The Draft UNCITRAL Model Law on Secured Transactions. Why and how? / Le projet de loi type de la CNUDCI sur les opérations garanties. Pourquoi et comment?

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PREFACE

In July 2012, the *United Nations Commission on International Trade Law* (UNCITRAL) has entrusted its *Working group VI (Security interests)* with the mandate to "prepare a simple, short and concise model law on secured transactions based on the general recommendations of the Secured Transactions Guide and consistent with all texts prepared by UNCITRAL on secured transactions" [1].

It seemed appropriate to ponder on the text of Model Law while it was being drafted. Convened in Geneva for an international conference in September 2014 under the auspices of the *Centre for banking and financial law* of the *University of Geneva,* experts from various legal systems (several of whom are members of *Working Group VI*) have analyzed the draft Model Law and compared it to other recent developments. They reflected on whether the draft was "simple, short and concise", whether it might be met with adequate support, whether it was sufficiently innovative without unnecessarily shaking up generally held principles, whether it served the various interests at stake in a judicious and balanced way, whether the careful and meticulous chiseling of the text did not hamper its readability, whether its rules did form a coherent and efficient system of security interests in movable assets – in short: whether the text could appropriately serve as model or as inspiration source for legislators striving to modernize their secured transactions laws.

Let us be thankful to the authors for the answers they provide to these questions and to many other ones. Their thoughts have contributed to the ongoing debate on the draft Model Law; in addition, they constitute numerous constructive contributions for the rejuvenation of this important part of the law and will remain precious in the interpretation of the Model Law.

We wish to thank the speakers as well as the participants to the conference. We also thank for their support Mrs. Monique Jametti, Judge at the Swiss Federal Tribunal (who was at the time vice-director of Switzerland's *Federal Office of Justice*), Dr. Michael Schöll, vice-director of the

1 Report (A/67/17) of the United Nations Commission on International Trade Law. Forty-fifth session (25 June–6 July 2012), p. 25 n° 105 (http://daccess-dds-ny.un.org/doc/UNDOC/GEN/V12/551/54/PDF/V1255154.pdf?OpenElement).

Federal Office of Justice (then director of the *Private international law division* at the *Federal Office of Justice*), professor Christine Chappuis (Dean of the *University of Geneva Faculty of Law*) and our friend and colleague prof. Luc Thévenoz (director of the *Centre for banking and financial law* of the *University of Geneva*). We are also grateful to the staff members of the *University of Geneva Faculty of Law* who have contributed to the organization of the conference and to this publication, Messrs. Alexandre Alvarez, Edouard Benoit and Gervais Muja, as well as to Mrs. Ariane Tschopp for the careful formatting and laying out of this book.

Bénédict Foëx

AVANT-PROPOS

En juillet 2012, la *Commission des Nations Unies pour le droit commercial international* (CNUDCI) a chargé son *Groupe de travail VI (Droit des sûretés)* d'"élaborer une loi type simple, courte et concise sur les opérations garanties, fondée sur les recommandations générales du Guide sur les opérations garanties et conforme à l'ensemble des textes de la CNUDCI sur les opérations garanties" [1].

Il a paru intéressant de faire le point en cours de travaux. Réunis en colloque international à Genève en septembre 2014 sous l'égide du *Centre de droit bancaire et financier* de l'*Université de Genève*, des spécialistes issus de différentes traditions juridiques (dont plusieurs membres du *Groupe de travail VI*) se sont penchés sur le projet de loi type, à la lumière notamment d'autres développements récents. Ils se sont notamment demandé si le texte envisagé était "simple, court et concis", s'il était susceptible d'emporter l'adhésion, s'il était suffisamment novateur sans bousculer inutilement les principes généralement reconnus, s'il servait de façon judicieuse et équilibrée les divers intérêts en cause, si la précision et le soin du détail apporté à sa rédaction ne nuisaient pas à sa lisibilité, si les règles qu'il posait formaient un système cohérent et efficace des sûretés réelles mobilières – en bref: s'il était susceptible de servir de modèle ou de source d'inspiration pour les législateurs désireux de moderniser leur droit des sûretés réelles mobilières.

Soyons reconnaissants aux auteurs des contributions qui suivent d'avoir apporté des réponses à ces questions, comme à bien d'autres encore. Ces réflexions ont contribué à nourrir le débat sur le projet de loi type; elles constituent en outre autant d'apports constructifs en vue du rajeunissement de ce domaine important du droit et demeureront précieuses à l'interprète de la loi type.

Nous remercions donc très vivement les orateurs ainsi que les participants au colloque. Nous remercions également de leur soutien M^me^ Monique Jametti, Juge au Tribunal fédéral (qui était à l'époque vice-directrice de

1 Rapport (A/67/17) de la Commission des Nations Unies pour le droit commercial international. Quarante-cinquième session (25 juin-6 juillet 2012), p. 26 n° 105 (http://daccess-dds-ny.un.org/doc/UNDOC/GEN/V12/551/55/PDF/V1255155.pdf?OpenElement).

l'*Office fédéral de la Justice*), M. Michael Schöll, vice-directeur de l'*Office fédéral de la Justice* (alors directeur de l'*Unité de droit international privé* de l'*Office fédéral de la justice*), la professeure Christine Chappuis (doyenne de la *Faculté de droit* de l'*Université de Genève*) et notre collègue et ami, le professeur Luc Thévenoz (directeur du *Centre de droit bancaire et financier* de l'*Université de Genève*). Des remerciements s'adressent en outre aux collaborateurs de la *Faculté de droit* de l'*Université de Genève*, pour l'aide qu'ils ont apportée dans l'organisation du colloque et la publication de cet ouvrage, MM. Alexandre Alvarez, Edouard Benoit et Gervais Muja, ainsi qu'à M^me^ Ariane Tschopp, qui a procédé à la mise en page de ce beau livre.

Bénédict Foëx

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Spyridon (Spiros) V. Bazinas is the Secretary of the UNCITRAL Working Group VI (Security Interests), which is currently preparing a draft Model Law on Secured Transactions. Mr. Bazinas served as Secretary of Working Group VI, when it prepared the UNCITRAL Legislative Guide on Secured Transactions (2007), the Supplement on Security Interests in Intellectual Property Rights (2010) and the UNCITRAL Guide on the Implementation of a Security Rights Registry (2013). He also served as Secretary of the Working Group on International Contract Practices, when it prepared the draft Convention on the Assignment of Receivables in International Trade (2001). He has also been involved in the Commission's work on insolvency, bank guarantees, procurement and electronic commerce. He has co-authored eight books and has published numerous articles on various international trade law topics and, in particular, on secured financing. He has also provided technical assistance and lectured all over the world on a variety of UNCITRAL work topics. He is also a lecturer at the Law School of the University of Vienna, Austria.

Leif Böttcher est notaire à Brühl, Allemagne. Après des études de droit à l'Université de Münster, il a obtenu un LL.M en droit comparé à l'Université de Miami en 2005. Docteur en droit, il a travaillé en tant qu'avocat avant de joindre le Ministère de la Justice en 2010 où il était responsable du droit des sûretés. Il a également été membre de la délégation allemande au groupe de travail VI (droit des sûretés) de la CNUDCI. Il enseigne à l'Université de Bonn et est l'auteur de nombreuses publications en droit civil et notarial.

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Bénédict Foëx is professor at the University of Geneva Faculty of law; he also practices law in a Swiss law firm. His teaching and research mainly focus on secured transactions, property law and contracts. He was a member of the Swiss delegation to the diplomatic conference that adopted the *Cape Town Convention on international interests in mobile equipment* and is a member of UNCITRAL's Working Group VI on Security Interests. He also has been the president of the Swiss Society of Jurists.

Michèle Grégoire focuses her practice on business restructuring and banking and financial law services. She acts on behalf of major listed companies, particularly financial institutions and investment funds in all sectors. Michèle is highly recognized for her experience in litigation, including before the Supreme Court as she is one of only 20 lawyers admitted to the Belgian Supreme Court Bar. She also regularly serves as an arbitrator in national and international cases. Michèle is a professor at the University of Brussels and the University of Paris II-Panthéon Assas and has served as dean of the law school at the University of Brussels. She is often invited by foreign universities to deliver lectures on issues with international themes. Michèle is author of numerous scientific books and is

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SUMMARY

ABBREVIATIONS

1st	first
2nd	second
4th	fourth
Add.	addendum
AG	Aktiengesellschaft
al.	alii
AppGr.	Appellationsgericht
art.	article(s)
ATF	arrêt du Tribunal fédéral
BE	Bern
BeurkG	Beurkundungsgesetz
BGB	Bürgerliches Gesetzbuch
BJM	Basler Juristische Mitteilungen
BlSchK	Blätter für Schuldbetreibung und Konkurs
bn.	billions
BS	Basel
c.	considérant
CA	Court of Appeal
CARIT	Convention on the Assignment of Receivables in International Trade
CC	Civil Code / Code civil
CCA	Consumer Credit Act
CCQ	Civil Code of Quebec
cf.	confer
chap.	chapter
CHF	Swiss Franc(s)
CIS	Commonwealth of Independent States
Civ. Div	Civil Division
CO	Code of obligations / Code des obligations

Cth	Commonwealth
DCFR	Draft Common Frame of Reference
DEBA	Debt Enforcement and Bankruptcy Act
Diss.	Dissertation
DML	draft Model Law
Dr. iur.	Doctor iuris
e. g.	exempli gratia (for example / par exemple)
EBRD	European Bank for Reconstruction and Development
ed. / éd.	edited / edition / édition
eds / éds	editors / éditeurs
EFD	Eidgenössische Volkswirtschaftsdepartement
EGBGB	Einführungsgesetz zum Bürgerlichen Gesetzbuch
Eidg.	Eidgenössische
eSchKG	elektronisher Bundesgestz über Schuldbetreibung und Konkurs
etc.	et caetera
EU	European Union
EWCA Civ.	England and Wales Court of Appeal Civil
f.	following page
ff.	following pages
FISA	Federal Intermediated Securities Act
FS	Festschrift
GBO	Grundbuchordnung
GmbH	Gesellschaft mit beschränkter Haftung
GRR	global recovery rate
HGr.	Handelsgericht
Hrsg.	Herausgeber
HSC	Hague Securities Convention
Ibid.	ibidem
i. e.	id est (that is)
IFC	International Finance Corporation
IMF	International Monetary Fund

Inc.	Incorporated
IP	Intellectual Porperty
J. T.	Journal des Tribunaux
KMU	Klein- und Mittelunternehmen
KMU-HSG	Schweizerisches Institut für Klein- und Mittelunternehmen an der Universität St. Gallen
LDIP	Loi fédérale suisse sur le droit international privé
LL. M.	Legum Magister (master of laws)
LLP	Limited Liability Partnership
Ltd.	Limited company
MIS	Marketing, Informatique et Services
No. / no / nº	number / numéro
NZ	New Zealand
OAS	Organization of Amercian States
OECD	Organisation for Economic Co-operation and Development
OHADA	Organisation on the Harmonisation of Commercial Law in Africa
OPPSA	Personal Property Security Act of Ontario
p.	page(s)
para.	paragraph
paras.	paragraphs
pas.	Pasicrisie belge
PD	probability of default
pp.	pages
PPSA	Personal Property Security Act
PPSAs	Personal Property Security Acts
prof.	professor
Q. B.	Queen's Bench
rec.	recommendation
Recs.	Recommendations
RSBC	Revised Statutes of British Columbia
R. S. O.	Revised Statutes of Ontario

RTD Civ.	Revue trimestrielle de droit civil
RTO	Ordinance on the Registration of Retention-of-Title Arrangements
R. W.	*Rechtskundig Weekblad*
s.	section / et suivant(e)
SECO	Secretariat for Economic Affairs
seq.	sequentes (and following)
SLV	Schweizerische Leasingverband
SMEs	small and medium-sized entreprises
ss	et suivant(e)s
St.	Saint
ST	Secured Transactions
subpara.	subparagraph
U. Pa. L. Rev.	University of Pennsylvania Law Review
UCC	Uniform Commercial Code
UK	United Kingdom
UN	United Nations
UNCITRAL	United Nations Commission on International Trade Law
U. S. / US	United States
v.	versus
vol.	volume(s)
WAK-N	Wirtschaft und Abgaben des Nationalrates
ZBJV	Zeitschrift des Bernischen Juristenvereins
ZGB	Zivilgesetzbuch (Swiss Civil Code)

THE DRAFT UNCITRAL MODEL LAW ON SECURED TRANSACTIONS

Spyridon V. Bazinas*

I. Introduction

The United Nations Commission on International Trade Law ("UNCITRAL" or the "Commission")[1] Working Group VI (Security Interests) is preparing a draft model law on secured transactions (the "DML").[2] The DML is based on the recommendations of the UNCITRAL Legislative Guide on Secured Transactions (the "ST Guide"), including the Supplement on Security Rights in Intellectual Property (the "IP Supplement"), the UNCITRAL Guide on the Implementation of a Security Rights Registry (the "Registry Guide"), and the provisions of the United Nations Convention on the Assignment of Receivables in International Trade (the "CARIT").[3] The purpose of this article is to briefly discuss the DML and compare its provisions with the recommendations of the ST Guide.

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1 For the origin, mandate, composition and methods of work of UNCITRAL, see www.uncitral.org/uncitral/en/about_us.html.

2 This article refers to the DML contained in documents A/CN.9/WG.VI/WP.63 and Add. 1–2 (see www.uncitral.org/uncitral/en/commission/working_groups/6Security_Interests.html) and documents A/CN.9/852 and A/CN.9/853 (see www.uncitral.org/uncitral/en/commission/sessions/48th.html).

3 See www.uncitral.org/uncitral/uncitral_texts/security.html.

II. The ST Guide and the need for a model law

Generally, UNCITRAL prepares various types of uniform law texts, including conventions, model laws and guides (legislative and contractual).[4] Those texts differ in a number of respects, including with respect to the certainty and flexibility they provide. A convention provides the highest degree of uniformity and the lowest degree of flexibility, as it has to be implemented as is, except to the extent it allows declarations with respect to one or the other of its provisions. To the contrary, a legislative guide provides the lowest degree of uniformity but the highest degree of flexibility in the sense that it contains an analysis of issues to be addressed in legislation and mere recommendations to the legislator. In the scales of uniformity and flexibility, a model law is between a convention and a legislative guide. While it contains legislative provisions, it is sufficient if the thrust, the philosophy of the model law is reflected in a national enactment. It does not need to be implemented verbatim, in one and the same law, or in a way that would not fit the legislative technique and method of each State. And with respect to certain issues, a model law may also include alternatives for the enacting State to choose from. All this is certainly the case with respect to the DML.

The question arises as to why is the DML necessary now that we have the ST Guide, a text that has been rightly described as remarkable achievement[5] and is already having significant influence on the development of national laws.[6] The answer is that, with its 248 recommendations and almost 500 pages of commentary (with the Intellectual Property Supplement), the ST Guide may not be easy for States to implement. In addition, the ST Guide address all issues with respect to security interests in all types of movable asset, with few exceptions (e.g. it does not address those issues with respect to securities).[7] Moreover, the ST Guide offers alternatives with respect to important issues, such as those relating to acquisition

4 See www.uncitral.org/uncitral/en/uncitral_texts.html.

5 Neil Cohen, Should UNCITRAL Prepare a Model Law on Secured Transactions?, *Uniform Law Review* 2010, p. 326.

6 Spyridon V. Bazinas, *The influence of the UNCITRAL Legislative Guide on Secured Transactions, EBRD Research Handbook on Secured Financing in Commercial Transactions EBRD*, ed. by Frederique Dahan, Edward Elgar Publishing, 2015, p. 26.

7 ST Guide rec. 4, subpara. (c).

security interests.[8] Thus, the DML will assist States in implementing the recommendations of the ST Guide and complement the ST Guide in providing more guidance to States with respect to issues addressed with alternatives or not addressed at all. The DML will also provide States with another authoritative text prepared by an international legislative body like UNCITRAL and adopted by consensus.[9]

Yet, a number of concerns or objections have been expressed with respect to a model law on secured transactions as compared to the ST Guide. For example, it has been argued that the DML might not add enough value to the ST Guide to justify the additional efforts, be eventually inconsistent with the ST Guide, create a disincentive for States to implement the recommendations of the ST Guide, be impossible to prepare, or reduce the flexibility of States in preparing a law that would meet their needs and thus not be as widely implemented as the ST Guide already is.[10] It has also been argued that a model law may not be desirable as there cannot be a "one size fits all" law on secured transactions, [11] or feasible as it would not create an international normative regime (like the Convention on International Interests in Mobile Equipment) or a regime with a narrowly defined area of law (such as letter of credit financing), and could create a difficult dilemma for States between revisiting issues already addressed in the ST Guide and refusing to address valid concerns.[12] Finally, it has been argued that that the timing is not right to prepare a model law as there is an oversupply and an under-demand for model laws.[13]

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8 ST Guide recs. 178–202.

9 The long-time practice in the Commission is to reach decisions by consensus (see A/65/17) – Report of the United Nations Commission on International Trade Law, Forty-third session (A/65/17, Annex III, para. 2) www.uncitral.org/uncitral/en/about/methods_documents.html (accessed 12 March 2015). Consensus in the practice of the Commission does not mean that any State can veto a decision, but rather that, while starting from the majority view, the Chairman makes an effort to address all concerns so that all States can accept or at least be able to live with the decision.

10 For a discussion of the considerations in favour of and against a model law, see Cohen (note 5), pp. 329–335.

11 Roderick A. Macdonald, A Model Law on Secured Transactions, *Uniform Law Review* 2010, p. 421. In fact, Macdonald accepts the idea of "many model laws" and raises the question whether UNCITRAL should prepare them or simply provide technical assistance to States implementing the recommendations of the ST Guide.

12 Ibid., pp. 422–423.

13 Macdonald (note 11), pp. 423–424.

The work of Working Group VI so far has proven that all these otherwise reasonable concerns have not created insurmountable difficulties. There can certainly not be a "one size fits all" law. But, as an UNCITRAL model law, the DML leaves States sufficient flexibility and is not a "one size fits all" law. States may implement it in various ways as long as they implement the key concepts of the DML (including the comprehensive scope, simple creation of a security interests, notice registration for third-party effectiveness, a complete set of priority rules, efficient enforcement regime, and main conflict-of-laws rules). The work of the Working Group progresses well.[14]

The DML simply reflects the policy of those recommendations of the ST Guide that have a normative character and thus belong in a model law. Other recommendations that are mere admonitions to the legislator have been left out or discussed in the guide to enactment of the DML. In addition, several recommendations have been revised for their policy to be reflected in legislative language. Moreover the DML addresses issues not addressed in the ST Guide (e.g. security interests in non-intermediated securities).

As to the timing of the work by the Working Group or the lack of a sufficient demand for a model law, the fact that so many States are currently reviewing their secured transactions law seems to suggest that the timing is perfect and the demand rather high. For these reasons, the Commission asked the Working Group to expedite its work.[15] As to the alleged oversupply of model laws because of the existence of a regional secured transactions law (such as the EBRD, the OAS or the OHADA Model Law), this does not seem to be an obstacle. Regional texts meet regional needs. An international text by UNCITRAL will meet international needs. This is particularly true if the regional texts have been prepared many years ago (as is the case with the EBRD and the OAS model

14 At its twenty-seventh session, the Working considered and approved in principle the substance of several chapters of the DML and submitted to the Commission for adoption in principle at its forty-eighth session, in 2015, the registry-related text and the conflict-of-laws and transition chapter of the DML (see A/CN.9/836, para. 122). The DML with the guide to enactment is expected to be submitted to the Commission for final adoption at its forty-ninth session, in 2016.

15 Report of the Commission at its forty-seventh session, in 2014, A/69/17, para. 163.

laws) and are looking for up-to-date guidance in the ST Guide and the DML.[16]

III. The scope of the DML

A. The unitary, functional and comprehensive approach

In line with the ST Guide, the DML follows a modern approach to secured transactions that can be described as a unitary, functional and comprehensive approach. In line with this approach, the ST Guide follows a unitary approach in the sense that it uses a single, unitary concept of "security right" rather than several terms (e.g., pledge, hypothec, etc.). In addition, the ST Guide follows a functional approach in the sense that all types of right in movable property created by agreement to secure payment or other performance of an obligation are included. In other words, the form of the transaction or the terminology used by the parties (e.g., transfer of title for security purposes, retention-of-title sale or financial lease) is not decisive. Moreover, the DML follows a comprehensive approach in the sense that security interests may: (a) secure all types of obligation, present or future, determined or determinable, including fluctuating obligations and obligations described in a generic way; (b) encumber assets described specifically or generally, or even all of the assets of a grantor, present and future, including a changing pool of assets; and (c) be created or acquired by any legal or natural person, including a consumer.[17]

This unitary, functional and comprehensive approach to secured transactions is not dictated by ideological considerations or preferences for one or the other national legal system. It is a practical response to the main

16 "Acknowledging the importance of modern secured transactions law for the availability and cost of credit and the need for urgent guidance to States, in particular those with developing economies and economies in transition, the Commission expressed its satisfaction for the considerable progress achieved by the Working Group in its work. The Commission thus requested the Working Group to expedite its work so as to complete the draft model law, including the definitions and provisions on non-intermediated securities, and to submit it to the Commission for adoption together with a guide to enactment as soon as possible." (see Report of UNCITRAL on the work of its forty-seventh session, in 2014, Official Records of the General Assembly, Sixty-ninth Session, Supplement No. 17 (A/69/17), para. 163).

17 ST Guide rec. 2 and DML art. 1.

problem of secured transactions laws around the world, that is, the fragmentation of secured transactions law into multiple and often outdated laws dealing differently with the transactions that fulfil security functions. The result of this fragmentation is the creation of gaps and inconsistencies, which cannot but have a negative impact on the availability and the cost of credit (even if judges, practitioners and business people do their best to minimize the negative impact). In addition, the unitary, functional and comprehensive approach is the approach typically followed in modern secured transactions legislation.[18] Moreover, it is the approach that facilitates harmonization of the laws of various States as it deals in a comprehensive and similar way with all types of security interest.

However, the unitary, functional and comprehensive approach does not mean that borrowers, such as consumers, that deserve special protection are not to be protected. In line with the ST Guide, the DML provides that secured transactions law cannot affect the rights of consumers under consumer-protection law.[19] In addition, the unitary, functional and comprehensive approach does not mean that unsecured creditors are not protected. In line with the ST Guide, with the exception of limitations based solely on the ground that an asset is a future asset, the DML preserves statutory limitations to the creation or enforceability of a security interest in certain types of asset (e.g., household items or employment and retirement benefits, at least up to a certain amount).[20] Unsecured creditors may also be protected by way of statutory privileges and, in line with the ST Guide, the DML only recommends that they should be limited and set out in the law in a transparent way for parties to be able to take them into account when deciding whether to enter into a transaction and at which terms.[21] Finally, the unitary, functional and comprehensive approach does not mean that retention-of-title sales and financial leases need to be recharacterized as secured transactions for all purposes (i.e., tax, accounting, etc.). It is sufficient to subject them to secured transactions law for its limited purposes (i.e., creation, third-party effectiveness, priority and enforcement). Nor does coverage of these devices in the ST Guide or the DML mean that providers of goods on credit cannot be protected. In fact,

18 See, for example, the new PPSA of Australia www.comlaw.gov.au/Details/C2012C00151.

19 ST Guide rec. 2, subpara. (b), and DML art. 1, para. 5.

20 ST Guide rec. 18 and DML art. 1, para. 6.

21 ST Guide recs. 83 and 239 and DML arts. 44 and 45.

in line with the ST Guide, the draft Model Law provides that, once they register within a short period of time after delivery of the goods, providers of goods of credit are given a special priority over general financiers. [22]

B. The scope of the DML and the scope of the ST Guide compared

Generally, the scope of the DML is the same as the scope of the ST Guide. However, there are certain exceptions. First, unlike the ST Guide, the DML deals with security interests in non-intermediated securities (e.g. shares and bonds that are not held in a securities account). The reason is that such securities are regularly used in commercial finance transactions and yet neither the ST Guide nor other texts prepared by other organizations deal with such securities. [23]

Second, unlike the ST Guide, the DML does not deal with security interests in letters of credit. The reason is that letter of credit financing is a very specialized and narrow area that is subject to specialized regulation and does not need to be addressed in the DML. States interested in letter of credit financing can still find guidance in the ST Guide.

Third, while both in the ST Guide and the DML apply to all receivables financing transactions whether they involve the creation of a security interest, a transfer for security purposes or the outright transfer of receivables, the Working Group is to consider a suggestion by the Secretariat to perhaps exclude certain types of outright assignment of receivables (e.g., an outright transfer of receivables as part of the sale of the business out of which they arose, unless the seller remains in apparent control of the business after the sale. The reason for this suggestion is that the potential that the transferor will be able to mislead other buyers of the receivables is very limited unless the old owner remains in apparent control of the business. [24]

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22 ST Guide recs. 180 and 182 and DML arts. 47 and 48.

23 See Report of Working Group VI on the work of its twenty-fifth session (A/CN.9/802), paras. 72 and 73 (www.uncitral.org/uncitral/en/commission/working_groups/6Security_Interests.html). The Unidroit Convention on Substantive Rules for Intermediated Securities (2013) and the Convention of on the Law Applicable to Certain Rights in Respect of Securities held with an Intermediary (2006) do not deal with non-intermediated securities.

24 DML art. 1, Note to the Working Group.

Fourth, unlike the ST Guide, the DML does not deal with security interests in attachments to movable or immovable property. The reason is that, while attachments are important, the recommendations of the ST Guide provide sufficient guidance for the benefit of States that would like to deal with attachments in their law.

IV. Creation of a security interest

A. General rules

One of the key objectives of an effective secured transactions law is "*to enable parties to obtain security rights in a simple and efficient manner*".[25] So, in line with the ST Guide, the DML provides that a security agreement is sufficient for the creation of a security interest, although in the case of assets in which the grantor acquires rights or the power to encumber after the time of the conclusion of the security agreement ("future assets"), the security interest is created at that later time.[26] The DML also provides that the security agreement must indicate the intent of the parties, identify them, and describe the secured obligation and the encumbered assets.

In view of the importance of the required description of the encumbered assets, the DML, deals with it in a separate provision that implements the policy of the ST Guide.[27] The assets must be described "*in a manner that reasonably allows their identification*". What is a reasonable identification of the assets may differ according to the circumstances and the type of asset involved. For example, in the case of inventory, a generic description, such as "*all my present and future inventory*" or "*all my present and future inventory of personal computers*" or "*all my present and future inventory of personal computers in warehouse X*", may be enough. However, in the case of intellectual property, a specific description, such as "*my patent X*", may be necessary (the same rule applies to the description of the encumbered assets in the notice).

25 ST Guide rec. 1, subpara. (c).
26 ST Guide recs. 13 and 14 and DML art. 6.
27 ST Guide rec. 14, subpara. (d), and DML art. 9.

Similarly flexible is the DML with respect to the form of a security agreement. A security agreement need be in writing only if it is not accompanied by delivery of the encumbered assets to the secured creditor.[28] This approach combines flexibility (no need for written agreement) with the protection of the legitimate interests of the secured creditor (written agreement only if the secured creditor is not in possession of the assets). The flexibility goes even further. First, it is enough if the agreement is concluded or, at least, evidenced in writing. Second, the writing need only indicate the grantor's intent to create a security interest, that is, the secured creditor's signature is not required. Third, the writing may lead to that result by itself or in conjunction with the course of conduct of the parties, that is, an order, shipment, delivery and acceptance of the goods may be enough. And fourth, writing includes an electronic communication and signature includes an electronic signature.

To facilitate financing practices, such as revolving credit arrangements, the DML provides that it should be possible for a security interest to secure any type of obligation, including future, conditional or fluctuating obligations.[29] Also, to reduce risks and ensure better credit terms for borrowers, the DML provides that it should be possible to create a security interest in future assets, that is, assets created or acquired by the grantor after the creation of a security interest.[30] In order to facilitate consideration of the matter by the national legislator, the commentary of the ST Guide discusses the various approaches taken in different legal systems in this regard to ensure that grantors are not over-committed.[31]

In order to simplify the creation of security interests in all assets of an enterprise the DML provides that a security interest may be created in all assets of a grantor. Characteristic elements of such transactions are two, a security interest may be created in all assets of a grantor with a single agreement and the grantor has the right to dispose of certain of its assets (e.g., inventory) in the ordinary course of its business.[32] The ST Guide discusses over-collateralization, suggesting ways in which it could be

28 ST Guide rec. 15 and DML art. 6, paras. 4 and 5.
29 ST Guide rec. 16 and DML art. 7.
30 ST Guide rec. 17 and DML art. 8.
31 ST Guide, chap. II, paras. 51–55.
32 ST Guide, chap. II, para. 63, and art. 8, subpara. (d).

addressed, but makes no recommendation as the appropriate response may vary widely from State to State.[33]

In any case, recognizing the need to protect certain parties or exclude certain types of asset from the scope of secured transactions law, as already mentioned, the DML defers to consumer protection legislation and to legislation according to which certain types of asset (e.g., employment benefits or household goods) may not be transferred or encumbered.

To protect the secured creditor from unauthorized transfers (in which a security interest follows the asset but the asset may be removed from the secured creditor's reach) or transfers in the ordinary course of business or in good faith (in which the transferee takes the asset free of the security interest) by the grantor, the DML provides that the security interest automatically extends to any identifiable proceeds of the encumbered assets.[34] Even in cases in which the security interest follows the assets in the hands of the transferee, it makes sense for the security interest to extend to the proceeds (where, for example, the proceeds may be of higher value than used assets). This approach ensures that the secured creditor is sufficiently secured and thus is more likely to offer better credit terms to the borrower. However, this does not mean that the secured creditor will ever obtain more than what it is owed.[35]

B. Asset-specific rules

The DML contains a series of asset-specific provisions. First, in line with the ST Guide,[36] an agreement limiting the creation of a security interest in a receivable does not invalidate a security interest created despite that contractual limitation.[37] This essentially means that, the agreement between the creditor and the debtor of the receivable does not affect third parties and thus the creditor of the receivable continues to bear the risk of insolvency of its contractual partner, the debtor of the receivable. It does not

33 ST Guide, chap. II, para. 69.

34 ST Guide rec. 19 and DML art. 10. The term "proceeds" is defined to mean "*whatever is received in respect of encumbered assets*" and includes proceeds of proceeds (see DML art. 2, subpara. (bb)).

35 ST Guide, chap. II, paras. 72–89.

36 ST Guide rec. 24.

37 DML art. 12.

mean, however, that, for example, the debtor of the receivable is deprived of any claim for damages against the creditor of the receivable for breach of contract that may exist under other law.

Second, also in line with the ST Guide, the DML provides that a security interest in a negotiable document extends to the goods covered by the document.[38] And third, also in line with the ST Guide, the DML provides that a security interest in assets containing an intellectual property asset (e.g., inventory of personal computers containing copyrighted software) does not automatically extend to the intellectual property asset and vice versa. This means that, in the absence of agreement, if the grantor defaults, the secured creditor can re-possess and sell the inventory as is, but not use the copyrighted software in other personal computers.[39]

C. *The treatment of creation issues in the ST Guide and the DML compared*

There is no policy change in the treatment of creation issues in the DML as compared with their treatment in the ST Guide. However, there are several changes of a drafting nature. For example, because of its importance, the issue of the description of the encumbered assets in a security agreement is addressed in a separate provision.[40]

There is also a potential change to the treatment of independent personal or property rights securing or supporting the payment of the secured obligation (e.g., an independent guarantee or stand-by letter of credit). Two alternatives are presented. One provides that the security interest automatically extends to such an independent personal or property right. Another provides that the grantor is obliged to create a security interest in the independent right in favour of the secured creditor.[41]

38 ST Guide rec. 28 and DML art. 14.
39 IP Supplement rec. 243 and DML art. 15.
40 DML art. 9.
41 ST Guide rec. 25 (b), CARIT art. 10 (2) and DML art. 13.

V. Third-party effectiveness of a security interest

A. General rules

Following the approach of the ST Guide, the DML distinguishes between effectiveness of a security interest as between the grantor and the secured creditor, on the one hand, and its effectiveness as against third parties (such as other secured creditors, buyers of the encumbered assets, judgement creditors and the mass of creditors or the insolvency administrator in the grantor's insolvency), on the other.

In addition, this approach makes it possible for the DML to apply to all devices serving security purposes, form-free types of transaction, such as retention-of-title sales and financial leases. In this way, the DML establishes a comprehensive and rational regime that addresses the problem of uncertainty and inconsistency created by a multiplicity of regimes or a piecemeal approach to secured transactions. This approach does not harm the rights of parties to these title devices. Once a retention-of-title seller registers a notice within a short period of time after delivery of the goods to the buyer, its priority goes back to the time of delivery of the goods. Such a notice may cover a multiplicity of transactions between the same parties for a long period of time. In a cross-border situation, it ensures that the retention-of-title seller will not lose its rights or its priority once the goods are moved to another country that does not recognize retention-of-title as such. Whether the remedies of the seller or the secured creditor are more efficient depends on the specific situation (e.g., whether the residual value of the used goods is higher than the part of the purchase price paid by the buyer minus the value of the use of the goods).

In legal systems in which a security interest has by nature effects *erga omnes,* the DML may be implemented in the following way: upon its creation, a security interest may be effective against all of the grantor's creditors as long as the priority is determined on the basis of the time when registration or another third-party effectiveness step occurred. [42]

The general method for achieving the third-party effectiveness of a security interest is the registration of a notice of the security interest in a publicly accessible registry. However, to avoid undermining well-functioning practices, the DML recognizes that the third-party effectiveness of a

42 ST Guide, chap. II, para. 4 and chap. III, para. 8.

security interest may also be achieved: (a) in a tangible asset by a transfer of the possession of the asset to the secured creditor;[43] and (b) in an asset, such as a ship, aircraft, patent or trademark registry, by registration in a specialized registry.[44]

B. Asset-specific rules

While the general rules apply to all types of asset, the DML also includes a set of asset-specific third-party effectiveness rules that are intended to accommodate specific financing practices. Thus, the third-party effectiveness of a security interest may also be achieved: (c) in a right to payment of funds credited to a bank account by the transfer of the bank account to the secured creditor, the creation of a security interest in favour of the depositary bank or the conclusion of a control agreement;[45] (d) in a negotiable instrument or a negotiable document by transfer of possession of the instrument or the document to the secured creditor;[46] and (e) in a non-intermediated security by notation in the books of the issuer or conclusion of a control agreement.[47] In addition, a security interest in certain types of asset, such as cash proceeds, may be achieved automatically upon the creation of the security interest.[48]

C. The treatment of third-party effectiveness issues in the ST Guide and the DML compared

Generally, the DML follows the policy of the ST Guide with respect to third-party effectiveness. Most of the differences are of a drafting nature and cannot be avoided as the DML is a legislative text, and not a recommendation to the legislator. The main difference between the DML and the ST Guide relates to the provision dealing with the third-party effectiveness of a security interest in non-intermediated securities. The general

43 ST Guide rec. 37 and DML art. 16, subpara. (b).
44 ST Guide rec. 38 and DML art. 16, subpara. (a).
45 ST Guide rec. 49 and DML art. 23.
46 ST Guide recs. 37 and 51–53 and DML arts. 16, subpara. (b), and 24.
47 DML art. 25.
48 ST Guide rec. 39 and DML art. 17, para. 1.

methods of third-party effectiveness (notice registration and transfer of possession) apply also to non-intermediated securities. Two asset-specific methods are added with respect to non-intermediated securities, notation in the books of the issuer and a control agreement (among the issuer, the secured creditor and the grantor according to which the issuer agrees to follow instructions from the secured creditor without further consent from the grantor).[49]

VI. The registry system

A. The DML and the Registry Act

The DML provides for the establishment of a publicly accessible security interests registry (the "Registry").[50] The details of the registry system are set out in a separate act (the "Registry Act"), which is based on the recommendations of the ST Guide and the Registry Guide, and may be implemented in the secured transactions law, another law, decree, regulation or other act, or a combination thereof.

In line with the ST Guide, the DML avoids imposing unnecessary formalities on the creation of a security interest. Thus, registration is not necessary for the creation of a security interest.[51] And, as the legal consequence of registration is to make a security interest effective against third parties (provided that there is a valid security agreement), there is no need to register the security agreement but only a notice thereof. As the commentary to the ST Guide points out, "*registries based on a notice-registration concept exist in an increasing number of States and have also attracted considerable international support*".[52] It is worth noting that notice-based registration has been so successful that it has been adopted even in the context of specialized (including asset-based) registration systems, such as the registration systems for the types of high-value mobile equipment covered by the Cape Town Convention on International Interests

49 DML arts. 2, subpara. (g) (i), and 25.

50 DML art. 26 (this article and the Registry Act are contained in document A/CN.9/852; see www.uncitral.org/uncitral/en/commission/sessions/48th.html).

51 ST Guide rec. 34 and DML art. 16.

52 ST Guide, chap. IV, para. 14.

in Mobile Equipment and its Protocols,[53] and patent and trademark registries.[54] For the same reason, notice registration is even advocated for immovable property registries.[55]

In such a notice-based registration system, quick and easy registration is ensured by requiring registration of a notice that contains a limited yet sufficient amount of data, that is, the identifier and address of the grantor and the secured creditor or its representative, a description of the encumbered assets and, if permitted by the law, a selection of the period of effectiveness of the registration and, if a State chooses the option offered, the maximum amount for which the security interest may be enforced.[56] First, this information is sufficient for the searcher to determine whether some assets of the grantor may be encumbered by a security interest in the sense that it provides a warning. Second, it does more than that, and points the searcher to the source of information about the transaction to which the notice may relate, that is, the secured creditor identified in the notice. Third and most importantly, it provides an objective method for determining priority.

Document registration is also discussed in the commentary of the ST Guide, but is not recommended. The reason is that a notice-registration system is inherently more efficient. It simplifies the registration process, minimizes the administrative burden, delays and costs, reduces the risk of error and liability, facilitates searching of information in the public registry record and is sufficient in view of the legal consequences of registration, that is, third-party effectiveness.[57]

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53 These registries are asset-based rather than debtor-based registries. Briefly, asset-based registration has the disadvantage that it is necessary to have a unique identification and cannot accommodate a generic description or after-acquired property. But it has the advantage that it shows all registrable interests, not merely those created by the debtor. See article 31 of the Convention and section 5 of the Aircraft Registry Regulations and Official Commentary (Revised Edition) by Sir Roy Goode, Unidroit, Rome, 2008, p. 122. The Aircraft Registry is a particularly successful example of such a registry (see www.internationalregistry.aero/irWeb/Controller.jpf).

54 IP Supplement, paras. 132–134.

55 J. Simpson and F. Dahan, *Mortgages in transition economies, Secured Transactions Reform and Access to Credit*, EBRD, 2008, p. 195.

56 ST Guide rec. 57 and Registry Act art. 7.

57 ST Guide, chap. IV, paras. 10–14.

With regard to the amount of information required in a notice, the DML balances the rights and interests of searchers and secured creditors.[58] In an effort to ensure the confidentiality of the transaction and avoid use of the registry by lenders to obtain information about the clients of competitors, the DML provides that a search be made possible only by the identifier (e.g., name and any identification number) of the grantor, and not by the identifier of the secured creditor.[59] In a further effort to ensure confidentiality, the DML provides that the secured creditor may choose not to identify itself on the notice but give the identifier and address of a representative.[60] The possibility to identify a representative also facilitates secured transactions that involve multiple lenders that appoint one of them to be their representative for the purpose of registration.

The description of encumbered assets in a notice may be generic or specific, depending on what is a reasonable identification in each case.[61] Whether the notice should describe the encumbered assets by stating their serial numbers, if any, is left to each practice. For example, description of the encumbered assets by serial number should be possible in the case of high-value mobile equipment, such as ships or aircraft, and intellectual property rights, such as patents or trademarks, while such description would be impractical in the case of inventory. With respect to indexing and searching, the DML provides that reference should be made mainly to the grantor identifier.[62] The reason is that grantor indexing and searching

58 For a comparison of the registry systems under UCC § 9, the Canadian PPSAs, the OAS Model Law on Secured Transactions and the OAS Registry Regulations, on the one hand, and the ST Guide, on the other, *see* M. Dubovec, UCC article 9 Registration System for Latin America, 28(1) *Arizona Journal of International & Comparative Law* 117 (2011), pp. 117-142.

59 ST Guide recs. 54, subpara. (h), and 58–60 and Registry Act art. 21. The ST Guide explains that this approach is intended to prevent lenders from using the registry in order to identify the clients of their competitors. The ST Guide also explains that this approach does not prevent a State from designing a registry so as to permit search by secured creditor identifier for internal purposes of the registry, such as, for example, for making a global amendment of notices at the request of the secured creditor to whom the notices relate (*see* ST Guide, chap. IV, paras. 29 and 30).

60 ST Guide rec. 57, subpara. (a), and Registry Act art. 7, subpara. (b).

61 ST Guide rec. 63 and DML art. 34, subpara. (c).

62 The registration number assigned to each registered notice is also a search criterion (see art. 21 DML). The ST Guide discusses in the commentary but does not recommend indexing and searching by serial number (see chap. IV, paras. 31–36). Thus, a legislator may determine whether to adopt grantor indexing, asset indexing or both.

greatly simplifies the registration process to the extent that a single registration can cover a changing pool of assets and future assets.

B. The treatment of registration issues in the ST Guide and the Registry Act compared

Generally, the Registry Act follows the policy of the ST Guide and the Registry Guide with respect to registration. Most of the differences are of a drafting nature. However, there are some new rules.

