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Comments on *A Revised Filing System*

R. Wilson Freyermuth*

Professor Edward Adams's article, both in terms of its basic structure and the myriad of options it offers, neatly highlights the basic dilemma facing the Drafting Committee as it addresses the future Article 9 filing system. As he correctly notes, the filing system's shortcomings are largely due to its continued dependence on paper records, despite the increasing sophistication and availability of computerized information technology for both filing and searching.¹ Should the Drafting Committee maintain the basics of the current system (a public, paper-based filing system) and merely attempt to identify and correct the existing shortcomings in that system, with some limited use of new information technology? Or should the Committee take a more aggressive approach and attempt to cure the "systemic" defects Professor Adams identifies in the current system?

I. CURING THE DEFECTS OF THE PRESENT SYSTEM

As to the defects of the existing filing system, there is little room for disagreement with Professor Adams's suggestions. His criticisms of the present filing system are well taken, and his recommendations echo those he and other Article 9 commentators have made previously.² At best, I can pick only a few nits with his specific suggestions.

The first concerns his recommendation that the Drafting Committee propose abolishing section 9-401(2)'s signature requirement.³ I wholeheartedly concur with this recommenda-

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

2. See Edward S. Adams & Steve H. Nickles, *Amending the Article Nine Filing System to Meet Current Deficiencies*, 59 MO. L. REV. 833, 847-48 (1994); Patricia B. Fry, *X Marks the Spot: New Technologies Compel New Concepts for Commercial Law*, 26 LOY. L.A. L. REV. 607, 636 (1993); Lynn M. LoPucki, *Computerization of the Article 9 Filing System: Thoughts on Building the Electronic Highway*, LAW & CONTEMP. PROBS., Summer 1992, at 5, 6.

3. U.C.C. § 9-402(1) (1990) ("A financing statement is sufficient if it . . . is signed by the debtor . . .").

tion, for without its passage, electronic filing becomes problematic at best. Nevertheless, the signature requirement serves a significant authentication function, signalling the debtor's consent to the secured party's staking of a claim to the debtor's property. Eliminating this requirement could make it easier for parties to make unauthorized and abusive filings.⁴ The Drafting Committee, therefore, should attempt to ensure that elimination of the signature requirement will not substantially increase the threat of such filings.

Professor Adams addresses this concern by suggesting that debtors against whom unauthorized filings are made should be able to "clear the record and receive damages for slander of credit or title."⁵ Such damages may be difficult and expensive to prove, however, and the mere threat of them may not provide sufficient disincentive. The Drafting Committee should therefore consider a threshold sanction, irrespective of actual damages, to discourage unauthorized and abusive filings.⁶

My second concern is that Professor Adams does not advocate the use of debtors' taxpayer identification numbers (TINs) as a primary indexing mechanism for financing statements. TINs on financing statements would easily remedy the problem of having 10,000 UCC-1 filings that list various persons named "John Smith" as debtor.⁷ This benefit led the ABA Filing System Task Force to recommend using the debtor's TIN in place of the debtor's name in the search process.⁸ After noting the bene-

4. In Missouri, for example, workers in the Secretary of State's UCC office note that prisoners often make UCC-1 filings against attorneys and public officials (out of either malice or the mistaken impression that such a filing would provide them with leverage of some sort). This problem cannot be eliminated; even with a signature requirement, forged unauthorized filings can occur. Eliminating the signature requirement, though, would make unauthorized filings easier, and thus predictably more prevalent, unless some alternative authentication system or punitive sanctions replaced the signature requirement.

5. Adams et al., *supra* note 1, at 894.

6. The present Code provides this type of sanction to consumer debtors aggrieved by secured parties who fail to dispose of collateral in a commercially reasonable manner. Section 9-507(1) provides that in the event of a commercially unreasonable disposition, a consumer debtor may recover "the credit service charge plus ten per cent of the principal amount of the debt" or "the time price differential plus ten per cent of the cash price" even if the debtor suffered no actual damages.

7. See Adams et al., *supra* note 1, at 899-900; Adams & Nickles, *supra* note 2, at 840-43; LoPucki, *supra* note 2, at 13-14, 19-22.

