Rationality, Accident, and Priority
Under Article 9 of the Uniform Commercial Code

David Gray Carlson*

A common project of law professors is to look at a body of law and to deduce the one normative or descriptive principle that "explains" it. Such explanations imply some sort of immanent rationality behind a vast quantity of historically disconnected law. I am sure that those who produce these simplistic explanations imagine that they are giving some sort of immanent rationality behind a vast quantity of historically disconnected law. 

* Associate Professor of Law, Cardozo Law School, Yeshiva University.
I wish to thank Allan Axelrod, William W. Bratton, Jr., Carolyn Bruckel, Arthur Jacobson, Steve Nickles, David Rudensteine, Jeanne L. Schroeder, Paul M. Shupack, Stewart Sterk, Katherine Van Wetzel Stone, David Trubek, and Charles Yablon for their help on earlier drafts of this Article. I also wish to acknowledge the valuable assistance of Homer Kripke and Carl Felsenfeld in helping to reconstruct the history of Article 9 priorities. A special debt is owed to Charles J. Ten Brink of the University of Chicago Law Library and Judith M. Scott of the New York Law Revision Commission for their very generous help with documentary research.

1. Anthony D'Amato has a theory on why so much revelatory literature encumbers the law reviews. He notes that "the information value of any given message increases as the actual message diverges from the predicted message." D'Amato, Legal Uncertainty, 71 CALIF. L. REV. 1, 19 (1983) (citing, inter alia, R. Cox, THE ALGEBRA OF PROBABLE INFERENCE 35-40 (1961)). D'Amato continues:

Many in this group [scholars, law review contributors, and other legal commentators] perceive that they may advance professionally if their writings provide a great deal of information value. Other things being equal, a professor of law will reap greater professional rewards by stating a new theory than by merely restating the law. For a new theory has information value; a restatement, by contrast and almost by definition, is not noteworthy.

Id. at 21-22.

2. Roberto Unger argues that most lawyers do assume an immanent rationality in the law. He writes:

The many conflicts of interest and vision that law-making involves, fought out by countless minds and wills working at cross-purposes, would have to be the vehicle of an immanent rationality whose message could be articulated by a single cohesive theory. This daring and implausible sanctification of the actual is in fact undertaken by the dominant legal theories and tacitly presupposed by the unreflective common sense of orthodox lawyers.

explanations, if pressed, would concede that their single theory is only one way of personally understanding a law—merely a "useful" heuristic. Few would claim that their overriding explanatory principle describes the historical intent of all legislators or represents the product of some evolutionary law of history. Fewer still have done the sociological research necessary to establish the connection between the purpose and effect of legislation. The more careful legal scholars will tend to hedge their deductions by pointing out that their empirical assumptions have not been and could not be demonstrated.

If this hypothetical confessional instinct were translated into legal scholarship, almost all the theogonies deduced from contemplating the texts of cases and statutes would disappear, to be replaced by some exceedingly modest suggestions full of self-consciousness about the difficulties of cause and effect between law and society. Although less dazzling, such a literature would constitute an advance. The assertion that laws are dictated by some overriding normative principle is paralyzing. The revelation that laws are sometimes the product of numerous conflicting desires, or even historical accident or public apathy, should help lawyers realize the full measure of choice open to them in dealing with the interpretation of law.

This Article is a stab at an "informed" explanation of the rules governing priorities between secured lenders under Arti-

Unger's criticism of the average lawyer seems overstated. Lawyers have their reflective and unreflective moments. The average lawyer would accept readily most of Unger's points about legal reasoning if they were carefully explained. Of course, even the most philosophically trained person occasionally confuses theory and practice. See, e.g., Boyle, The Politics of Reason: Critical Legal Studies Theory and Local Social Thought, 133 U. PA. L. REV. 685, 771 (1985) (describing alternative responses from the same people to deconstruction of immanent theory); Yablon, The Indeterminacy of the Law: Critical Legal Studies and the Problem of Historical Explanation, 6 CARDOZO L. REV. 917, 917 (1985) (describing the replication of Critical Legal Studies insights in everyday instincts of lawyers).

3. I realize that some people will feel the opposite. If those people have an overriding normative theory that tells them what to do, they feel powerful. Legal existentialism is paralyzing to them. See, e.g., Diamond, Not-So-Critical Legal Studies, 6 CARDOZO L. REV. 699, 703 (1985) ("One doesn't need to accept the status quo because it is necessary; one can reject action and change because of a fear that it is likely to lead to worse."); West, Authority, Autonomy, and Choice: The Role of Consent in the Moral and Political Visions of Franz Kafka and Richard Posner, 99 HARV. L. REV. 384, 424 (1985) ("Obedience to legal rules to which we would have consented relieves us of the task of evaluating the morality and prudence of our own actions, a task that would be time-consuming and beyond our powers." (footnote omitted)).
ARTICLE 9 PRIORITIES 209

cle 9 of the Uniform Commercial Code (UCC). These rules are asymmetrical. In most situations, Article 9 requires lenders to act in good faith. In two circumstances, however, the rules effectively legalize theft from lenders who have not attempted to perfect their security interests. Law professors have struggled to account for this asymmetry. Their attempts have been in the tradition of deducing the one deep structure that explains it all. I want to suggest something comparatively boring but much more defensible.

Historical evidence suggests that the statutory language of Article 9 priorities is the product of an unintended drafting error. This error has been widely interpreted to permit professional lenders ("experts") who know the rules well to take value from amateur lenders who do not. Because the experts heavily lobbied the drafters and the amateurs did not, provisions that might have protected amateur lenders against voracious experts were left underdeveloped. What emerged

---

4. Unless otherwise indicated, all references in this Article to articles, sections, and comments of the Uniform Commercial Code are to the 1977 version published as the 1978 Official Text.
6. By "error" I mean that if the drafters, at the time of drafting, had fully understood the construction later generations would place on their words, they would have written the statute differently.
7. The term "experts" in this Article refers to lawyers or commercial lenders who make repetitive secured loans to the public. Amateurism here denotes failing to attempt a filing. Of course, amateurism is not the only reason secured parties fail to file anything. For instance, experts occasionally may make a nonfiling error, such as by sending an unreliable messenger to the clerk's office. I only assert that this latter occurrence happens rarely enough to justify a strong correlation between amateurism and failure to file.
8. Grant Gilmore, a principal draftsman of Article 9, gave this description in his last article. Gilmore viewed the draftsmen as "lost in their nineteenth-century dream" and the lending industry lobbyists as concerned primarily with private advantage. Gilmore, The Good Faith Purchase Idea and the Uniform Commercial Code: Confessions of a Repentant Draftsman, 15 GA. L. REV. 605, 628 (1981); see also Beutel, The Proposed Uniform Commercial Code as a Problem in Codification, 16 LAW & CONTEMP. PROBS. 140, 144 (1951)
was a set of priorities that awards a bounty to experts for locating and punishing amateur lenders. Meanwhile, a much more altruistic standard applies when expert confronts expert or when amateur confronts amateur.

In spite of the evidence of drafting error, armies of law professors undertook to rationalize Article 9 priorities. These legitimating exercises have been surprisingly effective, given the controversial content of Article 9. Nevertheless, although law professors are practically unanimous in believing that Article 9 condones a race priority wherein knowledgeable lenders can defeat prior unknowledgeable lenders, some judges have not been as placid. These judges have noticed that Article 9's priority scheme encourages unconscionable behavior. When such behavior has been challenged, the judges have circumvented the priorities to punish the evildoer.

This Article explains Article 9 priorities as the product of historical mistake and reassures such judges that they have not violated important principles, such as the need to effectuate the intent of the legislature. With respect to Article 9, there is no single legislative intent. There is only accident, with subsequent justification by legal scholars based on the false assumption that every law has its rational function.

As a means of assessing the efficiency of Article 9's asymmetrical priorities, Part I of this Article sets forth an economic model to demonstrate that recording statutes generally have a sensible efficiency justification. The model, however, shows only one thing: that bona fide purchasers9 for value (BFPs) should take property transfers free and clear of earlier claims by transferees out of possession. The efficiency norm does not support granting priority to other second transferees, particularly those with knowledge of a prior unperfected security interest.

Part II of the Article introduces the relevant priority rules

---

9. "Purchaser" here is used in a very narrow sense. The word connotes the voluntary nature of the transferor's conveyance. See 11 U.S.C. § 101(23) (1982); U.C.C. § 1-201(32). Involuntary transfers, such as the creation of judicial liens, are not purchases. See 4 AMERICAN LAW OF PROPERTY § 17.10, at 562-63 (A. Casner ed. 1952); Reed's Appeal, 13 Pa. 475, 478 (1850) ("If anything is settled by reason and authority, it is that a judgment creditor is not entitled to the protection of a purchaser of the legal title against an equitable owner or to any advantage which his debtor had not.").
contained in Article 9, highlighting the asymmetry and ambiguity of the statutory language.

Part III explains why Article 9 priorities do not match the economic model presented in Part I. Part III summarizes the historical evidence that a drafting accident precipitated Article 9’s asymmetrical structure\(^{10}\) and describes the sociological factors that have permitted the continued application of priorities that favor experts at the expense of amateurs. This Part then compares the proffered description to the competing justifications advanced by courts and legal scholars. This analysis reveals ethical implications of Article 9 that many would find repugnant. Finally, Part III reviews the instances in which courts have rejected the harsh rules of Article 9 in favor of standards that force expert lenders to behave altruistically toward positionally weak lenders.

Drawing on explanations set forth in Parts I-III, the Article concludes that judges may enforce such altruistic standards without violating their duty to enforce the will of the legislature.

I. THE ECONOMICS OF PRIORITY

Philosophers have never succeeded in totally legitimating the concept of property\(^{11}\) and I am certainly not prepared to do so either. Nevertheless, I hope we can all agree on a few principles. First and foremost, if transferable property rights prevent the war of all against all, one may legally transfer only his or her own property and not that of another. Otherwise, the concept of property fails to mediate between claims to scarce resources.\(^{12}\)

\(^{10}\) The Appendix to this Article provides a detailed history of the Article 9 priority provisions.

\(^{11}\) For a critique of the utilitarian attempt to legitimate property, see Kennedy & Michelman, Are Property and Contract Efficient?, 8 Hofstra L. Rev. 711 (1980). These authors’ basic critique of utilitarians is that, although they purport to be neutral scientists, utilitarians in fact accept unspoken political assumptions about human morals, such as favoring commercial virtue over brute strength. Id. at 714. Truly neutral observers would be forced to concede that the efficiency of property is highly contingent from society to society. Id. at 719.

Some illuminating commentary on the libertarian position on property can also be found in Rosenfeld, Contract and Justice: The Relation Between Classical Contract Law and Social Contract Theory, 70 Iowa L. Rev. 769, 787-90 (1985).

\(^{12}\) R. NOZICK, ANARCHY, STATE AND UTOPIA at 152-53 (1974) (legitimacy of a property claim depends on receiving a transfer from someone who himself was entitled to it).
The idea that one may only transfer what he has leads to the priority rule "first in time is first in right." To illustrate, when a dishonest property owner D first gives property to transferee A and then tries to convey it a second time to transferee B, the second conveyance is utterly ineffective under the "first in time" rule. When D tries to convey the same property a second time, D is impermissibly trying to convey A's property. This he cannot do.

Fortunately for B, American property law rarely follows the "first in time" rule. Instead, the law frequently endows D with power to eliminate A's interest and grant good title to some others. Once A performs the often ritualistic act of publicity, however, D's power to cheat is exorcized. Granting D the power to create good title in another thus encourages A to publicize her newly acquired interest in the transferred property.

A. PERFECTION REQUIREMENTS

Roughly speaking, A's obligation to publicize her property interest, the "perfection requirement," makes sense when A's cost of perfection is less than the alternative costs deriving from B's risk that the double-dealing D has no property to convey. Let us call B's apprehensions the "innocent purchaser risk." By imposing the loss on the least cost avoider, perfection rules (or their absence) facilitate the movement of goods

---

13. Throughout this Article, "D" is used to designate a dishonest property owner who attempts to transfer overlapping or identical property interests to two separate parties. "A" refers to the first transferee who, unless otherwise noted, fails to perfect the interest obtained from D. "B" represents the second transferee. Whether B has notice of A's interest will be indicated in each example.

14. Many courts and commentators refer to a race statute (the first party to perfect wins, regardless of knowledge) as a "first in time" regime. E.g., National Bank v. Duggar, 335 So. 2d 859, 860 (Fla. Dist. Ct. App.) (referring to § 312 (5)(b) of Article 9), cert.denied, 342 So. 2d 1101 (Fla. 1976). In this Article, however, "first in time" refers to the first party who has a proprietary claim to a property. The "first to perfect" rule is another system entirely, wherein the second in time may win.

15. "First in time" is abandoned virtually every time it is possible for A to obtain a property right in D's property before A takes possession. For instance, the law of sales of personal property is not a "first in time" regime; A must perfect by taking possession, which could occur after A has property rights in the item sold. In the United States, real estate transactions are almost never subject to the "first in time" rule. Rather, real estate law generally requires A to record an interest for it to be good against all subsequent Bs.

from a comparatively low valuing user (LVU) to a comparatively high valuing user (HVU).

1. Absolute Ownership

Innocent purchaser risk, like other risks associated with goods, is inversely proportional to demand. As the risk increases, demand falls, creating a deadweight loss to societal wealth. A demonstration of the effect that innocent purchaser risk has on price serves to illustrate its disutility. Assume that goods are capable of generating income and that utility is primarily a function of the present value of future earnings. The maximum price a buyer is willing to bid for an asset, then, is set by the discounted value of the asset's future income stream. Determining the value of future income involves adding the products of every possible outcome multiplied by the probability that each outcome will occur. One risk that affects the present value of future earnings is innocent purchaser risk. As the risk increases, the present value of future earnings decreases, and the price the buyer is willing to pay decreases. At a certain point, the disutility of innocent purchaser risk becomes so large that the seller of risky goods must lower the offering price to keep the buyer in the market.

It may surprise some to learn that innocent purchaser risk per se does not prevent markets from maximizing societal wealth. As long as goods move to the HVU, efficiency of the market as an allocation of resources is preserved. If all buyers of an item have equal innocent purchaser risk (or equal derivative costs), the impact on their discounted future income calculations will be equal relative to one another. The item, therefore, will move to the HVU regardless of the extent of the shared innocent purchaser risk.

---

17. The adverse effects of innocent purchaser risk on the value of property have been the focus of legal theorists for centuries. See Hamburger, The Conveyancing Purposes of the Statute of Frauds, 27 AM. J. LEGAL HIST. 354, 358 (1983).
18. A buyer always hopes to pay less than this maximum, of course. The minimum a buyer must pay is set by the amount that the second HVU is willing to pay.
19. For this reason, the price of items that are or appear to be stolen is lower than the price of pedigreed property.
20. See, e.g., Goetz & Scott, Enforcing Promises: An Examination of the Basis of Contract, 89 YALE L.J. 1261, 1320-21 (1980) ("[u]ncertainty imposes a social loss that reduces the value of exchange").
21. It is important to make a very fine distinction about innocent pur-
In contrast, *unevenly distributed* innocent purchaser risk can defeat the movement of goods to the HVU. If one buyer has obtained perfect knowledge of the state of title, she bears no innocent purchaser risk and generates a relatively higher discounted earnings figure. If that person happens to be the HVU, the efficiency of the market allocation is not affected. Allocations to the HVU, however, will be pure coincidence. LVU's often will have the information advantages. If so, the goods will not move to the HVU whenever the difference between (a) the discounted earnings of the HVU with innocent purchaser risk and (b) the discounted earnings of the LVU with no such risk exceeds the difference between (c) the discounted earnings of the HVU with innocent purchaser risk and (d) the "perfect" hypothetical HVU without innocent purchaser risk.\(^2\)

If the LVU is able to purchase the goods because of his superior knowledge, society suffers a loss in cases where no perfect substitute is available to the HVU.\(^3\) Therefore, although innocent purchaser risk will not always prevent goods from moving to

---

22. In the following illustration, in which only one item is for sale, goods will fail to move to the HVU whenever a knowledgeable LVU falls on the demand curve between points A and B. The seller charges a price at X in this example. The model assumes that no substitute item is available for the HVU that produces utility greater than \(X - B\). The model further assumes that the LVU is indifferent between the risky item and some perfect substitute. If such an assumption were relaxed, the loss illustrated below would have to be offset by the LVU's gain from buying a more desirable item than otherwise would have been available to him.

![](image)

If innocent purchaser risk could be eliminated, the HVU would pay incrementally more than X and would get the purchase. The eliminated deadweight loss would then be preserved as consumer surplus.

23. When the HVU has a perfect substitute, she loses no utility by defect-
the HVU, it never furthers efficient allocation and frequently impedes it.

Investments in investigation and insurance can reduce innocent purchaser risk. The more B knows about the state of title, the less risk there is of a superior A appearing to claim the goods. In addition, B may insure against A's claim. Insurance is rational when an insurer's ability to bear innocent purchaser risk is greater than that of B, either because of a lower utility for marginal dollars or better investigation capabilities. In the end, B will invest in knowledge or insurance or will bear innocent purchaser risk in proportions that minimize his aggregate costs. Thus, given a set of legal rules that determine title, there is an optimal expenditure on costs associated with innocent purchaser risk and its avoidance.

