# AMERICAN PRIVATE LAW WRIT LARGE? THE UNCITRAL SECURED TRANSACTIONS GUIDE

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**Abstract** This article provides a critical evaluation of the main provisions of the UNCITRAL Legislative Guide on Secured Transactions. It examines the Guide in the context of other international and national secured transactions instruments including article 9 of the United States Uniform Commercial Code. The clear objective of the Guide is to facilitate secured financing. It is very facilitating and enabling, and permits the creation of security in all sorts of situations. Security is seen as a good thing, through enhancing the availability of lower-cost credit. The paper suggests that this closeness in approach to article 9 is likely to militate against the prospects of the Guide gaining widespread international acceptance. This is the case for various interlocking reasons including the battering that American legal and financial norms have taken with the global financial crisis.

## I. INTRODUCTION

In 2009 the United Nations Commission on International Trade Law (UNCITRAL) completed its long awaited Legislative Guide on Secured Transactions.[1] This article provides a critical evaluation of the main provisions of the Guide, looking at the Guide in the context of other international and national secured transactions instruments including article 9 of the United States Uniform Commercial Code.

The clear objective of the Guide is to facilitate secured financing. The possibility of taking security rights over the assets of the debtor is thought to expand the availability as well as to reduce the cost of credit, thereby producing benefits for both creditor and debtor as well as for the overall

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[1] See the UNCITRAL website—www.uncitral.org and for background see B Foex, L Thevenoz, S Bazinas (eds), *Reforming Secured Transactions: The UNCITRAL Legislative Guide as an Inspiration* (Geneva, Schulthess, 2007); U Drobnig 'Study on Security Interests' (1977) 8 UNCITRAL Yearbook 171; UN Doc.A/CN.9/SER.A/1977; S Bazinas, 'UNCITRAL's Work in the Field of Secured Transactions' in J Norton and M Andenas (eds), Emerging Financial Markets and Secured Transactions (London, Kluwer, 1998); H Buxbaum, 'Unification of the Law Governing Secured Transactions: Progress and Prospects for Reform' (2003) 8 Uniform Law Review 321: A Garro, 'Harmonization of Personal Property Security Law: National, Regional and Global Initiatives' (2003) 8 Uniform Law Review 357; N Cohen, 'Internationalising the Law of Secured Credit: Perspectives from the US Experience' (1999) 20 U Pa J Int'l Econ L 423.

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economy.[2] The Legislative Guide is very facilitating and enabling, and permits the creation of security in all sorts of situations. Security is seen as a good thing, through enhancing the availability of lower-cost credit. This perspective colours the approach adopted in the Legislative Guide on particular issues though, at the same time, it is recognized that beneficial economic results cannot be achieved by legislation alone—the legal and administrative infrastructure in a particular jurisdiction, including mechanisms for the enforcement of security, play a crucial role. In broad terms, the Legislative Guide follows the approach outlined in article 9 of the Uniform Commercial Code. While the Guide is not an exact mirror image of article 9, it is close in tone and spirit. It is submitted that this closeness in approach is likely to militate against the prospects of the Guide gaining widespread international acceptance. As Professor Catherine Walsh has remarked law is part of culture and fears of economic or cultural imperialism may be one of the factors inspiring resistance to models from a more powerful foreign state, however neutral or substantively superior the model may appear to be relative to the one adopted.[3] 'Legal policy makers may have to be prepared to accommodate a higher level of tolerance for complexity and pluralism in laws and legal structures than traditional ideas about the logical relationship between market-oriented law and economic development contemplate'.[4]

The discussion is divided into six parts. The first part looks at the overall philosophy of the Guide and how this can be situated within a particular political and economic context. The second part considers how the ideological underpinnings are exemplified in particular provisions of the Guide including the scope of assets that may be collateralized. It also notes, in this connection, important limitations on the scope of the Guide. The third part looks at all-assets security and possible carve-outs for unsecured creditors. The fourth part considers the creation and third party effectiveness of security rights. The fifth part addresses the treatment of quasi-securities. The sixth part considers the principles for working out priorities between competing securities including the extent of the super-priority status afforded to quasi-securities. This is followed by a conclusion which attempts to summarize some of the central themes in the discussion.

[2] For alleged poverty reduction effects see B Kozolchyk, 'Secured Lending and Its Poverty Reduction Effect' (2007) 42 Texas International Law Journal 727 and see generally DW Arner, *Financial Stability, Economic Growth and the Role of Law* (CUP, New York, 2007).

[3] 'Law and Development' in *Law in transition* (EBRD, Autumn 2000) 7, 12.

[4] ibid 13. See also T Waelde and J Gunderson, 'Legislative Reform in Transition Economies: Western Transplants—A Shortcut to Social Market Economy Status' (1994) 43 ICLQ 347; J deLisle, 'Lex Americana? United States Legal Assistance, American Legal Models and Legal Change in the Post-Communist World and Beyond' (1999) 20 University of Pennsylvania Journal of International Economic Law 179.

II. OVERALL PHILOSOPHY—BACKGROUND AND CONTEXT

Security rights give the credit provider property rights, normally in the debtor's assets. The whole harmonization and modernization agenda represented by the UNCITRAL Guide appears to be driven largely by a desire to strengthen security rights and to remove restrictions on the taking of security.[5] This is because of a widespread belief that a 'liberal' secured transactions regime promotes economic growth. In many World Bank and other studies, the availability of credit has been identified as one of the key factors driving economic growth.[6] Lack of access to credit, and in particular low-cost credit, is seen as a major constraint on economic development[7] While economic and other factors may hamper access to credit, legal, regulatory and institutional frameworks are also seen significantly to contribute to this problem.[8] In many jurisdictions, the laws relating to secured transactions are fragmented and antiquated. Businesses may be unable to utilize the full value of their assets or, if they try to do so, they are straight-jacketed down a particular and restrictive path. Unlocking the value of collateral to serve as security is seen as a highly important task. UNCITRAL itself has observed:[9]

> The key to the effectiveness of secured credit is that it allows borrowers to use the value inherent in their assets as a means of reducing credit risk for the creditor. Risk is mitigated because loans secured by the property of a borrower give lenders recourse to the property in the event of non-payment. Studies have

[5] UNCITRAL defines its mission as the 'modernization and harmonization' of trade law—see www.uncitral.org/. For discussion of the thesis that so-called modernization is really a euphemism for 'adaptation of a weaker country's laws in the direction of a powerful sovereign state or international organization which has the cultural authority to define the meaning of 'modern'' see S Block-Lieb and T Halliday, 'Harmonization and Modernization in UNCITRAL's Legislative Guide on Insolvency Law' (2007) 42 Texas International Law Journal 475–481.

[6] The World Bank *Doing Business* reports conclude that the wealth of a particular country is an important indicator of the effectiveness of institutions in that country that guarantee access to credit. The 'Doing Business' reports are available at www.doingbusiness.org/. and see generally Florencio Lopez-de-Silanes, ch 1; 'Turning the key to credit: credit access and credit institutions' in F Dahan and J Simpson (eds), *Secured Transactions Reform and Access to Credit* (Edward Elgar Publishing, Cheltenham, 2008).

[7] There are also sector-specific studies that purport to demonstrate the value of particular types of collateral, and the economic impact of a stable legal environment for security creation and enforcement. One such study concerns the 2001 Cape Town Convention on International Interests in Mobile Equipment—see generally R Goode, H Kronke, and E McKendrick, *Transnational Commercial Law* (OUP, Oxford, 2007) 441: 'the international regime established by the Convention could reduce borrowing costs by several US $billion a year'.

[8] See H Fleisig, 'The economics of collateral and collateral reform' in Frederique Dahan and John Simpson (eds), *Secured Transactions Reform and Access to Credit* (Edward Elgar Publishing, Cheltenham, 2008) 81.

[9] Draft legislative guide on secured transactions—Report of the Secretary General—Background remarks A/CN.9/WG.VI/WP.2 at p 2 and see also the report by the Asian Development Bank *Secured Transactions Law Reform in Asia: Unleashing the Potential of Collateral* (Manila, Asian Development Bank, 2000). But for something of an alternative perspective see R Cranston 'Credit Security and Debt Recovery: Law's Role in Asia and the Pacific' in J Norton and M Andenas (eds), *Emerging Financial Markets and Secured Transactions* (Kluwer, London, 1998) 219.

> shown that as the risk of non-payment is reduced, the availability of credit increases and the cost of credit falls. Studies have also shown that in States where lenders perceive the risks associated with transactions to be high, the cost of credit increases as lenders require increased compensation to evaluate and assume the increased risk. In some countries, the absence of an effective secured transactions regime has resulted in the virtual elimination of credit for consumers or commercial enterprises.

But the harmonization and modernization agenda also has its critics. The law of secured finance embodies cultural attitudes and public policy choices that vary greatly among States.[10] It can be argued that national law, even national commercial law, is closely connected with a country's history and development[11] and that the replacement of national provisions by supranational ones may involve casting aside a lot of a country's historical legacy.[12] Of course, not all aspects of a country's cultural and historical baggage are necessarily worth keeping, but proponents of cultural diversity may consider that the large scale submergence of national legal regimes in a supranational order is deeply troubling. Professor Cotterrell has suggested that the dominant trend in modern comparative law scholarship has been to assume that unification or harmonization of law is a primary objective of comparative legal studies.[13] Of the various reasons given for valuing the search for similarity in law, the main one has been to facilitate trade and transnational trade but Cotterrell points out that Law is not merely valuable as a facilitator of contractual, commercial and corporate relations. Law is also a protector and shaper of traditions, an expression of shared beliefs and ultimate values, and therefore, in much less definable ways, an expression of national expectations, allegiances and emotions. Put most imprecisely and mystically, law can be seen as embodying the spirit of a nation.

