

TRANSFER RULES AND THE
RESOLUTION OF COMPETING
OWNERSHIP CLAIMS

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ABSTRACT

This paper focuses on transfer rules, and specifically on transfer rules that determine ownership questions among claimants other than the parties to an immediate transfer. Rules governing who prevails among third-party claimants to property should be sensitive to the costs of those contests, and seek to minimize the net costs of defective transfers to society.

The paper is organized into three major parts. The first part is concerned with the informational effects of transfer rules. In it, two principal conclusions emerge. First, when considering the question of information regarding ownership claims, a rule limiting the sources of relevant information to those that are readily-available is superior to a rule where all information, whether or not readily-available, is relevant. Second, in considering what information should be deemed relevant, certain attributes of property lead to the superiority of a system where information contained in legally-designated files is deemed relevant along with information derived from possession.

The next part of the paper is concerned with the effects of various transfer rules on the incidence and costs of defective transfers, such as theft. In this part, the paper argues that, at least for property not otherwise suited to a recording system (which can sharply reduce the incidence of defective transfers), the effects of various transfer rules on the incidence and cost of defective transfers is uncertain at best and provides little support for the current form of theft rules, where all information regarding prior ownership is relevant. Finally, in the last part of the paper, the topic of transfer rules and consensual nonpossessory ownership claims, particularly contingent ownership claims such as security interests, is addressed using the framework developed in the earlier parts of the paper.

In its analysis, the paper deals with issues such as the relevance of the kind of market on which property is bought and sold and the relevance of particular attributes of purchasers and sellers. The paper, moreover, attempts to generalize its point about transfer rules, by considering (for example) questions such as the legal rules governing the rights of a buyer of all the assets of a firm relative to the firm's unsecured creditors.

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Thomas H. Jackson

In what follows, I assume that private property rules are justified in the first place.¹ Thus, for example, I assume that an owner of property has the right to have that property remain its unless and until that owner consensually agrees to transfer it to another.² Such an owner, whom I shall call a

1. These justifications run from labor theories, see 2 J. Locke, Two Treatises of Government § 27 (1698); Hamilton, Property -- According to Locke, 41 Yale L.J. 864 (1932), through first-possession theories, see Rose, Possession and the Origin of Property, 52 U. Chi. L. Rev. 73 (1985); Epstein, Possession as the Root of Title, 13 Ga. L. Rev. 1221 (1979), through utility theories, Demsetz, Toward a Theory of Property Rights, 57 Am. Econ. Rev. 347 (Papers & Proceedings 1967); 3 D. Hume, A Treatise on Human Nature 484-516 (L.A. Selby-Bigge ed. 1888) (London 1740), to positive law theories, see J. Bentham, Theory of Legislation 113 (4th ed. 1887). Despite the radically different nature of these justifications, they matter little to the topic of this paper. Although I rely heavily on the use of possession as evidence of title, I do so because of its informational content, and not because of any original justification theory.

2. This assumption may be incorrect in some respects. There may be other reasons to deprive an owner of his property. The case of adverse possession has long been explored as such an exception. See Merrill, Property Rules, Liability Rules, and Adverse Possession, 79 Nw. U.L. Rev. 1122 (1984-85); Ballentine, Title By Adverse Possession, 32 Harv. L. Rev. 135 (1918). The possibility of rewarding search for lost goods is another possible example. See Landes & Posner, Salvors, Finders, Good Samaritans, and Other Rescuers: An Economic Study of Law and Altruism, 7 J. Legal Studies, 83 (1978) (suggesting, however, that an award of title to the finder overcompensates it, and causes a socially-excessive amount of search). These qualifications, however, do not affect the thrust of this paper, as they involve cases where Prior Owner loses in a two-party transaction.

Prior Owner, can, therefore, always recover property from a thief or a person who defrauds it. This is an illustration of a two-party transaction, where the third-party effects are simply those of private property itself. My concerns are not these. Whether someone should be permitted to own property, or to recover it from a thief or charlatan, goes to whether private ownership of property has any net social advantage, instead of simply reflecting wealth transfers from one party to another.

I want to focus instead on transfer rules, and specifically transfer rules that determine ownership questions among claimants other than the parties to an immediate transfer. These issues arise only where, in the two-party transaction, Prior Owner would be entitled to prevail. This is so, because, if Prior Owner has no claim against First Taker, the point of that rule is to have ownership go to First Taker. With ownership comes the right of transfer, and Prior Owner's claim, irrelevant against First Taker is likewise irrelevant against people claiming through First Taker. Moreover, to focus on the issue I am concerned with, Prior Owner's rights in the two-party case must be those of a property rule -- a right to get the property itself back -- and not those of a liability rule -- a general claim for damages.³ For if cast simply as a

3. The differences between property rules and liability rules are set out in Calabresi & Melamed, Property Rules, Liability Rules and Inalienability: One View of the Cathedral, 85 Harv. L. Rev. 1089 (1972), and applied to specific performance by Kronman, Specific Performance, 45 U. Chi. L. Rev. 351 (1978).

liability rule, then Prior Owner does not have a right to the property itself, and subsequent purchasers of property generally leave the seller, and its liability problems, behind.⁴

For these reasons, I will assume that Prior Owner is entitled to recover the property from First Taker. That assumption by itself, however, does not also tell us that Prior Owner is entitled to recover from Purchaser, who bought the property in question from First Taker. This issue is of relevance only when Prior Owner is able to find Purchaser, the subsequent taker, and either (a) wants the property itself, and not just money damages, or (b) is unable, as a practical matter, to assert a liability rule successfully against First Taker in the two party transaction, notwithstanding a legal entitlement to do so. The most obvious example of the latter case is where First Taker is insolvent or cannot be found. Similarly, in the last part of the paper, although I assume that a secured creditor can assert its property rights against its debtor according to its contract, that assumption does not also mean that this secured creditor is entitled to assert those rights against a third party -- whether another secured creditor or a buyer -- who also claims rights in the same property through a contract with that debtor. These questions, which are not answered by invocation of the original

4. The justification for this rule, however, can be seen as a variant on the issue that is the topic of this paper. It is explored infra Part D.

justification (whatever it might be) for private property itself, form the focus of my inquiry.

Rules governing who prevails among third-party claimants to property should be sensitive to the costs of those contests, and seek to minimize the net costs of defective transfers to society. This ultimately is done by reducing the number of defective transfers. This reduction, in turn, can be accomplished by rules that work directly on the incentives of those that "create" defective transfers (such as penalties for theft) or by rules that work indirectly on those incentives (such as by providing information about sources of ownership). Although these effects are obviously related,⁵ they form a heuristically useful way of approaching the subject of transfer rules.

This paper, accordingly, is organized into three major parts. The first part is concerned with the informational effects of transfer rules. In it, three principal conclusions emerge. First, when considering the question of information regarding ownership claims, a rule limiting the sources of relevant information to those that are readily-available (a negotiability-form of rule) is superior to a rule where all information, whether or not readily-available, is relevant (a

5. If information about sources of ownership were perfect and instantly available (and if lost or stolen goods could be instantly and costlessly found), there would be no defective transfers. The informational effects themselves would solve the incentive effects. Notwithstanding this tie, the distinction between informational effects and incidence effects is useful as a method of examination.

derivation-form of rule). Second, in considering what information should be deemed relevant in a regime where sources of relevant information are limited by legal rule, certain attributes of property -- specifically, a combination of unique identifiability, longevity, and relatively high value -- lead to the superiority of a system where information contained in legally-designated files is deemed relevant along with information derived from possession. Third, the superiority of a system that limits the sources of relevant information over a system where all information is deemed relevant, is the principal impetus behind the legal treatment of intangible forms of property. The next part of the paper is concerned with the effect of various transfer rules on the incidence and costs of defective transfers, such as theft. In this part, I suggest that, at least for property not otherwise suited to a recording system (which can sharply reduce the incidence of defective transfers), the effects of various transfer rules on the incidence and cost of defective transfers is uncertain at best and provides little support for the current form of theft rules, where all information regarding prior ownership is relevant, particularly given the superiority in the production and flow of information of a system that limits the sources of relevant information. Finally, in the last part of the paper, I address the topic of transfer rules and consensual nonpossessory ownership claims, particularly contingent ownership claims such as security interests.

A. Negotiability and Derivation Rules and the Control of Relevant Information

The value of ownership of property -- whether an idea, wheat, or a car -- depends on the certainty with which the owner can enjoy something from it, through use or sale.⁶ Since many claims of ownership depend not on original entitlement to property, but on the acquisition of it from someone with an earlier claim, the value of property therefore depends in substantial part on the certainty with which the entity claiming ownership can establish that its right to use and sell the property both is superior to those earlier in line and will remain superior to those later in line, unless and until the entity relinquishes its claim by a consensual transfer.⁷ Legal rules must respond to the fact that such certainty is not automatic and costless. The mechanisms by which the extent of ownership certainty is set forth, both in the acquisition and in the disposition of property, constitute, broadly speaking, transfer rules.

A variety of rules are in fact used to resolve third-party ownership conflicts. The basic feature of what is generally referred to as a "negotiability" rule is that subsequent claimants for value defeat prior claimants. This is often expressed in the concept that, with a negotiability rule, a

6. If sold, the valuation question is just repeated by the buyer.

7. Value of property of course depends on other things as well, such as legal rules governing use, or taxing ownership.

claimant can take better title than the entity had from whom it acquired the property.⁸ Conversely, the basic feature of what can be referred to as a "derivation" rule is that prior claimants defeat subsequent claimants for value. This is often expressed in the concept that, with a derivation rule, a claimant's title rises no higher than that held by the entity from whom it acquired the property.⁹ If the seller's title is defective, the title of the purchaser is likewise defective.¹⁰

Defenses of one or another of these rules are typically made by slogan. In arguing for a negotiability rule, Blackstone asserted that the buyer should "be secure of his purchase, otherwise all commerce between man and man must soon be at an end."¹¹ In arguing for a derivation rule, others have suggested that "[o]wners of goods for commercial and other purposes must frequently intrust others with possession of them, and the affairs of men could not be conducted unless they

8. For goods, the essence of such a rule is embodied in U.C.C. § 2-403(1) (1978). See Gilmore, The Commercial Doctrine of Good Faith Purchase, 63 Yale L.J. 1057 (1954); Gilmore, The Good Faith Purchase Idea and the Uniform Commercial Code: Confessions of a Repentant Draftsman, 15 Ga. L. Rev. 605 (1981). The utility of such a rule is examined in Weinberg, Sales Law, Economics, and the Negotiability of Goods, 9 J. Legal Studies 569 (1980).