Modifying the "first in time" priority rule to impose publicity costs on A may lower these aggregate costs. In many cases,

25. It would help to think of innocent purchaser risk as a dead loss. For instance, assume an HVU would buy an item for $100 if there were no innocent purchaser risk. Before investigating, the HVU perceives there is a 50% chance the seller has perfect title and a 50% chance the seller has no title. Accordingly, the HVU values the item at $50. Suppose further that for $10 the buyer could hire a service that would provide definitive information about the state of the title. Whether the answer is good title or no title, the HVU should hire the service. For $10, the HVU can learn enough to justify a bid higher than $50, or the HVU can avoid a loss of $50. Either piece of information would be valuable. On the upside, the HVU increases her demand. On the downside, the HVU avoids wasting $50 on property the seller cannot properly sell.

If the HVU discovers the seller has no title, the HVU has at least avoided a loss, justifying the expenditure on information. In addition, the HVU may still have taken a step toward the purchase. The HVU now knows who does have title. The HVU can buy good title from the real owner and divest the seller (or any LVU who buys from the seller) and, at some cost, eventually end up with the item.

A complicating factor is that once the HVU spends $10 on investigation, the expense is a sunk cost and has no further influence on the decision to buy. In the above example, once the $10 is spent, the HVU will still bid up to $100, unless the loss of $10 so affects her wealth that her matrix of wants and desires is affected. It would be a mistake to assume that, having spent $10 on the purchase, the HVU will now bid only $90.

26. See McDaniel, Bondholders and Corporate Governance, 41 BUS. LAW. 413, 436-39 (1986); Roe, Bankruptcy and Mass Tort, 84 COLUM. L. REV. 846, 881-82 (1984). These factors explain the title insurance system for real estate. The insurer also may have some sort of emotional call upon D that would make D more likely to pay, as when a friend or relative cosigns D's note.
A's cost of creating a highly public symbol, such as dispossessing the seller or filing a statement in a central location, may be less than B's aggregate costs of borne risk, investigation, and insurance premiums. If so, it might be efficient to change from a "first in time" property regime to a system wherein D, pending A's perfection, retains the power to create good title in B. A perfection requirement in such circumstances facilitates the movement of goods to HVUs in two respects. First, requiring perfection reduces the chances that the LVU will win the auction because innocent purchaser risk is less of a disutility than it was before. Second, even if an LVU does win, he is comparatively an HVU over what would have been under the "first in time" regime.

One implication of the above analysis is that recording statutes contain an important normative element. Recording statutes "depersonalize" markets by neutralizing the inside information that positionally powerful bargainers have. Because they have this effect, recording statutes should be accorded an important place in the history of the ascendency of market ideology.

2. Security Interests

The "first in time is first in right" principle has different overtones for liens than it has for absolute ownership. If D conveyed absolute ownership of a thing to A, D's attempt to sell the same property to B a second time would be completely ineffective under a "first in time" rule. If D merely conveys a lien to A, however, D generally retains rights to possess the encumbered thing, pending default, and to receive any cash surplus in the event of foreclosure. D may honestly convey these

27. Cf. Kronman, supra note 24, at 4-5 (arguing that parties to a contract, if acting rationally, will assign the risks of occurrence of mistake to the better information gatherer).

28. See Rosenfeld, supra note 11, at 813, 832-40.

29. Liens are a peculiar type of future interest in property. Liens differ from absolute ownership of a future interest in that the lienor's right to the property, in recent times, is for the narrow purpose of selling it for cash. The lienor may retain cash proceeds to the extent of the unpaid debt, with the surplus going to the debtor. See Carlson & Shupack, Judicial Lien Priorities Under Article 9 of the Uniform Commercial Code: Part I, 5 CARDOZO L. REV. 287, 290-99 (1984).

30. Such rights exist even if the secured claim is large and the projected sale price is small. See United States v. Whiting Pools, Inc., 462 U.S. 198 (1983). In Whiting Pools, the Internal Revenue Service (IRS) had levied property but had not yet sold it. In the interim, the debtor filed for bankruptcy. The IRS argued that the debtor had no further rights in the property because
Notwithstanding the distinction between conveyances of absolute ownership and security interests, movement of goods to the HVU justifies modification of the “first in time” priority system to protect BFPs of liens. A secured party or mortgagee acquires rights in collateral solely to reduce the risk of nonpayment of its loan. The reduction of risk, of course, lowers the price of the loan. Security most effectively reduces the price of credit when the collateral is most likely to obtain high bids at the enforcement sale. If the rules protect buyers of liens from all earlier liens, bids at enforcement sales are higher. Secured loans become less risky and hence cheaper. Because secured lenders can reflect lower risk in lower loan prices, perfection rules almost always protect BFPs of liens on goods as well as BFPs of absolute ownership.

B. THE CLASS OF PROTECTED SECOND TRANSFEREES

To facilitate the movement of goods to the HVU, only a narrow class of second transferees need take free of an earlier unperfected property interest. Essentially, the perfection rules only need to protect BFPs. Protecting donees, general creditors, and mala fide purchasers (MFPs) from unperfected interests does not result in the movement of goods to HVUs. No justification exists, therefore, for interrupting the conveyance by D to A on behalf of second transferees that are not BFPs.

1. Donees

The law of gifts apparently troubles law professors who believe that every law must have its efficiency justification. Perfect market allocations depend on buyers signalling their perceived future utilities in a perfect market. Donees do not signal their utilities at all. Hence, some say that protection of

the debt was large and the collateral relatively low in value. See United States v. Whiting Pools, Inc., 674 F.2d 144, 149-50 (2d Cir. 1982). The Supreme Court ruled that the debtor continued to have rights in the property at least until the foreclosure sale. 462 U.S. at 211. Thus, the property remained part of the bankrupt’s estate. Id. at 209. See Note, The Outer Limits of Section 542 of the Bankruptcy Code: United States v. Whiting Pools, Inc., Revisited, 7 CARDOZO L. REV. 935 (1986).

31. As used here, “protect” means that buyers take free of the earlier lien regardless of personal knowledge. The buyer relies on the power of the enforcing lienor to foreclose all junior liens. See Carlson, Death and Subordination Under Article 9 of the Uniform Commercial Code: Senior Buyers and Senior Lien Creditors, 5 CARDOZO L. REV. 547, 569-71 (1984).

32. E.g., U.C.C. § 9-301(1)(c) & (d).
donees or thieves is harmful to allocative efficiency.\textsuperscript{33} Under this view, the failure of recording acts to protect donees is justified by efficiency.

It is not so clear to me that donee protection would necessarily interfere with the market allocation of goods to HVUs. If property owner \( D \) simply gives an item to \( C \) when \( B \) is the HVU, \( C \) can sell the item to \( B \) as well as \( D \) can. The efficiency case against protecting donees would have to show that the transaction costs imposed on an HVU in dealing with \( C \) are greater than they would be in dealing with \( D \). Absent data regarding relative transaction costs, efficiency is irrelevant to a determination of whether to protect donees from prior unrecorded property interests.

Yet perfection regimes almost never protect donees.\textsuperscript{34} Presumably, the failure to protect donees serves other norms, such as a residual libertarian notion that property rights are sacrosanct. After all, preferring a donee causes serious injury to the property rights of \( A \). Although society can make a buck or two by hurting \( A \) when \( B \) is a BFP and an HVU, the case for hurting \( A \) to benefit a donee is much less convincing. Thus, the sanctity of property rights reappears as the dominant norm of the moment.\textsuperscript{35}

2. General Creditors

Protection of unsecured creditors from unperfected property transfers also lacks substantial economic purpose.\textsuperscript{36} The

\begin{itemize}
  \item \textsuperscript{33} R. POSNER, ECONOMIC ANALYSIS OF LAW 120-22 (2d ed. 1977).
  \item \textsuperscript{34} Massachusetts's recording act protects "any person" without notice, including, presumably, any donee. MASS. ANN. LAWS ch. 183, § 4 (Law. Co-op. 1977). New York protects good faith donees from the prejudgment attachment lien until the sheriff levies pursuant to the lien. N.Y. CIV. PRAC. LAW § 6203 (McKinney 1980). One survey has declared this lien to be "America's weakest." Carlson & Shupack, supra note 29, at 297.
  \item \textsuperscript{35} See Rosenfeld, supra note 11, at 885 (discussing the philosophical issues of bona fide purchaser rules and libertarian opposition to them).
  \item \textsuperscript{36} This is not the same as suggesting that fraudulent conveyance law has no convincing economic justification, although that may also be true. Independent of Article 9 or real estate recording statutes, fraudulent conveyance law strikes down secret liens when (a) \( D \) intends to defraud, delay, or hinder general creditors and when (b) \( A \) is a mala fide purchaser for value (a co-conspirator with \( D \)). UNIF. FRAUDULENT CONVEYANCE ACT, §§ 7, 9 (1918). The law and economics movement assumes that fraudulent conveyance law is efficient because it represents what debtors and creditors would agree on anyway. Baird & Jackson, Fraudulent Conveyance Law and Its Proper Domain, 38 VAND. L. REV. 829, 835-36 (1985); Clark, The Interdisciplinary Study of Legal Evolution, 90 YALE L.J. 1238, 1249 (1981); see also Rose-Ackerman, Inalienability and the Theory of Property Rights, 85 COLUM. L. REV. 931, 940 (1985)
\end{itemize}
traditional argument for protecting unsecured creditors is that secret liens generally tend to mislead such creditors. Without protection, it is argued, unsecured creditors would have to charge more for their loans to compensate for the risk of secret liens.\textsuperscript{37} With that protection, the market for general credit is improved. The justification is analogous to the argument that protecting BFPs from earlier conveyances renders markets for property more efficient.

Whereas the argument is persuasive with respect to markets for ownership of property, it is problematic, or at least overstated, in markets for general credit. Its weakness is that unsecured creditors do not necessarily anticipate recoveries as a result of statutory protection. The existence of such protection probably would not cause the reduction of prices for unsecured loans. Furthermore, perfection by $A$ is costly, both in terms of filing a financing statement and in terms of learning the Article 9 rules. The efficiency case for protecting general creditors from unperfected liens, thus, depends on comparing the low-level benefits of the general creditor’s future remedy against any potential $A$ (as the creditor perceives them at the time of pricing the loan) against the added cost to $A$ of perfecting her lien.\textsuperscript{38} Protection of general creditors from $A$’s unperfected in-

\textsuperscript{37} Clow v. Woods, 5 Serg. & Rawle 275, 287 (Pa. 1819) (Duncan, J.); Baird & Jackson, supra note 5, at 302-03 (“Creditors are worried about a debtor’s trying to get credit by passing off things as his that he really does not own. Since creditors will charge debtors for that risk, a debtor wants a way of assuring such creditors that he in fact has the right to sell or offer as collateral what he says he does.”); Eisenberg, Bankruptcy Law in Perspective, 28 UCLA L. Rev. 953, 971 (1981) (“Unsecured creditors may be misled by delayed perfection even in the absence of a bankruptcy proceeding.”); Jackson & Schwartz, Vacuum of Fact or Vacuous Theory: A Reply to Professor Kripke, 133 U. Pa. L. Rev. 987, 997 (1985) (“[A] deal to give a particular creditor priority without public filing is prohibited because it is disadvantageous to other creditors...”); Morris, Bankruptcy Law Reform: Preferences, Secret Liens and Floating Liens, 54 MINN. L. Rev. 737, 741 (1970) (“A belatedly recorded lien would surprise those who had extended credit.”).

\textsuperscript{38} I am assuming that, as a result of extending a recording statute from BFP protection to general creditor protection, $A$’s perfection becomes incrementally more costly. Before the change, $A$’s decision to file was a function of the chance that a BFP might appear to take good title. Now the class of persons who could defeat title is expanded to include creditors. The increased...
interest is, therefore, not unambiguously efficient.

To demonstrate, consider the cases in which statutes enable general creditors to eliminate prior unperfected interests. For purposes of the ensuing discussion, assume that the double-dealing owner \( D \) in good faith\(^{39} \) conveys a mortgage to \( A \), who makes an honest perfection mistake. \( D \) then borrows from \( B \), an unsecured lender. Next, \( A \) wakes up and perfects the mistakenly unperfected security interest. Upon noticing that \( A \) has recorded, \( B \) accelerates \( D \)'s loan and obtains a judgment. Assume further that \( D \) has no remaining assets, so that \( B \) must levy on property claimed by \( A \) to recover anything. Some real estate recording statutes protect general creditors even though their judicial liens attach after the recordation of an unperfected consensual interest.\(^{40} \) Under such statute, \( B \) may sell the real estate and keep cash proceeds on a senior basis to \( A \).

These statutes probably do not induce unsecured lenders to lower the price of their loans. Granted, when setting a price, the unsecured lender \( B \) gambles that either \( D \) will voluntarily repay interest and principal when due or \( D \) will have assets to which \( B \) can attach a judicial lien. \( D \)'s present wealth and future prospects for income are directly relevant to the likelihood of both events. Furthermore, the risk that \( D \) has conveyed undisclosed liens to \( A \) relates to \( D \)'s present wealth and to the prospect for future income. That is, the existence of secret liens means that \( D \) was more highly leveraged than it appeared when \( B \) advanced the funds. If recording acts rendered secret liens visible, as powder does to fingerprints, \( B \) undoubtedly would raise the price of the loan upon discovering the secret lien. In fact, \( D \)'s failure to disclose the existence of \( A \)'s lien might reveal \( D \)'s hitherto unsuspected untrustworthiness, so that \( B \) might raise the price even more than the increased leverage otherwise would justify.

Recording acts, however, do not render secret liens visible, nor can they reconstruct events as if the liens never existed. No damage remedy is available to place \( B \) in the position it thought it occupied at the time of the loan. Rather, \( B \) will only benefit from recording act protection to the extent that, at the

---

39. Although many recording acts duplicate fraudulent conveyance law by protecting creditors, the examples will assume that \( D \)'s transfers to \( A \) were not fraudulent conveyances.

time of the judicial lien, the encumbered assets are available to B and not to other creditors. The advantage depends on three events beyond B’s control. First, D must not have sold the secretly encumbered item to a BFP. If D sells the asset to a BFP before B obtains a judicial lien, A’s interest disappears but so does all advantage bestowed on B by the recording acts. Second, B’s advantage depends on D not paying off A before B has obtained a judgment. B needs to have A’s secret lien in place to screen off other creditors—those who extended credit after A’s lien was recorded or those who extended credit before A’s lien was created. If D has discharged A’s lien by the time B establishes a judicial lien on the collateral, B has no advantage over other creditors. Finally, under existing bankruptcy doctrine, if D or D’s creditors file D into bankruptcy, the bankruptcy trustee expropriates B’s avoidance rights on behalf of all the creditors. B recovers only a pro rata share of the expropriation, assuming there is any distribution to general creditors at all. Therefore, to gain an advantage from the recording act, B depends on at least three contingencies beyond his control. Because of these contingencies, I doubt that recording act protection is an important factor in pricing unsecured loans.

---

41. Hence, for a secret lien on inventory or other “floating” collateral, the ex ante advantage of avoiding secret liens is low.

42. See, e.g., S.C. CODE ANN. § 30-7-10 (Law. Co-op. 1976); Prudential Ins. Co. of Am. v. Wadford, 232 S.C. 476, 480, 102 S.E.2d 889, 892 (1958) (holding that the South Carolina statute does not protect judicial lien holders where the obligation on which the lien was based arose prior to the execution of the unrecorded mortgage).

43. 11 U.S.C. § 544(b) (1982) (trustee is subrogated to avoidance rights of any unsecured creditor).

44. B’s pro rata share of the expropriation, however, conceivably could be relatively high. Suppose B’s claim is for $100. A’s unrecorded mortgage is for $100,000 on land worth exactly $100,000. There is enough money in D’s estate to pay all priority claims and no money for the general creditors. Assume also that there are 100 creditors each claiming $100.

One would expect the trustee to take over B’s right to recover the $100, giving each creditor a distribution of $1. Under the rule of Moore v. Bay, 284 U.S. 4, 5 (1931), however, the trustee may recover the entire $100,000 from A, leaving A with a general unsecured claim. Because there are now $110,000 of claims chasing $100,000 in assets, B (along with every other general creditor) collects almost 91 cents on the dollar.

45. According to the last available data, general creditors receive only 27% of the dividends in bankruptcies and obtain a return of about five cents on the dollar. ADMIN. OFFICE OF THE U.S. COURTS, TABLES OF BANKRUPTCY STATISTICS Tables F5, F6 (1977).