In the secured credit area, more than in other areas of commercial law, sovereignty issues remain central since many of the rules governing enforcement of security rights reflect policy interests that are external to the credit relationship itself. A debtor/creditor agreement cannot regulate completely the

[10] See generally R Cotterrell, 'Comparative Law and Legal Culture' in R Zimmermann and M Reimann (eds), *The Oxford Handbook of Comparative Law* (OUP, Oxford, 2006) and see also P Legrand 'The same and the different' in P Legrand and R Munday (eds), *Comparative Legal Studies: traditions and transitions* (CUP, Cambridge, 2003) 245.

[11] Professor Zimmermann records that when the German Civil Code, the BGB, was enacted a leading German publication marked the occasion with a large front page heading 'Ein Volk, Ein Reich, Ein Recht' which translates as One People, One Empire, One Law—see 'Civil Code and Civil Law, The 'Europeanisation' of Private Law within the European Community and the Re-emergence of a European Legal Science' (1995) 1 Columbia Journal of European Law 65. See more generally H Collins 'European Private Law and Cultural Identity of States' [1995] European Review of Private Law 353.

[12] See generally S Weatherill, 'Why Object to the Harmonization of Private Law by the EC' [2004] European Review of Private Law 633.

[13] See R Cotterrell, 'Comparative Law and Legal Culture' in R Zimmermann and M Reimann (eds), *The Oxford Handbook of Comparative Law* (OUP, Oxford, 2006).

operation of the resulting security right against third parties. In the event of debtor insolvency, there is an additional layer of policy issues to be considered. The rules governing the distribution of the debtor's assets may reflect local social goals. In considering the whole harmonization and modernization agenda, the broader political element cannot be ignored. Indeed, it is ever present. Sir Otto Kahn-Freund has reminded us that anyone[14] 'contemplating the use of foreign legislation for law making in his country must ask himself: how far does this rule or institution owe its existence or its continued existence to the distribution of power in the foreign country which we do not share?'

Changes to law and legal doctrine in a particular jurisdiction often mirror however, to a greater or lesser extent, changes that have taken place in other jurisdictions.[15] The desire for change may stem from societal developments or from a desire to promote the social and economic infrastructure of a particular country.[16] Turkey has been highlighted as an example of a country that set out on a path of modernity as a result of top-down political leadership and then consciously borrowed laws and legal institutions from other jurisdictions that were considered to offer a superior product.[17] Changes may also to a greater extent be coerced. In decades and centuries past, England exported the common law to its overseas territories and possessions, and generally these former colonies persisted with the common law as they gained political independence and cut away the apron strings of the Mother Country in other respects. The French Napoleonic Code found its way to Spain as a result of military conquest and from there it passed to the Hispanic world of Latin America.[18] In recent times, coercion has come in more subtle forms perhaps through

[14] O Kahn-Freund 'On Uses and Misuses of Comparative Law' (1974) 37 MLR 1, 12.

[15] On legal transplants see, for example, A Watson, *Legal Transplants* (Edinburgh, Scottish Academic Press, 1994) and for a range of somewhat contrary views see P Legrand, 'On the Unbearable Localness of the Law: Academic Fallacies and Unseasonable Observations' [2002] European Review of Private Law 61; 'The Impossibility of Legal Transplants' (2003) 4 Maastricht Journal 111; 'Antivonbar' (2006) 1 JCL 1; G Teubner, 'Legal Irritants: Good Faith in British Law or How Unifying Law Ends Up in New Divergences' (1998) 61 MLR 11. See also B Markesinis, 'Why a Code is Not the Best Way to Advance the Cause of European Unity' [1997] European Review of Private Law 519.

[16] See D Berkowitz, K Pistor and J-F Richard, 'The Transplant Effect' (2003) 51 AJCL 164, where it was stated that 'newly designed model laws for secured transactions marketed the value of Western law to their counterparts in the East, backing their campaign to transplant their home legal system with financial aid promises and/or the prospect of joining the European Union.'

[17] See E Orucu, *Critical Comparative Law: Considering Paradoxes for Legal Systems in Transition* (Kluwer, Deventer, 1999) 59, 81: 'What is regarded today as the theory of 'competing legal systems', albeit used mainly in the rhetoric of 'law and economics' analysis, was the basis of the reception of laws that formed the Turkish legal system in the years 1924–1930. The various Codes were chosen from what were seen to be 'the best' in their field for various reasons. No single legal system served as the model.'

[18] See generally N de la Pena 'Challenges in implementing secured transactions reform in Latin America' in F Dahan and J Simpson (eds), *Secured Transactions Reform and Access to Credit* (Edward Elgar Publishing, Cheltenham, 2008) 236.

conditions attached to international loans to developing countries from the World Bank and International Monetary Fund (IMF).[19]

The US strongly influences, if not entirely controls, the workings of these international financial institutions, in particular the IMF. World Bank and IMF conditionality may require economic austerity measures, and also changes to the economic structures of the country concerned, including privatization and restructuring of State-owned enterprises and strengthening the role of the private sector. The conditions may also require changes to corporate law, as well as the enactment of measures to enhance the availability of credit by means of a modern secured transactions regime. Prescriptions in this regard are most unlikely to be expressed as crudely as 'Enact Article 9 of the American Uniform Commercial Code'. Instead, they are more likely to call for progress and advancement in line with best international practice.

As one US commentator remarks 'efforts to export U.S. legal models are more likely to succeed if they eschew detailed, distinctively US-derived prescriptions in favour of presenting advice or exemplars in terms of more 'general' standards, 'international' norms, 'universal' principles . . . '[20] Best international practice is considered to be represented by the work of organizations such as UNCITRAL.[21] The US, by virtue of its economic power, and the associated prestige of its economic and legal models, heavily influences the work of UNCITRAL and analogous bodies.[22] Critical commentators have therefore spoken of a process of imperialism and imperialist law.

Professor Ugo Mattei has suggested:[23]

> Imperial law is produced, in the interest of international capital, by a variety of both public and private institutions, all sharing a gap in legitimacy, sometimes called the 'democratic deficit'. Imperial law is shaped by a spectacular process

[19] For critiques of IMF and World Bank 'conditionality' see J Stiglitz, *Globalization and its Discontents* (Penguin, New York, 2002) and *Making Globalization Work* (Penguin, New York, 2007).

[20] See J deLisle, 'Lex Americana? United States Legal Assistance, American Legal Models and Legal Change in the Post-Communist World and Beyond' (1999) 20 University of Pennsylvania Journal of International Economic Law 179 at 269 and see also his comment at p 202 about the US government promoting the indirect export of US models through multilateral organisations that shape international standards.

[21] See generally K Pistor, 'The Standardization of Law and Its Effect on Developing Economies' (2002) 50 AJCL 97.

[22] For a discussion of UNCITRAL working methods referring to earlier controversies see 'UNCITRAL rules of procedure and methods of work: Note by the Secretariat' A/CN.9/676 (31 March 2009). The controversies covered the role of 'experts', the status of non-State actors, primarily American-based organisations, and the dominance of the English language in UNCITRAL's deliberations.

[23] See U Mattei, 'A Theory of Imperial Law: A Study on US Hegemony and the Latin Resistance' (2002) 10 Indiana. Journal of Global Legal Studies 383 but for a somewhat different perspective see U Mattei, 'Efficiency in Legal Transplants: An Essay in Comparative Law and Economics' (1994) 14 International Review of Law and Economics 3. See also J Gardner, *Legal Imperialism, American Lawyers and Foreign Aid in Latin America* (University of Wisconsin Press, Madison, 1980).

> of exaggeration, aimed at building consent for the purpose of hegemonic domination. Imperial law subordinates local legal arrangements worldwide. . . . Predatory economic globalization is the vehicle, the all-mighty ally, and the beneficiary of imperial law.

The French economist Michel Albert has spoken of the irresistible force of US legal expansionism.[24] US legal paradigms gain a competitive advantage as a result of the sway exercised by the United States from the political and ideological perspective. Alternative approaches are overwhelmed by the political and cultural influences of the American competitor. Albert explains the spread of American influences using notions of seductiveness and appeal. In his view, the intrinsic characteristics of the neo-American model exalt the success of risk-taking, gambling and 'glittery' behaviour.

In the realm of literary and cultural discourse, notions of imperialism and American hegemony have been advanced by Edward Said.[25] He talks about American culture's phenomenally incorporative capacity and a system of pressures and constraints which induces other States to follow the essentially imperial identity and direction of US norms.[26] In his view, the pressures are subtle, and generally indirect.[27] Said makes the point that:[28]

> American attitudes to American greatness, to hierarchies of race, to the perils of other revolutions (the American revolution being considered unique and somehow unrepeatable anywhere else in the world) have remained constant, have dictated, have obscured the realities of empire, while apologists for overseas American interests have insisted on American innocence, doing good, fighting for freedom.

