

Permanent Editorial Board for the Uniform Commercial Code

PEB COMMENTARY NO. []
SECTIONS 9-309 AND 9-322(a)(1)

Draft for Public Comment

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Comments on this draft must be submitted by no later than May 3, 2021.

Comments may be submitted by email to UCCComments@ali.org

**This draft has been approved for publication by the PEB
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PREFACE TO PEB COMMENTARY

The Permanent Editorial Board for the Uniform Commercial Code acts under the authority of the American Law Institute and the Uniform Law Commission (also known as the National Conference of Commissioners on Uniform State Laws). The Permanent Editorial Board has resolved to issue from time to time supplementary commentary on the Uniform Commercial Code to be known as *PEB Commentary*. These *PEB Commentaries* seek to further the underlying policies of the Uniform Commercial Code by affording guidance in interpreting and resolving issues raised by the Uniform Commercial Code and/or the Official Comments. The Resolution states that:

The underlying purposes and policies of the *PEB Commentary* are those specified in UCC Section 1-103(a). A *PEB Commentary* should come within one or more of the following specific purposes, which should be made apparent at the beginning of the Commentary: (1) to resolve an ambiguity in the UCC by restating more clearly what the PEB considers to be the legal rule; (2) to state a preferred resolution of an issue on which judicial opinion or scholarly writing diverges; (3) to elaborate on the application of the UCC where the statute and/or the Official Comment leaves doubt as to the inclusion or exclusion of, or application to, particular circumstances or transactions; (4) consistent with UCC Section 1-103(a)(2), to apply the principles of the UCC to new or changed circumstances; (5) to clarify or elaborate upon the operation of the UCC as it relates to other statutes (such as the Bankruptcy Code and federal and state consumer protection statutes) and general principles of law and equity pursuant to UCC Section 1-103(b); or (6) to otherwise improve the operation of the UCC.

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PEB COMMENTARY NO. __
SECTIONS 9-309 AND 9-322(a)(1)

ISSUE

If a debtor sells a payment intangible or promissory note, so that the security interest acquired by the buyer is automatically perfected upon attachment, and the buyer previously filed a financing statement against the seller that covers the payment intangible or promissory note, does the priority of the buyer's security interest under the "first to file or perfect" rule of Section 9-322(a)(1) date to that previous filing?

DISCUSSION

Article 9 of the Uniform Commercial Code governs both the grant of a security interest in personal property to secure an obligation and the outright sale of accounts, chattel paper, payment intangibles, and promissory notes.¹ Because sales of those four types of receivables are within the scope of Article 9, the key terms in the Article have been defined broadly enough to cover those sales. Thus, "security interest" includes the rights of a buyer of such receivables, "secured party" includes the buyer of such receivables, "debtor" includes the seller of such receivables, and "collateral" includes the sold receivables. As a result, rules that apply to "security interests" (including, with relevance to the question at hand, rules governing enforceability, attachment, perfection and priority of security interests) apply, except where otherwise noted, to the rights of a buyer of such receivables.

Section 9-309 affords perfection upon attachment (usually referred to as "automatic perfection") to the security interest created when a payment intangible or promissory note is sold,² and implications of this automatic perfection rule on certain priority determinations have been subject to question. The question is framed by the following Example 1. Example 1 involves a payment intangible, but the same analysis would apply to a promissory note:

Example 1

1. At time T, SP-1 with proper authorization files a financing statement against Debtor indicating that the collateral is payment intangibles. Debtor does not yet grant SP-1 a security interest in any payment intangible.

2. At time T+1, Debtor authenticates an agreement that grants to SP-2, for value, a security interest in a given payment intangible ("X") owned by Debtor, which security interest secures an obligation. SP-2 files a financing statement against Debtor with an indication of collateral covering payment intangible X.

¹ § 9-109(a)(3) (Article 9 applies to "a sale of accounts, chattel paper, payment intangibles, or promissory notes"). Those four types of payment rights are often referred to, and are referred to in this Commentary, as "receivables."

² § 9-309(3), (4).

3. At time T+2, Debtor authenticates an agreement that sells payment intangible X to SP-1 for value. SP-1's ownership interest in X is a security interest as defined in Section 1-201(b)(35), and it is covered by the rule that provides for perfection upon attachment under UCC Section 9-309(3).

What are the relative rights of SP-1 and SP-2 in payment intangible X after these events?

The applicable priority rule, the "first to file or perfect" ("FTFOP") rule of Section 9-322(a)(1), is Article 9's baseline rule for determining priority between or among conflicting perfected security interests. The FTFOP rule is as follows:

Conflicting perfected security interests and agricultural liens rank according to priority in time of filing or perfection. Priority dates from the earlier of the time a filing covering the collateral is first made or the security interest or agricultural lien is first perfected, if there is no period thereafter when there is neither filing nor perfection.