46. If protection of the general credit market adequately justified the persecution of secret liens, the statute should not protect creditors who extend
Furthermore, B may be entitled to indirect protection of a recording act regardless of whether the recording statute protects general creditors. Suppose, for example, that D defaults and B obtains a judicial lien on the real estate encumbered by A's secret lien. B is entitled to no protection under the recording statute because B is not a BFP, and only BFPs are protected. At an auction to enforce B's lien, a BFP is the high bidder. The BFP takes free and clear of A's unrecorded interest.47 B's recovery under such circumstances is the same as it would have been under the recording statutes that protect creditors. This indirect benefit is a further reason why B would not lower the loan price substantially when general creditor protection is added to a recording act.48

Finally, the probability that B will obtain an advantage from recording act protection if D defaults may be positive but so infinitesimally tiny, in comparison to the other factors in the loan pricing decision, that real-life creditors may well ignore recording acts altogether. Some economists get so carried away with the excitement of discovering a market dysfunction that they attribute to it an importance that the actors in a market never would. Just because a rational lender in a perfect market with perfect information would lower the price of a loan when her chance of recovering principal on default increases, even a little, does not prove that the lender actually does so in the real world. If a banker must process numerous loans a day based on extremely rough information about the borrower, it may be highly rational for the banker to ignore the 100,000 microscopic contingencies and focus on the ten factors that will make or break the loan. The efficiency case for protecting general creditors in recording statutes, therefore, is extremely problematic. Although bankers will be glad enough to have protection when default does occur, the possible advantage, viewed from the

credit with knowledge of an unperfected lien. A knowledgeable creditor who desires protection can price the loan to reflect the true risk. Indeed, some courts construe statutes to require an investment decision in ignorance of the secret lien before the secret lien is voidable. E.g., City Nat'l Bank & Trust Co. v. City of Knoxville, 158 Tenn. 143, 147, 11 S.W.2d 853, 853 (1928). Other statutes, however, grant creditors avoidance rights, as long as the advance was made when the lien was unperfected, even if the creditor had knowledge. 4 AMERICAN LAW OF PROPERTY, supra note 9, § 17.29, at 611.


48. That is, if general creditor B already obtains substantial benefit from recording acts that only protect BFPS, B is unlikely to lower the price of a loan when recording act protection is extended to protect general creditors.
time of the loan pricing decision, may be too unimportant to command attention.\textsuperscript{49}

If $A$ has an unperfected security interest in personal property governed by Article 9 of the UCC, $B$ confronts yet another obstacle to recovery. Article 9 rules would not protect $B$ unless $B$ obtains a judicial lien before $A$ perfects.\textsuperscript{50} $B$ loses the advantage over other general creditors if $A$ perfects before $B$ obtains a lien.\textsuperscript{51} Thus, efficiency of the market for general credit is even less likely to justify the UCC priority scheme than is the case with real estate recording acts that protect general creditors.

3. Mala Fide Purchasers for Value

Whereas a choice of a recording system protecting BFPs over a “first in time” priority might be efficient, contingent on comparative costs and benefits to $A$ and $B$,\textsuperscript{52} the efficiency of race priorities, wherein bad faith Bs are protected, is very dubious indeed. Race priorities are likely to generate external costs. That is to say, race priorities are unfair in the view of some. Efficiency explanations for race priorities in lieu of notice priorities, therefore, depend on weighing the net gains from the race priority against the external costs the race priority generates.

If $B$ understands that $A$ claims rights in a thing, $B$ is like the buyer without innocent purchaser risk.\textsuperscript{53} A knowledgeable $B$ is in a position to obtain good title by paying $A$ instead of the double-dealing $D$. Absent some transaction cost in doing so, there is no economic reason to protect a bad faith $B$ from the rights of $A$. An argument in favor of race recording statutes must make the case that, without MFP protection, HVUs will abandon the market, imposing a deadweight societal loss.

I can think of two costs generated by refusing to protect MFPs. First, dealing with two parties is more expensive than


\textsuperscript{50} U.C.C. § 9-301(1)(b). The 1962 version protected only lien creditors without knowledge. The 1972 version is silent on whether knowledge makes a difference, but the legislative history makes clear that a race priority was intended. One of the reasons the UCC protects only lien creditors was to repeal the rule of Moore v. Bay, supra note 44. That case applied only to the trustee’s subrogation rights of unsecured creditors.


\textsuperscript{52} See supra text accompanying notes 16-32.

\textsuperscript{53} See supra note 16.
If MFPs are protected, $B$ can deal with $D$ only, instead of $D$ and $A$ together. The second cost is the risk of false accusations of knowledge that $A$ may make against a good faith $B$. If $B$, an HVU, perceives a general risk that $A$s exist and may falsely charge $B$ with knowledge simply because, under a BFP rule, false charges are easy to make, $B$’s utility for goods declines. $B$’s innocent purchaser risk may allow LVUs who know that $A$s do not exist to outbid him. The cost generated by such a risk would be measured by the difference between the utility of $B$ without innocent purchaser risk and the actual utility of the LVU. The above two costs of a notice priority system lower demand for goods just as innocent purchaser risk does.

---

54. See Kennedy, Form and Substance in Private Law Adjudications, 89 Harv. L. Rev. 1685, 1698-99 (1976); see also United States v. Handy & Harmon, 750 F.2d 777, 784 (9th Cir. 1984) (requirement of public notice by filing obviates problem of proof that notice was given and received); J. White & R. Summers, Handbook of the Law Under the Uniform Commercial Code § 25-4, at 1037 (2d ed. 1980) (“Under 9-312(5) no disappointed secured creditor can trump up facts from which a compassionate court might find knowledge on the part of the competitor.”).

55. The loss would be offset by the LVU’s utility gain from buying a more desirable item than otherwise would have been available. See supra note 23. Also, I assume no adequate substitutes are available to the HVU. If there are substitutes, the loss is defined by the utility of the HVU (assuming no innocent purchaser risk) minus the utility derived from the substituted good.

56. In contrast, Anthony Kronman has argued that efficiency points toward excluding the bad faith purchaser. In discussing the contract rule that the unilateral mistake-makers bear the loss of their errors, Kronman defends the protection given to the mistake-maker against a knowledgeable bad faith purchaser:

One well-established exception protects the unilaterally mistaken promisor whose error is known or reasonably should be known to the other party. Relief has long been available in this case despite the fact that the promisor’s mistake is not shared by the other party to the contract. . . .

A rule of this sort is a sensible one. While it is true that in each of the cases just described the mistaken party is likely to be the one best able to prevent the mistake from occurring in the first place . . ., the other party may be able to rectify the mistake more cheaply in the interim between its occurrence and the formation of the contract. At one moment in time the mistaken party is the better mistake-preventer (information-gatherer). At some subsequent moment, however, the other party may be the better preventer because of his superior access to relevant information that will disclose the mistake and thus allow its correction. . . . Of course, if the mistake is one which cannot reasonably be known by the non-mistaken party (that is, if he would have to incur substantial costs in order to discover it), there is no reason to assume that the non-mistaken party is the better (more efficient) mistake-preventer at the time the contract is executed. But if the mistake is actually known or could be discovered at a very slight cost, the principle of efficiency is best served by a compound liability rule which imposes initial responsibility for the mis-
Aside from the costs of a notice priority (as compared to a race priority), a complete efficiency analysis must consider society's external preferences for rules that visit punishment only on the guilty. A race statute, of course, may deprive an inno-

take on the mistaken party but shifts liability to the other party if he has actual knowledge or reason to know of the error. Compound liability rules of this sort are familiar in other areas of the law: the tort doctrine of "last clear chance" is one example.

Kronman, supra note 24, at 6-8.

An "inefficient" result implies the generation of unwanted costs, not merely the imposition of a loss on one party or another. Kronman must show that the inclusion of MFPs into the class of protected Bs will cause overinvestment in care by A. This overinvestment can occur only if the players can perceive the risks in advance. Overinvestment by A could occur when the market is full of knowledgeable Bs with expertise. If only BFPs take free of A's rights, the amateur A need not invest in expertise as much because the number of potential BFPs would be low. In such a market, an MFP rule would cause overinvestment in perfection. See also Tullock, Two Kinds of Legal Efficiency, 8 Hofstra L. Rev. 659, 668 (1980) ("[T]he last-clear-chance doctrine invalidates the basic efficiency argument normally offered for efficiency of the negligence-contributory negligence rule. The resources I would put into preventing an accident are clearly lessened if I know that my liability can be eliminated by way of the last-clear-chance rule."). A belief that large numbers of uninformed Bs exist in the market, however, makes the investment in expertise essential, no matter what the rule is. This latter hypothesis—A perceives a world full of potential BFPs—is probably more realistic. In such a market, vulnerability to any sort of subsequent purchaser at all may well provide the maximum incentive for each side to avoid mistakes. The addition of knowledge disability (assuming knowledge to be randomly distributed among Bs) probably neither reduces nor increases the incentive to avoid mistakes.

57. The term is from R. Dworkin, Taking Rights Seriously 234-38 (1977). Dworkin, however, writes about external preferences for racial prejudice and makes unconvincing arguments against ever including them in economic analysis. The external preferences referred to here are for fair dealings, which must be included in a complete utilitarian analysis of whether to choose rules over standards. See Calabresi & Meltzer, Property Rules, Liability Rules and Inalienability: One View of the Cathedral, 85 Harv. L. Rev. 1089, 1097-98 (1972) (noting that society's selection of a set of entitlements depends upon external preferences as well as upon considerations of economic efficiency); Kennedy, Cost-Benefit Analysis of Entitlement Problems: A Critique, 33 Stan. L. Rev. 397, 399 (1981) (arguing that a cost-benefit analysis of entitlements must recognize the significance of the value judgments involved in policy determinations); Markovits, The Distributive Impact, Allocative Efficiency, and Overall Desirability of Ideal Housing Codes: Some Theoretical Clarifications, 89 Harv. L. Rev. 1815, 1833 (1976) ("[T]o the extent that those members of society who approve of the distributive impact of housing code enforcement value this impact more than its opponents disvalue it, its allocative efficiency will be increased by the net equivalent dollar gains it generates for such 'non-involved' parties."); Michelman, Property, Utility and Fairness: Comments on the Ethical Foundations of "Just Compensation" Law, 80 Harv. L. Rev. 1165, 1214-15 (1967) (including societal demoralization cost in efficiency analysis of a compensation rule).
cent but unperfected A of his security interest by extending protection to a bad faith B who would not have been protected under a notice statute. In controversial cases, if the public is discomforted or demoralized by the spectacle of a “wrongdoing” B deliberately visiting harm on an innocent A, the public suffers “cost.” The structure of the public’s external preferences system will almost always determine whether a change in the law is efficient or inefficient.

In considering the influence of external preferences on the efficiency case for race priorities, it is helpful to consider the comparison between a knowledge-immune race system and a notice system on the basis of Duncan Kennedy’s distinction between rules and standards. In his evocative article, Form and Substance in Private Law Adjudication, Kennedy associates hard rules with an individualist view of society, while standards are associated with altruism. Individualism means the right to be selfish, so long as the liberty of others is not infringed. Altruism is the view that the strong should help the weak. Kennedy does not rigorously define what he means by a standard. He seems to mean that the more limited the judge’s fact-finding, the more a law is rule-like and individualist in character. The invitation to find more facts—especially subjective facts—makes the law more of a standard. The standard gives a judge more leeway to impose an altruistic result on the parties.

Little has been written in response to Kennedy about the circumstances in which legislators choose between rules or standards. At least theoretically, external preferences should help us assess whether the choice between rules or standards is efficient. If an indifference curve between the desire for

58. Kennedy, supra note 54, at 1685.
59. Id. at 1713-16.
60. Id. at 1717-18.
61. Id. at 1770-71.
62. Id. at 1752, 1772-74. See also Ehrlich & Posner, An Economic Analysis of Legal Rulemaking, 3 J. LEGAL STUD. 257, 258 (1974) (asserting that a standard denotes a general criterion of social choice while a rule is more precise and more restrictive); Nonet, The Legitimation of Purposive Decisions, 68 CALIF. L. REV. 263, 283-84 (1980) (“If anything, [factual] thoroughness must enlarge discretion since it ordinarily widens the range of options, costs, and benefits that must be considered.”); Simon, Legality, Bureaucracy, and Class in the Welfare System, 92 YALE L.J. 1198, 1201-04 (1983) (discussing the difference between rules and standards in the context of welfare reform).
63. Although scant commentary analyzing the choice between rules and standards exists, special mention should be made of the Ehrlich-Posner model, supra note 62, written before the Kennedy article. They create an equilibrium
high-quality justice and hard cash could be drawn, the following model might shed some light on the efficient choice between rules and standards. The vertical axis in the diagram below represents the costs of litigation. Litigation costs are high when a standard is chosen and low when a rule is chosen. The horizontal axis represents the external preferences for rules that are neither under-inclusive nor over-inclusive. Labelled "fairness feelings," the preferences derive from the belief that the innocent (guilty) are not accidentally swept in with the guilty (innocent) in the course of administering justice. When a rule is chosen, fairness feelings are low; when a standard is chosen, fairness feelings are high. Rules and standards are conceived of here as extremes on a continuum.

Fairness feelings are directly proportional to the costs of litigation, as represented by the justice supply curve. For any model, but do not make explicit the role of external preferences of the public, although perhaps it is implicit deep within their model. See infra note 67.

Other more casual descriptions of the decision process do not add litigation costs or external preferences into an equilibrium model. William Simon states that the efficiency of rules should only be judged on the extent to which they achieve the desired results. Simon, supra note 62, at 1201-04. My views will differ. It is inevitable at some level to take litigation costs into account. Eventually, the substitution of over-inclusiveness and under-inclusiveness for litigation expense must occur. Thomas Jackson, on the other hand, seems to think that the costs of over-inclusiveness and under-inclusiveness can be found by examining the wealth effects of the victims or escapees of over-(under-)inclusiveness. Jackson does not make clear how we can tell whether these wealth effects are mere redistributions or genuine deadweight losses. Nor does he consider external preferences. See Jackson, Avoiding Powers in Bankruptcy, 36 STAN. L. REV. 725, 765 (1984).

Meanwhile, Colin Diver creatively lists various costs of rules versus standards, but he stops well short of finding any equilibrating factors. See Diver, The Optimal Precision of Administrative Rules, 93 YALE L.J. 65 (1983). He does recommend that rulemakers perform a balancing test involving the costs he (selectively) designates and also makes some "second-best" suggestions why special interest groups succeed in obtaining a type of rule or standard that diverges from the balancing test result. Even assuming rule makers choose to behave according to Diver's suggestions, however, they can claim to follow utilitarian principles only if they consider the external preferences of others, as I suggest in the text.

On the treachery of such an enterprise, see Rizzo, The Mirage of Efficiency, 8 HOFSTRA L. REV. 641, 644-46 (1980).


66. That is, to maximize empathetic impulses or, perhaps, personal reassurance against arbitrary legal intrusions, society adopts standards instead of rules, but does so at the expense of higher litigation costs.

The legislature may find its own choice of rule versus standard easily subverted by a judge. If the legislature chooses a general rule to displace a judge's fact-finding, the judge can easily transfer the fact-finding from the merits to
given rule or standard, a point on the supply curve, there is a corresponding level of litigation cost and good feelings about the nature of society.

the jurisdictional boundaries of the rule. In this way, the general rule in question becomes a narrow specific rule, leaving new areas in which vaguer judicial standards can operate. Whittling down general rules into specific rules satisfies more fairness feelings, but at a higher process cost. See Shupack, supra note 65, at 957-58. The implication of this observation is that both the judge and the legislature have roles in determining the equilibrium point between rules and standards. Whether the legislature or the judge has a utilitarian basis or a deontological basis for reshifting the equilibrium point between rules and standards can only be decided on a case-by-case basis, of course. My model speaks only to the conditions for an efficient equilibrium point.

More problematic for my model is that the legislature can attempt to generate fairness feelings on its own by writing extremely detailed rules that eliminate over- or under-inclusiveness. The implication of this second observation is that the supply curve should probably be a continuum between general rules, at the one extreme, with standards and large amounts of extremely specific rules at the other. I have elected to reject this view of the continuum. It may be true that extensive codification always fails to rein in judicial discretion. See id. at 958-62. This point is important when the judge and the legislature do not agree on the purpose of the underlying legislative program. Where they do agree, specific rules could displace judicial discretion with legislative discretion, but only at a very high cost and only at the risk of generating small-scale controversies leading, once again, to fact-finding at the jurisdictional boundaries. Specific rules to raise the quality of justice when judges and the legislature agree on the underlying social goal seem to be a losing strategy. In my model, I assume that the court and the legislature agree on the nature or the ethics of the legislature's purpose. Hence, the continuum is conceived as a polarity between rules and standards.
The intersection of the external preference curve, a demand curve which memorializes external preferences for fairness, and the justice supply curve determines the efficient equilibrium point for rules and standards. Drawing such a demand curve is problematic indeed. I will content myself with emphasizing one of many factors that determines its shape: sympathy for the victims of over-inclusive or under-inclusive rules. Sympathy for the victim could be viewed as intersubjectivity with others or, if they insist, individualists could restate the sympathetic position as personal feelings of security from governmental intrusions. If the victims are like "us," it is easy to imagine that "we" also may be the victims of unjust laws. Thus, if the voter identifies with the victim, his demand curve tends to be placed in an outward direction, so that litigation costs and good feelings are high. On the other hand, when the victims are unsympathetic, the demand curve moves inward.