First, the Registry Act addresses the impact of a transfer of an encumbered asset on the effectiveness of a registration, that is, whether in the case of a transfer of an encumbered asset a new registration is necessary for the security interest to continue being effective against third parties.[63] This issue had been discussed in the commentary but not addressed in the recommendations of the ST Guide.[64] The DML offers three options, one requiring registration of a new notice, another requiring registration of a new notice within a certain period after the secured creditor acquires knowledge of the transfer and another that does not require registration of a new notice, which is the approach followed where the encumbered asset transferred is intellectual property.[65]

Second, the Registry Act addresses the question whether the secured creditor's authorization is required for the registration of an amendment or cancellation notice.[66] This question had been discussed in the commentary of the Registry Guide but not addressed in a recommendation as it is a question for the law (not the registry regulations).[67] Four different options are offered for discussion, requiring the secured creditor's authorization or not with different conditions.

Third, the Registry Act addresses two more related issues, correction of errors and limitation of liability of the Registry. Those issues too had been discussed in the Registry Guide but not addressed in a recommendation.[68]

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63 Registry Act art. 25.

64 ST Guide, chap. IV, paras. 78–80. Recommendation 62 simply states that the matter should be addressed!

65 Registry Act art. 33.

66 Registry Act art. 20.

67 Registry Guide, paras. 249–259.

68 Registry Guide, paras. 135–144.

With respect to correction of errors, options are offered for discussion, dealing with the following questions: (a) whether the Registry should be able to correct an error itself or inform the registrant to enable the registrant to correct the error; and (b) the time of effectiveness of a notice correcting an error.[69] Also with respect to the limitation of liability of the Registry, options are offered ranging from limitation of the basis or the amount of the liability to excluding liability altogether.[70]

Finally, while there is no policy change with regard to the registry fees, the Registry Act emphasizes the two options foreseen in the ST Guide and the Registry Guide.[71] The first option foresees fees at cost-recovery level to be specified by the enacting State. It is based on the assumption that one of the key objectives of a modern secured transactions regimes, that is, transparency with respect to secured transactions, cannot be achieved if the Registry is used as an opportunity to generate revenue. The second option foresee no fees and is based on the assumption that the cost of establishing and operating an electronic registry should be minimal and the cost should be borne by the enacting State, as the Registry is a key component of a modern secured transactions regime, which would enhance the availability of credit at a lower cost, and thus should be treated as a public service and not a benefit to the parties to secured transactions.[72]

VII. Priority of a security interest

A. General rules

The DML includes a comprehensive set of rules dealing with priority conflicts between a secured creditor and every possible competing claimant. In a conflict between two security interests in the same asset, the first that was made effective against third parties (by registration or otherwise) has priority.[73]

69 Registry Act art. 30.
70 Registry Act art. 31.
71 ST Guide rec. 54, subpara. (i), and chap. IV, para. 37; Registry Guide rec. 36 and paras. 274–280.
72 Registry Act art. 32.
73 DML art. 41.

A transferee of an encumbered asset takes the asset subject to the security interest, with the exception of situations that have to do with the good faith acquisition of an encumbered asset or its acquisition in the transferor's normal course of business.[74] Subject to insolvency rules, in principle, a security interest preserves its third-party effectiveness and priority.[75]

In line with the approach taken in the ST Guide,[76] the DML takes no position as to whether there should be any statutory preferential claims. It simply includes an article for enacting States to list their preferential claims.[77] The right of an unsecured creditor that has obtained a judgement and taken the steps necessary to have it enforced before a security interest became effective against third parties has priority over that security interest.[78]

Generally, an acquisition secured creditor that has registered a notice within a short period of time after delivery of the goods has priority as of the time of delivery of the goods, not the time of registration.[79] Priority among competing acquisition security interests is determined on the basis of the general rules.[80] Alternatives are provided with respect to whether the priority of an acquisition security interest (in goods or intellectual property) extends to its proceeds.[81]

B. Asset-specific rules

The DML includes detailed priority rules with respect to security interests in certain types of asset. First, to avoid interfering with the negotiability of negotiable instruments, the DML provides that a security interest in a negotiable instrument made effective against third parties by possession of the instrument has priority over a security interest in the same instrument made effective against third parties by registration.[82]

74 DML art. 42.
75 DML art. 44.
76 ST Guide, chap. V, paras. 90–93.
77 DML art. 45.
78 DML art. 46.
79 DML art. 47.
80 DML art. 48. There seems to be an inconsistency with recommendation 184, which gives priority to a supplier of goods on credit over any other acquisition financier.
81 DML art. 50.
82 DML art. 55, para. 1.

Second, with respect to rights to payment of funds credited to a bank account, the DML sets out the priority of a security interest depending on the method by which it was made effective against third parties. The order is as follows: the transferee of the account, the depositary bank, a secured creditor with a control agreement, in the case of several control agreements, the secured creditor with the earlier control agreement, the secured creditor that registered a notice.[83]

Third, again to avoid undermining the negotiability of negotiable documents, a security interest in tangible assets covered by a negotiable document made effective against third parties by possession of the document has priority over a competing security interest made effective against third parties by registration or possession of the assets covered by the document.[84]

C. *The treatment of priority issues in the ST Guide and the DML compared*

Other than changes of a drafting nature, a few new provisions have been included in the DML. The first is a proposed rule dealing with priority conflicts between security interests granted by different persons (i.e. the initial grantor and a transferee of an encumbered asset). In the case of such a priority conflict, priority is determined according to the time when third-party effectiveness was achieved, provided that the initial secured creditor registers an amendment notice adding the name of the transferee within a short period of time after the transfer or after the secured creditor acquires knowledge of the transfer.[85]

The second is a rule dealing with priority conflicts between security interests in non-intermediated securities. According to that rule, a security interest in certificated securities made effective against third parties by possession of the certificate has priority over a security interest made effective against third parties by registration of a notice in the security interests registry. With respect to uncertificated securities, there is a cascade of rules according to which notation in the books of the issuer beats any other method and control agreement beats any other method except

83 DML art. 56.
84 DML art. 58.
85 DML arts. 41, para. 2, and 37, para. 1, options A and B.

notation in the books of the issuer. The rule also deals with the question whether a transferee of encumbered non-intermediated securities acquires its rights free or subject to the security interest. Two options are offered. The first provides that defers to the law governing transfers of securities. The second provides that resolves the conflict in favour of the transferee of the securities.[86]

The priority rule with respect to security interests in rights to payment of funds credited to a bank account is not new. However, it is interesting to briefly discuss it to provide some comparison with the priority rule with respect to security interests in non-intermediated securities and to explain its usefulness for transactions, such as non-notification factoring and undisclosed invoice discounting. This provision also contains a cascade of rules, according to which the priority order from top to bottom is as follows: the secured creditor as the account holder, the depositary bank, the secured creditor with a control agreement, the secured creditor that registered a notice in the security interests registry. The depositary bank's rights of set-off have priority over any security interest, except one made effective against third parties by the secured creditor becoming the account holder. Finally, in the case of a transfer of funds from an encumbered bank that is initiated or authorized by the grantor, the transferee acquires its right free of the security interest, unless it had knowledge that the transfer violates the rights of the secured creditor under the security agreement.[87]

Under this rule, in the case of non-notification factoring or undisclosed invoice discounting, the factor or invoice discounter need not register a notice in the security interests registry. To have priority over all competing claimants, the factor will need to become the holder of its client's account to which the relevant receivables are being paid. To have priority against all except the depositary bank and a secured creditor that has become the account holder, the factor will need to take a control agreement. To have priority over the depositary bank (including for its set-off rights), the factor will need to obtain a subordination agreement.[88] Of course, all these methods protect the factor or invoice discounter if the receivables are paid and the proceeds are deposited in a bank account.

86 DML art. 60.
87 DML art. 56.
88 DML art. 52.

VIII. Enforcement of a security interest

A. General rules

Following the ST Guide, the DML recognizes that an enforcement regime that results in delays or excessive costs is likely to affect the availability and the cost of credit.[89] At the same time, the DML recognizes that the judicial enforcement regime does not lend itself to harmonization at the international level. Thus, the DML leaves enforcement before a court or other authority (e.g. a chamber of commerce) to other law, making a recommendation for the introduction of expedited proceedings. The DML also introduces enforcement out of a court or other authority (e.g. self-help remedies), introducing safeguards for the grantor and other parties with interests in an encumbered asset.

The first such safeguard is that the enforcing secured creditor must act in good faith and in a commercially reasonable manner (e.g., avoid selling the encumbered assets at a price below their actual market price).[90] To protect the grantor from undue pressure on the part of the secured creditor, the DML provides that the grantor may not waive the general standard of conduct. Other rights existing under the enforcement provisions of the DML may be waived, but only after default, not at the time of the negotiation of the security agreement, to avoid putting the grantor in the position of having to give up its rights to obtain a concession from the secured creditor.[91]

The second safeguard is that the enforcing secured creditor cannot obtain possession of the encumbered assets out of court, unless: (a) the grantor has consented in the security or other agreement to the secured creditor obtaining possession of the encumbered assets out of court; (b) the secured creditor has have given the grantor and any person in possession of the encumbered assets notice of default and extra-judicial repossession; and (c) at the time of repossession, the grantor and any person in possession of the encumbered asset has not objected.[92]

The third safeguard is an elaborate notice system according to which notice of the secured creditor's intention to dispose of the encumbered assets

89 ST Guide, chap. VIII, para. 6.
90 DML art. 5.
91 DML art. 81.
92 DML art. 87.

out of court must be given well in advance to all affected parties.[93] Similar safeguards for the grantor and other parties with interests in the encumbered assets are foreseen in the case of a proposal by the secured creditor to acquire the encumbered assets in satisfaction of the secured obligation.[94]

The fourth set of safeguards relates to the distribution of proceeds from the disposition of encumbered assets out of court. The DML provides that the enforcing secured creditor must apply the net proceeds (after deducting the reasonable costs of enforcement) to the secured obligation; if there is a shortfall, the grantor remains liable, but the secured creditor then has the position of an unsecured creditor; and any surplus remaining must be turned over to the grantor or to other creditors announced during the enforcement proceedings, or, in the case of doubt, be deposited with a competent judicial or other authority.[95]

To ensure finality of the rights acquired pursuant to an out-of-court disposition, the DML recommends that the transferee (lessee or licensee) acquire the encumbered assets free of any security interests that are subordinate to the security interest of the enforcing secured creditor, but subject to any security interests with priority over the security interest of the enforcing secured creditor.[96]

B. Asset-specific rules

The DML contains only one asset-specific rule, which deals with the right of the secured creditor to collect payment under a receivable, negotiable instrument, right to payment of funds credited to a bank account or non-intermediated security.[97]

C. The treatment of enforcement issues in the ST Guide and the DML compared

The addition of collection of payment under a non-intermediated security constitutes the main difference between the ST Guide and the DML

93 DML art. 89.
94 DML art. 91.
95 DML art. 90.
96 DML art. 93.
97 DML art. 94.

enforcement provisions. Collection may take place not only after default, but also before default provided that the grantor consents.

IX. Law applicable to security interests

A. General rules

The draft Model Law contains a complete set of conflict-of-laws rules, which are intended to enhance certainty as to the law applicable to security interests in movable property and facilitate the movement and the financing of movable property across national borders with a regime that would allow the cross-border recognition of national security interests.

The law applicable to the creation, third-party effectiveness and priority of a security interest in a tangible asset is the law of the State in which the asset is located (except if the asset is covered by a negotiable document, where the applicable law is the law of the location of the document). There are a few exceptions to the *lex situs*. The law applicable to a security interest in mobile goods that typically cross national borders is the law of the State in which the grantor is located. The law applicable to goods rights in which are subject to registration in a title registry (such as ships or aircraft) is the law of the State under whose authority the registry is maintained. Finally, the law applicable to a security interest in goods in transit or export goods is the law of the State of destination, provided that the goods reach their destination within a short period of time.[98] Following generally applicable rules, enforcement of a security interest in a tangible asset is referred to the law of the State in which enforcement takes place.[99]

The law applicable to security interests in intangible assets (with the exception of receivables related to immovable property, bank accounts, assets subject to registration, letters of credit, proceeds and intellectual property that are subject to special rules), the draft Model Law follows the approach of the Receivables Convention, providing for the application of the law of the grantor's location.[100] Location of the grantor is defined by reference to its place of business and, in the case of places of business in

98 DML art. 79. The conflict-of-laws provisions of the DML are contained in document A/CN.9/853 (see www.uncitral.org/uncitral/en/commission/sessions/48th.html).

99 DML art. 82.

100 DML art. 80.

more than one State, by reference to the place where the grantor has its central administration.[101] The rationale of this rule is that it is the rule that: (a) is most likely to lead to the application of the law of one State; (b) can reasonably be determined in most cases; and (c) is the law of the State in which the main insolvency proceeding with respect to the grantor will most likely be commenced. The relevant time for determining location of the asset or the grantor is, with respect to creation issues, the location at the time of the putative creation of a security interest, and, with respect to third-party effectiveness and priority issues, the location at the time the issue arises.

B. Asset-specific rules

Following the approach of the ST Guide, the DML contains a number of asset-specific conflict-of-laws rules (including rules dealing with the law applicable to security interests in bank accounts and intellectual property).[102]

C. The treatment of conflict-of-laws issues in the ST Guide and the DML compared

The main difference with the ST Guide is the new rule on the law applicable to security interests in non-intermediated securities. This rule offers three options for discussion. Under the first option, the law applicable for security interests in certificated securities is the law of the State in which the certificate is located; and the law applicable to security interests in uncertificated securities is the law of the State under which the issuer is constituted (to which also matters relating to the effectiveness of a security interest as against the issuer are referred, both with respect to certificated and uncertificated securities). Under the second option, the law applicable to all issues with respect to all types of non-intermediated securities is the law of the issuer's location. Under the third option, the law applicable to all issues with respect to equity securities (i.e. shares) is the law of the issuer's

101 DML art. 84.
102 DML arts. 90 and 92.

location and the law applicable to all issues with respect to debt securities (i.e. bonds) is the law governing the securities.

Each option has advantages and disadvantages. The first option appropriately distinguishes between certificated and uncertificated securities, but the law of the issuer's location may not be appropriate for debt securities. The second option refers all issues to the law of the issuer's location, but again that law may not be appropriate for debt securities. The third option distinguishes between debt and equity securities, but the distinction may not always be clear (as in the case of convertible securities) and, in any case, while it focuses on the contractual nature of debt securities that are analogues to receivables in a generic sense, it provides for the application of a law other than the law applicable to security interests in receivables.

X. Conclusions

The ST Guide, including the IP Supplement, and the Registry Guide, have become the main reference tools for the modernization and harmonization of secured transactions law. However, the two guides are long and complex texts and thus not always easy to implement. The DML is intended to assist States in this regard. This article briefly discussed the DML and its main differences with the ST Guide and the Registry Guide. These differences may be generally summarized as follows: (a) several recommendations have been revised to be reflected in legislative language; (b) a number of recommendations that do not belong in a legislative text have been left out or discussed in the Guide to Enactment of the DML; (c) a number of provisions have been added to the DML to address security interests in non-intermediated securities; and (d) the recommendations of the ST Guide and the Registry Guide have been reflected in a separate Registry Act that may be implemented in the secured transactions law or a separate act, or partly in the former and partly in the latter.

RÉFLEXION SUR LA VÉRITABLE NATURE DE LA "LOI TYPE" SUR LES OPÉRATIONS GARANTIES

Jean-François Riffard *

Abstract

What is the true nature of the Model Law on Secured Transactions currently drafted by the UNCITRAL Group VI? Is it really a model law in the classic sense of the term? Doubt exists especially when this project is compared with other model laws already proposed by UNCITRAL and other international institutions. While these latter are characterized by a relatively limited scope, a limited number of articles and the use of neutral terminology in order to achieve a high degree of standardization and unification, the current draft of the so called UNCITRAL Model Law has another face. The enacting State being allowed to adapt its provisions to their needs and legal context and to make some fundamental choices between several options, it appears less as a "ready to use" text which would serve as a simple example of what the law should be. This Project would tend to show that the concept of "model law" is not a unitary one, but in fact covers many forms of instrument, their normative density ranging from the true "normative or model law" with a high degree of standardization and which is a-unification tool, to what we can call an "example law" which is more open and therefore represents a simple harmonization tool.

A en croire la version anglaise du projet, le Groupe de travail VI de la CNUDCI aurait donc décidé de faire évoluer son Guide législatif sur les opérations garanties[1] vers une "*model law*". Beaucoup a déjà été écrit tant

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1 www.uncitral.org/pdf/english/texts/security-lg/f/LG_on_ST_French.pdf; Spiros V. Bazinas, "The UNCITRAL Legislative Guide on Secured Transactions: key objectives and fundamental policies", *Uniform commercial code law journal* (2010), 42:2:123-155;

sur les raisons de ce choix que sur la physionomie de ce futur instrument[2]. Mais il est une autre question qui n'a pas attiré l'attention des commentateurs et qui nous semble pourtant digne d'intérêt. Comment l'expression "*model law*" doit-elle être traduite en français? *A priori,* la question se résout d'elle-même par référence au glossaire officiel de la CNUDCI qui préconise l'utilisation du terme de "loi type". Dont acte. Pourtant, le choix de cette terminologie interroge lorsque l'on sait que d'autres institutions utilisent quant à elles l'expression de loi modèle[3].

Loi modèle / loi type: que représente alors cette dualité terminologique? Faut-il y voir la preuve de la richesse de la langue française, laquelle offre plusieurs mots pour désigner un seul et même concept? Faut-il considérer ces deux termes comme synonymes? La tentation est légitime puisque le lexique de la Commission européenne assimile les deux termes[4] et certains auteurs français les utilisent indifféremment, parfois dans un même article[5].

Pourtant, l'étude de l'instrument aujourd'hui proposé par la CNUDCI nous amène à penser qu'il existe une différence qui n'est pas aussi anodine qu'il y paraît. Cette étude tend en effet à démontrer que le concept de "*model law*" est loin d'être unitaire et que cette différence terminologique recouvre plusieurs réalités. Une telle réflexion fait surtout écho à un

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Bénédict Foëx/Luc Thévenoz/Spiros V. Bazinas (éds), Réforme des sûretés mobilières. Les enseignements du Guide législatif de la CNUDCI, Geneva: Schulthess, 2007; Jean-François Riffard, "Le Guide législatif de la CNUDCI sur les opérations garanties, Un pas décisif vers un droit des sûretés mobilières harmonisé in Le droit des sûretés à l'épreuve des réformes, ouvrage collectif", *Revue des Huissiers* (n° spécial, nov. 2006), EJT.

2 Neil B. Cohen, "Should Uncitral Prepare a Model Law on Secured Transactions?", *Uniform Law Review / Revue de De Droit Uniforme* XV (2010), p. 325 ss; Roderick A. Macdonald, "A Model Law on Secured Transactions. A Representation of Structure? An Object of Idealized Imitation? A Type, Template or Design?", *Uniform Law Review / Revue de Droit Uniforme* XV (2010), p. 419 ss; Jean-François Riffard, "Le Livre IX du Cadre commun de référence européen et la future (?) loi modèle de la CNUDCI sur les sûretés réelles mobilières: Quand l'un vient d'en bas et l'autre d'en haut, il y en aura un de trop", *Uniform Law Review / Revue de Droit Uniforme* XV (2010), p. 465 ss.

3 Par exemple Loi modèle sur les Emblèmes du CICR de juillet 2008 (même si le terme de loi type est utilisé dans le corps du texte); Loi modèle de l'Organisation de l'Unité Africaine (OUA) sur la sécurité en biotechnologie.

4 http://ec.europa.eu/justice/glossary/uniform-laws_fr.htm.

5 Jacques Raynard, "De la particularité de certaines sources internationales: l'exemple des lois-types de la CNUDCI", *RTD Civ.* (1998), p. 1014.

sentiment que partagent depuis le début des travaux du Groupe de travail, nombre de délégués et observateurs: il n'est pas sûr que le projet actuellement en cours soit, malgré sa dénomination, une "*Model Law*" ou loi type au sens où l'entend traditionnellement la CNUDCI.

Car bien évidemment, ce n'est pas parce que le projet a été libellé "loi type" qu'il doit nécessairement être qualifié comme tel. Ne faut-il pas toujours s'assurer d'appeler un chat un chat, comme nous l'avait suggéré notre ami Rod Macdonald [6]? Il est donc nécessaire de s'interroger sur la véritable nature de l'instrument proposé. La réflexion est d'autant plus légitime que le Groupe de travail n'a pas cru bon définir préalablement les caractéristiques que devait présenter cette loi type. Il s'est borné à vouloir élaborer son projet à partir des recommandations du Guide au risque de perdre de vue les éléments fondamentaux qui caractérisent une loi type. Mais si l'instrument préparé ne correspond pas exactement à la notion de loi type, qu'est-il alors?

Pour répondre à cette question, il est d'abord nécessaire de définir ce qu'est une loi type ou tout du moins d'en préciser les contours au regard de sa finalité (I), ce qui nous amènera à constater que ce type d'instrument n'est manifestement pas adapté en matière de sûretés mobilières (II). C'est donc d'une autre nature que procède le projet proposé par la CNUDCI (III) qui se situe alors à mi-chemin entre la loi type classique et le guide législatif (IV).

I. La "loi type": un instrument à haut degré de standardisation

A titre liminaire, il est intéressant de noter qu'il n'existe à notre connaissance aucune définition universelle de ce que serait une loi type. Sans doute le terme apparaît-il comme étant suffisamment explicite [7]. Pourtant il nous semble utile d'aller plus loin et de mieux cerner la notion.

On sait que la loi type est, avec le guide législatif et la convention, l'un des trois instruments à la disposition des institutions internationales leur

6 Roderick Macdonald, "Faut-il s'assurer d'appeler un chat un chat: observations sur la méthodologie législative à travers l'énumération limitative des sûretés, "La présomption d'hypothèque" et le principe de l'essence de l'opération", in Ernest Caparros (dir.), Mélanges Germain Brière, Coll. Bleue, Montréal, Wilson et Lafleur, 1993, p. 527.

7 Raynard (note 5), p. 1014.

permettant d'œuvrer à un rapprochement des législations étatiques. Plus précisément, elle est un instrument intermédiaire empruntant certaines caractéristiques à chacun des deux autres instruments. Comme le guide législatif, la loi type n'a pas de valeur normative directe. Elle relève en cela de la *soft law*[8]. Elle n'est qu'un instrument de réforme par incitation, non contraignant. Expression d'un droit savant[9], elle tire sa légitimité, voire son autorité de ce qu'elle est l'œuvre de juristes aux horizons divers "*qui ont longuement médité sur leurs règles avant de les proposer à l'adoption des gouvernements*"[10].

Mais à l'inverse, il est indéniable que sa physionomie, sa densité normative et sa finalité rapprochent la loi type de la convention. Ses dispositions ont en effet vocation à être intégrées, sinon directement dans l'ordre juridique de l'état adoptant, du moins avec le moins de modifications possible. Le but ultime de la loi type, comme de la convention, est une intégration telle quelle par le jeu d'un simple "copier/coller". Dans l'esprit des rédacteurs, l'énoncé d'une loi type "*soft law*" se doit d'avoir toutes les caractéristiques d'un énoncé "*hard Law*". Comme l'a écrit un auteur, "*tout est prêt. Il ne manque que l'engagement qui crée l'obligation*"[11]. Loi type et convention sont en cela de véritables instruments d'uniformisation.

Mais pour atteindre ce résultat, un certain nombre de conditions se doivent d'être réunies comme l'avait rappelé fort justement Rod Macdonald[12] alors que le Groupe VI s'interrogeait sur l'opportunité de se lancer dans une telle aventure.

De première part, la standardisation par le biais d'une loi type ne peut s'envisager que si elle a pour objet de créer un nouveau régime ayant trait à une question relativement nouvelle et limitée. Il faut éviter que le régime ne soit contaminé par l'existant, ce qui serait source d'incompatibilités. La loi type doit, de deuxième part, s'insérer dans un cadre déjà bien défini, suffisamment circonscrit et limité pour ne présenter que peu d'interactions avec les autres pans du droit de l'ordre juridique récepteur. Enfin de troisième part, l'uniformisation par loi type ne peut intervenir que si

8 Jean-Michel Jacquet, "L'émergence du droit souple (ou le droit 'réel' dépassé par son double)", *Etudes à la mémoire du Professeur Bruno Oppetit*, Litec, 2009, p. 343.

9 Jacquet (note 7).

10 Berthold Goldman cité par Raynard (note 5), p. 1014.

11 Julien Cazala, "Le soft law international: entre inspiration et aspiration", *Revue interdisciplinaire d'études juridiques* (2011) n° 66, p. 41 ss.

12 Macdonald (note 2), p. 419.

cette loi est rédigée en termes neutres pouvant être acceptés par n'importe quel ordre juridique, quelle que soit sa tradition juridique.

A la condition de respecter ces trois conditions, la loi type constitue alors un instrument d'uniformisation tout à fait efficace puisqu'elle est destinée à être intégrée de manière uniforme dans l'ordre juridique positif des états adoptants, tant sur le plan substantiel que terminologique.

En conséquence, les vraies lois types rédigées à ce jour sont d'une longueur assez faible et portent sur des questions juridiques relativement étroites. Ainsi les lois types de la CNUDCI vont généralement de douze articles pour les plus courtes, notamment celle sur la signature électronique[13], à une trentaine pour les plus longues telles que celles sur l'insolvabilité internationale ou sur l'arbitrage international qui comportent respectivement trente-deux et trente-six articles[14]. Seules les lois types sur le thème des passations de marchés et développement des infrastructures sont d'une longueur une peu plus conséquente mais en restant les limites du raisonnable, la plus longue atteignant soixante-neuf articles[15]. Quant à UNIDROIT, sa loi type sur la divulgation des informations en matière de franchise[16] ne comporte que dix articles et celle sur la location et la location financement de 2008 seulement vingt-quatre articles[17].

Dans ces conditions, était-il raisonnable d'envisager rédiger une loi type afin d'atteindre un objectif aussi difficile que l'uniformisation espérée du droit des sûretés mobilières?

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13 Eric A. Caprioli, "La loi type de la CNUDCI sur les signatures électroniques (Vienne 23 juin-13 juillet 2001)", *Communication Commerce Electronique* (01/12/2001) n° 12, p. 9-10.

14 Par ailleurs, la loi type sur la conciliation commerciale internationale (2002) comporte 14 articles et celle sur les virements internationaux (1992) 19.

15 Loi type sur la passation des marchés publics (2011). La Loi type sur la passation des marchés de biens, de travaux et de services de 1994 comporte 57 articles et celle sur la passation de biens et de travaux 47 articles.

16 Loi type sur la divulgation des informations en matière de franchise, Rome, UNIDROIT, 2004, 70 pages; Lena Peters, "The draft Unidroit Model Franchise Disclosure Law and the move towards national legislation", *Uniform Law Review / Revue de De Droit Uniforme* V (2000), p. 717 ss.

17 Text of the UNIDROIT Model Law on Leasing (Rome, 13 november 2008), *Uniform Law Review / Revue de De Droit Uniforme* V (2009), p. 648 ss; Martin Stanford, "UNIDROIT's Preparation of a Model Law on Leasing: the Crossing of New Frontiers in the Making of Uniform Law", *Uniform Law Review / Revue de De Droit Uniforme* XIV (2009), p. 578 ss.

II. La loi type: un instrument inadapté à l'uniformisation du droit des sûretés mobilières

Lorsque l'on confronte les caractéristiques que doit présenter une loi type au projet proposé par la CNUDCI, une évidence saute aux yeux: la Loi type sur les opérations garanties n'en est pas une! Cette conclusion était malheureusement prévisible. Avant même que le Groupe de travail ne s'engage dans ces travaux, certaines voix[18] avaient attiré son attention sur les difficultés voire l'impossibilité d'établir en la matière un tel instrument. Deux raisons fondamentales étaient avancées.

D'une part, il était évident qu'une uniformisation dans le domaine du droit des sûretés réelles, même limitée aux seules sûretés mobilières conventionnelles était une œuvre trop ambitieuse. Si une telle uniformisation peut se justifier sur le plan économique, il n'est pas sûr qu'elle s'impose sur le plan juridique. Il n'est pas possible ni même souhaitable d'uniformiser un pan aussi essentiel du droit, en important un modèle unique faisant fi du contexte juridique préexistant et de la tradition juridique de chaque Etat. Le droit des sûretés entretient des relations trop nombreuses et étroites avec d'autres branches du droit – droit des biens, des procédures collectives, des régimes matrimoniaux ou des obligations notamment – pour qu'une uniformisation soit réellement envisageable. Quand bien même le Groupe serait-il à même d'élaborer, de manière abstraite, un texte offrant un régime complet acceptable par tous, sa transposition ne pourrait à l'évidence s'opérer sans une modification profonde soit du contexte, soit du texte. La métaphore bien connue chez les comparatistes de la transplantation d'organes ou de plantes, est ici particulièrement éclairante[19].

D'autre part, l'uniformisation du droit des sûretés est techniquement impossible. Vouloir élaborer une loi type standard dans un domaine aussi vaste que le droit des sûretés mobilières suppose que l'on se mette d'accord, non pas tant sur le fond, mais aussi et surtout sur la forme. Se posent ainsi de nombreuses questions relevant de la technique légistique. Les oppositions de styles entre traditions civiliste et de Common Law sont trop importantes dans une matière aussi complexe et historiquement marquée pour que l'on puisse aboutir à une standardisation par le biais d'un texte soit

18 Macdonald (note 2); Riffard (note 2).

19 Roderick A. Macdonald, "Three Metaphors of Norm Migration in International Context", *Brooklyn Journal of International Law* 34 (2009), p. 603 ss.

disant "neutre" et *Common Law-civilo*-compatible. Le droit des sûretés fait appel à des notions fondamentales qui ne peuvent être réduites à une figure unique. D'ailleurs, le projet fait référence à certains concepts empruntés à un ordre juridique et trop attachés à celui-ci pour être transposés en l'état. Tel est le cas du concept de "*proceeds*" qui n'a pas peu d'équivalent dans les pays de droit civil. Certes, la Loi type prend le soin de définir le terme et de lui donner une traduction (produit). Mais peut-on admettre que ce terme ait alors dans les pays de droit civil une signification propre au droit des sûretés et une autre, traditionnelle dans un autre contexte? De même, l'adoption du standard de "commercialement raisonnable" visé dans la loi pourra poser difficulté dans les pays n'ayant aucune expérience d'application de cette notion.

Toujours sur la forme, les juristes civilistes ne peuvent accepter une loi type de plus de 240 articles dont certains n'ont qu'une valeur législative limitée, voire aucune, relevant plutôt de l'infra réglementaire. De l'autre côté, les *Common Lawyers* ne sont pas prêts à se contenter d'une loi type limitée à quelques principes fondamentaux et rédigée en termes généraux. L'opposition est trop marquée pour qu'un compromis satisfaisant puisse être atteint.

Or donc, il serait impossible d'élaborer une vraie loi type. Il n'en demeure pas moins qu'un projet nous est aujourd'hui proposé. Mais quelle est alors sa nature?

III. Une loi type qui ne serait qu'une "loi modèle" ou "loi par l'exemple"

Nous l'avons dit, et contrairement à une loi type classique, le projet proposé par la CNUDCI n'a pas vocation à être adopté tel quel. Il n'a d'ailleurs jamais été conçu comme tel. Au contraire, les législateurs sont invités à se l'approprier, à le moduler, à l'adapter au contexte économique et à leurs besoins spécifiques voire à opérer des choix politiques comme les y invitent les options proposées. C'est en cela que le projet peut être qualifié de véritable "loi modèle". En ce sens, il se rapproche du Guide législatif. On a d'ailleurs pu s'interroger sur l'opportunité d'établir un tel instrument dans la mesure où, sur le plan formel, il est parfois difficile de distinguer la Loi type des recommandations du Guide, elles-mêmes rédigées en termes quasi-législatifs. Cette similitude ne doit toutefois pas abuser car les recommandations du Guide, même compilées, n'ont jamais eu vocation à

constituer un ensemble cohérent et structuré, au contraire des lois types ou modèles. Celles-ci sont plus que la simple addition de recommandations portant sur des questions particulières.

Le Groupe de travail rédige donc en fait une véritable "loi modèle" ou "loi par l'exemple". Même si ce point est acquis, il n'en demeure pas moins qu'un doute subsiste toujours sur la physionomie générale de ce texte. Dès le début du projet, deux thèses se sont opposées. Certaines délégations ont entendu défendre une vision plutôt civiliste en adoptant une approche que l'on pourrait qualifier de *minimaliste*. Il s'agirait d'élaborer, non pas un texte complet, mais un squelette, une ossature type, regroupant les principes fondamentaux universellement admis, ossature sur laquelle chaque législateur viendrait ensuite, en fonction de ses besoins et de ses traditions, rajouter de la chair en s'inspirant des termes du Guide législatif. Sans doute était-ce la vision la plus communément admise au départ, comme en atteste le mandat donné par la Commission. Selon les termes de celui-ci, le Groupe de travail avait pour mission d'élaborer une loi type "courte, simple et concise" [20].

De l'autre côté, certaines délégations, notamment celle des Etats-Unis d'Amérique, ont prôné une approche *maximaliste* consistant à élaborer un modèle le plus complet et le plus précis possible. Un modèle de loi idéale en somme.

Cette opposition est intéressante sur le plan des méthodes d'uniformisation. Que vaut-il mieux? Fournir au législateur, un modèle le plus complet possible, charge à lui de supprimer certaines dispositions qui ne lui sembleraient pas utiles, ou lui proposer une ossature de base, sur laquelle il viendra greffer, en fonction de ses besoins, des dispositions complémentaires? En l'état actuel de projet et malgré certaines réticences des délégations de pays de droit civil, c'est l'approche "complète" prônée par les Etats-Unis qui a été privilégiée. Ou tout du moins vers laquelle tend le projet. Il faut dire qu'il est difficile pour les délégations de résister à la tentation d'être les plus exhaustives et précises possible, ce qui se traduit à par un alourdissement et une complexification croissante du projet.

Comme l'auteur de ces lignes a déjà pu l'écrire [21], on s'éloigne, avec une telle "loi par l'exemple" ou "Loi modèle" de l'idéal d'uniformisation standard universel souhaité. On peut le regretter, mais c'est la seule approche

20 45e session de la Commission (2012), rapport A/67/17, p. 25.

21 Riffard (note 2).

raisonnable possible. En premier lieu, elle évite une fâcheuse concurrence entre la Loi modèle et le Guide. Les deux instruments sont désormais complémentaires et forment un tout indissociable et cohérent: la Loi modèle sera la clé d'entrée pour comprendre le Guide, lequel est indispensable pour une application concrète de la Loi dans des contextes particuliers. En second lieu, elle offre un compromis acceptable entre fort degré de rapprochement et respect des spécificités juridiques de chaque Etat. En ce sens, elle permet d'aboutir, en quelque sorte, à une uniformisation que l'on peut qualifier d'intelligente.

IV. Les contours de la "loi modèle" en matière de sûretés mobilières

Lorsque le Groupe de travail s'est attelé à la rédaction de ce projet à partir de son Guide législatif, il a été confronté à la question non pas tant de savoir ce qu'il convenait d'y inclure, mais plutôt ce qui ne devait pas être repris. Il était en effet hors de question de transposer l'ensemble des recommandations contenues dans le Guide, en se bornant à supprimer la mention "*la Loi devrait prévoir que*" figurant au début de chacune d'elles. Une loi modèle ne saurait être une version allégée ou simplifiée d'un Guide législatif. Ce sont deux instruments fondamentalement différents, avec des fonctions particulières et répondant à des besoins bien spécifiques qu'il convient de respecter.

Un premier travail d'élagage par rapport aux 240 recommandations du Guide s'imposait donc. Le Groupe, avec l'assistance du Secrétariat, s'est employé à trier, adapter et reformuler les recommandations afin de les présenter sous forme de règles de droit, et surtout de les structurer de manière cohérente et rationnelle. A ce stade, il s'est surtout s'agit de distinguer entre ce que l'on pourrait dénommer les éléments fondamentaux unanimement admis et partagés, lesquels vont constituer l'ossature de la Loi modèle proposée, et les éléments secondaires pouvant être ou non choisis par les législateurs en fonction de leurs besoins.

A. Un modèle à conserver: les particules élémentaires

Parmi les principes et règles fondamentaux composant le noyau irréductible de facteurs d'uniformité, se retrouve en premier lieu la structure

générale du texte. Celle-ci, classique et dès lors consensuelle, est articulée autour de huit chapitres portant sur le champ d'application et les dispositions générales (I), la création de la sûreté (II), l'opposabilité aux tiers (III), le registre des sûretés (IV), les règles de priorité (V), la réalisation (VI), les conflits de lois (VII) et les règles transitoires (VIII).

Un autre élément fondamental et fédérateur est sans conteste, l'approche unitaire. Mais si ce principe, qui peut apparaître comme révolutionnaire dans certains systèmes juridiques, a pu aisément être élevé au rang d'objectif clé dans le cadre du Guide, il s'avère plus délicat à mettre en œuvre dans celui d'une loi modèle. Deux voies s'offraient en effet. La première consistait à consacrer un *numerus clausus,* en posant le principe selon lequel la sûreté dont le régime est défini par la loi, est la seule reconnue par le droit. La seconde conduisait à définir le champ d'application du nouveau régime de manière large voire "englobante" par le biais d'une approche téléologique. C'est ce dernier choix qui a été fait par le Groupe de Travail. Selon l'article 1 du projet, la loi porte sur les sûretés mobilières définies à l'article 2 comme "*tous droits réels sur des biens meubles constitués par convention en garantie du paiement ou d'une autre forme d'exécution d'une obligation quels que soient la terminologie employée par les parties, le type de biens, la qualité des parties ou la nature de l'obligation*". Il est cependant un peu regrettable que cette définition, au contraire de celle donnée par l'article IX 1-102 du Cadre Commun de référence, ne fasse pas expressément de la finalité – l'effet premier *voulu par les parties* est de produire un effet de garantie au profit du créancier – le critère de qualification principal de la notion de sûreté.

Un troisième facteur essentiel d'uniformité est la définition très large de l'assiette de la sûreté. Cette sûreté qui peut garantir tout type d'obligation, présente ou future, déterminée ou déterminable, conditionnelle ou non, à montant fixe ou fluctuant, peut en effet grever tout type de bien meuble, corporel ou incorporel, sauf exceptions légales lesquelles doivent être limitées.

Mais même en consacrant une approche unitaire et indifférenciée, il convient de rester réaliste. Il est impossible d'établir un régime taille unique. Des règles dérogatoires sont nécessaires afin d'adapter le régime à certains types de biens meubles particuliers. Le Guide avait listé ces biens, à savoir les créances, les instruments négociables, les documents négociables, les droits au paiement de fonds crédités sur un compte bancaire, les espèces et la propriété intellectuelle, auxquels il convient de rajouter

désormais les sûretés sur titres non intermédiés. Ces règles dérogatoires posent, dans le cadre d'une Loi modèle, deux questions. Est-il nécessaire de les traiter ou doit-on admettre que la Loi modèle ne contienne que le seul régime commun, les questions particulières étant renvoyées au Guide? Cette question a divisé le Groupe de travail qui a toutefois pris le parti d'exposer ses règles, partant du principe que certains d'entre elles, notamment celles afférentes aux créances, présentaient une importance pratique considérable. Il appartiendra alors au législateur, le cas échéant, de ne pas reprendre certaines de ces dispositions si celles-ci lui semble inadaptées à son propre contexte. Il n'est pas sûr en effet que les dispositions relatives aux sûretés sur le droit de recevoir le produit d'un engagement indépendant soient adaptées au contexte des Etats en voie de développement

Cette démarche n'est pas en soi contestable. Il s'agit simplement de vérifier que l'exercice par le législateur de sa faculté de "*opt out*" de tout ou partie de ces règles dérogatoires ne modifie pas l'architecture globale du projet et sa cohérence.

Dans le droit fil de cette discussion, s'est ensuite posée la question de savoir comment les règles afférentes aux biens spécifiques doivent être présentées. Doivent-elles être exposées à la suite de chacune des règles auxquelles elles dérogent ou doit-on les regrouper dans un chapitre spécial? C'est la première solution qui a été, après de nombreuses hésitations, choisie pour l'heure par le Groupe. Mais il est bien certain que cette présentation pourra être modifiée par les législateurs, en fonction de leur tradition légistique.

Un troisième élément fondamental autour duquel est structurée la Loi modèle est la question de l'opposabilité de la sûreté. Comme le Guide, la Loi apporte une attention toute particulière à l'un des trois modes possibles d'opposabilité, à savoir l'enregistrement sur un registre, considéré comme le mode de droit commun. Mais très vite, un débat s'est instauré entre les membres du Groupe de Travail qui souhaitaient ne voir être exposés dans la Loi modèle que les principes généraux relatifs à cette forme de publicité, les autres aspects techniques étant renvoyés à une réglementation en annexe, et ceux qui considéraient que tous les aspects de la question devaient y être traités. Après moult tergiversations, et en l'état du projet, il a été décidé d'inclure l'ensemble des dispositions dans le texte du projet, mais sous la forme d'une insertion. Le choix est alors laissé au législateur soit d'intégrer ce corpus de règle purement et simplement à sa loi, soit de l'insérer dans un texte de nature réglementaire suivant sa

tradition légistique. Quant au contenu de ces dispositions, le projet ne fait que reprendre les conclusions du Guide technique de la CNUDCI sur les registres. Il consacre ainsi notamment le principe du libre accès au registre et celui selon lequel l'inscription est celle d'un avis et non de la convention constitutive de sûreté. Ce point est fondamental car il autorise la mise en place d'un registre électronique permettant une inscription en ligne et le cas échéant anticipée.

