The Article 9 Filing System: Why a Race-Recording Model Is Unworkable

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Professor James J. White, in Reforming Article 9 Priorities in Light of Old Ignorance and New Filing Rules, advocates that the first-to-file secured party should always have priority over subsequent parties claiming an interest in the collateral. He justifies this priority by noting the need to relieve the first-filed secured party from monitoring the debtor's post-filing behavior. To effectuate this result, Professor White advocates changing a number of priority rules in Article 9 of the Uniform Commercial Code (UCC). Specifically, Professor White advocates treating section 9-312(5) as a pure race-recording statute. Professor White's recommendations, particularly regarding sections 9-

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2. Id. at 549.
3. Section 9-312(5) provides in relevant part:

[P]riority between conflicting security interests in the same collateral shall be determined according to the following rules: (a) Conflicting security interests rank according to priority in time of filing or perfection. Priority dates from the time a filing is first made covering the collateral or the time the security interest is first perfected, whichever is earlier, provided that there is no period thereafter when there is neither filing nor perfection.

4. U.C.C. § 9-312(5); White, supra note 1, at 535. Section 9-401(2) casts into doubt whether § 9-312(5) is in fact a pure race-recording statute at present. Section 9-401(2) provides:

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 complied with the requirements of this Article and is also effective with regard to collateral covered by the financing statement against any person who has knowledge of the contents of such financing statement.

U.C.C. § 9-401(2). Under this section, a certain type of knowledge can alter the priority position of a secured party under § 9-312(5).
would reach beyond the race between secured parties under section 9-312(5) and affect non-secured parties who might claim an interest in collateral, such as buyers and lien creditors. Although I may agree with some of his suggestions regarding changes to specific Article 9 sections, I take issue with Professor White’s conception of the Article 9 filing system as a pure race-recording statute.

The Article 9 filing system has never been analogous, for example, to race-recording statutes used to record transfers of real estate. A primary attribute of a pure race-recording system for real estate is that a party who has not filed record notice of its interest does not have an interest in that property superior to a party who is protected by the statute who has filed record notice. One effect of such a race-recording statute is that persons can consult the record and determine ownership or other interests in the property—that is, the state of the title—solely from the record. The Article 9 filing system, in its present form, fails to provide for either that attribute or its effect in a number of respects. Let me give two obvious examples.

First, under the present system, the debtor's rights in the collateral determine in part the effectiveness and scope of a secured party's security interest. Under section 9-203(1), the se-

5. Professor White advocates that secured parties should not have to monitor the debtor's activities regarding changing the location of the collateral or the debtor's place of business across state lines, as now required by virtue of § 9-103. White, supra note 1, at 539; U.C.C. § 9-103.

6. Professor White advocates repeal of § 9-301(4), which provides protection for future advances against an intervening lien creditor. White, supra note 1, at 552-53; U.C.C. § 9-301(4).

7. Professor White advocates repeal of § 9-307(3), which provides protection for future advances against a buyer not in the ordinary course. White, supra note 1, at 552-53; U.C.C. § 9-307(3).

8. See Peter F. Coogan, Public Notice Under the Uniform Commercial Code and Other Recent Chattel Security Laws, Including “Notice Filing,” 47 IOWA L. REV. 289, 337-38 (1962). In his article, Coogan states that except in unusual cases where some system of following the title of a chattel from beginning to end is in force—for example, under automobile title certificate statutes—it cannot be repeated too frequently that no chattel security record system can give the degree of assurance provided by even the poorest type of real estate mortgage system. No method of perfecting chattel security interests, be it filing, delivery, or otherwise, can create a good title in the debtor where he had none before.