9. See D. Baird & T. Jackson, Cases, Problems, and Materials on Security Interests in Personal Property 140-42 (1984).

10. The theft doctrine is perhaps the most prominent example of such a rule.

11. Quoted in J. Story, Sales of Personal Property 155-16 (1847). See also Peacock v. Rhodes, 2 Doug. 633, 99 Eng. Rep. 402 (K.B. 1781) (Mansfield, J.) ("If [a derivation] rule applied to bills and promissory notes, it would stop their currency").

could do so with safety."¹² Both slogans, however, encompass only half a truth. Negotiability rules increase the security of buyers against prior claimants, but decrease their security against subsequent claimants. Conversely, derivation rules increase the security of owners against subsequent claimants but decrease that security against prior claims. Because of this trade-off, the preferable rule is not obvious from slogans alone,¹³ but instead requires an examination of all the consequences of a choice of rule.

In a system in which information were perfect, and costless, a derivation rule would be the only rule needed to govern transfers of property. It would be, moreover, the only rule fully consistent with the assumption of private property that an owner has the right to have its property claim protected unless and until that owner consensually agrees to transfer it to another.¹⁴

Information, however, is neither perfect nor costless to acquire. Because of that, a rule that makes subsequent

12. California Jewelry Co. v. Provident Loan Assn., 6 Cal. App.2d 506, 513, 45 P.2d 271, 274 (1935); see also Levi v. Booth, 58 Md. 305, 314-15 (1882); Uniform Sales Act § 23.

13. See Karl Llewellyn, responding to a question as to why the Uniform Commercial Code generally protected bona fide purchasers over prior owners: "The choice is hard, and it gives little satisfaction either way; but the Code's choice fits more comfortably with the whole body of our commercial law," quoted in 1 New York Law Revision Comm., Hearings of the Uniform Commercial Code 59 (1954).

14. Again, some nonconsensual exceptions exist. See supra note 2.

claimants take subject to prior claims is not necessarily the superior transfer rule. One must now address an additional question: Under what circumstances should the information concerning ownership claims that one would have instantly and fully in a costless world be considered relevant to determine competing ownership claims to property?

By phrasing the inquiry in this fashion, it becomes clear that a negotiability rule and a derivation rule are not opposites at all, but are simply legal rules governing the flow of relevant ownership information. All transfer rules regulate the flow of relevant information. A derivation rule says that all sources of information are relevant -- meaning that a prior owner can prevail if it can show that (a) it once owned the property and (b) did not lose it in a transaction to the first taker. Proof of this information entitles the prior owner, under such a system, to prevail, whether or not it was known or knowable, at the time of a purchase transaction, to the one who purchased the property from the first taker. Possession, although it might be of relevance in determining title against the rest of the world, is of no relevance in determining title when set against the ownership assertions of a prior owner (other than as might relate to an original justification for private property itself). A negotiability rule, on the other hand, provides, in its most traditional form, that the only relevant source of information is that given by possession.¹⁵

15. One of course needs something to possess to implement this rule. I will discuss later legal rules that "paperize" (or otherwise make tangible) intangible forms of property, so that a possession-based negotiability rule can be implemented. So,

All other sources of information are irrelevant.

Legal rules governing transfers of property, accordingly, work to constrain the relevant information brought to bear on title determinations. This can be seen by considering the prototype of a negotiability rule, in Article 3 of the Uniform Commercial Code. It states that "[t]o the extent that a holder is a holder in due course he takes the instrument free from (1) all claims to it on the part of any person; and (2) all defenses of any party to the instrument with whom a holder has not dealt except [five exceptions follow]."¹⁶ This rule, however, is not a pure negotiability rule, for it makes some information (other than possession) relevant. Particularly, a purchaser will not become a holder in due course if the purchaser has "notice that [the instrument] is overdue or has been dishonored or of any defense against or claim to it on the part of any person."¹⁷ In addition, the negotiability of an instrument is destroyed by certain information appearing on the instrument itself (such as a statement that "this instrument is security for Jones' loan"). Thus notice of possible defects is also considered relevant information in sorting out competing

(continued)

too, can some forms of goods be made more negotiable by paperizing them, via the concept of "embodiment." Documents of title and chattel paper are examples of this paperizing of tangible goods.

16. U.C.C. § 3-305 (1978). With respect to goods, the leading example is the old English rule of "market overt," see 5 W. Holdsworth, A History of English Law 104-05-110-11 (1924).

17. U.C.C. § 3-302(1)(c) (1978). Notice is defined, id., § 3-304.

claims. The effect of the legal rule, then, is to make such information, along with that imparted by possession itself, relevant to title determinations, and to eliminate other sources of information (that not known or readily observable from the property itself) from consideration in the resolution of priority disputes.

Many other legal rules function in the same way, by delineating certain sources of information that are relevant in sorting out title claims and eliminating other sources from the universe of information a purchaser is responsible for. The doctrine of ostensible ownership, for example, that underlies much of Article 9 of the Uniform Commercial Code, is such a rule.¹⁸ A purchaser wishing to acquire rights to property in its debtor's possession can, under such a rule, rely on that possession unless competing ownership claims are listed in a certain fashion in legally-prescribed files. Under such a rule, relevant information (information the presence or absence of which will determine ownership claims) is defined as that information transmitted by possession or the files. In this pure race type of system, other information, whether known or knowable, is made legally irrelevant.

Sometimes, however, no source of information is excluded.

18. See generally Baird & Jackson, Possession and Ownership: An Examination of the Scope of Article 9, 35 Stan. L. Rev. 175 (1983). The doctrine also underlies the common law doctrine of fraud by retention of possession. See *Sturtevant v. Ballard*, 9 Johns. 337, 6 Am. Dec. 281 (N.Y. 1812). The doctrine retains vitality today. See U.C.C. § 2-402 (1978); Cal. Civ. Code § 3440.

from the universe of information certain categories of purchasers are responsible for. Under the rules of Article 9, for example, a true lessor or bailor prevails over a claimant asserting a security interest in the leased or bailed property in its debtor's possession.¹⁹ In such a case, the ostensible ownership doctrine does not apply, with the consequence that the lessor or bailor, as Prior Owner, prevails over the secured party who claims through the possessing debtor, even though ownership information concerning Prior Owner is neither known or easily knowable.²⁰

When one sifts through these various rules, one sees that the relevant question is not really the black and white one of whether a negotiability rule is preferable to a derivation rule for a particular type of property (and transaction), but, rather, what sorts of information should be recognized as legally-relevant in establishing ownership of property. For property with a defined physical existence, information derived from physical inspection constitutes a minimum set of relevant information. This includes possession itself, where, through

19. See, e.g., *In re Medomak Canning Co.*, 25 U.C.C. Rep. 437 (Bankr. D. Me. 1977), *aff'd* (D. Me.), *aff'd*, 588 F.2d 818 (1st Cir. 1978). This rule affects purchasers of contingent interests (such as security interests). The rights of a lessor or bailor against a buyer from the lessee or bailee are governed by general legal rules, not by Article 9 of the Uniform Commercial Code. See U.C.C. § 2-403(2) (1978) (buyer from merchant in possession will prevail over entruster, such as lessor or bailor).

20. This rule is criticized, Baird & Jackson, *supra* note 18, as inconsistent with the imposition of a filing rule for competing secured parties. See also *infra*, Part D.

the doctrine of ostensible ownership, possession implies title. It also includes matters such as title defects on the face of instruments or obvious warnings on goods that the goods may belong to someone other than the entity attempting to sell them (such as branding marks on cattle or names etched into stereos to deter theft).²¹

The use of this as a minimum set of relevant information makes sense. Possession is used to imply title, I believe, not because of anything intrinsic to possession but because of its informational content and the low cost and easy observability of that information. While who is in possession of what can sometimes be troubling,²² in the mine-run case it is not. Moreover, while many exceptions exist (and will be considered

21. To acquire "good title" from a person with "voidable title," the purchaser must be "a good faith purchaser for value," U.C.C. § 2-403(1) (1978). While the definitions of good faith in §§ 2-103 and 1-201(19) do not address this question directly, their common interpretation includes absence of knowledge of title defects. See McDonnell, The Floating Lienor as Good Faith Purchaser, 50 S. Cal. L. Rev. 429, 442-43 (1977) (derived from § 24 of the Uniform Sales Act, requiring the purchaser to be "without notice of the seller's defect of title"); but cf. *In re Samuels & Co.*, 526 F.2d 1238 (5th Cir.), cert. denied, 429 U.S. 834 (1976) ("the Code's definition of an Article Two good faith purchaser does not expressly or impliedly include lack of knowledge of third-party claims as an element. [It] requires only honesty in fact, reasonable commercial behavior, fair dealing."). Whether knowledge itself should defeat the claims of a purchaser is one question, see Baird & Jackson, Information, Uncertainty, and the Transfer of Property, 13 J. Legal Studies 229, 312-18 (1984) (questioning usefulness of a knowledge exception); it is an entirely different question when the source of knowledge is provided by the property itself, for it then becomes information like that imparted by possession.

22. See Baird & Jackson, supra note 18, at 185 n.35.

later), it nonetheless remains the case that an assumption that title and possession go hand-in-hand is valid as a first-cut operating premise, at least for property having a recognized, defined, tangible existence.²³ As such, possession is a means to an end -- providing informational certainty for the acquisition and disposition of property -- and not an end in itself.

The implication of title from possession is, of course, not always correct. Indeed, there are great costs to a possession-only rule as a source of information, particularly when considering temporal ownership claims (such as remainder

23. That information is more accessible when the transaction is face-to-face than by mail (or phone). For this reason, one suspects that the information was available at even lower cost, in general, one or two hundred years ago, when virtually all transactions were face-to-face, than is true today. Notwithstanding the change to a more faceless transaction society, however, no easily-available replacement for possession comes to mind. For those that care whether the seller is in possession in a faceless transaction, agents, or similar checking devices, can be used.

Some have suggested that, at least in the context of Article 9, the ostensible ownership principle is "archaic." See Dolan, The UCC Consignment Rule Needs an Exception for Consumers, 44 Ohio State L.J. 21 (1983); Hanna, The Extension of Public Recordation, 31 Colum. L. Rev. 617 (1931); Helman, Ostensible Ownership and the Uniform Commercial Code, 83 Com. L.J. 25 (1978). The suggested replacement is oftentimes financial statements. Cf. 1 G. Gilmore, Security Interests in Personal Property 464 (1965) (drafters of Article 9 originally proposed that "public files should be scrapped" and greater reliance placed on legally-monitored financial statements). This solution, however, in addition to being irrelevant in the case of individuals or others who do not have audited financials, also begs the question of how the accounting firm (that acts as gatekeeper) discovers whether the entity owns the property, unless it can rely on possession. It is, moreover, an argument that is rarely made generally, outside the context of security interests.

interests) or contingent ownership claims (such as security interests). Because of such costs, if one insisted on the purity of title inference conveyed by possession, some otherwise desirable separations of ownership and possession would not occur, or would be accompanied by expensive, and largely dead-weight, monitoring costs.

If the error introduced by relying solely on possession as evidence of title can be reduced in a cost-effective manner, there is little reason to insist rigidly on the link between possession and title. Sometimes, self-help devices can rebut the inference of title from possession. Prior owners, accordingly, should have the power to prevent trumping subsequent claims from arising by providing relevant information on the face of the item. As long as it is as readily-ascertainable from a physical inspection as possession itself is, the informational inference regarding title is as accessible to purchasers as that provided by possession. The function of a legal rule here is to facilitate such self-help devices, by recognizing open and notorious indications of nonpossessory ownership claims that will be evident upon physical inspection.