Corolaire nécessaire du principe de l'opposabilité, la question des règles de priorité est aussi articulée autour de quelques principes simples et essentiels. Sans surprise, la Loi modèle fait sienne le sacro-saint principe "*prior tempore, potior jure*" en disposant que la priorité entre des sûretés concurrentes sur un même bien est déterminée en fonction de l'ordre d'inscription au registre des suretés mobilières ou de l'ordre dans lequel ces sûretés sont rendues opposables selon ce qui intervient en premier. De par son caractère consensuel, ce principe est incontestablement facteur d'uniformité. Il en est de même des quelques aménagements que la Loi apporte à ce principe général. Le principal est celui relatif à l'acheteur dans le cours normal des affaires du constituant, généralement un acheteur de marchandises. Celui-ci va prendre le bien libre de toute sûreté, quand bien même elle lui serait opposable, à moins qu'il n'ait eu connaissance au moment de la vente que celle-ci violait les droits du créancier garanti. On peut regretter cette dernière précision. A notre sens, il aurait été plus judicieux de prévoir qu'un tel acheteur prend *toujours* les biens libres de toutes sûretés. En effet, il est légitime de présumer que le créancier qui se fait consentir une sûreté sur des marchandises, accepte nécessairement que le constituant puisse en disposer, la sûreté se reportant alors sur le produit. S'il n'est pas prêt à courir ce risque, il lui suffit de prendre une sûreté avec dépossession. Dans tous les cas, l'acheteur ne saurait, en fait ou en droit, être inquiété.

La Loi modèle invite ensuite le législateur à envisager plusieurs autres conflits à dimension hautement sociale et politique. Il en est ainsi du rang dérogatoire que la Loi entend accorder au créancier finançant l'acquisition du bien grevé. Compte tenu de l'importance économique de ce type de financement, le créancier va pouvoir bénéficier d'une super-priorité lui permettant de primer tout autre créancier ayant antérieurement rendu opposable une sureté sur biens futurs, à condition d'enregistrer un avis dans un certain délai à compter de la vente.

Enfin, s'agissant de la réalisation de la sûreté, le projet reste attaché au principe de libéralisation prôné par le Guide. C'est là une question fort sensible et il est à craindre que nombre de législateurs hésitent, compte tenu de la pression sociale, à s'engager dans cette voie. Conscient du danger, le Groupe a encadré cette libéralisation en conférant certaines garanties au constituant. En cas de défaillance du débiteur, le créancier doit être en mesure de reprendre rapidement, s'il ne l'a déjà, la possession du bien par des voies extrajudiciaires à condition toutefois que le constituant en possession y ait par avance consenti et qu'il ne s'y oppose pas au jour de la reprise de possession. Une fois le bien grevé entre ses mains, le créancier sera alors en droit de le vendre dans le cadre, à son choix, soit d'une vente publique, soit d'une vente privée sous sa propre autorité et après une simple notification faite au constituant. Dans ce dernier cas, il est prévu que la responsabilité du créancier peut être *a posteriori* engagée s'il s'avère qu'il a vendu le bien dans des conditions commercialement déraisonnables. Le créancier peut aussi, alternativement, proposer par écrit d'acquérir le bien à titre d'exécution intégrale ou partielle de l'obligation garantie. Toutefois, en cas de refus du constituant, le créancier devra procéder à la vente du bien. Il ne pourra faire ordonner en justice que le bien lui demeurera en paiement, contrairement à ce que retient le droit français. Nonobstant, ces mécanismes de réalisation apparaissent, objectivement, équilibrés.

B. Un modèle à moduler: les éléments secondaires optionnels

Nous l'avons dit, le droit des sûretés mobilières est trop vaste pour qu'une standardisation soit possible. Trop d'éléments ne pourront être traités de manière uniforme de sorte qu'une certaine marge de manœuvre doit être laissée aux législateurs.

A ce titre, certaines questions n'ont pas été réglées et leurs solutions sont laissées à l'appréciation de l'Etat adoptant. Le cas des conflits avec les créanciers privilégiés en est un bon exemple. Le législateur est simplement invité par la Loi modèle à faire figurer dans le texte qu'il adoptera, la liste exhaustive et limitée des privilèges qui primeront, dans la limite d'un plafond légal, les sûretés conventionnelles. Si une telle démarche se conçoit aisément dans un Guide législatif, elle est à l'évidence plus discutable dans le cadre d'une loi type ou même modèle.

Parfois le législateur est invité, non pas à "remplir les blancs", mais à opérer un choix entre plusieurs options que lui propose le projet, certaines techniques, d'autres plus substantielles. Dans le cadre d'un Guide, il est courant de surmonter l'absence de consensus entre les délégations en offrant au législateur, dans le texte final, une alternative entre les différentes positions possibles. Certes, le recours aux options n'est pas en soi incompatible avec une Loi modèle, mais il est bien évident que ces options en affectent grandement la portée notamment lorsqu'elles portent sur une question essentielle. Le sort de propriété sûreté constituait à cet égard un enjeu considérable [22]. De manière quasi miraculeuse, la difficulté a pu être surmontée, le projet de la CNUDCI n'envisageant désormais que l'approche unitaire. Mais cette uniformité n'est que de façade, puisque la Loi modèle prendra soin d'attirer l'attention du législateur sur le fait qu'il existe une autre approche, l'approche non unitaire, qu'il pourra décider ou non de suivre en se référant aux dispositions du Guide.

De même, la Loi modèle n'ayant pas tranché la question de la durée de l'inscription, elle offre trois options aux législateurs. Certes, l'on pourrait soutenir que ce choix n'est pas gênant en soi, s'agissant de dispositions techniques. Toutefois, sur le plan pratique, on peut regretter une telle distorsion qui ne manquera pas de créer une insécurité juridique pour les créanciers, notamment dans le cas d'opérations transfrontalières. Dans le même sens, le problème de la portée de la publicité, et donc de l'opposabilité de la sûreté, en cas de cession du bien n'a pas pu être résolu de manière uniforme, compte tenu de la divergence irréductible de vues entre les tenants de la protection du créancier et ceux attachés à la fiabilité des informations fournies par le registre. La position de ces derniers est reflétée dans les options A et B [23] de l'article 45, celle des premiers l'étant à l'option C [24].

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22 Ulrich Drobnig, Le projet de guide législatif face à la propriété-sûreté: un casus belli?, Revue Banque & Droit 2004 n° 97; Jean-François Riffard, "Propriété et garanties: faut-il destituer la reine des sûretés? Ou du caractère soluble de la propriété-sûreté dans le Guide Législatif de la CNUDCI sur les opérations garanties", in Repenser le droit des sûretés mobilières, Bibli TUNC, Paris I Sorbonne, LGDJ éd. 2005.

23 Selon l'option A, le créancier doit procéder à la modification de la publicité dans un certain délai à partir du jour du transfert. L'option B reprend la solution de l'option A en faisant cependant partir le délai de la période de grâce du jour où le créancier a eu effectivement connaissance de ce transfert.

24 En vertu de l'option C, la sûreté reste opposable à tous les ayant droits à titre particulier du constituant, solution qui n'est pas sans rappeler l'article 2337 du Code civil français.

Enfin, et quels que soient les efforts déployés par le Groupe de travail, la Loi modèle ne pourra jamais être transposée sans s'accompagner d'une acculturation importante, ne serait-ce que du fait de l'influence qu'a exercé sur elle le *security interest* américain du UCC article IX, et qui la rend parfois, sur certains points, incompatible avec la tradition juridique de nombre d'Etats. Les exemples de ce besoin d'acculturation sont légion. Le premier est celui du choix de la dénomination de la sûreté dont le régime est envisagé dans le cadre de la loi? Fidèle à l'esprit consensuel du Guide, la loi modèle continue d'utiliser une dénomination neutre pour désigner son objet à savoir "*security right* / sûretés réelles mobilières". Mais il est bien certain que ce terme générique a vocation à être substitué par toute autre dénomination que voudra choisir le législateur. Le choix du nom risque de faire naître bien des débats, notamment dans les pays civilistes où il faudra choisir entre "gage", "hypothèque mobilière", voire "nantissement"… sauf à créer un nouveau terme!

De même, l'acculturation conduira à s'interroger dans les pays à droit codifié de tradition civiliste, sur l'emplacement des nouvelles dispositions. Doivent-elles être codifiées, et dans l'affirmative figurer *in extenso* dans le Code civil ou peuvent-elles être éclatées entre ce code et le Code de commerce, dans la mesure où bon nombre de règles intéressent des relations de nature commerciales? A l'évidence, la première solution devra être privilégiée, sauf à annihiler l'effort de cohérence et de sécurité juridique recherché. L'exemple de la réforme française du 23 mars 2006 sur ce point, est malheureusement là pour conforter cette position.

En guise de conclusion: loi type / loi modèle, deux facettes d'un même instrument à densité variable

Cette brève étude consacrée à la nature du projet de "loi type" sur les opérations garanties nous amène à tirer deux enseignements majeurs.

Le premier a trait au choix de l'instrument. Le Groupe a opté, en fait, pour l'élaboration d'une "Loi modèle", conscient de l'impossibilité d'établir un régime standard commun à tous les systèmes juridiques. Ce constat est exact. Une loi type était impossible. Mais une autre solution existait peut être: en rédiger plusieurs. N'aurait-il pas été opportun d'établir autant de sous-modèles particuliers qu'il y a de systèmes juridiques? Partant du constat de l'existence de différences conceptuelles irréductibles entre le modèle de *Common law* et le système de droit civil en matière de

sûretés réelles, l'établissement d'au moins deux lois types, l'une respectant les standards techniques du UCC article IX, et l'autre les aménageant afin de les rendre compatibles avec la tradition civiliste pouvait apparaître comme une solution raisonnable. Pour preuve, n'est-ce pas ce que préfigurent les premières applications du projet de "loi type" de la CNUDCI? Car, et ce n'est pas le moindre des paradoxes, cet instrument est déjà en fait sinon en droit, utilisé avant même son adoption. De nombreux états ont déjà (Mexique, Colombie, Vietnam, Ghana, Guatemala) ou vont bientôt (Burundi, Haïti) adopté avec l'assistance de la Banque Mondiale, des réformes basées sur les préconisations du Guide et du projet de Loi, tout en les adaptant à leur contexte juridique. Comme pressenti, ce sont bien alors autant de véritables "Lois types" qui commencent à se dessiner, une pour chaque groupe de réformes mises en place par des Etats appartenant à un même système et à une même tradition juridique.

Le second enseignement est d'ordre plus général. A travers ce nouvel instrument, nous avons été amenés à constater que la loi type n'est pas un concept unitaire, mais plural. Les lois types peuvent donc présenter des densités normatives variables, certaines, vraies lois types, se rapprochant plus des Conventions, alors que d'autres, les vraies lois modèles, n'ont vocation qu'à servir d'exemple aux législateurs qui pourront les suivre plus ou moins fidèlement. Cette distinction fait toutefois naître deux difficultés. La première concerne le critère de distinction entre ces deux formes de lois types ou modèles. Tout dépend à notre sens du degré de standardisation auquel seront parvenus *in fine* les rédacteurs de tout projet de loi modèle. En clair, le choix entre les deux formes ne se ferait pas *ab initio*, mais à la fin, une fois le projet en voie d'achèvement. La seconde difficulté est d'ordre terminologique. S'il est aisé de trouver dans la langue française deux termes désignant chacune de ces deux formes de lois, il risque de ne pas en être de même pour nos amis anglophones qui seront confrontés à cette question: *How shall we translate "loi type" in English?*

THE UNCITRAL MODEL LAW ON SECURED TRANSACTIONS – A SWISS PERSPECTIVE

Hans Kuhn*

I. Introduction

Switzerland is an important financial center with a established practice and a modern statutory framework for creating security interests both in financial assets[1] and in real estate.[2] The law is much less satisfactory with respect to non-financial movable assets. Inventory, equipment, trade receivables, intellectual property rights, and other assets typically found on the balance sheet of small and medium-sized enterprises (SMEs) are not normally accepted as good collateral in order to secure the performance of an obligation. There is little doubt that these shortcomings have a negative impact on SMEs' access to credit. A broad consensus has therefore emerged in recent years that the law relating to security over personal property must be reformed. Hitherto, however, these calls have been largely ignored by the legislator and the business comunity.

This article argues that the UNCITRAL Model Law on Secured Transaction[3] should and will play a key role in any future reform process. The

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1 The law governing security interests in securities held with an intermediary was radically modernized a few years ago with the adoption of the Federal Intermediated Securities Act (FISA) of 3 October 2008. On the FISA see Hans Kuhn / Barbara Graham-Siegenthaler / Luc Thévenoz (eds.), *The Federal Intermediated Securities Act (FISA) and the Hague Securities Convention (HSC)*, Bern: Stämpfli 2010; see also Hans Kuhn, The Geneva Securities Convention and the Swiss Intermediated Securities Law Reform, in: Pierre-Henri Cognac / Ulrich Segna / Luc Thévenoz (eds.), *Intermediated Securities, The Impact of the Geneva Securities Convention and the Future European Legislation*, Cambridge: CUP 2013, p. 288–308.

2 The law relating to security in real estate, codified in articles 793–865 CC, has also been modernized recently by introducing a dematerialized mortgage bond (*Registerschuldbrief*: see articles 857 seq. CC).

3 This article refers to the September 2014 version of the draft: see UNCITRAL, Draft Model Law on Secured Transactions, Note by the Secretariat, A/CN.9/WG.VI/WP.61 (30 September 2014).

Model Law provides an excellent synthesis of contemporary personal property security legislation and is, moreover, very well structured and easily comprehensible. Therefore, it appears to be an excellent starting point for advancing the reform debate. However, it is too early to say whether a future Swiss Personal Property Security Act should be based on a partial or wholesale adoption of the Model Law. The answer will depend on how easily the Model Law lends itself to being integrated into the fabric of Swiss private law.

The remainder of this article is in two parts. First, it makes (again) the case for a reform of Swiss personal property security law by briefly describing the problems faced by SMEs in obtaining credit (II/A), which can largely be explained by legal and *de facto* restrictions on the use of most assets typically found on SMEs' balance sheets as collateral (II/B). The first part concludes with an overview of the state and main results of the discussion of a possible reform of personal property security law in Switzerland (II/C). The second part discusses the role that the Model Law can and should play in any such reform. It argues that the Model Law is based on economic and legal policies which are broadly supported by legal scholars in Switzerland and which represent sound commercial and business practice (III/B). However, a wholesale adoption of the Model Law would raise a number of conceptual issues, including replacing the current range of security devices by a single unitary security interest (III/C/1); the role of registration and other publicity requirements (III/C/2); and the legal concept of extending security rights to include assets replacing the initial collateral (III/C/3). The article then discusses a number of potential stumbling blocks to any secured transaction reform (IV), and ends with a few concluding remarks (V).

II. The Case for a Reform of Switzerland's Secured Transactions Law

A. SMEs' Access to Credit

Bank credit is an important source of finance for firms in Switzerland, particularly smaller firms.[4] While credit markets in Switzerland are, generally

4 See Eidg. Volkswirtschaftsdepartement (EFD), Bericht an die Kommission für Wirtschaft und Abgaben des Nationalrates (WAK-N), "Kreditversorgung der Schweizer

speaking, working well, and there is no evidence that Swiss businesses are suffering from credit rationing, let alone a credit crunch,[5] complaints from SMEs about difficulties in obtaining credit and worsening credit conditions are frequent and persistent. According to a 2013 survey commissioned by the State Secretariat for Economic Affairs (SECO),[6] 5% of SMEs which had recently applied for a bank credit reported that their application had been rejected,[7] and 50% of those seeking finance complained about a deterioration of credit conditions.[8] Difficulties in obtaining credit were encountered in particular by micro-firms (up to 10 employees) and small firms (11–49 employees).[9] The same survey also found that only about two thirds of all firms have bank credit or a credit line – meaning that one in three firms has no access to bank credit.[10]

Wirtschaft: Lagebeurteilung und möglicher Handlungsbedarf", Bern, 28 September 2009, p. 8. The total value of credit lines extended to firms was CHF 490.7 bn. in September 2014, of which about CHF 356.7 bn. was actually used. See Swiss National Bank, Credit Volume Statistics, www.snb.ch/de/emi/KRED (last accessed 15.1.2015).

5 See EFD (note 4), p. 19 [report commissioned by National Council committee stating that even during the financial crisis, credit conditions for Swiss firms were "relatively relaxed," with commercial credits increasing by 4.5% in one year]; see also BAK Basel, "Finanzplatz Schweiz, Volkswirtschaftliche Bedeutung und Wechselwirkungen mit dem Werkplatz," Basel, March 2011, p. 14 [no credit crunch during financial crisis] and 15 [Switzerland has lowest capital costs worldwide].

6 MIS Trend, "Studie zur Finanzierung der KMU in der Schweiz durchgeführt im Auftrag des SECO," Lausanne/Bern, January 2013; cf. SECO, Stabile Unternehmensfinanzierung, Medienmitteilung, 22.1.2013.

7 MIS Trend (note 6), p. 20 ff.

8 MIS Trend (note 6), p. 38, 48.

9 Schweizerisches Institut für Klein- und Mittelunternehmen an der Universität St. Gallen (KMU-HSG), "Wirkungsanalyse Bürgschaftswesen, Teilprojekt Marktstellungsanalyse," March 2013, p. 23 ["micro and small firms with less than 50 employees primarily faced with problems obtaining credit"]. The paper argues that public guarantee programs are necessary to remedy a market failure in the credit markets for small and young firms. See HSG-KMU (note 9), p. 17.

10 MIS Trend (note 6), p. 9 ff. The survey is consistent with earlier research by SECO: *see* EFD (note 4), p. 8. However, another survey found the percentage of firms without a bank credit line to be much lower, at around 11%. *See* Gabrielle Wanzenried Mowers, "Kapitalstrukturentscheide von KMU – Empirische Evidenz für die Schweiz," in: Christoph Lengwiler/Linard Nadig/Maurice Pedergnana (eds.), *Management in der Finanzbranche – Finanzmanagement im Unternehmen*, Zug: Verlag IFZ, 2012, p. 260.

Credit is granted to SMEs mostly on a secured basis, in particular credit to smaller and younger firms.[11] In the case of micro- and small firms only 20% of credit is granted on an unsecured basis,[12] compared to more than 50% in the case of large firms.[13] It is no surprise therefore that SMEs cite the lack of adequate collateral as the single most important reason for difficulties in obtaining credit.[14] It has long been acknowledged that collateral does not only limit the creditor's exposure if the debtor defaults: It also helps to overcome information asymmetries between creditor and debtor by mitigating problems of adverse selection and moral hazard.[15] Collateral can also help to mitigate credit rationing.[16] Problems with information asymmetries are most often encountered by very small and start-up firms which have no track record or have other problems with supplying information requested by banks.[17]

B. Restricted Use of Assets as Collateral

The reason why small and start-up firms encounter problems with providing sufficient security is simple: Most of the assets typically to be found on an SME balance sheet are not accepted as good collateral by banks or other lenders. By far the most important class of collateral is real estate, securing about two thirds of the credit volume extended to firms and about 74% in the case of micro-firms.[18] Other asset classes, including trade receivables, inventory, equipment, and intellectual property rights, are not normally considered as good collateral. Therefore unless a firm owns unencumbered real estate or sufficent financial assets (intermediated securities or cash), it can borrow only on an unsecured basis.

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11 HSG-KMU (note 9), p. 5, 17, 32.
12 HSG-KMU (note 9), p. 17.
13 HSG-KMU (note 9), p. 17.
14 HSG-KMU (note 9), p. 16 seq. See also Kathrin Wallquist, "*Kreditvergabe an Jungunternehmen in der Schweiz, Kriterien und Pricing im Vergleich zu etablierten KMUs*," Basel: University, 2009, p. 43, 45.
15 HSG-KMU (note 9), p. 17; Hans Kuhn, *Schweizerisches Kreditsicherungsrecht*, Bern: Stämpfli, p. 23 seq.
16 Kuhn (note 15), p. 25.
17 HSG-KMU (note 9), p. 17.
18 HSG-KMU (note 9), p. 25 (based on Swiss National Bank's credit volume statistics).

It is important to note that in this respect Swiss law is more restrictive than any other European legal system. The laws of all neighboring states, and also English law, have developed practices and schemes making it possible to perfect security interests in assets in the debtor's possession.[19] Moreover, the practice of financing by means of receivables is much more widely used in these countries than in Switzerland.

1. Trade Receivables

Trade receivables – i.e. receivables stemming from the sale of inventory or the provision of services – normally play a major role as collateral for SMEs, particularly in the services industry where no tangible assets are being produced or sold. However, Swiss banks do not usually lend against trade receivables as collateral.[20]

There is no obvious explanation for this limited relevance of trade receivables financing. Swiss law provides for two approaches to using trade receivables as collateral: pledging of claims (*Forderungspfandrecht*, article 899 seq. CC) and assignment for security purposes (*Sicherungszession*, article 164 seq. CO).[21] Both methods require the grantor to execute an instrument in writing (articles 900 (I) CC, 165 (I) CO).[22] However, no notification or similar procedure is required to make the pledge or the assignment effective against third parties.[23] Swiss law also recognizes the assignment of future claims as effective against the assignor's insolvency trustee, provided that the assigned claim arises before commencement of the insolvency proceedings.[24] Swiss law also permits the global assignment

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19 For a comprehensive comparative description see Barbara Graham-Siegenthaler, *Kreditsicherungsrechte im internationalen Rechtsverkehr*, Habil Zürich, Bern: Stämpfli 2005, p. 108, 787 seq.

20 See Kuhn (note 15), p. 391 f.

21 Kuhn (note 15), p. 389 seq.

22 Kuhn (note 15), p. 403.

23 A pledge of a claim represented by a deed also requires the transfer of that deed in order to make the pledge effective against third parties. See article 900 (1) CC. It is unclear what exactly constitutes a deed for the purposes of article 900 (1) CC and whether the same applies to assignment for security purposes. See Lionel Aeschlimann / Bénédict Foëx, "Sûretés mobilières: limites et réforme du droit suisse," in: Luc Thévenoz / Christian Bovet (eds.), *Journée 2005 de droit bancaire et financier*, Geneva/Zurich: Schulthess, 2006, p. 17–38, p. 28; Kuhn (note 15) p. 404 seq.

24 Kuhn (note 15) p. 393. See ATF 113 II 163, now codified in article 297 (4) DEBA.

of present and future claims.[25] Hence, the legal framework as such is not unfriendly towards receivables financing.

However, two legal shortcomings are frequently identified as major obstacles to receivables financing.[26] *First*, both the pledge of claims and the assignment for security purposes are non-public forms of security. Lenders therefore have no way of making sure that they do indeed acquire a first-ranking security interest in trade receivables assigned or pledged. *Second*, and more importantly, contractual clauses prohibiting the assignment of trade receivables are prevalent in many industries, and are even imposed by public sector entities charged with the procurement of goods or services.[27] Under Swiss law, an anti-assignment clause prevents the assignor from acquiring any rights in the claim assigned – an assignment (or a pledge) in contravention of an anti-assignment clause is therefore null and void.[28] A bank wishing to lend against trade receivables would therefore have to review the underlying contracts contionuously and carefully. It is for these and other reasons, that banks are reluctant to accept the assignement of trade receivables as collateral.

Factoring is a business practice better suited to tackle both of these shortcomings, in particularly if the factor also provides his client with account management services (full-service-factoring/standard-factoring). This enables him not only to monitor the client's business and cash flows on a continuous basis, but also to review the underlying contracts giving rise to the assigned receivables. Factoring has had a relatively slow start in Switzerland, but has gained a lot of traction more recently, with a total annual turnover estimated to be in the range of CHF 3.5 billion.[29]

25 ATF 112 II 433.

26 Aeschlimann/Foëx (note 23), p. 28; Kuhn (note 15), p. 396 seq.

27 Bénédict Foëx, "Sûretés mobilières: propositions pour une réforme," *Zeitschrift für schweizerisches Recht* 2007 II, p. 306; Kuhn (note 15), p. 397.

28 Kuhn (note 15), p. 396 seq.; see also Daniel Girsberger, "Reformbedarf beim pactum de non cedendo? Das vertragliche Abtretungsverbot im Lichte neuerer Entwicklungen in Gesetzgebung und Wirtschaftspraxis," in: Franco Lorandi / Daniel Staehelin (eds.), *Innovatives Recht, Festschrift für Ivo Schwander*, Zürich/St. Gallen: Dike 2011, 319–337 [Need to reform the law on anti-assignment clauses].

29 *See* Nadine Lethinen, "Wettbewerbsvorteile durch Factoring," in: *International Business*, February 2014.

2. Inventory

Inventory represents another important asset class for both trading and retail firms, as well as for manufacturers. It includes raw materials, work-in-process goods, and completely finished goods ready for sale.[30] Inventory is by definition used in the course of a manufacturing or resale process and must therefore remain under the debtor's control. Current Swiss law provides no legal instrument or technique permitting the use of inventory in order to secure credit.

The main reason for this state of play is the Civil Code's prohibition of the non-possessory pledge in movables (article 884 (3) CC), which also applies to full-title transfers for security purposes (*transfert de propriété à titre de garantie*; *Sicherungsübereignung*; article 717 (1) CC). This prohibition dates back to the enactment of the Civil Code in 1907.[31] The Code's drafter, Eugen Huber, had proposed to introduce a non-possessory security interest for cattle, equipment, and inventory used for commercial purposes. Perfection of the security interest would have required registration in a public registry.[32] In the course of the legislative process, the non-possessory security interest was restricted to cattle and then replaced by a retention of title scheme (*Eigentumsvorbehalt, rétention de titre*; article 715 CC). Retention of title, however, is not suitable for inventory, given the short-term nature of this asset class and the bureaucratic way the scheme is operated (see infra p. 68).

3. Equipment

The prohibition of non-possessory security interests also makes it impossible for firms to use operating equipment as collateral. Equipment comprises tangible assets used by a firm in the operation of its business, like machinery, rolling stock, or tools. However, Swiss law provides for two

30 See the definition in article 2(r) Model Law.

31 See Eugen Huber, *Erläuterungen zum Vorentwurf eines schweizerischen Zivilgesetzbuches*, vol. II: *Das Sachenrecht*, 2nd ed., Bern 1914, p. 119. See also Kuhn (note 15), p. 204 seq.; Föex (note 27), p. 300 seq.

32 See Huber (note 31), p. 119. See also Kuhn (note 15), p. 204 seq.

alternative methods to secure the financing of equipment purchases: retention of title, and financial leasing arrangements.[33]

a. Retention of Title

The retention of title right (*Eigentumsvorbehalt, rétention de titre*) pursuant to article 715 CC is the only non-possessory security interest permitted by Swiss law.[34] Perfection of the retention of title agreement requires the filing of a notice with a public registry at the debtor's seat or residence. This register is maintained by the debt enforcement offices, which are organized locally. This means that there are roughly 700[35] retention-of-title registries in Switzerland – a lot of local government even for federalist Switzerland. The filing procedure is highly bureaucratic (see article 7 RTO), resulting in costs of up to CHF 150 per entry.[36] If the debtor moves its residence or seat to another municipality, the entry loses its effectiveness after a grace period of three months (article 3 (I) RTO), even if the secured creditor did not know (and could not have known) that the debtor had moved.[37] The scheme does not provide for the extension of the security interest to the proceeds if the goods are sold or processed, making retention of title

33 Article 885 CC also permits the perfecting of a non-possessory pledge in cattle, but this kind of arrangement is completely irrelevant in practice; see Kuhn (note 15), p. 304 seq. Non-possessory security interests modeled on real-estate mortgages can also be established in aircraft, ships, and railways. See Kuhn (note 15), p. 290 seq.

34 Article 715 CC, the statutory basis for the retention of title scheme, stipulates that retention of title arrangements must be registered in a public register in order to make them effective *erga omnes*, but does not provide any details on the organisation of the registry system or the effects of a registration. This gap was filled in 1910 by the Federal Tribunal in its capacity as supervisory authority over the debt enforcement agencies (a power transferred to the Federal Council in 2005). See Ordinance on the Registration of Retention-of-Title Arrangements of 19 December 1910 (RTO).

35 See Federal Office of Justice, *Potentiale des eSchKG Verbundes im Hinblick auf eine Modernisierung des Betreibungswesens in der Schweiz* (April 2011), p. 6.

36 See article 37 of the Ordinance of 23 September 1996 on Fees levied under the Debt Enforcement and Bankruptcy Act (DEBA). The registration of a retention of title costs between CHF 25 (debt of up to CHF 1000) and CHF 150 (debt of more than CHF 10,000). The fee for searching the registry is CHF 8 per page.

37 See ATF 96 II 161 [debtor had moved place of residence (but not place of business) to another municipality. Secured creditor loses property after three months even though court and other public documents had referred to the former place of residence and the creditor had relied on those documents].

impractical with respect to inventory.[38] The usefulness of the scheme is also limited by a number of additional shortcomings, including restrictions on the claims which can be secured.[39] Last but not least, the filing affords the seller only a very limited protection in a priority dispute with a good-faith purchaser, because the law does not impose any obligation to search the registry.[40]

The retention of title scheme could have easily become the nucleus for a modern, publicity-based secured transactions system. Due to its shortcomings it is largely irrelevant today. While no statistical data is available, according to estimates no more than 30,000–40,000 entries, relating to assets with a total value of less than CHF 1 billion, are in existence at any given moment.[41]

b. Financial Leasing

Much more important are financial leasing arrangements: at the end of 2013 the total volume of the financial leasing market was about CHF 26 billion.[42] Assets frequently leased include private cars, commercial rolling stock, and other movable equipment such as machinery, construction equipment, computer and office equipment, medical equipment, ships, and aircraft.[43]

Financial leasing took hold in Switzerland more than 40 years ago and has gained importance steadily since then. It found statutory recognition when the Consumer Credit Act[44] subjected leasing arrangements

38 See Kuhn (note 15), p. 324 seq.

39 Claims arising directly from the sale of assets by the manufacturerer or seller can be secured by way of a retention of title, but not credit extended by a third party (e.g., a bank) to permit the acquisition of an asset. See Kuhn (note 15), p. 328. In addition, the courts have been extremely restrictive in construing what constitutes a sale: see ATF 102 III 150 E.2 [purchase price for coffee machine to be paid by purchasing coffee beans; registration denied]; ATF 56 III 79 [purchase price for shop equipment; registration denied because purchase price included compensation for goodwill].

40 See Kuhn (note 15), p. 337 seq.

41 See Kuhn (note 15), p. 311.

42 See Schweizerischer Leasingverband, Zahlen zur Marktentwicklung 2013, www.leasingverband.ch/de/slv/marktuebersicht/marktentwicklung/index.htModel Law.

43 See Schweizerischer Leasingverband, Zahlen zur Marktentwicklung 2013, www.leasingverband.ch/de/slv/marktuebersicht/marktentwicklung/index.html.

44 Federal Act of 23 March 2001 on Consumer Credit (CCA). See article 11 CCA.

entered into with private persons for non-commercial purposes to a number of formal and substantive requirements. As in many other civil-law jurisdictions, its place in Switzerland's private law system remained controversial for some time. This issue was largely settled after the Federal Tribunal began to qualify financial leasing as a contract *sui generis* allowing the lessee the use of an asset (*Gebrauchsüberlassungsvertrag sui generis*).[45] Moreover, in the 1993 landmark case *Wyss Holzbau*[46] the Federal Tribunal recognized the lessor's priority against the bankruptcy estate in the event of the lessee's insolvency. The Federal Tribunal's reasoning in this case was rather cryptic, as it based its conclusions mainly on the lower court's holding that the parties to the contract had no intention of transferring property from the lessor to the lessee.[47] However, the Federal Tribunal also recognized the "special features of leasing arrangements … which grant the lessee economic ownership while the lessor retains legal ownership of the leasing asset in order to secure its claim."[48] Some authors understood the Wyss Holzbau case as a conscious decision by Switzerland's Supreme Court to create a security interest *sui generis*, effective in the debtor's insolvency and not subject to any publicity requirements.[49]

While Wyss Holzbau is still good law, the courts have imposed a number of limitations and qualifications. First, the holding does not apply if the lower court finds that the parties' intent was in fact to transfer the property, as the Basle Court of Appeal found in a 1996 case involving the lease of office equipment.[50] Second, the Wyss Holzbau holding applies only to three-party leasing arrangements, not to sale-and-lease-back.[51] Third, the lessor has priority only if the leasing arrangement was entered into before

45 See Kuhn (note 15), p. 353 seq.

46 ATF 118 II 150.

47 ATF 118 II 150 c. 6c.

48 ATF 118 II 150 c. 6c.

49 See Kuhn (note 15), p. 365; Bernhard Berger, "Registrierung von Mobiliarsicherheiten, Vorschläge zu einer Reform des Mobiliarsicherungsrechts," *Zeitschrift des bernischen Juristenvereins* 2002, p. 197 seq., p. 234; Gerhard Walter, "Sicherungsrechte heute – Probleme und Lösungsansätze," in: Heinrich Honsell et al. (eds.), *Aktuelle Aspekte des Schuld- und Sachenrechts, Festschrift für Heinz Rey zum 60. Geburtstag*, Zürich: Schulthess 2003, p. 141 seq., p. 143.

50 AppGr. BS, 3.4.1996, BJM 1997, 26 c.3c.

51 Cf. Kuhn (note 15), p. 366 seq.

delivery of the asset to the lessee; otherwise the latter acquires ownership.[52] Finally, the lessor normally has no priority in a dispute with a party who purchased from the lessee in good faith, whether or not the sale took place in the lessee's ordinary course of business,[53] though there is an important exception relating to cars and other registered vehicles.[54] In that particular instance, a slightly absurd situation arises whereby the lessor is in a better position than the seller under a registered retention of title arrangement.

4. Intellectual Property and Other Rights

Intellectual property rights (IP rights) ought to be considered as a relevant source of collateral for start-up and high-tech firms, and for certain service providers for whom IP rights are among the most important balance sheet items. There is only anecdotal evidence regarding the frequency of secured transactions involving IP rights in Switzerland.[55] It seems that IP rights are sometimes used as collateral in financing transactions, but so far no relevant commercial practices have evolved in which IP rights are used to secure credit.

IP rights can be pledged and also assigned under Swiss law.[56] The possibility of pledging IP rights is expressly provided for in the Trademarks Act,[57] but is generally recognized even without express statutory provision.[58] With respect to the method of perfecting a security interest, IP rights qualify as "other rights" under article 899 (1) CC.[59] A pledge of

52 ATF 119 II 236; see also HGr. BE, 22.9.1992, BlSchK 1993, 65 c.3.

53 See Kuhn (note 15), p. 367 seq.

54 See Kuhn (note 15), p. 367 seq. An important exception applies to financial leases relating to cars and other vehicles where the leasing arrangement is annotated on the car title (so called SLV-Code 178), thus effectively preventing acquisition by a good-faith purchaser.

55 So far no article or research paper has been published dealing with the use of IP rights as collateral for secured transactions under Swiss law. But see Aeschlimann/Foëx (note 23), p. 28.

56 IP rights can be pledged or assigned if they are transferable; this now applies to all IP rights with the exception of the author's right to be named (*Urheberpersönlichkeitsrecht*).

57 Article 19 Trademark Act; article 30a Trademark Ordinance.

58 Roland von Büren/Eugen Marbach/Patrik Ducrey, *Immaterialgüter- und Wettbewerbsrecht*, Bern: Stämpfli 2008, p. 180.

59 Von Büren/Marbach/Ducrey (note 58), p. 180.

"other rights" is perfected by entering into a written pledge agreement and "the observance of such other form as may be prescribed for transferring the respective right" (see article 899 (1) CC). None of the Intellectual Property Acts requires any additional perfection requirement, even if the existence of the right requires registration (e.g. for patents and trademarks).[60] However, the registration of a pledge over patents or trademarks protects the secured creditor against good-faith acquirers. Article 132 (2) DEBA deals with the enforcement of security interests in IP rights, providing that the debt enforcement agency shall request its supervisory authority to specify the applicable procedure. The authority may order the sale of the right by way of a public auction or by appointing an executor or by making "any other appropriate arrangement" (article 132 (3) DEBA).

Other rights, such as goodwill, know-how, and trade secrets, are not recognized as objects of a disposition under Swiss private law.[61] Even if they represent an important economic value, such rights can be used as collateral only by encumbering the whole firm, e.g. by pledging its shares.[62]

III. Calls for Reform

For many years, legal professionals and academics have been harshly criticizing the lack of a reasonable legal framework for secured transactions.[63]

60 See article 33 (4) Patent Act; article 17 (2), 19 (2) Trademark Act; article 14 (2), 16 (2) Design Act; article 18 Varitey Protection Act (Sortenschutzgesetz).

61 Aeschlimann/Foëx (note 23), p. 28; Antoine Eigenmann, *L'effectivité des sûretés mobilières*, Fribourg 2001, p. 24 seq., 354.

62 Eigenmann (note 61), p. 24.

63 See (in chronological order) Wolfgang Wiegand, "Fiduziarische Sicherungsgeschäfte," *Zeitschrift des bernischen Juristenvereins* 1980, 537–567, 557 (Wiegand, ZBJV 1980) [proposing to use a retention-of-title registry to publish other non-possessory security interests]; Stephan Ottrubay, "Die Eintragung des Eigentumsvorbehalts unter besonderer Berücksichtigung des internationalen Rechts und der internationalen Harmonisierungsbestrebungen," Diss. Fribourg 1980, 85 seq. [proposals for improving the retention-of-title scheme]; Peter Altorfer, "Die Mobiliarhypothek. Ein Beitrag zur Reform des Fahrnispfandrechts," Diss. Zürich 1981, 211 seq. [proposing non-possessory security interests in inventory and equipment; registry]; Luc Thévenoz, "La fiducie, cendrillon du droit suisse. Proposition pour une réforme," *Zeitschrift für schweizerisches Recht* 1995 II, p. 253–363, 312 [non-possessory security interest in inventory and equipment]; Diego Bischof, *Le leasing de biens mobiliers. Etude de droit positif et*

Many have called for the introduction of a non-possessory security interest based on a centralized electronic registry.[64] Several authors have also put forward detailed proposals, including Antoine Eigenmann, who published a draft Federal Secured Transactions Act (*Loi fédérale sur les sûretés mobilières*, *Bundesgesetz über Mobiliarsicherheiten*) as an annex to his doctoral thesis submitted in 2001.[65] Graham-Siegenthaler drew up a blueprint for a future legal framework in the form of 40 proposals which are part of her professorial thesis published in 2005.[66] These calls for reform were forcefully echoed at the 2007 annual meeting of the Swiss Lawyers'

désirable, Lausanne 1996, 215 seq. [registry for financial leasing arrangements]; Daniel Girsberger, Ist das Faustpfandprinzip noch zeitgemäss? *Schweizerische Juristenzeitung* 1997, 97–109, 103 ff [arguing for a national webbased registry]; see also Daniel Girsberger, *Grenzüberschreitendes Finanzierungsleasing*, Habil. Zürich 1997, 184 seq., 512 seq.; Theodor Bühler, *Sicherungsmittel im Zahlungsverkehr. Dokumentenakkreditiv, Bankgarantie, Eigentumsvorbehalt*, Zürich 1997, 211 seq. [non-possessory security interest in equipment based on registration in a centralized registry]; Wolfgang Wiegand, "Eigentumsvorbehalt, Sicherungsübereignung und Fahrnispfand," in: Wolfgang Wiegand (ed.), *Mobiliarsicherheiten*, Bern 1998, 75–135, 127 seq. (Wiegand, Mobiliarsicherheiten) [proposing a centralized electronic registry]; Nicolas Iynedjian, *Les sûretés globales*, Zürich 1999, 214 seq. [global security based on electronic registry accessible by internet]; Eigenmann (note 61), p. 337 seq.; Berger (note 49), p. 197; Walter (note 49), p. 141; Graham-Siegenthaler (note 19), p. 724 seq.; Wolfgang Wiegand, "Zur Reform des Kreditsicherungsrechts – Der UNCITRAL Legislative Guide on Secured Transactions und das nationale Recht," in: Klaus-Peter Berger et al. (eds.), *Private and Commercial Law in a European and Global Context, Festschrift für Norbert Horn zum 70. Geburtstag*, Berlin: De Gruyter 2006, p. 177–190, p. 179 seq. (Wiegand, FS Horn); Daniel Girsberger, "Mobiliarhypothek gestern und heute," in: Daniel Girsberger / Michele Luminati (eds.), *ZGB – gestern – heute – morgen, Festgabe zum Schweizerischen Juristentag 2007*, Zürich: Schulthess, p. 247–272; Aeschlimann / Foëx (note 23), p. 31 seq.; Corinne Zellweger-Gutknecht, "Vermögenswerte im Finanzmarktrecht – das Ende aller dinglichen Prinzipien?" in: Tanja Domej et al. (eds.), *Jahrbuch Junger Zivilrechtswissenschaftler 2008*, Stuttgart etc. 2009, p. 87 seq., 106; Kuhn (note 15), p. 207. To the best of my knowledge only one author so far has expressed doubts with regard to the need for reform: see Nataša Hadžimanović, "Die allgemeine Mobiliarhypothek – unentbehrlich fürs Schweizer Recht?, *Aktuelle Juristische Praxis* 2009, p. 1335–1352.

64 See Berger (note 49), p. 507 seq.; Wiegand, Mobiliarsicherheiten, (note 63), p. 127 seq.; Foëx (note 27), p. 328 seq.; Walter (note 49), p. 150 seq.; Kuhn (note 15), p. 207 seq.; Girsberger (note 63), p. 103 ff.

