Spring 2009

Simultaneous Priority

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by Roger Bernhardt

This is a comment on an odd recording decision, but in order to make the point I need to tell the story in a roundabout way.

The National Conference of Uniform Law Commissioners has not been notably successful in enacting national real estate legislation. The Uniform Land Transactions Act (ULTA), The Uniform Simplification of Land Transactions Act (USOLTA), and the Uniform Land Security Interest Act (ULSIA) have all quietly passed away with little or no impact on state legislation. However, one set of provisions of USOLTA was given a second wind and subsequently reappeared as the Uniform Construction Lien Act (UCLA), which has had some slight success in piecemeal enactments in some states. (UCLA refers to what the rest of the profession call mechanic's liens as "construction liens," which phrase I will use for the rest of this article.)

An issue that UCLA seeks to solve is the uncertainty inherent in construction liens relating back to the uncertain time at which a work of improvement first commenced, by permitting the filing of a "notice of commencement," which sets that date in a fixed and public way. That allows a construction lender to assure itself of priority over construction lienors by having its deed of trust be recorded before any such notice of commencement is put on the records. That is the system operative in the State of Nebraska, where *Borrenpohl v. Dabeers Properties*, 755 N.W.2d 39, was decided by its state Supreme Court last year.

In *Borrenpohl*, the Bank of Bennington had loaned DaBeers $66,000 to improve its property and had taken a deed of trust on that property as security, which document it mailed to the county register of deeds office for recording. The trouble is that the bank also included in the same envelope the notice of commencement form in use in Nebraska, and it failed to include any cover letter containing any filing instructions in the envelope.

The county clerk's recording policy in cases where multiple documents are received in one envelope without instructions is to copy them into the record in the order received, *from the top.* And since the notice of commencement was the top document inside the envelope, it was stamped at 2:15 p.m., with the deed of trust not being stamped until 2:20 p.m. (perhaps a coffee break in between?). This sequence led to the legal consequence of two subsequent construction liens, which were recorded nine months later, relating back to a point in time five minutes earlier than the bank's deed of trust, putting those construction lienors prior to the bank's construction loan deed of trust.

At least that is the outcome one might expect if recording consists of copying documents into the official records. But that is not how every jurisdiction defines recording: some statutes, including Nebraska's, treat the presenting of the document to the recorder's office as the significant act. Under that definition, it is not the moment that an instrument is copied into the records that determines its priority but rather the moment that an envelope containing the instrument is opened by the recorder. That makes any time stamps on documents misleading, at least insofar as they are taken to convey relevant information as to when those documents were recorded.

The two instruments in this case were, according to the Nebraska Supreme Court, recorded *simultaneously*, because they arrived at the recorder's office in the same envelope and without filing instructions. In a previous column I complained about the vice of treating recording as consisting of delivery of a document to the recorder's office instead of as its being properly located in the indexes, *Misindexed Documents, ACMA Abstract, Fall 2006;* this ruling gives me another ground for complaint. A statute that provides that an instrument "shall take effect and be in force from and after the time of delivering such instrument to the register of deeds for recording" such as the Nebraska act does, simply invites trouble for future conveyancers when it is read literally. Instruments take effect as to the parties on "delivery" between them, and should take effect as to the rest of the world only when they are placed in the public records in a way that others in the world can find them, not when they are simply delivered to the recorder. Had that more functional concept of delivery been employed, two documents could be deemed simultaneously recorded in the impossible case where they bore not only the same time stamp but also the same serial number; there would really not be any such thing as a simultaneous recording for a court to have to deal with.

To avoid having its concept of simultaneous recording producing an unsatisfactory tie between the parties in this

case, the Nebraska Supreme Court adverted to its old rule that in such situations, priority is resolved according to the "intention of the parties." The principle of having priorities be controlled by intention is novel. Intent is a subjective fact, which makes it easy to fabricate post facto. (The court's opinion sought to avoid that obvious risk, by calling for the intention of "all parties in interest." The bank filed an affidavit declaring that it intended its deed of trust to be first; the borrower declared the same (probably to avoid being accused of fraud by the bank); and the construction lienors could produce no contrary evidence). Therefore, under this rule, the deed of trust had recording act priority over the notice of commencement and, therefore, also over the construction liens despite their relation back to the notice of commencement.

