

1995

# Managing the Paper Trail: Evaluating and Reforming the Article 9 Filing System: Foreword

Edward S. Adams

Follow this and additional works at: <https://scholarship.law.umn.edu/mlr>



Part of the [Law Commons](#)

---

## Recommended Citation

Adams, Edward S., "Managing the Paper Trail: Evaluating and Reforming the Article 9 Filing System: Foreword" (1995). *Minnesota Law Review*. 1224.

<https://scholarship.law.umn.edu/mlr/1224>

This Article is brought to you for free and open access by the University of Minnesota Law School. It has been accepted for inclusion in Minnesota Law Review collection by an authorized administrator of the Scholarship Repository. For more information, please contact [lenzx009@umn.edu](mailto:lenzx009@umn.edu).

# Foreword

Edward S. Adams

It is 7:12 a.m. You have been warming up and stretching your muscles for the past thirty minutes. You have been to the driving range to hit twenty warm-up balls. You have spent time on your short game and practicing your putting. Now, you stand on a slight plateau some eighteen to twenty feet above the fairway. Behind you, the sun is rising at your back. In the distance, some 412 yards slightly to the left, is the flag. Your goal is simple—to put the ball in the hole marked by the flag with a score of par or less. If you succeed, the others in your foursome will praise you. If you fail, and do so repeatedly, they will designate you a “hacker.”<sup>1</sup>

At last, your moment has come. After a deep breath, you swing the club effortlessly, the ball explodes off the club, and hurtles down the fairway. After a flight of 260 yards, it comes to rest slightly to the right of the center of the fairway. Moments later, after everyone in your foursome has teed off, you stand with an eight iron in your hands and stare at the green. Once again you swing effortlessly and the ball lofts through the air, landing on the green, to the left and a mere fifteen feet downhill from the cup. You then confront the tricky task of a downhill putt. Strike the ball too softly and it will not reach the hole. Be too firm with your stroke and the ball will roll by the hole. You gently tap the ball and it rolls every so slightly by the hole. You tap the ball again, and this time it stops short of the hole. Finally, two brief taps later, the ball unceremoniously falls into the hole. After doing everything right with your first two swings you end up with a disappointing double bogey, your score devastated by a simple misreading of the green.

Now, imagine yourself at the office on Monday morning. You have been working on a multi-million dollar transaction for the past two months. Pursuant to the transaction, your client will lend \$250,000,000 to Corporation X and take a security in-

---

1. Being a “hacker,” of course, does not have a negative connotation in all settings. Computer “hackers” are often praised for their considerable skills, although scorned for their often questionable activity.

terest in all of Corporation X's existing and after-acquired inventory and equipment. To perfect your client's security interest in the collateral, you must file financing statements in fourteen state and county offices. As you determine, some offices require payment of the filing fee by cashier's check, others require a certified check, and some allow you to draw off of a prepaid account maintained at the appropriate office. Moreover, some of the offices allow you to use a standard UCC-1 as the appropriate financing statement form while others require you to type in the relevant information on their special state form, which the office can then optically scan. Finally, even after you make the filings, you know you will have to remind your client to monitor carefully its collateral so that the debtor does not move it out of state, thereby squandering your client's priority.

As you have repeatedly told your client since negotiations for the loan began, your client's financial safety depends on making sure you do all the little things right at the filing level so that you perfect your security interest ahead of all other interests in the same collateral. Indeed, as you tell your client, the loan documents may be perfect, but if you make a mistake in filing, your client will lose in bankruptcy to a bankruptcy trustee<sup>2</sup> and will be fortunate to recover ten cents on the dollar for its loan. As you inform your client, of the \$450,000 in total attorney fee loan documentation costs in connection with the loan, over \$25,000 is attributable to the filing system—a non-trivial amount.<sup>3</sup>

Just as reading the greens is essential for a respectable golf score so is notice filing a centerpiece of the Article 9 secured transactions system. Notwithstanding the profound significance of filing, both the academic literature and the general debate regarding secured transactions law often ignore it. This Symposium addresses those deficiencies by revisiting, and in some cases reasserting or recasting, the role that the filing system plays in secured transactions law. To extend the metaphor, just as golf would be a vastly different sport without the many subtleties and complexities of putting on the green, so too would secured transactions law be manifestly different without the ex-

---

2. An unperfected security interest is subordinate to the rights of a person who becomes a lien creditor before the security interest is perfected. U.C.C. § 9-301(1)(b) (1990). A lien creditor "includes . . . a trustee in bankruptcy." *Id.* § 9-301(3). A creditor perfects its security interest, most commonly, by filing a financing statement in the appropriate state or local office. *Id.* § 9-401.