65 Eigenmann (note 61), p. 337 seq. (in French, with commentary), p. 431 (German translation).

66 Graham-Siegenthaler (note 19), p. 724 seq.

Association, an assembly of the Swiss legal profession with a proud record of pushing for legislative reform. Based on an analysis of the shortcomings of the current law and a proposal for reform presented by Foëx,[67] the assembly unanimously adopted a resolution exhorting the federal legislator "to proceed to a reform of the law on security in personal property and to introduce a general non-possessory security interest."[68]

The reaction to this resolution was … nil, zero, naught. None of the 248 members of the Swiss parliament – normally always eager to suggest improvements to the law – followed up the topic, even though discussions about SMEs suffering from a credit crunch ranked high among politicians' concerns during and after the financial crisis. The Federal Office of Justice says it cannot put forward a legislative proposal without a political mandate and/or the support of the business community. And the business community simply ignored the topic, most likely because no connection was made between secured transactions law and affordable credit. At the time of writing, therefore, it is unclear if and when the reform of the law relating to security in personal property will actually find its way on the political agenda.

While a broad consensus exists with respect to the need for and the general direction of a reform, many conceptual issues, and many details of the putative legislative framework, remain subject to debate.[69] Very roughly speaking, the following benchmarks for future legislation on personal property security law seem to emerge:

– There seems to be general agreement that future legislation should encompass *all forms of security*, i.e. not only pledges and full-title transfers of property (*Sicherungsübereignung*), but also retention-of-title arrangements and financial leases.[70] Assignments, including assignments for security purposes as well as outright assignments, should be covered by the legislation.[71] However, only a minority of authors are

67 Foëx (note 27), p. 287.

68 See "Verhandlungen des Schweizerischen Juristentags vom 21./22. September 2007 in Luzern" [minutes of discussions at Swiss Lawyers' Day], www.juristentag.ch/Tagungsprotokoll_220907.pdf (last accessed 15.1.2015).

69 See Zellweger-Gutknecht (note 63), p. 87 seq., 106.

70 Graham-Siegenthaler (note 19), p. 738, 740 seq., 747 seq.; Eigenmann (note 61), p. 358.

71 Eigenmann (note 61), p. 368 seq. [but only if the assignor is a firm]; Graham-Siegenthaler (note 19), p. 756 seq.

in favor of adopting the concept of a unitary security interest (see infra p. 79 seq.).[72]

– Most proposals call for any future personal property security legislation to have a *broad scope*, covering all sorts of movables, receivables, securities (other than intermediated securities), and other rights, including intellectual property, goodwill, know-how, and trade secrets.[73] Indeed, there seems to be no other way to avoiding gaps, overlaps, and contradictions.[74] It ought also to be possible to perfect a security interest in a collection of objects (*Sachgesamtheiten*, *universalités*), such as an entire firm;[75] and in assets that the grantor may acquire in the future.[76] Finally, all kind of debt can be secured, including future, conditional, or potential debt.[77]
– There is general agreement that security interests in personal property must be subject to *publicity requirements* and that non-possessory security interests are published by registration in a national public registry.[78] The need for the registry to be easily accessible for both filings and searches is emphasized by a number of commentators.[79] They also stress the need to limit the information to be filed to a minimum ("notice filing system") in order to avoid a filing process too burdensome.[80] There are diverging views, however, as to whether publicity is a condition for the creation of a security interest or only

72 Graham-Siegenthaler (note 19), p. 756 seq. Foëx (note 27), p. 326 proposes a new kind of security interest which would supplement the existing forms (pledge, full-title security interest etc.), though the latter would continue to exist.

73 Foëx (note 27), p. 325; Graham-Siegenthaler (note 19), p. 738 seq.; Eigenmann (note 61), p. 353 seq.

74 Foëx (note 27), p. 326.

75 Foëx (note 27), p. 332 seq.; Eigenmann (note 61), p. 372.

76 Foëx (note 27), p. 334.

77 Foëx (note 27), p. 334.

78 Eigenmann (note 61), p. 389 seq.; Graham-Siegenthaler (note 19), p. 758 seq.; Berger (note 49), p. 211 seq.; Foëx (note 27), p. 328 seq.; Walter (note 49), p. 150.

79 Eigenmann (note 61), p. 389 seq.; Graham-Siegenthaler (note 19), p. 758 seq.; Berger (note 49), p. 224; Foëx (note 27), p. 328 seq.; Walter (note 49), p. 152.

80 Graham-Siegenthaler (note 19), p. 764 seq. ["notice filing system"]; Berger (note 49), p. 224; Foëx (note 27), p. 331 seq.; Walter (note 49), p. 152. But see Eigenmann (note 61), p. 407 seq., whose proposal for an ordinance on the central personal property security registry seems to have been inspired by the land registry.

a condition for the effectiveness of the security interest against third parties (see infra p. 82 seq.).[81]

– Several authors have emphasized that the framework of any future secured transaction legislation ought to cover acquisition financing arrangements, like title-of-retention schemes, and also certain leasing arrangements.[82] It is also generally acknowledged that special rules should apply to the perfection and priority of such arrangements.[83]
– The importance of efficient enforcement procedures has been stressed by several authors.[84] It has therefore been suggested that private enforcement by the secured creditor should be permissible even if the debtor is insolvent.[85]

IV. What Role for the Model Law?

A. Importance of a Comparative Approach

Turning to the role the Model Law could play in a future reform of Switzerland's personal property security law, there is general agreement that any reform exercise would have to be based on other modern statutes on secured transactions. The use of comparative elements in legislative reform has a long tradition in Switzerland.[86] Looking at foreign laws helps to expand the pool of possible solutions to a particular problem,[87] and is an important element in competition among legal systems.[88] Even

81 Graham-Siegenthaler (note 19), p. 761 seq. [publicity needed to make security interest effective as against third parties]; Berger (note 49), p. 216 seq.; but see Eigenmann (note 61), p. 388 seq. [concept of relative effectiveness inter partes not acceptable; therefore publicity is condition for effectiveness of security interest as such]; Foëx (note 27), p. 331 [concepts of attachment and perfection should not be adopted in future Swiss legislation].

82 Graham-Siegenthaler (note 19), p. 741, 746 seq.; Eigenmann (note 61), p. 404 seq.

83 Graham-Siegenthaler (note 19), p. 746 [no registration required for purchase-money security interests in consumer goods], p. 775 [special priority for purchase-money security interests]; Eigenmann (note 61), p. 403 [priority of retention-of-title and financial leasing].

84 Foëx (note 27), p. 335 seq.; Graham-Siegenthaler (note 19), p. 776 seq.

85 Foëx (note 27), p. 335 seq.

86 *See* Peter V. Kunz, "Instrumente der Rechtsvergleichung in der Schweiz bei der Rechtssetzung und bei der Rechtsanwendung," *Zeitschrift für Vergleichende Rechtswissenschaft* 108 (2009), p. 31 seq., 81.

87 Kunz (note 86), p. 34.

88 Kunz (note 86), p. 48.

though European Union law has become more and more important in recent years as a source of inspiration for legislative reform,[89] German and United States law are still more important in company and commercial law matters.[90] Looking at foreign laws seems to be particularly useful in a field like personal property security law, where the legislative framework has not changed in Switzerland for over 100 years whereas much progress has been made in other legal systems.

It is also clear that when it comes to secured transactions legislation it is impossible to ignore Article 9 of the United States Uniform Commercial Code (UCC)[91] and its progeny – the Personal Property Security Acts (PPSA) enacted by the Canadian common law provinces,[92] in New Zealand,[93] and in Australia.[94] This may not be an overly popular proposition in continental Europe, but Article 9 UCC is the mother of all modern secured transactions legislation. There is in fact no other legal instrument relating to secured transactions that combines sound policies and sophisticated legal technique in a similar fashion. However, using Article 9 UCC as a model for the modernization of a continental system is fraught with difficulties. Most important, it is a highly complex statute – complexity being the flipside of its sophistication. It clearly does not make for easy reading.[95]

89 Kunz (note 86), p. 35, 37, 45.

90 Kunz (note 86), p. 45.

91 Article 9 UCC is a model statute drafted by the National Conference of Commissioners on Uniform State Laws in collaboration with the American Law Institute, and it has been adopted in all States. The text of Article 9 UCC can be downloaded from www.law.cornell.edu/ucc/9 (last accessed 15.1.2015).

92 Each province and territory in Canada has enacted a PPSA, with the exception of the civil law jurisdiction of Quebec, which has adopted a hybrid of civil law and PPSA inspired concepts. Even among common law pronvices important divergencies can be observed. See Ronald C. C. Cuming / Catherine Walsh / Roderick Wood, *Personal Property Security Law*, Toronto: Irwin Law, 2nd ed. 2012, at 20.

93 Personal Property Securities Act 1999 (NZ) ("New Zealand PPSA"). The act came into effect on 1 May 2002.

94 Personal Property Securities Act 2009 (Cth) www.austlii.edu.au/au/legis/cth/consol_act/ppsa2009356/ (last accessed 15.1.2015). The act came into effect on 30 January 2012.

95 While the drafters of the Canadian and particularly the New Zealand and Australian PPSA tried to improve the readability of their acts, complexity is still an issue. See Bruce Whittaker, "Review of the Personal Property Securities Act 2009, Interim Report," Canberra: Commonwealth of Australia 2014, p. 5, 17 seq. [feedback indicates that the PPSA and the Personal Property Securities Register are too complex, in particular for small businesses].

In my view, one important merit of the UNCITRAL Model Law is that it provides an excellent synthesis of modern secured transaction laws and the sound policies underpinning such laws, while avoiding excessive complexity. The Model Law's draft text is well structured and very readable. This is particularly true of the way general and asset-specific rules are combined. Moreover, the legal and technical framework for the registry system is excellently crafted. Of course, there is always room for improvement and the working group should be encouraged to pursue their efforts to produce a well structured and readable text. Nonetheless the Model Law's drafters deserve a lot of praise for what they have already achieved.

B. Adoption of the Model Law by Switzerland?

It is one thing to suggest that any reform exercise in Switzerland should be based on a thorough comparative analysis, in which process the Model Law will play a very useful role. It is quite another to suggest that Switzerland should consider adopting the Model Law on a wholesale basis. However, the suggestion should be seriously considered, in my view, so long as the following conditions are met:

- The policies underpinning the Model Law are sound and compatible with Swiss legal policy.
- The Model Law is capable of being integrated into the fabric of Swiss private law.

1. Sound Legal Policies

As to the first point, I strongly believe that the Model Law codifies sound and reasonable policies. It provides a very workable legislative framework for non-possessory security interests in the full range of assets suitable to be used as collateral, while successfully mastering the resulting complexities, which are to an extent unavoidable. The regulation for a registry system deals precisely and concisely with all the issues that need to be resolved when setting up a registry. Last but not least, the Model Law provides an efficient mechanism for the enforcement of security interests, while taking due account of the interests of both the secured party and the debtor. If the purpose of a reform is truly to provide firms with more credit at lower rates, then there is no doubt that the Model Law presents an excellent and

very workable legislative framework. Hence it fully satisfies all the requirements for a modern personal property security law framework, as put forward so far by Swiss legal professionals and scholars (see supra p. 72 seq.).

Of course, Switzerland could try to reinvent the wheel by drafting its own personal property security act. However, it is hard to imagine that such a draft would be easy to read while at the same time being as sophisticated and clearly structured as the Model Law.

2. Conceptual Issues

In a number of key areas, the Model Law relies on concepts first developed in Article 9 UCC.[96] Examples of these novel concepts are (i) the unified security interest, which replaces the broad array of security devices currently in use; (ii) the concepts of attachment and perfection, and (iii) the extension of security interests to proceeds when collateral is processed or disposed of. None of these concepts fits easily into the traditional categories and notions of continental private law systems.[97] While Switzerland's private law was always flexible enough to adapt to new and foreign legal concepts, such flexibility comes at a price. This is particularly true when a reform affects the deep structure of a legal system. There must therefore be good reasons for relying on foreign legal concepts in legislative reform.

a. Uniform Security Interest vs. Diversity of Security Devices (Functional Approach)

The draft Model Law is based on a unitary approach to security (see article 1 (1), 2 (ii) Model Law), creating a uniform "security right" which replaces the traditional diversity of legal devices used to secure the performance of an obligation. It not only encompasses limited interests (i.e. pledges) and full-title security interests (fiduciary transfer of property,

96 Anjanette Raymond, Cross Border Secured Transactions: Ongoing Issues and Some Possible Solutions, *Elon Law Review*, 2 (2011) p. 87–107, p. 92 seq.

97 With respect to the uniform security interest and the concepts of attachment and perfection, at least, this is also true for common law systems, i.e. this is not a problem when contemplating the introduction of common law concepts into a continental private law system. See Whittaker (note 95), p. 17 seq.

Sicherungsübereignung) but also integrates acquisition-financing devices based on retention of property (i.e. retention of title and leasing arrangements: "acquisition security rights," article 2 (b) Model Law). The Model Law also applies to assignments, including outright assignment of receivables.

The unitary approach is of course one of the distinctive features of any modern secured transaction law.[98] It is based on the idea that devices serving the same function should be subject to the same rules (functional approach), regardless of the terminology used by the parties (substance over form). This seems to be a fundamentally reasonable approach. Moreover, the unitary or functional approach has the advantage of reducing complexity. At the same time, the traditional dichotomy between limited interest and full-title security rights is deeply ingrained in the basic structure of private law. It is therefore not surprising that Europe (including, for this purpose, England) has hitherto shown little enthusiasm for the unitary approach.[99] Swiss scholars have been equally reluctant to embrace it (see supra p. 74 seq.).[100]

I would propose that this issue should be decided solely on the basis of the utility of the unitary approach. In other words, the traditional diversity of security devices should be maintained only if there are good and valid reasons for keeping it. Hence the real question is: what exactly is the value of a diversity of security devices? While it is not possible to discuss this issue fully here, the following points can be made:

– With respect to perfection requirements there is no room for distinguishing between various security devices. For example, an approach requiring the registration of pledges but not of full-title security interests is difficult to justify from a policy perspective, because it would undermine the integrity and functionality of any system providing for the publicity of security interests. Of course, this has long been the position of Swiss personal property law (see article 884 (3) CC).

98 Raymond (note 96), p. 95.

99 Raymond (note 96), p. 97 [arguing that England rejects the unitary approach to security interests for two basic reasons: it over-captures interests never intended to be within secured transactions system; and the system defies already existing property law].

100 Against a unitary approach Foëx (note 27), p. 327; Aeschlimann/Föex (note 23), p. 34; Eigenmann (note 61), p. 91; in favour of a unitary approach Berger (note 49), p. 227; for an intermediary approach Graham-Siegenthaler (note 19), p. 738.

– A legal framework based on the diversity of security devices makes the resolution of priority disputes much more complicated. This is particularly true when a full-title security arrangement is involved. Conceptually there can be no such thing as a priority dispute between two full-title security interests, or between a full-title security interest and a pledge. The social conflict to be resolved by priority rules, however, is exactly the same in each case.
– Under current law the distinction of full-title and limited security interests is relevant primarily with respect to the method of enforcement. Full-title security interests can be enforced only by way of private sale, whereas pledges can be enforced by either public or private enforcement – except that only public enforcement is possible once insolvency proceedings have been commended with respect to the debtor.[101] Accordingly, private enforcement requires an express agreement between debtor and secured creditor in the case of a pledge, whereas such an agreement is implied in the case of a full-title security interest.[102] From a policy perspective it is highly doubtful that the legal structure of the security interest should play any role in determining which method of enforcement is the most suitable. I would suggest that the debtor's need for protection, and the nature of the encumbered asset, are much more relevant. If a particular asset is traded in a highly liquid market, and an objective price can be determined at any time, enforcement by private sale or by appropriation should be permitted, irrespective of whether the security right is a full-title interest or a pledge.

Scholars have argued in favor of maintaining the diversity of security devices because it gives parties the freedom to structure their transactions in the way best suited to their needs (party autonomy).[103] However, party autonomy is basically limited to issues affecting only the parties to the security agreement, e.g. the secured party's right to use the collateral, or the attribution of rights relating to the collateral. These are issues where party autonomy is also respected by the Model Law (article 3 Model Law). The question therefore remains: what exactly is the value of the diversity model?

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101 Kuhn (note 15), p. 168 seq., 181.

102 Kuhn (note 15), p. 178 seq.

103 This argument is put forward by Raymond (note 96), p. 97 [" importance of … freedom of parties to choose different instruments with different legal effects even if serving the same economic function"].

b. *Creation and Perfection of Security Interests*

A second conceptual issue, of similar importance, arises with respect to the conditions for the creation of a security interest and its effectiveness against third parties – competing secured creditors, unsecured creditors, or an insolvency estate. Swiss scholars have hitherto assumed that publicity – by way of possession, registration, or control – is a necessary condition for the creation of a security interest.[104] In other words, the secured creditor acquires no proprietary interest in the collateral unless and until the security interest has been registered, or until he has obtained possession of or control over the collateral.

The Model Law provides for a more nuanced approach, following the example of Article 9 UCC[105] and its progeny, plus a number of civil law jurisdictions.[106] It distinguishes between creation of a security right (Chapter II, articles 5–14; "attachment" in the terminology of Article 9 UCC) and its effectiveness against third parties (Chapter III, articles 15–25; "perfection"). According to article 5 (1) Model Law, "a security right is created and is effective between the grantor und the secured creditor, if they enter into a security agreement" that identifies and describes the parties, the secured obligation, and the encumbered assets (article 5 (2) Model Law) and which must be in writing (article 5 (3) Model Law). In order to make the security right effective against third parties, the registration of a notice in the registry or the transfer of possession of a tangible encumbered asset is required as an additional step (article 15 Model Law). However, perfection is not a condition for the security right coming into existence – only for determining the order of priority among competing security interests (article 41 Model Law). This is made perfectly clear by article 5 (1) Model Law, which provides that the act of entering into the security agreement creates the security right and makes it "effective between the grantor and the secured creditor."

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104 See Eigenmann (note 61), p. 388 seq. [relative effectiveness of security agreement "unacceptable": the approach which makes registration a condition for the creation of a security interest is the only one that is "satisfactory from a dogmatic point of view"]; Foëx (note 27), p. 331 [arguing that distinguishing between attachment and perfection is foreign to Swiss law]; contra Berger (note 49), p. 216 seq.; undecided Graham-Siegenthaler (note 19), p. 735, 762 seq.

105 See § 9-203 (a) UCC.

106 See article 2941 CC Québec; article 3:237 (1) Dutch CC.

At first blush, the concept underpinning the Model Law is not easy to reconcile with the civil law notion of a disposition based on a contract which serves as its foundation (the *causa*). However, Swiss law already employs the Model Law's approach in at least two instances. First, a retention of property clause is fully effective *inter partes* once it has been agreed, but is not effective against third parties until it has been registered in the retention of title registry.[107] Second, pursuant to article 717 (1) CC, the transfer of property for security purposes without possession is, in certain instances, ineffective against third parties but fully effective between the debtor and the secured creditor.[108] Hence it is not really convincing to argue that the Model Law's approach is incompatible with Swiss private law.

As with the concept of a unitary security interest, this issue should be decided solely on the merits of the different approaches. Vesting the security agreement with proprietary effects *inter partes* has the advantage that the secured creditor is not forced to register the security interest if he deems this to be unnecessary. To be sure, he then takes the risk of being subordinated to competing creditors if a security interest is perfected by another creditor or the debtor becomes insolvent. But there may be good reasons why he believes this risk to be acceptable in a given situation, e.g. if the debtor's business is organized in a way which limits the risk of assets being encumbered by multiple security interests. Since no third party interests are at stake, it seems to be a reasonable policy approach not to force the secure creditor to waste money and time on perfecting the security right.

c. Extension of Security Interests to Proceeds

A third key concept of the Model Law is the extension of a security right in encumbered assets to its identifiable proceeds (article 8 (1) Model Law). "Proceeds" is defined as "whatever is received in respect of encumbered assets." It includes the purchase price paid into a bank account when inventory serving as collateral is sold (article 8 (2) Model Law), and products resulting from the processing or commingling of encumbered assets

107 See Kuhn (note 15), p. 320; Wiegand, Mobiliarsicherheiten (note 63), p. 89.
108 Kuhn (note 15), p. 235; see Wiegand, ZBJV 1980 (note 63), 548 seq.

(article 9 (1) Model Law). Claims arising from defects in or damages to an encumbered asset also qualify as proceeds, as do proceeds of proceeds (article 2 (bb) Model Law).

The extension of security interests to assets and values replacing the initial collateral is a necessary condition for making any system work which permits non-possessory security rights in inventory. Inventory includes, by definition, assets to be processed, to be commingled, or to be sold. A statutory framework which provides for security interests in inventory without extending such rights to the proceeds of the initial collateral would be pointless, because the interest in the initial collateral would expire or be subordinated to the right of a good-faith acquirer once the inventory was sold, processed, or commingled. This is also acknowledged by Swiss legal scholars.[109]

From a conceptual point of view, however, it is not easy to integrate the proceeds doctrine, which is based on common law trust law and its tracing doctrine, into a continental private law system. The next-best civil law substitute is the principle of proprietary subrogation, which is codified, for example, in article 57 (1) of the Insurance Contract Act.[110] This, however, is not recognized under Swiss law as a general principle. The concept of proceeds is much more inclusive.[111] This raises the question whether there are any alternative approaches, more in line with civil law principles, that also make it possible to extend security interests to proceeds. German law, for example, has developed an elaborate system of vertical and horizontal extensions under its retention-of-title scheme.[112] In view of the complexities of this area of law, however, it is highly doubtful whether that is a better approach than the relatively straightforward codification of the proceeds doctrine in the Model Law.

109 See Eigenmann (note 61), p. 384 seq.; Foëx (note 27), p. 334; Graham-Siegenthaler (note 19), p. 751; Berger (note 49), p. 240. This issue was recognized long ago by Eugen Huber; see Foëx (note 27), p. 334.

110 See Eigenmann (note 61), p. 386.

111 See Eigenmann (note 61), p. 385 [explaining similiarities and differences between proceeds doctrine and propietary subrogation].

112 Graham-Siegenthaler (note 19), p. 123 seq.

3. Terminology

A different, although somewhat related, issue arises with respect to terminology. It has long been acknowledged that unfamiliar terminology is a major obstacle to a comparative approach to legislative reform. This may be the case even if legal concepts are transferred within the same legal family, as demonstrated by the Australian secured transactions law reform.[113] While the Model Law has gone a long way towards avoiding such unfamiliar terminology, some examples remain. For example, the term "negotiable instrument," which is used throughout the Model Law (articles 11, 13, 22, 24 Model Law), is unfamiliar to Swiss lawyers and not easily brought into line with Swiss securities law.[114] The same is true for the phrase "undivided rights in assets" (article 7 (1) Model Law). These are all issues, however, which can be fixed quite easily in the course of the legislative process.

C. *Potential Stumbling Blocks*

1. Consumer Transactions and Credit to Consumers

The personal scope of application of the UNICTRAL Model Law is comprehensive, covering even transactions where the grantor is a consumer. The Model Law reserves consumer protection laws (article 1 (5) Model Law), but the only transactions that are actually excluded from its scope are those where the *secured party* is a natural person acting for personal, family, or household purposes (article 1 (4) Model Law). This comprehensive personal scope appears rather difficult from a political point of view. Extending credit to consumers has always been looked at with a certain disapproval.[115] Switzerland has therefore enacted one of the toughest

113 See Witthaker (note 95), p. 18 [pointing out that the Australian PPSA "uses many terms of art that are unfamiliar to the general business community … [and] to Australian lawyers as well … because much of the language in the act has been adopted from [Article 9 UCC]."]

114 See also Witthaker (note 95), p. 19.

115 This statement is not true, however, when it comes to credit for the acquisition of real estate, which is very common and actually encouraged by the tax system. That explains why Switzerland is among the countries with the highest amount of mortgage debt per capita.

consumer credit legislations in Europe.[116] The Consumer Credit Act does not apply when a credit is secured by real estate (article 7 (1) (a) CCA) or by collateral normally accepted by banks, particularly securities (article 7 (1) (b) CCA). Even if a direct conflict did not arise, any new legislation aimed at facilitating the consumer credit business would face stiff resistance. The best protection for this potentially fatal flank would probably be to restrict the personal scope of a secured transactions legislation to firms. However, this is not feasible whenever consumers are affected in their capacity as purchasers under a retention-of-title or leasing arrangement, or as third party debtors under a receivables financing transaction. Excluding these transactions from the scope of future legislation would open major loopholes and leave consumers with less, not more, protection.

2. Access to Registry and Data Protection

According to article 27 Model Law, the registry is open to the public in accordance with the Model Law and the Regulation. It seems clear that this openness will cause a great deal of discussion. While the retention of title registry and the land title registry are open to the public without the need to demonstrate a particular interest, the secured transactions registry is different for two reasons: (i) it is web-based and access is much easier than access to the land title registry or even the retention of title registry, and (ii) the secured transaction registry is comprehensive in scope and is therefore capable of providing a much more complete picture of a debtor's situation than any other registry. I think that restriction of access is technically feasible if it is arranged that the grantor can grant access with a few clicks. Our US friends will wost likely disagree strongly on this point, but sensitivity to privacy and data protection issues is much greater on this side of the Atlantic. I think it would be worth investing some time and brain power in the search for an answer to this issue.

116 See Kuhn (note 15), p 58 seq.

3. Interface with Debt Enforcement and Insolvency Law

It has already been mentioned that a mechanism for the efficient enforcement of security interests is a key component of any viable secured transactions regime, and that the Model Law fully satisfies this criterion. I have a few minor and one more fundamental comment on the interface with debt enforcement and insolvency law:

- The Model Law codifies the acquisition of the encumbered asset by the secured party, in satisfaction of the secured obligation, as one enforcement method (article 92 Model Law). This method is also permissible under Swiss law, but is subject to limitations arising from the *lex commissoria* (see article 816 (2) and 894 CC), which is considered to be part of Swiss public policy.[117] Enforcement by way of acquisition is compatible with the *lex commissoria* if the value of the collateral can be determined objectively and the secured party is under an obligation to turn over any survalue to the debtor under the terms of the security agreement.[118] This is still good policy and should continue to be part of any future personal property security act.
- The Model Law provides for the secured party's right to repossess encumbered assets without the need for prior intervention by a court or other public authority (article 88 Model Law). While the Model Law protects the debtor with a number of safeguards, including his right to object at any moment (see article 88 (1) (c) Model Law), giving a private party the right to repossess encumbered assets seems difficult to reconcile with fundamental notions of fairness and protection of privacy. It is true that exactly this kind of issue has arisen in the context of leasing arrangements, which sometimes provide for the lessor's right to repossess leasing objects without the need of a court order.[119] The legality of these clauses seems questionable, however.
- Pursuant to article 81 (2) (c) Model Law, the secured creditor is entitled to "sell or otherwise dispose of the grantor's business as a going concern" if he has a security right in all assets of the grantor. While acknowledging that the sale of a business as a going concern is an important option in this case, I would submit that codifying

117 Kuhn (note 15), p. 179 seq.
118 Kuhn (note 15), p. 180.
119 See Kuhn (note 15), p. 369 seq.

such a procedure would result in major conflicts with insolvency and merger law.

On a more fundamental note, any reform aimed at improving secured transaction law will of course have profound implications for insolvency law. An efficient secured transactions framework will inevitably have distributional effects in relation to the debtor's or grantor's unsecured creditors.[120] The possibility of encumbering inventory and equipment will also affect the chances of restructuring the debtor's business. There are answers to all these issues, but they need to be acknowledged before they can be answered.

V. Conclusions

After well over 20 years of discussion of the need to modernize Switzerland's personal property security law and the benchmarks for a possible reform, the Model Law offers an excellent opportunity to move on. It codifies sound legal policy and manages the complexities that inevitably result from a legal framework that spans the whole range of assets which can be used as collateral. I suggest, therefore, that the Model Law, once it is finalized, should be translated into German and Italian and then used as the primary point of reference in future discussions.

The modernization of Switzerland's personal property security law will not progress without the support of the business community. Lawyers therefore need to engage much more intensively with the business communities affected by any such reform. Moreover, policy makers need to better understand the problems firms are faced with in accessing credit. This requires empirical economic studies, current research being rudimentary at best. Finally, empirical data on the insolvency of smaller and medium-sized enterprises will also be needed if we are to discuss in a sensible manner the impact of secured transactions reform on unsecured creditors. Legislative reform always takes place in a given social, economic, and political setting. Commercial law reform in particular cannot be conceptualized and drafted in a "vacuum of facts."[121]

120 Kuhn (note 15), p. 29 seq.

121 On the need and perils of getting the facts right before embarking on a law reform see Homer Kripke, "Law and Economics: Measuring the Economic Efficiency

Any reform imposes costs on market participants, including the costs of training to understand the new law and adapting business documentation and practice. Moreover, no legislative scheme can produce absolute certainty on every point. Clarifying unclear, ambiguous, or mis-shaped rules takes time and comes at a price. It is important that any reform proposal be accompanied by an evaluation of the benefits and costs it entails.

Of course, there is also an important role for legal professionals and academics. In discussing secured transactions law reform, they should move on from stating the obvious – the need for reform – to suggesting how to fix the problem. A careful evaluation of conceptual approaches to secured credit will be of the utmost importance. Whether or not the Model Law is adopted one day as Switzerland's new Personal Property Security Act, one thing is for sure: The Model Law will play a key role in future discussions.

of Commercial Law in a Vacuum of Fact," 133 U. Pa. L. Rev. 929 (1985) and the response by Thomas H. Jackson / Alan Schwartz, "Vacuum of Fact or Vacuous Theory: a Reply to Professor Kripke," 133 U. Pa. L. Rev. 987 (1985).

GERMAN LAW ON SECURED TRANSACTIONS QUO VADIS?

SOME GENUINELY GERMAN OBSERVATIONS ON THE DRAFT UNCITRAL MODEL LAW

Leif Böttcher*

I. Secured transaction law from the German perspective

When a German lawyer is invited to speak about secured transactions, it is almost always the German law of land register he is going to talk about. Indeed, many so-called "developing countries" like Vietnam or Cambodia are very interested in the German law of land register which is widely praised for its reliability. This praise sometimes goes astonishingly far: Yale Professor *Robert Shiller* who was a recipient of the 2013 Nobel Prize in Economics alongside *Eugene Fama* and *Lars Peter Hansen* insinuates that the mortgage crisis in the U.S. would maybe not have happened if the U.S. had in place a secured transactions system for mortgages like the German one.[1] This makes it fairly common for a German lawyer to talk about the peculiarities of German law on real estate. When it comes to secured transactions concerning movable assets however, I think it is quite unusual for a German lawyer to be invited to such a high-level conference.

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1 The Subprime Solution, 2008, p. 134: *"Another possible default option would be a requirement that every mortgage borrower have the assistance of a professional akin to a civil law notary. (…) In Germany, for example, the civil law notary is a trained legal professional who (…) provides legal advice to both parties before witnessing their signatures. This approach particularly benefits those who fail to obtain competent and objective legal advice. The e participation of such a government-appointed figure in the mortgage lending process would make it more difficult for unscrupulous mortgage lenders to steer their clients toward sympathetic lawyers, who would not adequately warn the clients of the dangers they could be facing."*

Why is this the case? When it comes to German law on secured transactions concerning movable assets, one begins to find oneself confronted with an alleged paradox. While many German lawyers would argue that in relation to secured transactions law in Germany, "*tout est pour le mieux dans le meilleur des mondes possibles*",[2] some non-German lawyers might say that when it comes to secured transactions law Germany itself is a developing country.

II. A short evaluation – How German law on secured transactions stands at the moment

A. *The type of security*

Unlike many jurisdictions, German law does not provide for a floating charge or similar security over a business. Under German law the type of security depends on the asset classes available as collateral: Shares and partnership interests as well as bank accounts and intellectual property can be pledged. As for movable assets be transferred by way of security transfer, and receivables and intellectual property rights can be assigned by way of security assignment. Real estate can be encumbered with mortgages or land charges.

B. *From* Pfandrecht *to* Sicherungsübereignung *and* Sicherungsabtretung

The German civil code, the BGB of 1900 initially only provided for two types of security rights: the *Pfandrecht* (pledge) and the *Eigentumsvorbehalt* (retention of title). The *Eigentumsvorbehalt* plays an important role still today as most sellers will only sell their goods retaining title until full payment has been made. The pledge, however, nowadays lives a shadow existence although it is the general accessory security instrument foreseen by the German Civil Code. It is an encumbrance that may be created over movable assets or rights.[3] As a pledge over movable assets requires the

2 Cf. Voltaire, *Candide*, where the character *Pangloss* constantly repeats this sentence.

3 Mattias Von Buttlar, *Bank finance and regulation – Multi-jurisdictional survey Germany – Enforcement of security interests in banking transactions*. www.ibanet.org/

actual transfer of possession to the pledgee – and a pledge over receivables requires notification to the third party debtor – the pledge is considered impractical because in many cases the debtor will need the asset in order to conduct its business – and so to repay its debt.[4] Furthermore, the enforcement of a pledge is considered to be quite complicated. That is why case law and doctrine have invented the so-called *Sicherungsübereignung*, a transfer in rem by way of security. The *Sicherungsübereignung* involves transferring real und full legal ownership of certain assets to the secured party.[5] According to the requirement of specification (*Bestimmtheitsgrundsatz*),[6] a precise description of the assets transferred or to be transferred in the security transfer agreement which would enable any third party to physically identify the relevant assets without any further information and research, is necessary.[7] The security transfer agreement transfers full legal ownership of the assets to the secured creditor.[8]

As for rights, there is the possibility of a security assignment (*Sicherungsabtretung*).[9] The parties agree to assign certain rights, which need to be clearly identifiable (*bestimmbar*) to the secured party in order to secure certain obligations.[10] The secured party becomes the full legal holder of the assigned right. Like the security transfer, the security assignment is not specifically set out in particular law provisions. It has been developed in practice based on general civil law principles and has been acknowledged and shaped in numerous decisions of the Federal Supreme Court (*Bundesgerichtshof*).[11]

Document/Default.aspx?DocumentUid=BA60C158-9095-47EA-B3E9-1F28C6012298 (last accessed on 19 January 2015).

4 Jürgen Damrau, Münchener Kommentar zum Bürgerlichen Gesetzbuch: BGB, 6th ed, 2013, Vorbemerkung zu § 1204, marginal number 4.

5 §§ 929, 930 BGB (Bürgerliches Gesetzbuch).

6 Cf. Jürgen Oechsler, Münchener Kommentar zum Bürgerlichen Gesetzbuch: BGB, 6th ed, 2013, § 929 marginal numbers 1–11.

7 Von Buttlar (note 3).

8 The security transfer is not specifically set out in particular German law provisions. However, German courts have acknowledged this legal concept in order to bypass the requirement of actual transfer of possession.

9 §§ 398 ff. BGB.

10 Von Buttlar (note 3).

11 Von Buttlar (note 3).

C. *The question of publicity*

However there is one considerable disadvantage: Like almost all security rights under German law, the security transfer as well as the security agreement are created in secret. There is no form of publicity or asset registration (with the exception of aircraft and ships where Germany has a land-register-like registry). But, and that may come as a surprise to some, even when it comes to real estate and thus to the highly praised German land register, there is no real transparency: mortgages and land charges need registration to be effective, yes, however not everyone is allowed to check the land registry. According to the German Land Register Act, only those who have a "legitimate interest" are eligible to look up the registry.[12] That legitimate interest has to be proved.

III. German law and the draft Model Law – two worlds colliding

Current German law on secured transactions is not only slightly different from the approach the draft Model Law offers. One could even argue it is the outright opposite. In a first step, I would like to give you some of the reasons for the skepticism – I will not say "hostility" – of German lawyers towards a registry system for movable assets. I will then deal with some of the arguments step by step and finally give an outlook.

A. *German skepticism towards a registry system for movable assets*

When German lawyers are confronted with the idea of the installation of a registry system relating to movable assets, they will most likely consider the idea to be disproportionate if not impossible.[13] The project, they think, would have to fail because a precise description of the assets would be impossible, unlike land which can be clearly specified.[14] Also, they fear

12 Cf. § 12 GBO (Grundbuchordnung).

13 Cf. Eva-Maria Kieninger, "Gestalt und Funktion einer 'Registrierung' von Mobiliarsicherungsrechten", *Rheinische Notar-Zeitschrift* (2013), p. 217.

14 Cf. Kieninger (note 13), p. 217.

that the installation of such a register required a lot of time and money, an investment disproportionate in comparison to the relatively low value of each individual asset.[15] Finally many German lawyers deem it burdensome if not impossible to consult the register before each and every transaction because of the quick changes of ownership in movable property that can happen any time, but rather they feel it would create an impediment to the ease of economy and trade.[16] Finally, the traditional German view on secured transactions is that credit relations should under no circumstances be public, but should rather be kept completely secret.[17] So whenever a German lawyer hears the word "registration", he will inevitably think of the land register. That is why when discussing the Model Law or any form of registration with fellow German lawyers, it is preferable to avoid the term "registration", and speak of "notice filing". Let us go through some of the arguments systematically.

1. Confidentiality vs. publicity

I will start by the confidentiality issue. This is a much more complex issue than it may seem at first place: Most interestingly, while the overwhelming majority of German Lawyers uphold the idea of the secret creation of security rights, the same lawyers are looking for ways to make secured transactions more public. One of these ways is the pledge of shares in a GmbH (a German limited liability company), a very common form of security granted in connection with banking transactions in Germany. While it is not a legal requirement for the validity of the share pledge to be registered or notified to any third party, the pledgee may only assert rights resulting from the pledge vis a vis the company if it has been notified that its shares have been pledged.[18] In practice the parties authorize the notary conducting the notarization of the pledge agreement to notify the company of the pledge of its shares.[19] So in reality, German lawyers find a way around the "secret" security right by putting all the collateral into a company, a

15 Kieninger (note 13), p. 217.
16 Kieninger (note 13), p. 217.
17 Kieninger (note 13), p. 217.
18 § 1280 BGB.
19 Von Buttlar (note 3).

GmbH, before pledging the shares. This shows, in my opinion, that a certain form of publicity is actually wanted.

2. New forms of collateral – a call for a registry system?

More recently, new forms of collateral, i.e. extremely valuable assets have come into focus and have – for the first time in more than 100 years – resulted in the request of some German banks to install a registry system for movable assets. This concerns predominantly systems related to renewable energy such as photovoltaic systems and especially offshore wind power plants.[20] Let me explain this in greater detail. After the nuclear disaster of Fukushima/Japan in 2011, Germany's government did away with nuclear energy almost overnight: according to the legal reform, the last German nuclear reactor is to be shut down by 2020. By that time, the entire demand for energy both by German economy and by private persons has to be fulfilled either by coal-fired power plants or by renewable energy power plants. Consequently, some huge offshore wind farms located in the North Sea close to the German coast have already begun service. The wind power plants themselves are extremely valuable assets. Unfortunately, it turns out that German law lacks the necessary provisions for a legally secure creation of security rights: Not only is there no possibility to register these assets, but also there is even uncertainty as to whether German law applies to the creation of those security rights.[21] This insecurity stems from an unfortunate combination of three factors that are interrelated: First, and this always comes a surprise to U.S. colleagues, German law sees secured transactions as a question of property law. That is why the German conflicts of law rules relating to property also relate to security rights. In this respect, Germany follows a strict *lex-rei-sitae*-approach, i.e. the law of location of the asset will be applicable.[22] But since the wind power plants are not located on German soil but rather in the so-called "exclusive economic zone" according to the United Nations Convention on the Law of the Sea,[23] the conflict of law rules are futile, they walk into nothing because

20 Cf. Leif Böttcher, in: *Erneuerbare Energien in der Notar- und Gestaltungspraxis* (Leif Böttcher / Kurt Faßbender / Christian Waldhoff, Hrsg.), 2014, § 3.

21 Cf. Böttcher (note 20), marginal notes 22–36.

22 Art. 43 EGBGB (Einführungsgesetz zum Bürgerlichen Gesetzbuch).

23 According to art. 55 of the United Nations Convention on the Law of the Sea.

the location of the wind power plants are technically speaking "no-man's-land". This shows how a registry could help enormously here.[24]

3. A registry system as legal transplant

a. *The draft Model Law registry as a "model" for a German registry system?*

A Registry yes, but the question arises whether a registry system based on the model law would "fit in" in the German law. With this, we touch the well-known question of "legal transplant".[25] In recent years, there have been several legal transplants in Germany, especially in the area of corporate law: Thus German law now offers a British "Limited"-like company (the so-called "*Unternehmergesellschaft [haftungsbeschränkt]*") as well as a limited liability partnership – both of those phenomena would have been unthinkable ten years ago. But it is fair to say that the results of these legal transplantation processes are rather German versions of these Common law institutions. The German lawmaker has never adopted the foreign rules on a 1:1 basis, but has always attempted to integrate them the best way possible into the German legal system.[26] This leads us to the question whether the UNCITRAL Model Law could serve as a model for a possible German law reform, how the model might have to be adjusted to "fit" into German law. The difference here is that Germany already has an existing law on secured transactions and a well-balanced legal system. As pointed out before, German economy and German citizens are very much used to registries. So since the model law is based on the registry system, one could argue that a Model Law-like register would fit easily into the German legal order. However, the way the German land register works is in many ways extremely different from the UNCITRAL model: I have already dealt with one important factor: the question of public access. The second difference concerns the access to the land register: The land register – and also the

24 Cf. Leif Böttcher, "Das Meer als Rechtsraum – Anwendbarkeit deutschen Sachenrechts auf Offshore-Windkraftanlagen und Möglichkeiten der Kreditsicherung", *Rheinische Notar-Zeitschrift* (2011), pp. 589, 600–601.

