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New York Law Journal

Corporate Update

SECURED TRANSACTIONS

Timed to Perfection: PEB Commentary on the Priority of Security Interests

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April 2, 2025

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PEB Commentaries

Readers of this column know that a very helpful resource in successfully navigating the UCC is the Permanent Editorial Board for the Uniform Commercial Code (PEB).

The PEB is a joint committee of members of the American Law Institute and the Uniform Law Commission that from time to time issues commentaries interpreting the UCC or its official comments.

The PEB began issuing commentaries in 1990. These commentaries aim to resolve ambiguities in the UCC, address issues where judicial opinions or legal writings differ on outcomes, apply the UCC to new or changed circumstances, or interpret the UCC's role in light of applicable statutes, regulations or case law that may seem to suggest differing results.

They at times provide perspective on how a provision works or should work, often in response to a judicial decision misconstruing such provision. In other instances, they recommend specific amendments to the statute or will amend or supplement the UCC Official Comments.

The commentaries are often persuasive to courts, even when they don't go so far as to change the official comments or propose statutory changes.

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Recently, the PEB has been issuing commentaries more frequently. Of its total of 32 commentaries, 12 have been issued since 2009. And in fact, four of those 12 were issued on one day, Feb. 27, 2025. In this column we discuss the first two of those four new commentaries - PEB Commentaries No. 29 and 30.

PEB Commentaries No. 29 and 30

PEB Commentaries No. 29 and 30 address similar issues based on similar fact patterns. In both commentaries three things happen.

First, a creditor pre-files a financing statement (with proper authorization) against what the PEB refers to as receivables (which, in the case of Commentary No. 29, consists of payment intangibles, promissory notes, accounts and chattel paper, but, in the case of Commentary No. 30, consists of just payment intangibles and promissory notes, since that commentary focuses on automatic perfection).

The debtor then sells that receivable to a different creditor, who also files a financing statement. The initial creditor then perfects its lien on that receivable. Who wins? While there are different nuances in these two sets of circumstances, in both cases the result is the same. The initial creditor prevails.

PEB Commentaries No. 29 and 30 address similar issues based on similar fact patterns.

Commentary No. 29

Commentary No. 29 is centered around the following hypothetical (paraphrased for brevity):

1. At time T, Creditor 1 (C1) files a financing statement covering debtor's accounts. There is no signed security agreement.
2. At time T+1, the debtor sells an account (X) to Creditor 2 (C2) and C2 files a financing statement covering X.
3. At time T+2, the debtor signs a security agreement granting C1 a security interest in X.

According to the PEB, some believe that once the debtor has sold X to C2, it can no longer grant a security interest in that asset because it does not have rights in that collateral. The PEB disagrees.

The PEB notes that Article 9 has two sets of rules that determine the rights of a secured party as against other claimants. One is referred to as the *nemo dat* principle, an abbreviation for the legal maxim *nemo dat quod non habet* (meaning "one cannot give what he does not have"), reflected in Section 9-203(b)(2) as a requirement for obtaining an enforceable security interest.

The other is Article 9's set of priority rules contained in Sections 9-322 *et seq*. The PEB then states that "the relative rights of two secured parties to whom the debtor has purported to grant security interests in the same item of property have been resolved by application of Article 9's priority rules rather than the *nemo dat* principle."

In support of its conclusion, the PEB points to several items, including the official comment to former Section 9-312(5).

This comment explained that the justification for turning to the priority rules "lies in the necessity of protecting the filing system – that is, of allowing the secured party who has first filed to make subsequent advances without each time having, as a condition of protection, to check for filings later than his."

In the PEB's view, the policy under Article 9 has been and continues to be that a party that pre-files with respect to receivables when there are no other financing statements on file should not have to worry about a subsequent filer.

This priority rule, contained in Section 9-322(a)(1), embodies what is often referred to as the first-to-file-or-perfect (FTFOP) rule: priority amongst secured parties will be based on which is the first to file or perfect against collateral (discussed in greater detail below).

The PEB notes that it is possible to argue that *nemo dat* should apply in place of Article 9's priority rules where a purported security interest in receivables arises as a result of a sale of, as opposed to a loan secured by, such receivables.

Certain 2001 amendments to Article 9, especially to Sections 9-318(a) and (b), may have inspired some to take this position. Section 9-318(a) states: "[*a*] *debtor* *that has sold* [a receivable] *does not retain a legal or equitable interest in the collateral sold,*" while subsection (b) states that "[*f*]*or the purposes of determining the rights of creditors of, and purchasers for value of* [a receivable] *from, a debtor that has sold* [a receivable], *while the buyer's security interest is unperfected, the debtor is deemed to have rights and title to the* [receivable] *identical to those the debtor sold*."

The PEB concedes that a plausible reading of the foregoing might be that in the narrow circumstance of an unperfected receivable sale a debtor may retain an interest in a receivable sufficient to create a security interest in favor of a creditor other than the unperfected receivable purchaser.