He also links his theory of imperialism with a law-making creed that suggests it is the goal of US foreign policy to bring about a world increasingly subject to the rule of law, as defined in US terms.

In the secured credit context, the US article 9 has heavily influenced the Organisation of American States (OAS) Model Law on Secured Transactions.[29] The relative lack of success of this Model Law has been explained on the basis of a 'fundamental and longstanding suspicion that transplanting 'modern law', sold under the label of establishing an ideal environment for business and economic growth and thus a push for development, will only

[24] M Albert, *Capitalism Against Capitalism: How America's Obsession with Individual Achievement and Short-term Profit has Led it to the Brink of Economic Collapse* (Whurr, London, 1993); J Braithwaite and P Drahos, *Global Business Regulation* (CUP, Cambridge, 2000) 591.

[25] E Said, *Culture and Imperialism* (London, Chatto & Windus, 1993).

[26] ibid 392. [27] ibid 401. [28] ibid 7.

[29] The Model Law can be found on the OAS website—www.oas.org/. See generally B Kozolchyk and J Wilson, 'The Organisation of American States: The New Model Inter-American Law on Secured Transactions' (2002) 7 Uniform Law Review 69; J Wilson 'Secured Financing in Latin America: Current Law and the Model Inter-American Law on Secured Transactions' (2000) 33 Uniform Commercial Code Law Journal 43. Valuable preliminary material can be found at (2001) 18 Arizona Journal of International and Comparative Law.

benefit foreign multinationals doing profitable business in Latin America.'[30] This analysis refers to fears about the role of the creditor 'especially because they are often based on unfortunate experiences' thereby producing a lack of trust and mutual understanding. The strong socio-economic disparity between primarily creditor countries such as the US, directly and indirectly, exporting legal models and the mainly debtor countries who are recipients of these legal models can also be highlighted in this connection.[31]

It is hardly surprising however that US government agencies, as well as US private interests, should act to defend what they consider to be US business interests. An American-based organization, the Commercial Finance Association, played a significant role in the formulation and detailed drafting of the UNCITRAL Guide. Particular provisions of the Guide reflect particular provisions of the US article 9. To the extent that particular States adopt the Guide, then this creates an environment that is comfortable and familiar for US business interests.[32] In simple terms, what they consider to be good for the US they also consider of benefit for the world.[33] Others may disagree in the assessment of what is good both for the US and for the world.

To sum up this section, formal law like secured credit law is situated within a broader set of relationships that may appropriately be termed as 'legal culture'. This legal culture reflects a country's history and development; the distribution of political power and the broader constellation of special interest groups within a particular country. Legal culture is not impervious to change but change is often seen to be most effective if it takes in a path dependent fashion making use existing legal concepts within a particular country and of indigenous legal institutions.[34] Coerced changes to national legal culture have taken place in the place through political or military conquest. But in the modern world of independent, albeit interdependent, nation states, the appearance of coercion is likely to engender opposition on the grounds of

[30] See D Fernandez Arroyo and J Kleinheisterkamp, 'Inter-American Model Law on Secured Transactions' (2002) 4 Yearbook of Private International Law 251–252.

[31] ibid 252.

[32] The Commercial Finance Association (CFA) is one of the non-State actors whose role in UNCITRAL's deliberations has caused controversy—see 'UNCITRAL rules of procedure and methods of work: Note by the Secretariat' A/CN.9/676 (31 March 2009). See the statement on the CFA website —www.cfa.com: 'The Commercial Finance Association has been actively involved in the drafting of the legislative guide on secured transactions since the process began in 2002 and continues to play a key role in its development' (date last visited 28.06.2011).

[33] See the following statement by the CFA General Counsel—http://www.un.org/News/Press/docs/2004/eco56.doc.htm 'This guide is of great interest to my trade association. . . . CFA members, which include large United States banks but also smaller lenders, often make loans to companies located in other countries supported by collateral. The guide will help countries to modernize their laws, so that lenders who are interested in making loans in other countries will know with certainty and predictability what their rights and obligations are.'

[34] See also H Spamann, 'Contemporary Legal Transplants—Legal Families and the Diffusion of (Corporate) Law' [2009] Brigham Young University Law Review 1813; J Armour, S Deakin, P Lele, and M Siems, 'How Do Legal Rules Evolve? Evidence from a Cross-Country Comparison of Shareholder, Creditor and Worker Protection' (2009) 57 AJCL 579.

interference with national sovereignty. Countries wanting to 'export' their own national legal orders are likely to encounter less opposition if they avoid the appearance of coercion.

John Braithwaite and Peter Drahos, in their seminal book *Global Business Regulation*,[35] have spoken of how foreign legal models are adopted by countries 'when they appeal to identities that we hold dear. An identity that is particularly crucial in this regard is that of being successful, modern, civilised, advanced.' If a country adopts a text suggested by UNCITRAL this sends out a powerful signal that the country is modern and advanced. The flip side of the coin is that a country, such as the US, that may wish to have its national legal models used overseas, is more likely to achieve success indirectly by having its models adopted by UNCITRAL and then replicated elsewhere. The extent of the linkages between the UNCITRAL Guide and article 9 will now be explored.

## III. SCOPE OF THE GUIDE

The Secured Transactions Guide is a detailed document and the details were increased in 2010 with the addition of a separate annex that applies to security over intellectual property rights.[36] Subject to certain limitations, the Guide is designed to be comprehensive in its reach, both in terms of the range of persons to whom it may apply and also in terms of the assets that may serve as security. Essentially the Guide is an exhortation to States to be as comprehensive as possible in the process of framing their secured credit law and not to leave inadvertent gaps in coverage.

The first recommendation in the Guide sets out this key objective stating that the law should be designed: (a) To promote low-cost credit by enhancing the availability of secured credit; (b) To allow debtors to use the full value inherent in their assets to support credit; (c) To enable parties to obtain security rights in a simple and efficient manner; (d) To provide for equal treatment of diverse sources of credit and of diverse forms of secured transactions; (e) To validate non-possessory security rights in all types of asset; (f) To enhance certainty and transparency by providing for registration of a notice of a security right in a general security rights registry; (g) To establish clear and predictable priority rules; (h) To facilitate efficient enforcement of a creditor's rights; (i) To allow parties maximum flexibility to negotiate the terms of their security agreement; (j) To balance the interests of all affected persons; and (k) To harmonize secured transactions laws, including conflict-of-laws rules relating to secured transactions.

[35] J Braithwaite and P Drahos, *Global Business Regulation* (CUP, Cambridge, 2000) 591.

[36] See on the UNCITRAL website—www.uncitral.org—'Supplement on Security Rights in Intellectual Property' the Final Draft of which was pre-released on 15th July 2010.

The Guide is broad and sweeping in its remit insofar as the kinds of assets that may be 'collateralized' (used as security) is concerned. All types of property, both property presently owned by the debtor and property that may be acquired by the debtor in the future, can be the subject of security.[37] Moreover, a security right in assets extends to the proceeds, unless otherwise agreed.[38] An important aspect of the Secured Transactions Guide is to facilitate receivables financing and security may be created over future, fluctuating and conditional obligations owed to the debtor.[39] In addition, security rights may be created in bank accounts despite any contrary agreement between the grantor of the security interest and the depositary bank but, by virtue of the security agreement, no duties are thereby imposed on the depositary bank.

The Guide applies essentially to contractually created property rights. Security rights that arise by operation of law rather than from the agreement of the parties are outside its sphere of operation.[40] There is also a statement in the Guide to the effect that the law should apply equally to legal and natural persons i.e. to both companies and individuals. The extension envisaged by the Guide to persons that do not necessarily transact business through the corporate form carries with it however the caveat that the scope of consumer protection legislation should not be affected.[41]

At first, the reason for recommending the application to non business-oriented transactions seems obvious—it complicates the law if differing requirements apply to the creation and recognition of security interests depending on whether the security giver acts for business purposes, or as a consumer. The difficulty with the recommendation however, is that a particular jurisdiction may not have a very developed consumer protection regime to offset against the risks in the grant of security. Consumers may grant security without a full appreciation of the consequences in terms of the control that the creditor may exercise over their assets. Depending also on the bankruptcy laws in the jurisdiction, debtors may find themselves losing assets that are essential to their livelihood or sense of personality e.g. a family home. If there are no developed consumer protection principles in play, a more primitive form of protection is simply to deny the possibility of individuals creating security over certain types of property. A blanket ban of this nature is undoubtedly a blunt tool and may restrict the availability of credit. On the other hand, it provides consumers with a degree of respite from certain types of creditor enforcement action and in a world where 'consumer over-indebtedness' is seen as a pressing social problem, limiting consumer credit availability may be no bad thing.

[37] See Recommendation 2(a).

[38] Recommendation 19.

[39] See Recommendation 2(c).

[40] See Recommendation 2 stating that the law should apply to 'all rights in movable assets created by agreement that secure payment or other performance of an obligation, regardless of the form of the transaction, the type of the movable asset, the status of the grantor or secured creditor or the nature of the secured obligation.'

[41] Recommendation 2(b).

### A. Limitations on Scope

The Guide does not apply to security rights in 'securities' (in other words, investment intangible such as shares or bonds). This is a very significant omission and stems from a desire to avoid overlap with the work of other international organizations, in particular the Hague Conference on Private International Law.[42] The law relating to intermediated securities, including security rights in the same, was considered to fall within the domain of the Hague Conference and UNCITRAL did not wish to duplicate its efforts.

