to institute favorable law, and claims of consumer exploitation and redistributive inefficiency may well be justified. Understanding just how these private interests capture a return may provide instructive guidance for consumer advocates seeking to reverse the inequity they allege.

B. Estimating the Return on Political Investment ("ROPI")

An interest group in Stage Four of the PITI framework may consider a number of factors to assess the likelihood that political investment will yield a positive payoff. Despite the aforementioned difficulty of measuring the pecuniary gains of lobbying, this Section will examine several factors that an interest group may consider to predict the effects of political investment. As a preliminary caveat, because of the difficulty in measuring returns on lobbying, it is likely that firms cannot calculate ROPI as a financial statistic. Unlike return on equity ("ROE") or return on (non-political) investment ("ROI"), an investor will not find the ROPI ratio in a firm's public filings. Rather, ROPI is a conceptual term introduced here that firms might use to describe the success of their political activity.

ROPI is a function of four variables, and will more likely be positive under the following conditions: (1) few or no competing interest groups; (2) no disclosure of proprietary information; (3) low coalition costs (free-rider costs minimized); and (4) strong durability of the resulting law. These factors will be examined in turn. This framework will then be applied to the context of Articles 3 and 4. This application will determine whether the commonly held assumption in the U.C.C. literature—that banking interests can harness a positive return from lobbying for inefficient and redistributive terms in Articles 3 and 4—makes any sense.

1. Competing Interest Groups

As indicated by Stage Three of the PITI, an interest group is more likely to engage in lobbying activities to convey favorable information when the legislature is imperfectly informed.[68] However, an interest group's power and ability to convey credible information to the legislature is dependent upon the interest group environment. Where multiple interest groups with conflicting preferences emerge before the legislature, the power of any single interest group is diminished.[69] Although the specific substantive effects on law created in light of competing interest group influence are unclear,[70] the end legal product will not fully realize any single

[68] See supra note 51 and accompanying text.

[69] Schwartz & Scott, supra note 6, at 633.

[70] Professors Schwartz and Scott argue that in a private legislature (using the ALI and NCCUSL in the U.C.C. lawmaking process as a model), legislation as a product from competing interest groups will tend to preserve the status quo. Schwartz & Scott, supra note 6, at 636. Conversely, Professor Rubin has suggested that legislation as a product from competing interest groups may provide optimal public policy. Rubin 1991, supra note 4, at 589. Because lobbyists are particularly good at collecting large amounts of information, competing interest groups will generally convey verifiable facts, yielding a net balanced view of the world. Id.; see also Michael T. Hayes, Lobbyists and Legislators: A Theory of Political Markets 141–43 (1981) (describing the reform strategy of remedying the bias to pluralism that seeks to "restore perfect competition in the demand for public policies"). As noted above, a number of scholars advocate for this more "balanced" political process. See, e.g., Patchel, supra note 12, at 87 n.9; Rubin 1993, supra note 4, at 759–61. Despite these seemingly conflicting views between Scott and Rubin, the two might be reconciled by the legislature. In examining the ALI and NCCUSL, Professors Scott and Schwartz limited their conclusions to that of a private legislature. Rubin, however, applies his conclusions to the context of a public legislature. As has been noted, important distinctions exist be-

interest group's preferences. To the extent that an interest group lobbies for a particularly biased or favorable policy, the ROPI will vary inversely with the number of competing interest groups. Where an interest group anticipates strong political controversy with competing and informed interests, however, it will not simply refrain from lobbying altogether. Rather, evidence suggests that the parties might still influence the end policymaker, so long as the information disseminated by the interest group is credible.[71] In that context, the policymaker will at least be conscious of the interest group's position. When the group's report is confirmed by the report of "another group that has an opposing bias the report enjoys greater credibility."[72] Intuitively, a firm might still invest in lobbying in a competitive interest group environment merely to narrow the range of possible ex post policy worlds, thereby reducing the *variance* of its expected return. Though the presence of a competing interest group may in fact reduce the variance of a firm's expected return, it would certainly reduce the magnitude of the expected return. Consequently, the size of a firm's return on political investment will be greatest in a single interest-group environment.

2. Proprietary Information Risk

Both economic theory and empirical evidence suggest that a firm's incentive to invest in political activity varies inversely with the disclosure requirements of proprietary information.[73] This will occur despite the protections to safeguard private information, as firms possess a fear that "secrets will either intentionally or unintentionally leak out from the agency."[74] The disclosure of proprietary secrets that are fundamental to the firm's profitability would

tween these types of legislatures, which may explain these seemingly contrasting conclusions.

[71] Grossman & Helpman, supra note 9, at 132–33.

[72] Id. at 133.

[73] See de Figueiredo & Tiller, supra note 52, at 11; see also Joel S. Demski et al., Practices for Managing Information Flows Within Organizations, 15 J.L. Econ. & Org. 107, 108 (1999) ("When information flows are uncontrolled, a client's sensitive and proprietary information . . . cannot be protected."). But see Thomas A. Stewart, Intellectual Capital: The New Wealth of Organizations 102 (1997) (arguing that knowledge should be permitted to flow across corporate boundaries in a global economy that is becoming more information based).

[74] De Figueiredo & Tiller, supra note 52, at 11.

certainly reduce the firm's ROPI. As a result, the more proprietary information at stake, the less likely a firm will be to engage in political activities.

3. Collective Action and the Free Rider Problem

The first of the two most important factors bearing on an interest group's ability to reap positive returns from political activity is the extent to which it can overcome problems of collective action and the free rider problem. In his seminal book, *The Logic of Collective Action*, Professor Olson demonstrates why some groups are more capable than others at effecting favorable government action.[75] His premise was as follows: "unless the number of individuals in a group is quite small, or unless there is coercion or some other special device to make individuals act in their common interest, *rational, self-interested individuals will not act to achieve their common or group interests*."[76] That a group of individuals possess a common interest is not alone sufficient to spawn collective action in pursuit of that interest. To support his premise, Olson makes a distinction between collective and private goods, defining the former as any good that "cannot be feasibly withheld" from other members of a group if at least one member of the group consumes it.[77] This problem underlying rational collective action is commonly referred to as the "free rider problem," in which some members of a large coalition may benefit from the investment of others without themselves contributing.[78] As a consequence of the free rider problem, each group participant has an incentive to withhold its contributions and hope another member will provide the good.[79]

Olson directly applies this problem to the context of political investment, noting that "it would not be rational for [a single member of an interest group] to sacrifice his time and money to support a lobbying organization to obtain government assistance for the in-

[75] Mancur Olson, Jr., The Logic of Collective Action (1965).
[76] Id. at 2.
[77] Id. at 14–15.
[78] See Rothery Storage & Van Co. v. Atlas Van Lines, 792 F.2d 210, 212 (D.C. Cir. 1986) ("A free ride occurs when one party to an arrangement reaps benefits for which another party pays, though that transfer of wealth is not part of the agreement between them.").
[79] Olson, supra note 75, at 11.

dustry."[80] Because an interest group cannot restrict access to the collective good (the resulting favorable legislation) obtained through lobbying to only the investing members, each firm will have an incentive to free ride on the interest group without personal firm investment.[81] The free rider problem has adverse consequences on a firm's expected ROPI, which will vary inversely with the prevalence of free riders within the industry. The end-game equilibrium is failure to mobilize for political investment.[82]

The free rider problem is mitigated in smaller groups and magnified in larger groups.[83] In small groups, the contributions of each member are more obvious and each member may be subject to peer pressure and other extra-legal norms to participate in the group's collective action.[84] As a result, one might predict that interest groups with high coalition costs will not engage in collective political action. In fact, Olson provides evidence that this is the case.[85]

[80] Id.

[81] Of course, where the policy benefits conferred to the interest group can be allocated only to the investing members, the individual firms will have an incentive to participate in collective political action. Id. at 16; see also de Figueiredo & Tiller, supra note 52, at 7 ("[Where] the benefits conferred by the trade association . . . can be allocated solely to the participating members of the association, then individual firms have an incentive to participate in group action, thereby overcoming the free-riding problem.").

[82] See de Figueiredo & Tiller, supra note 52, at 7 ("For a given level of interest convergence, collective action will be difficult because individuals will attempt to free ride on the group effort. When the cost to lobbying is high, and the benefits are [sic] cannot be localized, no one will have the incentive to engage in political activity, and thus little lobbying will occur. . . . In equilibrium, no lobbying occurs because of this free riding behavior.").

[83] Olson, supra note 75, at 48.

[84] Id. at 62–63; Patchel, supra note 12, at 127–28.

[85] See Olson, supra note 75, at 165–66 ("Migrant farm laborers are a significant group with urgent common interests, and they have no lobby to voice their needs. The white-collar workers are a large group with common interests, but they have no organization to care for their interests. The taxpayers are a vast group with an obvious common interest, but in an important sense they have yet to obtain representation. The consumers are at least as numerous as any other group in the society, but they have no organization to countervail the power of organized monopolistic producers. There are multitudes with an interest in peace, but they have no lobby to match those of the 'special interests' that may on occasion have an interest in war. There are vast numbers who have a common interest in preventing inflation and depression, but they have no organization to express that interest."). But see Jan Potters & Randolph Sloof, Interest groups: A survey of empirical models that try to assess their influence, 12 Eur. J. Pol. Econ. 403, 417–18 (1996) (noting recent evidence provides "little direct

Although Professor Olson and others claim additional factors may influence the ability of groups to effectively coalesce,[86] the free rider problem is unique in its direct relationship to a firm's ROPI. Low organization costs and the consistency of policy goals, for example, may in fact promote collective action; however, a firm will not explicitly consider these factors as bearing on the ex post return on its lobbying efforts. Rather, it will consider these factors as bearing on the ex ante decision to lobby. Only the free riding problem represents an ex post cost bearing on a firm's ROPI: because free riders take a piece of the pie without contributing to the process that makes the pie, a politically investing firm may instead decide to leave the kitchen.

4. Durability of Law

The second of the two most important factors influencing an interest group's ROPI, and thus, its decision to lobby, is the durability of the resulting law. An interest group would generally not invest in political activities to evoke legal changes with a high risk of reversal in the near future.[87] Just as the time value of money is fundamental to a firm's return on equity, the "time value of law" is fundamental to a firm's return on political activity. Though excep-

empirical support" for Olson's theory on the inverse relationship between concentration and political investment).

[86] Olson also argues that because larger groups face greater costs of organizing, they will be less likely to effect collective action. Olson, supra note 75, at 48. Additionally, Professors de Figueiredo and Tiller argue that firms within the same industry with divergent policy goals will not mobilize collectively. See de Figueiredo & Tiller, supra note 52, at 6.

[87] As Professor Tollison has noted, "[A]n interest group would not bid very much for a protective statute if it lasted only for the current legislative session and was repealed in the next. To be worth anything to the interest group, a law must be durable—that is, it must have a present value of benefits that exceeds the costs of obtaining it." Robert D. Tollison, Public Choice and Legislation, 74 Va. L. Rev. 339, 345 (1988).

tions to that proposition exist,[88] interest groups that invest in lobbying generally prefer strong legal durability.[89]

In light of the desire for durable legal changes, an interest group may be more inclined to invest in lobbying when it possesses a greater understanding of the technical issues relative to competing interests.[90] The rationale for this proposition is simple: if a competing interest group does not understand the technical substance of the law, it will not be successful in effecting countervailing changes. Although consumer advocates frequently raise this issue as a criticism against complex anti-consumer laws enacted by informed corporations,[91] it is instructive on the question of durability. Consequently, in markets with participants that possess asymmetric technical expertise, the informed firms will be more likely to invest in political activity and expect the resulting law to possess a high degree of legal durability. Uninformed competing interests will be incapable of effecting legal change, and the relatively more informed interest group will realize a higher ROPI.

Three risks jeopardize the durability of a legislative policy change. First, the legislature may overturn the policy change in subsequent terms. However, there is little empirical evidence that subsequent legislatures endlessly overturn the changes made by previous legislatures.[92] To explain this, Professor William Landes and Judge Richard Posner argue that the procedural rules of the legislature (such as those governing committees, voting rules, and rules of order) may promote legislative durability.[93] Furthermore, because legislators typically serve for more than one term, they can

[88] A positive ROPI may vary inversely with legal durability when the interest group seeks policy change for only a limited time period, after which the policy may actually harm the interest group's operations. For example, when domestic demand is low, steel producers may seek temporary tariffs to curb excessive supply from overseas producers; however, when international demand surges, the tariffs may actually frustrate profitable international trade for the domestic steel producers.