Virtually all transfer rules go this far in defining legally-relevant information, as they should. The relevant normative question for transfer rules is what other sources of information should also be considered relevant in determining the rights of subsequent claimants. Certain transfer rules expand the scope of relevant information. For example,

consider how a rule works that provides that, if Prior Owner of real property does not record his interest in the real estate records, subsequent purchasers of the realty take free of Prior Owner's interest. If the information is not in the files, or conveyed by possession or other open and notorious indications,²⁴ then it is irrelevant (unless, under "notice" or "race notice" systems, it is actually known to the purchaser). This rule functions in the same manner as a traditional negotiability rule, as both function to limit the set of relevant ownership information subsequent purchasers are responsible for. The principal difference is only that traditional negotiability rules draw more narrowly the set of relevant information. Information in files is irrelevant under a traditional negotiability rule, and only information on the face of the property itself (plus, perhaps, actual knowledge) can defeat the title claim of the current possessor.

Accordingly, in looking at transfer rules, whether negotiability, derivation, or in between, the distinguishing feature becomes one of how much information a purchaser is responsible for, in the sense that proof of that information will award ownership to the prior owner, and how much information that purchaser is not responsible for, in the sense that it will prevail over prior ownership claims notwithstanding that they can subsequently be established by such information.

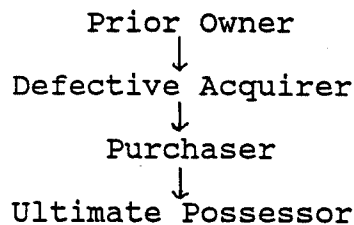
24. See McCannon v. Marston, 679 F.2d 13 (3d Cir. 1982).

B. Factors Affecting Optimal Transfer Rules:
Title Transfers

In this section, I want to focus on several factors that may affect optimal transfer rules. These factors, generally speaking, all relate to the question of information production, and ask whether, and to what extent, it is possible to minimize the costs associated with defective transfers as compared with the ideal world in which all information is instantly available and therefore relevant in establishing ownership. In the first part, I focus on information, the ease with which it can be made readily available, and the form legal transfer rules should take in order to facilitate its availability. This part, dealing as it does with the question of the costs of providing and discovering information concerning prior ownership claims, holds constant the number of cases in which competing ownership claims can arise. But as transfer rules can affect as well the number of cases in which such competing claims arise (by lowering or raising the incidence of theft, for example), this inquiry into informational concerns will paint a necessarily incomplete picture. I will return, in a later part, to the incentive effects various transfer rules might have on the incidence of theft or fraud in the transfer of property. I wish, moreover, to start by examining title claims; the issue of contingent ownership claims will be taken up in the last part.

1. Incentive Effects: Prior Owners and Ultimate Possessors

To examine the effects of adopting one form of transfer rule instead of another, consider a simple case that will encompass the various kinds of claimants that may arise along a chain of (defective) title. In this example, the path of an item of property looks like this:



Prior Owner is assumed to have good title. Defective Acquirer acquires possession of the property in question from Prior Owner, but not by way of a consensual contract that validly conveys title to Defective Acquirer. Defective Acquirer, then, has possession but not good title. It is assumed that Prior Owner has a right of suit against Defective Acquirer, for the property or its proceeds. Defective Acquirer then "sells" the property to Purchaser, delivering possession, and Purchaser then does the same to Ultimate Possessor. In this section, I would like to examine the effects of various rules on the availability of accurate information as between Prior Owner and Ultimate Purchaser. In the next section, I would like to examine such effects on the intermediate possessors, Defective Acquirer and Purchaser.

As between Prior Owner and Ultimate Possessor, I would like to establish that a rule that limits valid prior ownership claims to those evidenced by readily-available information -- essentially a negotiability rule -- is a superior way of dealing with incomplete information. This general point, I plan to show, remains true across property with a wide variety of attributes. Under such a legal rule defining normal sources of relevant information regarding ownership claims, such information is limited to that provided by possession and open and notorious indications on the property itself. This, consistent with the informational doctrine just described, limits relevant information to that apparent on a visual inspection. I then would like to explore the circumstances under which legal rules should expand the sources of readily-available information. The principal modification I will explore makes one additional source of information -- that contained in legally-designated files -- equivalent to open and notorious evidence of prior ownership claims. The effect of this modification is simply to increase the universe of legally-relevant information regarding prior ownership claims. Such a modification, I will show, makes sense when the property in question is relatively valuable, durable (in the sense of likely to be transferred numerous times over its life), and specifically identifiable. Such a modification, moreover, only works when the baseline rule is one that limits the sources of relevant ownership information. For that reason, a negotiability rule is a more flexible starting point, that can

accommodate a variety of kinds of property, than a derivation rule.

I would like to start by examining three substantially different cases -- those of land, wheat, and money -- and suggest why, with respect to all of them, a rule that limits relevant information to that available upon inspection of the property is the desired starting point as well as the additional attributes that may make it desirable to modify this rule with the introduction of an ancillary legally-prescribed recording system.

Considered in the context of information production, a rule providing that only possession, and certain other easily-available indications of prior ownership claims, affect the title of a subsequent purchaser, is superior to a rule providing that anytime a prior owner can establish prior ownership that was never lost in a two-party transaction, it is entitled to prevail over the claim of a subsequent purchaser.²⁵ The reason for limiting relevant information concerning prior claims to that readily available, I believe, is that, generally speaking, it is easier for Prior Owner to provide information to subsequent transferees, such as Ultimate Possessor, than it is for subsequent transferees to search backwards for

25. Many rules also include information actually known to the purchaser, whether or not it is open and notorious. The various ways information not in the files comes into play in various jurisdictions, is described by Johnson, Purpose and Scope of Recording Statutes, 47 Iowa L. Rev. 231 (1962). The use of actual knowledge in establishing priorities is criticized in Baird & Jackson, supra note 21, at 312-18.

information that has not been provided. Cameras can be engraved; cattle can be branded; land can be fenced and marked; and so forth. Once done, and assuming the identification marks are not obscured, subsequent claimants are at least warned about the prior ownership history of the property in question. Absent such an engraving or brand, however, a subsequent purchaser has no easy way of tracing the prior history of the camera, cow, or land in question.

As a corollary, a rule that limits relevant information to that that is readily available provides the correct incentive on the part of Prior Owner to have that information accessible at the time subsequent claims might arise. It does so by placing the risk of loss in the first instance on Prior Owner, who then has the ability to remove that risk, and place it on subsequent transferees, by providing information concerning Prior Owner's claim in an open and notorious fashion.²⁶ Under such a rule, information will be provided up to the point where the cost of providing the information exceeds the associated reductions in risk. A rule that permits prior owners to win simply upon proof of their prior ownership claims (and nonconsensual transfer), on the other hand, because liability

26. This is a point noted by Alison Dunham, albeit with respect to recording systems. See Dunham, Inventory and Accounts Receivable Financing, 62 Harv. L. Rev. 588, 612 (1949) ("public filing statutes allocate the risk to the secured lender but permit him to relieve himself of such risk by giving public notice"); cf. Warren, Cutting Off Claims of Ownership Under the Uniform Commercial Code, 30 U. Chi. L. Rev. 469, 469 (1963) ("One wonders if doctrines regarding claims of ownership are more than risk-shifting devices").

is not on Prior Owner in the first place, fails to produce the proper incentive for Prior Owner to provide information regarding its ownership claim in an open and notorious fashion. This is so because Prior Owner will win over Ultimate Possessor upon proof of Prior Owner's title claim, and the fact that it was not consensually transferred, whether or not that information was easily accessible to Ultimate Possessor at the time of purchase.

Thus, I start from the assumption that, for anything capable of unique identification, relevant information about existing ownership claims is generally more easily provided to subsequent claimants by prior claimants than it is ferreted out by subsequent claimants.²⁷ To be sure, the mechanisms by which such information is provided both have some costs and are not likely to work perfectly.²⁸ But when property is subject to

27. A variant on this rule could also be imagined. It would start at the same place, by placing the risk on Prior Owner. It would permit Prior Owner to shift the risk by taking reasonable steps to provide ownership information. It would diverge from the rule discussed in text in that it would protect Prior Owner whether or not that information was available to Ultimate Possessor at the time of purchase. (Thus, the rules would diverge where the information was removed between the time Prior Owner provided it and Ultimate Possessor purchased the property.) This rule would have the same kind of effect in providing Prior Owner with an incentive to make information available. It would diverge in who would bear the risk of subsequent removal. Neither party seems the better risk avoided. Selection would then be based on administrative convenience factors -- such as ease of proof. The basic contours of the rule, however, would be the same as those discussed in text for a rule that limited the sources of relevant information.

28. The Billy Sol Estes affair is an example of changing serial numbers in order to defraud creditors. See *Estes v. United States*, 335 F.2d 609, 612 (5th Cir. 1964).

numerous transfers, use of any transfer rule bears costs associated with imperfect information. To see why this is so, consider the opposite sort of transfer rule. Under a rule where Prior Owner can prevail if it can show that (a) it once owned the property and (b) did not lose it in a transaction to Defective Acquirer, Ultimate Possessor bears the risk of a nonconsensual transfer somewhere earlier in the life of the property being purchased. Ferreting out information concerning what occurred several transfers ago can quickly become enormously expensive. To be sure, some of this uncertainty can be reduced in a cost-effective way by search by Ultimate Possessor. Ultimate Possessor can question Purchaser closely, and he can investigate Purchaser's past. Ultimate Possessor, too, can insist on a warranty of title from Purchaser, thereby shifting the risk back to Purchaser. These effects are discussed in greater detail in the next section. In addition to being expensive, however, they do little to guard against the dishonesty, disappearance, or insolvency of Purchaser. As a result, much of the uncertainty over prior ownership claims cannot be reduced in a cost-effective way.²⁹

At the same time, Prior Owner has no incentive to make that information known, ahead of time, to those further down the line, such as Ultimate Possessor, since Prior Owner will win under such a rule simply upon proof of ownership. The

29. The risk that remains can be insured against. I have no reason to think, however, that purchasers as a group can insure more cheaply than sellers as a group.

result of adoption of a rule where prior ownership claims prevail upon being proved, accordingly, is to leave that acquisitional risk in place, and to lower the acquisition price.³⁰

Under a rule restricting relevant information about prior ownership claims to that available through an inspection of the property itself, acquisitional uncertainty (the risk of title defects existing when Ultimate Possessor acquires the property) is eliminated, but dispositional uncertainty (the risk of losing title to a subsequent possessor) is increased.³¹ This latter result occurs because Ultimate Possessor can lose its title to property if it is stolen or taken by fraud and then resold to a third party. But this uncertainty, which (holding the incidence of theft and fraud constant) is just the flip

30. How much the acquisition price may be lowered depends, in part, on the likelihood of subsequent transfer. For increased acquisitional uncertainty (which lowers value) may be offset in part by increased dispositional certainty (which increases value). Except for property of infinite duration, however, the effect is not likely to be totally offsetting. In addition, certain kinds of negotiability rules may allow the acquirer to affect dispositional certainty as well, lowering the aggregate incidence of uncertainty as compared to a derivation system. The ways this would work are discussed in text.