The Secured Transactions Guide also does not apply to immovable property with the exception of chattels that are attached to land and become so-called 'fixtures'.[43] The reasons for this exclusion appear pragmatic. Real property is often considered to be an area where sovereignty issues are particularly important. National governments, or even provincial or regional governments, guard jealously their legislative competence in this field. Article 9 applies only to personal property and against this backdrop it appeared logical to have a similar limitation on the sphere of application of the Guide. On the other hand, if the overall philosophy of the Guide is to facilitate the taking of security with a view to promoting the availability of low cost credit, should this same philosophy not permeate the law relating to security over real estate? Certainly, the European Bank for Reconstruction and Development (EBRD) seems to think so, for its Guide to Mortgage Law applicable to real estate is virtually identical in terms of substantive content to its Secured Transactions guidelines applicable to personal property.[44]

## IV. ALL-ASSETS SECURITY AND POSSIBLE 'CARVE-OUTS'

Under the Guide it is perfectly permissible to create 'all-assets security' i.e. the equivalent of a floating security or universal business security over the entirety of the business operations of an enterprise.[45] In many jurisdictions, it is perhaps only a slight exaggeration to speak about a wilderness of single instances when talking about the taking of security. For instance, in one comparative study it is suggested that[46] 'none of the jurisdictions of the EU Member States has developed a comprehensive, functional approach to

[42] On which see www.hcch.net

[43] Recommendation 4 and 5. There are other exceptions in Recommendation 4.

[44] See *Mortgages in Transition Economies—the Legal Framework for Mortgages and Mortgage Securities* (2007) available at www.ebrd.com/pubs/legal/mit.htm and for discussion see J Simpson and F Dahan 'Mortgages in transition economies' in F Dahan and J Simpson (eds), *Secured Transactions Reform and Access to Credit* (Edward Elgar Publishing, Cheltenham, 2008) 172.

[45] Recommendation 17 providing that a security interest may encumber all assets of the debtor.

[46] See E-M Kieninger (ed), *Security Rights in Movable Property in European Private Law* (CUP, Cambridge, 2004) 648. See also U Drobnig, 'Present and Future of Real and Personal Security' [2003] European Review of Private Law 623; C Bourbon-Seclet, 'Cross-border security interests in moveable property' [2005] JIBLR 419.

security rights in movables. Instead, there exists in each jurisdiction a wide range of security devices, which differ from each other with respect to the character of the secured debt, the collateral that may be used, and the legal concept on which the security rights are based: title-based security rights such as retention of title, security transfer of ownership or leasing exist side by side with the possessory pledge and various devices that are based on the idea of the pledge such as non-possessory registered charges in individualized property or entities of assets.' Often we have sector specific legislation that permits security in certain situations. This legislation may have been passed at the prompting of important political constituencies or pressure groups and it may be difficult to explain on more principled grounds. Interest groups who find their needs satisfied have no particular need to urge the enactment of more universal security instruments.

There are at least two arguments against the recognition of universal security rights. The first is the proposition that a debtor should have a cushion or margin of 'free' assets that are available to satisfy claims by unsecured creditors. The second is the proposition that certain assets can never serve as the subject of security. For instance, many non-lawyers may find baffling the concept that a debtor can create security over assets that it does not yet own. On the other hand, article 9 freely permits the creation of such security and the English common law does likewise through the medium of the floating charge.[47]

The arguments against the recognition of universal security rights have also been made in the US. While article 9 has no truck with the arguments, this outcome represents the result of a long process of historical development.[48] Pre-article 9 United States law did not have any place for a universal security right.[49] This conclusion comes through in a leading case—*Zartman v First National Bank of Waterloo*[50] where the security, in express terms, covered after-acquired property but the court, nevertheless, denied effectiveness to the provision. It was said that a borrower could not create security over property that it did not yet own and secondly, the borrower's freedom of disposition sanctioned by the security meant that the security was fraudulent as against other creditors.

[47] See generally on the floating charge R Nolan, 'Property in a Fund of Assets' (2004) LQR 120: J Farrar, 'World Economic Stagnation Puts the Floating Charge on Trial' (1980) 1 Co Law 83; E Ferran 'Floating Charges—the Nature of the Security' [1988] CLJ 213; S Worthington 'Floating Charges—an Alternative Theory' [1994] CLJ 81.

[48] One of the architects of art 9, Grant Gilmore, has said in 'Security Law, formalism and Article 9' (1968) 47 Nebraska LR 659 at 672: 'Article 9 draftsmen argued from the premise that, under existing security law, a lender could take an enforceable interest in all of a debtor's present and future personal property to the conclusion that the new statute should provide for the accomplishment of this result in the simplest possible fashion.'

[49] Professor Grant Gilmore, has argued that if floating charges had been accepted in the US, then some of the pressure for change which brought about art 9 would have been absent—see *Security Interests in Personal Property* (Little Brown, Boston, 1965) 359–361.

[50] (1907) 189 NY 267.

This line of authority was confirmed at the highest judicial levels in the United States.[51] Over time however, a sophisticated avoidance industry developed which had the effect of permitting large scale receivables and other financing.[52] This resulted in most types of personal property, including both tangible and intangible property, becoming available to serve as security. Like the current situation in Europe, this was often the result of legislative initiatives mounted by interest groups in the individual States.[53] Article 9 rationalized and systematized this state of affairs. The relevant terminology was simplified with the effective abolition of the multiplicity of separate security devices and their replacement by the concept of a single security interest that could exist in all a grantor's property. Article 9 implements the idea that there is no necessary incompatibility between the existence of a security interest in property and the debtor's freedom to dispose of the secured assets in the ordinary course of business. So, amongst other things, article 9 brings together a multiplicity of separate security devices as well as permitting universal security. The Secured Transactions Guide does likewise but a number of jurisdictions, including France, continue with an incremental approach adding to the number of security devices and leaving it to the market place to sort out those that will be made use of in practice.[54]

### *A. Carve-outs for Unsecured Creditors*

The validation of 'all-assets security' is one of the most significant features of the Guide.[55] This reflects an article 9 approach but one might also argue that it merely legislates for the equivalent of an English-style floating charge, which has functional analogues in other countries. These other countries however, including the UK, generally carve out a proportion of all-assets security for the benefit of unsecured creditors.[56]

Under English law, a certain percentage of floating charge realizations are set aside for the benefit of unsecured creditors. The percentage is calculated by secondary legislation on a sliding scale but subject to a global ceiling

[51] *Benedict v Ratner* (1925) 268 US 353.

[52] See generally G Gilmore, *Security Interests in Personal Property* (Little Brown, Boston, 1965) vol 1, chs 1–8.

[53] Art 9 has been described as 'an anthological collection of the most celebrated security law controversies of the preceding forty years' in Grant Gilmore 'Security Law, formalism and Article 9' (1968) 47 Nebraska LR 671.

[54] See Marie-Elodie Ancel, 'Recent reform in France: the Renaissance of a Civilian Collateral Regime?' in F Dahan and J Simpson (eds), *Secured Transactions Reform and Access to Credit* (Edward Elgar Publishing, Cheltenham, 2008) 259.

[55] See Recommendation 17 providing that a security right may encumber all assets of a grantor.

[56] See what is now s 176A Insolvency Act 1986 and the Insolvency Act 1986 (Prescribed Part) Order 2003 SI 2003/2097 which fixes the proportion of collateral set aside. See generally G McCormack, *Secured Credit under English and American Law* (CUP, Cambridge, 2004) 46–48 and 108–112.

of £600,000.[57] Moreover, the carve-out is inapplicable if the company's net property is less than a prescribed minimum and where the insolvency representative considers that the cost of making a distribution to unsecured creditors would be disproportionate to the benefits. Defenders of the English provision suggest[58] it constitutes a fair concession to unsecured creditors without destroying the notion of security in its entirety. It is admittedly a blunt instrument since it benefits all unsecured creditors and not merely non-adjusting creditors i.e. those who are unable to adjust the explicit or implicit lending terms to take into account the fact that the borrower has granted security.[59] The fixed ceiling however, allows attendant risks to be calculated.

The Guide does not recommend however, this approach of setting aside a proportion of security, or all-assets security, for the benefit of unsecured creditors. This clearly indicates a preference for the US approach where the idea of 'carve outs' for the benefit of unsecured creditors failed to gain acceptance in the article 9 revision process. Carve-out advocates pointed out that while the US Bankruptcy Code recognized security rights to their fullest, nevertheless, there were a number of rules, doctrines and practices that effectively operated to erode the priority of secured claims in bankruptcy.[60] For example, Chapter 11, which governs proceedings for the restructuring of ailing businesses, imposes restrictions on the enforcement of security interests and during this time the value of the collateral may fall.[61] State legislatures also had power to sanction the creation of statutory liens with priority over the claims of secured creditors and this power was increasingly exercised.[62] Advocates of a carve-out were sceptical at suggestions that their proposals would lead to a diminution in credit. They pointed out that a partial priority regime already obtained to a degree and that, in the final analysis, matters might turn on the extent of the carve-out.

Carve-out critics suggested however, that it would be factored into the borrowing base and secured creditors would extend less credit as a result. This would have a particularly adverse impact on marginal businesses resulting in

[57] See Insolvency Act 1986 (Prescribed Part) Order 2003 SI 2003/2097.