With respect to lien priorities, the race priority is more like a rule, and the notice priority is more like a standard. Each purports to pursue the common goal of moving goods to the HVU by limiting innocent purchaser risk. The race priority, however, pursues the goal at the expense of more innocent victims, a circumstance that for some reduces the good feelings from having laws that are neither over-inclusive nor under-inclusive. On the other hand, the race priority is less expensive for the courts to administer and for the parties to litigate. Meanwhile, a notice priority pursues the efficiency of markets at the expense of fewer victims and higher process costs. An external benefit of such a system is the maximization of fairness feelings.

The case for the efficiency of race priorities must show that the existing structure of external preferences does not permit

---

67. Cf. Ehrlich & Posner, supra note 62, at 271 (a strict criminal liability for statutory rape rule is efficient when society doesn't care about chilling sexual intercourse with children over 16 years old).
68. Cf. Phillips, supra note 5, at 232-33. Phillips categorizes a BFP rule as a "rule," not a standard. What Phillips means by this is that, in developing the perfection concept, legislators have assumed that A is always the cheaper cost avoider in comparison to the subsequent BFP. If the legislature had been less sure, it would have permitted the courts to determine which taker was the cheapest avoider by reference to a "standard." Despite the difference in terminology, we are not necessarily in disagreement. Phillips probably would concede that a BFP standard allows a judge more leeway to produce an altruistic result on the parties than a rule that protects MFPs. Phillips is undoubtedly right that the existence of a perfection rule is evidence that the legislature has classified As and Bs by their ability to avoid the loss.
the pro-notice priority forces to buy off those favoring a race statute.\footnote{The model assumes the existence of a race priority. Because this is so, the exercise measures utility based upon the altruists' offering price and upon the individualists' asking price. Such an assumption is arbitrary and, of course, probably outcome determinative. \textit{Kennedy, supra} note 57, at 415-19.} The existence of a net preference for race rules over notice standards must be based upon actual empirical research and may not be deduced from the existence of a race priority itself. That a race structure exists does not prove that it is the efficient rule. The existence of a race statute may reflect the political power of persons in a position to enforce their own preferences rather than the existence of a public preference for low process costs and low fairness feelings.

Because it is impossible to determine society's external preference structure, the case for an efficient race priority can never be made. The external preferences of each and every citizen in a transaction-cost-free world can never be measured. Furthermore, the very act of measuring such preferences changes the preferences themselves. Finally, because any finding would be useful for a limited time only, measurements would have to be taken frequently to determine the current equilibrium. In short, the external preference structure is not a normative value that could assist legislators.

II. THE STRUCTURE OF ARTICLE 9 PRIORITIES

Part I of this Article set forth a relatively complete theory of the conditions under which recording acts are efficient. The model suggested that recording acts make sense when the innocent purchaser risk and derivative costs in the second transferee $B$ exceed the cost of perfection by the first transferee $A$. Within the category of situations in which recording acts are appropriate, the model supported the efficiency of rules protecting subsequent BFPs. Protecting donee $Bs$ is irrelevant. The efficiency of protecting unsecured lending $Bs$ is problematic, depending on weighing the definitely positive costs on $A$ against the extremely low benefits to unsecured lending $Bs$. Finally, the comparative efficiency of race priorities over notice priorities depends heavily on whether the public has a sense of right or wrong about bad faith $Bs$ knowingly stealing from innocent $As$.

Anyone who has studied commercial law will know that the above model does not come close to describing the Article 9 priorities. In particular, Article 9 curiously modulates between
a notice system in some circumstances and a race system in others. To illustrate, assume $D$ is a dishonest owner of personal property who wishes to hypothecate the property to a secured lender $A$. $A$ does not perfect properly according to the rules of Article 9. The debtor later transfers the collateral a second time to $B$. The following diagram of priorities demonstrates the baroque⁷⁰ quality of Article 9’s structure. The middle column considers the legal position of a secured party who has attempted to file a financing statement but has made an honest mistake and filed it in the wrong place. The last column covers a secured party who did not even attempt to file. The first column of the diagram depicts the potential $B$s, second transfer- ees, of the encumbered collateral. Each $B$ could potentially take priority over $A$, depending on whether $B$ has taken the encumbered property with knowledge of $A$’s rights. The boxes within the matrix indicate whether $B$ can eliminate $A$’s security interest without any regard for $A$’s welfare.

<table>
<thead>
<tr>
<th>B Knowledgeable</th>
<th>A Tried to file</th>
<th>A Did not try to file</th>
</tr>
</thead>
<tbody>
<tr>
<td>Secured Party Who Perfection First</td>
<td>No ⁷¹ (9-401(2))</td>
<td>Perhaps (9-312(5))</td>
</tr>
<tr>
<td>Buyer of the Collateral</td>
<td>No (9-301(1)(c))</td>
<td>No (9-301(1)(c))⁷¹</td>
</tr>
<tr>
<td>Lien Creditor</td>
<td>No (9-401(2)) ⁷²</td>
<td>No in 1962; Yes in 1972 (9-301(1)(b))</td>
</tr>
</tbody>
</table>

Of the six boxes in the matrix, Article 9, as promulgated in 1962, was an altruistic notice or race-notice statute⁷² in five categories and arguably a race priority in one category. Under the

---

⁷⁰. “Of, relating to, or having the characteristics of a style of artistic expression prevalent esp. in the 17th century that is marked generally by extravagant forms and elaborate and sometimes grotesque ornamentation . . . .” WEBSTER’S NEW COLLEGIATE DICTIONARY 90 (1979).

⁷¹. A minor exception was added in the 1972 amendments. Buyers of real estate apparently have no bona fide requirements with regard to earlier unperfected security interests in fixtures. See U.C.C. § 9-315(4)(b); Carlson, Fixture Priorities, 4 CARDOZo L. REv. 381, 415 (1983).

⁷². This Article does not consider the choice between a notice and race-notice statute. A race-notice statute is distinguished by the requirement that
1972 amendments, Article 9 is a notice or race-notice system in only four categories and a race priority in two.

Even though professors are practically unanimous in saying that Article 9 contains race priorities in narrow circumstances,73 the statutes themselves, at least as they existed in 1962, are ambiguous.74 The argument that the 1962 version of Article 9 had a race priority depends largely on a comparison between section 9-312(5), which is silent on the significance of B’s knowledge, and statutes such as section 9-401(2), which expressly prohibits B from taking priority when B knows A’s claim exists. Section 9-401(2) is a typical altruistic rule, providing that “[a] filing which is made in good faith in an improper place . . . is nevertheless effective . . . against any person who has knowledge of the contents of such financing statement.” Section 9-312(5)(a), in contrast, ambiguously states that “[c]onflicting security interests rank according to priority in time of filing or perfection.” The provision does not expressly authorize B to eliminate A’s interest intentionally.

Legislative silence, however, speaks with a forked tongue.

the subsequent bona fide B must also be the first to file. If A files first, A can snatch title back from B.

When both A and B must file (as in real estate regimes) race-notice is the superior choice because it protects bona fide purchasers from A in the after-market. An example will illustrate. Suppose D double-deals Blackacre first to A and then to B. A has not filed and B is a BFP who has not filed. Under a notice priority, B owns Blackacre, even if A is the first to file. When A finally files and sells to X (a bona fide purchaser), X will wrongly infer from the record that A is really the owner. The record will not reflect the existence of B.

In a race-notice priority system, A has superior title if A files before B. This rule protects all potential Xs from B’s unpublicized interest.

Although the content of Article 9 is not certain on this point, Article 9, when it has a bona fide requirement, is race-notice when both parties have to file a financing statement. U.C.C. §§ 9-312(5)(a), -401(2). It is a notice statute when B has no filing requirement to meet. Id. § 9-301(1) (lien creditors and buyers not required to file).


74. Of course, modern linguistic philosophers would deny that any statute ever has a “plain meaning.” Under this view, language itself is a series of symbols with meaning supplied by the reader. Whether the meaning supplied by the reader was in fact shared by the writer is something that can never be known with certainty. Meanings change over history. See generally Boyle, supra note 2, at 762.
Other Article 9 sections expressly authorize B to eliminate A’s interest. For instance, assuming A had perfected a security interest in inventory and B is a buyer in the ordinary course of A’s business, section 9-307(1) explicitly eliminates A’s claim “even though [B] knows of its existence.” Compared to such express invitations, section 9-312(5)(a)’s silence implies a notice priority or at least suggests that the matter is ambiguous. The drafters’ “intent” regarding the type of priority structure, therefore, is an open question.

III. EXPLAINING UCC PRIORITIES

The greatest difficulty with the final form of Article 9 is to discover some plausible explanation for the fact that section 9-301 (as to lien creditors and transferees) categorically adopts the pre-Code majority rule as to the effect of knowledge, while section 9-315(5) apparently...
In this Part, I hazard an explanation for the asymmetry in Article 9 priorities. While explaining law is a common enterprise of law review writers, hardly any of them explain what an explanation is or why the project is important. Let me begin my own explanation with a short account of what I think I am doing.

Whether the law comes from statutes or whether it is abstracted from a body of cases, law is a text, produced by history. Legal explanation, therefore, could be viewed as a subset of historical or literary explanation. For any given text, as for any given event in history, there is no single correct explanation. There are infinite correct explanations, each co-existing with the other at different levels of generality. The choice of one explanation over the others as the "best" explanation is really up to the questioner. That is, the quality of the explanation really depends on what the questioner wants to know.79

Lawyers and judges tend to ask several different questions, and whether the explanation given is adequate depends entirely on whether it answers the question and otherwise corresponds with what the questioner knows about the universe. Among the questions members of the legal community are most likely to ask are:

1) Why was the law invented? (A historical question.)
2) Why has the law lasted all these years? (A sociological question.)
3) Is the law consistent with any of the traditional ethical norms? (An ethical question.)
4) Given my view of the world, should I support this law? (A personal question of judgment.)

Assuming these questions are those a reader of this Article would ask, the following sections will "explain" Article 9 priorities in a "convincing" way.

---

78. 2 G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 34.2, at 902 (1965).
79. See generally Yablon, supra note 2, at 928 ("One of the features of explanatory statements . . . is that their adequacy depends, to a considerable extent, on the knowledge and assumptions of the person seeking the explanation.").
A. ADOPTION AS A HISTORICAL ACCIDENT

The UCC was the great project of the legal realist movement that aimed at taking private law out of the hands of formalist-minded common law judges who had no idea or no interest in the "needs" of the business community. The realist professors thought they better understood what commercial actors wanted: a simpler, more uniform law from state to state and as much certainty as the law could provide. This desire for certainty included (simultaneously) protection from secret liens and easier perfection rules to protect security interests from subsequent transferees. These two goals are, however, at least potentially contradictory.

The drafters of Article 9 aimed at telescoping the proliferation of numerous security devices into one single concept of "security interest." They also overruled certain old-fashioned prejudices—hostility toward after-acquired property interests on inventory and receivables, future advance clauses, and the like. In more standard cases, the drafters had no great desire to change priorities between A and the various Bs (subsequent secured parties, buyers and lien creditors).

The race priority itself was probably an accident. Through 1954, the drafts of the UCC had no race priority at all. At that time, section 9-301 was a complete catalog of all subsequent parties who could defeat A, the unperfected first transferee.

80. The details that support the following historical description can be found in the Appendix following the conclusion of the Article.


82. A major exception is that the drafters wanted to eliminate general creditors from the list of Bs who could prevail over unperfected As. The reason for this change relates to federal bankruptcy law, which allows the trustee to subrogate herself to any rights of unsecured creditors to destroy unperfected security interests. See supra note 43. By eliminating the rights of general creditors—and substituting lien creditors—the drafters effectively denied bankruptcy trustees a devastating avoidance power.

83. Section 9-301(1) read in relevant part:
(1) Except as otherwise provided in subsection (2), an unperfected security interest is subordinate to the rights of
(a) persons as to whom a perfected security interest is subordinate (subsection (2) of Section 9-303);
(b) a subsequent secured party who becomes such without knowledge of the earlier security interest and perfects his interest before the earlier security interest is perfected;
(c) a lien creditor who becomes such without knowledge of the security interest and before it is perfected;
(d) a transferee in bulk or other buyer not in ordinary
tion 9-301 provided that if subsequent secured party B had knowledge of A, B could not be senior. Meanwhile, section 9-401(2) replicated B's good faith duties, stipulating that if A tried to file, the financing statement was effective against any B with knowledge of its contents.  

Because the priorities between secured party A and secured party B were too complex to handle in a sentence or two, the 1956 draft replaced B's priority rule in section 9-301(1)(a) with a curt cross-reference to new section 9-312, which would govern disputes between secured party A and secured party B.  

Section 9-312 was, however, completely silent on B's duty of good faith. In moving secured party B out of 9-301 and into 9-312, B's good faith duties fell through the cracks. The altruistic section 9-401(2) continued to exist so that when A tried to file, but did so in the wrong place, B had to behave. If A did not try to file, or if the content of the statement was defective, Article 9 was silent on whether or not B had to behave.  

Commercial lenders were intently interested in the UCC drafting process and made many requests for changes, which the drafters often accommodated. One request lenders apparently did not make was to require an express duty of good faith of B under all conditions. Commercial lenders probably viewed themselves as mostly Bs or perhaps As who would know what to file but not always where to file, given the highly fact-intensive nature of the latter. Correcting the error simply was not important to them. One way or another, neither they nor any-course of business to the extent that he receives delivery of the collateral without knowledge of the security interest and before it is perfected.


84. Section 9-401(2) read:

A filing which is made in good faith in an improper place or not in all of the places required by this section is nevertheless effective with regard to any collateral as to which the filing was proper and with regard to all collateral against any person who has knowledge of the filing of a financing statement which indicates that a security interest in all collateral wherever located was intended.

U.C.C. § 9-401(2) (1952).

85. The 1956 Recommendations deleted both § 9-301(1)(a) and § 9-301(1)(b) and inserted the cross-reference to section 9-312 so that new section 9-301(1)(a) read: “persons entitled to priority under Section 9-312.” ALI & NAT'L CONF. OF COMM'RS ON UNIF. STATE LAWS, 1956 RECOMMENDATIONS OF THE EDITORIAL BOARD FOR THE UNIFORM COMMERCIAL CODE § 9-301(1)(a) (1957) [hereinafter 1956 RECOMMENDATIONS], reprint ed in 18 UNIFORM COMMERCIAL CODE DRAFTS 297 (E. Kelly ed. 1984).

86. See 1956 RECOMMENDATIONS § 9-312.

87. See supra note 84 and accompanying text.
one else lobbied for a return to a complete good faith duty on all B's. By the 1960s, therefore, the UCC emerged with an express altruistic notice system in all cases except, arguably, that in which A did not try to file.

By the middle 1960s, enough criticisms and nonuniform amendments of Article 9 had occurred to justify extensive amendment. By then almost nobody questioned the correctness of a race statute. Some urged, in the name of consistency, that all priorities between A and B be made subject to a race priority. Judicial lien priorities were changed because California had passed a nonuniform amendment on the subject. Other priorities were not changed for the avowed reason that no one had agitated for it.

The introduction of a new race priority constituted a metonymic error. The Permanent Editorial Board of the UCC determined that the "spirit" of Article 9 was the race priority, when in fact the notice priority prevailed in five of six categories and when the race priority itself was the product of mistake. Hence, after 1972, the UCC provided for four notice

---

88. Cf. Gilmore, supra note 8, at 626. Gilmore described the professional lenders as mostly interested in private advantage and little concerned with structural or theoretical purity.

89. Carl Felsenfeld is a chief proponent of this view. See Felsenfeld, Knowledge as a Factor in Determining Priorities Under the Uniform Commercial Code, 42 N.Y.U. L. REV. 246, 255-58 (1967). His rationalization is that punishing bad faith Bs made sense only if they could have protected themselves at the time they gave value to D. For example, a bad faith buyer B should not be protected because B can protect himself from A by reducing the price paid to D. A lien creditor B, however, was not necessarily in a position to do that. His knowledge was tested when he received his lien in the collection process, not when B advanced value to the debtor. Ergo, the knowledge requirement for lien creditors made no sense.

The trouble with Felsenfeld’s argument is that it applies equally well to secured party Bs who advance new value to D with knowledge that A existed. To distinguish buyers who must be in good faith from secured parties who may be in bad faith, Felsenfeld noted that security interests “are primarily a concern of professionals. The change in the common law of knowledge may, therefore, be justified in some measure by the nature of the people who will be affected.” Id. at 257. It is not terribly clear who Felsenfeld thinks the “people affected” are. Presumably, he means that As are all professionals and need no protection (because they make no mistakes). But this is circular. If priorities were more generous to amateurs, the “people affected” would need protection, thereby justifying priorities that are generous to amateurs.

90. See Appendix at n.58.

91. Id.

92. See generally Harris, Recognizing Legal Tropes: Metonymy as Manipulative Mode, 34 AM. UNIV. L. REV. 1215 (1985) (suggesting that in law, categorization through metonymy tends to take on a life of its own).
priorities, one clearly intended race priority and one arguably race priority.