[89] See William M. Landes & Richard A. Posner, The Independent Judiciary in an Interest-Group Perspective, 18 J.L. & Econ. 875, 877–79 (1975) (using this reasoning of durability to conclude that interest groups and legislatures have an incentive to promote institutional arrangements that enhance the durability of laws).

[90] Patchel, supra note 12, at 133.

[91] See id.; see also Jonathan R. Macey, The Political Science of Regulating Bank Risk, 49 Ohio St. L.J. 1277, 1289 (1989).

[92] Tollison, supra note 87, at 344.

[93] Landes & Posner, supra note 89, at 877–79.

help preserve the status quo of the interest group's favored policy changes.[94]

Second, judicial interpretation may threaten legal durability. How the courts interpret legislation has significant implications on a firm's ROPI, as a single judge may frustrate the interest group's entire investment by misinterpreting or narrowly interpreting the law in question. Although there is a considerable amount of normative scholarship on whether the judiciary should interpret the law to comport with interest group preference and legislative intent,[95] most positive literature suggests that the institutional constraints of the judiciary promote strict legislative (and interest group) interpretation.[96] Nevertheless, because at least some scholars advocate for narrow construction of interest group-influenced legislation, the risk of judicial frustration raises the volatility of an interest group's ROPI, causing greater uncertainty and a greater probability of interest group political abstention.

The third and final risk to legal durability is the degree to which the legal rules are mandatory. If parties can contract around the resulting legal changes ex post, there is seemingly no rational incen-

[94] Id.

[95] For arguments in favor of narrow construction of interest-group influenced legislation, see Gillette, supra note 6, at 1875 (citing Jonathan R. Macey, Promoting Public-Regarding Legislation Through Statutory Interpretation: An Interest Group Model, 86 Colum. L. Rev. 223, 227 (1986)) ("[C]ourts [should] limit the consequences of such [interest group legislation] deals by interpreting statutes in a manner consistent with the public-regarding terms in which they are couched rather than with the interest group motivations that lie beneath the surface."); see also Cass R. Sunstein, Interpreting Statutes in the Regulatory State, 103 Harv. L. Rev. 405, 471 (1989) ("[C]ourts should narrowly construe statutes that embody mere interest-group deals.").

[96] See, e.g., Landes & Posner, supra note 89, at 885 ("[T]he fact that the legislative and executive branches do have means of coercing the judiciary helps to explain why the self-interest of independent judges is promoted by enforcing legislation according to its original tenor."); Sunstein, supra note 95, at 471 ("In interpreting statutes, courts employ a clear-statement principle in favor of the 'rule of law': a system in which legal rules exist, are clear rather than vague, do not apply retroactively, operate in the world as they do in the books, and do not contradict each other."); Tollison, supra note 87, at 345–46 ("Where the judicial branch acts to increase and sustain the durability of legislation, its budget and judicial salaries increase."); Triantis, supra note 12, at 117 ("In their desire to build prestige and popularity in legal and political circles, judges generally prefer not to have their judgments reversed, either by a higher court or by subsequent legislative action. Therefore, they are cautious not to deviate too much from the policy wishes of the legislature.").

tive to invest in the legal substance ex ante. As Professors Ribstein and Kobayashi note, "interest groups have little incentive to seek uniform adoption of a law that can be easily avoided by contract."[97] As will be shown below, this relatively small consideration is of the utmost significance in the context of lobbying for Articles 3 and 4 of the U.C.C., which largely consists of default rules.

In summary, four major factors affect a firm's ability to capture a return on political investment: (1) the presence of competing interest groups with conflicting policy preferences; (2) the extent of proprietary information disclosure required by the political activity; (3) the degree of coalition costs as measured by the size of the interest group and the prevalence of the free rider problem; and (4) the durability of the resulting policy changes.

C. Applying the ROPI Determinants

Having examined both the difficulty of calculating a return on political activity and the heuristics a firm might use in gauging the probability of positive ROPI, this Section will apply those findings to the context of banking interest group investment in the promulgation and revision of Articles 3 and 4 of the U.C.C. In doing so, it asks whether commercial banks can capture any permanent gains by lobbying for inefficient redistributive gains at the expense of consumers. In light of interest group competition, proprietary information disclosure, the free rider problem, and durability of law, it is not likely that commercial banks can expect to realize a positive ROPI.

1. Competing Interest Groups

Consumer interests were poorly represented at the creation and revision of Articles 3 and 4. This is puzzling, however. After all, the consumer movement mobilized in the 1960s[98] well before the com-

[97] Ribstein & Kobayashi, supra note 6, at 154.

[98] Schwartz & Scott, supra note 6, at 644. However, Schwartz and Scott note the emergence of consumer interests in the 1960s significantly altered the political landscape regarding banking law, and accounted for the removal of significant areas of banking law from the U.C.C. jurisdiction. Id. The resulting federal regulation, The Truth in Lending Act and The Electronic Fund Transfer Act, which govern consumer rights in electronic transfers and credit card transactions, is examined below. See infra note 250.

pletion of the revisions of Articles 3 and 4 in 1990.[99] However, empirical and anecdotal evidence both suggest that consumer interests were relatively nonexistent and bank interests overwhelmingly controlled the revision process.[100]

To further understand the relatively lopsided interest group influence on the revision of Articles 3 and 4, one need only look to the opening text of Article 3, which lists "Advisors" and "Additional Participants" such as the Federal Reserve Bank of New York, Citibank, Exxon Company, and Arnold & Porter.[101] The evidence is unambiguous: the revision of Articles 3 and 4 in 1990 was largely influenced by a lone interest group—the banking industry.[102]

The absence of consumer representation is puzzling in light of two facts. First, though consumer interests were not generally invited to participate in the drafting process,[103] they were never ex-

[99] U.C.C. art. 3 prefatory note at 354 (2005).

[100] Patchel, supra note 12, at 122–23; Rubin 1993, supra note 4, at 747–48, 759–61. Professor Rubin, who acted as chairman of the Subcommittees on Articles 3 and 4 of the ABA Ad Hoc Committee on Payment Systems, provides the following observation:

> [O]nly two of the three principal interests—financial institutions, corporate users and consumers—were represented. Apart from bank attorneys and corporate attorneys of various sorts, the only significant group consisted of commercial law professors . . . . The obvious counterweight to all these bank and corporate attorneys would have been some representatives from the consumer movement. . . . [But] [n]o consumer representatives were part of the Ad Hoc Committee when it was established; however, none were invited, as far as I know, and none volunteered.[100]

Rubin 1993, supra note 4, at 759–61. Professor Rubin also recounts the typical attendance breakdown of the Ad Hoc Committee meeting during the Article 3 revision process: of 108 members, 74 were attorneys representing banking institutions, 17 were professors, 16 sixteen were identified as "Others" (consisting of representatives from the Federal Reserve System, the New York Clearinghouse, and the American Bankers Association), and only one was identified as a consumer advocate. Id. at 748 n.17. Professor Patchel also notes, "The only participants representing bank customer interests were individuals from corporations and from the National Corporate Management Association, which represents corporate bank customers." Patchel, supra note 12, at 122 n.182.

[101] U.C.C. art. 3 prefatory note at 353–54 (2005).

[102] Although several large non-banking corporations participated in the revision process, their ability to frustrate the banking preferences was minimal. See Rubin 1993, supra note 4, at 765 (noting that the corporate interests had less of a vested interest in the substance of Articles 3 and 4 because while those articles may create problems for consumers, they "work well enough for corporate customers").

[103] Professor Rubin provides one account in which Roland Brandel, the chairman of the Ad Hoc Committee, invited Gail Hillebrand of the Consumers Union to attend a

plicitly barred from doing so. Rather, the ABA permitted "any member of the ABA who was interested in the subject matter [to] join the [Ad Hoc] [C]ommittee."[104] Furthermore, the NCCUSL openly encouraged "attendance and participation by interested observers at meetings of the drafting committees"[105] with the intent to make "the process more open and deliberative."[106] Proponents of Articles 3 and 4 have long defended its drafting on the grounds of this right to participate in the drafting process.[107] Second, there is evidence that suggests that countervailing influence to convey information contrary to the banking preferences may have been an effective means to thwart uniform passage of Articles 3 and 4. Professor Rubin provides an account in which he and other academic critics of Articles 3 and 4 sent letters of opposition to the state legislature, sometimes going so far as to testify on behalf of unrepresented consumer interests.[108] Though his individual lobbying had varying degrees of effect,[109] his efforts demonstrate the potential effect widespread consumer mobilization might have had against the uniform passage of Articles 3 and 4. Additionally, the relatively recent passage of the Electronic Fund Transfer Act and the Truth In Lending Act illustrates the ability of the consumer movement to both understand the complexity of payment systems and to effect pro-consumer legislation in light of strong banking opposition. A

few meetings upon recognizing the absence of consumer interests in the drafting process. Rubin 1993, supra note 4, at 761. However, her "participation was constrained by a lack of funding and a lack of time." Id. Rubin further provides three reasons that may account for the failure to consistently invite consumer groups to the deliberations: first, the drafters may have believed that the banking attorneys were capable of drafting a balanced and public-oriented statute; second, it is possible that consumer groups were willing "to produce legislation that catered to the interests of banks at the expense of their customers"; and third, the ALI and NCCUSL could not, or would not, subsidize consumer representatives with significantly fewer resources than the financial institutions. Id. at 762.

[104] Rubin 1993, supra note 4, at 747.

[105] Ring, supra note 20, at 290.

[106] Id.

[107] See, e.g., Miller, supra note 20, at 873 ("It is the *opportunity to participate* and not the fact of participation that is important in the legislative context. Certainly, all interest groups have had the opportunity to participate in uniform law making and, indeed, have been solicited to participate.") (emphasis added).

[108] Rubin 1993, supra note 4, at 782–85.

[109] In some states, Professor Rubin's opposition avoided immediate and unopposed passage of the revised Articles. Id. at 784. In others, the revisions still "sailed through the legislature." Id.

number of scholars have recognized the emergence of federal legislation to combat the effects of the U.C.C.[110] The passage of these federal statutes unequivocally illustrates the ability of a legislature to balance both consumers and banking interests,[111] and underscores the puzzling absence of consumers from the U.C.C. revision process.

Although consumer advocates clearly possessed an option to participate in the drafting of Articles 3 and 4 in the late 1980s, their decision not to exercise it may be explained in light of the history of the U.C.C. As noted, the original purpose of the Code was to facilitate economic activity.[112] To promote this purpose, the drafters desired the Code to reflect actual business practices and concepts intelligible to sophisticated people.[113] Consequently, the ALI and NCCUSL recruited advisors who were predominantly engaged in commercial transactions: banks and their corporate customers.[114] Conspicuously absent were consumer interests. The original drafters would argue that consumers, in fact, held little expertise in the technical characteristics of payment systems that was so essential to "facilitating economic activity." Of paramount importance to the drafters, however, was the desire for uniform adoption,[115] which

[110] See Schwartz & Scott, supra note 6, at 644 ("When consumer protection issues came to public consciousness in the 1960s, important areas were removed from the Code's jurisdiction. The Truth in Lending Law, the Magnuson-Moss Act, the Consumer Product Safety Act, other statutes, and Federal Trade Commission regulations substantially altered or overruled UCC rules."); see also Rubin 1988, supra note 4, at 627 ("This basic [U.C.C.] orientation towards banks has become increasingly controversial since the development of the consumer movement. The federal statutes that govern credit cards and electronic funds transfers, which are in large part products of that movement, generally reflect an opposite orientation; they specify bank obligations and consumer rights while allocating the major proportion of losses to the banks as costs of doing business.").

[111] See Rubin 1991, supra note 4, at 586 ("[T]he EFTA was, in fact, the product of a highly political process. Essentially, the statute represents a bargain negotiated by the American Bankers Association ("ABA") and the consumer lobby[.]").