[58] D Milman and D Mond, *Security and Corporate Rescue* (Hodgsons, Manchester, 1999) 52. The 1982 Department of Trade and Industry Committee on Insolvency Law and Practice (the 'Cork Committee') which recommended a carve-out for unsecured creditors specifically rejected the proposition that any such diminution of credit would occur (Cmnd 8558 at para 1535).

[59] See V Finch, 'Security, Insolvency and Risk: Who Pays the Price?' (1999) 62 MLR 633 at 652.

[60] See L Bebchuk and J Fried, (1996) 105 Yale LJ 857; (1997) 82 Cornell L Rev 1279; E Warren 'Making Policy with Imperfect Information: The Article 9 Full Priority Debates' (1997) 82 Cornell L Rev 1373 at 1377.

[61] See D Baird and T Jackson, 'Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy' (1984) 51 U Ch L Rev 97, 112–114.

[62] See K Klee, 'Barbarians at the Trough: Riposte in Defense of the Warren Carve-Out Proposal' (1997) 82 Cornell L Rev 1474–1475.

more bankruptcies.[63] The lawyers responsible for the drafting of article 9, Professors Harris and Mooney,[64] took on board these concerns. In their view, even a partial subordination of secured credit would cause many potential lenders to refuse to advance loans. They urged caution since the social and economic benefits of priority rights were indirect.[65] In their assessment, the denial of full priority might detract from the capacity of entrepreneurs to attract investors although it was impossible to identify particular companies that never came into existence as the result of a particular change in priority rights. Unpaid workers were easier to spot than workers who were never able to find a job because a particular project did not receive start-up financing.[66] It was suggested that while secured creditors might lose profits under a carve-out regime, the biggest losers would be debtors, who would receive less funding, and potential contracting parties with such debtors.[67]

The US Attorney General's Office concurred with this general assessment stating that the carve-out proposal:[68] 'could have detrimental effects on many highly leveraged sectors of the economy, such as small businesses and agriculture.' Political realities meant that carve out proposals fell by the wayside in the United States. But the political realities are different in the rest of the world and what plays well in Peoria, Illinois may not necessarily play well in Beijing or St Petersburg or Poitiers.[69]

## V. CREATION AND THIRD PARTY EFFECTIVENESS OF SECURITY RIGHTS

The Guide provides that a security right is created by an agreement concluded between the grantor and secured creditor. The relevant agreement may be oral

[63] See Klee ibid 1472: 'For example, where the debtor is in a risky start-up venture or on the verge of insolvency, the risk to unsecured creditors might be so great that instead of seeking a high interest to compensate for increased risk, they simply will not extend new credit. The resulting liquidity crisis will force the debtor into bankruptcy, where unsecured creditors will recover less than if the debtor had not filed.'

[64] See SL Harris and CW Mooney, 'A Property-Based Theory of Security Interests: Taking Debtors- Choices Seriously' (1994) 80 Va L Rev 2021; 'Measuring the Social Costs and Benefits and Identifying the Victims of Subordinating Security Interests in Bankruptcy' (1997) 82 Cornell L Rev 1349 and see also SL Schwarcz, 'The Easy Case for the Priority of Secured Claims in Bankruptcy' (1997) 47 Duke LJ 425.

[65] For a strong riposte to this see E Warren (1997) 82 Cornell L Rev 1373 n 62: 'Harris and Mooney state: 'For example, data may confirm that small businesses (and, accordingly, minority-owned businesses) would disproportionately comprise that group [that would face constriction of credit]' . . . their support? Anecdotal evidence. This argument can be rephrased to say that banks want full priority to help their minority friends. Some critics may demand more than anecdotes to support this proposition.'

[66] See D Baird, 'The Importance of Priority' (1997) 82 Cornell L Rev 1421.

[67] SL Harris and CW Mooney, 'Measuring the Social Costs and Benefits and Identifying the Victims of Subordinating Security Interests in Bankruptcy' (1997) 82 Cornell L Rev 1357.

[68] (1997) 82 Cornell L Rev 1349 n 49.

[69] Perhaps one can add that playing well in Peoria—the epitome of heartlands America—is often considered to be barometer of acceptability and commercial success for the Hollywood movie industry.

if it is accompanied by dispossession of the grantor pursuant to the agreement.[70] Otherwise however it must be in writing or evidenced in writing. The Guide is however, medium neutral and the writing requirement can be met by something that serves as its electronic equivalent.[71] The security agreement must identify the parties and also reasonably describe both the secured obligation and the assets to be encumbered by the security interest.[72] The Guide cautions however against overly exactly description requirements and suggests that a generic description of the secured obligation and the encumbered assets is sufficient. A security agreement may relate to property that is not yet in existence, or not yet owned by the grantor.[73] In those circumstances, the security right is deemed to have been created when the grantor acquires rights in the asset, or the power to encumber the asset.[74] It is also the case that a security right may be effective as between the grantor and the secured creditor even if it is not effective against third parties.[75]

As far as receivables financing is concerned, the Guide tracks the provisions of the United Nations Convention on the Assignment of Receivables in International Trade.[76] Bulk assignments, for example, are permissible and so too the assignment of future receivables and parts of, and undivided interests in, receivables.[77] An assignment is declared to be effective despite a non-assignment clause in the contract creating the receivable.[78] With respect to the secured party, the Guide tries to limit liability for breach of a non-assignment clause. A third party who took an assignment notwithstanding the non-assignment clause is not liable say for inducing a breach of contract on the 'sole ground that it had knowledge of the agreement'.[79] It should be noted also that knowledge, in the context of the Guide, means 'actual knowledge' and not 'constructive knowledge' i.e. the knowledge that one would have acquired had one deigned to make reasonable inquiries.[80]

### *A. Security rights and publicity*

Under the Secured Transactions Guide, third party effectiveness of security rights generally requires registration of the security in a general security rights register.[81] Of itself, this notion is pretty controversial in that many jurisdictions, mostly notably Germany, are committed to the concept of

[70] Recommendation 15.
[71] See Recommendation 11.
[72] Recommendation 14.
[73] See Recommendation 17.
[74] Recommendation 13.
[75] Recommendation 30.
[76] See http//:www.uncitral.org/uncitral/ed/uncitral_texts/payments/2001Convention_receivables.html
[77] Recommendation 23.
[78] Recommendation 24. Certain common contracts where non-assignment clauses are often found are however, excluded from the ban—see Recommendation 24(c).
[79] Recommendation 24(b). Nothing in the recommendation affects any obligation or liability of the assignor for breach of the non-assignment agreement, but the other party to such agreement may not avoid the original contract or the assignment contract on the sole ground of that breach.
[80] See Legislative Guide 'Terminology'.
[81] See Recommendations 32–35.

registrationless regimes of personal property security. Even someone not ill-disposed towards the US article 9 approach like Professor Ulrich Drobnig has downplayed the importance in this connection of the publicity principle asking 'is the complicated technical system really necessary if all the information it offers is a notice that there may exist a security interest, so that intending creditors are put on notice but have to turn to the debtor in order to verify the true state of affairs. Is not nearly the same effect achieved in countries without a registration system where the courts proceed from a general presumption that business people must know that any major piece of equipment is bought on credit?[82] On the other hand, one might argue that a registrationless regime of personal property security only works well in a relatively closed credit market like Germany where there are a number of powerful players with a quasi-monopolistic control on credit.[83] In a closed credit market, leading banks have detailed information on the financial behaviour and credit needs of businesses. This is much less likely in a global credit market with financial institutions operating across national frontiers. Potential lenders simply do not have the business background and information on potential borrowers. If one does not have information that is publicly available through a filing system, then financial institutions who are trying to enter the credit market are also effectively excluded. They do not have the fund of built-up knowledge and experience and have to rely more on credit reference agencies who may operate less transparently than a public filing system. Advocates of the American approach argue that it is more facilitative of entrepreneurial endeavour than the German one i.e. it opens the availability of credit to persons who were previously not on first name terms with bankers.[84]

[82] See U Drobnig, 'Present and Future of Real and Personal Security' (2003) European Review of Private Law 660.

[83] For a somewhat sarcastic panegyric to the American system see J White 'Reforming Article 9 Priorities in Light of Old Ignorance and New Filing Rules' (1995) 79 Minnesota Law Review 529 at p. 530: 'The filing system is an integral part of the most sophisticated secured lending system known to mankind. Only by an effective filing system can a secured lender know of other lenders and only by it can later secured lenders and unsecured lenders be encouraged to lend. Without such a system, lenders would grow wary, commerce would be hobbled, and the manifold commercial ends that are met by commercial lenders would be stunted, rendered more costly, or stymied altogether . . . I can see generations of law students writing this down and repeating this incantation in negotiations, in court, and elsewhere. This view even extends to Americans abroad who approach the English, Dutch and Germans with an air of superiority, asserting the superiority of our filing system and belittling the European efforts to put together a filing system worthy of the name.' You may delete this quotation if you wish.

[84] See A Dunham 'Inventory and Accounts Receivable Financing' (1949) 62 Harvard Law Review 588 at 611: 'One banker though the questions [about sources of debtor information] 'silly' because his bank did not make a loan unless the borrower 'was properly introduced' and therefore a fraudulent borrower was an impossibility.'