25 Alan Watson, *Legal Transplants: An Approach to Comparative Law*, 1974.

26 Cf. Leif Böttcher, Vorsorgende Rechtspflege durch Notare bei der Registrierung von Mobiliarsicherheiten, *Rheinische Notar-Zeitschrift* (2013), pp. 285–286.

German commercial register – will not accept private documents, but only official document, i.e. those that are either issued by state authority such as death certificates, or authentic documents, documents that have been notarized.[27] Under German law, the notary is not only to ascertain the identity of the transaction participants[28] and establish that they have legal capacity to perform the legal acts they have in mind,[29] but he is also responsible for assuring that the documentation used comports exactly with the legal needs of the particular transaction that is documented. In other words: The notary by law resumes full responsibility as to the legal validity of the act.[30] The third difference is somehow linked to the first: After the documents have been sent to the register, the judge or clerk will examine the documents once more and only register them if they meet all formal legal requirements and – in some cases even – if they are legally valid.[31] This shows another rather important difference: the concept of mere notice of the Model Law is completely new to German lawyers and has no comparison whatsoever in the German law. The fourth difference becomes apparent if we look at the effect of registration itself. According to art. 15 of the Model Law, a security right is effective against third parties, if it has been created in accordance with art. 5 § 1 and a notice is registered. When it comes to the land register, German law follows a strict "constitutive" approach: Only those rights that are registered are effective at all, no matter whether against third parties or between the parties to the security agreement.

b. Cultural aspects

If we want to try to understand this approach, we have to go back in time and look, for instance, on the rules concerning real estate law: According to the legislative motives of the draft bill of the Civil Code from 1888, the German legislator had initially hesitated to make the notarial authentication of real estate contracts mandatory, but then opted to compulsory

27 §§ 29, 35 GBO.
28 § 10 BeurkG (Beurkundungsgesetz).
29 § 11 BeurkG.
30 §§ 4, 17 BeurkG.
31 §§ 19, 20 GBO.

authentication, especially in view of the legal certainty and unambiguity.[32] I am only mentioning real estate, but the list of legal concepts the rationale of which is based on the certainty of transaction could be continued almost *ad infinitum*. It is not only legal certainty, it is the realization of rights (*Rechtsverwirklichung*). Where does this skepticism, not to say, hostility, of German lawyers towards a register for security interests in movable assets come from? In order to answer this question properly, we have to go a little deeper into German legal tradition and culture. As *Rolf Stürner* professor emeritus at the university of Freiburg im Breisgau and an expert in property law and secured transactions, puts it, the German legal culture differs from other legal cultures by a social understanding of liberty, one that puts *égalité* and *fraternité* on an equal level with *liberty*.[33] Of course, individual liberty, private autonomy remains the point of departure, but it is complemented by the idea of paternalistic preventative justice that – from a classical German standpoint – only enables the individual to exercise its private autonomy and prevents it from any manipulation.[34] If you take a close look on the German law in many areas, you can see this paternalistic approach: It is the state that provides for legal certainty and legal clarity. Not only the land register but many other features of German law can be named: the commercial register which can be completely relied on, that is complete, specific performance, and many others. That is why the actors to legal translations in Germany rely on the correctness of registers. It is true that against this background, a register that follows the rules of the draft Model law would be a foreign body in the German legal system. Also, one should forget that unlike many of the countries that have already installed a registry system based on the UNCITRAL principles did not have a well-functioning law on secured transactions in place before. This is definitely not the case for the Federal Republic of Germany. It is true that the German system of secured transactions is very different from many countries. But: it works. Banks are used to it and despite some recent requests for a registry system seem to be satisfied.

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32 Cf. *Motive Zu Dem Entwurfe Eines Bürgerlichen Gesetzbuches Für Das Deutsche Reich*, Volume 2, pp. 189–191.

33 Rolf Stürner, "Das Zivilrecht der Moderne und die Bedeutung der Rechtsdogmatik", *Juristenzeitung* (2012), pp. 10, 19.

34 Stürner (note 33), p. 19.

4. German law vs. draft Model Law

Another question is whether the system of creation and registration of security rights provided for by the draft Model Law is superior to the secret creation of security rights under German Law. This leads us back to the two main reasons – one could even say the underlying philosophy – of the Model Law: publicity and – even more importantly – the solution of priority conflicts between competing security interest in the same collateral. These aspects should not be judged independently from one another: Under German law determining priority can become a tricky thing: In the case of insolvency of the grantor, the security transfer is privileged. However, it may become difficult to determine who holds the security right because the assets may have been "pledged" more than once.

Rolf Stürner whom I mentioned before is nevertheless reluctant when it comes to the question of whether German law on secured transaction should be reformed in a UNCITRAL way. In his opinion, a register might help, however he asks himself whether the benefit resulting from the exchange of the current system in favour of a registry system is worth the effort, given that Germany has a working system in place that everybody in Germany, banks and private creditors included, is used to. [35]

IV. An outlook

So 10 years from now, how will law on secured transactions look like in Germany? Will it be still the same? Or will Germany have converted to a UNCITRAL model law style system? It is hard to tell, but I guess it is fair to say the neither the first nor the second options sounds very likely. Certainly the trend will go towards some form of registration, especially for high value items such as offshore wind power plants. Germany should not have any legal uncertainty in this field. The interesting question will be whether this register be will more similar to the Model law register or to the German land register. Another question is whether Germany might one day be forced to give in and install a registry system. That would be the case if the so-called "Draft Common Frame of Reference" would be

35 Fritz Baur/Jürgen F. Baur/Rolf Stürner, *Sachenrecht*, 18th edition, 2009, § 64 marginal note 139.

transformed into law, i.e. either by way of EU directive or EU regulation. In its book IX, the DCFR deals with security rights in movable assets. The rules provide for a registry for movable assets. But it is very uncertain if – and especially when – this draft might be transformed into binding law. At this early stage, in the European Commission is trying to make a first step towards unification of contract law – and is already facing heavy criticism, especially from Germany.

It is true that the German law on secured transactions works for Germany, and that all parties involved are reluctant to change. *Alors, en Allemagne tout est pour le mieux dans le meilleur des mondes possibles?* "Never change a running system", the proverb says. But on the other hand one should never forget the lesson so skillfully formulated by *Voltaire* in his "Candide": "*Il faut cultiver notre jardin*."

THE UNCITRAL MODEL SECURED TRANSACTIONS LAW: A SHARIʿAH PERSPECTIVE

Michael J.T. McMillen*

I. Introduction

An effective legal regime for security interests in property – particularly movable property – is central to the promotion and operation of commercial and financial markets. It provides structure to commercial and financial activity, influencing the degree of certainty, stability and predictability that attach to various courses of action in the markets. Thus, it is a primary consideration in risk assessments pertaining to these markets, both generally and as to individual transactions and specific transactional factors. The existence and nature of the legal regime for security interests in movable property influence whether persons and entities will participate in the markets, and thus the scope of commercial and financial activity. In particular, the legal regime for secured transactions is a fundamental factor in determining whether external capital will be attracted to a specific market. And is a critical determinant of the pricing structure of specific markets and, in the aggregate, to the economic systems comprised of the affected markets.

Working Group VI (Security Interests) of the United Nations Commission on International Trade Law ("UNCITRAL") has labored long on the development of a comprehensive legal regime for secured transactions over movables. A draft of a concise and workable model law on secured transactions over movables (the "Model Law") is well advanced.[1] The current draft of the Model Law was the topic of discussion and analytical

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1 Both the current draft, and past drafts, of the Model Law are available at www.uncitral.org/uncitral/en/commission/working_groups/6Security_Interests.html, a web page that contains links to all of the documents produced by Working Group VI. The draft of the Model Law used in the preparation of this chapter is available that set forth as A/CN.9/WG.VI/WP.61 under the heading "26th Session, 8–12 December 2014, Vienna".

focus of the international conference that served as the source for the papers presented in this book.[2]

The Model Law is proposed for adoption, or as a source of inspiration, to countries that desire to adapt their legislation to current developments. The Model Law is supported by the UNCITRAL Legislative Guide on Secured Transactions[3] and the UNCITRAL Legislative Guide on Secured Transactions: Terminology and Recommendations,[4] among other documents.[5]

The Model Law, and supporting materials, focus on systems that do not apply principles and precepts of Islamic shariʿah (the "Shariʿah"). However, there is a pressing and immediate need to develop and implement legal regimes for secured transactions that will be enforceable under the Shariʿah. That need arises as a result of the growth of Islamic finance[6] since the 1970s, and particularly since the mid-1990s, and the relative dearth of legal regimes for secured transactions in many of the jurisdictions in which Islamic finance is practiced.[7]

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2 This chapter was presented at "The Draft UNCITRAL Model Law on Secured Transactions: Why and How?", an international conference held on 19 September 2014 in Geneva, Switzerland. The author is grateful to the conference hosts and participants. In particular, the author is especially grateful to Bénédix Foëx and Luc Thévenoz of the Université de Genève for organizing and guiding this exceptionally stimulating and enlightening conference with elegance and precision and for ensuring an environment of collegiality, robust (though gentle) humor and dedication to mission. Views expressed in this chapter are those of the author personally and not of any institution with which the author is associated.

3 United Nations Publication Sales No. E.09.V.12, 2007, available at www.uncitral.org/pdf/english/texts/security-lg/e/09-82670_Ebook-Guide_09-04-10English.pdf.

4 Annex I to the Legislative Guide, United National Publication Sales No. E.09.V.12, 2009, available at www.uncitral.org/pdf/english/texts/security-lg/e/Terminology-and-Recs.18-1-10.pdf.

5 See, for example, the legislative guides pertaining to proceeds, attachments, masses or products, negotiable instruments, receivables, intellectual property and registries at www.uncitral.org/uncitral/en/commission/working_groups/6Security_Interests.html.

6 "Islamic finance" is comprised of four areas of activity that are conducted in accordance with Shariʿah principles: (i) banking; (ii) finance; (iii) investing; and (iv) *takaful* (cooperative insurance).

7 The development of contemporary Islamic finance is discussed in Michael J.T. McMillen, *The Shariʿah and Islamic Finance: The Dow Jones Fatwa and Permissible Variance as Studies in Letheanism and Legal Change*, 2013, which uses a single *fatwa* (opinion; *fatawa* is the plural) issued to the Dow Jones Islamic Market Index as the vehicle for the discussion.

This chapter considers select provisions of the Model Law from the Shariʿah perspective. The objective is to provide a comparative vantage on the types of adjustments that must be considered in adapting the Model Law to jurisdictions in which Shariʿah principles are applied. In certain instances, suggestions are made as to how the Model Law might be modified to take cognizance of the relevant Shariʿah principles.

II. The Shariʿah and Rahn Principles

For present purposes, and as a gross oversimplification, the Shariʿah is Islamic law. The Shariʿah is derived from two divinely revealed sources: (i) the Qurʿan, or holy book of Islam; and (ii) the *sunna* (established practices that Muslims are required to follow, including *hadith*, or verified reports of the utterances, actions and tacit approvals of the Prophet Mohammed).[8] There are other means of ascertaining the Shariʿah from non-revealed sources. Those most frequently referenced are *ijma*, or the consensus of (in present times) the Shariʿah scholars, and *qiyas*, or reasoning.[9]

The Shariʿah principles discussed in this chapter derive from Sunni Islam. That is because (a) Sunni principles predominate in the countries in which the Model Law will see the greatest application, and (b) Sunni principles are predominant in international Islamic finance generally.

From the global perspective, four schools of Sunni Islamic jurisprudence (*madhahib*; *madhhab* is the singular) are most frequently encountered in Islamic finance.[10] These are the Hanafi, Hanbali, Maliki and Shafiʿi *madhahib*. Each *madhhab* tends to have a somewhat different interpretation of the relevant Shariʿah principles. Generally stated, the influences of the different *madhahib* correlate with different geographic regions. These correlations are: Hanafi in countries that were within the Ottoman Empire; Hanbali in Saudi Arabia; Maliki in Northern Africa; and Shafiʿi in

8 With respect to *sunna* and *hadith*, see, for example, Zafar Ishaq Ansari, "Islamic Juristic Terminology Before Šāfiʿī: A Semantic Analysis with Special Reference to Kūfa", *Arabica* 19 (1972), p. 255.

9 For a discussion of the Shariʿah, Shariʿah scholars, *fatawa*, the four most frequently encountered *madhahib*, and contemporary Islamic finance, see McMillen (note 7), especially chapters 5–7.

10 There are other *madhahib*, such as the Ibadi (which is dominant in the Sultanate of Oman) and the Zahiri (which is adhered to by minority communities in Morocco and Pakistan).

Southeast Asia and the Persian Gulf. It is primarily because of interpretive variations among *madhahib* that this chapter does not suggest a greater number of modifications of the Model Law text: the precise modification will depend upon which *madhhab* is, or *madhahib* are, applied in a specific jurisdiction.

Developing structures (including products and legal regimes) that are acceptable to all four *madhahib* is a particularly challenging exercise in contemporary global markets. Shariʿah scholars are acutely aware of these challenges and have striven to support the global Islamic finance initiative and find resolutions that allow a type of global standardization. By way of example, a structure may be designed so as to be acceptable to all four *madhahib* despite interpretive differences. Scholars from diverse interpretive positions may all agree that a given product is acceptable despite disagreements as to the supportive reasoning.[11]

Where doctrinal diversity is irrelevant or unnecessary, the interpretation of a single *madhhab* may be dispositive. Thus, the implementation of a legal regime for secured transactions in Saudi Arabia, where the Hanbali *madhhab* predominates, may take little or no cognizance of Hanafi, Maliki or Shafiʿi principles. The implementation of the Model Law in different jurisdictions will have to be sensitive to these varying approaches to relevant principles and interpretive positions.

Security rights concepts have been integral to the Shariʿah since the earliest days of Islam. The relevant principles are incorporated in the term "*rahn*". This term encompasses principles pertaining to security interests in both movable and immovable property, both real and personal property, without distinction.[12] A *rahn* consists of a mortgage or pledge (they

11 See McMillen (note 7), for a discussion of this topic, including an example of a *fatwa* that includes a footnote setting forth the varying positions of Shariʿah scholars from different *madhahib* as to why a particular aspect of a lease (*ijara*) structure is acceptable despite disagreements as to the relevant Shariʿah basis.

12 *Rahn* principles are discussed in (a) Wahbah al-Zuhaylī, "Al-Fiqh Al-Islami wa-Adillatuh (Islamic Jurisprudence and its Proofs)", *Wahbah al-Zuhaylī, Financial Transactions in Islamic Jurisprudence* (Mahmoud El-Gamal, translator, and Muhammad S. Eisaa, revisor) (1997), which is a translation of Volume 5 of Al-Fiqh Al-'Islami wa 'Adillatuh, fourth edition and appears in two volumes (*al-rahn* concepts are discussed in part X, chapters 69–74, volume II, at 79–194; all references in this chapter are to volume II, unless otherwise specifically indicated), (b) the "Majelle", of which there are two accessible English language translations, *Majalat Al-Ahkam Al-Adliyah* (an English language translation prepared by Judge C.A. Hooper as *The Civil Law of*

are treated identically) by a *rahin* (mortgagor or pledgor) to a *murtahin* (mortgagee or pledgee) of *marhūn* (or *marhoun* or *marhoon*; identified property that is the subject of the *rahn*).[13] That is, *al-rahn* is the making of a designated property into security for a debt (obligation) that may be partially or totally recovered from such property or its price.[14] Shariʿah

To provide some orientation, it is helpful to consider generalized summaries of a few basic *rahn* principles under classical orthodox jurisprudence and under a contemporary formulation of the Accounting and Auditing Organisation for Islamic Financial Institutions ("AAOIFI"): *Shariʿa*

Palestine and Trans-Jordan, Volumes I and II (1933), and reprinted in various issues of 4 Arab Law Quarterly 1968), and C. R., Tyser/D. G. Demetriades/Ismail Haqqi Effendi, *The Majelle: Being an English Translation of Majallah El-AhkamI-Adliya and a Complete Code on Islamic Civil Law*, 2001, and (c) Ibn Rushd, *The Distinguished Jurists' Primer, Volume II, Bidāyat al-Mujtahid wa Nihāyat al-Muqtasid* (Imran Ahsan Khan Nyazee, translator, and Mohammad Abdul Rauf, revisor), 1996. The two translations of the Majelle are essentially identical (the minor differences are irrelevant for present purposes).

The Majelle is an unfinished digest of principles and rules of the Shariʿah under the Hanafi *madhhab* as applied in civil law transactions (*muamalat*). It was prepared by a committee of Ottoman Hanafi scholars during the period from 1869 to 1888, was published between 1870 and 1877, and was codified as law in the Ottoman empire as applicable to matters outside the commercial code. See S.S. Onar, "The Majalla", *Law in the Middle East* (Majid Khadduri and Herbert J. Liebesny, eds) (1955). Abū al-Walīd Muhammad ibn Ahmad ibn Rushd, known in the West as Averöes, died in 1198 C.E. (595 H.). This work of Ibn Rushd is considered a book of *khilāf*, a discipline that records and analyzes the differences among Muslim jurists: a type of comparative Islamic law. As an orientation to the citations set forth in this chapter, a review of the Introduction to ibn Rushd, at xxvii to xlii, is recommended.

13 See, e.g., Ibn Rushd (note 12), § 37.1, and Majelle (note 12), articles 701–704. The term "*rahn*" is sometimes used to describe the act of granting the security interest (often translated as "pawning" or "insuring"), sometimes as the security interest (often translated as the "insurance" for the secured obligation), and sometimes as the collateral subject to the security interest. For the most part, this chapter does not explore more refined complexities embodied in *rahn* definitional concepts, such as are evident from the Shafiʿian definition presented at al-Zuhaylī (note 12), at 79: "Taking a non-fungible property as insurance against a fungible debt." This formulation implies, among other things, that a usufruct may not be used as the *marhūn* because it is transient and does not provide the required insurance. That position is debated in contemporary practice, as where the usufruct is available pursuant to a contractual arrangement (such as an *ijara*) for the term of the secured obligation. The Malikis allow the taking of usufruct as the *marhūn*, requiring that it be defined by reference to a specific time period or task: see al-Zuhayli (note 12), at 80.

14 See, e.g., Majelle (note 12), articles 701–61, and al-Zuhaylī (note 12), at 79.

Standard No. (39): Mortgage and Its Contemporary Applications (the "AAOIFI Standard").[15] These will be refined and modified in the course of the comparative discussions of the Model Law, particularly to note interpretive variations of different *madhahib*. For purposes of this chapter, it will be assumed that the debtor is the grantor of the relevant security right and that the encumbered property is that of the debtor-grantor, although the Shariʿah clearly permits the provision of security rights by non-debtor third parties (as grantors), including in respect of the property of those third parties.

Under the Shariʿah, a "mortgage" of real property or immovables is treated, in most respects, identically with the treatment of a "pledge" of personal property or movables. Each may be made the subject of a *rahn* and each may be used as collateral to secure indebtedness or another

15 For convenience and simplicity, many of the classical principles described in this summary are of the Hanafi *madhhab* as set forth in the Majelle. For a discussion of *rahn* principles as applicable to modern secured transactions regimes, see: Michael J.T. McMillen, "Implementing Shariʿah-Compliant Collateral Security Regimes: Select Issues", *EBRD Research Handbook on Secured Lending in Commercial Transactions* (2015); Michael J.T. McMillen, *Rahn Concepts in Saudi Arabia: Formalization and a Registration and Prioritization System*, 2012, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1670104 (discussing a Saudi Arabian legal regime) ("McMillen, Saudi Rahn") and contained, in an earlier version, in *Islamic Capital Markets: Products and Strategies* (M. Kabir Hassan and Hans-Michael Mahlknect, eds), 2011; and Michael J.T. McMillen, "Islamic Shariʿah-Compliant Project Finance: Collateral Security and Financing Structure Case Studies", *Fordham International Law Journal* 24 (2001), p. 1184 ("McMillen, Project Finance") (discussing the development of the collateral security structure under the Shariʿah for the first project financing in Saudi Arabia, a particularly revealing exercise given that, since 1981, Saudi Arabian Public Notaries have refused to record security interests (in most instances) on the grounds that such mortgages secure an indebtedness that is likely related to an interest-based transaction and therefore inconsistent with the Shariʿah: see Saudi Arabia Supreme Judiciary Council Decision No. 291, dated 25/10/1401 A.H. (Aug. 25, 1981)).

The AAOIFI Standard is a contemporary formulation of certain *rahn* principles. It was issued by AAOIFI on 17 Rabi Awwal 1430H, corresponding to March 15, 2009. Although the AAOIFI Standard is not discussed in detail in this chapter, it will likely be a foundational element in any undertaking to adapt the Model Law for application in any jurisdiction that incorporates the Shariʿah in its secular law. The AAOIFI standards are relatively high-level statements of Shariʿah principles in the contemporary context. They are recommended standards, in a sort of "best practices" sense, and are not binding upon any person (unless a state adopts them into secular law).

obligation.[16] The same principles are applicable to both categories of property. However, there are variations in the interpretation of the relevant principles that are responsive to the different characteristics of real versus personal property or immovable versus movable property. Examples of those interpretive differences include, for example, the constituent elements of "possession" or "receipt" (as further discussed in this chapter).

To obtain a security right in the "benefits" of a property it is necessary that the underlying property be subject to a *rahn*. Increases in the value of the *marhūn*, additions to, and products derived from, the *marhūn*, are automatically subject to the *rahn* of that *marhūn* for certain *madhahib*, and appreciation in value and income from the encumbered asset are subject to the existing security right on the encumbered asset under the AAOIFI Standard.[17] Under the applicable precepts as applied by other *madhahib*, however, they may be made subject to the *rahn* only by some definitive action or agreement. In each case, interpretations and applications of these precepts vary.

The indebtedness may be totally or partially recovered from the *marhūn*.[18] The entirety of the *marhūn* will remain subject to the *rahn* until payment in full of the secured obligation.[19]

The *marhūn* must be something that can be validly sold.[20] As such, it must (i) be in existence at the time of the execution of the *rahn* contract, (ii) have a quantifiable value, and (iii) be saleable and deliverable.[21]

16 See, e.g. Majelle (note 12), articles 711, 723, 724, with respect to real property and immovables, and 711 and 714, with respect to personal property and movables, and al-Zuhaylī (note 12), at 79–80. Certain types of rights may not be pledged: they must be assigned: see McMillen (note 15, Project Finance), at 1203–05, 1213–14, particularly footnote 31, and 1217–21, particularly footnote 42.

17 See, e.g., Majelle (note 12), article 711 (defining a *rahn* of a piece of land as including all trees growing thereon and the fruits of such trees) and article 715 (discussing increases of or arising out of the *marhūn*), and AAOIFI Standard, § 3/2/8.

18 See, e.g., Majelle (note 12), articles 711, 712, 723 and 724 (citing examples).

19 See, e.g., Majelle (note 12), article 731. Correlatively, the entirety of the secured obligation is associated with the *marhūn*.

20 See, e.g., Majelle (note 12), article 709.

21 See, e.g., Majelle (note 12), article 710, and Ibn Rushd (note 12), § 37.1. Sale principles are discussed in al-Zuhaylī (note 12), Volume I, at 1–366 and, with respect to leases, which are a sale of usufruct, at 381–434, Majelle (note 12), articles 1–611 (which includes lease), and Ibn Rushd (note 12), §§ 24–30 (which includes leases).

Accordingly, a *rahn* of "after acquired" (including "subsequently constructed") property is presumptively invalid.[22]

Uncertain sums may not be mortgaged or pledged.[23] An existing *rahn* may not be valid with respect to future advances or loans in the view of some Islamic jurists.[24] Finally, and subject to qualifications, borrowed property may be subjected to a valid *rahn* by the borrower to another secured creditor only with the permission of the owner of the secured property.[25]

Under the Shariʿah, the secured party is responsible for expenses of safeguarding the secured property and preserving the *rahn*, such as the erection of the fence around the property, the wages and fees of the security agents, the wages of the guard posted at the property, the cost of erection of signs and the like.[26] The debtor is responsible for all expenses in connection with the improvement and maintenance of the *marhūn*, including repairs and operation and maintenance expenses.[27] Any agreement modifying these allocations is void. If either the debtor or the secured party should of their own accord pay the expenses that are rightly paid by the other, that payment is in the nature of a gift and no subsequent claim may be made for such amounts.[28]

Under the Shariʿah, a *rahn* is, by definition, possessory. The Qurʿan refers to the idea of a *rahn* as a "*rahn* with possession" (*fa rihanun maqboudha*). Thus, perfection of the security right (*i.e.,* enforceability against third-party creditors) is dependent upon "possession" of the *marhūn*. If the secured party ceases to have "possession" of the *marhūn*, the secured party will be treated as an ordinary unsecured creditor. Some courts and Shariʿah scholars require actual physical possession to satisfy this requirement. Only one *madhhab* (the Maliki) expressly acknowledges

22 But see Majelle (note 12), article 713.

23 See, e.g., Majelle (note 12), article 709.

24 See, e.g., Majelle (note 12), article 714.

25 But see, Majelle (note 12), articles 726–28, 735 and 736, and AAOIFI Standard, § 3/2/6 (owner permission is required), and see the discussion of the positions of the different *madhahib* in al-Zuhaylī (note 12), at 128–30.

26 See, e.g., Majelle (note 12), article 723.

27 See, e.g., Majelle (note 12), article 724. In many instances, it is difficult to distinguish between arrangements for safekeeping of the property and preservation of the *rahn* from those pertaining to operation and maintenance of the property.

28 See, e.g., Majelle (note 12), article 725.

"constructive possession" concepts. However, a Shariʿah principle is that "possession is in accordance with the nature of the property to be possessed" (*qulu shay'in yuqbadhu bi hasabihi*), and in many instances physical possession is an impossibility. The AAOIFI Standard distinguishes "actual possession" (putting a hand on the property) and "legal possession" (the latter may be accomplished through registration or documentation). Thus, the AAOIFI Standard recognizes registration of the security right as a substitute for physical receipt and possession.

Provided that a secured party has possession of the *marhūn*, that secured party has priority, under the Shariʿah, over all other creditors of the debtor in the collection of the secured amounts owed to that secured party from the value of the *marhūn*. A security interest (*rahn* interest) in the *marhūn* may not be separately granted to another secured party under classical principles because the original *rahn* will be voided by the second grant, in most instances, but the AAOIFI Standard allows grants to more than one person or entity.[29]

Neither the debtor nor the secured party may sell the collateral without the consent of the other.[30] If the secured debt becomes due and the debtor does not satisfy the secured obligation, the secured party will not – and usually cannot – obtain title to the *marhūn* under classical principles. Rather, the debtor will sell, or be coerced to sell, the *marhūn* or a judicially-directed sale of the *marhūn* will be effected. Under the AAOIFI Standard, the secured party or its agent may have the self-help remedy of selling the encumbered asset.[31] The secured party will have priority with respect to those sale proceeds in satisfaction of the secured amounts owed to it. If the proceeds are insufficient to pay all secured obligations in full, the secured party will become an unsecured creditor with respect to the remaining balance.

While the practice of secured creditors is to avoid holding collateral prior to a judicially directed sale of the *marhūn*, the Shariʿah does

29 See, e.g., Majelle (note 12), article 744, and AAOIFI Standard, § 3/2/3. An example of an exception to this statement of classical principles relates to granting of a security interest to a partner of the original secured party). See the discussion under the heading "Select Definitional Matters: Priority (IV.B)".

30 See, e.g., Majelle (note 12), article 756.

31 See the discussion under the heading "A Few Comments on Remedies (VII)". And see, e.g., Majelle (note 12), at articles 756–61, and AAOIFI Standard, § 3/1/4.

contemplate such a holding. In any such case, the secured creditor will have responsibility for the safekeeping of the *marhūn* during such period.

There is no prescribed form of *rahn* under the Shariʿah. However, there are numerous principles applicable to the descriptive characteristics of a valid *rahn*, particularly as to the specificity of the description of the *marhūn* and the secured obligation. The *rahn* contract must include an accurate designation and description of the *marhūn*. In the case of a *rahn* of real property, the location and description of the real property, as specified in the deed pertaining thereto, should be included. A *rahn* of real property may also specify that it covers fixed assets located on the land, such as buildings and immovables (fixtures).[32] The *rahn* will not be valid to the extent that it covers property that does not exist at the time of the execution of the *rahn* contract, with limited exceptions.

The *rahn* contract must also identify the secured obligation with some specificity. There appears to be agreement that a reference to the agreement pursuant to which the secured obligation is incurred is necessary and that the exact amount of the secured obligation is required to be specified in the *rahn* contract. Often, there must be separate detailed specifications of amounts constituting each element of indebtedness (*i.e.,* principal, profit, and other amounts). Of course, interest is impermissible under the Shariʿah and a *rahn* securing interest payments would be unenforceable, at least to the extent that it secures the interest payments.

The *rahn* agreement should also include the terms under which it may be exercised and the remedies of the secured party to occupy, use, and operate the *marhūn*, and to sell such assets, and, in each case, to apply the proceeds thereof to pay off the secured obligations.

III. Scope of Application

As a point of embarkation in the comparative analysis, various provisions of the Model Law highlight issues relating to the respective scope and roles of the secular legal system and its legal admonitions (such as the Model Law), on the one hand, and the Shariʿah, on the other hand. These issues

32 Immovable property under the Shariʿah is defined as any property that is stable and fixed so that it may not be moved or transported without damage. It includes land, buildings, and trees. As noted in subsequent text of this chapter, movable property may become immovable property.

pervade any analysis such as that provided in this chapter. And they pervade the process of implementing any law, including the Model Law, in jurisdictions in which the Shariʿah is incorporated, to some greater or lesser extent, in the operative legal regime. They are present to some degree in virtually every matter that is discussed in this chapter, although they will not be specifically noted in other sections. They are mentioned at this point in the discussion in order to emphasize that one should be cognizant of these issues throughout this chapter.

The Shariʿah is divinely revealed, comprehensive, and immutable over time.[33] As such, it is impermissible, as a pure Shariʿah matter, to exclude topics from its coverage or allow variations of the principles applicable to topics, even with unanimous consent of transactional parties. Secular law, on the other hand, allows for such exclusions and variations, including those described in the Model Law.

The initial provisions of the Model Law illustrate the contrast well. The Model Law "applies to movable assets … regardless of the form of the transaction or the terminology used by the parties, the type of asset, the status of the grantor or secured party, or the nature of the secured obligation."[34] That said, the Model Law then goes on to exclude a range of different interests, transactions, and categories of assets. For example, the Model Law is not applicable to "a security right created in favor of an individual for his or personal, family and household purposes."[35] Nor is the Model Law applicable to rights to draw under an independent undertaking, certain assets where another law addresses those assets (e.g., aircraft, railroad rolling stock, space objects, ships and mobile equipment), intellectual property, certain types of securities, netting arrangements, payment rights under foreign exchange transactions, and situations in which

33 And, although it has been defined narrowly as Islamic law, it has strong moral and ethical imperatives.

34 Model Law, Article 1, Paragraph 1.

35 Model Law, Article 1, Paragraph 4. See also the definition of "consumer goods" in Article 2, clause (f) (tangible assets that a natural person or individual grantor uses or intends to use for personal, family or household purposes), Article 21 (which provides that an acquisition of a security right in consumer goods is effective as against third parties upon its creation), Articles 49 and 51 (addressing priorities of acquisition and non-acquisition security rights in respect of consumer goods), and Article 61 (acquisition security rights in tangible assets used or intended for use in personal, family or household purposes).

another law addresses proceeds of an excluded asset (to the extent of the application of the other law).[36]

The Shariʿah stands in stark contrast to this approach. *Rahn* principles apply to both movables and immovables, to real and personal property, without distinction or qualification. It makes no distinction as among categories of assets (such as equipment or inventory), with a very limited range of exceptions.[37] *Rahn* principles apply equally, and comprehensively, to both commercial and consumer transactions, again without distinction. In short, the aforementioned provisions of the Model Law would be inappropriate if the Shariʿah were the sole framework for analysis.

In other instances, of which there are many, the Model Law acknowledges the right and power of each of the enacting state (the "State") and the parties to the security agreement giving rise to the security right to vary the coverage of the Model Law. For example, the State is allowed to modify the coverage of the Model Law.[38] Again, if the Shariʿah were the sole framework for analysis, these variations would be impermissible: neither the State nor the contracting parties is permitted to exclude or modify the coverage of the applicable Shariʿah principles (although the AAOIFI Standard does allow the parties to agree as to the application of certain permissible variations, such as the right of self-help remedies).

As a practical matter, the Shariʿah is not the sole determinative framework, however. In virtually all States, the legal regime is structured primarily around the concept of the primacy of secular law. The Shariʿah may have a role, and may be incorporated in the body of applicable law, but (with only one exception or very few exceptions) the Shariʿah is not the paramount law of the land.[39] The exact role of the Shariʿah in any given jurisdiction varies.

Thus, while theory as regards the Shariʿah may suggest that neither the State nor the contracting parties should be permitted to exclude or vary the relevant principles, it seems appropriate to construct the Model

36 Model Law, Article 1, Paragraph 3.

37 Transfers of receivables, which are addressed by the Model Law, are one such (quite complicated) exception under the Shariʿah, and are not addressed in this chapter.

38 Model Law, Article 1, Paragraph 3, with clause (h) expressly so providing. And see, in particular, Article 1, Paragraph 7.

39 The sole exception known to the author is Saudi Arabia where, in theory, the Shariʿah is the paramount law of the land. In Saudi Arabian practice, it is difficult to sustain the theory.

Law to allow for variations. This would allow variation to accord with the principles of such *madhahib* as may be applicable in any given jurisdiction. Exclusions or variations can be permitted, leaving any Shariʿah-based rejection or modification of those matters to the discretion of the States that incorporate the Shariʿah in their body of secular law and, even, to the contracting parties, who will seek guidance from, or be provided with guidance by, Shariʿah scholars that are involved in the regulation of Shariʿah-compliant commerce and finance.

IV. Select Definitional Matters

The definitions set forth in the Model Law highlight both areas of shared concepts and areas in which it will be necessary to craft reconciliations between the Model Law and the relevant Shariʿah concepts. Three definitions are considered in this section: "possession"; "priority" and "mass or product".

A. Possession

"Possession", as defined in the Model Law, is limited to actual physical possession. The Model Law definition expressly excludes constructive, fictive, deemed, or symbolic possession.[40]

For the most part, the actual possession orientation of the Model Law is harmonious with *rahn* principles. Three *madhahib* require actual possession for a *rahn* to be valid. Those three *madhahib* also require "receipt" of the *marhūn* by the secured party, a requirement that goes to bindingness of the arrangement rather than validity.[41] For these *madhahib*, it is necessary to physically possess movables, and a valid *rahn* is not binding until the *marhūn* is received (i.e., before receipt, the debtor is permitted a change of heart and mind).[42] The principles applicable to immovables permit of either physical possession or removal of the impediments to receipt and physical possession.

40 Model Law, Article 2, clause (u).

41 See al-Zuhaylī (note 12), at 106–22, for a detailed discussion of the rather intricate receipt principles and rules.

42 al-Zuhaylī (note 12), at 106.

One *madhhab*, the Maliki, diverges somewhat and recognizes constructive possession concepts. The Malikis also take the position that delivery can be required by the secured party where there has been offer and acceptance. The AAOIFI Standard also acknowledges constructive possession concepts pursuant to registration or documentation.[43]

All four *madhahib* agree that conclusion of an agreement with a stipulated condition that the *marhūn* remain in the possession of the debtor invalidates the *rahn*. This illustrates the fine distinction between possession and use of the *marhūn*. The AAOIFI Standard allows debtor benefit during the term of the *rahn* with the permission of the secured party.[44]

There has been, and there remains, a debate as to whether registration in a registry will operate as a substitute for physical possession. The matter is unresolved, although the trend seems to be toward acknowledgement of registration as a type of substitute for physical possession as illustrated by the AAOIFI Standard.

Practices, both ancient and modern, regarding the holding and operation of *marhūn* during the period of a *rahn* hint at the complexities of Shariʿah-based possession concepts.[45] It was common, classically, although not universally accepted, for the debtor to hold and use the encumbered asset during the term of the security right or *rahn*. Where debtor operation was permitted, the debtor was required to produce the encumbered asset for confirmation upon demand by the secured creditor in certain circumstances, such as at the specific dates of repayment.

The interplay between the debtor use principles and the possession principles illustrates some of the tensions within the Shariʿah paradigm. These tensions are more easily accommodated under the Maliki constructive possession model.

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43 al-Zuhaylī (note 12), at 107, with respect to the Maliki position, and AAOIFI Standard, § 3/1/2.

44 AAOIFI Standard, § 3/2/9. See the discussion of "use" of the *marhūn* under the heading "Secured Obligations and Encumbered Property: Property May be Encumbered and its Use (V.B)".

45 Debtor possession is discussed in greater detail under the heading "Secured Obligations and Encumbered Assets: Property that May be Encumbered and its Use (V.B)".

B. Priority

The Model Law defines "priority" as the right of a person to derive the economic benefit of its security right in preference to a competing claimant (with "competing claimant" being a specifically defined set of persons).[46] A primary focus of the Model Law, as is true in all secular legal regimes applicable to secured transactions, is on the relative priorities of those holding security rights.[47]

Priority, in the Shariʿah context, relates to the priority of the secured creditor to the price of the property subject to the *rahn* in favor of that secured creditor as against other creditors of the debtor. It allows the secured creditor to be the first to recover rights in the price of the *marhūn*, leaving other creditors to share equally in the excess of the price over the unpaid amount of the secured obligation.[48]

The reference to equal sharing in the preceding paragraph is based upon an important Shariʿah consideration that is at odds with modern conceptions of priority in non-Shariʿah realms. The relevant *rahn* principles, as classically formulated, are hostile to multiple grants of security rights.

Grants of a second security right without permission are void.[49] Permissive second security rights are not entirely void. A permissive second security right invalidates the first security right under classical principles, although the AAOIFI Standard allows multiple grants of differing ranks.[50] Thus, for example, under classical principles if the original debtor grants a security right to a third party with the consent of the original secured party, the initial security right is voided and the second security right stands as the exclusive security right. And if the original secured party grants a security right to a third party with the consent of the original debtor, the original security right is voided and the second security right is considered to be valid.

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46 Model Law, Article 2, clause (v).

47 Consider, for example, Chapter V, Articles 42–62, of the Model Law which address priority considerations, and Article 86, Paragraph 1, of the Model Law, which allows a secured creditor having priority over an enforcing creditor to take over the enforcement process at any time prior to sale of the asset.

48 See, e.g., al-Zuhaylī (note 12), at 175.

49 See, e.g., Majelle (note 12), article 743.

50 See, e.g., Majelle (note 12), articles 743–745, and AAOIFI Standard, § 3/2/3.

As might be imagined given contemporary commercial and financial practices, contemporary legal regimes for security rights in jurisdictions that incorporate the Shariʿah into secular law struggle mightily with these doctrines. Examples are Saudi Arabia and the AAOIFI Standard, each of which acknowledges multiple security rights and the relative priorities of different security rights, although in somewhat different formulations.[51] These accommodations sharply accentuate the issues and practical tensions previously noted with respect to the role and scope of the Shariʿah in the legal regime.

C. *Mass or Product*

The Model Law's definition of "mass or product" (and some uses of that defined term) are overlapping with, but also emphasize areas of distinction from, a fundamental *rahn* concept that pertains to fungible assets and fungibility. Fungibility is a pervasive, and complex, topic under the Shariʿah that arises in a range of different areas in addition to *rahn* principles. Fungibility concepts apply, for example, to both assets and liabilities, and the applicable rules vary somewhat with the different permutations involving fungible assets and fungible liabilities. Reconciling the mass or product concepts under the Model Law with fungibility concepts under the Shariʿah will entail some careful parsing.

The Model Law defines mass or product as tangible assets other than money that have become so physically associated or united with other tangible assets that they have lost their separate identity. This definition includes both fungibility concepts (e.g., a kernel of grain in a silo) and integration concepts (e.g., a gear in a machine).

The Shariʿah takes a somewhat different vantage on these issues. Fungibility concepts are, as a general statement, treated similarly under the Shariʿah to their treatment under the Model Law. Some instances of integration are treated similarly, others are treated differently.

Integration, under the Shariʿah, may of itself change the characterization of the property. For example, movable property placed, by its owner, on immovable property also owned by such owner for the purpose of

51 McMillen (note 15, Saudi Rahn).

serving or exploiting that immovable property becomes immovable property. Examples include doors and windows in a building that, even though they are originally movable property, become part of the immovable property in actual use. This is akin to the concept of "fixtures" under the Uniform Commercial Code in the United States of America.

However, integration concepts shade off, under the Shariʿah, into the realm of "increases" to the encumbered asset (both attached and unattached increases). Increases, including growths, are discussed in greater detail under the heading "Secured Obligations and Encumbered Assets: Property that May be Encumbered and its Use".

V. Secured Obligations and Encumbered Assets

Articles 6 through 9 of the Model Law address:

- Obligations that may be secured (any type of obligation: present or future; determined or determinable; conditional or unconditional; fixed or floating)
- Property that may be encumbered (any type; any part; undivided interests; current or future; all assets or categories of assets)
- Proceeds (identifiable or commingled, including in accounts or mass or product) [52]

Matters are a tad more complicated under the Shariʿah. The first two of the bulleted matters are discussed in the following two subsections.