[112] Twining, supra note 23, at 307.

[113] Patchel, supra note 12, at 99.

[114] See id. at 99–100 ("[R]eporters for the various articles, some of whom were non-experts on the subject matter of the articles they were assigned to draft, solicited informal contacts with the affected industries to find out how commercial transactions operated in the field, and generally maintained these contacts throughout the drafting process.").

[115] Fairfax Leary, Jr. & Michael A. Schmitt, Some Bad News and Some Good News from Articles Three and Four, 43 Ohio St. L.J. 611, 614 (1982).

depended not only on the commercial banks' technical expertise, but also their political support.[116] The result was that banking interest groups "did not simply remain suppliers of technical knowledge; rather they used their access to the drafters and the sponsoring organizations to make their views about the preferred substance of the law known."[117] Thus, while both the original purpose of the U.C.C. and the objective of the drafters required private banking interest input, neither required consumer interest input.

In light of these political origins of the U.C.C., historical inertia may explain the absence of the consumer movement in the drafting of Articles 3 and 4. It may merely be that the entrenched substance of Articles 3 and 4 dissuaded consumer advocates from engaging in U.C.C. politics. The argument offered by Professors Schwartz and Scott that legislation produced from competing interest groups in a private legislature (such as the ALI and NCCUSL) will tend to preserve the status quo further supports this observation. Because the status quo predominantly reflects bank preferences, consumer groups may be unable to effect any change.[118] Finally, the consumer movement decision to pursue consumer rights at the federal level corroborates this possibility.[119] Among the federal legislation within the last twenty years that has adopted a more consumer-friendly approach to transactional law are the "Truth in Lending Act, the Fair Credit Reporting Act, the Equal Credit Opportunity Act, the

[116] Twining, supra note 23, at 302 (stating that Karl Llewellyn, the principal drafter of the original U.C.C., recognized that if the U.C.C. was to be enacted, "it would have to satisfy three principal groups of people: the lawyers in the sponsoring organizations, the more organized pressure groups outside the legislatures, and the legislators themselves"); see also Ribstein & Kobayashi, supra note 6, at 143 ("Interest group opposition in several important states can prevent widespread adoption of an efficient NCCUSL proposal. . . . Indeed, because such opposition can threaten uniformity, the NCCUSL may permit influential groups effectively to veto certain types of provisions or may even deter the NCCUSL from promulgating certain types of uniform acts.").

[117] Patchel, supra note 12, at 122.

[118] In other words, consumer groups sit on the opposite, but symmetric, side of the fence, where the expected ROPI from lobbying for amendments to Articles 3 and 4 is most likely to be negative.

[119] See Edward L. Rubin, The Code, the Consumer, and the Institutional Structure of the Common Law, 75 Wash. U. L.Q. 11, 33 (1997) (noting the emergence in the last twenty years of federal legislation that routinely provides for attorney's fees and court cost awards to prevailing consumer plaintiffs in commercial disputes, contrary to the U.C.C. treatment of damages).

Fair Debt Collection Practices Act, the Electronic Funds Transfer Act, the Expedited Funds Availability Act, and the Magnuson-Moss Warranty Act."[120] This abundance of federal law suggests that consumers have opted to mobilize for change in the federal forum, where the playing field may be equal, or at least is not subject to a history of lopsided interest group solicitation.[121]

In summary, the revision of Articles 3 and 4 was dominated exclusively by banking interests with common preferences. The implications of this framework are fundamental to the banking interest group's expected ROPI. As the sole influence on Articles 3 and 4, it is almost certain that banking interests would prevail in effecting favorable uniform legislation that reflects their commercial preferences.

2. Proprietary Information Risk

The second factor affecting a firm's expected ROPI is relatively straightforward: the more proprietary information at risk, the greater the probability that it may be intentionally or unintentionally disclosed to competitive sources.[122] Because firms rely on proprietary information to obtain a competitive edge in the marketplace, the risk of proprietary disclosure will substantially bear upon a firm's expected ROPI.

The risk of disclosing proprietary information is small or nonexistent in the context of Articles 3 and 4 lobbying. As noted above, banking interests were originally included in the drafting of Articles 3 and 4 for their general expertise on industry norms.[123] Professor Rubin provides evidence that the bank attorneys present during the drafting process united in their understanding of common industry practices.[124] Additionally, the substance of Articles 3

[120] Id. at 33–34.

[121] This tension between the federal legislation closely parallels that of the federal Bankruptcy Code and Article 9 of the U.C.C. While the former is considered largely a product of debtor capture, the latter is considered largely a product of creditor capture. Scott, supra note 6, at 1822 n.115.

[122] See supra notes 73–74 and accompanying text.

[123] See supra notes 115–17 and accompanying text.

[124] See supra note 70 and accompanying text. When confronted with opposition to U.C.C. § 4-403(c), which placed the burden of proving an improperly paid stop payment order on the consumer, the bank attorneys collectively argued that a legal rule was unnecessary in light of the industry practice of automatically crediting a cus-

and 4 is inherently nonproprietary, and the provisions therein address such exogenous issues as the definition of ordinary care,[125] defenses to liability on fraudulently indorsed checks,[126] the scope of presentment warranties,[127] rights acquired by transfer of an instrument,[128] and the right to stop payment of an instrument.[129] While banking interests played a fundamental role in the final substance of these provisions, there was seemingly no need to divulge valuable proprietary business practices or information for such non-firm-specific questions. Proprietary information is more likely to be at risk when the legal policy sought is noncollective. In other words, firm-specific information will yield firm-specific legislation; industry-wide information, on the other hand, will yield industry-wide legislation.

Because the drafting of Articles 3 and 4 does not expose firms to the risk of disclosing proprietary information, it is more likely that they will politically invest in the U.C.C. drafting process. This proposition may be extended further to any instance in which a firm is choosing whether it should devote resources to political action.

3. Collective Action and the Free Rider Problem

Olson's theory of collective action and the free rider problem has an important bearing on a banking interest's decision to invest in political activity. His theory has been heavily scrutinized, but may be summarized as follows: because an interest group cannot restrict access to the collective good of favorable legislation resulting from political investment, each member will have an incentive to free ride on the other members of the interest group without personal firm investment. As U.C.C. law represents a collective good, Olson's proposition leads to the prediction that if the banking industry is widely dispersed, the firms therein refrain from lob-

tomer's account upon the allegation of improper payment. Rubin 1993, supra note 4, at 750–52. A legal rule, they argued, would unnecessarily frustrate practical flexibility. Id at 751.

[125] U.C.C. § 3-103(9) (2005).

[126] Id. § 3-406.

[127] Id. §§ 3-417, 4-208.

[128] Id. § 3-203.

[129] Id. § 4-403.

bying for the legal substance of Articles 3 and 4, expecting ex post benefits without contributing ex ante resources. Conversely, evidence that banking interests do in fact engage in political activity with respect to Articles 3 and 4 would suggest the banking industry is concentrated enough to reduce or eliminate the risk of free riding. This does not appear to be the case. Although the commercial banking industry is not as diverse and dispersed as consumer interests,[130] the banking industry is nevertheless large.[131] Although there is no literature examining the scope of the free rider problem in the banking industry, it is reasonable to believe the size of the industry promotes the emergence of the problem, which would in turn cannibalize a commercial bank's expected positive ROPI.

Despite the strong possibility of free riders in the commercial banking industry, there are at least two factors that might mitigate the extent of the free rider problem. First, the banking industry is not as dispersed as the FDIC figures facially suggest. Among the 8832 banks reported by the FDIC,[132] nineteen are large, publicly traded commercial banks, known as "money center banks."[133] Of the $10.9 trillion of total assets in the FDIC-insured banking industry, the money center banks account for $6.7 trillion.[134] Assuming the amount of total assets provides a reasonable proxy for market share,[135] these figures suggest that the nineteen domestic money

[130] Olson, supra note 75, at 166.

[131] As of December 31, 2005, the Federal Deposit Insurance Corporations ("FDIC") reported 8832 insured financial institutions (designated as "Commercial Banks" or "Savings Institutions"), with total assets exceeding $10.9 trillion. FDIC, Statistics at a Glance, http://www.fdic.gov/bank/statistical/stats/2005dec/industry.html (last visited Apr. 12, 2006).

[132] See id.

[133] Compiled through the use of the MSN Moneycentral Deluxe Stock Screener, http://moneycentral.msn.com/investor/finder/customstocks.asp (last visited Apr. 12, 2006) (search on "Industry = Money Center Banks"). Among these money center banks are the common household names: Bank of America, Citigroup, JPMorgan Chase, and Wachovia.

[134] To substantiate this figure, use the website provided, supra note 131, to see that the total assets for the banking industry amount to $10.9 trillion. Then, to identify the assets of the nineteen "money center banks," see supra note 133. The combined total assets of these money center banks, as of December 31, 2005 (the date on which the FDIC statistics are based), amounted to $6.7 trillion. Dividing this figure by the total assets for the industry, $10.9 trillion, shows that the money center banks constitute approximately 61% of the FDIC-defined banking industry.

[135] Customarily, market share is determined by comparing revenue. See, e.g., United States v. Waste Mgmt., 743 F.2d 976, 981 (2d Cir. 1984) (describing the calculation of

center banks constitute approximately 61% of the FDIC-defined banking market. In this light, the collective action problems significantly diminish. Because so few commercial banks constitute a significant sect of the banking market, it stands to reason that they have the greatest incentive to invest ex ante resources in order to reap the majority of the ex post legislative benefits. Professor Olson acknowledges this phenomenon:

> [I]n a very small group, where each member gets a substantial proportion of the total gain simply because there are few others in the group, a collective good can often be provided by the voluntary, self-interested action of the members of the group. In smaller groups marked by considerable degrees of inequality—that is, in groups of members of unequal "size" or extent of interest in the collective good—there is the greatest likelihood that a collective good will be provided; for the greater the interest in the collective good of any single member, the greater the likelihood that that member will get such a significant proportion of the total benefit from the collective good that he will gain from seeing that the good is provided, even if he has to pay all the cost himself.[136]

This observation identifies how a firm might overcome the free rider problem when it operates in an industry with a relatively small number of competitors. In fact, the creation and revision of Articles 3 and 4 were influenced largely by these money center banks. Representatives from Chemical Bank, Citibank, Chase Manhattan Bank, and Manufacturers Hanover Trust Company[137] all participated in the Article 3 revision process, providing some evidence for the argument that the banking industry is more concentrated than FDIC figures suggest.

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the defendant's combined market share post-merger to be determined by "comparison of revenues of the various [producers] within this market").

[136] Olson, supra note 75, at 34. At its extreme, a large collective market share may translate into monopoly power. As the court in *United States v. Waste Management* noted, "large market shares are a convenient proxy for appraising the danger of monopoly power . . . ." *Waste Mgmt.*, 743 F.2d at 981. Of course, this Note does not, and could not, suggest that the banking industry is monopolistic.

[137] U.C.C. art. 3 at 353–54 (2005). Chemical Bank, Chase Manhattan Bank, and Manufacturers Hanover Trust Company are now all part of JPMorgan Chase Bank.

In addition to the presence of large banking concerns with a strong vested interest in the legal substance of Articles 3 and 4, a number of financial and banking *collective organizations* assisted in the U.C.C. revision process.[138] The basis for these organizations' engagement in political activities can be explained in two ways. First, Olson proposes that some industry organizations will voluntarily arise when the industry features only a few players with a great deal at stake: "[t]he high degree of organization of business interests, and the power of these business interests, must be due in large part to the fact that the business community is divided into a series of (generally oligopolistic) 'industries,' each of which contains only a fairly small number of firms."[139] The composition of the New York Clearinghouse corroborates this theory: twenty-two large commercial banking institutions account for its membership, many of which are among the previously noted money center banks.[140]

In addition to Olson's oligopolistic theory, the "by-product" theory may explain the mobilization of associations such as the American Bankers Association and the Credit Union National Association, where membership consists of a large number of firms.[141] Although the diversity of these associations suggests a high risk of

[138] Among these organizations were the American Bankers Association, the New York Clearing House Association, the Bankers Clearing House Association, and the Credit Union National Association. U.C.C. art. 3 preface at 353–54 (2005).