31. Except for the original owner and the final owner (in the case of consumables that will be used quickly), every owner of property is both a purchaser and a potential seller. Rules that decrease ownership certainty at the time of acquisition -- such as a derivation rule -- also increase the certainty with which ownership of the property can be retained successfully. Conversely, rules that increase ownership certainty at the time of acquisition -- such as a negotiability rule -- also decrease the certainty with which ownership of the property can be successfully retained. See A. Schwartz & R. Scott, *Commercial Law: Principles and Policies* 459-62 (1983).

side of the acquisitional uncertainty of a rule where prior title claims prevail upon being proven, can more easily be reduced in a cost-effective way. By steps such as engraving, branding, or signs, Ultimate Possessor, just like Prior Owner, can reduce the dispositional uncertainty, wholly apart from a question of increased monitoring. A rule where prior owners prevail only if evidence of their claims are readily available upon simple inspection again provides an incentive to take these steps, whereas a rule where prior title claims prevail upon being proved does not.³²

Principally for this reason, when considering the informational effects of various rules on the behavior of Prior Owner and Ultimate Possessor, a rule providing for the security of the claim of a subsequent claimants unless evidence of prior ownership was readily available in a legally-specified way, generally seems preferable to a rule where prior owners prevail upon proof of their claims, because the rule that limits the sources of relevant information places the burden of supplying (vel non) ownership information on the party who can do so most cost-effectively.³³ Under a rule that limits the sources of

32. This is not to say that an owner would not engrave or brand in a world where the transfer rule provided that all information about prior title claims was relevant. Taking such steps might still be justified because, for example, they make tracing easier. My point is only that, apart from tracing-type issues, a rule limiting relevant information to that readily-available provides an incentive to provide that information, whereas a rule where all information is relevant does not.

33. The informational desirability of a rule that limits the sources of relevant information is buttressed by the administrative desirability of that rule. When all information is relevant, there is a source for much litigation and fact-finding costs that can be sharply minimized if only certain

relevant information, there will, of course, be some residual uncertainty as to what is "open and notorious" enough to qualify as constructive notice (meaning subsequent claimants take subject to claims revealed by such information, whether or not they actually were aware of it). Legal rules, however, can provide substantial certainty even here. This is perhaps most clearly the case when ancillary recording files are used. But it applies to all types of rules limiting the sources of relevant information as well. For example, Ultimate Possessor may have a "duty" to inspect land, or chattels, or instruments being purchased (in the sense that Ultimate Possessor bears the risks of information such inspection would reveal), and certain kinds of warning flags (such as defaced serial numbers) could be identified as requiring further inquiry or assumption of the risk. So, too, pawnbrokers -- or purchasers from pawnbrokers -- may have special duties imposed on them because the setting in which the purchase transaction occurs itself carries earmarks of questionably-derived title. Deciding on what should count as relevant information may need to be done different ways for goods with different attributes, but this is not the same as saying that it should not be done at all or can only be done in an ad hoc fashion.

Certain legal rules, moreover, may lower the cost of supplying that relevant information. These rules work by

(continued)

sources of readily-identified information are considered relevant in the first place.

deeming certain of information to be relevant, and then ensuring that such information is, in fact, readily available to Ultimate Possessor. Ultimate Possessor will then take subject to title claims revealed by that information, just as it does with respect to title claims revealed by other relevant sources of information. Such legal rules, accordingly, supplement possession-based limited informational (negotiability) rules by deeming other information relevant. Principal among these supplemental devices are recording systems. Other supplemental devices may, however, also be observed. For example, rules stating that one cannot be a buyer in ordinary course if the purchase is from a pawnbroker,³⁴ provide a similar channelling device, deeming information regarding prior ownership claims adequately "given" to the purchaser by the type of store the property is purchased from (in the sense that the purchaser assumes the risk of title defects).

Consider the case of land, where a recording system channels and constrains relevant information. It tells Prior Owner where it can stake a claim to the property, and it tells Ultimate Possessor, as a potential purchaser, where to search for title information. Absent these files, Prior Owner, in order to ensure that it retained title, would either have to remain in possession of the property at all times (a task

34. U.C.C. § 1-201(9) (1978). The wording of the section may not accomplish this; but the intent seems clear. See U.C.C. § 1-201(9) (1952).

perhaps easier to accomplish with a suburban tract than with Reyeta), or resort to means such as sign-posting that, even assuming another legal rule treating such signs as constructive notice, might or might not be seen, and might, in any case, be torn down or removed.

Use of a recording system as a source of relevant information, when coupled to a general regime where information regarding prior ownership claims must be accessible to be relevant, is superior, for land, to self-help solutions that would be devised in the absence of legal assistance in the form of a recording system. Possession, of course, is available, and there are no particular reasons not to continue to rely on it as a source of relevant information. But in a world in which property is divided temporally -- with life tenants, remaindermen, and the like -- use of a possession rule as the sole device for determining relevant information quickly becomes fraught with difficulties. Moreover, because ownership and use of land is often divided, as is the case with leased land, possession by itself is too rigid a rule even for the establishment of title ownership claims³⁵ (putting to one side the establishment of contingent ownership claims). Open and notorious indications, apart from possession, that real property was not free and clear should, therefore, also defeat the claim of Ultimate Possessor to good title. But what would

35. These problems are discussed briefly in P. Goldstein, Real Estate Transactions 207 (2d ed. 1985).

these indications look like? Few privately-devised open and notorious indications are effective against the efforts of thieves and charlatans. Signs, for example, that state "This land is owned by Prior Owner," can be removed, thereby defeating Prior Owner's claim against Ultimate Possessor. Although devices such as signs or markings on the property will have some protective effect, they seem less ironclad than a recording system, and little cheaper.

Thus, in looking for a low-cost surrogate for possession in providing relevant information, recording systems seem particularly promising for real property. The legal rule, however, must first make the information derived from the recording files work in the same way that information derived from possession works: separating it from the universe of information that will not be considered relevant. The problem is one of the need to establish a monopoly: files are searched both to discover the information in it and because the absence of information also conveys something of value. This is already the way a possession-based rule works: if ownership claims are evident from possession, they are relevant, otherwise no. But recording files do not rely on information imparted by possession, so they need the same sort of legal assistance in restricting relevant information. Private files would be a poor substitute for the presence of a legal rule specifying files, because private filing systems cannot tell third parties, not signatories to the private arrangement, that

only information in this particular file is relevant.³⁶ A legal rule can provide that certainty, stating not only that information in the files is relevant (which private systems could do, too), but also that information not in the files is irrelevant. By doing so, it provides certainty to the transfer of property, and removes a cost to its ownership, that itself makes property more valuable. Unless the information is contained in the recording files, or is otherwise visible and evident (such as would be conveyed by possession by an entity not listed in the files),³⁷ it is irrelevant.

The presence of the recording system does mandate that purchasers, such as Ultimate Possessor, either check the files or assume the risk of title defects. To that extent, its existence imposes a cost on all transfers. The cost, however, is likely to be a small fraction of the value of the property. Moreover, because land is durable and will be transferred many times over the years, it provides a way of maintaining information -- and the associated security of ownership -- over time and transfers. A rule providing that prior owners prevailed upon proof of their claim would not provide this security of ownership and would lead to substantial, and increasing, uncertainty over time, as purchasers would have no

36. Title insurance could, of course, provide this assurance. But such insurance only shifts the risk; we would still face the same question of how the title insurance company got its information.

37. See, e.g., McCannon v. Marston, 679 F.2d 13 (3d Cir. 1982).

easy way of tracing in a certain way the history of the land backwards many generations. And adding recording files onto such a system would accomplish little, because as long as information not in the files remained relevant, the system would not provide the correct incentive to put information in the files.

Given land's key attributes -- relatively high value, long durability (and hence repeat transfers), and unique identification -- a recording system seems ideally suited for establishing title ownership. The result is to create two sources of relevant information. If the information is in the recording system or is imparted by physical possession, it is deemed relevant, in the sense that a subsequent purchaser takes subject to the risk of prior ownership claims revealed by such information. As for other sources of information, the legal rule makes them irrelevant.

A recording system, however, is not a panacea for all types of property. Property for which the value is low may not justify the costs of a recording system. Similarly, property that is of short duration (and hence will be transferred few if any times during its life) may also not justify a recording system. Finally, the property may not be sufficiently identifiable to support a recording system.

Consider a product such as wheat. It is of relatively low value, is likely to be transferred but a few times during its useful life, and is hard to identify uniquely. For wheat, establishment of a title recording system would make little

sense. Few, if any, owners would use it. Attempts to use it would largely turn back to possession as the basis of description ("the wheat located on M's farm is P's"), and would seem to be a circular addition insofar as relevant information was concerned. Even if the recording system were used, despite these weaknesses, efforts to trace ownership of missing wheat into the hands of a third person such as Ultimate Possessor would often be unsuccessful, or would rely on markings (such as packaging) that might provide inquiry notice in any case.

The problem with recording files for products such as wheat runs deeper, however. Recording systems are not necessary for two-party transactions. They are devices to reveal information about third-party claims to the property. It is for that reason that such systems can work to show nonpossessory claims of parties such as secured creditors (or, indeed, lessors or bailors). But these parties can record their claims because they are aware of, and consent to, the possession by the person they file against, and can then describe the property in question by that possession. ("The computers being used by M are or might be on lease from P.") The issues peculiar to these types of consensual nonpossessory claims are discussed in Part D.

The kinds of ownership questions we are addressing here, however, arise out of substantially different circumstances. For our current inquiry, Prior Owner loses possession to Defective Acquirer other than by means of a consensual transfer. In these cases, it is not clear what information in

the recording files that Prior Owner could put there with respect to fungible goods, such as wheat, would provide any help whatsoever to someone contemplating a purchase from Defective Acquirer. If the files are organized by owners' names or property location, as they virtually need to be when the property is not uniquely identifiable, a filing under Prior Owner (or Prior Owner's location) will not be found by someone contemplating a purchaser from Defective Acquirer. The information in the files, accordingly, would quickly become worthless in any case that counted: nonconsensual, nonpossessory, third-party claims to the property in question.

Not all goods, of course, are as fungible as wheat. Many goods -- consumer electronics, for example -- may be uniquely identified by serial number. Because all such goods contain them, serial numbers, by themselves, convey little warning of prior ownership claims other than that of the current possessor. But they can solve the identification problem for recording files that renders such files useless for fungible goods. Is there any reason not to adopt a title recording system for such types of goods? To say that many people would not use them (because of their relative cost) is not a reason not to have such a system in reserve, that could be used if someone wished to avail himself of it.