52 Proceeds that constitute "increases" or "growth", and related principles, are discussed under the heading "Secured Obligations and Encumbered Property: Property that May be Encumbered and its Use (V.B)". The applicable Shariʿah principles are significantly different than the principles embodied in the Model Law. The treatments of proceeds resulting from the sale of an encumbered property are similar under the Model Law and the Shariʿah. The Shariʿah principle is that the proceeds of such a sale become *marhūn* that is substituted for the *marhūn* that was sold. However, the interplay of other Shariʿah principles (e.g., that a debtor cannot be required to pay its debt prior to the agreed and scheduled payment date) with the proceeds principles produces some notable differences in the results that are obtained under the Model Law and those that are obtained under the Shariʿah. See, for example, the final three paragraphs under the heading "A Few Comments on Remedies (VII)".

A. Obligations that May be Secured

Under the Shariʿah, there are, for analytical purposes, three forms of security rights:[53]

- Those *originating with the debt-generating contract*, such as a condition in a sale agreement that a security right be provided to secure payment of the sale price
- Those *originating after the establishment of the relevant secured debt*
- Those *granted prior to the establishment of the relevant secured debt*, such as on property prior to incurrence of any indebtedness

Before considering the three categories, it is important to note that the secured obligation must always be compliant with the Shariʿah. That is an independent undertaking that harkens back to sale principles under the Shariʿah.[54] The security right granted by the *rahn* will be invalid if and to the extent that it secures an impermissible obligation.

Consider a couple examples, beginning with the easier case. May a *rahn* may secure an obligation that is contrary to fundamental Shariʿah principles, such as an obligation to deliver wine or swine? Thus, wine and swine, being impure objects, and an obligation to deliver or pay for wine or swine, are impermissible. Items that may not be validly sold may not be the subject of a *rahn*.[55] Taking a contemporarily relevant, and mixed, example, may a *rahn* secure an interest-bearing loan obligation? The answer varies. The *rahn* may be valid to the extent of the principal amount of the loan but invalid with respect to the interest component of the loan. Other scholars might find the entire arrangement impermissible. The AAOIFI Standard

53 al-Zuhaylī (note 12), at 91.

54 See the sources cited at note 21, *supra*.

55 There are also variations among *madhahib* regarding security rights in non-fungible liabilities. For the most part, security rights in non-fungible liabilities are impermissible, although there are multiple scenarios, including whether the *marhūn* is held in a possession of trust (e.g., a leased object, a deposit or capital in a partnership), is an object that guarantees itself (through replacement of an equal object or the price of the object, such as in situations where the buyer holds the object prior to consummation of the sale of that object), or is an object that is guaranteed by another object (such as where the seller possesses the object prior to the sale of that object, in which case the price guarantees the object). See al-Zuhaylī (note 12), at 96–98. Fungible liabilities are generally eligible to be secured, although the Malikis do not permit *rahn* arrangements in respect of *salam* (forward sale) obligations or currency exchanges. See at 100–01.

specifies that the encumbered asset must be a Shariʿah-permissible property, but develops the statement no further.

All *madhahib* recognize the validity of the first two categories of security rights, leaving aside, for the moment, future advances and incurrences of debt. Both indicate express consent and lack of uncertainty and both categories will usually allow for the precision in description that is required under the Shariʿah.

The third form of security rights are those granted prior to establishment of the relevant secured obligation. For the Shafiʿis and most Hanbalis, such a security right is not valid. The basis for this position is that a derivative legal right (the security interest) may not precede the establishment of the legal right (ownership of the property that will become encumbered property). Further, the secured obligation (debt) must be binding and matured. The AAOIFI Standard does not require that the debt be established prior to the *rahn*, which would ensure that future advances and incurrences are secured. [56]

Formulations of a "matured" debt vary with *madhhab* and Shariʿah scholar. The most common interpretation is that the relevant liability or debt must be fully established and known, or definitively established as a fully-defined liability. Future advances and future incurrences, even under a single agreement providing for those advances or incurrences to a designated maximum amount, are the area that best frames the critical issue.

The position of the Malikis and the Hanafis is that the future advances and incurrences are valid obligations that can be the subject of a security right. The AAOIFI Standard also adopts this position. Thus, the original *rahn* is valid as to the future advances under a revolving credit agreement and increases in indebtedness. [57]

The Hanbalis and the Shafiʿis (and some Hanafis) do not consider future advances and incurrences to be valid obligations that can be the subject of the original security right. They do not allow the future debt to be secured

56 Each *madhhab* has established a set of conditions as to the underlying obligation that is to be secured. These include, in addition to a matured and binding liability, the ability to extract repayment of the liability from the *marhūn*, and that all parties know of the liability (which raises issues as to future advances), including as to the amount and characteristics of the liability (which also raises issues regarding future advances). See al-Zuhaylī (note 12), at 93–101. See AAOIFI Standard, § 3/3/1, with respect to the execution of the *rahn* agreement prior to the establishment of the debt.

57 See, e.g., Majelle (note 12), article 714.

by the original security right.[58] Thus, the debt must be fully advanced or incurred and the liability must be definitively known (although it need not then be due and payable). The basis for this position is that the insurance of a legal right cannot precede the establishment of the legal right.

The position of the Hanbalis and the Shafiʿis raises significant issues in contemporary financing arrangements: future advances and subsequently incurred indebtedness under an existing agreement, including where the existing agreement provides for the future or subsequent advance or incurrence. In this context, consider, as examples, revolving credit facilities of different types, rent for as-yet-unreceived usufruct (i.e., future rent under an *ijara*), and wages for future services under a service agreement.

Another group of Shariʿah requirements relates to the degree of specificity that is required in the contract establishing the secured obligation. This set of requirements is interactive with determinations as to whether an obligation is matured or established. Precision and detail should define the practice of specifying the debt, the terms of repayment, the relevant repayment dates and other fundamental terms in the security agreement. These are Shariʿah requirements in any case, but the level of detail is increased in circumstances where future advances and incurrences are involved.

Rules regarding the specificity of debt descriptions are applied with rigor. In all instances, only debt described in the *rahn* contract will be covered by the security right, which suggests careful description of all potential future advances and incurrences. The different *madhahib* also have different positions on the maturity of the secured debt, including rules as to whether the debt is "finally established" and with respect to other underlying debt conditions. These are all matters to be carefully studied as the Model Law is tailored to any specific jurisdiction.

Another set of Shariʿah principles of relevance to the Model Law pertain to the association of the encumbered property with the underlying secured obligation. The secured obligation is associated with the entirety of the encumbered asset.[59] And the encumbered asset is associated with

58 There are exceptions to this statement. Consider an *istisnaʿa* (construction or manufacture agreement with multiple advances) and a *salam* (forward sale, in which payment is made in the future). The positions of the *madhahib* vary with respect to whether the future payment obligation in a *salam* may be secured. See, for example, al-Zuhaylī (note 12), at 94–95.

59 See al-Zuhaylī (note 12), at 144–46, and Majelle (note 12), article 731.

the entirety of the secured obligation.[60] Repayment or forgiveness of part of the secured obligation leaves the remaining unpaid portion of the secured obligation associated with the entirety of the encumbered asset. No portion of the encumbered asset is released until payment in full of the secured obligation (even if there are multiple debts or multiple assets).

It is important to be aware of an issue that relates to prepayments and Shariʿah principles. The Shariʿah allows a debtor to prepay an obligation at any time, even if the financing arrangement expressly precludes early prepayment. Illustrating the inter-relationship between secular law and the Shariʿah, even in a jurisdiction in which the Shariʿah is the paramount law of the land, the new Saudi Arabian mortgage law allows prepayment of indebtedness prior to its maturity in accordance with the agreement of the parties (thereby allowing prohibitions on early prepayment).[61] The critical question in each jurisdiction in which the Shariʿah is applied is whether a dispute resolution body (e.g., a court) will enforce a restriction on early prepayments of debt? The likelihood, given the predominant Shariʿah interpretation, is that it will not enforce that restriction (although the effect of a contrary secular law provision is uncertain).

B. Property that May be Encumbered and its Use

The validity of property as *marhūn* under the Shariʿah proceeds from a different set of principles: sales principles. As a first principle, the property must be eligible for sale (because, among other reasons, it is sold to make payment of the obligation if the obligation is not paid). Whether property is eligible for sale is itself a complicated, and fundamental, inquiry in *fiqh*.[62]

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60 This discussion ignores situations involving multiple debtor, multiple creditor and multiple secured obligations, each of which is subject to separate Shariʿah principles.

61 McMillen (note 15, Saudi Rahn).

62 *Fiqh*, as a classical Islamic discipline, is the study of law. The word is derived from an Arabic root word, f-q-h, meaning understanding. Classical *fiqh* texts relating to commercial and financial matters customarily begin with sales. See, e.g., Wael B. Hallaq, *Sharīʿa: Theory, Practice, Transformations*, 2009, at 551–55, Appendix A, summarizing the topical arrangement and organizational scheme of books of *fiqh* as an historical matter and the relative percentage of discursive attention, as a generalization, allocated to each topic. That Appendix A examines the al-Mīzān al-Kubrā of ʿAbd al-Wahhāb al-Shaʿrānī, which Hallaq takes to be representative. al-Zuhaylī (note 12), is another example.

Among the relevant critical sale elements are the following: (a) the property must *exist* at the inception of the contract; (b) the property must be *deliverable* at contract inception;[63] and (c) a variety of others, including that the property constitute property[64] and be valued, known,[65] owned,[66] not be occupied by a non-*rahn* property,[67] separate,[68] clearly identified[69] and received by the secured party.[70]

As a result of these sales elements, and with variations as among *madhahib* (particularly the Malikis), security rights cannot be separately created in "increases" to property under classical principles, such as, (a) fruits

63 Consider, in connection with deliverability, the non-Hanafi view that usufruct is not deliverable at the inception of the *rahn* contract because "it does not exist at that time, and since it vanishes immediately following its transient existence." al-Zuhaylī (note 12), at 102–03.

64 For example, the Hanafis do not consider usufruct to be property. The Shafiʿis prohibit the use of usufruct as a valid *marhūn* at the inception of the *rahn* contract, but permit usufruct as *marhūn* subsequent to inception of the *rahn* contract. al-Zuhaylī (note 12), at 103.

65 For example, a *rahn* on a house and all its contents is valid for the Hanafis, but invalid for the Shafiʿis and Hanbalis.

66 Ownership is not a condition to validity of the *rahn*; it is a condition to executability of the *rahn*. Permission of the owner may make render a *rahn* of non-owned property permissible.

67 For example, it is impermissible to create a *rahn* on agricultural land without also subjecting the crops to the *rahn* or to create a *rahn* on a house without also subjecting the furniture in the house to the *rahn*. It is permissible to create a *rahn* on the furniture in a house without subjecting the house to the *rahn*, but not permissible to create a *rahn* on the crops because they are attached or connected to the agricultural land (after severance, the crops could be subjected to a separate *rahn*).

68 Connected or attached fruits and crops may not be subjected to a separate *rahn*. See the preceding footnote.

69 This doctrine, in addition to specificity requirements, precludes the creation of a *rahn* on a fraction of a property for the Hanafis. The Hanbalis, Malikis and Shafiʿis allow a *rahn* on an unidentified share of property, whether or not the property is divisible. These interpretations give rise to further rulings in respect of possession, which must also be considered. The Malikis have ruled that the secured creditor must take possession of the entire property, including the non-owned portion. The Hanbalis and the Shafiʿis treat immovable and movable properties distinctly. Possession of an immovable property is established by giving the secured creditor access to the property, with or without the permission of the co-owner. Possession of a movable property requires both physical possession and the permission of a co-owner. See al-Zuhaylī (note 12), at 123–25.

70 These conditions are discussed in al-Zuhaylī (note 12), at 101–39, and in more abbreviated form, in Ibn Rushd (note 12), § 37.2.

of a tree, (b) wool on sheep, (c) unborn offspring of cattle, and (d) a fraction of a house (although Hanafis allow creation of a security right in an unidentified portion; it is unclear whether this addresses undivided interests). Upon severance of the increases (fruits, wool or calves), separate security rights can be granted in these properties.

As a general principle, increases or growths to an encumbered property, prior to severance, go with the encumbered property and are subject to a security right on that property. To grant a security interest in the increase in a property prior to severance, it is necessary to grant a security right in the principal property that gives rise to the increase. Granting a security interest in a tree will result in a grant of a security interest in the fruit of that tree. A grant in the sheep will include a grant in the wool. A grant in a cow will ensure a grant in the unborn calf.

The general statements presented in the next preceding paragraph are subject to considerable variation from one *madhhab* to another. Consider the following positions.[71]

- Hanafi: Contiguous growths (e.g., fruits, wool and milk) and separate growths (e.g., offspring) are part of the encumbered asset and are subject to a security right in that encumbered asset. However, separate, non-derivative growths (e.g., rent) are not part of the encumbered asset and belong, separately, to the debtor.
- Hanbali: All increases, growths and output of an encumbered property are part of the encumbered property and subject to the *rahn* on the underlying encumbered asset.
- Maliki: Contiguous and non-contiguous growths and products (e.g., offspring and palm shoots) and non-separable growths (fat) are part of the encumbered property. Increases that are not of the same form as the underlying property that is the subject of the *rahn*, whether derivative (e.g., fruits) or non-derivative (e.g., rent), are the property of the debtor and not subject to the *rahn* of the underlying property. In a fine distinction, wool growing on the back of sheep is subject to the *rahn* of the sheep if the wool existed at the time of the grant of the *rahn*.
- Shafiʿi: Contiguous growths (fat), increases in size and fruit are part of the encumbered property. Separate and separately identifiable growths and increases are not part of the encumbered property and

71 See al-Zuhaylī (note 12), at 183–85, and Ibn Rushd (note 12), § 37.2, and AAOIFI Standard, § 3/2/8.

are separate property of the debtor outside the security right on the encumbered property (e.g., offspring, milk, eggs, wool, hair and rent). Separate, non-derivative growths (e.g., rent) are the property of the debtor and not subject to the *rahn* of the property that is rented.

– AAOIFI Standard: Apprciation in the value of the encumbered asset and the income from the encumbered asset is subject to the security right on the encumbered asset, unles the parties otherwise agree.

There are obvious and significant implications of these types of interpretive differences in implementing a legal regime for secured transactions. How does one structure the Model Law for a jurisdiction that applies principles from more than a single *madhhab*? And consider the care that must be taken in ensuring a sound understanding of the definition of each of the relevant categories, such as "contiguous", "derivative", "non-derivative", "separate", and "separately identifiable", among others, and then assigning properties to each category.

In the context of modern commercial and financial transactions, critical sets of considerations arising out of these Shariʿah principles relate to security rights in after-acquired and after-arising property and determinations as to when such property is or is not subject to an existing security right. Alternatively, there may be a necessity for the imposition of covenants (both positive and negative) that specifically address these types of property and for continual reporting and monitoring and the establishment of new security rights.

Another set of considerations that flow from Articles 6 through 9 of the Model Law relate to use of encumbered property. A fundamental Shariʿah principle prohibits allowing a usufruct of a property to go to waste. In general terms, property (including the usufruct) is to be used, not wasted, including during the term of a *rahn*. The rules pertaining to use by the debtor and the secured creditor have been developed with this no-usufruct-waste principle as a background. There are different interpretations of the use rules, which are summarized as follows:[72]

– Shafiʿi: The basis for the interpretations of the relevant principles by Shafiʿian jurists is that the debtor owns the encumbered property.[73] As

72 See al-Zuhaylī (note 12), at 152–65, and AAOIFI Standard, § 3/2/9. See, also, Ibn Rushd (note 12), § 37.1.3.

73 Assuming that the security right is not in property provided by a guarantor or other third party.

a result, the debtor is entitled to use and extract all usufruct from the encumbered asset, even without consent from the secured party. Preservation of collateral value is ensured through application of principles to the effect that the debtor may do no harm in using and extracting value from the encumbered property, and may not do any act that decreases the value of the encumbered property without authorization from the secured creditor. Proceeding from the doctrinal base of debtor ownership, secured creditors are prohibited from using the encumbered asset during the term of the *rahn* and, generally, benefits from the use of the encumbered asset accrue to the debtor. The Shafiʿis provide an exception, and allow the benefit of the usufruct to accrue to the secured creditor in certain sales arrangements where the usufruct is of a known amount at inception of the sales contract and the *rahn* is stipulated in the sales contract (e.g., where a sale and a lease are combined in one contract). A minority of Shafiʿian jurists allow secured creditor use with debtor permission if the *rahn* contract does not specify use matters.

- Hanafi: The usufruct of an encumbered asset is part of the encumbered property and, as such, is subject to the security right on the encumbered property.[74] In most instances, the debtor is only permitted to use the encumbered property with the permission of the secured creditor. However, if the debtor can benefit from the encumbered property without taking possession of it (e.g., a machine or land), then the benefit or output belongs to the debtor. Secured creditors are generally permitted to use the encumbered asset, but there are variations in interpretive positions within the Hanafi *madhhab*. One position is that debtor permission is required for use of the property by a secured creditor. A second position is that that debtor use of the encumbered property is never permitted, even with the consent of the secured creditor. A third, and middle, positon precludes secured creditor use if that arrangement is stipulated in the contract but allows it if debtor permission is given but not stipulated in the contract.
- Hanbali: The usufruct of an encumbered asset is part of the encumbered property and, as such, is subject to the security right on the encumbered property. In most instances, the debtor is only permitted to use the encumbered property with the permission of the secured

74 See, also, Majelle (note 12), article 715.

creditor. However, if the debtor can benefit from the encumbered property without taking possession of it (e.g., a machine or land), then the benefit or output belongs to the debtor. These interpretations are thus the same as the Hanafis, with respect to debtor use. Secured creditors are generally not permitted to use the encumbered property, other than animals that require feeding, without the permission of the debtor.[75] There are specific rules applicable to situations in which the secured obligation is a loan. In those situations, secured creditor use of the *marhūn* is permissible only if compensation (usually at market rates) is paid to the debtor by the secured creditor. The Hanbalis add a provision that the property will remain unused (despite the aversion to waste) if the debtor and secured creditor cannot agree on allowing one or the other to benefit from the use of the encumbered asset. They do allow the secured creditor to take the benefit of the usufruct of an animal in limited circumstances. The compensation must be milk from the animal or riding of the animal and the value of the milk or riding must be equal in amount to the expenditures made by the secured creditor in feeding and caring for the animal, which anticipates the discussion in the next section of this chapter.

– Maliki: The strictest interpretations of *rahn* principles pertaining to use of the property during the term of the *rahn* are those of the Maliki *madhhab*. The debtor is prohibited from using the encumbered asset. A permission from a secured creditor allowing debtor use invalidates the *rahn*. The analysis of secured creditor use rulings provides for eight scenarios. Secured creditor use is prohibited in seven of those scenarios.[76] Secured creditor use is permitted only if the security right secures a sale contract and then only if the security agreement specifies the period of secured creditor use. In the permissible case,

75 Under the Saudi Arabian mortgage law, it is permissible for a secured creditor to be authorized, pursuant to relevant security agreement, to collect and receive the proceeds from operation of the encumbered asset prior to foreclosure, but the secured creditor is not allowed to retain those proceeds. Any provision authorizing the retention of proceeds by the secured creditor is null and void (although the remainder of the security agreement remains valid and binding). The provisions of the Saudi Arabian law should permit the use of lockbox structures and reserve accounts so long as the funds in those accounts are not applied to the debt except in accordance with the enforcement provisions of the law. See McMillen (note 15, Saudi Rahn).

76 These involve different loan and sales arrangements.

compensation must be paid to the debtor or deducted from the outstanding debt. Secured creditor use is always prohibited if the secured obligation is a loan.[77]

– AAOIFI Standard: The debtor can benefit from the encumbered asset with the permission of the secured creditor. The secured creditor may not benefit from the encumbered asset without the permission of the debtor and, if secured creditor use is permitted, the secured creditor must make "normal payments" for the use and benefit of the encumbered asset.

In considering the structure of the Model Law, as modified for a jurisdiction in which the Shariʿah is applied, careful consideration must be given to the precise interpretations that will be applied to principles regarding (a) use of the encumbered property, (b) waste of the usufruct of the encumbered property, and (c) the interplay of use and waste principles in the entire set of permutations involving debtor use, secured creditor use, and the impact of decisions to allow or prohibit each of those uses. The starting point in the analysis is the strength of the basic assumption as to whether the debtor continues to "own" the encumbered property after it is encumbered and the impact of the security right on ownership rights. A second set of relevant considerations pertain to preservation of the encumbered asset and the respective responsibilities of the grantor and the secured party, which is the topic of the next section.

VI. Preservation and Creditor Rights

Concepts of preservation of the encumbered asset (*marhūn*) and the rights of creditors in the encumbered asset are embodied in both the Model Law and the Shariʿah, although they differ somewhat. Under the Model Law, a secured creditor that is in possession of an encumbered property must take reasonable steps to preserve the property and its value.[78] With respect to secured creditor rights, the Model Law provides that a secured creditor that is in possession of an encumbered property is entitled:[79]

77 Ibn Rushd (note 12), at § 37.1.2, notes that a condition may be imposed prohibiting secured party use of the *marhūn*.

78 Model Law, Article 10.

79 Model Law, Article 12.

- To be reimbursed for reasonable expenses of preservation of the property
- To make reasonable use of the property (which was discussed in the preceding section of this chapter)
- To apply the monetary proceeds of the property to payment of the secured obligation
- To inspect an encumbered property in the possession of the grantor

Not surprisingly, the various *madhahib* have a range of interpretations of the Shariʿah principles of relevance to preservation of the *marhūn* during the term of the *rahn*. If either the secured creditor or the debtor pays expenses that the other is obligated to pay, the payment is considered a non-recoverable gift. The AAOIFI Standard takes a somewhat different position. The debtor is required to make expense payments to repair the encumbered asset and those to prevent its diminution in value, as well as those in respect of safekeeping and sale of, and documentation relating to, the encumbered asset. If the secured party makes payment of any such expenses, with or without the consent of the debtor, the secured party is entitled to reimbursement of those payments.[80]

Beginning with classical Hanafi interpretations, (a) the secured party is responsible for the expenses relating to the safeguarding of encumbered asset, without credit against the secured debt and without reimbursement from the debtor,[81] and (b) the debtor is responsible for preservation and use of the encumbered asset, including repairs, watering, grafting, weeding and taxes, without credit against the secured debt.[82] With respect to medical expenses for an animal given as *marhūn*, the secured creditor is responsible up to the value of the secured debt, and the debtor is responsible for any amount in excess of the value of the secured debt.

The other three *madhahib* have a different view (as does the new Saudi Arabian mortgage law).[83] For these, the debtor is responsible for expenses relating to the benefit, upkeep and safeguarding, including medical

80 See, e.g., Majelle (note 12), article 725, and al-Zuhaylī (note 12), at 152, and AAOIFI Standard, § 3/2/10.

81 This may include the rent of the place where the *marhūn* is kept and of any watchmen. See, e.g., Majelle (note 12), article 723, and al-Zuhaylī (note 12), at 150–51.

82 See, e.g., Majelle (note 12), article 724, al-Zuhaylī (note 12), at 150–51, and Ibn Rushd (note 12), § 37.3.

83 See, e.g., al-Zuhaylī (note 12), at 150–51, and, with respect to Saudi Arabian law, McMillen (note 15, Saudi Rahn).

expenses for an animal given as *marhūn*. The basis for this interpretation is that the debtor is the owner of the encumbered asset, is entitled to its output, and is thus responsible for its expenses.

A related group of Shariʿah principles relates to the concept of debtor negligence or willful misconduct in connection with preservation responsibilities. To provide some perspective on current practice, under the Saudi Arabian mortgage law, if there is a decrease in the value or loss of the *marhūn* that is the result of the debtor's negligence or willful misconduct, the secured creditor (i) may require immediate payment of the debt in full, or (ii) may demand additional security.[84]

Classical Shariʿah principles addressing these matters vary by *madhhab*.[85] The Hanbali, Maliki and Shafiʿi *madhahib* take the position that there is no reduction in the underlying debt, absent transgression or negligence on the part of the secured party.

The Hanafi position is that the secured creditor's possession is one of trust with respect to the *marhūn* and a possession of guaranty with respect to the financial aspect of the *marhūn*, up to the value of the *marhūn*. Thus, if the secured property perishes, the debt is considered repaid up to the value of the secured property that is lost (i.e., there is a reduction in the underlying debt in that amount). The amount of the secured debt in excess of the lost value of the *marhūn* will continue to be payable. If the value of the lost *marhūn* is greater than the amount of the secured debt, that amount is payable by the secured creditor only in cases of transgression or negligence by the secured creditor. Three conditions apply to the foregoing rules: (a) the secured obligation must exist at the time of the loss or damage; (b) the *marhūn* must have been lost or damaged while in the possession of the secured party or a trustee (and not while in the possession of the debtor or a usurper); and (c) the lost or damaged property must constitute part of the original *marhūn* (and not be an increase or growth).

Finally, it is worth noting that losses and decreases resulting from third party acts are not attributable to the debtor. The lost value must be recovered from, and compensated by, the responsible third party. That compensation will then become *marhūn* and subject to the security right that attached to the original *marhūn*.

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84 McMillen (note 15, Saudi Rahn).

85 See Majelle (note 12), article 741, and al-Zuhaylī (note 12), at 166–69.

VII. A Few Comments on Remedies

Remedies are an area in which the relevant Shariʿah principles are frequently in conflict with secular legal regimes for secured transactions (such as the Model Law.) A primary area of conflict relates to provisions in a security agreement that allow the secured party to take ownership of the encumbered asset upon non-payment of the secured debt or to otherwise exercise self-help remedies.

The Model Law permits the secured creditor to exercise a range of different rights with respect to an encumbered asset.[86] These rights include obtaining possession of a tangible encumbered asset[87] and selling or otherwise disposing of an encumbered asset.[88] The taking of possession by the secured creditor may be for the purposes of acquiring an encumbered property in total or partial satisfaction of the secured obligation, if the grantor and other secured creditors do not object.[89] Post-default rights of the secured creditor may be exercised judicially or extra-judicially, in the discretion of the secured creditor.[90] The debtor is afforded a right of redemption in the encumbered asset, which entails payment in full of the secured obligation.[91]

Under the relevant Shariʿah principles, provisions in a security agreement that allow the secured party to take ownership of the encumbered property in payment default scenarios, and similar self-help provisions, are usually null and void (although the security agreement and its remaining provisions remain valid and enforceable). These provisions are derivative of the principle that the debtor continues to own the encumbered property and thus only the debtor has the right to sell the encumbered property.[92] However, there are nuances as among the different *madhahib*. Thus, for

86 Enforcement of a security right is addressed in Model Law Articles 81 through 94.

87 Model Law, Articles 2(a), 87 and 88. The requirements for permissible secured party self-help possession pursuant to Article 88 are that the debtor has consented to that arrangement in the security agreement, the secured creditor has given notice of its intent to obtain possession, and the debtor or other person in possession of the encumbered asset does not object at the time of the exercise of self-help by the secured creditor.

88 Model Law, Articles 2(b) and 89.

89 Model Law, Article 92.

90 Model Law, Articles 83(1), 84, 87, 88, 89 and 90.

91 Model Law, Article 85.

92 al-Zuhaylī (note 12), at 171–74.

example, the Hanafis and the Malikis consider the debtor's sale rights to be suspended during the term of the *rahn*. And the AAOIFI Standard permits self-help remedies by the secured creditor.

The Shariʿah favors sales of encumbered properties in virtually all debtor default scenarios. The initial preference is sale of the encumbered asset by the debtor (not the secured party), which may include sale by the debtor's agent.[93] The basis for this preference is the continuing debtor ownership of the encumbered property, which leads to the principle of debtor control of the sale and substitution of the proceeds of the sale for the encumbered property. That is not the end of the matter, however; there are further refinements. These are exemplified by the requirements of the Hanbalis and Shafiʿis that the secured creditor provide consent to the sale by the debtor.[94]

Judicial sale of the encumbered property is the second-ranking preference of the Shariʿah. The Hanafis and the Malikis take the position that the judge may force the debtor's agent to sell the property. The Hanbalis and the Shafiʿis are of the opinion that compelling the debtor's agent is contrary to agency principles and do not allow compulsion of the debtor's agent. In any event, the judge is eventually entitled to order a judicial sale of the encumbered property under non-Hanafi principles. The Hanafis do not allow a direct judicial sale; the court will coerce the debtor until the debtor or the debtor's agent sells the encumbered property.[95]

As to the proceeds of a sale of an encumbered asset, the secured creditor has priority. If the sale proceeds are insufficient to pay the secured obligation in full, the secured creditor becomes an unsecured *pari passu* creditor with respect to the unpaid balance of the (formerly) secured obligation. This is quite similar to secular concepts, including those embodied in the Model Law. The important point to note here has been previously discussed: there are no competing secured creditors under the Shariʿah because any grant of a security right will void the initial security right.

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93 al-Zuhaylī (note 12), at 171–72.

94 al-Zuhaylī (note 12), at 173. It is to be noted that refusal of the secured creditor to give permission allowing debtor-grantor sale allows the debtor-grantor to appeal to the judiciary. The judge will then provide the secured creditor with two options: giving permission to the sale; or absolving the debt. If the secured creditor rejects both of those options, the judge may allow the debtor to sell the encumbered property.

95 al-Zuhaylī (note 12), at 173–74.

The Saudi Arabian mortgage law illustrates the types of issues that arise under Shariʿah principles as a result of the interaction of different sets of principles.[96] To set the stage, consider two Shariʿah principles. The first is that a debtor cannot be required to make early prepayment of its debt or secured obligation.[97] The second is that a debtor-grantor continues to own the proceeds of a foreclosure sale as encumbered property that is substituted for the original *marhūn* that is the subject of the foreclosure sale.

The Saudi Arabian mortgage law accommodates these principles in the foreclosure sale context by paying to the secured creditor a portion of the sale proceeds equal to installments due and unpaid at the time of the foreclosure sale. The remainder of the sale proceeds is then placed in a bank account and released to the secured creditor in accordance with the original payment schedule for the secured obligation. This approach is designed to give effect to the theory underlying classical Shariʿah principles, which is that the proceeds obtained by foreclosure sale substitute for the original encumbered property, with continuation of the original transaction arrangements in respect of the underlying secured obligation until its scheduled maturity.

Obviously, this introduces a host of issues, including issues pertaining to a previously unconsidered credit, that of the bank holding the funds until maturity. These credit risks may not be insubstantial, depending upon the legal and regulatory regime applicable to the bank. And this arrangement exposes the amounts in the bank account to the subsequent bankruptcy or insolvency of the debtor (although it is likely that the secured creditor's priority in those amounts would continue during the bankruptcy or insolvency).

VIII. Conclusion

This chapter has considered select provisions of the Model Law from a Shariʿah vantage. The focus has been on comparative differences between the Model Law and the relevant Shariʿah principles and interpretations of those principles.

96 See McMillen (note 15, Saudi Rahn).

97 The corollary is that the debtor has the option of prepaying its obligation or debt at any time, without adjustment to (reduction in) the amount being paid early.

An implication, or express conclusion, of this examination of is that rendering the Model Law useful in jurisdictions that apply the Shariʿah is a daunting – possibly insurmountable – endeavor. Taking that implication or reaching that conclusion is inappropriate, however.

The bulk of the Model Law is not comprised of differences; it is harmonious with Shariʿah principles and need not be modified. And the AAOIFI Standard is illustrative of the interpretive trend as regards the application of classical Shariʿah precepts in contemporary systems, a trend that is increasingly compatible with the approach taken by the Model Law. The Model Law is a sound, efficient and effective base upon which to build. And the modifications to render the Model Law efficient and effective in jurisdictions that apply the Shariʿah, while entailing significant rigor and attention to fine detail, seems manageable.

What is quite clear is that the game is worth the candle. Legal regimes for secured transactions, where they exist at all, are significantly underdeveloped in the context of modern commerce and finance. And they are notably unclear as regards their application of Shariʿah principles. That severely hampers the ability of potential and actual market participants to make risk assessments and the ability of market participants to achieve predictability with respect to, and certainty and stability in, their transactional relationships. Those factors serve as disincentives to market participation and distort market pricing functions, to the disadvantage of both commercial and financial actors in these jurisdictions and the broader populations of these jurisdictions.

Given these impediments, the accelerated growth of Islamic finance in these jurisdictions, and the progress of globalization to include both these jurisdictions and Shariʿah-compliant arrangements as well as more pervasive arrangements, a draft of the Model Law that is sensitive and responsive to Shariʿah concepts is both appropriate and timely: more, it is imperative.

CONFLICT-OF-LAWS RULES ON RECEIVABLES FINANCING

THE NEED FOR HARMONIZATION

Michel Deschamps*

This paper presents an overview of the conflict-of-laws rules in effect in various jurisdictions in the area of receivables financing. The disparity of these rules demonstrates the pressing need to harmonize them. Harmonization of secured transactions laws is one of the goals of the draft Model Law on Secured Transactions which is currently prepared by the United Nations Commission on International Trade Law (the "Uncitral Model Law"). The Uncitral Model Law contains conflict-of-laws rules on security rights in receivables, which come from the UNCITRAL Legislative Guide on Secured Transactions adopted in 2007[1] and the United Nations Convention on the Assignment of Receivables in International Trade adopted in 2001 (the "UN Assignment Convention").

The lack of harmonization in the area of receivables financing is often an impediment to the grant of security in multi-jurisdictional transactions, both at the substantive law and the conflict-of-laws levels. This paper focusses on the conflict-of-laws rules and will illustrate the need for their harmonization by way of an example involving the laws in effect in Canada, the United States, England, France, Germany and Switzerland (the "Example").

Part 1 sets out the fact pattern of the Example. Part 2 describes the analysis that a financier must conduct to ensure that its security on the related receivables will be recognized in all relevant jurisdictions. Part 3 summarizes the conflict-of-laws rules of the various jurisdictions used in the Example. Part 4 explains the conflict-of-laws rules proposed by the Uncitral Model Law for security rights in receivables. For sake of concision, conflict-of-laws rules are referred to as conflict rules.

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1 The recommendations of the Guide are accompanied by an extensive commentary including on conflict-of-laws matters.

As in the Uncitral Model Law, this paper uses the term "security right" instead of "security interest" to describe a consensual right or interest in a receivable (or other property) that secures an obligation, including a charge, pledge, hypothec or other form of security. The transfer of a receivable made for security purposes (a "security assignment") is therefore treated as a security right. The term "outright assignment" refers to a transfer of a receivable not made for security purposes, such as a sale or other transaction whereby the "ownership" of a receivable is transferred (sometimes called an "absolute assignment").

A person who grants a security right is called a "grantor" in the Uncitral Model Law and in some national laws ("debtor" in other national laws). The UN Assignment Convention uses the term "assignor" as a generic term to describe both a person granting a security right in a receivable and a transferor under an outright assignment. In this paper, the term "assignor" generally has the same meaning and the term "grantor" is used in relation to a security right.

The term "creation" refers to the requirements to be met in order for property to be affected or charged by a security right. "Validity" or "attachment" is used in some national laws as a similar concept. Form requirements prescribed by national law for a security agreement to be valid are matters normally falling under the notion of creation.

The expression "effectiveness against third parties" is used instead of "perfection", again to be consistent with the Uncitral Model Law (although these terms are in many respects substantially equivalent). Referring to effectiveness against third parties allows for making a clear distinction (where necessary) between effectiveness against competing claimants (third parties) and against the debtor of a receivable. The conflict rules may point to different substantive laws for each of these issues.

The term "competing claimant" describes a person who could potentially claim rights in a receivable superior to those of a creditor having obtained security on that receivable. A competing claimant may be another secured creditor of the grantor, an unsecured creditor of the assignor attempting to seize or attach the receivable, another assignee under an outright assignment or an insolvency administrator in insolvency proceedings relating to the assignor.

A country with two or more territorial units may have different laws that will be applicable on an issue, depending on the allocation of legislative powers in that country. For instance, in a federal State such as Canada, secured transactions laws generally fall under the legislative authority of

the Canadian provinces (or territories). Thus, each province has substantive laws and conflict rules in that area. To accommodate the situations where the conflict rules or the substantive laws are those of a territorial unit of a country (instead of the country as a whole), this paper uses "jurisdiction" as a neutral term to refer to the country or, as the case may be, the territorial unit whose laws are applicable.

The receivables which are the subject-matter of this paper consist of monetary obligations arising from the sale of goods or supply of services in the ordinary course of the activities of the seller or supplier (commonly called "trade receivables"). Other types of receivables are not covered except to the extent that the same conflict rules apply to them in the relevant jurisdiction. For instance, the right receive payment of a bank deposit or of a letter of credit (which are monetary obligations of the depositary or issuing bank) is governed in certain jurisdictions by conflict rules different from those for trade receivables. The Example used in the discussion below involves trade receivables. Negotiable instruments are also outside the scope of this paper.

Although this paper deals with security rights in receivables, it must be stressed that in several jurisdictions the conflict rules are essentially the same for outright assignments. The reason is that distinguishing between a security right in a receivable and an outright assignment is sometimes a difficult task. Certain transactions are labelled as a sale but their features may lead to their recharacterization in certain jurisdictions as a security right for a loan, where for instance the sale of a receivable is for a price far below its market value, the seller guarantees the payment of the receivable up to the amount of the purchase price plus a yield thereon, with the purchaser being obliged to remit to the seller collections exceeding the amount guaranteed [2].

2 The recharacterization issue may arise notably in jurisdictions which have a unitary concept of security right (security interest) such as the United States or the common law provinces of Canada. For a review of the recharacterization issues and criteria in the United States, see: S.L. Harris and C.W. Mooney, "When is a Dog's Tail Not a Leg?: A Property Based Methodology for Distinguishing Sales of Receivables from Security Interests", Vol. 82, 2014, University of Cincinnati Law Review, p. 1029. For Canada, a comprehensive review of the relevant criteria may be found in the decisions of the Ontario Superior Court of Justice and the Court of Appeal of Ontario in *Metropolitan Toronto Police Widows and Orphans Fund et al* v. *Telus Communications Inc.*, (2003) 30 B.L.R. (3rd) 288, (2005) B.L.R. (4th ed.) 251 and 12 C.B.R. (5th ed.) 251 (Ont. C.A.).

More importantly, a competition between a creditor holding security over a receivable and an outright assignee of the same receivable might be difficult to resolve if their respective priorities are not governed by the same law. Consider a scenario where the conflict rules of the forum State (State A) point to the substantive law of State B for the priority of a security right (or security assignment) and of State C for an outright assignment. In such case, one could not easily ascertain the substantive law that would determine which assignment has priority over the other. The priority contest would be almost impossible to resolve by a court in State A if the law of State B gives priority to the security assignment and the law of State C gives priority to the outright assignment. This scenario shows that States should have the same conflict rules for security assignments and outright assignment.

I. Example of a multi-jurisdictional transaction

Alpha, a supplier of information technology services, is a Canadian company incorporated under the federal laws of Canada and has its registered office (statutory seat) in Toronto in the Province of Ontario. Alpha is a wholly-owned subsidiary of another Canadian company (the "Parent"), also incorporated under the federal laws of Canada. The registered office and the chief executive office of the Parent are located in Montreal in the Province of Quebec. All of the executive and major decisions relating to the management and operations of Alpha are made by directors and officers of the Parent based in Montreal (the directors and senior officers of Alpha being all officers of the Parent). The Toronto office of Alpha is mostly concerned with day-to-day ongoing services to customers.

Alpha has obtained credit facilities from a Canadian bank (the "Bank") for the purposes of financing its operations. A condition to the extension of credit to Alpha by the Bank is that Alpha must grant a security right in all of its present and future trade receivables owed by customers with places of business in Canada, the United States, England, France, Germany and Switzerland. Some of the contracts under which the receivables arise are governed by the laws of Ontario or England, while other contracts are governed by the laws of the jurisdiction of the place of business of the relevant customers. The contracts specify that the customers must make their payment by wire transfer to a bank account of Alpha in Montreal, Canada.

Indeed, the Bank wants to hold enforceable security over all receivables of Alpha. As the Bank is dealing with senior officers of Alpha based in the Province of Quebec and as Alpha's customers are directed to make their payments to a bank account of Alpha maintained with the Bank in Montreal, the Bank believes it is sufficient to take first ranking security over the receivables under Quebec law.

Unfortunately, this would be insufficient and would not provide the Bank with the desired protection. Part 2 below explains the analysis to conduct to determine if and how the Bank may obtain enforceable security in all relevant jurisdictions, namely obtain a security right which will be considered as validly created, effective against third parties and benefiting from priority in each jurisdiction.

II. The analysis to conduct and the role of conflict rules

A. The Analysis to conduct

A lender or other financier who extends credit under a transaction having connections with several jurisdictions will usually need to ensure that its security will be enforceable in the principal jurisdictions where the security may have to be enforced. In the case of receivables financing (as in the Example), the relevant jurisdictions include those where the insolvency of Alpha may be administered and those where the receivables may have to be collected.

In the Example, it is crucial that the Bank's security be recognized in the jurisdiction (or jurisdictions) where Alpha's insolvency will be administered if Alpha becomes subject to insolvency proceedings. Otherwise, the insolvency administrator (such as a trustee in bankruptcy) could treat the receivables as forming part of the assets available to the unsecured creditors of Alpha. Alternatively, another secured creditor of Alpha could claim priority over the Bank's security right if the other creditor's security is effective against the insolvency administrator under the law that the insolvency court would apply to decide the issue.

The jurisdictions where the receivables may have to be collected must also be considered. Suppose that the Bank, further to Alpha becoming in default under the credit facilities, wish to collect the receivables owing by customers located, say, in France. If the Bank's security is not effective in France, then a French customer of Alpha may refuse to make payment to

the Bank. Or an unsecured French creditor of Alpha may have seized (or attach) the receivable owing by the French customer.