Intent is not only a subjective fact, it is an offrecord "secret" fact. No examination of the records, nor even of the extrinsic facts surrounding delivery of the original documents to the records office—date on the envelope or instructions in the cover letter, assuming that could be found—would tell a searcher which instrument was intended to have priority over the other, or even to make a prudent searcher suspicious and thereby trigger further inquiry about them. The fact that a document stamped after another document in the records might be deemed to have been recorded before it is an outcome that even cautious counsel might be unlikely to worry or warn a client about. (Dale Whitman, to whom I spoke about the case, thought that counsel for an apprehensive contractor might well search the records to ascertain just what priority any future construction lien his or her client might later obtain would have, but that only makes reliance on the time stamped records even more dangerous.)

There is a temptation to view the actual result as harmless, because it merely denied a construction lienor—who probably came long afterwards on the scene—the opportunity of gaining a windfall leap in priority over a construction lender who had been financing the very improvements that were made. However, the court's rule that intention controls in cases of simultaneous recordation derived from an earlier decision by the same tribunal, in a case involving two different mortgages, with two different lenders, and, obviously, no relation back as in the case of construction liens. So the rule can bite innocent lenders as well as contractors.

Of course, where parties have actual knowledge of each other, recording act principles need not control; other factors, such as the time of execution or the time of delivery of the documents, or even the shared or unilateral intents of those parties can come into play and legitimately affect an outcome. But where priority situations involve parties who do not know one another, or even know of one another, there are only the records to go on, and these are somewhat shaky in Nebraska.

There are goods and bads in making construction loans in Nebraska. On the one hand, the concept of a notice of commencement may be a helpful way of reducing uncertainties. But on the other hand, the definition of recording as consisting of handing instruments to clerks in the recorder's office rather than looking at whether they are properly entered in the records or indexes creates dangerous priority risks; and that danger exists in other jurisdictions besides Nebraska. Finally, the notions of simultaneous recording and the determining of outcomes for uninvolved third parties by reference to offrecord intentions is enough to make me more contented with the idiosyncracies of my own California legal system!

PS. After I had submitted this column to ACMA, I got curious as to why Article 9 so proudly goes the other way, defining filing as simply communicating a financing statement to the filing office, so I went on to the UCC list serve and asked. Here is a sprinkling of some very thoughtful responses:

- The real estate system is not a lien-recording system. It is a title recording system that has accepted lien recording as an adjunct, subject to its other rules. With minor exceptions, we do not record titles to personal property and this has clearly not been an impediment to commerce. The UCC filing system is not a title system; no one would consider the UCC filing system as proving who had title to a particular asset. The characteristics of the filing system for security interests take nearly all the opposite choices from the real estate system: no signatures, filing indexed by debtor only, no need to list a particular loan instrument, descriptions by category or even "all assets." So it would not be preposterous to say that the presumption would be that if the real estate system had a particular rule, say, that the risk of filing office error was on the initial filer, the opposite rule should obtain for personal property. The filing system is not static, and errors can appear and disappear without anyone knowing. It is only a backup system. The real due diligence takes place at the level of the relationship between the debtor and the secured party.

- The vast majority of UCC filings is for deals under $50k, e.g., personal property equipment financing. The business model pricing and overhead

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simply can not support the level of inquiry necessary for a real estate loan, where typical values are probably 3-4 times that dollar amount.

- If a filing were not "good" until indexed, every filing would require a follow up search (and related cost) and consideration of a delayed funding. Indexed filings may not be available to check for a few weeks. The presumption is that the filing offices do a good job and that submitted documents in fact do get indexed.

- It took me about five minutes to check for filings against 5 debtors on the Illinois Secretary of State's website. Total out-of-pocket costs: $0

- We recommend to our clients that they always do a post-filing lien search to confirm that filings to perfect their security interest are properly indexed.

- The only way to know that no one else has filed in front of my filing is to wait for the certification date to catch up and reflect my filing. UCC Insurance solves this problem by insuring over the gap. With insurance a lender can search, file and fund on the same day without waiting for a post search reflecting the indexed filing.

- This string points up the benefit of pre-filing a financing statement so that the SP's filing will show up on a search made prior to funding the loan (at least in large transactions). The authorization is often contained in the lender's loan commitment or proposal letter signed by the Debtor. ◆