B. PUBLIC APATHY ABOUT AMATEURS

In spite of the accidental origins of the race priority provisions of Article 9, they have endured. I doubt seriously that we can fairly attribute the law's perseverance to functionalist rationalizations that satisfied the public as to the justice of Article 9 priorities. Rather, public apathy played the leading role. Although some law professors think the details of Article 9 are important, the public surely does not. Few voters are swayed by the need to make Article 9 fair and internally consistent. Furthermore, the lobbyists who care about Article 9 probably do not care about amateur As. Because lobbyists usually are the source of suggestions for amending Article 9, no suggestion to improve the lot of amateur As ever surfaces. Meanwhile, professors who have considerable expertise do not often empathize with amateur As at all. They classify the amateur A as evil or vaguely undeserving of sympathy. Experts have shown much solidarity in ignoring the plight of As who have not attempted to file.

93. "Arguable" in the sense that the race priority was not necessarily the intent of any drafter when the words were written.

94. See, e.g., R. Henson, supra note 73, § 7-1, at 240 (acknowledging that there is generally "no particular reason to benefit a secured party who did not properly perfect his security interest").

95. An interesting statement of this point of view is by Justice O'Connor, dissenting in Mennonite Board of Missions v. Adams, 462 U.S. 791 (1983). In Adams, Justice O'Connor defended a rule that the state, as senior tax lienor, did not have to notify junior lienors that they were about to lose their liens in a foreclosure sale. The junior lienor in question was the clearly amateurish Mennonite Board of Missions, which had taken a real estate mortgage on the debtor's property. Pointing out that 95% of real mortgages are held by experts, Justice O'Connor saw no reason why the state should do anything to help the amateur mortgagee. The mortgagee could have monitored the tax records and thus could have discovered the sale. "When a party is unreasonable in failing to protect its interest despite its ability to do so," she wrote, "due process does not require that the state save the party from its own lack of care." Id. at 809.

Implicit in such views is the assumption that amateurs have no business taking real estate mortgages. Although the burden on the state to send letters to record holders of real estate cannot be very great, see id. at 799-800 (majority opinion), the effort was nevertheless too altruistic and too caring for the plight of amateurs who have made the serious mistake of playing out of their league. Justice O'Connor, then, has a paternalist or protectionist plan in mind: by punishing amateurs, we can teach them their place.

This plan—promotion of self-reliance or perhaps protection of expertise—was inconsistent with the majority's political program. The majority explicitly
Furthermore, once in place, the race priority system reinforces the apathy people feel about it. To the extent practiced, the race priority teaches amateur lenders to stay out of the secured financing market. If an expert B locates an amateur A, the UCC race priority encourages the expert B to eliminate A's interest and split the profit with D. Because of such a system, it is unlikely that many amateurs extend secured loans. The result is that there are simply not enough amateur As in the market to agitate for reform.

rejected the idea that amateurs should receive no notice. Id. at 800 ("Notice by mail . . . is a minimum constitutional precondition to a proceeding which will adversely affect the liberty or property interests of any party, whether unlettered or well versed in commercial practice . . . . "). Compare Justice Marshall's refusal to make rules punishing amateurs in secured financings with Justice Traynor's similar instinct in Handy v. Gordon, 65 Cal. 2d 578, 422 P.2d 329, 55 Cal. Rptr. 769 (1967), discussed infra note 99.

96. See Kennedy, supra note 54, at 1692 ("[W]hatever its purpose, the requirement of a formality imposes some cost on those who must use it, and it is often unclear whether the lawmaker intended this cost to have a deterrent effect along with its cautionary and evidentiary functions.").

97. An anonymous author of a student note has made an insidious suggestion for improving the effectiveness of the bounty system. See Note, Knowledge and Priorities Under Article Nine: A Proposed Rule Change in the "Race of Diligent Creditors," 47 U. COLO. L. REV. 467, 482-85 (1976). The author notes that courts do not require second secured parties with knowledge to see the erroneously filed financing statement itself. It is enough if they have gained "knowledge of the contents" from other types of investigations. E.g., American Employers Ins. Co. v. American Sec. Bank, 747 F.2d 1493, 1498-99 (D.C. Cir. 1984) (misfiled financing statement effective against party with actual knowledge). The author is concerned that § 9-401(2) unduly crowds the race priority in § 9-312(5). Therefore, the author proposes that § 9-401(2) be amended so that only those who file in one of the two correct places (in a dual filing state) be protected from knowledgeable secured parties.

Although the proposal would increase the amount of expertise A must have to qualify for the law's mercy, it does make the bounty system more efficient. Having discovered the existence of an unperfected security interest, B can determine the first lender's vulnerability simply by checking the two proper filing places. Under the current regime, B must check every office in the state to be sure that A is vulnerable.

98. Census data on the extension of credit secured by real property may be representative of the professionalization of the secured market generally. That data shows that institutional lenders hold 95% of all real estate mortgages. BUREAU OF CENSUS, STATISTICAL ABSTRACT OF THE UNITED STATES: 1982-83, at 511 (103d ed. 1982).

99. The future advance rules under Article 9, largely added in the 1972 amendments, present parallel barriers to amateurs. The rules govern the effect of a future advance given by A, the expert who has perfected. If B, the second transferee, is a buyer or lien creditor, A has a limited duty to restrain from squeezing out B by giving D future advances. U.C.C. §§ 9-301(4), -307(3). If B is a competing secured party, however, A is free to give D future advances at will, U.C.C. § 9-312(7), suggesting a code of conduct under which expert lenders do not interfere with each others' customers. A B who does interfere
It would be a mistake to deduce public acceptance of Article 9 ethics from the continued existence of the statute itself.\(^{100}\) In a utilitarian exercise, each person's desires would count in choosing a rule or standard. In the real world, however, the preferences of legislatively inactive and uninfluential persons are likely to be ignored. If so, the choice actually made by legislators may differ significantly from the utilitarian result. Arguably, the Article 9 priority structure resulted from just such a phenomenon. Nobody was there during or after completion of the drafting process to lobby for the point of view that victimizations of amateurs might have a demoralizing effect. Therefore, the current race priorities in Article 9 are not necessarily in a state of efficient equilibrium.\(^{101}\)

C. COMPETING ACCOUNTS OF ARTICLE 9 PRIORITIES

The above account of Article 9 priorities seems more con-

is at the mercy of A's future advances. Although the rule no doubt serves to perpetuate A's power over D, it also penalizes amateur lenders who find themselves in a junior position.

Compare the voracity of Article 9 future advance priorities with Justice Traynor's instinct regarding subordination agreements in real estate financing. In Handy v. Gordon, 65 Cal. 2d 578, 422 P.2d 329, 55 Cal. Rptr. 769 (1967), an amateur entered a contract to sell land in exchange for a purchase money mortgage. The seller also agreed to subordinate the purchase money mortgage to any future construction mortgage, regardless of amount. When the seller tried to renege on the contract, the buyer sought specific performance. Justice Traynor ruled that the contract was unenforceable because the subordination provision would create an opportunity for a squeeze-out by future advances. \(\text{Id. at 581-82, 422 P.2d at 331-32, 55 Cal. Rptr. at 771-72.}\) Significantly, the unconscionable contract did little more than duplicate the actual future advance rules of Article 9.

100. See supra text accompanying notes 63-67 for a model in which demand curves for justice differ by the amount of empathy the aggregate of society feels for the victims.

101. Some readers may find it inconsistent that the public is apathetic about rendering Article 9 fair and that the public may not accept the fairness of Article 9. It is important to distinguish between apathy about and legitimacy of a social institution. Suppose the average person, when told about the ethical consequences of the Article 9 race priority, feels two cents worth of pain at the thought of some lender knowingly taking advantage of an innocent A who made no attempt to file. Anyone whose commitment to a social issue is limited to two cents is surely apathetic. On the other hand, by aggregating the total pain of the entire world's population, the aggregate external cost of the race priority could easily overwhelm any gains from the reduced process costs a race priority may engender. Therefore, it is quite appropriate to conclude that the public has not been mollified about the fairness of the Article 9 race priority, while at the same time suggesting that Article 9 ethics is not an issue that any one person cares a great deal about. In short, the Article 9 race priority is a minor injustice, but an injustice nevertheless.
vindictive to me than some of the existing justifications. The most common explanation offered for the race priority is that it encourages filing, produces certainty, and the like. A recent and more ambitious argument by Douglas Baird and Thomas Jackson\textsuperscript{102} suggests that efficiency is the grand unifying theme of Article 9 priorities. Meanwhile, David Phillips tries to explain the regime by reference to a moral culpability scale, supposedly implicit in Article 9.\textsuperscript{103} I find none of these competing explanations to be persuasive.

1. Encouragement of Filing and Certainty

There is a group of explanations that is best discussed together because the explanations suffer from similar virtues and similar flaws. Their virtue is that they are generally one or two sentences long. Their vice is that they assert the importance of values that are not ends but are only means to other ends. There are four such justifications: that the race priority (a) increases certainty,\textsuperscript{104} (b) encourages filing,\textsuperscript{105} (c) protects the integrity of the filing system,\textsuperscript{106} or (d) rewards creditor diligence.\textsuperscript{107}

a. Increasing Certainty

Increasing certainty is a particularly unsatisfactory justification for race priorities. It is vital to ask what becomes more certain. Certainty that Bs can impose intentional harms on As is a goal that few would acknowledge or defend. At best, the certainty argument refers to the elimination of the risk that disappointed As will fabricate accusations that innocent Bs acted in bad faith.\textsuperscript{108} If this is what the certainty argument means, it presents only one side of the efficiency argument. Costs imposed on A and the public must be considered as well.\textsuperscript{109} For the public, certainty is desirable for good faith Bs, but certainty for bad faith Bs is probably undesirable. The sav-

\textsuperscript{102} Baird & Jackson, supra note 5, at 307-09.
\textsuperscript{103} Phillips, supra note 5, at 248-51.
\textsuperscript{104} See, e.g., Todsen v. Runge, 211 Neb. 226, 236, 318 N.W.2d 88, 93 (1982); B. Clark, supra note 73, at § 3.8[1], at 3-44.
\textsuperscript{106} See In re Smith, 326 F. Supp. 1311, 1315 (D. Minn. 1971).
\textsuperscript{107} U.C.C. § 9-312 comment 5, example 2.
\textsuperscript{108} See supra note 54 and accompanying text.
\textsuperscript{109} These costs were not completely ignored by the students of the Cornell Law Review who have assured us that "the predictability that section 9-312(5)(a) ensures as a pure statute more than offsets the few inequities it pro-
ings created by certainty always must be netted against the deficits created elsewhere. Otherwise, the call for certainty is not an efficiency argument but is a protectionist argument that is designed to promote the interests of one group over another.

b. Encouraging Filing

Encouragement of filing likewise is a poor justification for the race priority because filing is not inherently valuable in any sense. It is costly and bureaucratic. Those who wish to encourage filing must explain what social goals they are really trying to achieve by filing. One rationale for recording systems is that they improve the market for goods by lowering the cost of B's title investigation and thereby reduce B's innocent purchaser risk.\(^\text{110}\) Bad faith Bs already know the state of title; for them, filing is not valuable. No conceivable reason exists to further encourage As to file beyond that provided by notice priority.

Additionally, encouragement of filing fails to explain why Article 9 empowers only bad faith secured parties to harm As. If the goal is to encourage filing, similar powers in bad faith buyers or donees would be as useful. Article 9 does not, however, protect knowledgeable buyers or donees.\(^\text{111}\) In fact, if we want to encourage filing in the abstract, we might as well do away with the concept of the unperfected security interest and define perfection as the moment a security interest is created.

c. Integrity of Filing System

Integrity of the filing system, presumably referring to the maintenance of a system containing a complete record of secured financing, also is not inherently valuable. There is no reason to have a central index to all security interests in personal property if bona fide Bs are protected against unfiled security interests. In fact, it is not even clear that the integrity argument is different from the encouragement of filing argument generally. If so, "integrity of the files" also is either an incomplete efficiency argument or a protectionist argument favoring those already blessed with expertise.\(^\text{112}\)

---

\(^\text{110}\) See supra note 16 and accompanying text.

\(^\text{111}\) See supra text accompanying notes 70-72.

\(^\text{112}\) Furthermore, the existence of § 9-401(2) undermines the argument that integrity of the files is important. Section 9-401(2) imposes a notice prior-
d. Creditor Diligence

Finally, some have asserted that diligent creditors ought to be rewarded with priority over undiligent creditors.113 Again, creditor diligence alone is not inherently important. Although diligent creditors tend to win race priority disputes, no one has suggested why they deserve to win because of diligence alone.114 The assertion of diligence as a value is entirely circular: creditor diligence is valuable because the Article 9 race priority rewards creditor diligence. In fact, creditor diligence is merely a response to legal rules that require creditor expertise. Assertion of creditor diligence seems based on the protectionist premise implicit in the certainty, encouragement of filing, and integrity of the filing system arguments.

2. Efficiency

Whereas a decent efficiency argument can be made for recording statutes over nonrecording statutes in certain instances,115 no such argument can be made for the choice between race and notice priorities because race priorities reward conduct that many people would find unfair.116 Douglas Baird and Thomas Jackson have argued a contrary position, relying on the elimination of $B$'s transactions costs as the justification for Article 9 theodicy.117

113. U.C.C. § 9-312 comment 5, example 2.
114. On creditor diligence as a value, see Carlson, Simultaneous Attachment of Liens on After-Acquired Property, 6 CARDOZO L. REV. 505, 519-20 (1985).
115. See supra notes 16-32 and accompanying text.
116. See supra notes 63-69 and accompanying text.
117. Their account of the transaction costs imposed and eliminated by a race priority is defective in some respects. First, they assume without explanation that, without a race priority, a subsequent purchaser with knowledge of a security interest would flee the market at the first sight of an earlier security interest. Defections, however, are not, without more, affronts to efficiency.

Their abbreviation of the economic harm due to buyers fleeing markets seems to have misled Baird and Jackson into a serious error with regard to markets in which perfect substitutes are available. They claim that a BFP rule is the least efficient in a competitive market because buyers will be quicker to shun risky goods in favor of the non-risky substitutes. Where substitutes are less satisfactory, they find a BFP rule more acceptable because the buyer is less likely to flee the market.

Abandonment of a transaction has efficiency consequences only when an HVU drops the transaction and substitutes an inferior one. If Baird and Jack-
At best, the Baird-Jackson theory explains only one-sixth of the 1962 priority structure or one-third of the 1972 structure. Baird and Jackson do not explain why, in economic terms at least, knowledge is still a significant disability on B in the other cases.118 Presumably, transaction costs are also present when the second taker is a buyer or is a secured party where a filing has been made in the wrong place.

Aside from their failure to develop a coherent relationship between transactions costs and the structure of Article 9 priori-

son had focused on inferior substitutions—and not the mere fact that the buyer flees the market—as the principal evil, they would or at least should have seen that the opposite is true from what they say in their article. If perfect substitutes are available, the buyer loses no utility by switching from risky goods to non-risky goods. Hence, it does not matter if the switch is made. When no good substitutes are available, abandonment of the auction for a risky item results in lost utility. Assuming that a BFP rule is inefficient, it would cause the least harm in competitive markets.

Second, in assessing the costs a race priority causes for secured transactions, Baird and Jackson assume that everyone in the market for such loans already knows the rule and that all education costs are sunk. Although this is probably a realistic view of the status quo, they should have made explicit their normative assumption that the status quo should continue. Once having done so, it is acceptable to analyze perfection costs at the margin. Expertise then becomes a significant barrier to entering the market.

Third, Baird and Jackson do not deal with external preferences, see supra note 57 and accompanying text, although many of their comments indicate that they think that demands for well-administered justice are low. They do not explicitly state whether such demands are their own or those of society, however.

118. The article by Baird and Jackson suffers from some serious internal contradictions in explaining why knowledge requirements appear where they do. In accounting for their presence in real estate statutes, the authors comment:

Neither of these questions [the status of a B with knowledge or a good faith B who has not actually searched the record] looms large in litigation surrounding real property, for the most part because the transactions are sufficiently large and the rituals sufficiently well known that defective filings are the rare exception rather than the rule. Defective filings, however, are an everyday affair when at issue are security interests in personal property, and thus the question is far from being merely of theoretical interest.

Baird & Jackson, supra note 5, at 312. See also id. at 314 ("Ferreting out those who took with knowledge despite a defective filing is not worth the uncertainty and the litigation it generates."). If I may pass over their complete lack of empirical data to support their assertions about litigation frequency, their main point is that knowledge disabilities are acceptable for real estate because everyone knows the rules, and therefore everyone avoids errors. With so few errors, looking into knowledge is affordable. Not so with Article 9, where defective filings are common. The authors apparently have forgotten that when there are defective filings, Article 9 supplies a knowledge disability for second takers of all sorts. See U.C.C. § 9-401(2). Hence, their attempt to explain the existence of knowledge disabilities is substantially embarrassed.
ties, Baird and Jackson also fail to measure all transaction costs. Having noted that it is less costly for B to litigate under a race priority than a notice priority, they apparently believe that they have sufficiently “explained” the race priority in Article 9.119 Like the one-sentence explanations from the cases and treatises,120 however, their account is incomplete. The under- and over-inclusiveness of rules produce social costs that must be netted out against the judicial expense saved by choosing a race priority rule over a notice priority standard.121

Baird and Jackson do make three observations which could be construed as implying that the countervailing social costs are not high. First, they think that B’s knowledge is irrelevant in B’s decision whether to lend or not. Second, they claim that Article 9 provides Bs with no incentive to disclose their information and that this lack of incentive implies that it is all right for Bs to wipe out As. Third, they worry that a notice priority serves as a disincentive for Bs to acquire knowledge. They suppose knowledge to be inherently valuable.122 Each of these arguments is either unconvincing or demonstrably wrong.

a. Is Knowledge Irrelevant?