The Bank must conduct a two-step analysis to determine whether it will have enforceable security in all jurisdictions concerned. The first step is a conflict rule analysis and the second step is a substantive law analysis.

B. The first step of the analysis

The conflict rules of a jurisdiction (the "forum") identify the substantive law to apply in that jurisdiction to a particular legal issue. For instance, if litigation occurs in jurisdiction A with respect to the priority of a security right, a court in jurisdiction A (the forum) must examine the conflict rules of its own jurisdiction; these conflict rules will indicate the jurisdiction whose substantive law will be applicable to resolve the priority dispute. The applicable substantive law could be that of the forum or of another jurisdiction.

The conflict rules of the forum identify the jurisdiction whose substantive law will govern an issue through a factor that connects the issue to such jurisdiction ("connecting factor"). As will be seen below, the conflict rules of certain jurisdictions refer to the law of the place where the grantor is located to determine the priority of a security right in a receivable. The location of the grantor is then the connecting factor, that is, the factual element which will allow a court to determine the applicable law.

Each jurisdiction has its conflict rules and accordingly the forum court will use the conflict rules of its own legal system. These rules may vary from one legal system to another. For instance, the conflict rules of jurisdictions A and B may determine which laws apply to the priority of a security right in a receivable through different connecting factors[3]. Jurisdiction A may use the location of the grantor (e.g. its domicile) as the connecting factor, while jurisdiction B may use the place where payment of the receivable must be made as the connecting factor. This means that a court in jurisdiction A will not resolve the priority dispute under the same

3 The merits and flaws of the connecting factors used in various jurisdictions are comprehensively discussed by C. Walsh, "Receivables Financing and the Conflict of Laws", 1999, Vol. 106, Dickinson Law Review, p. 159. See also M. Deschamps, "Conflict of Laws Rules for Security Rights", in *The Future of Secured Credit in Europe*, European Company and Financial Law Review, De Gruyter-Recht, 2008, p. 321.

law as a court in jurisdiction B would do, if the grantor's location and the place of payment of the receivable are not in the same jurisdiction.

This highlights the need for a lender to perform a conflict-of-laws analysis in each jurisdiction where its security right may have to be enforced. In the above scenario, the lender will normally want to obtain priority in both jurisdictions A (the place where the grantor is located) and B (assuming it is the place where the debtor of the receivable must make payment). It is therefore necessary for the lender to know what law a court in each of jurisdictions A and B would apply to determine whether the lender's security has priority.

C. The substantive law analysis

The conflict-of-laws analysis will permit the identification of the jurisdiction(s) whose substantive law(s) will govern the creation, effectiveness against third parties and priority of the security right as well as its effectiveness against the debtor of the receivable.

Therefore, a review of the substantive law of each relevant jurisdiction must be conducted to ascertain its content and, in particular, the requirements to be met for the security right to afford the intended protection. The content of the applicable substantive laws is beyond the scope of this paper. It is however worth noting that there may be significant differences among jurisdictions as to their substantive laws on security rights in receivables. Among other things:

- certain jurisdictions require in certain circumstances that the agreement creating the security right be in the form of a notarial deed;
- certain jurisdictions do not permit a security right covering all present and future receivables of the grantor and rather require the identification of the receivables to be encumbered;
- certain jurisdictions do not recognize the possibility that a security right be granted to a person acting as agent for the benefit of a class of present and future creditors of the grantor (e.g. in a syndicated credit facility scenario);
- the respective priorities of two secured creditors with a security right in the same receivable are based on substantive priority rules which vary from one jurisdiction to another (e.g. first-in-time to create the security right, first-in-time to notify the debtor of the receivable of the

existence of the security right or first-in-time to make a filing or registration in a public registry).

III. The conflict rules of the jurisdictions in the Example

Alpha's registered office (statutory seat) is in Toronto in the Province of Ontario (Canada), but the place where its executive decisions are made is in Montreal, in the Province of Quebec (Canada). Alpha also has customers in both provinces. Under Canadian bankruptcy laws, Alpha, if it becomes insolvent, may be subject to insolvency proceedings administered by a court in the Province of Quebec or in the Province of Ontario. It follows that the Bank's security right should be enforceable in Quebec and Ontario.

As certain customers of Alpha are also based in the Canadian province of British Columbia as well as in the United States, England, France, Germany and Switzerland, the Bank wants in addition to obtain enforceable security over the receivables owed by these customers.

This Part will review the conflict rules of Ontario, Quebec, British Columbia, the United States, England, France, Germany and Switzerland on the creation, effectiveness against third parties and priority of a security right. Enforcement will only be discussed in relation to the ability or power of the secured creditor to claim payment of a receivable from the debtor of the receivable. One must examine in this regard the conflict rule indicating the law that will apply to the effectiveness of a security right against debtors of receivables covered by a security right.

It should be noted that the conflict rule to which practitioners pay the most attention is the rule on effectiveness against third parties. This is so because many national laws do not prescribe specific requirements for the creation of a security right, with the result that a security right created under the law of one jurisdiction will often be recognized as validly created by the laws of other jurisdictions. Moreover, the conflict rules for the effectiveness against third parties and priority of a security right in a receivable generally point to the substantive laws of the same jurisdiction. Thus, for some practitioners in Canada and the United States, the conflict-of-laws analysis is summarized in short-hand by the following question: "Where do you file?" Of course, even in the context of effectiveness against third parties, framing the analysis in that way is inaccurate because "filing" is not a universal mode of achieving third-party effectiveness. There are

jurisdictions where security rights in receivables are not subject to registration or filing to gain priority.

A. Ontario

Under the *Personal Property Security Act* of Ontario [4] ("OPPSA"), the creation, effectiveness against third parties and priority of a security right in a receivable are governed by the law of the location of the grantor [5]. The location of a grantor who carries on business is defined as its place of business or, if the grantor has more than one place of business, its chief executive office [6].

In the Example, the chief executive office of Alpha will be considered as located in the Province of Quebec. As a result, a court in Ontario will apply the substantive laws of Quebec to determine whether the Bank's security right is effective in Ontario against competing claimants. Therefore, the Bank should obtain security which is valid and effective against third parties under Quebec law, in order to obtain priority in Ontario.

The effectiveness of the security right against the debtor of the receivable will however be subject to the law governing the receivable (which is usually the law governing the contract under which the receivable arises) [7].

B. Quebec

In the Province of Quebec, the conflict rules are found in the *Civil Code of Quebec* ("CCQ"). For intangible property such as receivables, the conflict rule points to the law of the domicile of the grantor for the law applicable

4 R.S.O. 1990, chapter P. 10.

5 OPPSA, s. 7. The OPPSA uses the term "validity" instead of "creation" and the term "perfection" instead of "effectiveness against third parties".

6 For an analysis of the conflict rules in the Canadian provinces (including Ontario) see: R.C.C. Cuming, C. Walsh et R.J. Wood, *Personal Property Security Law*, 2nd ed., Irving Law Inc., 2012, p. 180. On January 1, 2016 (after the preparation of this paper), the definition of "location" in the OPPSA was changed. New rules determine the location of a grantor and these rules do not necessarily lead to the same law as the former rules.

7 J. Legge and D. MacKenzie, *Personal Property Security Law in Ontario*, LexisNexis 2014, p. 57; Cuming, Walsh and Wood, (note 6), p. 235.

to the creation, effectiveness against third parties and priority of a security right [8]. Conceptually, the rule is similar to the Ontario rule (location of the grantor), but with a significant practical difference as the Example illustrates. The domicile of a corporation is defined under Quebec law as the place where the corporation has its legal "head office" (statutory seat), which, in many corporation laws, means the "registered" office of the corporation [9].

Accordingly, to ensure the effectiveness and priority of its security right in Quebec, the Bank will have to fulfill the relevant requirements of Ontario law. As under Ontario substantive law registration of the security right in the personal property security registry is one of such requirements, it will be necessary to make a registration in the Ontario registry for the Bank's security right to be enforceable against competing claimants in Quebec.

The end result of the Ontario and Quebec conflict rules may be surprising for the unwary: a priority dispute between the Bank and a competing claimant will be resolved by a Quebec court by applying Ontario law, whereas an Ontario court will resolve the dispute by applying Quebec law.

With respect to the effectiveness of the security right against the debtor of the receivable, a Quebec court (as an Ontario court) will apply the law governing the legal relationship between the secured creditor and the debtor [10].

C. British Columbia

The British Columbia conflict rules are the same as in Ontario, with a notable difference. British Columbia recognizes the doctrine of renvoi [11]. Under this doctrine, the reference to the law of another jurisdiction includes not only the other jurisdiction's substantive law but also its conflict rules.

The consequence of renvoi is that a court in British Columbia will apply the substantive law of Ontario to resolve a priority dispute in British

8 Article 3105 of the CCQ.

9 Article 307 of the CCQ.

10 Article 3120 of the CCQ.

11 See Section 7 (2) of the British Columbia *Personal Property Security Act* (RSBC 1996, c. 359) which refers to the law of the jurisdiction of the grantor's location, "including the conflict of laws rules" of that jurisdiction.

Columbia between the Bank and a competing claimant. As noted above, a court in Ontario would rather apply Quebec's substantive law.

The reasons why in the Example the doctrine of renvoi leads to the application of Ontario law are the following:

- the British Columbia conflict rule points to the law of the location of the grantor, namely, under British Columbia conflict rules (as in Ontario), the location of the chief executive office of the grantor;
- Alpha has its chief executive office in Quebec, but its statutory seat is in Ontario;
- the Quebec conflict rule refers to the law of the statutory seat of the grantor.

As a result, a British Columbia court will look first to Quebec law (because Alpha's chief executive office is in Quebec). However, as the Quebec's conflict rule refers to Ontario law (because Alpha's statutory seat is in Ontario), the British Columbia court (because of the renvoi) will ultimately apply Ontario law to resolve the dispute.

It goes without saying that the doctrine of renvoi complicates a conflict-of-laws analysis and may run against the normal expectations of the parties.

D. The United States

In the United States, the conflict rules relating to security rights are principally found in the *Uniform Commercial Code* ("UCC") in effect in each State[12]. Variations from one State to another are not relevant for the purposes of this paper. Therefore, with respect to Alpha's customers located in the United States, the State in which they are based is not pertinent to the review of the UCC conflict rules that a US court will use in the event of litigation in the State of their location.

The conflict rules of the UCC which govern the issues at hand (except for effectiveness against the debtor of the receivable) are the following: (i) for creation, the UCC refers to the law governing the agreement whereby the grantor has agreed to grant the security right, and (ii) effectiveness

12 For an analysis of the UCC conflict rules, see: N.B. Cohen and E.E. Smith, "International Secured Transactions and Revised UCC Article 9", Vol. 74, 1999 Chicago Law Review, p. 1191.

against third parties and priority are governed by the laws of the jurisdiction in which the grantor is located[13].

The location of a grantor such as Alpha (a corporation) is determined under the UCC pursuant to a cascade of sub-rules, the most important of which in the context of this paper are the following[14]:

b) if the corporation is incorporated under the laws of a State of the United States, the corporation's location is in that State;
c) if the corporation is incorporated outside the United States, it is located at its place of business or, if it has more than one place of business, at the place of its chief executive office;
d) however, sub-rule b) applies only to the extent that the jurisdiction of the place of business (or the place of the chief executive office) is in a jurisdiction whose law generally provides that a non-possessory security right must be the subject of a registration or filing in a public registry in order to obtain priority against a "lien creditor"[15]; if the law of the relevant jurisdiction does not provide for such a public registry, then the grantor is deemed to be located in the District of Columbia.

In the Example, Alpha is incorporated outside the United States and has its chief executive office in the Province of Quebec. Presumably, the Quebec registry for security rights is a public registry that satisfies the requirements set out in c) for the application of sub-rule b). Under the UCC, Alpha will then be located in the province of Quebec as its chief executive office is in the province of Quebec. As a result, if litigation occurs in a State of the United States, a court of such State will apply Quebec law to determine

13 UCC 9-301 (1). See Official Comment 2 for the law applicable to attachment and validity (which are UCC notions intended to be captured by the term "creation" as used in this paper). As attachment is a component of perfection under the UCC, it is however arguable that the form requirements to fulfill for attachment to occur are governed by the law governing perfection and not by the law governing the security agreement. The latter would only govern the consensual aspects of creation (e.g. whether the grantor has effectively agreed to the grant of the security right). However, the better view is that attachment is also a matter falling under the law governing the security agreement.

14 UCC 9-307.

15 Under UCC 9-102 (52), the term "lien creditor" is defined as also including a trustee in bankruptcy.

the effectiveness against third parties and priority of the Bank's security right[16].

The legal relationship between the Bank and customers of Alpha based in the United States will be governed by the law governing the relevant receivables[17].

E. England

In England, the conflict rules developed by the courts generally refer to the law of the location (*lex situs*) of the charged property as being the law applicable to the creation, effectiveness against third parties and priority of a security right. Strictly speaking, intangible property (such as a receivable) cannot have a *situs* in the same way as tangible property. The conflict rule has therefore been adapted to receivables in order to locate them in a specific place. The situs of a receivable would be the place of the residence or place (or principal place) of business of the debtor of the receivable. The traditional view is that the above issues (or at least effectiveness against third parties and priority) are governed by the *lex situs*[18].

The current state of English law on these issues appears however unclear, in particular since the decision of the English Court of Appeal in *Raiffeisen Zentralbank Ostereich AG* v. *Five Star General Trading*[19] ("Five Star"). The dispute was between a secured creditor and an attaching creditor; each of them was claiming an entitlement to payment from the debtor of the receivable. The law governing the receivable was English law (under which the secured creditor was entitled to collect the receivables from the debtor) and the situs of the receivable was in France (where the attaching creditor might have enjoyed priority). The Court of Appeal resolved the dispute in favour of the secured creditor. The Five Star case has been cited as supporting the view that in England the law governing the receivable applies to effectiveness against and priority between competing

16 Except to the extent that United States insolvency laws do not displace the effect of Quebec law. This exception may be relevant for other jurisdictions.

17 This may be inferred from comment 3 to UCC 9-401.

18 R.M. Goode, *Commercial Law*, Penguin Books (1st Ed.), 1982, p. 932; *Goode on Commercial Law*, 4th ed., E. McKendrick, Penguin Books, 2010, p.1240.

19 [2001] EWCA Civ. 68; [2001] Q.B. 825 (CA (Civ. Div.)).

claimants [20]. However, the case may also be read as not challenging the rule referring to the *lex situs* for priority matters [21]. The analysis made by the Court of Appeal in Five Star has been criticized, as the Court reached its conclusion by framing the dispute as relating to a contractual matter (the effectiveness of an assignment against the debtor of the receivable); this led the Court to apply the law governing the receivable. Commentators have remarked that the dispute might have been characterized more appropriately as involving a priority issue relating to property rights [22].

It has been suggested that for creation issues (the proprietary effect as between the parties of a security right or an outright assignment), the law of the location of the grantor or assignor should be a more appropriate rule. The rationale for this suggestion is that in the case of a bulk assignment of present and future receivables, one single law would govern the validity of the assignment and it would then be possible to ascertain that law at the time of the assignment. The rule pointing to the *lex situs* for creation results in a series of *lex situs* to be potentially applicable (without necessarily knowing where would be the *situs* of the future receivables) [23].

For similar reasons, the law of the location of the grantor or assignor has also been proposed as the most appropriate law to govern the effectiveness against and priority among competing claimants [24]. As mentioned above, this is the conflict rule in Canada and the United States.

Effectiveness against the debtor of the receivable is governed by the law governing the contract under which the receivable arises. This rule is

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20 J. Perkins, "A question of priorities: choice of laws and proprietary aspect of the assignment of debts", 2008 Law and financial Market Review, p. 238. See also G. Affaki, *infra*, note 27.

21 See paras. 19, 30 and 36 of the decision where the Court held that no proprietary issue was arising in the case.

22 R. Goode, "The Assignment of Pure Intangibles in the Conflict of Laws", in L. Gullifer and S. Voguenauer (editors), *English and European Perspectives on Contract and Commercial Law*, Hart Publishing, Oxford, 2015; M. Bridge, "The Proprietary Aspects of Assignment and choice of Law", (2009) 125 Quarterly Law Review, p. 671. In another comment, M. Bridge observed that if "a contest did arise between two assignments, it cannot with complete confidence be concluded that an English court would find the answer" in applying the law governing the receivables "though it is likely that the court would seek to do so": chapter on England and Wales in *Cross-Border Security over Receivables*, edited by Eva-Maria Kieninger and Harry Sigman, European Law Publishers, 2009, p.177.

23 See McKendrik (note 18), p. 1241.

24 See Goode and Bridge (note 22).

provided by Article 14 (2) of the Rome 1 Regulation on the Law Applicable to Contractual Obligations ("Rome I") to which the United Kingdom has adhered. As Article 14 is also relevant to the French and German conflict rules, its text is reproduced here in its entirety:

"*Article 14*

Voluntary assignment and contractual subrogation

1. The relationship between assignor and assignee under a voluntary assignment or contractual subrogation of a claim against another person (the debtor) shall be governed by the law that applies to the contract between the assignor and assignee under this Regulation.

2. The law governing the assigned or subrogated claim shall determine its assignability, the relationship between the assignee and the debtor, the conditions under which the assignment or subrogation can be invoked against the debtor and whether the debtor's obligations have been discharged.

3. The concept of assignment in this Article includes outright transfers of claims, transfers of claims by way of security and pledges or other security rights over claims."

It should also be noted that recital 38 of the Preamble to the Rome I states:

> "In the context of voluntary assignment, the term 'relationship' should make it clear that Article 14(1) also applies to the property aspects of an assignment, as between assignor and assignee, in legal orders where such aspects are treated separately from the aspects under the law of obligations."

This statement has been viewed in a recent comment as a correct reading of Article 14 (1) of Rome I and meaning that the proprietary effect of an assignment as between the assignor and the assignee are governed by that Article. [25]

Given the uncertainty surrounding the applicable conflict rules in England, to ensure it has enforceable security in England against the English customers the Bank should meet the requirements of the substantive laws of the jurisdictions of the situs of the receivables owed by the English customers and of the jurisdictions whose laws govern the contracts between Alpha and the English customers.

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25 See Goode (note 22). McKendrick does not however share that view and would refer the issue to the *lex situs* (note 18).

F. France

Generally speaking, the French conflict rules on the issues under consideration are similar to those in England under the traditional English approach: *lex situs* transposed to receivables in the same manner as under such approach (law of the location of the debtor of the receivable) [26].

There are however exceptions such as in the case of an assignment made in France pursuant to the Loi Dailly. A Dailly assignment is enforceable regardless of "the law of the debtor's country of residence". This seems to imply that a court in France would give effect to a Dailly assignment covering a receivable owing by a debtor located in a jurisdiction outside of France, even if under the law of the foreign jurisdiction the assignment does not meet the requirements of that law.

The result of the French conflict rules is that the requirements of French law will have to be met in order for the Bank to obtain effective security over the receivables owing by Alpha's French customers. As the conventional view in France is that a security right cannot cover all present and future receivables of the grantor without further identification, the Bank could not rely on its Quebec or Ontario law security right to charge the French receivables.

G. Germany

In Germany, the predecessor of Article 14 (2) of Rome I (Article 12 of the Rome Convention) has been read in an extensive fashion by the courts so as to apply to the effectiveness of an assignment not only against the debtor of the receivable but also against third parties. Article 14 (2) is silent on the third-party effectiveness of an assignment, but the reasoning for extending its scope to such issue is that logic dictates that an assignment effective against the debtor of the receivable should be also effective and benefit

26 James Leavy, chapter on France in *Cross-Border Security over Receivables*, edited by Eva-Maria Kieninger and Harry Sigman, European Law Publishers, 2009, p. 123; G. Affaki (*infra*, note 27), p. 6 et 13; See also Jean-Pierre Mattout, *Droit bancaire international*, Revue Banque Edition, p. 86. For an exhaustive analysis of the French conflict rules, see D. Pardoel, *Les conflits de lois en matière de cession de créance*, L.D.J.D., 1977.

from priority against third parties[27]. Under that analysis, the validity of the transfer as between the assignor and the assignee is also a matter for the law governing the receivable.

As Article 14 (2) of Rome I leads to the application of the law governing the receivable, in order to obtain enforceable security over the German receivables, the Bank will have to inquire about the governing law of all contracts under which the receivables arise. In the Example, some of these contracts are governed by German law while others are governed by Ontario law or English law. The substantive law requirements of Germany, Ontario and England should therefore be met for the Bank to obtain enforceable security in Germany as well as to ensure its security is effective against Alpha's German customers.

H. Switzerland

In Switzerland, the conflict rules may differ depending on whether the security right will constitute a security assignment or a pledge[28]. This paper does not discuss the Swiss conflict rule for pledges on the assumption that Alpha's security will constitute or will be treated as a security assignment and that there would be no risk of a dispute with a "pledgee".

The conflict rule in Switzerland on the creation of a security assignment in a receivable refers to the law selected by the parties as being the law governing the assignment. Failing such choice, the law governing the receivable will apply[29]. The effectiveness of the assignment against the debtor

27 Julia Klauer Rakob, chapter on Germany in *Cross-Border Security over Receivables*, edited by Eva-Maria Kieninger and Harry Sigman, European Law Publishers, 2009, p. 119; Lilian Stephens, "The New Rules on Assignment of Rights in Rome I – The Solution of all our Proprietary Problems – Determination of the Conflict of Laws Rule in Respect of the Proprietary Aspects of Assignment", in European Review of Private Law 4 – 2006, p. 543. See also G. Affaki "L'apport de la Convention CNUDCI sur la cession de créances aux opérations de banques", in *Banque & Droit*, no 90, 2003, fn 27.

28 *Loi fédérale sur le droit international privé* ("LDIP"), Article 105 (conflict rule for a pledge) and Article 145 (conflict rule for an assignment, including as security) may lead to the application of different substantive laws. This is another example which demonstrates the difficulties arising where a jurisdiction does not have the same conflict rule for all types of security rights in receivables.

29 LDIP, art. 145. See Andrea Bonomi, in *Commentaire Romand sur le droit international privé* (edited by Andreas Bucher), Helbing Lichtenhahn, Bâle, 2011, fn. 13 ad art. 145.

of the receivable will be governed by the law selected by the assignor and the assignee as the law governing the assignment.

With respect to effectiveness against and priority among competing claimants, the Swiss conflict rules do not contain any specific provision on these issues. Commentators favour the application of the law governing the receivable (for the same reasons as in Germany) [30].

Thus, to obtain enforceable security in Switzerland, the Bank will have to obtain valid security under the law governing the security agreement and also to fulfill the requirements of the various substantive laws governing the contracts with the Swiss customers.

IV. The conflict rules of the Uncitral Model Law

The Uncitral Model Law follows the approach of the United Nations Assignment Convention in respect of receivables and recommends as a general rule that the law of the location of the grantor govern the creation, third-party effectiveness and priority of a security right in intangible property [31]. As the Uncitral Model Law contains exceptions for security rights in bank deposits, intellectual property and proceeds from letters of credit, the conflict rule pointing to the jurisdiction of the location of the grantor is almost confined to trade receivables.

The Uncitral Model Law considers the location of the grantor as a connecting factor more appropriate in respect of receivables than a factor deriving from the *lex situs*, such as the place where the receivable must be paid or where the debtor of the receivable is located. In addition to the fact

30 LDIP, art. 145. See A. Bonomi, fn. 20 ad art. 145.

31 For an analysis of the rule and more generally of the United Nations Assignment Convention, see S. Bazinas, R. Kohn and L. Del Duca, "Implementing a Global Uniform International Receivables Financing Law: Facilitating a Cost-Free Path to Economic Recovery", Vol. 44 2012 UCC Law Journal 277. See also: Affaki, note 27; C. Walsh, note 3; C. Walsh, "Security Interests in Receivables", in *The Future of Secured Credit in Europe*, vol. 2, European Company and Financial Law Review, De Gruyter-Recht, 2008 p. 321; M. Deschamps, "Conflict of Laws Rules for Security Rights", in the same book, p. 284; M. Deschamps, "La Convention des Nations-Unies sur la cession de créance dans une perspective canadienne", (2003) 90 *Banque & Droit*, p. 40; M. Deschamps, "The Priority Rules of the United Nations Receivables Convention", (2002) 12 Duke Journal of Comparative & International Law 389; H. Sigman and E. Smith, "Toward Facilitating Cross-Border Secured Financing and Securitization", (2002) 57 The Business Lawyer 727.

that third parties cannot easily identify such places, other disadvantages would ensue with a conflict rule pointing to any of such places. First, one single law could not apply to a bulk assignment of present and future receivables unless all such receivables have the same *situs* (which is not the case in the Example if *situs* is defined as the place of business of Alpha's customers). Second, with respect to future receivables covered by a bulk assignment, the assignee might be unable at the time of the assignment to identify their *situs* and, consequently, to determine the law or laws to comply with in order to be protected against competing claims. The same considerations explain why a conflict rule based on the law governing the receivable has not been retained.

An approach leading to the law governing the assignment (as in the Netherlands but not discussed in this paper) avoids some of these problems and allows for the same law to govern the creation and third-party effectiveness of the security right in respect of all present and future receivables covered by the security. However, this approach does not take into account the interests of third parties who may need to identify the law applicable to the security right without the assistance of the grantor or the secured creditor. More importantly, selecting the law governing the assignment is unworkable in a situation where the same receivables have been assigned to another assignee under an assignment governed by a different law. It would then be impossible to know what law determines which of the two assignees is entitled to priority.

The Uncitral Model Law recommends a conflict rule based on the location of the grantor in order to avoid all these problems. Such a rule permits an easy identification of the applicable law (including by third parties) and results in one single law governing a priority contest between competing claimants.

The location of the grantor is defined in the Uncitral Model Law as its place of business or, if the grantor has places of business in more than one jurisdiction, the place where the central administration of the grantor is exercised. A grantor with no place of business is located at the place of its habitual residence. It must be emphasized that the place of central administration of a legal person is not necessarily the place of its statutory seat (as illustrated by the Example). In a scenario where the two places would not be in the same jurisdiction, the Uncitral Model Law considers that the place of central administration would be more closely connected to the situation and would better meet the expectations of third parties.

With respect to effectiveness against the debtor of the receivable, the Uncitral Model Law recommends the application of the law governing the receivable (which is the Rome I rule and appears to be the rule in all of the jurisdictions of the Example).

It is worth noting that the conflict rules of the Uncitral Model Law exclude the doctrine of renvoi and are substantially the same as in Ontario.

INCREASING ACCESS TO CREDIT THROUGH REFORMING SECURED TRANSACTION LAWS

Georges Affaki

The Economic Impact of Secured Transactions

The availability and cost of credit are directly influenced by the laws affecting secured transactions. Whether it be a micro business in the agricultural sector which needs to borrow money to buy a tractor, an enterprise which needs credit from its supplier, or the promoters of a power plant who need to finance a major new project, the inability to obtain valuable and efficient security over the debtor's assets is likely to discourage potential providers of credit.

All businesses, whether manufacturers, distributors, service providers or retailers, require working capital to operate, to grow and to compete successfully in the marketplace. It is well established, through empirical studies conducted by such organizations as the World Bank, the International Monetary Fund (IMF), the Asian Development Bank and the European Bank for Reconstruction and Development (EBRD), that one of the most effective means of providing working capital to commercial enterprises is through secured credit. A creditor will not extend credit – whether a loan or a payment facility – if he is not convinced that such credit will be repaid. While this is dependant on the ability of the debtor to generate the required cash flow, the projected flows can be disturbed by a change of circumstances, and the creditor will still want certainty that, should the debtor experience financial difficulties, he can still get repaid. Hence the expectation of the creditor that, in case of default, a security right will identify and dedicate certain debtor's assets for the exclusive benefit of the creditor, who could seize and sell them in case of default and receive the proceeds of sale ahead of other creditors.

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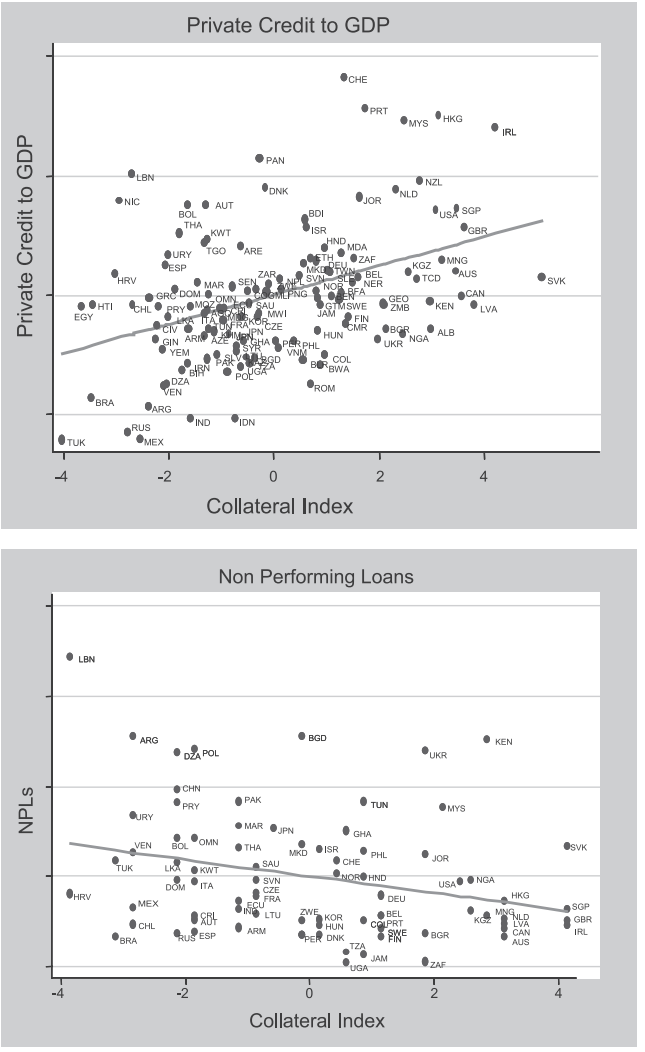
Box 1: Diagram demonstrating the corollary between a more efficient collateral, increasing credit and fewer defaults

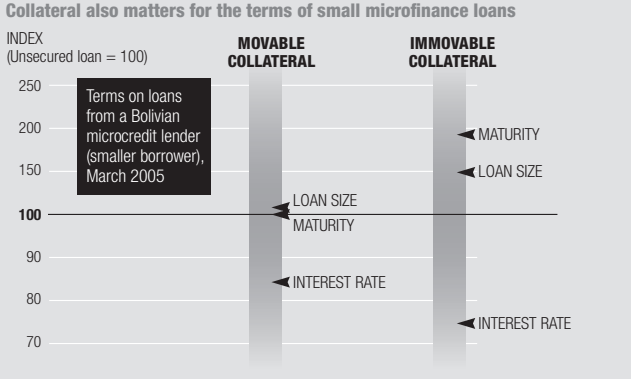


Source: Doing Business in 2005, World Bank.

Box 2: Study on the percentage of businesses required to pledge collateral compared to the number of businesses that applied for credit

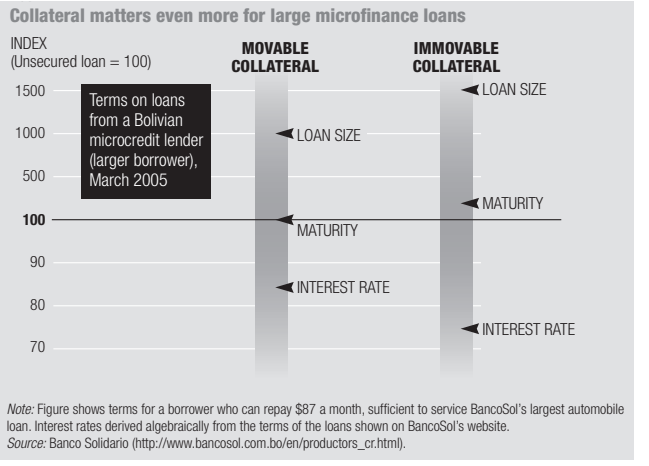
Note: Data are from surveys conducted in more than 60 countries in 2001–05.
Source: World Bank Group, Enterprise Surveys (http://rru.worldbank.org/EnterpriseSurveys).

Box 3: The efficiency of collateral and its impact on small microfinance loans, immovable collateral being considered as more efficient in pre-reform systems



Note: Figure shows terms for a borrower who can repay $87 a month, sufficient to service BancoSol's largest unsecured loan. Interest rates derived algebraically from the terms of the loans shown on BancoSol's website.
Source: Banco Solidario (http://www.bancosol.com.bo/en/productors_cr.html).

Box 4: The efficiency of collateral and its impact on large microfinance loans, immovable collateral being considered as more efficient in pre-reform systems



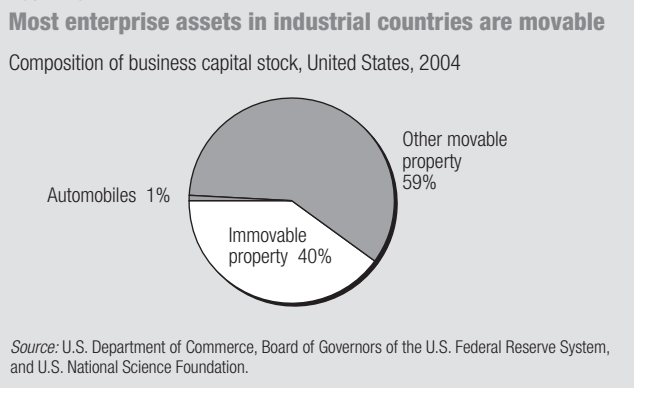
Note: Figure shows terms for a borrower who can repay $87 a month, sufficient to service BancoSol's largest automobile loan. Interest rates derived algebraically from the terms of the loans shown on BancoSol's website.
Source: Banco Solidario (http://www.bancosol.com.bo/en/productors_cr.html).

The key to the effectiveness of secured credit is that it allows businesses to use the value inherent in their assets as a means of reducing risk for the creditor. Risk is reduced because credit secured by assets gives creditors access to the assets as another source of payment in the event of non-payment of the secured obligation. As the risk of non-payment is reduced, the availability of credit is likely to increase and the cost of credit is likely to fall.

A. Optimizing the use of assets as collateral

Secured lending experience shows that it is wrong to consider that it is the lack of sufficient assets to serve as collateral that limits businesses in low- and middle-income countries accessing finance. Businesses generally have assets that could be used as security for loans – movable assets such as the goods they produce or process, the machinery they use in manufacturing, present and future accounts receivable from clients, intellectual property rights, and warehouse receipts. Around the world movable assets, rather than land or buildings, account for most of the capital stock of private businesses and an especially large share for micro, small, and medium-size enterprises.

Box 5: Most enterprise assets in industrial countries are movable

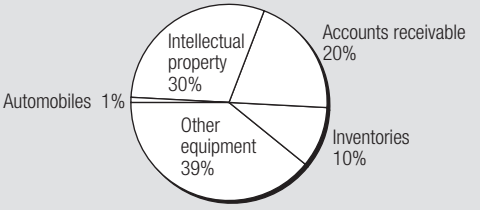


In the industrial countries with the most advanced legal systems for collateral – Canada, New Zealand, and the United States – lenders consider such assets to be excellent sources of collateral. Regrettably, most of the rest of the world's businesses face a very different situation. In most low- and middle-income countries only urban real estate and to a lesser extent new motor vehicles can serve as collateral. For businesses in some sectors, such as urban transport companies, some heavy utilities, and commercial office buildings, this system of finance works. But for other enterprises it means that little of the property they own can serve as collateral. A closer look at what makes up the movable capital stock tells more about the disparity in businesses' ability to use as collateral the assets they have or will need to have as they develop. Businesses in the developed world hold movable capital stock in a wide range of categories, all of which would be considered excellent collateral by lenders (Box 6). Yet most of this capital could not serve as collateral in a low- or middle- income country with an unreformed collateral system. To take one example, a World Bank report indicates that nearly 99% of movable property that could serve as collateral for a loan in the United States would likely be unacceptable to a lender in Nigeria.

Box 6: Movable assets in industrial countries are wide-ranging and widely accepted as collateral

Movable assets in industrial countries are wide-ranging—and widely accepted as collateral

Composition of movable business capital stock, United States, 2004



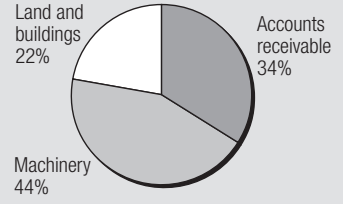
Note: Data are from surveys conducted in more than 60 countries in 2001–05.
Source: World Bank Group, Enterprise Surveys (http://rru.worldbank.org/EnterpriseSurveys).

The above empirical studies show the important mismatch in low- and middle-income countries between the type of assets that businesses have, or will need to have, and the type of assets that lenders can accept as collateral (Box 7) – and *it is this mismatch that explains the lack of access to credit*. Businesses seeking to finance equipment that is not acceptable as collateral are often forced to rely on non-commercial funding sources, which can be both scarce and extremely expensive.

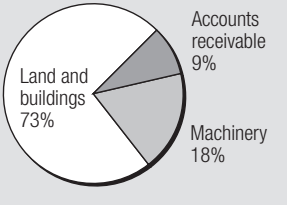
Box 7: The mismatch in low- and middle income countries between the assets businesses own and what lenders accept as collateral

In low- and middle income countries the assets firms own are a poor match for the assets lenders accept as collateral

Composition of assets banks have accepted as collateral



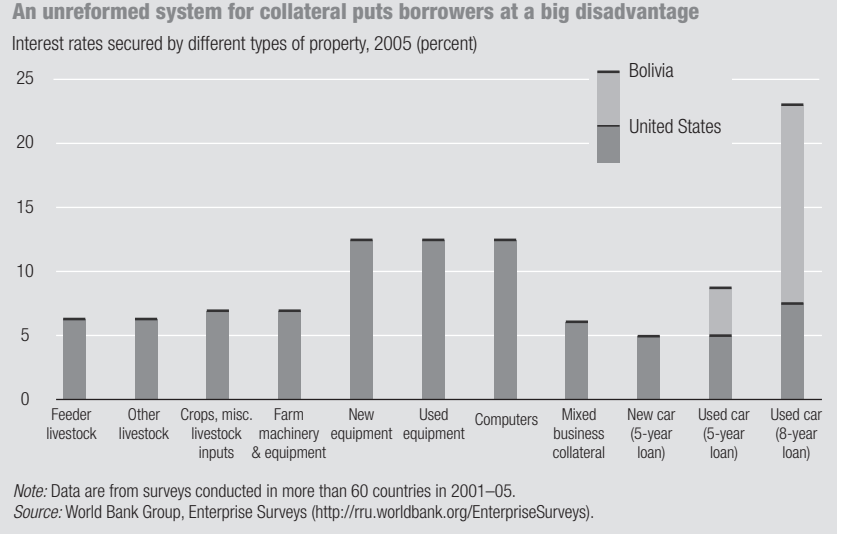
Composition of assets banks have accepted as collateral



Note: Data are from surveys conducted in more than 60 countries in 2001–05.
Source: World Bank Group, Enterprise Surveys (http://rru.worldbank.org/EnterpriseSurveys).

For the avoidance of any misunderstanding, the problem of businesses in the developing world accessing finance does not lie in the particular composition of their assets. That composition generally reflects a good mix that is driven by technology, market prices, and the needs of markets. Thus productive assets consist of a wide range of equipment, inventories, and accounts receivable – just as they do in industrial countries. Nor is the problem that the benefits of using collateral are unknown in low- and middle-income countries. Indeed, where the collateral system works, these countries see much the same outcome as countries with modern systems do. World Bank studies show, for example, that interest rates for loans secured by automobiles in Bolivia, differ from those in the United States by about the same amount as Bolivia's country risk premium. Put another way, full macroeconomic stabilization in Bolivia would give Bolivians access to credit for purchasing automobiles similar to that enjoyed by U.S. residents. The problem is that this effect of collateral does not extend to other movable property in Bolivia. So while U.S. borrowers can readily obtain loans for a broad range of movable property, Bolivian borrowers seeking loans for many of the same types of property could not even get interest rates quoted (Box 8).

Box 8: An unreformed system for collateral puts borrowers at a big disadvantage



Note: Data are from surveys conducted in more than 60 countries in 2001–05.
Source: World Bank Group, Enterprise Surveys (http://rru.worldbank.org/EnterpriseSurveys).

Box 9: Jurisdictions with Modern Secured Transactions Have more Favorable Credit Policies for Borrowers

LOAN-TO-VALUE RATIOS			
TYPE OF COLLATERAL	OECD	EMERGING MARKETS	
		Friendly/Reformed	Difficult/Unreformed
FIXED – Real Estate MOVABLE	Up to 90%	Up to 80%	Between 60–80% (cities) 30–60% (rural areas)
Vehicles	Up to 100%	Between 70 and 100%	Between 60 and 85%
Equipment	Up to 80%	Up to 80%	From 60 to 80%. Most times no value (secondary collateral)
Accounts	Up to 80%	Up to 50%	No value (secondary collateral)
Inventory	Up to 50%	No value (secondary collateral)	No value (secondary collateral)

Source: International Finance Corporation.

This example is not unique. In most low- and middle-income countries, once country risk premiums are removed, interest rates for loans secured by new cars or urban real estate are similar to those charged in industrial country markets.