10. Id. at 232-33.

11. Section 9-203(1) provides in relevant part: “[A] security interest is not enforceable against the debtor or third parties with respect to the collateral and
cured party's security interest attaches to the debtor's rights in the collateral.\textsuperscript{12} Because of the concept of derivative title,\textsuperscript{13} a secured party's security interest, even when properly filed, is generally not effective beyond the debtor's rights in the collateral.\textsuperscript{14} The drafters incorporated this basic concept of derivative title at various points in the UCC.\textsuperscript{15} For example, a debtor-lessee can grant only a security interest in the leased property coextensive with its rights as lessee under the lease.\textsuperscript{16} If Article 9 is structured as a pure race-recording statute, in a contest between a lessor who does not record notice of its lease of the collateral to the debtor and the first-filed secured party who claims an interest in the leased collateral in the debtor's hands, the secured party conceivably could obtain better rights than the debtor had against the lessor if the lessor's failure to file precludes the lessor from asserting its interest in the leased goods.\textsuperscript{17}

Second, buyers of goods in the ordinary course,\textsuperscript{18} holders in due course of negotiable instruments, bona fide purchasers of se-

\textsuperscript{12} See Donald P. Board, \textit{The Scope of Article 9 is Only One Quarter as Great as Is Commonly Supposed}, 47 U. MIAMI L. REV. 951, 983-95 (1993) (discussing problems in interpreting the phrase "debtor's rights in the collateral").

\textsuperscript{13} This principle of derivative rights has a long-standing history in commercial law, see Boris Kozolchyk, \textit{Transfer of Personal Property by a Nonowner: Its Future in Light of its Past}, 61 Tul. L. REV. 1453, 1510 (1987), and is based upon the principle of \textit{nemo dat qui non habet}, "He who hath not cannot give." BLACK'S LAW DICTIONARY 1037 (6th ed. 1990).


\textsuperscript{16} Section 9-307(1) provides:

A buyer in ordinary course of business (subsection (9) of Section 1-201) other than a person buying farm products from a person engaged in farming operations takes free of a security interest created by his seller
 securities, and holders of negotiable documents have priority over the security interest of the first-filed secured party without those holders or purchasers filing notice of their interests. Priority provisions such as these clearly reject a pure race system.

Although Article 9 currently does not conform to a pure race-recording model in a number of respects, Professor White argues that it should so conform. He is unrealistic in what he expects from the Article 9 filing system. One of the purposes of this Symposium is to discuss how the Article 9 filing system could be reformed to accomplish its basic mission in a better and more efficient manner. A necessary premise of this discussion is that the filing system is not currently working exactly as we think it should for a variety of reasons.

Though some disagreement exists, courts and the comments to section 9-402 imply that the basic mission of the current Article 9 filing system is to warn other interested parties that a secured party might have an interest in the described collateral. This much less ambitious mission, thus, is not to give even though the security interest is perfected and even though the buyer knows of its existence.

U.C.C. § 9-307(1).

19. Section 9-309 provides:

Nothing in this Article limits the rights of a holder in due course of a negotiable instrument (Section 3-302) or a holder to whom a negotiable document of title has been duly negotiated (Section 7-501) or a bona fide purchaser of a security (Section 8-302) and the holders or purchasers take priority over an earlier security interest even though perfected. Filing under this Article does not constitute notice of the security interest to such holders or purchasers.

U.C.C. § 9-309.

20. There are other examples as well, some of which Professor White discusses in his proposals. If Article 9 was intended to create a true race-recording system for personal property, it is hard to see why Article 9 excludes various types of personal property from its scope under § 9-104, allows perfection without filing for various types of collateral under § 9-302, and generally does not provide for filing for non-secured parties' interests in personal property. See U.C.C. §§ 9-104, 9-302.


22. See, e.g., Mooney, supra note 17, at 686-87 (noting that fairness and the prevention of fraud, as well as a concern for interested parties, influenced the development of the Article 9 filing system).

23. See, e.g., Thorp Commercial Corp. v. Northgate Indus., Inc., 654 F.2d 1245, 1248 (8th Cir. 1981) ("The financing statement . . . serves the purpose of putting subsequent creditors on notice that the debtor's property is encumbered. The description of collateral . . . does not function to identify the collateral and define property which the creditor may claim, but rather to warn other subsequent creditors of the prior interest."); U.C.C. § 9-402 cmt. 2 ("The notice
record notice of the state of ownership or title in personal property to persons who consult the record. Should the Article 9 filing system be reformed, as Professor White argues, to accomplish the more ambitious goal of a race-recording statute; that is, to provide record notice of all interests in the personal property and enforce only those interests so recorded?