Baird and Jackson claim that B’s knowledge that A will be hurt makes B no more or less likely to undertake the transaction that results in A’s loss. A secured loan by a bad faith B is therefore not like insider trading on the stock market, they say. An insider profits because he has the knowledge. The inside knowledge is itself an incentive to enter the market.

This assertion misperceives the source of profit. The double-dealing D and the conspiring B are in a position to impose a loss on A. D can repledge the collateral a second time for essentially no cost. Anything D receives from the co-conspirator B is a gain. The knowledgeable B can coerce concessions from D by threatening to make the unperfected security interest public. On this scenario, D and B are analogous to the thief and the knowing fence who split the wealth transfer that the thief has won. The only distinction is that the thief may have incurred some personal risk in creating the theft and,

119. Baird & Jackson, supra note 5, at 314.
120. See supra notes 104-114 and accompanying text.
121. See supra notes 58-69 and accompanying text.
122. See Baird & Jackson, supra note 5, at 314 (“[E]veryone is ultimately better off with a clear rule than with a legal regime that is somewhat more finely tuned but much more expensive to operate.”).
therefore, has at least some claim to our admiration. In contrast, the double-pledging $D$ may well have incurred no cost in obtaining the opportunity to impose a loss on $A$. Furthermore, the knowing fence is criminally and civilly liable if caught—not so the bad faith $B$ under the Article 9 race priority. Article 9 practically throws him a testimonial dinner. Thus, it is incorrect or at least misleading to state that the knowledge of $B$ creates no incentive to the second transaction.\textsuperscript{123}

b. \textit{No Incentive to Disclose}

Baird and Jackson also claim that a notice priority imposes no incentive to disclose the information that a knowledgeable $B$ has acquired, thereby leaving the marketplace uncorrected.\textsuperscript{124} This is flatly incorrect with regard to buyers\textsuperscript{125} and not completely correct with regard to subsequent secured parties.\textsuperscript{126} In any case, a lack of incentive to share information, even if it existed, is a red herring. The ability of bona fide $B$s to take free

\textsuperscript{123}. Lord Mansfield understood this point. In Worseley v. De Mattos, 97 Eng. Rep. 407, 411 (1758), he wrote, “A. buys an estate from B. and forgets to register his purchase deeds: if C. with express or implied notice of this, buys the estate for a full price, and gets his deeds registered; this is fraudulent, because he assists B. to injure A.”

Professor Jackson seems to have forgotten this point since he participated in writing Jackson & Kronman, Secured Financing and Priorities Among Creditors, 88 YALE L.J. 1143, 1169-70 & n.84 (1979) (discussing the incentive of $B$ and $D$ to take value from a prior $A$ and split it between themselves).

\textsuperscript{124}. Baird & Jackson, supra note 5, at 315-16.

\textsuperscript{125}. A subsequent buyer in a notice regime has the incentive to communicate with $A$ so that he can pay him off and obtain good title. If anything, a race statute destroys the incentive to communicate.

\textsuperscript{126}. A second security interest is somewhat different from a buyer’s absolute possessory interest. A secured party $B$ does not always strive to obtain good title against $A$. Instead, if knowledge results in subordination, $B$ might substitute higher compensation for the increased riskiness of the loan. Nevertheless, a knowledgeable secured party $B$ has a considerable incentive to take $A$ out by refinancing $A$’s loan. Refinancing assures that $B$ rather than $A$ controls foreclosure proceedings. See J. White & R. Summers, supra note 54, § 25-4, at 1040 (“We suspect that it is a rare banker who will lend against the same collateral which secures a prior loan; in our experience the commercial practice is for the second lender to pay off the first and so take a first priority as to all of the collateral.”). Furthermore, if $B$ elects not to refinance, as a junior secured party, $B$ must notify senior secured parties that he expects to be given any cash surplus in case $A$ enforces her security interest. U.C.C. § 9-504(3) (“notification shall be sent to any other secured party from whom the secured party has received . . . written notice of a claim of an interest in the collateral”). Although $B$ need not set forth a reminder that $A$ should perfect against subsequent bona fide purchasers, common courtesy frequently will produce the reminder. Hence, it is wrong to say that subordination of knowledgeable Bs never leads to the elimination of unperfected liens.
of earlier unperfected security interests corrects the market regardless of communication. It is not necessary for subsequent knowledgeable Bs to advertise the existence of still earlier unperfected interests. Bona fide Bs are fully protected from earlier unperfected security interests without disclosure.127

c. No Incentive to Gather Information

Finally, Baird and Jackson fear that a race-notice system creates a disincentive for all creditors to obtain knowledge.128 Their concern, however, misconceives the purpose of perfection rules, which is to reduce the amount of knowledge Bs need to complete honest transactions.129 Knowledge cannot be a good in and of itself but only has value as a means to some greater end.

In markets, transactional knowledge is good or bad depending on whether it helps or hurts the movement of goods to the HVU.130 Brokers who bring buyers and sellers together, for example, are valuable. The price of brokerage is financed from the difference between the price the seller would have received from a buyer he located and the higher price presumably offered by a buyer whom the broker locates. Here, knowledge is all to the good, at least to the extent of the arbitrage. A “socialization” of knowledge in this context would serve as a disincentive to its generation in the future.131

The incentive to gather knowledge in some contexts, however, can actually prevent goods from moving to the HVU. This context is defined by the presence of large innocent pur-

127. In failing to see that their argument is a red herring, Baird and Jackson replicate the error of the “integrity of the files” view. The files need not have any integrity if BFPs are protected from unfiled security interests. See supra text accompanying note 112.
128. See Baird & Jackson, supra note 5, at 315-16.
129. See supra text accompanying notes 24-27.
130. See Kronman, supra note 24, at 30.
131. There is another sense in which brokerage could be inefficient. Suppose an entire brokerage system could be replaced by some sort of central advertising system that was cheaper to administer. A law against such a system would promote broker interests, but few would maintain that such a prohibition is efficient. On the other hand, if technology cannot currently replace brokers, a socialization of broker knowledge would undoubtedly be a bad thing in a market economy.

Similarly, if knowledge is of a type that is generally the natural by-product of some activity that the economic actor would engage in anyway, its socialization will not inhibit its generation. Kronman, Contract Law and Distributive Justice, 89 YALE L.J. 472, 489-91 (1980).
Large risk of this sort is an incentive to search. Perfection requirements—imposing the cost of publicity on A—lower B’s cost of searching and hence the amount of innocent purchaser risk. If knowledge were always a good thing, the best incentive to invest in it would be to repeal Article 9. Creating such incentives, however, would result in fewer purchases by HVUs.

The attempt by Baird and Jackson to minimize the social costs of a race priority is a complete flop. They do not rehabilitate the knowledgeable B who deliberately imposes a loss on an innocent A. In addition, they err in supposing that knowledge is not always valuable. Indeed, some knowledge is harmful from a societal perspective. The Article 9 race priority encourages certain Bs to steal. By supporting the race priority, Baird and Jackson wish to protect the knowledge developed by dishonest, thieving Bs. Such knowledge hardly seems worth protecting.  

3. The Commercial Culpability Scale

In the course of a very interesting essay on comparative culpability in commercial laws, David Phillips also provides an explanation for Article 9 priorities. He asserts that UCC questions generally can be answered by determining which of two disputing parties is more despicable according to a scale of bad behavior. Those who inflict intentional harm are at the vortex of UCC hell. Those who act with knowledge are in the second circle. Those who act negligently are in the third. The most efficient cost avoiders are the virtuous pagans who bear residual liability when there are no more guilty parties. Where the litigants stand comparatively on the culpability scale determines which party bears the loss under the UCC.

The race aspect of Article 9 priorities is where Phillips’s model is least descriptive. In a great many cases, when A does...
not attempt to make a filing, A is negligent. Either A simply
forgets to file or A has never learned the rules. Meanwhile,
when a secured party B has knowledge of A's negligence, the
comparative culpabilities suggest that A should have priority
over B.

Phillips does not concede that failing to file anything can
ever result from accident or stupidity. If he did, then of course
Article 9 priorities would not fit his model. Instead, Phillips re-
lies on the theory that the drafters viewed non-perfecting As as
guilty of intentional fraud. In other words, he simply notes
that the drafters of the UCC have carried forward the tradition
that a hypothecation of goods absent a filing is always treated
as fraudulent, even though A never meant to perpetrate any
harm. The reason drafters did this, Phillips asserts, is that
fraud so often explains A's conduct that courts need not spend
time considering the individual morality of the particular A
before them. This use of "constructive" fraud enables Phil-
lips to label A's conduct intentional, rendering A more culpable
than the knowledgeable B.

Explaining the Article 9 race priority on a constructive
fraud theory is inconsistent with other Article 9 provisions. If
A's conduct always constitutes fraud, then A should not get the
benefit of a notice priority when B is a bad faith buyer. In
addition, the resort to such a classificatory device violates Phil-
lips's starting premise that it is possible to predict the victor of
a UCC dispute by examining the comparative mental states of
the parties. Under a race priority, B is worse than A much of
the time and yet B still wins.

Phillips makes an interesting use of section 9-401(2) in his
model. Under that provision, knowledge in B does become a
disability when A attempts to file in the right place but does so
in an inefficacious location. The bungled attempt to file
looks more like negligence and less like intentional misconduct
to Phillips. Although this particular context seems to fit his

136. Id. at 249-50.
138. "When the probability of [intent] is high, the Code, (like other laws)
sometimes draws a per se rule based upon the existence of intention . . . , even
though the relevant state of mind is not proved in the individual case." Phil-
lips, supra note 5, at 233 n.13 (referring to discussion of Article 9 priorities).
139. See supra text accompanying notes 70-72.
140. See supra text accompanying note 135.
141. Phillips, supra note 5, at 250-51.
142. See supra text accompanying note 84.
model better, Phillips still fails to explain why the UCC does not protect merely negligent As who did not file at all or negligent As who filed without meeting the formal requirements of section 9-402. Nor does he explain why “intentional” As are protected against knowledgeable buyers under section 9-301(c) and (d).

Phillips is over-eager in claiming that his culpability scale is descriptive. In fact, its normative power is impressive. Rigorous use of the model militates for a notice priority system. As an explanation for the status quo, however, his suggestion with respect to Article 9 priorities must be rejected.

D. JUDICIAL SUBVERSION OF ARTICLE 9 PRIORITIES

The final question, “Given my view of the world, should I support this law?,” is a question judges will ask not so much about the text of Article 9, which lacks content, but about the construction placed on the text by law professors after the fact.

Many judges are likely to have a formalist definition of justice. The judge appreciates the division of function between the legislative and judicial branches of government and, to the extent possible, believes that a judge’s job is to do the will of the legislature. Furthermore, the judge vividly understands that often statutory words imperfectly convey legislative intent or that the legislature sometimes has no directly governing intent. Therefore, in ambiguous cases, the judge should explore the purpose of legislation and try to reconstruct an answer from that purpose.

Such judges are not bound by the language of Article 9 to uphold a race priority. Evidence suggests that the drafters had no clear intent in this regard. The state legislatures enacted Article 9 well after the process of ex post rationalization was under way, but it is unlikely that legislators specifically considered the race priority. In addition to the ambiguity of the statute, there are independent doctrines of good faith that pervade Article 9. A judge could easily conclude that Article 9 does not create a race priority at all.

143. Of course, not all judges maintain this formalist view and its very plausibility has been attacked. See, e.g., Tushnet, supra note 77, at 800-06.

144. E.g., Posner, Statutory Interpretation—in the Classroom and in the Courtroom, 50 U. Chi. L. Rev. 800, 817 (1983) (“The judge should try to think his way as best he can into the minds of the enacting legislators and imagine how they would have wanted the statute applied to the case at bar.”).

145. See supra text accompanying notes 77 & 82-93.

Accordingly, judges might search for the normative goals behind Article 9 priorities. One important goal is perfection of the market mechanism in pursuit of efficiency, but this is not a goal that is convincingly served by the race priority. Existing external preferences for just and fair commerce make it impossible to tell whether the race priority really increases aggregate utility. Even if it did, protection of bad faith Bs would be an ad hoc use of the efficiency norm in that a majority of Article 9 categories do not permit the court to apply a race priority.

If a goal or purpose must be deduced for the race aspect of Article 9 priorities, the protection of expertise seems to be a unifying idea. Bad faith secured lenders are rewarded for locating prior secured parties who did not even know enough to attempt a filing. The race priority could be viewed as a bounty system to drive amateurs from the market. A marketplace free of amateurish intermeddling may be desirable, and it does appear that few amateurs compete in the secured financing market. If amateurs knew that judges would protect them from their mistakes, they might start to enter the market, undercutting the experts and perhaps rendering the market less efficient.

On the other hand, if the race priority were abandoned by judges on a case-by-case basis, it does not follow that the structure of the secured financing market would change. Not every change in law produces a change in society. Even though protected by a notice priority, amateurs are not likely to repeat transactions. Strategic reaction to changes in law by such a class of persons is improbable. Also, Article 9 contains enough other technicalities that the race priority is unlikely to be the crucial factor that encourages amateurs to enter the market. Thus, a judge need not fear collapse of an efficient market because a few knowledgeable Bs are denied a race priority.

In the case of Article 9 priorities, the drafters have aided the cause of altruistic subversion by articulating some concepts directly contradictory to the race priority. For instance, section 1-203 requires all commercial transactions to be in good faith. Some courts have determined that a second secured party with knowledge is in bad faith and hence not entitled to priority.

147. See supra notes 52-69 and accompanying text.
148. See supra note 69 and accompanying text.
149. See supra text accompanying notes 70-72.
150. See supra note 98.
151. In re Davidoff, 351 F. Supp. 440 (S.D.N.Y. 1972), contains language broadly stating that knowledge and good faith are incompatible. Attempted
Other courts have noted that Article 9 does not explicitly repeal the equitable lien. Unperfected security interests may be equitable liens that survive transfer to subsequent purchasers with knowledge.\textsuperscript{152} Another possibility, with roots in the Bankruptcy Code, is equitable subordination. A significant number of Article 9 priority contests will occur in bankruptcy court, where section 510 of the Bankruptcy Code authorizes the transfer of the perfected knowledgeable secured party’s lien to the unperfected secured party.\textsuperscript{153} As an inherent power of equity courts, equitable subordination also could apply outside of bankruptcy courts. Thus, in appropriate cases, an ample supply of legal rules exists to defeat the apparent race priorities of Article 9.

CONCLUSION

The ultimate conclusion to be drawn is that the UCC has two rules—a race priority and a good faith duty on all Bs. Judges are free to rid themselves of unmeritorious claims by asserting section 9-312(5)’s failure to provide a good faith duty on knowledgeable Bs. On the other hand, judges who are offended by B’s conduct may justifiably choose to find an equitable lien or an expanded good faith requirement in section 1-203 filing in that case, however, could indicate that it was an explication of § 9-401(2).

\textsuperscript{152} See, e.g., General Ins. Co. of Am. v. Lowry, 412 F. Supp. 12, 14-15 (S.D. Ohio 1976) (finding an equitable lien where a security interest in stock was unperfected), aff’d, 570 F.2d 120 (6th Cir. 1978); see also 1 G. Gilmore, Security Interests in Personal Property § 11.1, at 334-37 (1965) (defending the equitable lien under Article 9). The leading pre-Code case relying on equitable liens to save an amateur secured lender is Porter v. Searle, 228 F.2d 748 (10th Cir. 1955).

\textsuperscript{153} See In re Pat Freeman, Inc., 42 Bankr. 224, 229-32 (Bankr. S.D. Ohio 1984). In this case, the court made some interesting steps toward the proposal in the text. A had sold trade fixtures to B in exchange for a purchase money security interest. D guaranteed B’s personal obligation to pay. B, however, neglected to execute a security agreement and financing statement as promised. B then sold his equity in the fixtures to D in exchange for a purchase money security interest. B perfected his interest.

Applying the straight Article 9 rules, B had a security interest that was valid in bankruptcy and A had no security interest at all. The court, however, used section 510 of the Bankruptcy Code to divest B of his lien.

Unfortunately, the court concluded that the benefits of equitable subordination should go to all the creditors. This solution ignores the fact that only A was harmed by B’s behavior. Section 510(a) authorizes subordination to a single wronged creditor. Subordination to less than all the creditors amounts to an assignment of the junior creditor’s claim and the accompanying lien to the senior creditors. See Carlson, A Theory of Debt and Lien Subordination, 38 Vand. L. Rev. 975, 989-90 (1985).
that subordinates B.\textsuperscript{154}

The assertion that Article 9 has two rules may lead to a condition of uncertainty, but so what? There is nothing inappropriate about such a condition. Some commentators view it as the natural and inevitable state of all law. The costs of uncertainty generated by the availability of doctrinal choice are not likely to be high. What ought to be controversial is that ethical principles could or should be sacrificed in the name of legal predictability. The public interest in preserving the weak from the wicked is ineluctable. It is as welcome in commercial law as anywhere else. Nothing except the consensus of legal scholars stands in the way of judges who wish to do the right thing in Article 9 priority cases.