There is, however, a cost to the availability of the system in a world in which most people would not view it cost-justified to use it. One problem is that it introduces a new vehicle for theft. If chains of title are not unflaggingly

kept in the system, it will be hard to stop spurious entires from being made. The problem has two components. Prior Owner shows up at the recording office with a receiver and wants evidence of its title ownership recorded. If the system cannot assume chains of title are unflaggingly kept, Prior Owner's ability to record will be based on something like possession (thus using possession as evidence for purposes of establishing the recording system). The problem is compounded at the other end. Prior Owner sells the receiver. The buyer does not bother to record its interest. The buyer resells the receiver to another. Prior Owner then claims the reciver,³⁸ pointing to the recorded entry and the absence of a notation in the files of a consensual transfer from Prior Owner. To defeat Prior Owner's claim, however, the current possessor will have to establish the chain of title back to the consensual transfer from Prior Owner, a messy factual problem. Given these difficulties, not establishing the recording system in the first place seems preferable, even in the case of goods that can be uniquely identified, unless the relative value of the property is sufficient to independently warrant resort to the recording system.

In addition to the problems already identified in establishing a recording system where it would not be used unflaggingly, there may be some problem of adverse selection.

38. This assumes Prior Owner can find the current possessor. But in cases where it cannot, the form of transfer rule is irrelevant.

If purchasers generally would not consider it worth their while to check the recording files, but instead would discount by the the general risk of bad title, sellers would have an incentive to sell those goods first whose title was defective, as buyers would be overpaying for them. For this reason, buyers may face increased risks, and thereby have an additional incentive to check. Wherever this stabilizes, it imposes a cost on the transfer system that probably exceeds its benefits, and that can be avoided by simply not having a title recording system available for property until the property's natural attributes -- high value, durability, and identifiability -- would lead most people to use such a system naturally. Those attributes exist with land and perhaps automobiles, but not with wheat, receivers, or Cuisenarts.

For these reasons, an original owner of a fungible product, such as wheat, or an identifiable, but relatively low-value item such as a receiver, may decide that its value of the wheat would be maximized if a rule were adopted that limited sources of relevant information to that imparted by possession, without the ancillary support of a recording system. In this way, buyers such as Ultimate Possessor would be certain of getting good title to the wheat or receiver, a factor that would lead them to pay as much for the item as they would in a world where there was a recording system, without its ancillary costs. To be sure, Ultimate Possessor would be less certain of retaining good title under a rule of this sort, but the discount for that factor may well be less than the costs of

maintaining the recording system itself. To the extent that Ultimate Possessor is likely to use the item, such as wheat, it purchases with reasonable dispatch, the chance of involuntary loss of title is minimized, and as such risk is lowered, the discount for problems with maintaining good title are lowered as well.

Wheat, accordingly, seems well-suited to a rule that limits sources of relevant information to that imparted by possession, without an ancillary recording system. One should note, however, that here, unlike with land, an opposite rule is likely to have little impact. Imagine that wheat was subject to a rule where all information was relevant. This rule would make a difference, when compared to a possession-based limited informational rule, only when the wheat (a) could be traced into the hands of Ultimate Possessor and (b) was not marked in an open and notorious fashion (for, in those cases, a possession-based limited informational rule would function in the same way as a rule deeming all information to be relevant). Many of wheat's attributes, however, suggest that the number of cases in which these conditions would be satisfied would be few in number, as wheat has a relatively finite life (and accordingly few transfers) and substantial fungibility.

Given this relatively small marginal difference in the choice of rules, other factors might appropriately lead one to favor one rule or the other. Two factors would support sticking with a possession-based limited informational rule. First, such a rule is likely to be less costly to administer

than a rule where all information is relevant because, by limiting the sources of information that can be brought to bear on title disputes, it reduces the scope where costly factfinding might be necessary. As such, it is likely to lead to less litigation, and less costly litigation when it occurs. Second, on grounds of consistency, there is a benefit in not deviating from the general legal rule -- here, a possession-based limited informational system -- unless a case is made out that another rule is actually superior.

For one further kind of property, consider money. Money can be uniquely identified (by serial number), and is likely to be transferred many times. In those respects, it is like land. Yet a title recording system makes as little sense for money as it makes sense for land. Why? To say that money is the essence of a negotiable form of property only begs the question.³⁹ If a recording system existed, it does not mean that Ultimate Possessor would check it before accepting money from Purchaser, instead of just discounting that money for the associated risk. The principal reason is, instead, that the relative value of money is probably not high enough to warrant maintenance of a title recording system. Money -- and I am now talking about specific, identified bills and not abstract things such as deposit accounts -- is rarely held by any

39. The usual defense of negotiability for money (and other negotiable instruments) usually stops here. See *Peacock v. Rhodes*, 2 Doug. 633, 99 Eng. Rep. 402 (K.B. 1781) (Mansfield, J.).

individual for very long. If each time Prior Owner received a dollar bill, it wanted to protect itself by going to the recording office, Prior Owner would be there constantly.⁴⁰ The costs of doing so would mean that Prior Owner would rarely ever use the system. It is probably instead much more cost-effective for Prior Owner to take precautions against theft or other loss (such as by diversifying, and never carrying much wealth in money at any one time) that do not bear the negotiation discount. Once that is the case, all of the problems with using recording files for wheat or receivers reappear. Given that, a transfer rule that focuses on possession as the source of relevant information seems preferable not only to a rule where prior owners prevail upon proof of their claims but also to a possession-based transfer rule buttressed by an ancillary recording system.

To this point, I have been examining types of property where physical possession is a reliable source of observable ownership information. From there, I have suggested the general superiority of rules governing transfers that limit the sources of relevant information to that that is readily accessible. Such rules, because they rely on possession as the fundamental indicia of ownership (whether or not buttressed by a recording system), however, are unsuited by themselves for intangible forms of property. This does not mean, however,

40. There would be the same problem as how Prior Owner proved its ownership claim (other than through possession), that was explored, supra pp. 32-33.

that a rule where prior owners prevail upon proof of their ownership is a necessary response to ownership of intangible property. In fact, even when focusing on intangible property, the desire to avoid the effects of such a rule can be seen in two ameliorative responses. One response is to rely on a special kind of limited informational system. Under such a regime, because open and notorious evidence of ownership is not given by possession, the sole source of relevant information becomes the recording files. Intellectual property rights -- patents and copyrights -- are largely assimilated into such a system.⁴¹

A competing response is sometimes made with respect to intangible property to avoid the difficulties of an system where prior claimants prevail upon proof of their claims. In this response, the relevant intangible property right is reified into a tangible item. Once done, a rule that limits the sources of relevant information can again be used, because possession can again be used as a source of information.⁴² This is the response most prominently associated with promises to pay -- accounts -- which can be "paperized" into instruments⁴³ and with partial ownership of firms, which can be

41. See U.S.C. § 261 (patents); 17 U.S.C. § 204 (copyrights); see generally Note, Transfers of Copyrights for Security Under the New Copyright Act, 88 Yale L.J. 125 (1978).

42. See generally Clark, Abstract Rights Versus Paper Rights Under Article 9 of the Uniform Commercial Code, 84 Yale L.J. 445 (1975); see also Jackson, Embodiment of Rights in Goods and the Concept of Chattel Paper, 50 U. Chi. L. Rev. 1051 (1983).

43. See U.C.C. § 9-105(b); 9-105(1)(i) (1978).

paperized into securities. In those cases, one says that the underlying property right is "embodied" in the paper, in the sense that possession of the paper is itself accepted as proof of ownership of the underlying right.

Attributes of particular types of intangible property may suggest the superiority of one response -- sole reliance on recording files -- over the other -- possession via embodiment. For example, although intellectual property rights could be embodied in paper, and thereby subjected to a possession-based information system, the low incidence of transfer and the possibility of loss or theft may make a recording system generally preferable. This is especially the case when one recognizes that partial ownership claims (such as security interests) in such property may also be created for which a filing system would be preferable.⁴⁴ Accounts, on the other hand, like money, may be created with too great frequency to make reliance on a recording system worth its costs. In such a case, the realistic choice is that of embodiment (and a possession-based limited informational system) or not (and an unconstrained informational system or some other sorting device).⁴⁵

44. See infra Section D.

45. Both responses are seen. Accounts can remain unembodied. In those cases, while many "sales" of accounts get swept into Article 9's system, see U.C.C. § 9-102(1)(b) (1978), some are excluded, id., § 9-104(f). Those latter cases are sorted out on either a first-to-claim basis, or a first-to-notify the account debtor basis, or some similar solution. Where the likelihood of transfer is high, however, accounts can also be embodied (in instruments or chattel paper), where possession-based rules, and recording files, are available to sort out relevant information.

Share ownership in firms may be undergoing a shift in the response. Hitherto, sources of relevant information were limited by an embodiment response: ownership was locked up in the paper. Partial ownership claims were handled by the divisibility of the paperized claim: a thousand share certificate could be changed into ten one hundred share certificates. But the longevity of share ownership, their relatively high value, and likelihood of frequent transfer (including as security) may make a recording system equally as effective as a source of information, with fewer worries of theft or loss. As a result, share ownership may be moving from an embodiment response to a recording response. The change may have been the result of the advent of the computer age, which may have shifted the comparative costs and advantages of an embodiment response relative to a recording response.

In all these cases, however, we observe the legal system devising devices so as to move away from a system where, because information is not easily accessible, there is no effective way to sort between information that will be deemed relevant and not, and to move towards a rule where information is made easily accessible (by possession or by files) and where relevant information can thereby be logically limited to those sources. This may provide the best positive evidence we have of the superiority of a rule that limits the sources of relevant information in dealing with a world of less-than-

perfect information.⁴⁶

2. Incentive Effects: Intermediate Acquirers

A rule that limits sources of relevant information regarding prior ownership claims to those that are readily accessible, as we have seen, provides an incentive for an entity who held good title, such as Prior Owner, to provide such information regarding its ownership, so as to defeat negotiability later on. A rule that permits a prior owner to prevail upon proof of its claim, as we have seen, does not provide that incentive. Analysis, however, should not stop with the incentives of Prior Owner and Ultimate Possessor. What about the incentive effects on intermediate possessors,

46. The discussion to this point has assumed no greater comparative advantages in information production or acquisition among sellers as a group than among buyers as a group (or vice versa). I do not think much changes when one considers different attributes of participants. Consider, for example, the differences between consumers and merchants. Consumers as a group presumably are more likely to be buyers than sellers (as they are more often end-users). A rule that limits the sources of relevant information suits that characteristic better than a rule where all information is relevant. Even if one assumes consumers underestimate the risk of theft from them (because of the use of incomplete heuristics), they are likely, as well, to underestimate the risk that the goods they are purchasing have a defective title. Indeed, they may be less likely to underestimate the risk of dispositional loss than the risk of acquisitional loss, because of factors such as presence. See generally R. Nisbett & L. Ross, *Human Inference: Strategy and Shortcomings of Social Judgment* 43-62 (1980). Thus, consideration of the nature of buyers and sellers seems not to add any weight to the rule side of the scale where all information should be considered relevant (a derivation system).

such as Defective Acquirer and Purchaser? In the case of Defective Acquirer, its claim to ownership is subject to defeat by Prior Owner, whatever the transfer rule, as it is a two party rule invoking the original justification for private property. A rule that limits sources of relevant information to that given by possession provides Defective Acquirer with no incentive to give -- and subsequent purchasers with no incentive to ask for -- assurances that title is rightfully Defective Acquirer's. Indeed, like true owners, it leaves Defective Acquirer with an incentive to provide information regarding its ownership (such as engraving) to defeat negotiability claims vis-a-vis Defective Acquirer later on should the property in question be taken from Defective Acquirer without its consent. Such information is not necessarily "false," however, as Defective Acquirer may have rights superior to the property in question as against anyone other than Prior Owner, and to that extent does not clutter up the system with incorrect information (which would be a cost).