Aside from determining the appropriateness of changing the Article 9 filing system's current mission, the answer to this question requires that we consider the barriers to accomplishing this more ambitious goal. Perhaps first and foremost are the differences between personal property and real estate. One obvious difference between personalty and realty is that it is vastly easier to create and to destroy personal property than it is to create and to destroy real estate. In addition, personal property is, in many instances, fungible and difficult to identify specifically. Creating a race-recording system that requires the recording of all interests in specifically identifiable personal property to determine priority may thus be infeasible or undesirable. 2

To employ a pure race-recording scheme would also require the commercial world to get over the concept of derivative title in personal property. In other words, we would have to be willing to write a law that allows the debtor to transfer to the secured party a greater interest in personal property than the debtor has. Precisely because personal property is more fungible and less identifiable, I think discarding the concept of derivative title in personal property law is more troubling than it is in real estate law.

In a race-recording statute for real estate, the debtor can convey property to a grantee and then give a mortgage to a mortgagee. If the mortgagee records first, in essence, the debtor has given away to the mortgagee more title than the debtor has. This is somewhat troubling, but the grantee has a cheap and easy way of protecting itself: record in the real property records. In the personal property scenario, the same argument could be made: the buyer of personal property could record its interest and protect itself against a secured party who files after the transaction with the buyer. This personal property analogy itself indicates merely that the secured party who has filed may have a security interest in the collateral described. Further inquiry from the parties concerned will be necessary to disclose the complete state of affairs.

nores an additional cost encountered when dealing with personal-
ality rather than realty. The buyer of personal property will
incure greater costs than a mere filing in ultimately protecting its
rights because personal property is less identifiable, easier to de-
stroy, and easier to change into something else than real estate.
Those greater costs are incurred in identifying the particular as-
set that filing protects. When the secured creditor and the
buyer fight over the asset in question, how would the buyer con-
vince the creditor that she meant to buy this particular asset?
In contrast, when a grantee files a deed to real estate, the proper
legal description leaves no doubt as to what parcel of real estate
the grantee intends.

Different types of personal property may lend themselves
more easily to a pure race-recording scheme. We recognize this
reality in the certificate of title laws for motor vehicles. Many
Article 9 transactions, however, stem from inventory financing,
which would not mesh well with a particularized race-recording
system requiring specifically-identifiable property.

A third barrier to a race-recording statute for personal prop-
erty stems from the technological limitations of the system.
Many of the current filing systems are overburdened now, even
given the more modest and limited goal of the current Article 9
system. Broadening the scope of the filing system to require
that chains of all interests in personal property be filed to be
enforceable would place an unacceptably heavy burden on an al-
ready failing system.

Finally, although it would be infinitely easier for searchers
to look in one place to determine all interests in personal prop-

25. Professor LoPucki correctly observes that this type of dispute happens
now between contending parties given the vagueness of the property descrip-
tion on financing statements. That is, under current Article 9, a secured party
in a priority contest with a competing party must prove that the particular as-
set in question is the one described in the financing statement. \textit{Id.} at 34-36.
My contention is that the number of disputes will skyrocket if we attempt to
turn Article 9 filing into a race-recording statute and track ownership rights in
personal property in addition to all security interests or other lien interests in
one system.

26. \textit{See, e.g.}, \textit{id.} at 32-34 (noting that automobiles are stable in form, rela-
\textit{tively expensive, and stable in use and appearance}).