Determination of the relative priority of the security interests in payment intangible X in Example 1 depends upon whether the financing statement filed by SP-1 at time T is effective with respect to payment intangible X.³ If it is, then SP-1's priority under the FTFOP rule dates from time T. SP-2's priority dates from T+1, the time at which SP-2's security interest was both filed and perfected. As a result, SP-1's security interest would have priority over SP-2's security interest. Inasmuch as SP-1's security interest in X is an ownership interest, there would be nothing left for SP-2.

Because a sale of a payment intangible is perfected upon attachment under Section 9-309, it might be argued that the filing of a financing statement in regard to such a sale has no effect on perfection of the security interest and, therefore, should not be considered to be "effective." Under that reasoning, SP-1's priority under FTFOP would date from T+2 (the time of attachment and perfection) rather than from time T (the time of the ineffective financing statement). In that event, SP-2's security interest, which was filed and perfected at T+1, would have priority over SP-1's security interest. As a result, SP-1 would own payment intangible X subject to SP-2's security interest. However, that reasoning is based on the supposition that, if a security interest perfects automatically upon attachment under Section 9-309, the filing of a financing statement should not be considered to be a method of perfection for that security interest and, accordingly, the date that such a financing statement is filed should not play a role in determining the priority of the competing security interests.

Yet, as a general matter, nothing in Article 9 prevents a security interest from being perfected by two methods concurrently. Indeed, some provisions of Article 9 refer explicitly to the possibility of concurrent perfection by more than one method.⁴ Section 9-309 states that the security interests listed in the section "are perfected when they attach." It does not state that such

³ See § 9-322 cmt. 4 ¶1 ("Filing," of course, refers to the filing of an effective financing statement.')

⁴ § 9-306(c) ("This section does not apply to a security interest that is perfected only under Section 9-308(d)."); § 9-323(a) (stating that the priority date, under the FTFOP rule, of a security interest dates from the time an advance is made if at that time the security interest "is perfected only: (A) under Section 9-309 when it attaches; or (B) temporarily under Section 9-312(e), (f), or (g) . . .").

perfection is the only acceptable method of perfection. Likewise, Section 9-310(a) requires a financing statement to be filed to perfect a security interest unless one of several listed exceptions in Section 9-310(b) and 9-312(b) applies. While Section 9-312(b) lists situations in which filing is ineffective to perfect a security interest, Section 9-310(b) lists alternative methods of perfection that *may* be used in lieu of filing a financing statement. For example, Section 9-310(b)(6) provides that a financing statement need not be filed to perfect a security interest in goods or other tangible collateral that is perfected by possession under Section 9-313; this does not mean that such a security interest cannot be perfected by filing. Section 9-310(b)(2) provides that “[t]he filing of a financing statement is not necessary to perfect a security interest ... that is perfected under Section 9-309 when it attaches.” As with Section 9-310(b)(6), the fact that filing a financing statement is not necessary to perfect such a security interest does not mean that perfection cannot also be based upon filing. There is no question that a security interest in a payment intangible or promissory note can be perfected by filing as a general matter.⁵ When Article 9 makes a given method of perfection exclusive, or excludes filing from the permitted methods of perfection, it says so.⁶ Nothing in the text of Article 9 makes perfection under Section 9-309 an exclusive method of perfection, or excludes filing from the methods of perfection allowed for a security interest in a payment intangible or promissory note when the security interest arises from a sale.⁷

In addition, it would not be anomalous for Article 9 to give a legal effect to the filing of a financing statement that is not necessary for the security interest to be perfected. Consider a purchase-money security interest in consumer goods. Under UCC Section 9-309(1), such a security interest is perfected upon attachment. Yet, if the secured party nonetheless files a financing statement covering the purchase-money collateral, it will gain a legal benefit – as a result of that filing, if the debtor subsequently sells the collateral to another person who uses it for personal, family, or household purposes, that buyer will not be eligible to take to goods free of the secured party’s security interest under Section 9-322(b).

Moreover, each provision of the UCC must be interpreted to promote the purposes and policies of that provision and of the UCC as a whole.⁸ A regime in which SP-1’s filing at time T does not count for purposes of FTFOP in Example 1 would be inconsistent with fundamental policies of Article 9.

⁵ § 9-312(a) provides that a security interest may be perfected by filing in “instruments,” which includes promissory notes. Perfection by filing against both payment intangibles and promissory notes is sufficient by the general rule of § 9-310(a).

⁶ § 9-312(b) (control or possession are the exclusive methods of perfection as to certain security interests); § 9-311(b) (compliance with the perfection formalities prescribed by an applicable certificate-of-title statute is, in general, the exclusive method of perfection as to a security interest in goods covered by a certificate of title).

⁷ Section 9-513(c) refers to sales of accounts and chattel paper but does not refer to sales of payment intangibles or promissory notes. That omission could be read to imply that filing is not effective to perfect a sale of a payment intangible or promissory note. The omission was a scrivener’s error that should be ignored. *See* § 1-103(a) (providing that the UCC “must be liberally construed and applied to promote its underlying purposes and policies.”); Steven L. Harris & Charles W. Mooney, Jr., *Using First Principles of UCC Article 9 to Solve Statutory Puzzles in Receivables Financing*, 46 GONZ. L. REV. 297, 316-17 (2010/11) (acknowledgment of this error by the co-reporters for the drafting committee). A similar scrivener’s error appears in § 9-505(a). This Commentary does not address the methods of perfection allowed by Article 9 for transactions automatically perfected under § 9-309 other than sales of payment intangibles and promissory notes.