8. PETER A. ALCES & ROBERT M. LLOYD, REPORT OF THE UNIFORM COMMERCIAL CODE ARTICLE 9 FILING SYSTEM TASK FORCE TO THE PERMANENT EDITORIAL BOARD'S ARTICLE 9 STUDY COMMITTEE 21 (Permanent Editorial Board for the Uniform Commercial Code Working Document No. M4-26, 1991).

fits of using TINs, however, Professor Adams stops short of suggesting that they be used as a primary indexing mechanism under a revised filing system:

Individuals who provide TIN information, as well as those who subsequently copy the information to other documents or media, could inadvertently transpose the string of numbers making up the TIN. Guarding against this possibility would require the institution of potentially costly internal checking procedures to ensure accuracy before filing. In addition, confirmation of the TINs provided by debtors may prove difficult because many debtors have multiple TINs. Further complicating matters, the merger or acquisition of a corporation may lead to confusion as to the proper TIN to include on a financing statement. Finally, federal privacy laws could prove troublesome if individuals are required to provide their Social Security numbers.⁹

None of these concerns justifies excluding TINs as a primary indexing mechanism under Article 9. The risk of making a mistake or transposing numbers in a TIN does not differ in kind from the risk that a mistake or transposition will occur in spelling a name; some transpositions will occur whether we use letters, numbers, or both. Furthermore, under the current system, a secured party can either institute a "potentially costly internal checking procedure" to ensure the correct spelling of the debtor's name or can instead take the debtor's word regarding the proper spelling. Using TINs as a primary indexing mechanism would not change the secured party's decision calculus. Finally, the federal Privacy Act prevents government actors from denying a benefit, right, or privilege *provided by law* to an individual on account of her refusal to disclose her social security number.¹⁰ Even if private secured parties were "deputized" as state actors for purposes of the Privacy Act, it is not obvious that requiring the debtor to provide its TIN before obtaining credit is tantamount to denying a recalcitrant debtor any benefit, right, or privilege otherwise provided by law.¹¹

9. Adams et al., *supra* note 1, at 899-900.

10. Privacy Act of 1974, Pub. L. No. 93-579, 88 Stat. 1896 (codified at 5 U.S.C. § 552(a) (1988)) ("It shall be unlawful for any Federal, State or local government agency to deny to any individual any right, benefit, or privilege provided by law because of such individual's refusal to disclose his social security account number.").

11. Alternatively, if a filing system using TINs as a primary indexing mechanism would be demonstrably superior to the present system, the Drafting Committee might propose that the National Conference of Commissioners of Uniform State Laws (NCCUSL) lobby Congress for federal legislation that permits mandatory disclosure of social security numbers for UCC filing statements. See 5 U.S.C. § 552(a) (1988) (explaining that the Privacy Act does not prevent denial of rights, benefits, or privileges where "disclosure . . . is required by Federal statute").

Rather than using TINs as an "optional" indexing mechanism, the new Article 9 should, as Professor Lynn LoPucki has suggested, require the use of both a debtor's name and its TIN as a primary indexing mechanism.¹² Use of both name and TIN would moot the common name problem. It would also reduce "seriously misleading" errors attributable to simple mistake or transposition because searchers would discover a financing statement if either the name or the number were entered correctly. This double layer of protection would eliminate the consequences of transposition in essentially all cases. Finally, requiring the use of TINs may lessen the risk of abusive or unauthorized filings because the truly abusive filer would be less likely to know the debtor's TIN than the debtor's name.¹³

II. "SYSTEMIC" DEFECTS AND THE NEED FOR CONSENSUS IN THE REVISION PROCESS

After prescribing a series of medications for what ails the filing system, Professor Adams suggests that the system would benefit more from a transplant of most of its vital organs. In a brave new filing world of "privatization plus," a privately maintained database (presumably with uniform procedures for nationwide electronic filing) would supplant state and local filing offices. Alternatively, if states continue in the filing business, Professor Adams would force them to sell filing information in bulk to commercial information vendors.

Professor Adams is convinced that such a privatized filing system would operate more quickly and accurately than the present filing system. I think he is probably right. Nevertheless, I question how useful his proposals are in their current form. Because these proposals seem more likely to gain consensus support in the classroom than in state legislatures, I doubt they will help forge political consensus on issues of filing system reform.