[139] Olson, supra note 75, at 143.

[140] Members of the New York Clearinghouse (now known simply as "The Clearing House") include Bank of America, Citibank, JPMorgan Chase, and Wachovia. The Clearing House, About Us, http://www.theclearinghouse.org/about/000211f.php (last visited Apr. 12, 2006).

[141] According to the American Bankers Association website, "[t]he American Bankers Association is the preeminent banking trade association in the country. . . . Many people are surprised to learn that ABA's median-sized member had $96 million in assets." American Bankers Association, ABA Bank Membership, http://www.aba.com/About+ABA/mem_main.htm (last visited Apr. 12, 2006). Additionally, the 2003 Annual Report of the Credit Union National Association claimed a membership of 92% of over 11,000 federally insured credit unions. Credit Union National Association, 2003 Annual Report 3, http://www.cuna.org/download/2003annualrpt.pdf (last visited Apr. 12, 2006) (reporting membership equal to 92.9% of the credit union market); Credit Union National Association, What is a Credit Union?, http://www.creditunion.coop/what_is_a_cu.html (noting the existence of more than 9000 federal and state-chartered credit unions nationwide) (last visited Apr. 12, 2006).

free riding, the foundation of their systematic organization lies in the *non-political* services they each provide. As Olson notes:

> A purely political organization—an organization that has no function apart from its lobbying function—obviously cannot legally coerce individuals into becoming members. . . . But if for some nonpolitical reason, if because of some other function it performs, an organization has a justification for having a compulsory membership . . . that organization may then be able to get the resources needed to support a lobby. The lobby is then a by-product of whatever function this organization performs that enables it to have a captive membership.[142]

Thus, to invoke collective action, these associations must provide additional noncollective services that would provide nonpolitical, positive selective incentives to its members. This is, in fact, the case. In addition to advertising its strong lobbying presence, the American Bankers Association currently solicits new membership by offering services to assist members in detecting and detering robbery, solving liquidity problems, and safeguarding customer information.[143] Additionally, the American Bankers Association offers discounts on training, issue-specific newsletters, and an American Bankers Association-sponsored insurance program.[144] The Credit Union National Association ("CUNA") offers similar nonpolitical benefits, including industry-specific publications, access to market research and trends, and education and training materials.[145] Thus, the organization of the banking industry associations can be explained by Olson's "by-product" theory: by offering noncollective services of value to its members, these associations substantially reduce the free rider problem. As a result, they can effectively invest in political activity, as they did in the drafting of Articles 3 and 4 of the U.C.C.

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[142] Olson, supra note 75, at 133.

[143] American Bankers Association, ABA Toolboxes, http://www.aba.com/About+ABA/ABAToolboxes.htm (last visited Apr. 12, 2006).

[144] For a full list of ABA member benefits, see American Bankers Association, ABA Membership Benefits 2004–2005, http://www.aba.com/About+ABA/mem_benefits.htm (last visited Apr. 12, 2006).

[145] For a full list of CUNA member benefits, see Credit Union National Association, The Power of Association Means . . . , http://www.cuna.org/download/powerofassoc05.pdf (last visited Jan. 22, 2005).

In summary, the free rider problem, while not wholly absent, is not prohibitively costly for commercial banks. Despite a seemingly fragmented market, commercial banking is largely dominated by a handful of large money center banks. Additionally, the industry associations responsible for politically influencing the substance of Articles 3 and 4 were able to do so because of the quasi-oligopolistic nature of the banking industry, and because the larger industry associations offer noncollective, nonpolitical services of value as a by-product of membership. In light of these considerations, it is unlikely that the free rider problem substantially diminishes a firm's expected ROPI.

4. Durability of Law

Up to this point, the determinants of ROPI have largely supported the empirical evidence that banking interests invested in politically influencing the uniform enactment of Articles 3 and 4 of the U.C.C. Interest group competition was minimal, the disclosure of valuable proprietary information was unnecessary to the drafting, coalition costs were low, and the structure of the banking industry substantially reduced the free rider problem.

Before reaching the conclusion that banking interests were justified to engage in political activity, however, the durability of the resulting law must be examined. It is this final consideration that makes the empirical evidence so puzzling. The basis for this puzzle is the non-mandatory nature of the U.C.C. The provisions found in Articles 3 and 4 are predominantly default rules—or "off-the-rack" rules supplied by the law in the event that the transacting parties fail to or choose not to negotiate—that may always be explicitly varied by contract.[146] Unlike steadfast mandatory rules, around

[146] Default rules have been defined as:

> [R]ules [that] establish the legal rights and duties of contracting parties in circumstances with respect to which their contract is silent (or has a gap). The law and economics literature distinguishes between two types of default rules. One set provides terms that the parties would not find cost-effective to consider explicitly . . . . The second type of default rules creates incentives for the resolution of asymmetries in information about the subject matter of the contract, its terms, or the conditions of the parties. These 'information forcing' . . . default rules are designed to encourage the informed party to propose a different contract term and, by doing so, reveal information to the less informed party.

Triantis, supra note 12, at 117.

which parties cannot negotiate, default rules may be wholly bargained away ex post, as if they never existed ex ante. The default nature of Articles 3 and 4 is articulated in U.C.C. Sections 1-302(a)[147] and 4-103(a). While the former provision applies to the entirety of the U.C.C., the latter provision applies specifically to Article 4, and states the following:

> The effect of the provisions of this Article may be *varied by agreement*, but the parties to the agreement cannot disclaim a bank's responsibility for its lack of good faith or failure to exercise ordinary care or limit the measure of damages for the lack or failure. However, the parties *may determine by agreement* the standards by which the bank's responsibility is to be measured if those standards are not manifestly unreasonable.[148]

In light of the lobbyist preference for durability of law,[149] one might have predicted the banking interest groups to insist upon mandatory rules that would have effectively etched their preferences into uniform stone. This is far from what actually transpired. Rather, the banking interests emphatically lobbied for the exact opposite—freedom of contract—on the ground that the ability to bargain around the legal provisions would ensure flexibility in a rapidly changing field.[150]

[147] U.C.C. § 1-302(a) reads as follows: "(a) Except as otherwise provided in subsection (b) or elsewhere in [the Uniform Commercial Code], the effect of provisions of [the Uniform Commercial Code] may be *varied by agreement*." U.C.C. § 1-302(a) (2005) (emphasis added).

[148] Id. § 4-103(a) (emphasis added). The Official Comment 1 to § 4-103(a) provides further evidence of the broad freedom of contract contemplated by the Article 4 drafters: "[t]his section . . . permits within wide limits variation of the effect of provisions of the Article by agreement." Id. § 4-103 cmt. 1.

[149] See supra Subsection II.B.4.

[150] See Patchel, supra note 12, at 102 ("The most important of these issues [at the original drafting of Article 4] was the extent to which Article 4's provisions would be subject to agreement otherwise. The banks argued that they needed to be able to contract out of Article 4's provisions in order to allow the bank collection process to change over time as conditions of collection changed."). U.C.C. proponent Professor Grant Gilmore, instrumental in the early drafting of Articles 3 and 4, explained the bank's position as follows:

> Bank collections is a highly technical field; the operation, because of the enormous number of items handled by banks, must be routinized; as conditions change, new operating procedures become necessary—it would therefore be unwise to freeze any particular procedure by statute; bankers are the only people with a sufficient understanding of the technical processes to establish rea-

Despite this rationale for Section 4-103, some drafters, including staunch U.C.C. proponent Professor Grant Gilmore, vigorously objected to the provision as anti-consumer, and suggested that it might cause courts to declare Article 4 unconstitutional as an improper delegation of legislative power to private interests.[151]

Though this broad freedom of contract was particularly inflammatory for opponents of the early drafting, it is not part of the recent controversy.[152] Nevertheless, the original criticism may have been misguided. What the original critics of Section 4-103 evidently failed to consider in their analysis of the consumer-banker bargaining balance of Articles 3 and 4 was the possibility that freedom of contract was in the best interest of the otherwise unrepresented consumers. The reason for this is twofold. First, the provision allows informed consumers to bargain around the inefficient rules that allegedly redistribute the consumer surplus in favor of the commercial banks. Second, even if customers are initially uninformed, market participants and new entrants have an incentive to inform them, perhaps through advertising, to remove any inefficient redistributive effects.[153] Despite this theoretical soundness, the legal academy has failed to study its likelihood. If this does, in fact, reflect reality, any ex post redistributive gains to the commercial banking interests from the institution of inefficient contract terms would be short-lived at best.

Contrary to Professor Gilmore's initial inclination, these provisions facilitate weak legal durability and, hence, a low probability of capturing a positive ROPI. Consequently, it is a great mystery as

> sonable rules; it is absurd, fanciful and professorial to imagine that banks would ever take undue advantage of their customers.

Gilmore, supra note 4, at 376.

[151] Gilmore, supra note 4, at 375–76 (viewing the provision as "a blank check to the order of any private interest group"); see also Beutel, supra note 4, at 360 (referring to § 4-103 as a "trick provision" that enables banks to shirk their collection procedures); Rubin 1988, supra note 4, at 627 n.22 ("The problem that the commentators noted is that the section allows interbank agreements to bind customers who are not parties to the agreement, and allows banks to vary any provision of article 4 . . . by means of small print on the back of a deposit agreement.").

[152] Rubin 1988, supra note 4, at 627 n.22.

[153] For a provocative essay on the limited incentives a banking interest group would have on lobbying for inefficient terms, see Triantis, supra note 12, at 118–20 (proposing interest groups would only lobby for inefficient terms "to facilitate price collusion, exclude competitors or exploit unsophisticated customers").

to why commercial banking interest groups heavily invested in the revision of Articles 3 and 4. Fundamental economic theory suggests that parties will reach ex post efficient equilibrium, notwithstanding ex ante inefficient default terms. In this light, banks will not harness a non-negative ROPI.

With the heart of the puzzle identified, the following section will further examine the notions that a competitive market and informed consumers might frustrate redistributive gains from inefficient terms in Articles 3 and 4. To determine whether the default nature of the U.C.C. might protect consumers from commercial bank exploitation, one must first understand the nature of default rules, the effect of market competition, and the factors that may lead to market failure, thereby upsetting the prediction that firms cannot realize a positive ROPI in the default context of Articles 3 and 4.

III. DEFAULT RULES, EFFICIENT MARKETS, AND INFORMATION ASYMMETRY

A. Microeconomic Theory and the Default Nature of Articles 3 and 4

The analysis that follows requires an understanding of the role default rules play in Articles 3 and 4 of the U.C.C., which consist almost wholly of such rules. Two examples are instructive. First, U.C.C. Section 3-311 states that a party's claim against another is discharged "if the person against whom the claim is asserted proves that the instrument or an accompanying written communication contained a conspicuous statement to the effect that the instrument was tendered as full satisfaction of the claim."[154] Like any default rule, the parties to which this provision applies may contract around its effect. If the claimant (generally a bank) prefers some means other than a "conspicuous statement" by which the person against whom the claim is asserted (generally a customer) informs it of a payment in full accord and satisfaction, the bank could bargain for it.[155] In the end, parties that dislike the default rules can always contract for a different governing regime.

[154] U.C.C. § 3-311(b) (2005).

[155] Incidentally, § 3-311(c)(1) includes a provision that the commercial banks intended to further address the issue of accord and satisfaction. This provision allows

Second, U.C.C. Section 4-406 provides for a term that parties to a banking transaction may vary by contract. The provision reads, "The statement of account [created by the bank] provides sufficient information [to the customer] if the item is described by item number, amount, and date of payment."[156] This provision places a relatively low burden on commercial banks to supply their customers with statement information and places a relatively high burden on customers to track their own banking transactions. While banks may appreciate this legal advantage, consumers may find it annoying. However, because Section 4-406(a) is only a default rule, a customer who prefers a bank statement with more information than that mandated by Section 4-406 could lawfully contract with the bank to achieve that result.