### B. Methods of Achieving Third Party Effectiveness

Article 9 uses the expression 'perfection' as a general synonym for third party effectiveness of security rights. Filing is the standard method of perfecting an article 9 security interest though other methods of perfection are permissible in certain circumstances including possession where physical possession of the property used as security is handed over to the security taker. Of course the transfer of physical possession is not practicable in most situations. The assets may be intangible, or the debtor may need them for the carrying on of its business. In deference to the needs and wants of the capital markets, the revised article 9 makes use of a notion of perfection by control.[85] In the case of certain types of financial collateral, including dematerialized or immobilized shares, the security taker can perfect the security though taking control of it. An example of control is where a securities intermediary agrees to respond to instructions from the secured party rather than from the debtor.

In its approach to the third party effectiveness of security rights, the Guide follows the basic tenor of article 9. Filing or registration is given pride of place notwithstanding the general lack of appeal of this construct to civil law jurisdictions. The Guide also contains asset-specific recommendations along the lines of article 9 that validate alternative methods of achieving third party effectiveness of security rights in relation to particular types of collateral.[86]

In the Guide moreover, it is the US concept of notice filing that finds favour, rather than the concept of transaction filing found in English law, and also more familiar to other jurisdictions.[87] Under the notice filing regime, the security agreement itself is not filed but a so-called 'financing statement' providing limited information.[88] The filed notice merely indicates that a person may have a security interest in the collateral concerned but further inquiry by a searcher from the potential creditor and/or debtor will be necessary to ascertain the true state of affairs. Notice filing is party specific rather than transaction specific. The information filed is an invitation to further inquiry

[85] For the definition of control see art 9-106. 'Control' is recognised as a superior method of perfection over financial collateral than filing. Art 9-328 lays down that a secured party who is perfected by control will have priority over an earlier secured party who has perfected its security interest by filing.

[86] Recommendations 48–53.

[87] See Recommendations 54 and 57 of the Legislative Guide. For a succinct explanation of the distinction between notice filing and transaction filing see the Scottish Law Commission discussion paper *Registration of Rights in Security by Companies* (TSO, Edinburgh, October 2002) 8.

[88] According to the Scottish Law Commission, the only civil law jurisdictions to have introduced notice filing are Quebec and Louisiana; see Discussion paper *Registration of Rights in Security by Companies* (Edinburgh, October 2002) 1.28 and see further T Harrell, 'A Guide to the Provisions of Article 9 of Louisiana's Commercial Code' (1990) Loyola Law Review 711; M Bridge, R Macdonald, R Simmonds and C Walsh, 'Formalism, Functionalism and Understanding the Law of Secured Transactions' (1999) 44 McGill LJ 567.

rather than being a synopsis of the transaction. The notice may be filed either before, or after, a particular transaction and a single filing is effective to cover multiple transactions.[89]

Advance registration allows a secured party to mark out its intentions in advance of the conclusion of the agreement and while negotiations between the parties are continuing. It is claimed that this is more convenient and flexible than 'after the event' transaction filing.[90] The parties are given more time to attend to registration rather than having to do it post-transaction when there may be a lot of other formalities to deal with. Moreover, the facility whereby a single filing covers multiple transactions renders more concrete the possibility of extending registration requirements to trade credit transactions where there may be a number of separate transactions between the same buyer and seller. If each one required individual registration, then cost and inconvenience would militate against registration being achieved in practice.

Many observers, and indeed legislatures, however, remain to be convinced about the merits of notice filing. Registration in advance of a transaction seems relatively small beer and, in any event, its benefits can largely be secured through a modification of a transaction based filing system that allows registration in advance but under which the registration lapses if a confirmatory filing is not made within a particular period of time. Divorcing registration from particular individual transactions opens up the possibility that the register may become less reliable as a source of information. A searcher cannot be sure whether a particular entry on the register relates to an actual transaction between the parties or whether it relates to a transaction that was contemplated but never in fact materialized. The information that is publicly available is less than under a transaction filing system and, in the modern information age, this state of affairs hardly seems justifiable. The Internet and modern methods of data capture should also allow easy registration of security instruments and any loss of financial privacy associated with such a procedure could be alleviated by the hiving off of commercially sensitive information to a separate document.[91]

## VI. THE TREATMENT OF QUASI-SECURITIES

In nailing its colours to the mast of notice filing, the Guide demonstrates the US influence in its drafting. This influence is also evident in the

[89] Recommendations 67 and 68.

[90] The EBRD has been sceptical about the merits of allowing advance registration or pre-registration stating that 'the advantages of allowing a potential creditor to take priority during the negotiations are debatable'—see *Publicity of Security Rights: EBRD Guiding Principles for the Development of a Charges Registry* (December 2004) at p 14 available on the EBRD web site www.ebrd.com/st.

[91] In the UK the Department for Business, Innovation and Skills (BIS) has recently suggested for enactment a modified version of this idea 'Government Response Consultation on Registration of Charges created by Companies and Limited Liability Partnerships' (London, December 2010).

Guide's treatment of quasi-securities. Quasi-securities are legal devices or arrangements, that do not strictly speaking, in terms of the law, constitute securities but which serve many of the same economic functions in terms of releasing funds to an entity in need of finance.

Article 9 and legal regimes modelled upon it, such as those in New Zealand and in the common law provinces of Canada, adopt a 'recharacterisation' approach towards quasi-security. Attention is paid to what is perceived to be the economic substance of a transaction rather than to its legal form.[92] Article 9 is also specifically stated to apply to certain transactions like factoring of debts and retention of title clauses that, in traditional legal terms, do not involve the creation of security but nevertheless, in economic terms, serve the same financing purpose. In its deeming provision, article 9 seems to be consciously extending the concept of security. Certain transactions are redesignated as security rights and the security rights regime is then applied to them subject to certain modifications.[93]

The Guide takes the same functional track. It provides that the law should treat all devices that perform security functions as secured transactions, including the transfer of title to tangibles or the outright assignment of receivables for security purposes.[94] This comprehensive approach would cover more or less all title transfer 'security' devices i.e. rights of a proprietary kind that secure payment or the performance of obligations. There is a general principle enshrined in the Guide that public notice of quasi-security interests must be given by means of filing in a register that is open to public inspection.[95]

The European approach is very different.[96] The dividing line between security strictly so-called and 'quasi-securities' may be a thin one in particular cases, but it is a line that is generally respected. In the main, quasi-securities do not have to be publicized through registration as a condition of third party effectiveness. By and large, European jurisdictions, both civil and common law, do not apply registration requirements to quasi-securities.

[92] Art 9-109 states the scope of application of art 9 and art 1-201(37) defining 'security interest' as meaning an interest in personal property or fixtures that secures either payment or else the performance of an obligation.

[93] See J Ziegel, 'The travails of English chattel security law reform—a transatlantic view' [2006] LMCLQ 116 'a conditional sale agreement is only a short form of chattel mortgage and that in each case the seller or mortgagee merely retains or obtains title as security for performance of the buyer's obligation.'

[94] Recommendation 2(d): which states that the law should apply to 'all property rights created contractually to secure the payment or other performance of an obligation, including transfers of title to tangible assets for security purposes or assignments of receivables for security purposes, the various forms of retention-of-title sales and financial leases'.

[95] See Part IX of the Legislative Guide 'Acquisition Financing' with Option A Unitary Approach and Option B Non Unitary Approach.

[96] See generally See E-M Kieninger (ed), *Security Rights in Movable Property in European Private Law* (CUP, Cambridge, 2004).

The Guide has the general rule of registration for quasi-securities. Moreover, while certain exceptions are allowed, these are much more in keeping with American article 9 sentiments than with European legal traditions. Under article 9 there is a certain grace period for registration of a quasi-security—20 days from the date of creation, and this provision finds its way into the Guide.[97] One might ask rhetorically why does the Guide mirror article 9 in this respect? There are other international parallels close at hand such as the EBRD Model Law on Secured Transactions under which a simple retention of title clause is categorized as an unpaid vendor's charge and is valid for 6 months without registration.[98]

More fundamentally, one might criticize the article 9 approach for ignoring and overriding the parties' intentions. The parties never intended to create a security interest but are deemed by legislation to have done what they never intended to do. Critics say that this approach does not so much involve looking to the substance of the transaction. The intention of the parties, as manifested in the form that they have drawn up, represents the substance of the transaction and what article 9 does is to disregard the substance.[99] Even some supporters of article 9 type regimes have acknowledged this argument:[100]

> There are two features of the UCC, Article 9 approach that appear to be troublesome even to those who are attracted to it. The first is the total reconceptualisation that it requires in the context of types of transactions that traditionally are not viewed as secured financing devices. . . . The second feature . . . is the extent to which it requires a bifurcated approach to the characterisation of certain types of transactions. Since a title retention sales contract or a lease falls within a secured financing regime because it functions as a security device, it follows that the seller or lessor is not the owner of the goods sold or leased. . . . What is troublesome is that outside this regime, the recharacterisation might not be acceptable with the result that same transaction is viewed differently depending on the legal issues being addressed.

In the same vein Professor Roderick MacDonald has argued that the 'boosterism of Article 9 norm entrepreneurs needs to be tempered by a realistic assessment of what can actually be accomplished in transnational

[97] See Recommendations 180(a)(ii) and 192(a)(ii).