In one sense, this criticism may seem unfair; after all, Professor Adams admittedly finesses the political feasibility of several of his proposals.¹⁴ I am not certain, however, that he can

12. LoPucki, *supra* note 2, at 21.

13. Prisoners, for example, would be unlikely to have access to their target's TIN, and thus a TIN requirement should eliminate this sort of abusive filing. See *supra* note 4 (discussing prisoners' abusive filings).

14. For example, Professor Adams admits that the political feasibility of a uniformly privatized filing system would be "difficult" or "unclear" to predict. Adams et al., *supra* note 1, at 916.

escape questions about the political feasibility of his proposals merely by assuming that issue away. Although it may be important for the filing system of the twenty-first century to be innovative, it is more important that it be uniform and gain prompt passage in every state. The experience with the 1972 amendments to Article 9 provides an object lesson in this regard. The 1972 amendments, which were not particularly controversial in nature, were not enacted uniformly for over twenty years.¹⁵ This experience suggests that any comprehensive revision of Article 9 and its filing system should be based upon proposals that can generate consensus support and rapid adoption. If Professor Adams wants his proposals to make a constructive contribution that leads the revision process toward consensus, we need more information than his proposals currently provide.

A. THE QUESTIONABLE REALITY OF THE STATE FILING OFFICE AS PROFIT CENTER

For example, Professor Adams's proposal does not explain why we should expect state legislatures to agree to privatize filing systems, especially if (as Professor Paul Shupack estimates) filing offices are a \$400 million profit center for state and local governments.¹⁶ Professor Adams characterizes the surplus revenue that filing systems generate as "monopoly profits" attributable to a state's position as sole operator of its filing system. Although this characterization may be accurate, it ignores the fact that the filing system is a public monopoly whose "monopoly profits" theoretically redound to the benefit of every citizen of the state.

And therein lies the cold political reality that Professor James Bowers recognizes when he uses the metaphor of the filing officer's brother-in-law to depict the "fat" associated with the filing system. Professor Bowers argues that "[t]he filing system . . . operates as if it were a tax on secured transactions."¹⁷ If

15. Fourteen states—Alaska, Delaware, Indiana, Kentucky, Louisiana, Missouri, Montana, New Mexico, Pennsylvania, South Carolina, South Dakota, Tennessee, Vermont, and Wyoming—did not adopt the 1972 amendments until 1983 or later. In fact, the 1972 amendments did not become effective in Vermont until January 1, 1995. See Table of State Enactments of 1972 Amendments (Article 9), [State UCC Variations Binder] U.C.C. Rep. Serv. (Callaghan) at ix-x.

16. Paul M. Shupack, *On Boundaries and Definitions: A Commentary on Dean Baird*, 80 VA. L. REV. 2273, 2273 n.1 (1994).

17. 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, 733 (1995).

filing offices are in fact a \$400 million profit center for state and local governments, my only disagreement with Professor Bowers's statement is that he weakens his point when he includes the words "as if." Whether we like it or not, the filing system is a tax on secured transactions. Accordingly, one can question why rational government actors—assuming such creatures exist—would agree to cease levying that tax when the efficiencies gained will be taken from the pockets of the general public and placed in the pockets of the shareholders of financial institutions and private information providers.

It is certainly appropriate to debate whether, as a normative matter, one can justify a public tax upon secured transactions as a basis for funding public functions that are unrelated to the filing system. Until this debate explains where state and local governments can expect to recoup \$400 million of lost revenue, however, it will not bring filing system reform any closer to consensus. Therefore, if Professor Adams wants his proposal to help generate consensus on meaningful systemic filing system reform, he should first accurately quantify the net tax that the current system does impose on secured transactions. Once that figure is quantified, he should then either incorporate into his proposal some creative mechanism that allows state and local governments to recoup this lost revenue,¹⁸ or explain to those government actors how the efficiency gains associated with his reforms would otherwise offset these losses.