3. Peter A. Alces, *Abolish the Article 9 Filing System*, 79 MINN. L. REV. 679, 691-92 (1995).

isting filing system. The works contained in this issue explore the underlying filing system's assumptions, the justifications and purported needs for the system, and revisions that may improve the system's operation. More impressively, those who embark on this explorative task in the succeeding pages constitute the intellectual core of the raging secured transactions and filing system dialogue that is occurring as the Drafting Committee transforms Article 9 in the present revisionary process.

Article 9 is a part of the most successful piece of uniform legislation in United States history. Wholesale provisions of the Uniform Commercial Code, and, in particular, Article 9, have been adopted in all fifty jurisdictions and are a part of the curriculum at all law schools. Few practice law today without at least some understanding of and exposure to Article 9. The body primarily responsible for studying and revising Article 9 today is the National Conference of Commissioners on Uniform State Laws (NCCUSL). In his piece, Professor Fred H. Miller speculates on the future of uniform legislation generally and on Article 9 specifically.<sup>4</sup> Beginning with the premise that uniform laws are useful but that federal legislation is undesirable, Miller contends that only cooperation between NCCUSL and state legislatures will achieve successful, thoughtful, and useful uniform legislation. Miller rejects the notions that the possibility of federal legislative enactment in the implicated areas, the inevitability of non-uniform amendment, and the sometimes problematic participatory process render the current uniform legislative process impractical. In short, Miller admonishes us to remember that the extension of credit would be costly and inefficient but for the considerable effort and expertise of those who participate in the uniform process. To that end, Miller concludes that any speculations about the impending death of uniform legislation are greatly exaggerated.<sup>5</sup>

Picking up where Professor Miller leaves off, Judge Nancy C. Dreher<sup>6</sup> and Vance K. Opperman,<sup>7</sup> president of West Publish-

---

4. Fred H. Miller, *The Future of Uniform State Legislation in the Private Law Area*, 79 MINN. L. REV. 861 (1995).

5. Professor Larry Ribstein has speculated about the demise of uniform legislation and its replacement by increased use of various choice-of-law provisions. Larry Ribstein, *A Theory of Uniform Laws*, Address at the Faculty Workshop Series at George Mason University School of Law (Spring 1993) (on file with author).

6. Nancy C. Dreher, *One Judge's View of the Uniform Commercial Code in Bankruptcy Court: Why It Doesn't Work the Way You Thought It Would*, 79 MINN. L. REV. 777 (1995).

ing, urge us to consider the impact of the uniform commercial code and the filing system on both judicial decisionmaking and the economy. Judge Dreher's observations are particularly useful because bankruptcy judges such as herself author so many of the judicial decisions discussing, considering, and interpreting Article 9.<sup>8</sup> She, in a way unlike anyone else in the Symposium, pays the price for poor drafting or unclear prose. Ambiguity, an unavoidable consequence of any legislative drafting, haunts and affects her work. Reviewing the nine uniform commercial code opinions she has authored in her seven years as a bankruptcy judge, Judge Dreher makes clear that true uniformity comes at two levels: in drafting and adoption and in interpretation. As she concludes, uniformity in interpretation follows from careful draftsmanship, both in the Uniform Commercial Code and its Comments.

Opperman is the harbinger of a different message. An active participant in the Clinton Administration's quest to build a National Information Infrastructure (NII), Opperman suggests that the NII provides a unique opportunity to strengthen the business sector by revolutionizing the way we file and track commercial filings. Noting that electronic commercial filing affords the advantages of speed, reduced costs, uniformity, and the possibility of a broader range of filings, Opperman reminds us of the tangible benefits that a uniform, national, electronic filing system may create. Opperman also observes that any changes that are made in Article 9 are not undertaken in a vacuum, but rather are subject to other rapidly evolving developments in our society.