\textsuperscript{154} See generally Kennedy, supra note 54, at 1776 (discussing the use of good faith standards and rules by altruistic and individualistic judges). Felsenfeld recognized the duality of Article 9 priorities in writing that “[s]ince the bankruptcy court is a court of equity, it may well be questioned whether the rule of section 9-312(5)(a), that the first to attach wins without regard to knowledge of another’s interest, will be respected.” Felsenfeld, supra note 89, at 254. I disagree only in that all courts in this context should feel free to choose the doctrine to fit the result that is just.
Appendix

Historical Evidence on the UCC's Race Priority

1. GENERAL BACKGROUND

The UCC was the joint project of the National Conference of Commissioners on Uniform State Laws (the Conference) and the American Law Institute (ALI). The idea of a uniform commercial code was first proposed to the Conference in 1940 by William A. Schnader, a former Attorney General of Pennsylvania. The ALI was viewed as an important source of academic wisdom and cheap labor. By 1944, the Conference and the ALI had agreed upon a bureaucracy to accomplish the task. There would be an Editorial Board, which would include a chairman and two representatives each from the Conference and ALI. The Editorial Board would supervise a Chief Reporter, Karl Llewellyn, and an Associate Chief Reporter, Soia Mentschikoff. In addition, there would be a separate reporter for each Article of the UCC. Each reporter was to submit his work to a committee of advisors. If the advisors approved, they would forward the work to the Council of the ALI and to one of two sections of the Conference for final sanctification before submission to state legislatures.

Up to 1951 or so, the actual drafters of Article 9 seem to have been Allison Dunham and Grant Gilmore. Thereafter, Gilmore seems to have had administrative control over the text


2. For discussions of the roles of the Conference and the ALI, see 1940 HANDBOOK, supra note 1, at 116-17; ASS'N OF THE BAR OF THE CITY OF NEW YORK, REPORT ON PROPOSED UNIFORM COMMERCIAL CODE 2 (January 20, 1953) [hereinafter CITY BAR REPORT], reprinted in 15 UNIFORM COMMERCIAL CODE DRAFTS 310 (E. Kelly ed. 1984); Mentschikoff, supra note 1, at 541.


5. See Dunham, Reflections of a Drafter, 43 OHIO ST. L.J. 569, 569-70 (1982).

6. See 1 G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY at x (1965). Separately, Gilmore states that he served with Dunham for five years. Id. at xi.
of Article 9. It is unclear, however, exactly who was involved in the events that follow.

2. THE DRAFTING ERROR

The first official draft of the UCC was produced in 1952. In this draft, secured party A and subsequent secured party B were governed by a race-notice priority. The structure of the relevant sections at that time was as follows:

<table>
<thead>
<tr>
<th>Article</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>9-301(1)</td>
<td>Unperfected A to be subordinate to (a) Bs who could beat even perfected A's; (b) secured party B's &quot;who become such without knowledge . . . and perfects . . . before [A].&quot;</td>
</tr>
<tr>
<td>9-312</td>
<td>Between A and B (a perfected security party), the first to perfect wins, except for enumerated circumstances; B's knowledge not mentioned</td>
</tr>
<tr>
<td>9-401(2)</td>
<td>In its present form—financing statement in wrong place effective against Bs with knowledge of the contents</td>
</tr>
</tbody>
</table>

Section 9-401(2) seems redundant in light of section 9-301(1)(b) (1952). Apparently, the drafters were concerned about "occasional decisions that an improperly filed record is ineffective to

8. The enumerated exceptions were as follows: (1) The basic rule was "first to perfect." Perfection, however, was quite precisely defined to mean filing plus attachment. Attachment was, in turn, defined to mean (i) a security agreement, (ii) debtor had rights in the collateral, and (iii) creditor had given value. Hence, it was possible for A to perfect after he filed. The first exception therefore made clear that A's priority related back to the time of A's pre-perfection security interest. (2) A similar rule for A's future advances gave priority as of the time A filed. (3) A similar rule gave priority to A when D acquired new property and A had after-acquired property rights thereto. (4) The purchase money lender was given a superpriority over the after-acquired property lender. (5) Conflicting purchase money lenders were to share equally. (6) Short-term crop financers were given a superpriority. (7) A surety's security interest was subordinated to subsequent lenders who gave new value.

This last item was highly controversial. Although passed into law by Pennsylvania, the first state to adopt the UCC, the legislature quickly eliminated subsection (7) at the suggestion of the insurance industry. See ALI & NAT'L CONF. OF COMM'R'S ON UNIF. STATE LAWS, SUPPLEMENT NO. 1 TO THE 1952 OFFICIAL DRAFT OF TEXT AND COMMENTS OF THE UNIFORM COMMERCIAL CODE at III (1955) [hereinafter SUPPLEMENT NO. 1], reprinted in 17 UNIFORM COMMERCIAL CODE DRAFTS 309 (E. Kelly ed. 1984).

9. See 3 STATE OF NEW YORK, LAW REVISION COMMISSION, STUDY OF THE UNIFORM COMMERCIAL CODE 63 (1955) ("This subsection is probably intended to emphasize the rule stated in Section 9-301(1) . . . ").
The 1952 draft was introduced in numerous legislatures.\textsuperscript{11} The Pennsylvania legislature unanimously enacted the draft into law in April 1953.\textsuperscript{12} In New York, however, some objections were immediately raised and the legislature asked the New York Law Revision Commission to study the UCC as a whole.\textsuperscript{13} Meanwhile, numerous state legislatures decided to wait for New York's decision. A frequently expressed justification was that New York was the country's leading commercial state and that the UCC should not be considered unless New York blessed it first.\textsuperscript{14}

In response to some of the objections from New York and elsewhere,\textsuperscript{15} the recently enlarged Permanent Editorial Board appointed subcommittees to consider changes in the 1952 draft. The Article 9 subcommittee's first product was Supplement No. 1 to the 1952 Official Draft, published in January 1955. In this draft, section 9-312 was radically rewritten into largely its present form. The other sections were unaffected, so that the structure of the priority between \textit{A} and \textit{B} was as follows:

\begin{itemize}
\item \textit{A}. U.C.C. § 9-401(2) comment 4 (1952). See also In re Turchin, 260 A.D. 447, 448, 23 N.Y.S.2d 144, 145 (1940) (allowing a judgment creditor to prevail over an improperly filed mortgage lien).
\item \textit{B}. See City Bar Report, supra note 2, at 5.
\item \textit{D}. According to Soia Mentschikoff, Governor Thomas E. Dewey was influenced by Nelson Aldrich, President of Chase Manhattan Bank, to commit the UCC to the Law Revision Commission study. Mentschikoff, supra note 1, at 544. Robert Braucher blames Emmett Smith, in-house counsel of Chase Manhattan Bank, who circulated a memorandum criticizing the drafting of the UCC. Braucher wrote, "It seems a fair guess that Smith was largely responsible for the fact that no state except Pennsylvania enacted the Code before 1957." Braucher, supra note 3, at 802.
\item \textit{F}. See City Bar Report, supra note 2, at 9-10.
\end{itemize}
Soon after issuing Supplement No. 1 in 1955, the Article 9 subcommittee made what may have been a drafting error. The meetings at which the subcommittee made the changes were held August 12 and 13. Eventually, the changes were published as part of the suggested 1956 changes, which were republished as the official 1957 draft. On August 12 or 13, 1955, the

---

17. A document prepared by the New York Law Revision Commission states that the changes occurred in August 1955. See Report of a Meeting of the Committee on Uniform Commercial Code: Article 9—Secured Transactions, held at the House of the Association of the Bar of the City of New York, 42 West 44th Street, New York City, December 1, 1955 at 10:00 a.m., December 2, 1955 at 2:00 p.m., December 8, 1955 at 10:00 a.m., December 15, 1955 at 10:00 a.m. and December 16, 1955 at 10:00 a.m. at 61 (papers of K. Llewellyn, University of Chicago Law Library, item J.XVII.4.a.) [hereinafter New York Minutes].

In these minutes, the New York Committee refers to two papers by Francis Ireton, a member of the Permanent Editorial Board’s Article 9 committee. One of these papers describes changes made at meetings of July 22-24, 1955. The other describes changes made at meetings held August 12 and 13.

I have not been able to locate Ireton’s paper covering the August meetings, but I do have Ireton’s paper covering the July meetings. This document was located by Judy Scott of the New York Law Revision Commission in the basement files of the Commission’s office in Albany, New York. See J. F. Ireton, Article 9 Sub-committee—Uniform Commercial Code Interim Summary of Action Taken at Meeting Held July 22, 23, and 24, 1955. The race priority is not referred to in Ireton’s description of the July meeting. Therefore, based on the quotations from the New York Minutes, I have concluded that the race priority was invented either August 12 or 13, 1955.

See also Coogan, Uniform Commercial Code Article 9—Secured Transactions (Oct. 6, 1955) (papers of K. Llewellyn, University of Chicago Law Library, item J.XVII.4.b.). This document probably was revised by Laura T. Mulvaney, Assistant to the Director of Research, New York Law Revision Commission, because her initials are typed into the margins of the document. The document notes, at 24, that § 9-301 was revised July 22, August 12 and August 13, 1955, by the Permanent Editorial Board, and that § 9-312(5) (then codified as § 9-312(6)) was revised August 12, 1955. Id. at 44.

18. These changes are described in 1956 HANDBOOK, supra note 14, at 113-14 (statement of William A. Schnader) and 1957 HANDBOOK, supra note 14, at 100-01.
Permanent Editorial Board's Article 9 committee apparently determined that section 9-312 should be the only provision covering the contest between A and secured party B. Section 9-301(1) still mentioned secured party Bs. The reference to knowledge, however, was gone. Furthermore, a knowledge reference never was put into section 9-312, although it remained in section 9-401(2). As a result, the priority between an unperfected A and a secured party B had the following structure:

<table>
<thead>
<tr>
<th>Section</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>9-301(1)</td>
<td>Unperfected A to be subordinate to secured party Bs according to 9-312</td>
</tr>
<tr>
<td>9-312</td>
<td>In approximately its present form; knowledge not mentioned except that 9-301 expressly preserved</td>
</tr>
<tr>
<td>9-401(2)</td>
<td>In its present form—financing statement in wrong place effective against Bs with knowledge of the contents</td>
</tr>
</tbody>
</table>

I have found only one document that reflects the intent of the drafters directly involved in the race priority. Francis Ireton, chairman of the Permanent Editorial Board's Article 9 committee, prepared a memorandum describing the meeting. I have not been able to find this memorandum, but the minutes of a meeting of the New York Law Revision Commission's advisory committee on the UCC refer specifically to it. The anonymous author of these committee minutes comments:

It was observed that [Ireton's] Summary of Action of the Subcommittee on Article 9 taken at its August, 1955 meeting proposes a revision of paragraph (b) of subdivision (1) of Section 9-301 to refer merely to "a secured party entitled to priority under Section 9-312" instead of "a subsequent secured party who becomes such without knowledge of the earlier security interest and perfects his interest before the earlier security interest is perfected."

This proposed revision is explained in [Ireton's paper] as directed to an inconsistency between the existing text and Section 9-

---

19. See ALI & NAT'L CONF. OF COMM'R'S ON UNIF. STATE LAWS, 1956 RECOMMENDATIONS OF THE EDITORIAL BOARD FOR THE UNIFORM COMMERCIAL CODE § 9-301 reason for change ("Subsection (1) has been changed to transfer all questions of priority to Section 9-312"), reprinted in 18 UNIFORM COMMERCIAL CODE DRAFTS 298 (E. Kelly ed. 1984).

20. Apparently, this was done to preserve § 9-301 as a complete catalog of Bs who could possibly beat unperfected As. Even so, it is not a complete list. For example, § 9-301(1) nowhere states that buyers in the ordinary course of business take free of unperfected security interests, although there is no question that they should.

21. Members of the Article 9 committee at the time included J. Francis Ireton, Homer L. Kripke, Anthony G. Felix, Jr., Peter F. Coogan, Grant Gilmore, and Harold F. Birnbaum.
312(5)(a) or (c), which . . . state rules of priority among security interests in the same collateral.

It was observed that the language of Section 9-301(2)(b)\(^2\) is indeed inconsistent with Section 9-312(5), in that it refers to a subsequent secured party who “becomes such” without knowledge of the earlier security interest, and perfects his security interest before the earlier interest is perfected, whereas Section 9-312(5) does not require that the subsequent secured party be without knowledge of the earlier security interest . . . .\(^2\)

In the above passage, the author of the minutes quotes Ireton as recognizing explicitly that section 9-301(1)(b) was inconsistent with section 9-312(5). I do not believe that this acknowledgment of inconsistency proves that the race priority is the product of deliberate choice. The eventual comments to section 9-312(5) discuss the race priority in the following way:

A and B make non-purchase money advances against the same collateral. The collateral is in the debtor’s possession and neither interest is perfected when the second advance is made. Whichever secured party first perfects his interest . . . takes priority and it makes no difference whether or not he knows of the other interest at the time he perfects his own.\(^2\)

If Ireton’s justification for eliminating the knowledge requirement in 9-301(1)(b) is related to the above comment on the effect of B’s knowledge, it appears that the Article 9 subcommittee was concerned about subordinating a BFP B who was originally unperfected and who had knowledge at the time of perfection, not at the time B first made the loan. The equities of the above problem are miles away from the equities of a bad faith B who has not given an advance and could avoid harm to A by refraining from the loan. The subsequent remarks from the comment to section 9-312 bear this out: “This result may be regarded as an adoption, in this situation, of the idea, deeply rooted at common law, of a race of diligence among creditors.”\(^2\)

Now, race priorities were not deeply rooted (among secured creditors) at common law, but race-notice priorities were. In a race-notice priority, A and B have not perfected. B is a BFP. Between A and B, the first to perfect wins, so that A has the potential to regain priority from a BFP. Thus, A and B are engaged in a race, but only if B was a BFP at the time B gave value. This is done to protect the aftermarket. If A is the first

\(^{22}\) This reference is incorrect. It should refer to § 9-301(1)(b).

\(^{23}\) New York Minutes, supra note 17, at 61-62.

\(^{24}\) U.C.C. § 9-312 comment 5, example 2 (emphasis added).

\(^{25}\) Id.
to perfect and wants to sell to X, X could never tell from the record that A was not really the owner or that B (the BFP) was. Therefore, I believe that the comment to section 9-312 is interested in establishing a race-notice priority between A and B, not a pure race in which MFPs could destroy innocent As.26

At any rate, the first state to adopt the race priority was Massachusetts.27 Although Pennsylvania had enacted the UCC in 1954, the 1956 amendments were not added until 1959, two years after their adoption in Massachusetts.28

3. SUBSEQUENT RATIONALIZATIONS OF THE RACE PRIORITY

The first documented reaction to the introduction of the race priority in the set of changes following Supplement No. 1 occurred at meetings held by the UCC subcommittee of the New York Law Revision Commission. These meetings were held in December 1955.29 I have already quoted from the min-

26. Accord 2 G. Gilmore, Security Interests in Personal Property § 34.2, at 900-01 (1965) (dismissing comment 5 as not necessarily relevant in proving that a race priority was intended).

Gilmore’s role in the drafting is somewhat mysterious. He was a member of the Permanent Editorial Board’s subcommittee, but he denies that he was involved in the changes reflected in the 1956 Suggested Changes. See 1 G. Gilmore, supra note 6, § 21.6, at 590 n.4. He does, however, acknowledge that he “was in general responsible for preparing the Article 9 Comments,” which were produced a few years after the changes were made. Id. See Braucher, Book Review, 33 U. Chi. L. Rev. 890, 892 (1966) (“In the drafting of article 9, Professor Gilmore had much greater control of the process leading up to the 1952 Draft than in the revisions made in 1956 and subsequently.”).

I can offer one theory: Gilmore, as a member of Ireton’s committee, was not present at the meeting but did receive Ireton’s memorandum justifying the changes in § 9-301. On the basis of this memorandum, Gilmore wrote the comments quoted in the text of the appendix. Years later, in writing his treatise, Gilmore could say (authoritatively) that the official comments were not intended to defend a race priority. Meanwhile, Gilmore, on the basis of the memorandum (or his recollection of it) was free to speculate, as he did, that the race priority was not intended to be placed in the statutory language. See infra text accompanying notes 44-46.

It may be noted that the first edition of the Gilmore and Black admiralty treatise appeared in 1957. Perhaps, in the summer of 1955, Gilmore was so fully occupied with his admiralty project that he could not focus upon minor developments in Article 9 draftsmanship.