[98] See art 9 of the EBRD Model Law which can be consulted on the 'secured transactions' section of the EBRD website—www.ebrd.com/.

[99] See the comment by I Davies 'The reform of English personal property security law' [2004] LS 295 at 321: 'The difficulty with the functionalism as applied in Article 9-type regimes is that it can be both over-inclusive and also under-inclusive at the same time. A more appropriate approach in any reform of English personal property security law is to operate within the existing legal landscape rather than to seek to transform it.'

[100] Professor Ronald Cuming 'The Internationalisation of Secured Financing Law' in Ross Cranston (ed), *Making Commercial Law: Essays in Honour of Roy Goode* (OUP, Oxford, 1997) 522–523.

commercial law reform.' He also suggests that the 'claim to universalism in accounts of modernization must be given up in favour of more differentiated analyses and prescriptions for particular times and for particular places.'[101]

Perhaps recognizing these realities, there is a twist to the tale in that the Guide admits the possibility of a 'non-unitary approach'. Under this approach, the substantive treatment of functionally similar transactions would be the same as for security rights strictly so-called but the legal characterization would remain different.[102] In deference to primarily civilian sensibilities, and with a view to gaining greater international acceptance, the UNCITRAL Guide is more subtle in its approach than the blunt tool of article 9. Two options are available with one option (the unitary approach) being an article 9 style regime with all its trappings. Another possibility however, is the non-unitary approach. The latter approach would entail States still applying a different formal characterization to quasi-security devices. States nevertheless, would effectively be obliged to apply the same legal rules to both security and quasi-security. Both types of transaction would be subject to filing or registration obligations for third party effectiveness.[103]

## VII. PRIORITY RULES

One of the perceived advantages of article 9 is the presence of clear and rationally determined priority rules. There is the general principle that the first security interest to be filed has priority over competing security interests over the same property subject to an exception for purchase money security interests.[104] The latter outrank general security interests that extend to the same property. The purchase money security interest is basically the provision of funds to enable a debtor to acquire particular property with the debtor obtaining a security interest in the property. Under article 9, there is a distinction drawn between general security interests and purchase money security interests with the latter enjoying a form of super-priority that has traditionally been enjoyed by those relying on quasi-securities such as title retention devices. Other financiers extending credit to facilitate the acquisition

[101] See R MacDonald, 'Article 9 Norm Entrepreneurship' (2006) 43 Canadian Business Law Journal 240 at 291 who also states that 'we need to locate our evaluations of commercial law reform within a better understanding of how local entrepreneurial networks and credit institutions function on the ground.'

[102] See generally recommendation 192 of the Legislative Guide.

[103] Recommendation 192 of the Guide. Both would also constitute an exception to the general first-to-file-has-priority principle underlying the Guide.

[104] Art 9-324 deals with the priority of purchase-money security interests and see generally on this area P Shupack, 'Defining Purchase Money Collateral' (1992) 29 Idaho Law Review 767; K Meyer, 'A Primer on Purchase Money Security Interests Under Revised Article 9' (2001) 50 Kan LR 143. For an argument against the PMSI super-priority rules see A Schwartz, 'A Theory of Loan Priorities' (1989) 18 J Legal Stud 250–254.

of property can now enjoy this super-priority status in certain circumstances. If, for example, a debtor has created security over all its assets, including future property then, despite the general first-to-file priority principle, a financier whose credits facilitated the acquisition of 'new property' by the debtor will take priority over the earlier creditor in respect of the new property.[105]

In its provisions in this area, the Guide once again sticks to the contours of article 9.[106] There is a first to file has priority principle but subject to a special priority treatment of purchase money security interests. In the associated commentary, purchase money lending, or acquisition financing as it is referred to, is spoken of as potentially a more competitive source of financing than all-assets financing. The provisions on acquisition financing are said to embody the general policy objective of providing a source of affordable credit particularly for small/medium-sized enterprises; ensuring the equal treatment of all acquisition financiers and creating transparency.[107] There is a broad definition of 'acquisition security rights' to encompass all security rights in an asset that secure the obligation to pay any unpaid portion of the purchase price or other obligation incurred to enable the grantor of the security right to acquire the asset. The definition includes retention of title rights, financial lease rights and 'hire-purchase' agreements (lease agreements with the option to purchase the goods).[108]

Pursuant to the 'equivalence of treatment' principle, the same general rules on the creation of general security rights apply to the creation of acquisition security rights.[109] But the idea of requiring registration for third party effectiveness of finance lease and title retention mechanisms is likely to be controversial for many jurisdictions.

The economic justification for investing acquisition security rights with super-priority status focuses on the fact that the debtor's total pool of assets has been increased. Existing debt is not simply being refinanced. With the infusion of funds the debtor is acquiring new assets and if existing security interest holders were allowed to claim priority in these new assets then, it is argued, they would receive a windfall benefit as they had done nothing to fund the acquisition.[110] Moreover, if an all-assets financier is allowed to obtain

[105] Under art 9-324(g) the holder of a purchase money security interest that secures the unpaid purchase price of collateral will prevail over the holder of a conflicting purchase money security interest that enables the collateral to be acquired. This means that a retention of title seller has priority over a lender that makes an enabling loan. For a similar rule under the Secured Transactions Guide see recommendation 182.

[106] Recommendations 180 and 192.

[107] See the statement of purposes in Part IX of the Guide.

[108] See the 'Terminology' section of the Guide.

[109] Recommendations 178 and 187 of the Guide.

[110] For a law and economics perspective on this view see H Kanda and S Levmore, 'Explaining Creditor Priorities' (1994) 80 Va LR 2138–2141.

priority with respect to the debtor's after-acquired assets, then that financer may have an effective credit monopoly. If the financier is unwilling to advance any further funds then it may be very difficult for the debtor to procure financing from other creditors who may be loath to accept lower-ranking security or to lend on an unsecured basis. Moreover, financiers who are lending against specific assets may be in a position to offer more competitive interest rates than general all-assets financiers. The financiers who are lending against specific assets are lending against specific risk rather than general risk. They may be able more easily to establish the risk associated with specific assets including risk of default etc.[111]

There are counter-arguments. For instance, it might be argued that lenders against discrete assets are more likely to be smaller, secondary lenders and less likely to provide competitive interest rates than general lenders. Moreover, attributing a privileged status to acquisition loans seems premised on the assumption that the advance of funds which is specifically tied to the purchase of 'new' assets is somehow more valuable for the debtor's business than the advance of funds for non acquisition reasons, such as to pay the wages of employees.[112] One might question whether this is necessarily the case and whether paying the wages of employees should not be regarded at least as equally socially valuable.

Acquisition security rights exist in embryonic form in many jurisdictions through the recognition of quasi-securities. In the main, these quasi-securities have priority over security interests, strictly so-called, over the same property.[113] The move to an article 9 regime however, would greatly expand the boundaries of purchase money super-priority. This would have implications for other creditors, both secured and unsecured, that are not always fully appreciated. Moreover, purchase money super-priority is not an ever present feature of international model laws on secured transactions. The mechanism is not contained, for example, in the EBRD Model Law on Secured Transactions. Under this Model Law however, like many national laws, creditors are free to vary the order of priorities amongst themselves, though without prejudicing the position of third parties. One might argue that if purchase money super priority is really beneficial to existing lenders then

[111] See A Schwartz, 'The Continuing Puzzle of Secured Debt' (1984) 37 Vand LR 1051.

[112] See the comments in WJ Gough, *Company Charges* (2nd edn, Butterworths, London, 1996) 436.

[113] See also R MacDonald, 'Article 9 Norm Entrepreneurship' (2006) 43 Canadian Business Law Journal 283: 'Collapsing the distinction between owing and owning, between true security and title deployed to secure the performance of an obligation, does not relieve a legislature of the need to determine whether, in a competition between secured creditors, a distinction should be drawn between a creditor who was once an owner (a vendor) and a creditor who is merely a financier (a lender). Indeed, the priority afforded to the vendor's hypothec (or a 'purchase money security interest') merely replicates the logic of an instalment sale or a sale under a resolutory condition in regimes that continue to distinguish between security and title devices.'

existing lenders should be perfectly prepared, on a voluntary basis, to consent to a new lender having super-priority.

### *A. The Extent of Super-priority and Enforcement*

Under the Guide, like in article 9, there is a special rule to deal with purchase money security interests in consumer goods. Such a security right—an acquisition security right in the language of the Guide—becomes automatically effective against third parties upon creation and has super-priority over any claims by third parties even though the latter may have secured their claim by a prior filing. This result, although express in complex conceptual language, seems eminently sensible. If, say an individual buys a computer from a retailer for personal use and the retailer retains ownership of the computer until it is paid for, then the retailer under the Guide is deemed to have an acquisition security right. Ordinarily such a right should be registered in a public register against the name of the purchaser to be effective against third parties such as a prior creditor with a claim against the consumer's after-acquired property. This result however, would seem to run counter to the expectations of the parties and to make credit sales fraught with hazards for the retailer. The Guide avoids this inconvenient conclusion by deeming the retailer to have an acquisition security right which has automatic third party effectiveness and is given super-priority status.