Many of the authors in this Issue agree that the current system is fundamentally sound but requires some revision to accommodate either recent technological developments or to cure identified or perceived glitches in the system's present operation. In an article<sup>9</sup> that commentator Dean Robert E. Scott notes marks the transformation of Professor David Gray Carlson from "trenchant, fire-in-the-belly, no-holds-barred crit to abstract-modeling, implausible-assuming, game-theorizing law and economics maven,"<sup>10</sup> Carlson persuasively and masterfully

---

7. Vance K. Opperman, *Opening Comments on Electronic Commercial Filings and the National Information Infrastructure*, 79 MINN. L. REV. 771 (1995).

8. Dreher, *supra* note 6, at 778-82.

9. David Gray Carlson, *Debt Collection as Rent Seeking*, 79 MINN. L. REV. 817 (1995).

10. Robert E. Scott, *The Mythology of Article 9*, 79 MINN. L. REV. 853, 853 (1995).

justifies the present system by hypothesizing that because private information and power in the hands of creditors lead to non-competitive localist credit markets in which local creditors can capture economic rents, the existence of Article 9 filing is good because it ties "information disclosure to the retention of property rights in the security taken by the local creditor."<sup>11</sup> Article 9 filing thus eliminates the local creditors' positional advantage over national creditors to the benefit of the debtor and thereby contributes to nation-building and other collective goods. Accepting that Carlson is right both "normatively and descriptively,"<sup>12</sup> Scott, in his commentary, reminds us that Article 9 allows certain classes of creditors (i.e., purchase money secured lenders) to escape the constraints of the first-in-time filing rules. Article 9 is thus engaged in an internal "tug of war" between the dual goals of eliminating information asymmetries and providing an efficient mechanism for repeat players—a tension that may be resolved only through the venue of Article 9 politics.

Professor Paul M. Shupack, taking a different approach to the utility of filing, asserts first that there are substantial reasons to believe that a noticeable number of creditors engage in lending in which the asset rather than the debtor is central to the transaction.<sup>13</sup> He then offers reasons to believe that filing facilitates this type of lending and that such lending constitutes a significant part of the current American economy. Shupack also contends that although secured transactions could easily be explained as an artifact of existing hierarchical capital structures, such an account is incomplete. Accordingly, he maintains that "[t]he areas in which finance theory does not explain creditor behavior also provide the strongest theoretical basis to believe that" asset-based lending can "be defended on theoretical, as well as practical, grounds."<sup>14</sup>

Professor James J. White's article<sup>15</sup> seeks one simple revision to Article 9, a revision that would reduce transaction costs and improve the overall efficiency of the filing system: "grant priority to the first to file and . . . force others to defend their

---

11. *Id.* at 854 (citing Carlson, *supra* note 9, at 831).

12. *Id.*

13. Paul M. Shupack, *Preferred Capital Structures and the Question of Filing*, 79 MINN. L. REV. 787, 792 (1995).

14. *Id.* at 815.

15. James J. White, *Reforming Article 9 Priorities in Light of Old Ignorance and New Filing Rules*, 79 MINN. L. REV. 529 (1995).

right to superiority over the first to file."<sup>16</sup> In arguing for a first-to-file priority system in its purest form, and thus impliedly defending the virtues of the filing system, White contends that there is little rationale for preserving and defending the rights and interests of many of those parties who now enjoy priority over the first to file. As White suggests, those who improperly enjoy such a priority include: 1) prior parties who made an improper filing that the first to file properly somehow discovered;<sup>17</sup> 2) later claimants such as lien creditors or non-buyers in the ordinary course in the context of future advances by a secured party;<sup>18</sup> and 3) later claimants to derivative or after-acquired collateral, such as proceeds.<sup>19</sup> In conclusion, White urges us to focus on efficiency as well as fairness in revising Article 9, reminding us that "fairness to a few often brings complexity to many."<sup>20</sup>

In response to White's article, Professor Linda J. Rusch's commentary<sup>21</sup> questions the fundamental premise that she contends White impliedly advances: that the Article 9 filing system is, or should be, a race-recording statute. As she indicates, Article 9 in its current manifestation is unlike race-recording statutes used to record transfers of real estate because it neither provides that a party that has filed record notice is superior to a party that has not recorded its interest, nor allows a party to determine the state of title solely from the record. Moreover, White's desire to make Article 9 conform to the race-recording model is misplaced, she believes, given the stated mission of the filing system—"to warn other interested parties that a secured party might have an interest in the described collateral."<sup>22</sup> She finds the race-recording model simply inappropriate in the personal property context. Rusch recognizes that there may be some merit to particular individual initiatives that White proposes, but she suggests that this is not a model of notice filing that anyone presently has in mind.