Microeconomic theory suggests that the ultimate terms governed by Articles 3 and 4 of the U.C.C. will be efficient and in the best interest of both commercial banks and consumers.[157] If consumers are sophisticated and informed, they will bargain for efficient terms. However, even where consumers are unsophisticated and uninformed, the market should correct the legal inefficiencies created by Articles 3 and 4 through market expansion and the entry of new competitors. Where the cost of contracting around the default rule is low, new entrants stand to profit.[158]

In other words, if the banking market operates as microeconomics predicts, efficient contract terms should emerge, regardless of consumer information. U.C.C. Section 4-406 provides an instructive example. Because this default term places a minor burden on commercial banks to supply information to their customers regarding their banking transactions, the supply curve will effectively shift out. The motivation behind this is sensible: the legal rule as drafted reduces the cost for producers to engage in business, more find it cost-effective to enter the commercial banking industry, and the

organizations to specify a "designated person, office, or place" to which all customers claiming a payment in full accord and satisfaction of a debt must send their correspondence, effectively placing the burden on the consumer. Id. § 3-311(c)(1).

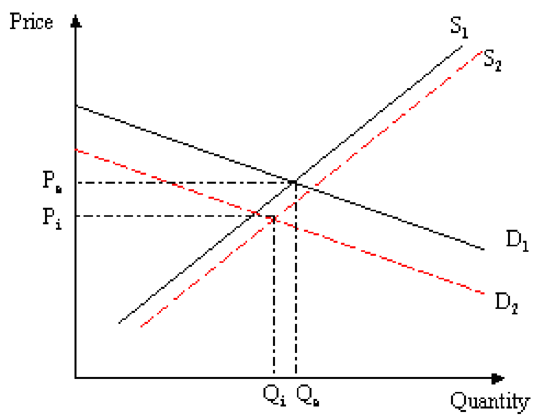
[156] Id. § 4-406(a).

[157] See R. Ted Cruz & Jeffrey J. Hinck, Not My Brother's Keeper: The Inability of an Informed Minority to Correct for Imperfect Information, 47 Hastings L.J. 635, 637 (1996) ("In a perfect world, efficient markets are ubiquitous. Microeconomics provides the foundation and the underlying assumptions for imagining such a world.").

[158] See Triantis, supra note 12, at 120.

net market supply increases. Conversely, because the provision places a greater burden on consumers to track their own financial transactions, the demand curve for such services will shift in. In other words, fewer informed consumers would find it cost-effective to contract for commercial banking services, thereby reducing the market demand. Where the term is inefficient, the shift in the curves would reflect a net cost, in which the latter demand contraction will exceed the former supply expansion.[159] The following exhibit illustrates this economic effect:

Exhibit 2. Economic Effect of an Inefficient Default Term



In this exhibit, S_1 and D_1 represent the original supply and demand curves, respectively, before the institution of the inefficient contract term. At this level, consumers will demand and commercial banks will supply an equilibrium quantity of Q_e at an equilibrium price of P_e. After the law creates an inefficient term, S_1 shifts outward to S_2, but to a lesser degree than D_1 shifts inward to D_2.[160] In this scenario, consumers demand fewer banking services, Q_i, which commercial banks can sell only at a reduced price, P_i. Thus, in the passage of an inefficient term, the expected redistributive gain to the commercial banks disappears, as they must share the

[159] See id. at 119.
[160] Id.

social cost of the inefficient term with consumers.[161] In this context, "[i]f transaction costs are low enough, competition will drive the parties to contract around the inefficient term . . . ."[162]

As a preliminary matter, the ability of a customer to contract around the default rules of Articles 3 and 4 depends in large part on the degree to which a customer is idiosyncratic. A customer that possesses idiosyncratic preferences may in fact be disadvantaged in her ability to contract if she cannot afford to do so. But this is nothing new.[163] There is undoubtedly a cost to changing the legal rules of a banking relationship. If a single customer wishes to contract around Section 4-406(a) so that her account statement contains significantly more detail than that required by the law, the bank will accommodate her by incurring additional marginal costs. Of course, the bank will merely transfer this cost to the customer. The magnitude of these additional costs may in fact be sufficient to dissuade the customer from preferring the new legal rules in the first place. On one hand, if the bank's marginal cost in providing additional statement information is low, the customer may be both willing and able to pay for it. On the other hand, if the bank's marginal cost in providing the additional statement information is high, the customer may be willing but *unable* to pay for it. Thus, idiosyncratic customers may be at an inherent disadvantage due to income constraints. Then again, if only one consumer disagrees with the rules governing her banking relationship, this does not a market make, and it could hardly be argued that all consumers have been exploited. However, if a significant number of customers prefer account statements with more information than that which is provided by Section 4-406(a), the change in demand may no longer reflect a single idiosyncratic customer. Rather, it may reflect a wholly different market than that which the banks anticipated. In this latter context, the default nature of Articles 3 and 4 will facilitate a supply-demand equilibrium that results in efficiency of terms. In short, if the consumers as a *market* demand better, they will receive better.

[161] Id.
[162] Id.
[163] See Robert Cooter & Thomas Ulen, Law and Economics 23 (1988) (explaining that the rational consumer will choose preferences that maximize his welfare, but will be constrained by his income).

Although parties may theoretically contract around default rules, it is not yet clear if the banking market operates as microeconomic theory predicts, and under which circumstances banks and consumers can contract for efficient terms. Fundamental economic theory suggests that producers and consumers will form contracts with only efficient terms when the market is perfectly functioning and the parties have complete information.[164] To understand if consumers will in fact contract with commercial banks for optimal terms, notwithstanding the rules provided by Articles 3 and 4, one must understand whether the commercial banking industry is susceptible to market failure.

B. Asymmetric Information in the Commercial Banking Industry

Economists describe market failure as "a situation in which a market departs so far from one of the competitive assumptions that its performance is impaired."[165] In the context of contracting, the predominant competitive assumptions relate to individual rationality[166] and the contractual environment.[167] The presence of any of the four sources of market failure—monopoly threats, externalities, public goods, and asymmetric information—may significantly undermine one or all of these assumptions. Two of these sources, monopoly threats and asymmetric information, are especially relevant to the commercial banking context. As noted above, the banking industry is thick.[168] It is unlikely that the threat of monopoly looms large in the banking industry. The question therefore centers on the extent to which banking consumers face information asymmetries relative to their corporate counterparties.

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[164] See Russell Korobkin, Bounded Rationality, Standard Form Contracts, and Unconscionability, 70 U. Chi. L. Rev. 1203, 1208 (2003).

[165] Cooter & Ulen, supra note 163, at 233.

[166] The three primary assumptions regarding individual rationality are the following: "1. Decisionmakers have stable preferences; 2. they are constrained in pursuing them; and 3. they advance their private purposes as far as the constraints permit." Id. at 234.

[167] The four primary assumptions regarding the contractual environment are the following: (1) the contract does not create any externalities; (2) each decisionmaker has "full information about the nature and consequences of his choice"; (3) there are enough consumers and producers so that each person has "alternative trading partners"; and, (4) executing a transaction is costless. Id. at 235–36 (emphasis omitted).

[168] See supra notes 131–134 and accompanying text.

Asymmetric information presents a source of market failure that may prevent parties from contracting for efficient terms. Professors Cruz and Hinck describe the problem of imperfect information as follows:

> If information is imperfect . . . the market will not be characterized by complete efficiency. If consumers do not have perfect information, then producers will have an incentive to supply too much or too little of a particular product or product attribute. Consumers may buy too much or too little of a product—foregoing buying products that make them better off and purchasing products that make them worse off.[169]

Imperfect information imposes two costs, which have been termed the "quality effect" and the "quantity effect."[170] Quality effects relate to the reduction in welfare because consumers purchase goods with sub-optimal quality. This is particularly relevant to banking customers opening accounts governed by legal rules not in their best interest. If the asymmetry were exposed and eliminated, the parties would choose an alternative legal regime to maximize their joint welfare.[171] However, the inefficient transaction will persist with asymmetric information because the producer (the bank) receives a larger profit from the redistributive effects of the inefficient term. In other words, the bank has an incentive to exploit consumer ignorance and usurp unilateral profits.[172] Quantity effects reduce welfare when consumers miscalculate the value of a particular good or service, and consequently purchase too much or too little of it.[173] This effect also relates to the commercial banking context, in which consumers may use their bank accounts too much without understanding the true legal risks of doing so.

The implications extend further than the mere avoidance of quality and quantity effects. Regardless of whether the market is perfectly competitive or monopolistic, when both parties have full information, producers will provide efficient contract terms.[174] In a

[169] Cruz & Hinck, supra note 157, at 637.
[170] Id. at 639.
[171] See id. at 638–39.
[172] Id. at 639.
[173] Id.
[174] See Korobkin, supra note 164, at 1209–12.

perfectly competitive market,[175] consumers need not even have the ability to negotiate with producers to obtain efficient contract terms.[176] The strength of the market alone will force producers to provide efficient terms. To illustrate this principle, consider again the account statement disclosure requirements of U.C.C. Section 4-406(a). Assume a commercial bank can provide any additional account information at a flat marginal cost of $5. Assume further that consumers are willing to pay an additional $15. Thus, there is $10 of additional value that parties can extract. If information is perfect and buyer preferences homogeneous, then trade will occur. If a commercial bank attempts to charge more than $15 for this service, consumers will refrain from buying. However, in a thick market, at least one commercial bank will provide the preferred terms, at a price at least greater than $5 (to cover the producer's cost) and less than $15 (to make it worthwhile for consumers to trade). Only when the producer fails to understand the consumer's demands, or the consumer fails to understand the quality of services, will the market fall short of efficient equilibrium. In the end, market pressure will force the bank to offer the efficient disclosure terms at some price between $5 and $15.

1. Perfect Information and Comparison Shopping

In light of this framework, the question remains whether consumers face asymmetric information in their bargaining with commercial banks. If all consumers are informed, the analysis is relatively straightforward and market efficiency should follow. In this event, the primary risk to consumers is that of supracompetitive pricing, which may be reduced or eliminated by promoting comparison-shopping.[177] As Professors Schwartz and Wilde note, "[E]ven when consumers are sufficiently informed about risks to choose contract terms correctly and are getting the contract terms they want, an information problem may exist: firms could be charg-

[175] As noted, the banking industry is not prone to monopoly threats. Therefore, the question of information symmetries may be examined in the context of a perfectly competitive market.

[176] Korobkin, supra note 164, at 1210.

[177] Alan Schwartz & Louis L. Wilde, Imperfect Information in Markets for Contract Terms: The Examples of Warranties and Security Interests, 69 Va. L. Rev. 1387, 1390–91 (1983).

ing supracompetitive prices for terms in response to consumer ignorance of market opportunities."[178] To remedy this problem, they propose that the government first identify those commercial contexts in which informed consumers are ignorant of market opportunity and then institute regulations to promote comparison-shopping. As applied to the commercial banking industry, even if customers are knowledgeable of the legal regime governing their banking agreements, supracompetitive pricing may still pose a risk. Although there is no evidence regarding the extent to which consumers "shop around" for commercial banking services, it is reasonable to believe the costs of doing so are not high. Nevertheless, the risk of supracompetitive pricing is particularly acute in the commercial banking industry, where the U.C.C. consciously fails to regulate pricing of commercial banking services.[179] If future empirical evidence suggests that too few informed consumers comparison shop for commercial banking services, Professors Schwartz and Wilde's argument may be of particular significance, and consumer advocate groups may wish to devote additional resources toward regulations that facilitate comparison-shopping.[180]

2. Imperfect Information, Hidden Default Rules, and Consumer Exploitation

When some or all consumers are uninformed, the plot thickens, and the quantity and quality effects identified above breed inefficiency. As an initial matter, this concern of consumer ignorance should be distinguished from the conventional criticism that pro-

[178] Id.; see also Korobkin, supra note 164, at 1214–15 (noting that when no buyers shop, "each seller should offer the efficient set of contract terms and charge a supracompetitive price designed to maximize profits").

[179] See Rubin 1988, supra note 4, at 625 ("No precedent exists for dealing with pricing issues in uniform state law . . . and pricing in general is among the most difficult subjects to regulate with statutory language. Consequently, the revision [of Articles 3 and 4], like most other payments statutes, restricts itself to stating obligations, rights, and liabilities, and makes no effort to control the price of payment services.").