27. \textit{See, e.g.}, \textit{PERMANENT EDITORIAL BOARD FOR THE UNIFORM COMMERCIAL
CODEx, PEB STUDY GROUP, UNIFORM COMMERCIAL CODE ARTICLE 9: REPORT, at
88-90 (1992) (noting the systemic delays caused by inadequate computer sys-
tems and by insufficient staffing in the current filing system); Peter A. Alces &
Robert M. Lloyd, \textit{An Agenda for Reform of the Article 9 Filing System, 44 OKLA.
L. REV. 99, 105-08 (1991) (noting problems with speed and accuracy, and noting
the cost of the current filing system).
property, current experience under Article 9 indicates that this may be an unrealistic ideal. At least the federal government is not enamored of the concept of using the Article 9 filing system for recording interests in property—such as copyrights, patents, and trademarks—that are now governed by federal law. Even if Article 9 is reformed to provide for a pure race-recording system, overriding federal law will limit the filing system's ability to be comprehensive.

I realize that Professor White does not necessarily advocate changes as extreme as I posit above. He states that he is not so bold as to call for the repeal of section 9-307(1) protection for buyers in the ordinary course of business. Nor does he directly attack the concept of derivative title in his critique of certain sections of existing Article 9. The implications of his call for a pure race-recording statute for interests in personal property, however, certainly have the potential for mischief in the ways that I have discussed.

As I have implied throughout this Commentary, I do not favor using the Article 9 filing system as a pure race-recording mechanism. Nonetheless, I do not reject out-of-hand Professor White's specific proposals regarding changes in some of the Article 9 priority rules. We should instead evaluate his proposals on their merits in light of the notice-filing goal of the current Article 9 system. Professor White advocates changing those priority rules that require the first-filed secured party to monitor the debtor's behavior to protect itself from becoming unperfected as to collateral or losing priority as to collateral based upon events happening after the secured creditor has filed. These priority rule changes would promote certainty for the first-filed secured party. Instead of having the first-filed secured party monitor the debtor's behavior and the collateral, Professor White would place upon the party claiming a subsequently-arising interest the burden to search the records to find the secured party's

30. Professor White obliquely attacks the derivative title concept by stating his premise as "the first to file should defeat all others, both those coming before and those coming after." White, supra note 1, at 535.
31. Id. at 548.
Professor White bases this recommendation on the premise that the later-in-time parties can bargain with the first-filed party for priority. In thinking about this proposal, two primary concerns come to mind: would changing these priority rules as Professor White suggests really reduce monitoring costs, and is a comparison of searching and monitoring costs the only consideration in deciding appropriate priority rules?

Even if Article 9 were amended so that the secured creditor would theoretically not have to monitor the debtor to ensure that filing continues its perfection, some monitoring of the debtor will always be necessary, practically speaking. None of Professor White’s proposals eliminates the need for the first-filed creditor to monitor the debtor’s behavior regarding disposal of the collateral. Even though the first-filed secured party’s priority would continue under sections 9-306(2) and 9-312(5), the secured party still must find the collateral in order to repossess and sell it or to recover its value in conversion damages. Thus, the careful secured party will continue to monitor the debtor at the creditor’s desired level of risk to protect its interest in collateral even if it has priority. Likewise, a careful secured creditor will have to determine every forty-five days if there are any tax lien filings under the tax lien statute or risk losing priority as to advances made after forty-five days following the filing of a federal tax lien notice. Using Professor White’s analysis and given that the careful secured party still needs to monitor the debtor’s behavior, very little in monitoring costs really will be saved by eliminating the first-filed secured creditor’s need to monitor the debtor’s behavior to protect himself in situations involving future advances under sections 9-307(3) and 9-301(4).

In comparing the first-filed secured party’s monitoring costs with subsequent parties’ searching costs, Professor White’s