The New York Minutes recognize that there were some legitimate reasons to take the broad knowledge rule out of section 9-301. After the above-quoted reference to Ireton's paper, the minutes cover several ways in which a general knowledge disability in section 9-301(1)(a) would have interfered with legitimate purposes in section 9-312. For instance, a purchase money lender has a superpriority over after-acquired property lenders who filed first. The New York committee thought that a knowledge requirement on subsequent secured parties would interfere with the after-acquired property rules, with the purchase money superpriority, and with the rule that once A files, A should be free to give future advances with permanent priority over B, regardless of A's knowledge. It also expressed concern that the old version of section 9-301(1)(b) might translate into a straight notice priority, rather than a race-notice priority.

When it came to an unambiguous race priority, however, the New York committee drew the line and drew it clearly:

[1] In most cases, if not all, the time at which knowledge is relevant

30. See supra notes 17 & 23 and accompanying text.
31. "[A] rule depriving a secured party of his means of obtaining priority by prompt filing would operate harshly in a case where he gave value without knowledge of any earlier interest, but obtained that knowledge before the debtor had rights in the collateral and thus before the security interest attached." New York Minutes, supra note 17, at 63-64 (emphasis added).
32. Id. at 62-63. The New York committee was wrong in this observation. Section 9-301(1)(b) disabled knowledgeable subsequent secured parties. A purchase money lender and an after-acquired property lender obtain their security interests at precisely the same time. See Carlson, Simultaneous Attachment of Liens on After-Acquired Property, 6 CARDOZO L. REV. 505, 516 (1985).
33. In a new § 9-312(5), the Article 9 subcommittee proposed that A be given complete freedom to wipe out any B foolish enough to give advances after having seen (constructively or actually) A's financing statement on file. The New York Committee supported revising § 9-301(1)(b) to make sure that A's knowledge would never subordinate A's future advances, although it gave a perfected A monopoly power over any customer bound on a future advance clause. New York Minutes, supra note 17, at 64-65. For a discussion of this technicality, see Coogan, Article 9 of the Uniform Commercial Code: Priorities Among Secured Creditors and the "Floating Lien," 72 HARV. L. REV. 838, 857-61 (1959).
34. The Minutes also refer to a similar discussion:

It was also suggested that the language of Section 9-301(1)(b) is ambiguous in referring to a subsequent party who "became such" without knowledge of the security interest, in that it is not clear whether the time of "becoming such" is the time when the security interest attaches, or the time when the security agreement was made, or when the secured party gives value . . . .

New York Minutes, supra note 17, at 63.
is the time when value is given, but *quaere* whether a person should be allowed to obtain priority over an existing but unperfected security interest by taking the same collateral as security for an unsecured debt, or as additional security for a debt already secured, when he knows of the unperfected security interest at the time of the security agreement.35

With regard to the race priority, the New York Minutes reflect the following resolutions:

(a) there is an inconsistency between Section 9-301(1)(b) and Section 9-312 which should be corrected;

(b) it is perhaps desirable, in order to avoid confusion, that all rules of priority between security interests in the same collateral be stated in Section 9-312, limiting Section 9-30636 to rules of subordination of an unperfected security interest to creditors and to transferees who are not secured parties, and to a cross-reference to Section 9-312 in the case of other security interests.

(c) the principle embodied in Section 9-301(1)(b) under which knowledge of an existing but unperfected security interest will prevent an intervening secured party from obtaining priority should, however, be preserved and stated in Section 9-312 as applicable to some of the cases where Section 9-312 now provides for priority without regard to it . . . . 37

We have here a clear denunciation of the race priority, with appreciation for the fact that a broad knowledge requirement could be used to interfere with purchase money superpriorities and the like. The New York committee therefore wanted section 9-312 to be the sole priority section between A and B (both secured parties).

Given that the New York Law Revision Commission was immensely influential in UCC drafting matters, why was not this advice followed? Or, at least, why did not any of the active participants in the drafting even respond to these concerns?

Reference to the eventual report of the New York Law Revision Commission shows why. Recall that the Commission had received unpublished markups of Article 9 that were not generally available to the public. At the time of the New York Law Revision Commission Report (February 29, 1956), only Supplement No. 1 (containing a notice priority) had been officially promulgated by the Permanent Editorial Board. The Report's passage on the race priority is as follows:

[A] The present text of Section 9-301(1)(b) [1952 draft] also declares that an unperfected security interest is subordinate to the rights of a subsequent secured party who 'becomes such' without knowledge of

35. *Id.* at 66-67.
36. This reference is incorrect. It should refer to § 9-301.
the earlier security interest and who perfects his interest before the
earlier interest is perfected. [B] Section 9-312 and several supplemen-
tal sections state detailed rules as to priority between conflicting se-
curity interests. [C] Under these provisions, an unperfected security
interest may also be subordinate to the interest of a subsequent se-
cured party who had knowledge of the earlier interest. (Section
9-301(1)(a) and Section 9-312 as revised in Supplement No. 1.) [D] The
Editorial Board's subcommittee on Article 9 has reconsidered the
question, how far knowledge of an earlier unperfected interest should
defeat a subsequent party's claim to priority if he perfects his interest
first. The subcommittee has proposed a substitute rule under which
knowledge would be immaterial except in particular cases where the
governing sections refer to it expressly. The problems are very com-
plex. [E] The Commission recognizes that some qualification may be
needed in the statement in Section 9-301(1)(b) indicating that the sub-
sequent party must be 'without knowledge,' but it questions the advis-
ability of a rule under which a subsequent party with knowledge of a
prior unperfected interest could acquire priority merely by prior
filing.

That the Commission did in fact receive an advance copy of
the 1956 changes and noticed the introduction of a general race priority between A and B is by no means apparent from
the quotation. As far as the public and even the Article 9 draftsmen were concerned, this comment could have been chal-
lenging the 1952 version of section 9-301(1)(a), which allowed
knowledgeable Bs to beat unperfected As when knowledgeable
Bs can also beat perfected As. The Report may be suggesting
that knowledgeable Bs should always lose, as they did when
section 9-301(1)(b) (1952) applied. Under this reading, the Law
Revision Commission does not even refer to the possible error
in the 1956 changes. Clause [D] refers only to Supplement No.
1 and its re-write of section 9-312, which does not mention
knowledge. Nevertheless, in Clause [E], the Commission disap-
proves of race priorities and favors general notice priorities.

Although the Law Revision Commission Report in general
generated numerous responses, the above criticism was never
discussed. The lack of reaction suggests that the Commission

38. NEW YORK REPORT, supra note 16, at 47.
39. Id. at 8 & n.4.
40. That knowledgeable Bs should win in this particular circumstance, by
the way, seems quite appropriate. Section 9-301(1)(a) provided that "[a]n un-
perfected security interest is subordinate to the rights of (a) persons as to
whom a perfected security interest is subordinate (subsection (2) of Section
such persons as buyers in the ordinary course of business and materialmen
with a superpriority. If such Bs can win in spite of A's perfection, what such
Bs know should be totally irrelevant.
41. For instance, in a panel discussion on the New York Law Revision Re-
Report was misunderstood as aimed at section 9-301(1)(a) (knowledge did not matter when B could beat even perfected A's) and was dismissed as an uncogent criticism. Meanwhile, no one else noticed that Article 9 had deleted the notice priority.

In commercial law scholarship, the earliest references to Article 9 as a “race” priority are surprisingly late. In 1959, Peter Coogan, a member of the Article 9 subcommittee, briefly mentioned the race priority in an article defending against the frequent criticism of the floating lien and its grant of monopoly power to the first lender to file. The reference by no means assumes that Article 9 is a race priority. Coogan stated that “[u]nless the good faith requirements of section 1-203 change the results, generally knowledge on the part of a holder of a security interest otherwise entitled to priority does not control . . . .”

Soon thereafter, the first treatises on the UCC began to appear. Most of them do not really discuss the priority between A and secured party B's with knowledge. William Hawkland authored the first treatise to say that B should win.

In 1965, Gilmore commented extensively on the alleged UCC race priority:

We are left with a puzzling situation. Until 1956, the Article followed the approach which had been traditional under pre-Code law by providing that an unperfected security interest was good against subsequent claimants (including secured parties) with knowledge of the unperfected interest. In the 1956 draft, it is clear that there was a deliberate decision to deal separately with the case of the subsequent secured party: he is deleted from § 9-301 (which otherwise maintains the earlier position as to the effect of knowledge) and moved over to § 9-312. The general priority rule, which has become § 9-312(5), is then rewritten without making any reference to knowledge.44

42. Coogan, supra note 33, at 859 n.80.
43. 2 W. HAWKLAND, A TRANSACTIONAL GUIDE TO THE UNIFORM COMMERCIAL CODE 656 (1964). Hawkland gives as a reason for the race priority the encouragement of filing and the elimination of circular priority problems (A fails to file and is senior to B, a bad faith purchaser, who files and is senior to C, a good faith purchaser who is therefore senior to A). Hawkland also refers to the race priority as “despotic.” Id.
44. In fact, § 9-312(5) had already been rewritten. See SUPPLEMENT No. 1, supra note 8, at 74-76.
Neither the text of subsection (5) nor the accompanying Comment is conclusive on whether, with respect to the case of the earlier unperfected interest, the lack of reference to knowledge was by design or inadvertence. If it is assumed that the draftsmen were deliberately making a considerable change in prior law, this was an odd and unsatisfactory way to have done it—particularly in view of the fact that the 1956 version of § 9-301 maintains the earlier policy unchanged in comparable situations. 45

Unfortunately, Gilmore does not give us his personal recollection on the matter. 46

A year later, Carl Felsenfeld wrote an article that characterized the history of the Article 9 race priority as follows:

[Article 9] effects a change in the basic pre-Code rule that failure to

45. 2 G. GILMORE, supra note 26, § 34.2, at 901.

Gilmore made similar remarks about other drafting changes made in the 1956 Suggestions for Change. For instance, in writing about lapsed perfection Gilmore noted that § 9-403(2) (lapse of five year limit on financing statements) seemed to allow junior security interests to receive a promotion when the senior security interest lapsed. Gilmore suggested that some words from the statute that would have prevented such a promotion were inadvertently dropped. 1 G. GILMORE, supra note 6, § 21.6, at 589 n.4.

Robert Braucher specifically disputed this particular allegation of drafting error.

As one who participated in the 1956 deliberations on the Code, I find this treatment of the lapse question unsatisfying. My recollection is that most of the members of the responsible subcommittee were far less cheerful than Professor Gilmore now is about the prospect of circular priority, and that the revisions in question are two examples of great pains taken to eliminate circular priorities. Braucher, Book Review, 33 U. CHI. L. REV. 890, 893 (1966). I cite Braucher’s comment for two reasons. First, it shows that Gilmore was not necessarily always right that apparent drafting accidents were indeed accidents. Second, a race-notice priority itself produces circular priorities. For instance, A fails to file. B files and has knowledge of A. C files and has no knowledge of A. A is therefore senior to B, who is senior to C, who is senior to A, and so forth. If the Article 9 subcommittee really disliked circular priorities, doing away with the race-notice priority altogether was a good way to do it. On the other hand, § 9-401(2) (if A tries to file but does so in the wrong place, B is junior if B has knowledge of the contents of the statement) also creates a circular priority. Yet the Article 9 subcommittee retained § 9-401(2). If hatred of circular priorities explained the race priority, how did § 9-401(2) survive?

46. A word must be said about the semiotic assumptions of Gilmore and others writing about commercial law in the 1960s. Even though Gilmore must have been consulted on the 1956 deletions to § 9-301, and even though he had just put forth the proposition that the race priority may have been the result of accident, he still refers to the “meaning” of § 9-312(5) as being a race priority. 2 G. GILMORE, supra note 26, at 901 (“The apparent meaning of § 9-312(5) is that there is no good faith limitation and that knowledge at any time is irrelevant.”). Thus, meaning is something different from the motives of those who wrote the language in question and even different from what is perceived by most readers of the language. Instead, statutes seem to have an essential meaning that has been produced, perhaps, by consensus.
perfect a lien will not destroy it as against one with knowledge of its
eexistence. While this change represents a conscious decision on the
part of the draftsmen,[47] there is reason to believe that it may not
have been fully deliberated.48

Appended to this statement was a footnote, which, with Gil-
more's work, constitutes the only historical research published
on the race priority. Professor Felsenfeld noted that "[k]nowledge appeared as a significant factor in the 1952 Offi-
cial Draft . . . . The recollections of the draftsmen with whom the writer has talked are generally to the effect that they de-
sired to make Code perfection, as the factor presenting the few-
est evidentiary problems, the dominant test of lien priorities."49

In January 1986, Felsenfeld, now a professor at Fordham
Law School, was unable to reconstruct those conversations,
although he recalls that Homer Kripke and possibly Peter Coo-
gan held such a view.

After 1967 came a series of treatises on the UCC.50 The
treatises generally assume the existence of a race priority.51
They rarely discuss the history of the race statute, although they occasionally refer to the linguistic ambiguity of section 9-
312(5). Only Steve Nickles has taken the position that the race priority may not be the "meaning" of Article 9.52

4. EXTENSION OF THE RACE PRIORITY IN 1972

Concurrent with the above rationalization of Article 9's race
priority, Peter Coogan and Grant Gilmore engaged in a genteel
debate about the priority of lien creditor B against voluntary
future advances of secured party A, where A has perfected a se-

47. At this point, Felsenfeld notes the contrary view of Gilmore. See
supra note 45 and accompanying text.

48. Felsenfeld, Knowledge as a Factor in Determining Priorities Under
the Uniform Commercial Code, 42 N.Y.U. L. REV. 246 (1967) (footnote
omitted).

49. Id. at 247 n.11.

50. The history of UCC treatises is discussed in Winship, Contemporary
Commercial Law Literature in the United States, 43 OHIO ST. L.J. 643, 653-55
(1982).

51. E.g., J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE
UNIFORM COMMERCIAL CODE § 25-4, at 906 (1st ed. 1972). It is more than safe
to assume that the White and Summers treatise is the most read treatise on
the UCC.

52. Nickles, Rethinking Some Article 9 Problems—Subrogation; Equitable
Liens; Actual Knowledge; Waiver of Security Interests; Secured Party Liabil-
ity for Conversion Under Part 5, 34 ARK. L. REV. 1, 89 (1979). Gilmore also
comes close. See 2 G. GILMORE, supra note 26, § 34.2, at 898 ("The argument
can be made, with some degree of plausibility, that the apparent meaning of
the relevant provisions of the Article should be disregarded.")
security interest for an initial advance. Coogan thought that lien creditor B would be senior to A’s advances. Gilmore thought the opposite.

The disagreement might have amounted to little enough. After all, voluntary advances after B has obtained a judicial lien on A’s collateral seems a questionable lending strategy. At about the same time, however, Congress undertook a reform of the federal tax lien, giving the tax lien whatever priority it had under state law. This reform suddenly made the Coogan-Gilmore debate very important indeed. At stake was whether lender advances could have priority over earlier tax liens. The vulnerability of revolving credits to federal tax liens helped lead to the decision to review Article 9. Thus, the Permanent Editorial Board appointed a Review Committee to produce suggested amendments in these areas.

The stated methodology of this committee limited amendments to areas in which nonuniform enactments had occurred or the practicing bar had complaints. The status of future advances against judicial liens was one such topic. The existence of a notice priority between A and lien creditor B was another, owing to California’s adoption of nonuniform legislation on the matter. The Review Committee’s rationale for

53. Coogan, supra note 33, at 888.
54. 2 G. GILMORE, supra note 26, § 35.6, at 937-38.
55. “[W]ho cares?” White and Summers have written, commenting that “the cases in which a secured creditor will willingly make subsequent advances after another creditor has gone through the tedious process leading to a lien on the collateral are likely to be as scarce as hen’s teeth.” J. WHITE AND R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE § 25.2, at 1033 (2d ed. 1980).
57. “[T]he Committee has eschewed amendment merely for the sake of theoretical improvement where there was no pressing problem illustrated by nonuniform amendment or by substantial demand for change.” 1972 Official Text Showing Changes Made in Former Text of Article 9, Secured Transactions, and of Related Sections and Reasons for Changes—General Comment on the Approach of the Review Committee for Article 9 (October, 1970) in UNIFORM COMMERCIAL CODE 1978 OFFICIAL TEXT app. II, at 870 (West 1978) [hereinafter Review Committee Comment].
58. Section 9-301(4) was drafted to protect future advances from judicial liens and hence from the federal tax lien. Id. E-44, at 898.
choosing the race priority was that the former section "was completely inconsistent in spirit with the rules of priority between security interests, where knowledge plays a very minor role." Such reasoning constitutes a metonymic error—mistaking a part for the whole. The "spirit" of Article 9 priorities was, more accurately, a notice priority in five of six categories plus a potential drafting error in the sixth category. The 1972 Review Committee seemed to rely upon a consensus of meaning among law professors, as opposed to the meaning set in place by the authors of the words.

Stat. 1849, 1977-78 (codified as amended at CAL. COM. CODE § 9301 (West 1986)). The Review Committee also created a race priority between A and lien creditor B but did not grant a grace period. Review Committee Comment, supra note 57, E-47, at 899.

60. Review Committee Comment, supra note 57, § 9-301, at 942.