Tinkering with the edges of the filing system, Professor Lynn M. LoPucki advances an incorporation-based system for corporate filings whereby Article 9 filings against a registered

---

16. *Id.* at 535.

17. *Id.* at 538; *see also* U.C.C. § 9-401(2).

18. White, *supra* note 15, at 538-39; *see also* U.C.C. §§ 9-301(4), 9-307(3).

19. White, *supra* note 15, at 539; *see also* U.C.C. § 9-306(3).

20. White, *supra* note 15, at 563.

21. Linda J. Rusch, *The Article 9 Filing System: Why a Race-Recording Model is Unworkable*, 79 MINN. L. REV. 565 (1995).

22. *Id.* at 568.

ommendations for improving the efficiency of the filing system, such as eliminating the signature requirement and implementing more systemic filing system innovations. We also recommend requiring state filing office monopolies to reduce their artificial barriers to entry by providing "private vendors with complete and timely filing information at a price equal to the states' costs of obtaining that information."<sup>26</sup> Although we recognize the obvious benefits of allowing government a role in the filing process, we question whether government is the rightful recipient of filing profits.

Taking issue primarily with our suggestion of creating a privatized filing system, Professor R. Wilson Freyermuth questions the political feasibility of our proposal.<sup>27</sup> Freyermuth asks why we anticipate that state legislatures will relinquish control over these substantial profit centers. Moreover, if the filing system serves a valuable societal function, Freyermuth asks why we want to create the risk that private entities may at some point choose not provide a filing service. Finally, Freyermuth questions how we would achieve uniform technological change among over fifty widely disparate jurisdictions.

Although many Symposium contributors view the present system as fundamentally sound, Professor Peter A. Alces urges us to consider both the benefits and costs of the filing system as well as any likely benefits and costs of revised systems.<sup>28</sup> Proceeding under the hypothesis that the filing system "should do no more than we are absolutely certain it can do well: insure a secured party of a memorandum of collateral interest that will afford the secured party the priority rights provided by Article 9," Alces advocates a revised filing system in which filing offices offer assurance that the secured party filing a financing statement has a particular priority claim to a debtor's assets. As he points out, the primary benefit of this system is that it imposes any costs of the system's malfunction on the actor in the best position to maintain the system: the public filing office. In this way, filing offices would have an incentive to "internalize what are now externalities."<sup>29</sup>

In response to Alces's proposal, Edwin E. Smith, a partner at Bingham, Dana & Gould, contends that Alces overstates the

---

26. *Id.* at 931.

27. R. Wilson Freyermuth, *Comments on A Revised Filing System*, 79 MINN. L. REV. 957, 960 (1995).

28. Alces, *supra* note 3, at 679-81.

29. *Id.* at 710.

(i.e., corporate) debtor would be made in the state in which the debtor is incorporated rather than the location of the collateral or the debtor, as is the case under the present system.<sup>23</sup> LoPucki argues that such a modification would reduce transaction costs and lead to greater accuracy. LoPucki also notes that those who will benefit the most from his system are those filers and searchers who most value certainty. Under the present system filers are expected to know the correct name of their debtor, the location of the collateral, and the intentions of their debtor with regard to that location, as well as to monitor the locations of their collateral, their debtors, and changes in their debtors' names. Under LoPucki's revised system, filers need only know the correct name and state of incorporation of their debtor. Moreover, they need not monitor their debtor's actions. So long as the filer complies with this simple requirement, it is guaranteed to have properly filed.

In their reply to LoPucki's work,<sup>24</sup> Professors Steven L. Harris and Charles W. Mooney, Jr. acknowledge the difficulties the current choice-of-law system poses. They disagree, however, with some of LoPucki's underlying assumptions and question whether LoPucki's proposal would ever be adopted. First, they point out that on a number of levels the filing system he advocates may not be as simple as it first appears. For example, accounting for corporations that dissolve, or for the fact that a "registered entity" may be chartered in more than one jurisdiction, adds complexity. Second, even if these problems prove trivial, as Harris and Mooney concede they might, they argue that political opposition from filing officers and other state officials who perceive they might lose substantial revenues to states such as Delaware make uniform adoption of the LoPucki proposal unlikely. Moreover, as they note, non-uniform adoption could make it impossible for a filer to determine where to file to perfect its security interest.