[180] Professors Schwartz and Wilde offer the following regulatory proposals as potential solutions to promote comparison shopping: (1) to standardize the format relating to disclosure of contract terms; (2) to "require firms to quote price and major terms over the telephone" or an electronic medium (perhaps the Internet, though this was not explicitly contemplated in their 1983 article); and (3) to allow the government to subsidize the production and distribution of price and contract terms that firms offer. Schwartz & Wilde, supra note 177, at 1460–61.

ducers unjustifiably extract the majority of the bargaining surplus by refusing to negotiate the fine-print details of form contract banking agreements with informed customers.[181] As noted, when consumers *know* the contractual terms, efficiency of those terms will follow. The instant argument is fundamentally different, and addresses the situation in which consumers are wholly ignorant of the contract terms; it is not concerned with the bargaining of the parties that results following the consumer's understanding of the contract terms.

There is some intuition that sellers in general enjoy a comparative advantage in possessing unilateral information regarding the quality of the goods or services they provide.[182] This intuition is no doubt magnified in the commercial banking context, which Professors Cooter and Ulen use as their paradigm for asymmetric information in contract: "when a bank presents a depository agreement for the signature of a person opening a checking account, the bank knows far more than the customer about the legal consequences of the agreement."[183] Further fueling this risk of consumer ignorance is the understanding that commercial banks are under no obligation to disclose the legal provisions provided by the U.C.C. to their customers. Although the provisions of Articles 3 and 4 are default terms, they are unique to the extent that they are hidden from the consumers and not readily accessible without some degree of legal acumen. The criticism that consumers will be asymmetrically informed regarding form contract terms should be even greater when there is no form contract whatsoever. Consumers will not find the legal terms governing their banking relationship on the contractual agreement in "fine print"; rather, consumers will not find the legal terms on the agreement at all. As Professor Triantis notes, "Although lobbying for the legislation of [a] term is costly, the statutory term is more likely to escape notice by the contracting partner if it is buried in legislation . . . ."[184] Bank customers may therefore become informed of their legal commercial banking rights in one

[181] See Korobkin, supra note 164, at 1205.

[182] Cooter & Ulen, supra note 163, at 48.

[183] Id.; see also Rubin 1991, supra note 4, at 561–62 (noting that information asymmetry is a source of market failure likely to pose a "major problem in the checking system").

[184] Triantis, supra note 12, at 120.

of two ways: by suffering through a negative experience in which their rights are significantly curtailed by Articles 3 and 4, or by studying the legalese of the U.C.C. in their spare time. The former is likely to create idiosyncratically disenfranchised consumers (which, as noted, is insufficient to cause a shift in market demand[185]) while the latter is likely to be limited to a small fraction of society.[186]

The relatively low risk of a commercial banking consumer encountering a dispute where Articles 3 or 4 provide a suboptimal rule, coupled with the relatively high cost of learning the relevant law, undoubtedly contributes to the persistence of consumer ignorance regarding the legal terms governing their commercial banking agreements. Professor Landes and Judge Posner have argued that when the risk of harm is low, and the information costs are great, imperfect information will constitute a barrier to efficient contracting.[187] A number of scholars have subscribed to and developed this risk-reward analysis.[188]

The commercial banking industry provides a relatively strong, if not obvious, forum in which this low-risk, high-cost tension might thrive. As Professor Patchel notes, "[i]n areas involving technical knowledge, the public generally will 'find it irrational to obtain the information necessary to identify their interests on any given issue and moreover will be ill-equipped to interpret any information they do obtain.'"[189] In light of the relatively low risk of harm compared to the relatively high cost of understanding the relevant but dormant commercial law, it is easy to see why consumers may be

[185] See supra note 159 and accompanying text.

[186] Notwithstanding the clichés regarding the ubiquity of lawyers and law students, it is seemingly unlikely even for this fraction of society to demand more efficient rules governing their banking agreements.

[187] William M. Landes & Richard A. Posner, The Economic Structure of Tort Law 280–82 (1987).

[188] See, e.g., W. Kip Viscusi, Toward a Diminished Role for Tort Liability: Social Insurance, Government Regulation, and Contemporary Risks to Health and Safety, 6 Yale J. on Reg. 65, 82 (1989) ("[I]nformation and transactions costs make complete internalization of the costs of risk impossible."); see also Steven P. Croley & Jon D. Hanson, Rescuing the Revolution: The Revived Case for Enterprise Liability, 91 Mich. L. Rev. 683, 771 (1993) ("Rational consumers will invest only up to the point at which the marginal costs of additional information equal the marginal benefits.").

[189] Patchel, supra note 12, at 132 (quoting Macey, supra note 91, at 1289).

ill-informed regarding their rights and obligations created by Articles 3 and 4.

To respond to the argument that consumers will be uninformed of latent contract terms and therefore subject to exploitative contractual inefficiencies, market proponents have employed the "informed minority" argument.[190] The argument has been summarized as follows: "if a sufficient number of consumers read and understand latent terms and thereby become informed, then they will demand efficient terms, and the producers will in turn provide those terms to all consumers."[191] The theory assumes that a producer will be driven in part by the marginal consumer as opposed to the infra-marginal consumer. Because the cost of losing the former exceeds the benefits of exploiting the latter, a producer will agree to efficient terms for all customers to maximize its profits.[192]

Though the informed minority argument has theoretical credibility,[193] it is subject to a number of practical problems. First, "the existence of any sizable informed minority" sufficient to move the market is unlikely.[194] The first basis for this is the likely emergence of the free rider problem in the consumer context. Consequently, each consumer has an incentive to withhold his or her contribution and instead hope another member will donate time to understand the full import of the banking contract.[195] Given the vast number of consumers, the problems of collective action will be exaggerated in the commercial banking context. Few customers would be willing to incur information costs to study Articles 3 and 4 so that all consumers may benefit. As Professors Cruz and Hinck note, "we are left with a situation where all buyers would prefer that an informed minority existed . . . but none want to incur the cost of information necessary to be part of that minority."[196] The free riding problem seriously threatens the validity of the informed minority theory.

[190] Cruz & Hinck, supra note 157, at 636.
[191] Id.
[192] Id. at 646.
[193] For a model of the informed minority theory, see Alan Schwartz & Louis L. Wilde, Intervening in Markets on the Basis of Imperfect Information: A Legal and Economic Analysis, 127 U. Pa. L. Rev. 630, 648–53 (1979).
[194] Cruz & Hinck, supra note 157, at 664.
[195] See Olson, supra note 75, at 11.
[196] Cruz & Hinck, supra note 157, at 669.

In addition to the free rider problem, it may be irrational for uninformed buyers to incur information costs, and therefore they may not be expected to do so.[197] For individual offers (non-form contracts), Professor Katz has argued that a producer will invest in information costs to bring each term to the consumer's attention. By doing so, the producer will maximize the trade surplus. However, for standard form contracts, Professor Katz predicts that the consumer will choose not to read each term of the contract, and the seller will therefore provide the lowest level of quality.[198] The reason for this has both intuitive appeal and direct application to the commercial banking context.[199]

Although the assumptions underlying Professor Katz's theory are subject to several criticisms,[200] his use of game theory to predict

[197] Avery Katz, The Strategic Structure of Offer and Acceptance: Game Theory and the Law of Contract Formation, 89 Mich. L. Rev. 215, 272–93 (1990). For a summary of Professor Katz's findings, see Cruz & Hinck, supra note 157, at 664–68.

[198] Katz, supra note 197, at 288.

[199] Professor Katz's theory is briefly as follows: To become informed, consumers must incur information costs. Because commercial banks do not provide their customers with the legal substance of Articles 3 and 4—not even on a form contract—banking customers directly bear this cost. If they choose to incur these costs, consumers become informed, and will demand banking services with a predetermined reservation quality for a predetermined reservation price. Anticipating this, commercial banks will offer their informed customers that reservation quality, but only at a price roughly equal to the consumers' reservation price. Because the resulting price approximately equals the consumers' expected value of the services, they receive no added value from the transaction. Rather, the consumer is left with a residual net decrease in value equal to the incurred information costs. Thus, in equilibrium, consumers will not spend resources to acquire information. Realizing this, commercial banks will provide contracts with latent terms of the lowest quality acceptable to consumers. In turn, by anticipating this poor quality, consumers will agree to pay a price equal to that which they would pay for a contract with the most unfavorable terms. If the commercial bank has more to gain by offering more favorable terms, it will make an individual offer so that the quality of the contract is available to the customer at no cost. Though banks may in fact offer individual terms for corporate banking contracts where the notional value at stake is high, they are unlikely to do so for consumers generally. See Katz, supra note 197, at 272–293.

[200] Professors Cruz and Hinck identify two potential criticisms that may undermine Professor Katz's theory. First, his analysis relies heavily on the game theory notion that the transacting parties are highly rational and engage in a great deal of forethought to anticipate each other's moves. As Cruz and Hinck suggest, "rarely do people take the analysis through multiple iterations to anticipate the behavior of others, their expected responses, and others' expected responses to their expected responses." Second, Professor Katz's "assumption that reputation is not a factor may be" empirically flawed. Id. If reputation is a major factor for commercial banks, they

why consumers will not incur information costs provides a reasonable basis to conclude commercial banking customers will not likely become informed. The more likely means by which banking customers will come to understand the terms of Articles 3 and 4 is through idiosyncratically negative experiences—not through some premeditated concerted effort that requires the high cost of comprehending the substance of Articles 3 and 4.

Professors Cruz and Hinck provide a third criticism of the informed minority theory, arguing that even where an informed minority exists, it would "rarely solve the problem of imperfect information."[201] Two arguments support this proposition. First, it is not certain that the marginal consumer will represent the *average* consumer.[202] Consequently, "the preferences of the marginal consumers should not be presumed to be efficient for the market as a whole."[203] Second, the assumption of the informed minority theory that sellers cannot differentiate among buyers may not be valid.[204] By providing heterogeneous products and services (perhaps a menu of different checking accounts with distinct features), "producers can allow buyers to self-differentiate. They can offer some products with efficient terms and some without."[205] While the informed customers will choose to purchase services with efficient terms, the uninformed customers will remain ignorant of the inefficiencies.[206] Ultimately, these practical objections to the informed minority theory suggest that consumers may not be able to rely on an informed minority for protection from asymmetric information inefficiencies.

3. The Behavioral Economics Consideration: Bounded Rationality

Notwithstanding the informed minority theory and its objections, there is another reason to believe that consumers are not necessarily exploited by sophisticated commercial banks. The effi-

may choose instead to offer more favorable terms. Cruz & Hinck, supra note 157, at 667.

[201] Cruz & Hinck, supra note 157, at 664.
[202] Id. at 670.
[203] Id. at 676.
[204] Id. at 672.
[205] Id.
[206] Id.

cient operation of a thick market does not rely upon consumers to actively inform themselves of important contract terms. Rather, market competition itself is sufficient to inform the participants. For example, if term *X* offered by Bank *A* is truly inefficient, but flies under the radar of the average consumer, it does not necessarily follow that consumers will blindly accept term *X*. A competitor—Bank *B*—could easily incur some small cost to offer a more desirable and efficient term ~*X* to consumers, or at least market the term such that consumers are now informed of the formerly inconspicuous term. In light of this consideration, an alternative reason must explain why consumers fail to contract for more efficient terms. Mere information asymmetry provides an incomplete explanation. A better answer, therefore, may be found in the behavioral economics findings that consumers possess bounded rationality.