A rule providing that a prior owner prevails upon proof that it once held title, and never relinquished it to the first taker, provides different incentives. In a sale to Purchaser, Defective Acquirer can contract into responsibility for the information regarding prior ownership claims -- via a warranty of title -- or out of responsibility -- via a disclaimer of any warranty of title. Such a rule, accordingly, holds promise of

a signaling function that a negotiability-type rule does not.⁴⁷ Those who are confident of their title, such as Prior Owner, will provide a warranty, because doing so conveys valuable information and is costless to someone assured of his own good title; those who are not, such as Defective Acquirer, will be less likely to issue it, because doing so has a cost.

The validity of this signal, however, is only as strong as the likelihood that it will not be misused. The possibility of abuse in this context seems high. The cost of issuing the warranty is the likelihood that it will be drawn on times the amount of recovery. The cost of not issuing the warranty, however, is the reduced resale price. Because of the greater uncertainty to the purchaser, the price discount for not issuing the warranty may exceed the cost of issuing the warranty. Defective Acquirer, accordingly, may prefer to issue the warranty, take the extra proceeds, and then take steps to insulate itself from recovery. Assuming goods with warranties can be sold for more than goods without warranties, sellers engaged in a scam, or engaged in an end-period game⁴⁸ (a description that may fit most sellers of stolen and fenced goods), will often provide that warranty, and then disappear before either Prior Owner or Purchaser can sue.

47. Signalling is discussed in A. Spence, *Market Signaling: Informational Transfer in Hiring and Related Screening Processes* 1-4 (1974).

48. End-period games in game theory are described by Hirshleifer, Evolutionary Models in Economics and Law: Cooperation Versus Conflict Strategies, 4 Res. in Law & Econ. 1 (1982).

For these reasons, the incentive effects on intermediate purchasers seem less significant than do the incentive effects for prior owners. Moreover, legal rules can, at least with respect to some kinds of goods, provide superior ways of providing the requisite information, and do so best when coupled with a rule whereby sources of relevant ownership information are limited. I speak here of title recording systems. A rule limiting relevant information to that easily accessible, coupled with a decision to treat such recording files as providing that kind of information, provide an incentive for owners to provide ownership information in those files. Such ancillary features to a rule that limits the sources of relevant information eliminates much of the problem discussed here, and make it more amenable than a rule under which all information is legally relevant to accommodations of information-production devices such as this.

In addition, one has to consider the possibility of downstream suits in a system that limits the sources of relevant information. While such a rule seemingly places liability on Prior Owner (assuming Prior Owner cannot find or successfully sue Defective Acquirer), this is not true where subsequent parties, such as Purchaser, purchased with open and notorious evidence of potential competing claims to property evidenced through relevant sources. Many of the markets in which goods with defective title are sold, such as pawnshops, may provide such evidence, and, accordingly, open up the possibility of suit by the original owner against the purchaser

from the market. Thus, if Purchaser is a pawnshop, Ultimate Possessor may lose in a suit by Prior Owner, even in a world that limits the sources of relevant information. Moreover, suit against the seller on that market -- against Purchaser, the pawnshop -- would seem to be equally available, for just as purchasers from a pawnshop can be deemed to be on notice of possible title defects in the goods being purchased, so, too, can the pawnshop itself be deemed to be on notice of possible title defects in the goods it purchases for resale. Even where liability against Ultimate Possessor is cut off -- such as where the fencing operation operates through an apparently legitimate outlet, so there is no open and notorious evidence of title defects when Ultimate Possessor purchases from Purchaser -- Purchaser may still be tagged by a suit by Prior Owner if the persons selling to the outlet, such as Defective Acquirer, give evidence of suspiciously-derived title. In those cases, the upstream suit along a warranty of title in a world where all information is relevant and the downstream suit in a world where the sources of relevant information are limited, will end with liability on the same person: Purchaser, the entity that purchases from Defective Acquirer, the entity with bad title.

C. Of Theft and Carelessness

To this point, I have been relatively casual in the discussion of the impact of various transfer rules on theft.

Theft, along with forms of fraud and carelessness (the forgetful owner who loses property at the beach or who sells it twice), form the basic cases out of which competing title claims arise that are not handled by notions of consensual transfers.⁴⁹ Assuming -- from our original assumption that private property is justified -- that reducing theft is both a private and a social good, is there a reason to favor a rule where prior owners prevail upon proof of their claims over a rule limiting the sources of relevant information on the ground that it better deters theft?⁵⁰ The nature of the argument that would be made to answer that inquiry in the affirmative is that, by imposing liability on the taker from the thief (one assumes that the thief is gone or insolvent), as does a rule making all information relevant with upstream recovery along a warranty of title,⁵¹ one induces that taker to investigate more fully, and such inducements lower the thief's recovery, which will lower the incidence of theft.⁵² But this argument seems

49. The lost-goods case is not as easy even for the two-party case as is the theft case. But that involves a part of the original justification inquiry. See supra note 2.

50. United States law favors a rule where prior owners prevail upon proof of their claim. See Oliver, Sales of Goods by Parties Lacking Title, 14 Central L.J. 146 (1882). English law is different. See Sales of Goods Act, 56 & 57 Vict. ch. 71 S.22 (1893).

51. See U.C.C. § 2-312 (1978).

52. See Weinberg, supra note 8. This argument was advanced by counsel (with a negotiability rule "the temptations to theft would be increased") and rejected by Judge Mansfield, in Peacock v. Rhodes, 2 Doug. 633, 99 Eng. Rep. 402 (K.B. 1781).

incomplete. Most stolen goods are never recovered, so the deterrent-discount is likely to be small. To the extent it exists, moreover, it will reduce the precautions against theft that could be taken by the original owner. As Professors Schwartz and Scott suggest, "[i]t seems difficult to say, as a general matter, that these precautions are always more costly than the steps open to the purchaser."⁵³

A rule limiting the sources of relevant information, moreover, does not necessarily leave the original owner without a remedy (assuming recovery from the thief is unavailable). There may be a right of recovery downstream, against the original taker from the thief. Even with a limited informational rule, many of the markets on which stolen goods are disposed (such as pawnshops or flea markets) are those where the purchasers from the thief can easily be deemed to be on sufficient notice of possible title defects that it makes sense to have them assume that risk.⁵⁴ Moreover, the second generation purchaser, that purchases from the pawnshop or flea market, may likewise be on sufficient notice of possible title defects that this purchaser, too, could be sued by the original owner.⁵⁵ In that case a rule that limits the sources of

53. A. Schwartz & R. Scott, supra note 31, at 476. In addition, one would have to investigate the comparative advantages of modifying this rule as compared to other rules (such as increasing the criminal penalty for theft).

54. Cf. J. Hall, *Theft, Law, and Society* 155-56 (2d ed. 1952) (discussion of commercial criminal fences; some appear legitimate).

55. See U.C.C. § 1-201(9) (1978).

relevant information places ultimate liability on the same entity (via downstream suit to the pawnshop or first purchaser therefrom) as does a rule that makes all information relevant with an upstream suit along a warranty of title.

Thus, on analysis, a rule where prior owners prevail upon proof of their ownership seems to offer no strong advantage in deterring theft over a rule that limits the sources of relevant information.⁵⁶ A rule for theft where prior owners prevail

56. Professors Schwartz and Scott construct "an economic justification for the theft rule," that relies on certain assumptions that they apparently believe are implausible (calling the justification "somewhat speculative" and "weakly explicable"). A. Schwartz & R. Scott, supra note 31, at 459-62. Under this justification, a prior owner attributes only a nominal value to the potential benefits from recovery, both because "recovered goods are used, and the thief and others could have abused them," and because "the owner may have already replaced the goods and a sale of recovered goods is likely to yield little because the goods were stolen." (In addition, they suggest, "the owner, who may not normally be a seller, may not obtain the best price for the goods.") The effect of these factors would be that prior owners would be "unaffected by any legal rule that allocated property rights to stolen goods." Purchasers from thieves, Professors Schwartz and Scott suggest, however, might be influenced by the legal rule, because the purchaser "will place a relatively high value on the goods." Because of this, a legal rule allocating property rights in stolen goods may make a difference: "If purchasers must yield the goods, they will take greater precautions than owners to reduce the risk of surrender."

As Professors Schwartz and Scott acknowledge, the assumptions on which this rationale rests appear questionable. They identify two such assumptions: "first, that owners assign a negligible value to the potential benefits of returned goods; and second, that purchasers value such goods more than owners." They are correct to be skeptical about the validity of these assumptions. To be sure, "recovered goods are used," and could have been abused, but that factor does not explain why a prior owner would place a lower value on them than a purchaser. Abuse by the thief would affect both equally. Abuse by the purchaser would be recoverable in a suit by the prior owner, presumably, in the form of money damages (although proof problems may complicate this analysis). Nor is there any easy explanation why "a sale of returned goods is likely to yield little because the goods were stolen." Once returned to the prior owner, that owner can pass on good title; it is unclear

upon proof of ownership, moreover, may have one other undesirable effect. Just as the probability of theft is not fixed, so, too, the probability of recovery is not a given. Purchasers who bear risks of title defects may be able to reduce the chances of a prior owner's recovery by taking steps (such as hiding the goods or moving them to a distant state). These steps seem a social deadweight loss. A rule limiting the sources of relevant information removes the need, once the property is transferred beyond the first taker from a pawnshop, for current possessors (if they have checked such sources) to take such steps.⁵⁷

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how the prior theft would continue to negatively affect the value, other than through uncertainty as to how the goods were treated in the hands of the thief, but that, again, is a problem that affects all purchasers (including those from the thief) equally. Nor is it clear that the "greater precautions" taken by purchasers "to reduce the risk of surrender" will necessarily be in the direction of more careful inquiry; they might be in the direction of hiding the assets. Finally, the prior owner may not be stuck with the stolen goods on which he now places a low value. In those circumstances, a damage remedy -- perhaps based on the cost of the replaced goods -- might be available in lieu of the specific performance remedy of return of the property. Such a damage remedy does not suffer the discounting in value as do the goods themselves.

When one finishes with the analysis, it is unlikely that a terribly convincing case has been made to depart from a presumptive rule that limits the sources of relevant information, beyond those steps that deem certain information (e.g., purchase from pawnshops) part of the relevant set of information.