Leaving aside consumer goods, in article 9 and PPSA regimes there are difficult questions more generally about the conditions that must be satisfied before super-priority status can be obtained and whether a distinction should be drawn, as in some schemes, between inventory and capital equipment. It is also debatable how far the super-priority of the acquisition financier should extend into proceeds of the original goods supplied. The Secured Transactions Guide, while specifying the required outcomes in considerable detail, allows for alternative approaches on both these issues. Basically the possibility of alternative approaches is carried through into both the unitary and non-unitary treatment of acquisition security rights.

One alternative laid out in Recommendations 180 and 192 is to make super-priority in inventory more difficult to establish. In the case of inventory, before delivery of goods to grantor/buyer etc, the holder of potentially competing and already registered security right should be notified of the acquisition financier's intentions. On the other hand, to acquire super-priority in 'non-inventory', registration of the acquisition rights within a 20/30 day grace period after delivery of the goods to the grantor/buyer is all that is required. The justification for the difference in the legal treatment of inventory and 'non-inventory' can be accounted for by differences in the risk equation insofar as new financing is concerned. As Professors Kanda and Levmore have remarked in respect of similar rules in article 9: 'The rules intimate that the acquisition of new inventory and its associated debt is more threatening to

earlier creditors than the debt-financing of new equipment but that debt tied to new inventory is still less threatening than new money unlinked to particular assets.'[114] The Official Comment to Article 9-324 of the Uniform Commercial Code explains that the purpose of a notification requirement is to protect a non-purchase money inventory secured party which, under an arrangement with the debtor, is typically required to make periodic advances against incoming inventory, or periodic releases of old inventory as new inventory is received. If the inventory secured party receives notice it may not make an advance. The notification requirement is not the same as giving the existing secured party a veto on the new financier having super-priority, but it may function in roughly the same way through the existing secured party exerting pressure on the debtor.

One might object to a notification requirement however, on the basis that it complicates the law unnecessarily, and that the distinction between inventory and non-inventory is somewhat arbitrary. Recognizing these realities, the UNCITRAL admits the possibility of an alternative approach which does not discriminate between inventory and other types of collateral. Under this alternative approach, there would be no prior notification requirement for inventory. A supplier etc. could acquire super-priority simply by filing a general notice in the security rights register without having to contact existing financiers on the register individually.[115]

The Secured Transactions Guide is also pluralistic when it comes to the extension of super-priority of the acquisition financier into proceeds. The alternative approaches are set out in Recommendation 185 dealing with unitary treatment of acquisition and non-acquisition security and Recommendation 199 (non-unitary). The second, and simpler alternative, is to deny the possibility of super-priority in proceeds, thus limiting it to the original assets financed. The first alternative is more complex. Basically it again makes the distinction between inventory and non-inventory, with super-priority in proceeds of the latter easier to establish. There is also a distinction in part between different kinds of proceeds. For non-inventory, the principle is that super-priority should extend into proceeds. For inventory the same principle obtains except where the proceeds consists of receivables etc. In the latter scenario, super-priority is conditional on the acquisition financier notifying secured creditors that have already filed notice of a security interest that would cover the receivables.

The justification for not extending the super-priority of the inventory financier into proceeds consisting of receivables is to encourage a receivables financier to provide credit against the receivables. The proceeds of this

[114] See H Kanda and S Levmore, 'Explaining Creditor Priorities' (1994) 80 Virginia Law Review 2139 and see generally M Bridge, R MacDonald, R Simmonds and C Walsh, 'Formalism, Functionalism and Understanding the Law of Secured Transactions' (1999) 44 McGill LJ at fns 99–108.

[115] See Recommendations 180 and 192 'Alternative B'.

credit would then be used to pay the inventory financier. In many jurisdictions including England where retention of title clauses are recognized, the supplier's super-priority is limited in practice to the physical goods supplied and does not extend to receivables arising from the resale of those goods.[116]

The unitary/non-unitary divide also comes into play when it comes to the enforcement of acquisition security rights. Under the unitary approach, the Secured Transactions Guide takes the line that enforcement of acquisition security rights should conform to the law that applies to the enforcement of security rights generally.[117] Moreover, in the case of insolvency proceedings with respect to the debtor, the provisions that apply to security rights should apply also to acquisition security rights.[118] The non-unitary approach is less prescriptive however. In the insolvency context, it allows for the possibility that the law governing retention-of-title rights or financial lease rights could be made compatible with the regime applicable to the enforcement of ownership rights of third parties rather than with the security rights regime.[119] The same recognition of alternative possibilities carries through to the principles governing post-default enforcement of acquisition security rights under the non-unitary approach.[120] It stipulates however that the law should specify whether a retention of title seller or financial lessor has any right to retain surplus value if goods subject to retention of title or financial lease were repossessed by the seller or lessor and resold for more than the outstanding debt plus expenses. But there is also a statement that the regime applicable to the post-default enforcement of security rights applies to the post-default enforcement of retention-of-title or financial lease rights, except to the extent necessary to preserve the coherence of the overall sale and lease regime.[121]

## VIII. CONCLUSION

The UNCITRAL Secured Transactions Guide adds to the toolbox for States wishing to reform their law on secured transactions. In broad terms, the Guide follows an article 9 functional approach towards security with the treatment of title-retention devices assimilated to that of traditional security rights. Registration is required for third party effectiveness of the rights in question.

[116] See *Pfeiffer GmbH & Co v Arbuthnot Factors Ltd* [1988] 1 WLR 150; *Compaq Computer Ltd v Abercorn Group Ltd* [1991] BCC 484. See more generally G Monti, G Nejman and W Reuter, 'The Future of Reservation of Title Clauses in the European Community' (1997) 47 ICLQ 866; J-H Dalhuisen, 'The Conditional Sale is Alive and Well' in J Norton and M Andenas (eds), *Emerging Financial Markets and Secured Transactions* (London, Kluwer, 1998); and also E Kieninger 'Securities in Movable Property within the Common Market' (1996) 4 European Review of Private Law 41.

[117] Recommendation 178.

[118] Recommendation 186.

[119] Recommendation 202.

[120] See Recommendation 200.

[121] See Recommendation 200(b).

There is a subtle twist however in the recognition and development by the Guide of a 'non-unitary' approach to so-called acquisition security rights such as title retention devices. Under the 'non-unitary' approach, title retention mechanisms may still be labeled somewhat differently by the law of a particular jurisdiction than security rights in the strict sense but the same outcomes would result irrespective of the classification exercise. This 'non-unitary' approach is designed to make the contents of the Secured Transactions Guide more acceptable to Civil Law Jurisdictions.[122] It remains to be seen however whether the apparent sleight of hand in the Guide will prove convincing in practice.

Generally the UNCITRAL Secured Transactions Guide is a much more detailed instrument than say the EBRD Model Law on Secured Transactions or EBRD's Core Principles on Secured Transactions Laws.[123] The Core Principles cover the same ground as the UNCITRAL Guide, and embody many of the same points, but they are on the whole much less prescriptive. The Core Principles do not track the content of article 9 to the same degree. There is much greater flexibility and tolerance of divergence in the Core Principles than in the Guide. For example, while the Core Principles talk about having an effective means of publicizing the existence of security rights, unlike the UNCITRAL Guide they do not come down in favour of notice filing as distinct from transaction filing. Article 9 enthusiasts extol the virtue of notice filing to the nth degree but this paper has suggested that the arguments are not all one way. The same considerations apply in relation to priority rules. Article 9 has a specific set of priority rules that may facilitate the extension of credit in an American context but these rules are not exactly replicated in Europe. The UNCITRAL Guide, in the main, however follows the straight-down-the-line prescriptions of article 9.

In the introduction to this paper it was suggested that this closeness in approach to article 9 is likely to militate against the prospects of the Guide gaining widespread international acceptance. This is so for three interlocking reasons. The first is that the Guide may be technically deficient in certain respects or at least there are alternative models that offer equally, if not more, plausible solutions. The second reason is the American imprint itself on the Guide, however subtle and disguized this may be in certain respects. Frederick Schauer, for instance, comments that 'factors other than the receiving nation's own evaluation of the worth of legal ideas, and other than an objective

[122] See R MacDonald, 'Article 9 Norm Entrepreneurship' (2006) 43 Canadian Business Law Journal 291.

[123] See generally F Dahan and J Simpson, 'The European Bank for Reconstruction and Development's Secured Transactions Project: a model law and ten core principles for a modern secured transactions law in countries of Central and Eastern Europe (and elsewhere!)' in E-M Kieninger (ed), *Security Rights in Movable Property in European Private Law* (CUP, Cambridge, 2004) 98. See also L Mistelis 'The EBRD Model Law on Secured Transactions and Its Impact on Collateral Law Reform in Central and Eastern Europe and the Former Soviet Union' (1998) 5 Parker School Journal of East European Law 455.

assessment of the worth of legal ideas, are significant determinants of the patterns of legal transplantation and legal globalization.'[124] He also makes the point that 'copying' US law has a bad smell in numerous parts of the world, or in some political quarters, and therefore avoiding American influence, just because it is American, often appears tog be a driving force. The third reason is the battering that American legal and financial norms have taken with the Crash of 2008. It is almost as if the Guide harks back to an 'age of innocence' before the Crash when belief in the self-correcting mechanisms of markets reigned supreme and American global financial hegemony went largely unchallenged.

[124] See F Schauer, 'The Politics and Incentives of Legal Transplantation' (2000) Centre for International Development at Harvard Working Paper No 44 at p 24. www.cid.harvard.edu/cidwp/044.htm.