Professor Korobkin has pointed to bounded rationality as a basis for consumers' inability to fully embrace and discount relevant information *even when explicitly informed of the contractual terms*. He summarizes his argument as follows:

> Efficiency requires not only that buyers be aware of the content of form contracts, but also that they fully incorporate that information into their purchase decisions. Because buyers are boundedly rational rather than fully rational decisionmakers, they will infrequently satisfy this requirement. The consequence is that market pressure will not force sellers to provide efficient terms.[207]

This theory, deeply rooted in decisionmaking behavioral theory, rests upon a distinction between "salient" and "non-salient" terms. Salient terms are those "product attributes that are evaluated, compared, and implicitly priced as part of the purchase decision."[208] Non-salient terms, alternatively, are those that are not (though the consumer may be aware of their existence).[209] Although Professor Korobkin acknowledges that research in this field suggests it is "highly contingent on context," he argues there are two reasons to believe that terms located in form contracts will be non-salient to

[207] Korobkin, supra note 164, at 1217–18.
[208] Id. at 1225.
[209] Id.

customers: (a) the complexity of form contracts and (b) the inherent non-salience of attributes.[210]

First, the complexity of form contracts suffices to discourage consumers from investing adequately in understanding them.[211] To support this point, Professor Korobkin relies upon research by decision theorists that suggests "increased information load causes increased selectivity in the information processed."[212] Empirical research also suggests that decisionmakers are prone to investigate only a few product attributes.[213]

The implications of this empirical research directly bear on the commercial banking context. The complexity of Articles 3 and 4 is without dispute. If the U.C.C. purported to be consumer-accessible, this argument might not withstand objection. This is not the case, however, and a tenet of the original drafting of Articles 3 and 4 was to reflect actual business practices and concepts intelligible to sophisticated people.[214] Consequently, the terms provided by Articles 3 and 4 are not intended for the layperson. As Professor Rubin notes, "Deposit contracts are complex, involving a variety of different price items . . . . Loss allocation provisions are even worse; they involve unfamiliar legal concepts, and virtually no consumer can estimate the likelihood of falling victim to a bank error or fraud."[215] In light of these considerations, it is reasonable to con-

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[210] Id. In an unpublished article, Professor Schwartz provides an argument suggesting that the market is strong enough to overcome some degree of consumer cognitive deficiencies. Drawing on results from behavioral psychology experiments aimed at testing whether market participants are driven by their own rationality or by the market mechanism itself, Professor Schwartz concludes that the market may substitute for irrationality in at least some simple contexts. Alan Schwartz, How Much Irrationality Does the Market Permit? 3 (Jan. 24, 2005) (unpublished manuscript), available at http://www.law.virginia.edu/home2002/pdf/olin/schwartz.pdf. Although these results must be tested in more rigorous contexts, they may ultimately cast doubt on both Professor Korobkin's theory of bounded rationality, as well as Professor Katz's game-theoretic objection to the informed minority theory.

[211] Korobkin, supra note 164, at 1225–26.

[212] Id. at 1226.

[213] Id. at 1227–28 ("[E]mpirical research . . . suggests the number of attributes decisionmakers are likely even to investigate . . . when choosing between alternatives is surprisingly modest by contemporary product standards, perhaps as few as five (although this number can certainly vary depending on the individual, the importance of the choice, and the time allotted to make the decision).").

[214] See supra note 113 and accompanying text.

[215] Rubin 1991, supra note 4, at 562. For additional authority on the role of asymmetric information of consumers caused by complexity in credit transactions, see Jef-

clude that the complexity of Articles 3 and 4 facilitates asymmetric information at the expense of consumers.[216]

Second, Professor Korobkin argues that relative to other product attributes that receive the most attention from consumers (such as price), form terms do not attract consumers' voluntary or involuntary awareness and incorporation.[217] Fine-print contract terms are non-salient for two reasons. First, the "terms found in form contracts often, although not always, will be less important to buyers than other attributes such as price, functionality, and physical appearance, and thus will be a less likely focus of attention."[218] In the commercial banking context, customers will concentrate only on salient terms such as pricing, withdrawal limits, and overdraft protection. Articles 3 and 4 do not govern these salient issues. More importantly, the provisions of Articles 3 and 4 are not even available on form contracts: they are *hidden default rules*, physically unavailable to the consumer. If Professor Korobkin's analysis applies to form contracts, it is certainly reasonable to extend the analysis to off-contract statutory terms. Not only are the relevant legal terms governing most consumer banking agreements absent from the banking agreement, but Articles 3 and 4 impose no requirement on commercial banks to disclose the legal terms governing the contract. This regime creates an even greater risk of consumer bounded-rationality than standard form contracts.

In addition to non-salient terms, Professor Korobkin notes that consumers will not pay attention to terms that address "eventualities that are extremely unlikely to occur."[219] This provides further evidence that consumers will refrain from devoting resources to understanding Articles 3 and 4, which govern the loss allocation between parties resulting from fraudulently forged indorsements,

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frey Davis, Protecting Consumers from Overdisclosure and Gobbledygook: An Empirical Look at the Simplification of Consumer-Credit Contracts, 63 Va. L. Rev. 841, 845 (1977).

[216] This problem of legal complexity is unlikely to emerge when commercial banks bargain with businesses, which have the resources and expertise to parse through Articles 3 and 4. Rubin 1991, supra note 4, at 562.

[217] Korobkin, supra note 164, at 1226.

[218] Id. at 1230.

[219] Id. at 1232.

forged signatures, and material alterations.[220] Although the risk of fraud is within the range of ex post possibilities, and industry losses per year are significant,[221] consumers are likely to be incapable of calculating the true probability of such an occurrence.[222]

As a result of term non-salience, product complexity, and consumer inability to appropriately discount risks, sellers possess an incentive to behave strategically and increase their own profits at the expense of informed, but "unknowing buyers."[223] Market forces will rarely correct the resulting inefficiencies. New entrant attempts to make salient terms that would otherwise be non-salient through advertising will only succeed if the advertising firm possesses a competitive advantage in providing the more efficient term.[224] Without the competitive advantage, advertising is but a public good susceptible to the free rider problem.[225] Additionally, it is unlikely that sellers will consistently find success in this advertising strategy. First, the problem of adverse selection, in which the resulting buyers that respond to the advertising will not be profitable, might alone be sufficient to dissuade customers from advertising

[220] The treatment of forged indorsements, forged signatures, and material alterations is not easily discernible from Articles 3 and 4. Instead, it requires a relatively complex patchwork involving several transfer and presentment warranty provisions, including U.C.C. §§ 3-416, 3-417, 3-418, 4-207, and 4-208. As a general matter, the payor bank is responsible for losses resulting from fraudulently signed checks, while the bank of first deposit is responsible for losses resulting from fraudulently indorsed checks and materially altered checks. Articles 3 and 4, however, make a number of defenses available to commercial banking entities that substantially shift the risk of loss from fraud to consumers as a practical matter. These defenses include fraud by an entrusted employee of the payee (§ 3-405), negligence of the customer contributing to the forgery (§ 3-406), failure of the customer to report forgery in a timely manner (§ 4-406), and fraud induced by imposters or fictitious payees (§ 3-404).

[221] In 2003, there was $677 million in actual losses and $5.5 billion worth of attempted fraud. Press Release, American Bankers Association, Attempted Check Fraud Increases to $5.5 Billion According to ABA Survey (Nov. 22, 2004), available at http://www.aba.com/Press+Room/112204CHECKFRAUD.htm.

[222] See Korobkin, supra note 164, at 1232 ("One of the most robust findings of social science research on judgment and decisionmaking is that individuals are quite bad at taking into account probability estimates when making decisions."). Korobkin notes that a possible "explanation for why individuals might treat certain low-probability risks as if they were virtually non-existent is that they are excessively confident in their likelihood of avoiding harm." Id.

[223] Id. at 1234.

[224] Id. at 1242–43.

[225] Id. at 1241.

non-salient terms.[226] Second, sellers must "balance the benefits of exploiting their competitive advantage" with the cost of awakening the market: "[o]ften, the value to a seller of making a term salient will be relatively small and the cost of changing the way a substantial number of buyers shop for the product enormous."[227] Finally, it is unlikely that a seller could ever make a term salient "no matter how many resources it expends on advertising" if the term will rarely be invoked in the course of business.[228] In light of these considerations, it is improbable that the market can significantly effect endogenous changes in consumer salience. Rather, sellers will be more inclined to exploit consumer ignorance and provide inefficient terms to redistribute the bargaining surplus.

The implications of market failure because of cognitively-rooted information asymmetry are great. Of primary importance, it suggests that consumers will not exploit the default nature of Articles 3 and 4, which has a direct bearing on a bank's expected ROPI. Contrary to the provisions of the U.C.C. that suggest otherwise (Sections 1-302 and 4-103), Articles 3 and 4 may in fact possess a great degree of legal durability. This conclusion, heretofore unacknowledged in the legal literature, suggests that banking interest groups will be able to capture a positive return on their lobbying activities.

IV. THE POSITIVE RETURNS FROM LOBBYING FOR ARTICLES 3 AND 4

Part III sought to demonstrate how and why the commercial banking industry is able to harness a positive return on its political investment. The finding that information asymmetries in the commercial banking context are sufficient to cause market failure and prevent efficient contracting lends support to those critics of the U.C.C. who have argued that banking interests jeopardize the substance and efficiency of Articles 3 and 4. Part III, however, did not contemplate the actual substantive returns that banks hope to capture through their lobbying efforts. Four primary benefits accrue to

[226] Id. at 1242.

[227] Id. at 1242–43; see also Cruz & Hinck, supra note 157, at 660 (noting that sellers will bear the cost of advertising latent terms only when expensive products are at stake).

[228] Korobkin, supra note 164, at 1243.

commercial banks by influencing Articles 3 and 4. First, commercial banks obtain favorable "sticky" default terms that unsophisticated and uninformed consumers cannot reasonably bargain around and that the competitive market cannot correct. Second, commercial banks invest in political activity to acquire market power, which may be accomplished in two ways: (a) by raising the cost of business for commercial banking competitors and (b) by avoiding antitrust regulation. Third, banks will lobby for bright-line rules in Articles 3 and 4 to restrain judicial interpretation that may be adverse to commercial banking interests. Finally, banks politically invest in the substance of Articles 3 and 4 to prevent the regulation of legal terms that are currently favorable to their interests at common law. Banking interests would prefer to take the terms off of the regulation table, rather than face the risk that common law currently favorable to their interests might be altered in favor of consumers. The following sections examine these four benefits commercial banks hope to realize by influencing the U.C.C. lawmaking process.

A. Favorable "Sticky" Default Terms

The first benefit commercial banks receive by shaping the substance of Articles 3 and 4 is the passage of favorable but inefficient legal terms that govern their banking agreements and redistribute the bargaining surplus from the consumer to the bank. As the foregoing analysis illustrated, consumers will be largely incapable of reversing the redistributive effects of these terms.

Furthermore, the uniform character of Articles 3 and 4 endows the governing terms with an entrenched character that contributes to their "stickiness." As Professors Ribstein and Kobayashi note, "Wide adoption may more fully achieve the [interest] group's objectives by making it harder for those who lose under the law to escape it by moving or by contracting to apply the law of a nonenacting state."[229] This may explain the commercial banking industry's primary objective of uniform adoption.[230] Although the introductory text to Article 3 reflects the drafters' belief that uniformity or federal preemption is necessary for the use of checks as a "viable

[229] Ribstein & Kobayashi, supra note 6, at 147.
[230] See supra note 115 and accompanying text.

payment system in international and national transactions,"[231] uniform adoption also substantially reduces the likelihood that consumer advocates can curtail the legal effect of Articles 3 and 4.

B. Acquisition of Market Power

Increased market power constitutes the second positive return commercial banks might capture from lobbying for the substance of Articles 3 and 4. Because the legal terms provided by the U.C.C. represent a collective good, however, it is unlikely that competing commercial banks invest in lobbying these provisions to gain market power relative to *each other*. Rather, banks may lobby in order to gain market power relative to competing industries or economic substitutes. In general, a firm politically invests in lobbying to elevate its market power in two ways: (a) as a sabotage strategy to elevate the cost of doing business for small or new competitors[232] or (b) to avoid the scrutiny of antitrust regulators.[233]

1. Competitor Cost-raising

Firms frequently use political lobbying as a means to elevate a competitor's costs. This cost-raising may emerge in two ways. First, a politically dominant producer may provide information to effect substantive rules that uniquely disadvantage other industry competitors;[234] or a particular interest group may provide the legislature with negative information regarding a competing interest group to sabotage its countervailing political influence.[235]

Although cost-raising represents a real return on political investment, it is unlikely that commercial banking interests partici-

[231] U.C.C. art. 3 prefatory note at 354–56 (2005).

[232] See, e.g., Thomas G. Krattenmaker & Steven C. Salop, Anticompetitive Exclusion: Raising Rivals' Costs To Achieve Power over Price, 96 Yale L.J. 209, 230–42 (1986) (discussing generally the corporate strategy of engaging in conduct that elevates the cost of business for competition in the antitrust context, though not explicitly identifying lobbying as one incarnation of this strategy); see also Triantis, supra note 12, at 119 ("[T]he statutory terms may affect more adversely the position of actual or potential competitors than that of the dominant party itself.").