57. Insurance would seem to change little in this analysis. Professors Schwartz and Scott suggest that prior owners appear to be the cheapest insurers -- a factor that, if true, would support the text's application of a constrained informational rule. See A. Schwartz & R. Scott, supra note 31, at 476. They cite, in support of this conclusion, evidence suggesting that while "coverage against theft is common," coverage "against the risk of buying goods is uncommon." This evidence may not, however, suggest any conclusion about cheapest insurer. Buyers and sellers are insuring against different things. Sellers are insuring against the risk of unrecovered theft; buyers would be

To say that a rule that limits the sources of relevant information remains preferable even in the case of theft, however, does not necessarily mean that prior owners cannot recover from subsequent owners. Relevant sources of information include what I have called open and notorious evidence of title defects. I have suggested that such information can be conveyed by devices, such as engraving and branding, that make the information accessible upon physical inspection. I have also suggested that relevant information, even in a system that limits the sources of relevant information, can be conveyed by the forum in which the good is sold (such as a pawnshop).

This may make certain kinds of property look like they are subject to a rule where prior owners prevail upon proof of ownership, when really the analysis would be much the same under a rule that limits the sources of relevant information. To take a recent, and famous, case, unique and valuable items, such as a Utrillo painting, may demand some inquiry into prior ownership, at least when a professional (such as a gallery) is

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insuring against the risk of recovered theft. If the probability of one category (unrecovered theft) is much higher than the probability of another category (recovered theft) -- as is probably often the case -- incidence of insurance tells us little about cheapest insurers. To say this, however, does not suggest that there is any evidence going the other way -- that purchasers are the cheapest insurer (a factor that, if it existed, might favor a rule where prior owners prevailed upon proof of ownership).

purchasing the painting.⁵⁸ Under those circumstances, even a rule limiting relevant sources of information would permit recovery from the gallery that purchased the painting from a thief, even if it would not permit recovery from a person who buys from the gallery. Such an analysis may justify a holding such as Porter v. Wertz,⁵⁹ because of the special attributes of unique paintings and purchases by professionals.

Cases other than theft can be analyzed in the same fashion. Consider the case of lost goods,⁶⁰ and do so by considering an item such as a camera. In a world in which Defective Acquirer's title was subject to attack by Prior Owner, would a rule that limited the sources of relevant information, giving priority to purchasers from Defective Acquirer unless competing ownership information was available from a relevant source, be a good rule? Many of the effects of having this rule would be similar to that for theft. Ultimate Possessor, as purchaser, would expend no search efforts on title (beyond those it was responsible for -- such as checking

58. The reason for perhaps imposing extra inquiry duties on a professional purchaser is the possibility of superior access to information. Art galleries, for example, may know how to check out prior ownership of a particular Utrillo (because they have access to information about the last recognized owner) that nonprofessionals would not have.

59. 53 N.Y.2d 696, 439 N.Y.S.2d 105, 421 N.E.2d 500 (1981). The case was a fraud case, not a theft case, but there is no particular reason why the relevant analysis is not the same.

60. Lost goods are sometimes not negotiable. See R. Brown, *The Law of Personal Property* § 11 (2d ed. 1955). Fraud rules are distinct. See S. Williston, *The Law Governing Sales of Goods* §§ 311-320 (1909).

the camera body for an engraved name), because Ultimate Possessor is protected even if it performs no search. An opposite rule, unless Ultimate Possessor planned to sell the camera yet another time, would lead Ultimate Purchaser to pay less for the camera in the first place (either because it would have to pay for more search or because it would have to bear an increased risk of title defect in the absence of search). Paying less would lower the returns to the original finder, Defective Acquirer, and might lower the benefits of selling, rather than returning, the camera.

But this factor may not be decisive. Recall that Prior Owner has a right of recovery against Defective Acquirer, either for the property back or for the proceeds of the property.⁶¹ If Prior Owner is able to find the camera in the hands of Ultimate Possessor, Prior Owner usually should be able to find Defective Acquirer as well (as Prior Owner will either uncover Ultimate Possessor by tracing thorough Defective Acquirer or Ultimate Possessor will usually be buying from someone it knows; again, if Ultimate Possessor is buying from a pawnbroker, the analysis may change substantially). Unless Defective Acquirer is insolvent or planning to flee with the proceeds, it has few incentives to swap the camera for proceeds under such circumstances, and the rule has few effects on the incentives of Bystander to return the product to Prior Owner.

61. This rule may have incentive effect on recovery, and arguably could be questioned on that ground. See supra note 2.

Unlike the theft case, moreover, it is less plausible to assume that Defective Acquirer will be motivated to flee, as the marginal wealth increment to most finders of found property is small.

Such a rule would also affect, at the margin, the efforts Prior Owner would put into being careful not to lose the camera: since Prior Owner's chances of recovering it are now higher, it is likely to put somewhat fewer efforts into keeping track of the camera in the first place. When one assesses the various incentive effects, there appears (not suprisingly, given the conclusion with respect to the theft case) to be no reason to suspect the superiority here of a rule where prior claimants prevail upon proof of their claims.

D. Nonpossessory Ownership Claims: Contingent and Otherwise

Principally because of the incentive effects on the production of information, accordingly, rules limiting the sources of relevant information (negotiability rules) generally are preferable to rules where prior claimants prevail upon proof of their claims (derivation rules). The power of this principle may be seen by considering the norm in related cases that are usually not thought of as involving competing claims to property (although that labeling may itself strongly show the force of a negotiability rule). Corporation A owns some property. It sells it to Corporation B. Later, Corporation A becomes insolvent, and its creditors are on the hunt for

someone that can make them whole. Can the general creditors of Corporation A (at least those that were in existence at the time Corporation B purchased the property, and could make a claim of prior "ownership") sue Corporation B for the property or its value? As a general matter, the answer is no.

I would suggest that the most satisfactory explanation for this result is a variant on the informational question previously discussed in the context of competing ownership claims to property. If Corporation B bought subject to Corporation A's troubles, it would pay less for the property. It has a limited ability to find out what Corporation A was up to, because of the difficulties of an upstream search. Corporation B, accordingly, has few effective ways of reducing its risk. For that reason, it is likely that the creditors of Corporation A were better able to protect themselves (by means of closer monitoring of Corporation A's future activities or by taking, and publicizing, property interests, such as security interests, of their own). A rule that places liability on the creditors in the first place (who are in the equivalent position of prior owners) better allocates the risk of finding out about transfers that were not consented to.

Exceptions to this rule are of two types.⁶² One type is

62. There is a third type of exception, represented by fraudulent conveyance law. But in those cases, a purchaser, such as Corporation B, is protected if it purchased for fair consideration without knowledge of the fraud. See Uniform Fraudulent Conveyance Law § 9; Uniform Fraudulent Transfer Act § 8(a). Thus, this really is not an exception from the kind of rule I am addressing in text.

represented by requirements such as those imposed by bulk sales law.⁶³ In these cases, Corporation B is not required to search backwards, but is required to provide some public notice of the transaction as a condition of being protected. Such a rule is not, however, inconsistent with the basic thrust of a rule protecting purchasers by limiting the sources of relevant information regarding prior claims, but instead attempts to reduce the risk by imposing simple notice duties on a party that perhaps can prevent an incipient fraud at the last moment.⁶⁴ A second type of exception is that represented by successor liability law. Under this doctrine, purchasers of the business itself bear responsibility for unsatisfied tort liability against the seller that was not manifested at the time of the sale. Within a risk minimization rational, this exception may itself be explained. For nonmanifested tort victims, it is hard to assert that they are able to reduce the risk to themselves by closer monitoring or whatever, as they do not even know that they have claims against Corporation A at the time of the sale. Thus, successor liability law can be seen as an attempt, in this special circumstance, to impose liability on Corporation B in order to conscript it in forcing internalization of the cost of the torts.⁶⁵

63. See U.C.C. Article 6 (1978).

64. The analogy is one of last clear chance in tort law.

65. See R. Gilson, *The Law and Finance of Corporate Acquisitions* 1095-1100, 1123-33 (1986); Roe, Mergers, Acquisitions, and Tort: A Comment on the Problem of Successor Corporate Liability, 70 Va. L. Rev. 1559 (1984).

This analysis of whether purchasers should take free of the claims of general creditors of the seller has proceeded along the framework of this paper, by examining which rule would better minimize the costs of defective transfers. This approach seems preferable to other explanations for the result. For example, consider an argument that Corporation B should prevail, because it paid fair consideration, and therefore the creditors of Corporation A were not harmed. This explanation, while true as far as it goes, does not distinguish this case from the cases where any subsequent owner pays fair consideration for property that had a defective transfer in the chain of title. Even if one assumes that the creditors of Corporation A should not get both the proceeds and the property, this does not answer the case where Corporation A has dissipated the proceeds, so at best its creditors can now get only one recovery.⁶⁶ Nor is it particularly helpful to focus on the lack of a claim to specific items of property on the part of the creditors of Corporation A. Those creditors had inchoate claims to the property of Corporation A, that they could pursue by court means, and, under the prevailing legal rule, they lost those claims when Corporation B purchased all the assets.⁶⁷

66. Sometime legal rules provide the creditor with a claim both to the proceeds and the property. See U.C.C. § 9-306 (1978).

67. More precisely, they were replaced by the ability to pursue the proceeds. But, again, that is true in any case where an entity transfers property that was not its to transfer.

Thus, the case of unsecured creditors can be seen as responding to the same concerns that motivates third-party transfer rules in general. The question I would like to focus on now is whether and to what extent possession-based rules for determining ownership in this context can be supplemented by other sources of information. As we saw in Part B, the usefulness of a recording system to supplement possession in providing title information, varies depending on the attributes of particular forms of property.

To suggest, however, that recording systems to establish title ownership are undesirable for certain kinds of property -- or are at least less desirable than simple possession rules -- is not to say that nonpossessory claims to property, including claims of less than full title, are equally unsuited to a recording system that supplements title, when considered against the rights of other contingent claimants through the person in possession. Many forms of property have both physical and financial uses. The desire to use particular property to secure a loan -- thereby providing the lender with priority over other claimants to that property -- may not be consistent with the owner's need to possess the property for other purposes. The owner may be a more capable tanner, or blacksmith, or manufacturer of microprocessor chips, and needs the property for that business.⁶⁸ In those cases, even though

68. At the core, this involves a specialization of function. Owner is a specialist in the business, while the lender is a specialist in financing. If the lender were more proficient in the business, then it would make more sense to have an outright sale of the property. In many cases, of course, there is no comparative advantage to be derived from possession (such as

possession is consistent with title, it is a poor source of information about competing financial claims to the property.

In those cases, when a consensual transaction between two parties creates a system where possession is separated from ownership of property, the nonpossessory property claimant may desire a surrogate for possession that protects it from the claims of third parties.⁶⁹ One way of providing that protection is by application of a rule where prior claimants prevail upon proof of their claims, such as exists for lessors and bailors as against Article 9 claimants. But here, the difficulties with such a rule that were discussed earlier are compounded. A purchaser trying to check backwards into the title of property possessed by its seller, faces an enormously difficult task, and one that will largely lead the purchaser to assume the risk of title defects (reducing the price paid for the property -- even as security -- accordingly).