However, the PEB concludes that there is "no textual basis" in Article 9 that would mandate the application of differing rules depending on whether a security interest arises by grant or by receivable sale, and notes that differing resolutions depending on whether the security interest arises by grant or by receivable should be avoided if possible.

In the PEB's view, the policy under Article 9 has been and continues to be that a party that pre-files with respect to receivables when there are no other financing statements on file should not have to worry about a subsequent filer.

It refers to 2001 amendments to Section 9-203(b)(2), which explicitly state that a debtor can create an enforceable security interest even if the debtor no longer has "rights in the collateral."

The PEB then gives as an example a scenario in which a debtor sells a promissory note to a purchaser, but then subsequently sells it to another secured party, who takes possession of the note in good faith, for value and without knowledge that its purchase violates the rights of another party.

Under Section 9-330(d), the secured party taking possession would prevail, even though it would be contrary to the "baseline rule" of *nemo dat*.

The commentary concludes that in the context of a security interest resulting from a sale of receivables, the priority rules of Section 9-322 and not the *nemo dat* rules of Section 9-203(b)(2) will determine which security interest prevails in the event of conflicting claims in the same receivables.

It then amends the official comments to Sections 9-203 and 9-318 to make clear that under the priority rules there are circumstances in which a debtor can create an enforceable security interest in favor of an unperfected third party even after it sold the asset, *if* that third party filed a financing statement in the sold asset before the purchaser acquired such asset.

Commentary No. 30

Commentary No. 30 deals with a legally similar but narrower category of transactions when compared to Commentary No. 29. In Commentary No. 30, the PEB again focuses on the FTFOP priority rules (mentioned above) of Section 9-322(a)(1), but this time in the context of automatic perfection under Section 9-309 when selling a payment intangible or promissory note.

Section 9-322(a)(1) contains what the PEB describes as the "baseline rule" (i.e., the FTFOP rule) for determining priority: "(a)… (1) [*c*]*onflicting 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*."

The hypothetical anchoring Commentary No. 30's discussion is as follows (paraphrased for brevity):

1. At time T, Creditor 1 (C1) files a financing statement covering debtor's payment intangibles. There is no security interest granted at T.

2. At time T+1, the debtor signs an agreement granting a security interest in a payment intangible (Y) to Creditor 2 (C2) and C2 files a financing statement covering Y.

3. At time T+2, the debtor sells Y to C1, creating a security interest in Y which automatically perfects upon attachment.

The PEB notes it could be argued that, as a result of the perfection upon attachment outlined above, the filing of a financing statement for a payment intangible is superfluous and therefore not "effective" for the purposes of the FTFOP rule.

This line of thought is, per the PEB, "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."

However, Commentary No. 30 states that nothing in 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."

By way of example, the PEB notes that, while the holder of a purchase-money security interest in consumer goods benefits from perfection upon attachment pursuant to Section 9-309(1), such secured party nevertheless gains a legal advantage vis-à-vis a subsequent purchaser of the consumer goods if it files a technically superfluous financing statement due to the fact that that secured party can then avail itself of Section 9-322(b)'s priority rules.

The PEB concludes Commentary No. 30 in much the same way as it did Commentary No. 29: by stressing the importance of interpreting the UCC in a manner so as to uphold its "purposes and policies"; by contrasting the grant of a security interest with the sale of a receivable to highlight the commercial impracticability of having priority determined by the nature of the secured transaction; and, by noting that the sale-versus-grant dichotomy is "blurred" and, in any event, unascertainable from the public record.

Commentary No. 30 also includes a conclusory paragraph highlighting the fact that "'prefiling' is a basic feature of Article 9" which allows for a "potential secured party to establish its priority date under FTFOP for a future transaction it may enter into with the debtor."

The PEB notes further that to then allow a subsequent creditor to have priority would be to "needlessly disregard the good sense and practical functioning of Article 9's filing system."

The PEB concludes by amending Official Comment 9 to Section 9-309 to explicitly state that that section does not provide for exclusive methods of perfection and that "a secured party whose security interest is or will be perfected without filing under this section [9-309] may wish to perfect by another method as well."

Conclusion

Commentaries No. 29 and 30 can be said to stand for two broad propositions.

First, the priority of pre-filed financing statements should, consistent with the purpose and functioning of the public filing system, be determined under the FTFOP rule as opposed to the *nemo dat* rule, giving secured parties comfort that they can pre-file financing statements without worrying about intervening filings pre-empting their priority.

Second, the priority of competing security interests cannot be determined based on the transaction structures under which such interests arise. In neither commentary does the PEB countenance applying Article 9's priority rules in reliance on deciphering competing creditors' relationship with their mutual debtor—a task which may be as legally perplexing as it is commercially impracticable.

The final takeaway from both of these commentaries is the significant potential benefit of pre-filing a UCC financing statement. The drafters are clearly pointing to this as a low-effort, high-reward step for a potential secured party. Whether the finance industry will agree and move in that direction remains to be seen.

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