B. PRIVATIZATION AND A SAFETY NET FOR THE FILING SYSTEM

Professor Adams also does not explain what safety net, if any, exists under his "privatization plus" option. As long as the filing system remains a service of state and local governments, there exists essentially no risk that the filing system operator

18. Professor Alces's "state filing assurance" proposal is a good example of a creative "political" solution to filing system reform because it would provide a carrot to otherwise recalcitrant state and local government actors. Under his proposal, state filing officers would issue assurances that a secured party filing a financing statement has a particular priority claim to the debtors' assets. Peter A. Alces, *Abolish the Article 9 Filing System*, 79 MINN. L. REV. 679, 707-13 (1995). Professor Alces argues that this system would reduce the transaction costs associated with secured transactions and enable "the state [to] make a good deal of money" in the process. *Id.* at 713.

I am not certain that a government system of lien priority insurance would be a substantial improvement over the status quo. Consequently, I am not prepared to accept Professor Alces's proposal as the best option for reform. Nevertheless, his proposal does show an appreciation of the need for solutions that can be sold to state legislatures.

may cease business. If in fact the filing system provides an *essential* societal function (the orderly facilitation and memorialization of commercial transactions), assured delivery of this function may be the best reason for having government run the filing system.

Constant availability of filing services becomes less certain if (as Professor Adams proposes) private companies replace governments as operators of the filing system. An interruption in filing office operations could have a chaotic effect on commercial transactions. Yet Professor Adams's proposal does not account for the risk that a private filing system operator may become insolvent and cease operations. Unless his proposal can demonstrate some method of assuring that a private operator's insolvency would not interrupt filing services, it seems doubtful his privatization proposal can generate consensus support in state legislatures.

III. ACHIEVING TECHNOLOGICAL CONSENSUS ON THE INFORMATION SUPERHIGHWAY

How far should the Drafting Committee push the filing system toward a truly paperless paradigm? At least as far as technological capability is concerned, a paperless filing system appears increasingly feasible, given Iowa's success with the use of Electronic Data Interchange (EDI). Nevertheless, the success of Iowa's EDI project must be viewed side by side with present realities: six states still maintain entirely manual filing systems,¹⁹ others have just begun or completed a transition to computerized systems,²⁰ and technological nonuniformity exists among those states that have fully computerized systems.²¹ The pace of technological achievement is dizzying. Because the cost of technological innovation is substantial, and because filing officers understandably develop a high comfort level with their existing system, consensus on the exact shape and speed of technological innovation will be exceptionally difficult to achieve.

Is this a critical problem? Probably not. As long as the filing system remains a public system, it will always lag behind cutting-edge technological development (unlike its users, whose businesses may depend upon incorporating the latest technologi-

19. ALGES & LLOYD, *supra* note 8, at 115-18 (detailing computerization of the filing system).

20. *Id.* at 115-18.

21. *Id.* at 109-11.

cal developments). Experience tells us that as time passes, advances in technology, decreases in cost, and users' demands for increasing technological sophistication will coalesce, prodding filing officers to continue on the path toward technological innovation.²² If consensus regarding the shape of a paperless filing system is unachievable today, Article 9 reform should encourage state filing offices to continue experimenting with different technologies such as EDI, BC Online, and others.²³ The success or failure of such experiments, combined with continuing technological developments, should bring us closer to consensus as we shape tomorrow's filing system.

22. *Id.* (listing 20 states in which technological changes were planned as of 1991).

23. In one sense, state experimentation with various technological advances could serve a function similar to that served by the concept of percolation of issues through the lower federal courts. The theory of percolation suggests that judicial disuniformity among the federal circuits leads to better judicial decisionmaking. See Samuel Estreicher & Richard L. Revesz, *Nonacquiescence by Federal Administrative Agencies*, 98 *YALE L.J.* 679, 735-37 (1989); Samuel Estreicher & John E. Sexton, *A Managerial Theory of the Supreme Court's Responsibilities: An Empirical Study*, 59 *N.Y.U. L. REV.* 681, 719-20 (1984); Richard L. Revesz, *Specialized Courts and the Administrative Lawmaking System*, 138 *U. PA. L. REV.* 1111, 1155-57 (1990). Just as intercircuit disuniformity theoretically leads to better final decisions, so also "technological disuniformity" and experimentation with competing technologies may eventually generate consensus about the superior technological framework for the filing system.