[233] Triantis, supra note 12, at 119.

[234] Ribstein & Kobayashi, supra note 6, at 142 ("[I]ndustry groups may advocate inefficient laws that disproportionately burden their smaller or newer competitors.").

[235] See Kai A. Konrad, Sabotage in Rent-Seeking Contests, 16 J.L. Econ. & Org. 155, 156 (2000).

pated in the revision of Articles 3 and 4 as a means to elevate the costs of competing banks or interest groups. None of the Article 3 and 4 provisions encumber small or new banking entrants. If anything, the provisions of Articles 3 and 4 lower the barriers to entry by lowering the legal burdens placed on banks. Additionally, as noted above, no competing interest groups participated in the revisions process that might have threatened the commercial banking preferences.[236] Non-banking corporate interests—the only significant interest group outside banks that contributed to the promulgation and revision of Articles 3 and 4—did not oppose the banking industry's preferences.[237] In light of these considerations, it is improbable that commercial banks expected a positive return from their political investment in the form of increased competitor costs.

2. Avoidance of Antitrust Regulation

A second means by which an interest group may secure stronger market power is by lobbying to avoid antitrust regulation.[238] While private agreements among members of a cartel provoke antitrust scrutiny, several Supreme Court decisions have held that "concerted efforts to restrain trade by petitioning governmental entities are immune from antitrust liability."[239] Consequently, lobbying for rules that standardize non-price terms may effectively reduce the risk of antitrust liability.

Because Articles 3 and 4 in fact standardize a number of non-price terms that apply to consumer banking agreements, it is possible that the resulting returns from lobby expenditures may encompass reduced antitrust scrutiny. These returns may be especially beneficial to the commercial banks in light of the recent governmental deregulation and increased consolidation of the banking

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[236] See supra Subsection II.C.1.

[237] Rubin 1993, supra note 4, at 765.

[238] Triantis, supra note 12, at 119.

[239] Id. at 120 (discussing *United Mine Workers of America v. Pennington*, 381 U.S. 657 (1965) and *Eastern Railroad Presidents Conference v. Noerr Motor Freight*, 365 U.S. 127 (1961)). This is commonly referred to in antitrust law as the Noerr-Pennington Doctrine.

industry, which may very well garner heightened scrutiny from the Department of Justice Antitrust Division.[240]

C. Restraint on Judicial Interpretation Adverse to Commercial Banking Interests

Perhaps the most important return banking interest groups obtain from politically influencing Articles 3 and 4 is the resulting restraints placed on judicial interpretation that may be adverse to commercial banking interests. By drafting bright line rules that leave little room for judicial discretion, commercial banks effectively reduce the volatility of their expected gains from the favorable legislation. Coupled with the asymmetric information that prevents consumers and competitors from agreeing to economically or socially optimal terms, unambiguous rules that restrain judicial interpretation insure strong legal durability of Articles 3 and 4, notwithstanding their default nature. As Professor Tollison has noted, when judges interpret the law according to the legislature's original intent, the "laws become more valuable because they endure longer. The acting legislature's intent is upheld in this theory of the independent judiciary, making each legislature's actions more durable and worth more to interest groups."[241]

Because courts may upset the banking industry's expected positive ROPI by misinterpreting or narrowly interpreting Articles 3 and 4, the revisions process may be seen more as a means of influencing the *judiciary*, rather than the legislature. In fact, restraining judicial discretion was a priority in the original drafting of Articles 3 and 4. Professor Kripke observed the tension between practitioners and academics regarding the extent to which the U.C.C. left some issues ambiguous:

[240] Beginning in the 1970s, deregulation of the banking industry removed significant barriers for commercial bank acquisition and evoked a heightened concern for the threat of monopolization in the banking industry. However, the evidence of post-deregulation merger activity suggests a procompetitive result. See, e.g., Kevin J. Stiroh & Philip E. Strahan, Competitive Dynamics of Deregulation: Evidence From U.S. Banking, 35 J. Money, Credit & Banking 801, 801 (2003) ("This deregulation created a more competitive environment by allowing banks to enter new markets and threaten incumbent banks.").

[241] Tollison, supra note 87, at 345.

> The extent to which the draftsmen left commercial law without rules operating with certainty made some of the practicing members of the sponsor organizations very unhappy. . . . Where the practitioners wanted problems answered in the statute, the draftsmen were content to leave the answers to the judicial process.[242]

The revision's emphasis on clarity was no different. At the time of the revision, Professor Rubin noted, "The first goal [of the Articles 3 and 4 revisions] is to modernize the UCC rules and make them consistent with current technological developments. The second is to clarify or correct those provisions that have caused interpretive difficulties for the courts."[243] To limit judicial discretion, the Official Comments to at least one provision in Article 4 explicitly adopt the interpretation of a particular court thought to be an accurate representation of the drafters' original intent.[244]

Most positive scholarship suggests the institutional constraints of the judiciary affect strict legislative interpretation.[245] Professors Goetz and Scott have noted that courts generally tend to treat state enacted rules as presumptively fair, which "often leads to judicial disapproval of efforts to vary standard implied terms by agreement."[246] This judicial deference directly applies to the instant context and may serve to magnify the stickiness of the default terms in Articles 3 and 4. As a result of this institutional bias, opting out of these default provisions may be difficult for consumers even when

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[242] Kripke, supra note 4, at 332.

[243] Rubin 1988, supra note 4, at 628.

[244] For example, the interpretation of damages against a collecting bank for its failure to return an item within the midnight deadline in *Appliance Buyers Credit Corp. v. Prospect National Bank*, 708 F.2d 290, 295 (7th Cir. 1983), is explicitly adopted in Official Comment 3 to U.C.C. § 4-214. U.C.C. § 4-214 cmt. 3 (2005). Conversely, the revised definition of "ordinary care" codified in § 3-103(a)(9) overruled the effect of *Medford Irrigation District v. Western Bank*, 676 P.2d 329, 332 (1984), which held that a bank's failure to examine the checks constituted lack of ordinary care. Rubin 1991, supra note 4, at 567.

[245] See supra note 96 and accompanying text.

[246] Charles J. Goetz & Robert E. Scott, The Limits of Expanded Choice: An Analysis of the Interactions Between Express and Implied Contract Terms, 73 Cal. L. Rev. 261, 263 (1985).

the contract terms are salient,[247] and may very well raise the banking interest's expected ROPI.

While the normative debate regarding the role of the judiciary in enforcing the intent of the legislature when subject to interest group influence remains unresolved, the evidence suggests that interest groups are largely successful in restraining judicial discretion. This allows commercial banks to capture yet another positive return on their lobbying investment.

D. Prevention of Legislation

Finally, banks may lobby merely to prevent regulation of favorable common law. If law is already favorable at common law, firms may find it unnecessary to codify the common law through statutory legislation. Doing so may merely upset the status quo. As Professor Hart notes, "[i]ndustries (and individual firms within them) may take political action in order to mitigate risks or bolster their legitimacy, rather than to secure tangible gains. *Maintenance of the status quo may well be considered a victory for a threatened industry . . . .*"[248]

The limited scope of the early drafts of Articles 3 and 4 lends credence to this proposition. To combat the potential early criticism that Articles 3 and 4 addressed to wide a scope, "the drafters made compromises within the subject matter covered by the Code . . . . To the extent possible, these compromises took the form of exclusions of certain subject matter from the Code."[249] The issues that were not embraced by the early drafts of the U.C.C. were those terms that are generally favorable to banks at common law, and therefore (according to the banks) need not be regulated whatsoever. Among the rights favorable to commercial banks at common law but unregulated by the U.C.C. are the "common law

[247] Id. As a possible solution to this problem of institutional bias in favor of implied terms, Professors Goetz and Scott suggest well-defined rules of interpretation that provide "certain standards of artful wording" that allow courts to easily discern when parties to a contract wish to opt out of the state-provided terms. Id. at 290–91.

[248] Hart, supra note 59, at 265 (emphasis added); see also McChesney, supra note 1, at 2–3 (noting how campaign contributions may be paid "in exchange for politicians' doing nothing, when they could do something").

[249] Patchel, supra note 12, at 100–01.

rights to accelerate notes and exercise setoffs."[250] It is also possible that this explains why the drafters of Articles 3 and 4 avoided any regulation of pricing.[251] Banks have consistently avoided the regulation of these terms under the U.C.C for fear that the codified law will adopt a position more favorable to consumer interests.

CONCLUSION

The foregoing analysis addresses a question currently unanswered in the academic literature condemning Articles 3 and 4 of the U.C.C. The puzzle this Note centers around is the default nature of the Code provisions. Scholars have long argued that these Articles are inefficient and impose permanent costs on consumers. Microeconomic theory and the right to contract, however, suggest the ultimate terms of Articles 3 and 4 will achieve efficient equilibrium notwithstanding ex ante sub-optimality. This Note considers both theories and provides an analytical framework to show why the default nature of Articles 3 and 4 prevents parties to a banking agreement from arriving at socially optimal contract terms.

Recent scholarship regarding behavioral decision-making and bounded rationality suggests consumers will be incapable of discounting and internalizing non-salient contract terms. As a result, consumers may suffer from "locked" asymmetric information that effectively precludes them from bargaining for ex post efficiency. The line between the salient and non-salient is particularly acute in the context of a commercial banking agreement, where the terms are complex, hidden, and contemplate small risks that most consumers do not expect to encounter at the time of contracting. It is therefore both plausible and probable that commercial banks are able to exploit the sticky default rules in their favor, and capture a positive ROPI. This explanation comports with the empirical evi-

[250] Rubin 1988, supra note 4, at 627. Despite U.C.C. silence on these issues, a number of other unregulated concerns have been addressed by federal legislation. The Electronic Fund Transfer Act, 15 U.S.C. §§ 1693–1693r (2000), and the Truth in Lending Act, Pub. L. No. 104-208, 92 Stat. 3278 (codified as amended in scattered sections of 15 U.S.C.), for example, govern credit card transactions and electronic funds transfers. This obviously poses the greatest risk to commercial banks choosing to lobby for less regulation: if consumers or other interest groups with antithetical preferences mobilize, unregulated issues such as pricing and note acceleration may ultimately be regulated by federal legislation unfavorable to banks.

[251] Rubin 1991, supra note 4, at 563.

dence of commercial banking lobbying activity, as well as conventional economic theory holding information asymmetry as a source of market failure. As this Note illustrates, the cognitive limits of consumers enable banking firms to realize at least four different returns from their political investment.

Exploring the question of whether and how a banking interest group can capture a positive ROPI has significant implications for scholars, lobbyists, consumers, and policymakers alike. First, understanding how interest groups can capture a positive ROPI provides support to the current criticism directed at Articles 3 and 4. Policymakers and consumers cannot simply expect the marketplace to resolve inefficient legal provisions. Second, the above analysis provides interest groups with a framework from which they might re-evaluate their lobbying strategy. Only when an interest group addresses the four Political Investment Threshold Inquiries may it expect to best allocate its resources for political ends. Of primary importance is the bank's ability to predict its expected ROPI. Finally, the foregoing analysis illuminates the *substantive* returns that interest groups might expect to realize through political investment of Articles 3 and 4. Policymakers might contemplate these ends, oftentimes not explicit, to shape future banking regulations.

The observation that bounded rationality constitutes a new source of market failure raises a number of questions beyond the scope of this Note. If human cognitive deficits essentially transform default rules into quasi-mandatory rules, it is no longer clear how effective default rules are in arriving at socially-optimal values. This further suggests that, in at least some circumstances, the law should fix values for consumer contract terms that are remote or unusually complex. Although this prescription depends largely on the institutional competence of policymakers to overcome their own bounded rationality, it is more likely to facilitate efficient trade than the current regime. At the very least, this behavioral economics approach provides policymakers with a different angle to examine public choice concerns. The insights of bounded rationality suggest that, in some cases, private interest group capture is more likely, and the marketplace will stand idle in its supposedly inevitable pursuit of the invisible hand.