This problem may underlie a principal distinction between secured and unsecured debt. Unsecured creditors, who have at least inchoate rights to the property, lose out, as we have seen, to anyone who first claims an interest in the property and provides notice of that fact in a prescribed fashion (usually by taking possession of the property or by recording

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with stocks and bonds); in those cases, transfer of possession does not create any special problems.

69. See Epstein, Notice and Freedom of Contract in the Law of Servitudes, 55 S. Cal. L. Rev. 1353, 55 (1982).

evidence of it in the public files).⁷⁰ Under the analysis of this paper, the reasons for rules of this sort are easy to fathom. It is easier to install devices providing relevant information about competing claims to property to subsequent claimants than it is for subsequent claimants to search backwards into the affairs of the person from whom they are purchasing the property. At least when dealing with consensual claimants, who can charge for the risk of default, use of a rule limiting the sources of relevant information to possession or the files makes sense. In that respect, the status of unsecured creditors can be seen as a special application of a general rule that limits sources of relevant information. To be sure, such creditors remain subject to problems of debtor misbehavior, but other legal devices, such as bulk sales laws,⁷¹ may more effectively provide protections against that misbehavior than a generalized rule permitting prior claimants to prevail upon proof of their claims would do.

Creditors can, however, increase their level of protection against competing claimants, even in a system that limits the sources of relevant information to that available from possession or the files. Creditors that first take possession,

70. U.C.C. § 9-301 (1978) provides that rule vis-a-vis secured and unsecured creditors. Similar rules vis-a-vis competing unsecured creditors are given by state execution rules.

71. See U.C.C. Article 6 (1978); see generally Harris, The Interaction of Articles 6 and 9 of the Uniform Commercial Code: A Study in Conveyancing, Priorities, and Code Interpretation, 39 Vand. L. Rev. 179 (1986).

for example, should prevail over other entities claiming rights to the property.⁷² Like with other aspects of a system that limits the sources of relevant information, the crucial question is less the appropriateness of a possession rule than a question of whether and to what extent other sources of information about competing ownership claims should count. A possession-based limited informational system without an ancillary filing system is less desirable in cases where possession and ownership are consensually separated in the first place. Unlike with theft, here the nonpossessory claimant -- such as a secured party -- knows about and consents to the possession by another -- such as the original owner -- and about its claim to the property. In such cases, however, the nonpossessory claimant always needs to worry about misbehavior by the possessor. The nonpossessory lender may accept that the owner will sell the wheat free of its interest, because permitting such sales maximizes the lender's chance of recovery.⁷³ But the nonpossessory lender would not approve of

72. This is the basic priority rule for unsecured creditors who, following a judgment, levy on assets. It is also a means of perfection for secured creditors. Once in possession, the creditor should prevail against not only other creditors, but also entities such as buyers, who should not be able to rely on their seller's possession (since the seller is not in possession). See Baird & Jackson, *supra* note 18; Kripke, Should Section 9-307(1) of the Uniform Commercial Code Apply Against a Secured Party in Possession, 33 Bus. Lawyer 153 (1977); but see *Tanbro Fabrics Corp. v. Deering Milliken, Inc.*, 39 N.Y.2d 632, 385 N.Y.S.2d 260, 350 N.E.2d 590 (1976).

73. Note that a rule that a buyer check files under its seller's name for other ownership claims would not itself undercut the conclusion in Part B, regarding the use of title recording files for fungible goods. The information in the recording files would affect only the first generation buyer, not subsequent purchasers, as is explored next. The question of

superior financial interests being created by the owner, because doing so is inconsistent with the lender's desire for security against competing lenders in the first place. Unless it is willing to assume the risks of that misbehavior, it needs to take steps to reduce it -- either by marking the property in a way that satisfies a possession-based informational rule or by monitoring the entity in possession more closely. Neither solution, however, appears particularly promising. That monitoring is likely to be difficult or costly to do, however, especially when one considers it requires ensuring that the debtor does not enter into a security contract with another. As for marking (or other forms of evidence that would be apparent upon a physical inspection), many kinds of property (such as wheat or raw materials) are not easily adaptable to such solution.⁷⁴ Recording systems for nonpossessory contingent interests respond adequately to many of these concerns, and even handle some identification problems with fungible goods. A recording to the effect that "some of the wheat in M's possession is P's" provides ample notice, when someone else is contemplating using M's wheat as security, to check first with P, who made the recording.⁷⁵ If a possession-

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whether the first generation buyer should check files for interests that would be revealed under its seller's name turns instead on matters such as those discussed in text.

74. Sign laws are a possibility, but appear to function poorly. They have all but disappeared as a means of providing legally-adequate notice in consignment cases.

75. This feature may explain why Article 9 provides a very simple "first to file" rule. See Baird, Notice Filing and the Problem of Ostensible Ownership, 12 J. Legal Studies 53 (1983).

based limited informational rule is adopted, an ancillary recording system for such nonpossessory ownership claims seems to be a sensible addition. It makes it possible for the nonpossessory prior claimants to provide adequate information to subsequent claimants, and solves a problem (discovery of information about prior ownership claims) that is much more intractable under a pure derivation system where prior claimants prevail upon proof of their claims.

We in fact observe a possession-based limited informational rule with an ancillary recording system some of the time, such as with Article 9 security interests, and a rule providing that prior claimants prevail upon proof of their claims some of the time, such as with leases and bailements when in competition with Article 9 security interests. I have criticized the latter rule before,⁷⁶ and one can see now that it is not simply on the grounds of inconsistency. Instead, it stems from the normative undesirability of a rule that does not limit the sources of relevant information as a means of establishing rights among competing nonpossessory claimants.

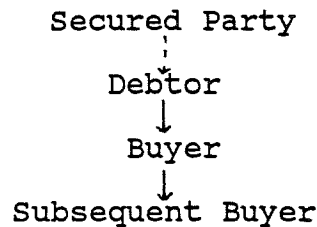
On the other hand, there is nothing inconsistent about the establishment of an ancillary recording system for nonpossessory claims of ownership, but not for possessory ownership claims. Because the files would be organized by debtor's name or location, they would serve to govern only first-generation transfers, and would not be used to record

76. See Baird & Jackson, supra note 18.

chains of title, as is the case in real estate systems. Thus, their role is much narrower. Moreover, requiring a title recording system would accomplish little even in that first-generation transfer if coupled with a rule such as section 9-307(1). Buyers in ordinary course who take possession take free of interests recorded in the files. For them, possession is the determinate of title. For cases where information about possible ownership claims is accurately conveyed by possession, the costs of duplicating that information -- in belt and suspender fashion -- relative to its benefits seems high. Moreover, absent a means of uniquely identifying the property, the file organization may have to resort back to possession for an accurate description. Exceptional cases, such as land, not only are cases where description may be more accurate than possession, but also where the value of the property is high enough that the reduction in risk caused by duplicating most of the information -- by possession and recording -- is worth its costs. This is particularly true where there is a risk of theft when the owner was not in possession -- as is the case with automobiles.

The solution of systems such as Article 9, however, has limits. The effect of these systems is to provide two sources of relevant information concerning ownership: possession and the files. Legal rules provide the rules of who has the responsibility of searching the files, or bearing the risks of such information as would there be revealed. But when files are organized by debtor name, as they almost necessarily are

with respect to many kinds of personal property, the files quickly lose their great virtue when property is transferred to another and then a competing claimant arises. For example, assume for the moment the following scenerio:



Assume, too, that Buyer is not one of those entitled to take free of Secured Party's security interest. This means that Secured Party is entitled to win in a contest vis-a-vis Buyer. But if Buyer now takes possession of the property and resells it to Subsequent Buyer, is Secured Party still able to prevail against Subsequent Buyer? The answer given by most courts is "yes," since, under the relevant statutory language, Subsequent Buyer takes free only of "security interests created by his seller" (emphasis added).⁷⁷ Subsequent Buyer's seller is Buyer, not Debtor, and the security interest was "created" by Debtor.

Under the analysis of this paper, however, this answer seems wrong. Secured Party is in the position of Prior Owner asserting against Ultimate Possessor. Viewed that way, there is no reason Secured Party (the holder of a contingent property right) should win where Prior Owner (the original title

77. U.C.C. § 9-307(1). See New England Merchants National Bank of Boston v. Auto Owners Finance Co., 355 Mass. 487, 245 N.E.2d 437 (1969).

claimant) would lose. The only factor in Secured Party's favor is that its interest is noted in public files. But Subsequent Buyer has no easy way to find it in those files, as they are organized by name, and the name Secured Party's interest is filed under is that of Debtor, not Buyer. Subsequent Buyer would first have to be able to find out about Debtor before it could accurately search the files to find Secured Party. That upstream title search, however, is precisely the kind of search that is difficult to make. For this reason, unless recording files are themselves justified for chains of title (such as is the case with real estate), their use for nonpossessory claims against a particular debtor should be limited to first-generation transfers from that debtor.

Conclusion

Rules deciding whether someone that purchases property needs to worry about the prior life of that property are basic to a system of private property. They are, indeed, sometimes so basic -- such as rules governing purchasers versus unsecured creditors of the seller -- that we do not even think of them as a species of property transfer rule. But in whatever form, and under whatever label, "transfer" rules function to govern the placement of risk as between prior and subsequent parties.

This paper has argued that all such rules should be concerned with minimizing the costs of defective transfers. Because of the relative advantages of a risk allocation rule

that places risk in the first instance on the party able to provide information -- and shifts it when that information is provided -- over a risk allocation rule that places the risk in the first instance on the party that would have to search out information, this paper has argued that the basic transfer rule should be a negotiability-type rule -- a rule that limits the sources of relevant information.

The form such a rule should take, however, depends on the attributes of the property concerned. This is particularly true when considering the question of whether the sources of relevant information should include recording files as well as possession. In that instance, land differs dramatically from money or wheat. Chains of title transfers, moreover, may vary dramatically from contingent transfers through the same person: while recording systems for wheat make little sense across generations of buyers, they may make enormous sense in sorting out competing claims against a debtor in possession of property. Finally, one must be sensitive to not only the attributes of the property, but also to the attributes of the markets property is sold on: rules governing takers from a pawnbroker should not necessarily be the same as rules governing takers from department stores. These differences stem from the distinctions in the quality of the information received from the setting in which the property is purchased and is, I have argued, a part of the question of what kinds of information are readily available enough to justify shifting the risk to the purchaser. So, too, the comparative attributes

of buyers of the assets of companies relative to the nonmanifested claimants of those companies, may justify a different rule for these nonmanifested claimants.

To say that there is a richness in outcome, is not to say that there is no advantage to a consistent approach to the inquiry. When considering rules that allocate who prevails among competing third-party claimants to property, there is no better place to start than by examining the effects of those rules on the incidence of undesirable conflicts in the first place.