⁸ § 1-103(a) & cmt. 1 ¶3.

Consider a modified version of Example 1 (“Example 2”), in which, at time T+2, SP-1 does not buy payment intangible X but, instead, is granted a security interest in payment intangible X that secures an obligation. There is no question that SP-1 has priority over SP-2 in Example 2, by virtue of SP-1’s filing at time T. A rule that would resolve the priority contest differently in Example 1 than in Example 2, merely because SP-1’s security interest is an ownership interest in the first case and secures an obligation in the second case, would require a determination in typically complex transactions involving payment intangibles of whether a transaction should be characterized as a sale of payment intangibles or as a security interest in payment intangibles that secures an obligation. Yet, “[i]n many commercial financing transactions the distinction is blurred.”⁹ Indeed, a major purpose of including sales of receivables within the scope of Article 9 is “avoiding difficult problems of distinguishing between transactions in which a receivable secures an obligation and those in which the receivable has been sold outright.”¹⁰

Such a difference also would lead to commercially unsound results. Article 9 allows a potential secured party to file a financing statement before any transaction has occurred or been committed to.¹¹ Such “prefiling” is a basic feature of Article 9. Its very purpose is to allow a potential secured party to establish its priority date under FTFOP for a future transaction it may enter into with the debtor.¹² When at time T+1 SP-2 elects to take a security interest in payment intangible X, SP-2 does so with record notice of SP-1’s prefiled financing statement. SP-2 can have no way of knowing whether SP-1 will ever acquire an interest in X or, if SP-1 does so, whether the interest will be ownership (as in Example 1) or an interest that secures an obligation (as in Example 2). If SP-2 takes a security interest anyway, SP-2 certainly will be junior to SP-1 if events transpire as in Example 2. To award SP-2 priority if events instead transpire as in Example 1 would be to needlessly disregard the good sense and practical functioning of Article 9’s filing system.

CONCLUSION

If Debtor sells a payment intangible or promissory note to SP-1, the interest thus acquired by SP-1 being automatically perfected, and if SP-1 previously filed a financing statement against Debtor that covers the payment intangible or promissory note, then SP-1’s priority under the “first to file or perfect” rule of Section 9-322(a)(1) dates to that previous filing.

A new Comment 9 to § 9-309 is added as follows:

9. Not Exclusive. This section does not provide the exclusive method by which the security interests that it covers may be perfected. (Compare, e.g., Sections 9-311(b) and

⁹ § 9-109 cmt. 4 ¶1.

¹⁰ Id.

¹¹ § 9-502(d).

¹² Prefiling would be of no benefit for a security interest whose priority contests are resolved by a rule other than FTFOP. For example, §§ 9-309(10) and (11) automatically perfect a security interest in “investment property created by a broker or securities intermediary” and in “a commodity contract or a commodity account by a commodity intermediary.” A priority contest between such a security interest and a competing perfected security interest would not be resolved by FTFOP, but rather by § 9-328(6), under which all security interests rank equally unless perfected by control. A prefiling with respect to such an automatically-perfected security interest would be pointless.

9-312(b), which declare exclusive certain methods of perfection for certain types of collateral.) In some circumstances a secured party whose security interest is or will be perfected without filing under this section may wish to perfect by another method as well. For example, a buyer of a payment intangible or promissory note may wish to file a financing statement before buying the item in order to establish an earlier priority date under the “first to file or perfect” rule of Section 9-322(a)(1):

Example: At time T, SP-1 with proper authorization files a financing statement against Debtor covering payment intangibles. Debtor does not grant SP-1 an interest in any payment intangible. At time T+1, Debtor authenticates an agreement that grants to SP-2, for value, a security interest in a particular payment intangible owned by Debtor (“payment intangible X”), which security interest secures an obligation. SP-2 files a financing statement against Debtor covering payment intangible X. At time T+2, Debtor authenticates an agreement that sells payment intangible X to SP-1, for value. SP-1’s ownership interest in payment intangible X is a security interest as defined in Section 1-201(b)(35), and paragraph (3) of this section provides that the security interest is perfected upon attachment. Priority between the perfected security interests of SP-1 and SP-2 is resolved by the “first to file or perfect” rule of Section 9-322(a)(1). Under that rule, SP-1’s security interest has priority over SP-2’s security interest because of SP-1’s filing at time T. If SP-1 had not filed a financing statement at time T, but instead had relied solely upon perfection under this section, SP-2’s security interest would have priority over SP-1’s security interest under Section 9-322(a)(1). In that event SP-1 would own X subject to SP-2’s security interest.

See PEB Commentary No. [], dated [TBA].

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