Also touching on the notion of state revenues, and hence the state role in the filing system, in our piece<sup>25</sup> Professor Steve H. Nickles, Susan Sande, Bill Schiefelbein, and I make specific rec-

---

23. Lynn M. LoPucki, *Why the Debtor's State of Incorporation Should Be the Proper Place for Article 9 Filing: A Systems Analysis*, 79 MINN. L. REV. 577, 581 (1995).

24. Steven L. Harris & Charles W. Mooney, Jr., *Choosing the Law Governing Perfection: The Data and Politics of Article 9 Filing*, 79 MINN. L. REV. 663 (1995).

25. Edward S. Adams et al., *A Revised Filing System: Recommendations and Innovations*, 79 MINN. L. REV. 877 (1995).

costs concerning the present Article 9 filing system and understates those same costs with regard to his proposed system.<sup>30</sup> As Smith suggests, the costs associated with single jurisdictional filings under the present system are significantly lower than Alces suggests and the costs likely to be incurred in moving from the current system and implementing the Alces model are likely to be greater than Alces recognizes. So too, Smith notes that Alces ignores the benefits of the existing filing system. As he asserts, the informational benefits of the filing system should not be ignored; indeed, the frequent requests of parties making credit inquiries attest to their utility.

In a more sweeping indictment of the existing system, Professor James W. Bowers argues that there is serious reason to doubt that the filing system advances welfare better than the market for information acting alone.<sup>31</sup> He asserts, first, that the filing system is unnecessary—if the services it provides are really valuable, the market would provide them as efficiently. Second, Bowers asserts that even if the filing system is efficient, there are persuasive reasons for reorganizing it. Bowers thus advocates the adoption of a “properly privatized system” which would, he believes, cure any technological concerns about the filing system by “encourag[ing] those who own the system to adopt any advantageous technologies, without a legislative mandate.”<sup>32</sup>

Professor John D. Ayer and Carl S. Bjerre, a partner at Cleary, Gottlieb, Steen & Hamilton, contest Bowers’s conclusions in their respective works. Ayer admonishes Bowers to remember that it is not a government filing system that is the problem per se, but rather the idea of rent-seeking.<sup>33</sup> Ayer reminds us that before we oppose the government’s role in filing, we should at least inquire into whether the government is the more efficient provider of the requisite information. If it is, then opposing the government’s role in filing may increase, rather than reduce, the inefficiencies in the system about which Bowers laments. Pursuing a different line of analysis, Bjerre argues that Bowers’s proposals would throw out the baby with the bath

---

30. Edwin E. Smith, *Commentary on Abolish the Article 9 Filing System by Professor Peter Alces*, 79 MINN. L. REV. 715, 715-17 (1995).

31. James W. Bowers, *Of Bureaucrats’ Brothers-in-Law and Bankruptcy Taxes: Article 9 Filing Systems and the Market for Information*, 79 MINN. L. REV. 721, 722-23 (1995).

32. *Id.* at 734.

33. John D. Ayer, *Some Comments on Bowers*, 79 MINN. L. REV. 745, 745 (1995).

water.<sup>34</sup> Instead of the complete elimination of the filing system, Bjerre recommends that "only the most onerous portions of existing filing requirements" be altered.<sup>35</sup> He suggests that these include collateral descriptions, debtor-related details other than name and address, and certain filer details. He concludes by embracing Bowers's suggestion that privatization may indeed make some sense in this area.

This Symposium is a significant first step toward determining if, how, and why the present filing system might, or should, be revised. Ultimately, of course, just as it is impossible to devise rules that take into account both the desires of all golfers and advances in golf technology, it may be impossible to produce a perfect filing system that meets all the goals or objectives assigned to it at a low cost and in an efficient manner. The dialogue contained in these pages, however, brings into focus many of the issues central to the filing system debate as well as the competing concerns of both filing system proponents and opponents. In this way, these contributions may very well lead the way to improvements in the system that serve debtors, creditors, the economy, and society as a whole.

---

34. Carl S. Bjerre, *Bankruptcy Taxes and Other Filing Facts: Comments in Response to Professor Bowers*, 79 MINN. L. REV. 757, 757 (1995).

35. *Id.*