32. Id. at 554.
33. Id. at 552-53.
34. Section 9-306(2) provides: “Except where this Article otherwise provides, a security interest continues in collateral notwithstanding sale, exchange or other disposition thereof unless the disposition was authorized by the secured party in the security agreement or otherwise, and also continues in any identifiable proceeds including collections received by the debtor.”
35. See supra note 3 (noting that § 9-312(5) provides priority security interest to the first party to file).
calculus fails to take into account interests other than the comparison of those costs. For instance, in the purchase-money security-interest context, more is at stake than simply whether the purchase-money creditor can search for and bargain with the first-filed secured party for priority. One important reason for allowing a later purchase-money creditor to have priority over an earlier-filed secured party is to provide some balance of power between the first-filed secured party and the debtor.\footnote{38} The run-of-the-mill Article 9 transaction usually does not involve equal bargaining power between the debtor and the first-filed secured party regarding the initial terms of the borrowing. Anyone who has represented debtors or lenders in transactions knows that it is rare for a debtor to hold out successfully on a provision that a creditor wants included in the agreement, including the types of collateral that will be subject to the creditor's security interest. Even more rare is where the borrower is the drafter of the security agreement, and thus exercises some control over the agreement's terms. Purchase money priority provisions provide the debtor some leverage against a secured party who files first but refuses to lend any more money to buy goods needed for the debtor's business.\footnote{39} Granted, this is not


\footnote{39} Professor White sees no distinction between service providers and purchase money secured creditors, as both provide value to the debtor and both have rights ultimately based upon contract. Looking at legal rules in a variety of contexts, distinctions are often drawn between property rights and contract rights. For better or worse, a secured party is seen as having something like a property right whereas a service provider is seen as having a contract right. See James S. Rogers, \textit{The Impairment of Secured Creditors' Rights in Reorganization: A Study of the Relationship Between the Fifth Amendment and the Bankruptcy Clause}, 96 \textit{Harv. L. Rev.} 973, 988-95 (1983) (criticizing the distinction). Even though one can make the argument that no real economic difference exists between property rights and contract rights, legal rules seldom have equated the two. For a discussion of the different treatment of contract and property rights under the United States Constitution, see Michael W. McConnell, \textit{Contract Rights and Property Rights: A Case Study in the Relationship Between Individual Liberties and Constitutional Structure}, 76 \textit{Cal. L. Rev.} 267 (1988). Professor White's argument that because there is no economic difference between providing value in the form of property or services, so that the goods provider therefore should not get a special priority, could be turned around to a rule that service providers should get the same purchase money priority as property providers. For an economic efficiency justification for limit-
much leverage, in that the first-filed secured party can provide that allowing any liens on property that is collateral constitutes a default. But the fact that it is not much leverage is not a rationalization for taking it away.

Another example is the quasi-negotiable status of chattel paper under section 9-308.40 Perhaps for commercial financing reasons, such priority for chattel paper purchasers who give new value and take possession of chattel paper in the ordinary course of business is appropriate, despite the monitoring and searching costs.41 Even if these priority rules decrease the first-filed secured parties' certainty, other considerations might make such a decrease worthwhile. A comparison solely of monitoring versus searching costs denies the relevance of other reasons for structuring filing and priority rules in the way that they currently are structured.

In conclusion, Professor White's proposals have the salutary effect of forcing an articulation of the goals of the Article 9 filing system. Professor White, however, propounds as a first principle of commercial law the overriding priority of the first-filed secured party; a principle that currently does not exist and should not exist in Article 9. Although a revised Article 9 filing system should take into account the certainty of parties' claims (not just the certainty of first-filed secured parties' claims), certainty should only count as one of many considerations. I think it would be grand if the system could actually do in a timely and efficient manner what it purports to do: provide record notice of

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40. Section 9-308 provides:
A purchaser of chattel paper or an instrument who gives new value and takes possession of it in the ordinary course of his business has priority over a security interest in the chattel paper or instrument
(a) which is perfected under Section 9-304 (permissive filing and temporary perfection) or under Section 9-306 (perfection as to proceeds) if he acts without knowledge that the specific paper or instrument is subject to a security interest; or
(b) which is claimed merely as proceeds of inventory subject to a security interest (Section 9-306) even though he knows that the specific paper or instrument is subject to the security interest.
U.C.C. § 9-308.

secured parties' possible interests in personal property in the bulk of commercial financing situations. To make the filing system take on the additional burden of being a race-recording statute when the system cannot currently handle its much more modest task seems to me to be a recipe for disaster.