Most businesses face collateral requirements they cannot meet and get none of the benefits of collateral from the assets they own. Across developing countries, when businesses apply for a loan or a line of credit, the most common reason that their application is rejected is insufficient collateral (Box 9). Regrettably, those businesses bother no longer to apply for loans because they know in advance that they will be unable to meet the lender's requirements for collateral. For these businesses, the reform of the laws governing the use of collateral is important to increasing their access to the financing they need to develop and operate in a competitive world.

Box 10: Many businesses in low- and middle-income countries cannot meet collateral requirements for loans

Note: Data are from surveys conducted in more than 60 countries in 2001–05.
Source: World Bank Group, Enterprise Surveys (http://rru.worldbank.org/EnterpriseSurveys).

B. Benefits to the country of reform

Sound secured transactions laws can have significant economic benefits for States that adopt them, including attracting credit from domestic and foreign lenders and other credit providers, promoting the development and growth of domestic businesses (particularly small and medium-size enterprises) and generally increasing trade. Such laws also benefit consumers by lowering prices for goods and services and making consumer credit more readily available. To be effective, such laws must be supported by efficient and effective judicial systems and other enforcement mechanisms. They must also be supported by insolvency laws that respect rights derived from secured transactions laws.

The objective of reform of secured transactions laws is primarily economic. A lender or creditor will take a security in order to reduce the risk of losing the money that he is owed. If the law or the way in which it is applied does not give creditors confidence that they can recover real value from the collateral it will have little economic effect. On the other hand,

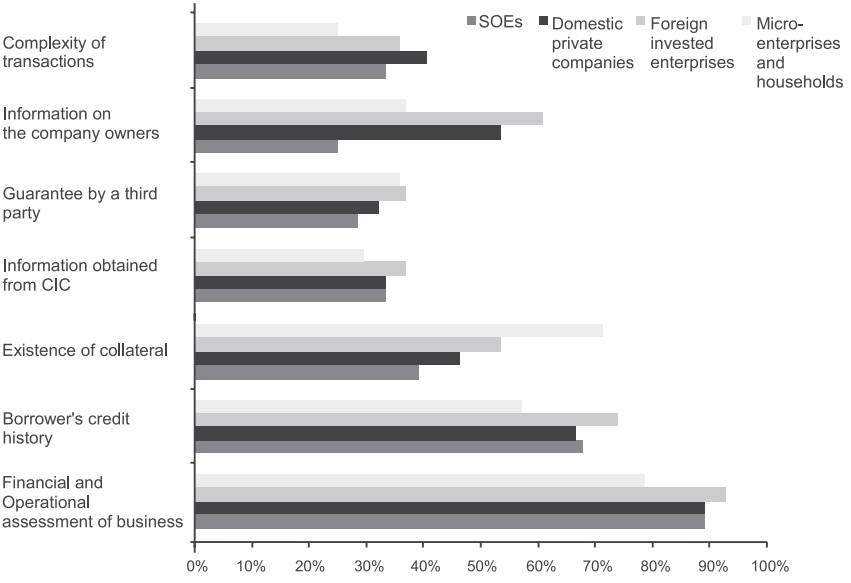
a security system which effectively reduces the risk of giving credit can increase the availability of credit and improve the terms on which it is available. A lender who knows that he has legally recognised rights to turn to his debtor's assets in case of non-payment will assess the credit risk quite differently. The availability of such recourse may influence his decision whether to give credit or not. If he does give credit it will also affect the price for such credit.

True, it can be argued that security is not necessarily a condition for credit. In developed economies, credit cards are a common means by which people and businesses borrow on credit. Blue chip companies routinely borrow unsecured. Security is not, in itself, a sufficient guarantee of repayment either – as mentioned above, prudent lending requires adequate credit analysis to assess the ability of the borrower to repay from income, cash flow, or profits. Security, however, is very likely to encourage and enhance credit by changing the terms on which the creditor is prepared to lend, typically by:

- increasing the amount of the loan,
- extending the period for which the loan is granted, and
- lowering the cost of the credit.

The establishment of an attractive legal and regulatory framework for taking security over movable assets constitutes one of the building blocks stimulating secured lending. Developing countries have increasingly paid attention to this area of the law to reap these benefits. An advanced legal regime, properly implemented, should encourage the use of security and therefore facilitate access to credit and/or reduce borrowing cost.

Box 11: Factors for Making Business Loan Decisions



Source: IFC-VBA Financial Sector Survey.

C. *Calculating the credit price under an efficient collateral system*

An example tracking a bank credit assessment financial model illustrates the above. At the outset, it should be recalled that banks are subject to regulatory capital requirements for prudential purposes. This requires them to hold total capital equivalent to at least 8% of their risk-weighted assets. The Revised international capital framework (Basel 2) has not changed this feature of the initial Capital Accord (Basel 1). What has actually changed is the risk weighting rules. Simply put, instead of setting aside eight units of capital for each 100 units of credit granted, eight units of capital have now to be set aside for the risk-weighted equivalent of the credit granted which could range from 0% (therefore effectively dispensing with any obligation to set aside equivalent capital) to 1250% of the amount of credit (in effect resulting in 100% of the credit amount being set aside in capital equivalent (1250% × 8%)). It is this risk-weighting equivalent of credit that is directly influenced by the efficiency of the security.

Take a bank loan of 3,000 made to a borrower presenting a 1% default probability from a creditworthiness standpoint. Suppose that the bank takes a security over a collateral of a value of 4,000. Suppose also that that collateral is situated in a country that allows the secured lender to take a proprietary right over the collateral, make it effective against other competing claimants through a formality that would publicise that right, such as notice registration, and to foreclose on the collateral in the event of default through a rapid, certain and inexpensive procedure, including in the event of bankruptcy of the grantor. In this case, the lender certainly benefits of a high expectation of recovery due to the efficiency of the security system which allows a security right to be perfected through registration on a public registry that enhances predictability and certainty and to be realised through a certain, predictable and inexpensive procedure.

If the lending bank considers that the expected rate of return of an enforcement of the security is 60% (in effect recovering 2,400 out of the nominal value of the collateral), and hence a global recovery rate (GRR) on the extended credit of 80%, capital adequacy obligations would compel the bank to hold 95.52 in capital. This figure is the result of the crossing on the risk-weighting table in Box 1 of the probability of default (PD) and the GRR: 39.8%

Box 12: Basel 2 risk-weighting table

PD / GRR in %	0.03%	0.48%	1%	13.32%	21.81%
80	**7.24%**	**29.2%**	**39.8%**	**122.0%**	**156.2%**
70	10.85%	43.8%	59.6%	183.0%	234.3%
60	14.47%	58.4%	79.5%	244.0%	312.4%
50	18.09%	72.9%	99.4%	305.0%	390.5%
40	21.71%	87.5%	119.3%	366.0%	468.6%
30	25.33%	102.1%	139.2%	426.9%	546.7%
20	28.95%	116.7%	159.1%	487.9%	624.8%
10	32.56%	131.3%	178.9%	548.9%	702.9%

Source: BNP Paribas.

Applied to the credit in the example given above:

3,000 × 39.8% = 1,194 risk-weighted equivalent of the credit
1,194 × 8% = 95.52

Accordingly, the capital that the lending bank would have to hold in the example of a loan of 3,000 secured by the collateral in the conditions described above is 95.52.

This capital has to generate a return that meets the rate set by the bank, say 20%, which gives 4.7.

Let's vary now a single parameter of this example: consider that the same collateral (same type of asset and same value) is displaced to a jurisdiction where the secured creditor is not allowed a proprietary right certain over the collateral that would rank ahead of competing claimants in the event of bankruptcy. This limitation could be due to a wide variety of defects in the secured transaction system, including, for example, the absence of a public registry for security rights in the jurisdiction where the collateral is situated, or the length, cost and contingency of the security enforcement procedure.

The lending bank could in such a case consider that the return rate expected from the enforcement of the security is 7.5%, thus leading to a GRR of 10% of the extended credit. Capital adequacy rules would require the bank in this case to hold capital for an amount of 429.36.

Crossing the new parameters on the table in Box 1 above shows a risk-weight of 178.9%. Applied to the credit:

3,000 × 178.9% = 5,367
5,367 × 8% = 429.36

The credit in this case will use 429.36 of the bank's capital, which has to generate the same rate of return as the one fixed earlier: 20%, which gives us: 85.87.

The above example demonstrates how an inefficient security requires the bank to use 4.5 times more capital than an efficient one: (429.36 – 95.52) and will cost 4.5 times more (85.87 – 19.10).

It would be a mistake to believe that the riskier the transaction the greater the return to the bank. The bank's rate of return on capital in the example above is 20%. This rate does not vary. The bank has to charge a higher spread to achieve that return when the increased risk requires using a higher capital. At the end, the borrower ends up paying more by way of credit cost when the security is inefficient.

It is precisely for this reason: getting credit (including international bank finance) at a more reasonable cost that a number of eastern European and CIS countries have accompanied their transition to market economy by the enactment of a modern secured transaction system. Other developing countries are seeking actively a similar approach. This is the reason, for example, behind the revision of the 1997 Uniform Act on Security Rights of the Organization on the Harmonisation of Commercial Law in Africa (OHADA). It is important for the success of their project and to meeting their objective in attracting capital with a view of increasing the availability of low-cost credit that developing countries conduct the necessary reform to their secured transactions laws methodically and with careful planning.

Secured transactions reform is now widely recognized as a cornerstone of economic development. For example, the World Bank Annual Reports "Doing Business", which investigate and compare regulation enhancing business activities in 175 economies, have included one full chapter out of ten on "Getting Credit", which covers secured transactions. International and bilateral financial institutions (the Asian Development Bank, World Bank, Inter-American Development bank, Millennium Challenge Corporation, UN Commission for International Trade Law, etc.) have also promoted, in one form or another, reform in this area of the law. A considerable amount of material is thus available on the subject from and including the following resources:

- Basic requirements of the legal system to support the economic aspects of the reform (e.g. EBRD Core Principles for Secured Transactions Law, World Bank General Principles on Insolvency Law and Creditors' Rights).
- Illustration and model on how legal provisions can be drafted (e.g. EBRD Model law) or registration systems developed (e.g. Asian Development Bank study to Movables Registries).
- Background material and recommendations on secured transactions law (e.g. UNCITRAL Legislative study on Security rights over Movable Property).
- National laws and regulations now adopted in many emerging countries on the subject.

THE LAW OF 11 JULY 2013 AMENDING THE BELGIAN CIVIL CODE WITH RESPECT TO SECURITY INTERESTS IN MOVABLE ASSETS, AND REPEALING VARIOUS PROVISIONS IN THIS AREA

Michèle Grégoire*

I. Introduction

The Law of 11 July 2013 amending the Belgian Civil Code in respect of security interests in movable assets, and repealing various provisions in this area (hereinafter the "*Law on Security Interests in Movable Assets*") is in keeping with a wave of reforms aimed at simplifying asset valuation techniques with a view to obtaining loans, while safeguarding the likelihood of repayment to the extent possible. It is expected that it will enter into force as from 1st January 2017.

The most characteristic innovation lies in the elimination of the dispossession requirement, which had already become a token or even fictional aspect of many forms of pledges, in order to render this form of arrangement and publication optional. Dispossession must exist alongside the formality of registering the pledge in a central electronic register, which can be freely added to under the responsibility of the beneficiary of the security for each transaction.

Furthermore, practitioners have long been critical of the fact that perfection procedures were inconsistent and ineffective. There is a contrast between the extreme ease with which financial collateral can be called and the continued use of the obsolete public auction process for other forms of pledges. The system proposed by the Law on Security Interests in Movable Assets aims for an optimal use of resources, by limiting the involvement of the courts, and leaving more room for contractual freedom, subject to retrospective audits, with special protection for a pledgor who may be

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classified as a consumer within the meaning of Article 2.3 of the Law of 6 April 2010 on Market Practices and Consumer Protection.

Practice has also highlighted the need to recognise and organise a system for holding and exercising warranty rights on behalf of third parties.

UK and US law use the Security Trust structure, within which a trustee acts on behalf of a group of determined or determinable creditors.

The Law on Financial Collateral introduced the recognition of this structure into Belgian law, in principle. The Law on Security Interests in Movable Assets generalises and extends this flexible form of representation.

Due to the general enshrinement of the option to arrange a pledge, and to make it enforceable against third parties with no dispossession via registration, several forms of pledges can be eliminated, including pledges on business assets, agricultural lenders' contractual liens, warrantage, and commercial pledges. Accordingly, the assets that make up the underlying assets for these various kinds of pledges can easily be encumbered via the registration of a pledge.

II. Conditions for arranging a pledge

A. In principle, consensual

Article 2073 of the Belgian Civil Code is replaced by Article 1 of the Law on Security Interests in Movable Assets, which defines the pledge by assessing it according to its end-purpose. The Article specifies that "*The pledge grants the pledgee the right to be paid from the assets that are the object of the pledge, in preference to the other creditors*".

Accordingly, it is the favourable position of the pledgee in the event of voluntary non-enforcement of the guaranteed receivable that is highlighted, relegating (but nonetheless not ignoring) the effects of the security during the window period, which is limited to a remote check on the situation of the encumbered assets. However, this safeguard period is nonetheless of major importance, as it undoubtedly prepares for the possibility of enforcement, which is necessary for the full exercise of the pledgee's rights.

Article 2074 of the Belgian Civil Code is replaced by Article 2 of the Law on Security Interests in Movable Assets regarding the arrangement of the pledge, which is now consensual and no longer *in rem*. In fact, this

Article specifies that "*Subject to Article 4.2, the pledge shall be arranged via the agreement entered into by the pledgor and the pledgee*".

B. *Protection of the pledgor consumer*

Article 4.2, as reserved, establishes an exceptional arrangement, which provides that "*If the pledgor is a consumer within the meaning of Article 2.3 of the Law of 6 April 2010 regarding Market Practices and Consumer Protection, the validity of the agreement shall be conditional on the drafting of a written document drawn up in accordance with the specifications of Article 1325 or Article 1326, depending on the case.*
The written document referred to in Sub-Paragraph 2 shall mention the value of the pledged asset or assets, for the purpose of applying Article 7.4".

Said Article 7.4 provides that "*If the pledgor is a consumer within the meaning of Article 2.3 of the Law of 6 April 2010 regarding Market Practices and Consumer Protection, the value of the pledged asset or assets may not exceed 200% of the extent of the pledge, as determined by Article 12*".

According to Article 12 "*The pledge shall include the principal amount guaranteed and ancillary expenses such as interest expense, the penalty clause, and the perfection costs within the limits of the amount agreed.*
However, if the pledgor is a consumer within the meaning of Article 2.3 of the Law of 6 April 2010 regarding Market Practices and Consumer Protection, these ancillary expenses may not amount to more than 50% of the principal amount".

The system arranged by the above provisions has a dual purpose: where the pledgor is a consumer within the meaning of the Economic Code, the pledge is a formal agreement, the validity of which is conditional on the drawing up of a written document including various references expressing substantive requirements. These requirements are as follows: the written document must include an indication of the value of the pledged asset or assets, along with the terms "*valid for*" handwritten in full and including a reference to the exact amount guaranteed, if such amount has been determined, or to the ceiling, if only such ceiling can be determined, where the arrangement of the pledge arises from a unilateral agreement that only creates obligations for the pledgor. Conversely, if the arrangement of the pledge is one of the obligations included in a bilateral agreement, the requirement for multiple original copies to be drawn up shall apply, in

exchange for a specification of the value of the pledged asset or assets; this specification does not need to be preceded by the handwritten term "*valid for*". In any event, the value of the pledged asset or assets may not exceed 200% of the principal amount of the receivable, plus ancillary expenses, which consist of interest expense, the penalty clause and the perfection costs, which are limited to 50% of the principal overall.

Where the pledgor is not a consumer within the meaning of the aforementioned provisions, the agreement shall remain purely consensual, in accordance with common law.

C. Common Contract law

Furthermore, the other conditions for the validity of the pledge agreement, which are inherent to common contract law, to family estate law, to corporate law and to criminal law, shall remain in place.

III. Conditions for enforcing the pledge

A. Registration

Article 15 of the Law on Security Interests in Movable Assets is innovative, in that it specifies that "*The pledge may be enforced against third parties via its registration in the Pledge Register in accordance with Article 29.1.*
The incorrect identification of the pledgee or their representative, or the incorrect description of the assets encumbered by the pledge invalidates the registration, except if such incorrect information does not seriously mislead a reasonable person who is performing a search, notwithstanding Article 29.2.
The ranking of the pledge shall be determined by the chronological order of its registration.
The Law shall determine the application procedures for this Article".

Article 29, to which Article 15 refers, describes the registration formalities as follows: "*The pledgee is authorised to register their pledge, pursuant to the pledge agreement, by entering the data referred to in Article 30, as shown in the written document referred to in Article 4, in the Pledge Register, in accordance with the procedures determined by the King on the recommendation of the Belgian Privacy Commission.*

The pledgee shall be responsible for any damage that may arise from the entry of incorrect data.
The pledgee shall inform the pledgor of the registration in writing".

According to Article 30, the data to mention in the register are:

1. *"The identity of the pledgee or of their representative;*
2. *The identity of the pledgor;*
3. *The description of the assets encumbered by the pledge;*
4. *The description of the guaranteed receivables;*
5. *The maximum amount up to which the receivables are guaranteed;*
6. *A statement by the pledgee that they shall be responsible for any damage that may arise from the entry of incorrect data".*

Pursuant to Article 31 of the Law on Security Interests in Movable Assets, all the data listed above shall be available for consultation, together with the number and registration date of the pledge, by certain categories of persons specified in Article 34 of the Law on Security Interests in Movable Assets, namely the pledgor and the pledgee, as well as the persons determined by the King on the recommendation of the Belgian Privacy Commission, in accordance with the procedures determined in the same way.

In accordance with Article 35 of the Law on Security Interests in Movable Assets, "*the registration of the pledge shall expire after a 10-year period. The pledge shall no longer be available for consultation in the Pledge Register as from that date.*
However, this timeframe may be renewed for successive periods of 10 years. Renewals shall be performed via registration in the Register prior to the expiry of the 10-year period, in accordance with the procedures determined by the King on the recommendation of the Belgian Privacy Commission.
The pledgee shall inform the pledgor of the renewal of the registration in writing".

The Register may include a series of details reflecting changes in the security, including removal of the registration, assignment of the guaranteed receivable, or assignment of its ranking.

Article 36 of the Law on Security Interests in Movable Assets specifies that "*The pledgee is required to ensure that the registration of the pledge is removed, in the event that the liability is settled.*
The pledgee and the pledgor may jointly agree to ask the Mortgage Department to remove the registration of the pledge at any time.

If an agreement cannot be reached, the removal shall be requested via the courts, notwithstanding any potential damages and interest".

Pursuant to Article 37 of the Law on Security Interests in Movable Assets, "*The registration of the assignment of the pledge in the event of the assignment of the guaranteed receivable shall be performed according to the procedures determined by the King on the recommendation of the Belgian Privacy Commission.*
The registration shall remain in effect up until that point, in accordance with the registration by the assignor. The registration of the assignment shall mention the name of the assignee.
The assignment must be registered by the assignor".

Lastly, according to Article 38 of the Law on Security Interests in Movable Assets, "*An assignment of rank can only be enforced on third parties via its registration in accordance with the procedures determined by the King on the recommendation of the Belgian Privacy Commission".*

This process for adjusting the information shown in the Register is somewhat reminiscent of the system established by Article 5 of the Mortgage Act where property is concerned.

However, Article 5 of the Mortgage Act makes the enforcement on third parties of the transfer of a receivable guaranteed by a mortgage or a property lien and of a legal or contractual subrogation relating to such a receivable, or to the pledge based on that receivable, conditional on an entry in the margin of the registration of a mortgage or a property lien. It is true that the information is less crucial for the pledge (since the security does not necessarily result in a change in ownership of the receivable) or for subrogation (where the conditions for its existence are more stringent than those for the transfer, since subrogation assumes payment of all or part of the receivable to the subrogating creditor by the subrogated party). Nevertheless, third parties may find it useful to find out about the actual or potential transfer of the guaranteed receivable, as this transfer influences the pledge attached to the receivable.

B. Erga omnes effect

As a result of the *erga omnes* enforceability of the pledge, said pledge shall follow the encumbered assets to any owner to whom they are transferred,

pursuant to Article 24.1 of the Law on Security Interests in Movable Assets, while the assignee shall be deemed to have acted as a pledgor as from the time of assignment.

As further specified by Article 24.2 of the Law on Security Interests in Movable Assets, these rules do not apply if "*the pledgor was authorised to dispose of the encumbered assets in accordance with Article 21, if their disposal had been authorised by the pledgee, or if the purchaser can invoke Article 2279*".

Excluding the assumed transfer of the encumbered asset via a liquidation sale, said asset may become the unencumbered property of a third-party purchaser according to three scenarios: first, it the purchaser's rights have been granted by a pledgor who remained within the limits of Article 21, according to which "*Unless agreed otherwise, the pledgor may freely dispose of the encumbered assets during the normal course of business*"; second, if a special agreement extending the limits of the power granted to the pledgor to use the assets beyond the normal course of business has been entered into by the pledgor and the pledgee, and third, when faced with a third party acting in good faith who benefits from an act of disposal relating to a tangible movable asset; in which case the consequences of ignoring the effect of the pledge shall be confined to the scope of the inter-party relations established between the pledgor and the pledgee.

However, Article 22.1 and 22.2 of the Law on Security Interests in Movable Assets sanctions abuses in the following terms:
"If the pledgor fails to fulfil their obligation in a material way, the judge may order the encumbered assets to be delivered to the pledgee, at the latter's request, or to be placed in court-ordered receivership.
The fraudulent disposal or removal of the encumbered assets is subject to the sanctions provided for in Article 491 of the Belgian Criminal Code".

Another limit, which targets the third-party purchaser in this case, is established by Article 25 of the Law on Security Interests in Movable Assets, which specifies that:
"Registration in the Pledge Register excludes the application of Article 2279 to beneficiaries of the pledgor under a specific title, who are acting within the context of their professional activities".

C. *Responsibility for processing the data*

Pursuant to Article 26 of the Law on Security Interests in Movable Assets, the Pledge Register intended for the filing of the enforceability formalities described above is a national register; it is known as the "*Pledge Register*", and is kept at the Mortgage Department of the Federal Government Finance Department's General Administrative Authority for Estate Documentation. It is a computerised system, where the King shall determine the operating procedures.

Article 26.3 of the Law on Security Interests in Movable Assets assigns the responsibility for processing the data within the meaning of the Privacy Law of 8 December 1992 to the aforementioned Mortgage Department where the processing of personal data is concerned.

Article 27 of the Law on Security Interests in Movable Assets requires that the identity of the person using the Register be checked at the time of every registration, consultation, amendment, renewal, or removal of the pledges registered.

Lastly, Article 28 of the Law on Security Interests in Movable Assets specifies that:

"*The registration, consultation, amendment, renewal and removal of data may give rise to the payment of a fee, the amount of which shall be determined by the King.*

"*Consultation of the Pledge Register shall be free of charge for the pledgor and for the categories of persons or institutions determined by the King, on the recommendation of the Belgian Privacy Commission*".

D. *Dispossession*

1. Tangible asset

Alongside its registration, according to Article 39 of the Law on Security Interests in Movable Assets, a pledge on a tangible asset can also be enforced via the transfer of material ownership to the creditor or an agreed third party.

2. Receivable

Where the pledge involves a receivable, Section 7 of the Law on Security Interests in Movable Assets, entitled "*Enforcement of a receivable via dispossession*" includes Articles 60 to 68; however, only Article 60 specifically rules on the issue of enforceability, while the following articles relate to proof, the consistency of the underlying asset, or the perfection methods.

Under the terms of Article 60 of the Law on Security Interests in Movable Assets, "*Condition for possession (control)*", "*the pledgee shall be granted possession of a pledged receivable via the signing of the pledge agreement, on condition that they have the power to inform the debtor of the pledged receivable of the pledge.*
The pledging of the asset can only be enforced on the debtor of the pledged receivable as from the time when they have been informed of such pledging, or have acknowledged it.
Articles 1690.1.3 and 1690.1.4, and Article 1691 shall apply".

The analogy between the assignment of a receivable and the pledging of a receivable in view of the rules on enforceability is maintained by the Law on Security Interests in Movable Assets. This means that the system is as follows, as before:

(1) the pledge is enforceable on a *solo consensu erga omnes* basis, in accordance with Article 1690.1.1 of the Belgian Civil Code, and Article 60.1 of the Law on Security Interests in Movable Assets;
(2) the pledge can only be enforced against the debtor of the pledged receivable as from the time when they have been informed of said receivable or have acknowledged it, in accordance with Article 1690.1.2 of the Belgian Civil Code and Article 60.2 of the Law on Security Interests in Movable Assets;
(3) if the pledgor has arranged several pledges on the same receivable, or has assigned and pledged that receivable to several creditors, the preferred party among the various assignees or pledgees shall be the one who can claim in good faith that they were the first to inform the debtor of the assignment of the receivable, or were the first to receive acknowledgement of the assignment by the debtor, in accordance with Article 1690.1.3 of the Belgian Civil Code, to which Article 60.3 of the Law on Security Interests in Movable Assets refers;

(4) the pledge cannot be enforced on the pledgor's creditor, who can invoke pre-emptive rights to the pledged receivable other than those arising from an assignment or a pledge (this assumption is subject to the previous rule, which is included in Article 1690.1.3 of the Belgian Civil Code, and in Article 60.3 of the Law on Security Interests in Movable Assets), i.e. who can invoke their capacity as a creditor who has issued an order for the attachment of the pledged receivable, or who is subrogated to the rights of the pledgor as a result of having settled all or part of the pledged receivable, or who has brought a direct action against the pledgor, or else who may benefit from a delegation authorising them to demand payment of all or part of the pledged receivable from the pledgor, where the debtor of the receivable has validly settled it with the creditor in good faith – i.e. they were unaware of the fact that the receivable settled in this way had been pledged – and before they were informed of the transfer) as long as the accepting creditor is also acting in good faith – i.e. is unaware of the pledging of the receivable for which they are receiving payment. This last rule, which is include in Article 1690.1.4 of the Belgian Civil Code, to which Article 60.4 of the Law on Security Interests in Movable Assets refers, gives precedence to good faith over compliance with the *erga omnes* enforcement of the receivable pledge on third parties in general.

Lastly, the enforceability of the exceptions that the debtor of the pledged receivable may raise against the pledgee is governed by Article 1691 of the Belgian Civil Code, to which Article 60.4 of the Law on Security Interests in Movable Assets also refers. By analogy with Article 1691.1 of the Belgian Civil Code, a debtor who has paid the pledgor in good faith (i.e. who was unaware of the fact that the receivable settled in this way had been pledged), and before they were informed of the pledge or had acknowledged it, shall be released of any liability. Accordingly, they may invoke this payment in discharge if the pledgee subsequently makes use of their right to demand payment for the pledged receivable by informing them of the pledge. Obviously, once they have been informed, the payment made to the pledgor may no longer amount to a final settlement[1]. Other exceptions that the debtor might have been able to invoke against the pledgor may be invoked against the pledgee in the same way, if the legal deed that

1 Belgian Supreme Court, 15 June 2007, Pas., 2007, I, 1234; C.06.0661.N.

is the basis for such exceptions is executed before the debtor of the pledged receivable has been informed of the pledge. This rule is included in Article 1691.2 of the Belgian Civil Code, to which Article 60.4 of the Law on Security Interests in Movable Assets refers.

IV. Proof

Specifically where proof of the pledging of a receivable is concerned, Article 61 of the Law on Security Interests in Movable Assets provides that "*The pledge agreement shall be proven by a written document that includes a detailed description of the receivables encumbered by the pledge and the guarantees. The provisions in Section 1 regarding the reference to the maximum amount up to which the receivables are guaranteed in the written document shall apply.*
If the pledgor is a consumer within the meaning of Article 2.3 of the Law of 6 April 2010 regarding Market Practices and Consumer Protection, the written document shall need to be drawn up in accordance with the specifications of Article 1325 or Article 1326, depending on the case, and the maximum amount up to which the receivables are guaranteed shall need to be clearly mentioned, in order for the agreement to be proven".

Where the pledgor of a receivable is a consumer, the formalities provided by Article 61.2 of the Law on Security Interests in Movable Assets therefore have a dual purpose, i.e. they aim to ensure the validity of the agreement, and to provide proof of said agreement.

V. Nature of and changes to the underlying asset

A. Principle

The general principle is established by Article 7.1 of the Law on Security Interests in Movable Assets, which is dedicated to the object of the pledge: "*The object of the pledge may be a tangible or intangible movable asset, or a determined group of such assets*".

B. *Fluctuating entities*

The next two paragraphs address the pledging of the two asset groups that are most frequently envisaged as possible underlying assets for a security, namely business assets and farms. Articles 7.2 and 7.3 of the Law on Security Interests in Movable Assets specify that:
"Barring a restrictive provision in the pledge agreement, a pledge involving business assets includes all the assets that make up the business assets.
"*Barring a restrictive provision in the pledge agreement, a pledge involving a farm includes all the assets that are used to run the farm".*

These two fluctuating entities remain understood in a changing and teleological manner. The composition of the underlying asset is continually determined over time according to the goal pursued by grouping assets that are united by their purpose, i.e. attracting, maintaining and developing a customer base where business assets are concerned, and the profitable operation of the farm, land and livestock where a farm is concerned.

Aside from these two scenarios, there were no other *de facto or de jure* groups of assets, understood as such, that could form the underlying asset for a pledge. However, over the past few years, the consensual nature of a pledge on a receivable had released this security from the straightjacket of demanding dispossession, and had allowed a portfolio of current and future receivables to be used as the underlying asset.

The flexibility of the forms required to ensure dispossession, which is governed by the Law on Financial Collateral, had the same effect on the pledging of financial instruments and of cash amounts held in an account.

Henceforth, nothing prevents the valuation of other components of an asset base, such as a business line, to the extent that the asset base includes moveable assets, or even all the moveable assets of a company or of an individual.

C. *Protection for the pledgor consumer*

Undoubtedly, as Article 4.7 of the Law on Security Interests in Movable Assets specifies:
"*If the pledgor is a consumer within the meaning of Article 2.3 of the Law of 6 April 2010 regarding Market Practices and Consumer Protection, the value of the pledged asset or assets may not exceed 200% of the extent of the pledge, as determined by Article 12".*

This limit guarantees protection for a consumer who may be required to take excessive risks.

Article 7.5 of the Law on Security Interests in Movable Assets reminds us that: "*Only assets that are transferable pursuant to the law may be pledged*". This is the logical consequence of the end purpose assigned to the security, i.e. preferential payment when the encumbered assets are realised.

Lastly, the final sub-paragraph of Article 7 of the Law on Security Interests in Movable Assets establishes this law as the common law for pledges, from which the specific arrangements for charges that may encumber intellectual rights are exempt: "*the provisions of this chapter only apply to pledges involving intellectual property rights to the extent that they are not incompatible with other provisions that specifically govern such pledges*".

This information is in keeping with the hierarchy of standards, as the intellectual rights area is governed by rules that find their source in international law, which takes precedence over domestic law.

D. Future assets

Article 8 of the Law on Security Interests in Movable Assets reaffirms a clear principle of civil law: like any agreement, "*the pledge may involve future assets*". Case law has added a restrictive criterion, according to which these future assets must be determined or determinable, in order to be the valid object of an agreement. This criterion is obviously relevant for the pledge. It is expressly used in the case of pledges on receivables in Article 63 of the Law on Security Interests in Movable Assets, which specifies that "*The pledge may be established on one or several future receivables, on condition that they are determinable*".

E. Subrogation in rem

Article 1.9 of the Law on Security Interests in Movable Assets amounts to a particular application of the general legal principle regarding subrogation *in rem*, where the application requires three cumulative conditions: assignment of the asset for a specific purpose, a threat to the fulfilment of that purpose due to the disappearance of all or part of the asset allocated

thereto, and the replacement of this asset by a substitute asset in the same asset base. It provides that *"the pledge shall extend to all the receivables that replace the encumbered assets, including the receivables resulting from the assignment of these assets, and the receivables offsetting the loss, damage or impairment of the encumbered asset"*.

Pursuant to the aforementioned general principle, it is appropriate to add that, aside from the substitute receivable, which is expressly referred to, the cash paid for execution of the receivable or of another substitute asset, could also take the place of the substitute asset and assume its purpose, regardless of whether financial instruments or tangible property are involved.

F. Ancillary proceeds

Articles 9.2 and 9.3 of the Law on Security Interests in Movable Assets address changes to the underlying asset, not via subrogation *in rem*, but via the application of the "*accessorium sequitur principale*" rule. It provides that *"unless agreed otherwise, the pledge shall extend to the proceeds generated by the encumbered assets. The pledgor and the pledgee, where applicable, are required to account to the other party*".

The benefits are the ancillary proceeds generated by a principal asset, without damaging the substance of that asset. As such, their creation does not affect the integrity of the asset underlying the pledge. They therefore amount to an additional benefit that can only be automatically encumbered according to the specific rule regarding ancillary nature set out above. The same does not apply to proceeds defined as ancillary income generated by a principal asset by damaging its substance, i.e. the proceeds. In the case of such proceeds, their assimilation to the main asset is a requirement, which does not require a specific explanation. Allowing relief on these proceeds would amount to reducing the value of the actual asset underlying the pledge.

G. Inseverable nature

Once the scope and contents of the asset underlying the pledge have been determined, Article 13 of the Law on Security Interests in Movable Assets confirms its inseverable nature in specific terms: "*The pledge is inseverable*

notwithstanding the severability of the liability between the universal beneficiaries of the debtor or of the creditor, or their beneficiaries by universal title. The creditor's universal beneficiary, or beneficiary by universal title who has received their portion of the liability, cannot renew the pledge to the detriment of their fellow universal beneficiaries or beneficiaries by universal title who have not been paid".

The rule is standard. It reflects the simple idea that as long as the guaranteed receivable has not been settled in full, the entire underlying asset remains in play.

H. Alterations

Alterations to the pledged asset threaten its purpose and its assignment as a guarantee if the asset that was initially encumbered is unrecognisable as a result of such alterations. Accordingly, any changes shall be handled with caution. Article 18 of the Law on Security Interests in Movable Assets specifies the following in this regard:
"Unless agreed otherwise, if the pledge concerns assets that are intended to be altered, the pledgor is authorised to make such an alteration.
If a new asset arises from this authorised alteration, the pledge shall encumber this newly created asset, unless agreed otherwise. Articles 570 et seq. shall apply in the event of an unauthorised alteration.
If third parties' assets are used to perform the alteration, and if these assets cannot be separated, or if their separation is not financially justifiable, the pledge shall encumber this newly created asset if this asset is the main asset within the meaning of Article 567, or if this asset is the one with the highest value, where applicable. In this case, the third party has the right to lodge an appeal against the pledgee for undue enrichment". The solutions adopted in this way comply with the common law consequences of the right of accession to movable goods.

According to Article 19 of the Law on Security Interests in Movable Assets, "*the immobilisation of the encumbered assets does not affect the pledgee's right to receive preferential payment from the proceeds generated by those assets*".

Article 20 of the Law on Security Interests in Movable Assets introduces an innovation compared with the conventional rule in property law, according to which the delivery of fungible assets amounts to ownership

of said assets, accompanied by the creation a personal obligation to return them, modelled in accordance with the legal reason for their delivery. In fact, the Article specifies that:
"The consolidation of fungible assets that are encumbered in whole or in part by a pledge issued by one or several pledgors does not affect the pledge. If there are several pledgees, they may enforce their pledge over the consolidated assets in proportion to their rights".

This system is based on setting up an aggregate assigned as a guarantee for the main receivables. It ultimately results in a compartment within the asset base in which the consolidation occurs. This may involve the asset base of the pledgee, where the fungible assets are delivered to them in order to arrange the pledge, or the asset base belonging to the pledgor, where the pledge is consensual and has been made enforceable on third parties via registration.

The aggregate encumbered assets retain their purpose regardless of where they are located. Accordingly, they may give rise to enforcement followed by a deduction or post-valuation deduction from the guaranteed receivable, or else if that receivable has been full and validly settled, to an obligation to return the assets in accordance with the procedures provided for in Article 20 of the Law on Security Interests in Movable Assets.

The collective mortageable interest system is common where financial instruments are concerned.

However, no consolidation shall arise if, in accordance with Article 44 of the Law on Security Interests in Movable Assets "*Unless agreed otherwise, where the object of the pledge are interchangeable items, the pledgee or the agreed third party must keep them separate from items of the same type*". In this case, the same Article continues "*Following a confiscation, a bankruptcy, or any multiple attachment affecting the asset base of the pledgee or of the agreed third party, the pledgor may exercise their rights over the individual assets*".

The final section of Article 44 on the Law on Security Interests in Movable Assets returns to the system recommended in Article 20, namely a collective security, by providing that: *"If the assets have been consolidated, the assets available at this time shall be deemed to be the assets encumbered by the pledge up to the amount encumbered by the pledge. If there are several pledgors, they may assert their claims over the consolidated assets in proportion to their rights".*

Even though it may be set aside via an agreement, the duty to segregate the assets that is incumbent on the pledgee may also give rise to the setting up of arrangements freely organised by the parties. Accordingly, the parties may agree on entrusting an audit and oversight assignment to an agreed third party, acting in the same way as companies that specialise in warrantage transactions.

VI. The parties' rights and obligations during the latency period

Under the terms of Article 14 of the Law on Security Interests in Movable Assets, "*the pledgee is not entitled to commit the asset*".

No agreement to the contrary may set aside this prohibition, which is therefore of a mandatory nature. Accordingly, Article 11 of the Law on Security Interests in Movable Assets grants the creditor, to the extent that the parties have reached an agreement in this regard, the right to use the encumbered financial assets in any way whatsoever, as if they were the owner of these assets, although they will be responsible for substituting them with equivalent assets when the guaranteed liability falls due, or for deducting the value of such assets therefrom, as an exception to common law.

The aforementioned rule is identical where a pledge with dispossession is involved.

Pursuant to Article 42 of the Law on Security Interests in Movable Assets, *"the pledgee can only use the encumbered assets if and to the extent that such use is required for safeguarding them"*. In accordance with Article 43 of the Law on Security Interests in Movable Assets, the pledgee must therefore *"take care of the assets encumbered by the pledge as a careful pledge"*, and answer for *"any loss or damage to the pledge that has occurred due to their negligence in accordance with the rules established under agreements or contractual obligations in general". Any expenses paid by the pledgee that are necessary for safeguarding and maintaining the assets, including the charges attached to the assets by the latter, must be repaid to them by the pledgor. The pledgor is authorised to inspect the assets at any time"*.

As we have seen when reviewing the consequences of the alterations made to the underlying asset pursuant to Article 44 of the Law on Security

Interests in Movable Assets, encumbered interchangeable items must be kept separate from items of the same kind included in the asset base of the pledgor or of the agreed third party, except where agreed otherwise.

The penalty for non-compliance with these obligations involves the lapsing of the security. Accordingly, under the terms of Article 45 of the Law on Security Interests in Movable Assets, the pledgor can only demand the return of the pledged asset once they have paid both the principal and ancillary amounts of the liability in exchange for which the asset was pledged as a security in full, *"except if the pledgee or the agreed third party is in serious breach of their obligations"*.

Where the pledgor is concerned, they must *"take care of the pledged assets as a careful pledgor"*, as required by Article 16 of the Law on Security Interests in Movable Assets, subject to potential inspection by the pledgee, who *"has the right to inspect the pledged assets at any time"*.

However, Article 17 of the Law on Security Interests in Movable Assets grants the pledgor *"the right to make reasonable use of the pledged assets, in accordance with their purpose"*.

In the same spirit, Article 18 of the Law on Security Interests in Movable Assets grants the pledgor the flexibility to alter the encumbered assets, if they are intended to be altered, unless agreed otherwise. The potential consequences of such alteration on the parties' respective rights are subject to the rules governing ownership of movable assets.

According to Article 21 of the Law on Security Interests in Movable Assets, the pledgor may also *"use the encumbered assets freely as part of the normal course of business"*.

The penalty for the incorrect implementation of this right of disposal is as follows: under the terms of Article 22 of the Law on Security Interests in Movable Assets, *"The clause pursuant to which the pledgee can have all or part of the encumbered assets delivered to them on request shall be deemed void"*, however "*if the pledgor is in serious breach of their obligations, the judge may order the assets to be delivered to the pledgee, at the latter's request, or placed in court-ordered receivership*", and in addition *"The fraudulent disposal or removal of the encumbered assets is subject to the penalties provided for in Article 491 of the Belgian Criminal Code"*.

VII. Voluntary enforcement of the guarantee

The guaranteed receivables are understood as the current or future determined or determinable receivables, the maximum amount of which is determined via the pledge agreement, pursuant to Article 10 of the Law on Security Interests in Movable Assets, and which exist at the time when the pledge agreement expires. The possible term of the pledge agreement is determined by Article 11 of the Law on Security Interests in Movable Assets, which specifies that:
"The pledge agreement may be entered into for a limited or indefinite term. If the agreement is entered into for an indefinite term, the pledgor may terminate it in exchange for at least three and at most six months' notice. Unless agreed otherwise, where the pledge agreement ends due to the expiry of the term or via notice, the pledge shall only extend to guaranteeing the receivables that exist at the time when the agreement ends".

In the event that these receivables are settled, Article 36 of the Law on Security Interests in Movable Assets obliges the pledgee "*to ensure that the registration of the pledge is removed".* The same article provides that *"The pledgee and the pledgor may jointly agree to ask the Mortgage Department to remove the registration of the pledge at any time*", and that *"If no agreement can be reached, removal shall be requested via the courts, notwithstanding any potential damages and interest".*

Where the pledge has been made enforceable via dispossession, Article 45 of the Law on Security Interests in Movable Assets provides that *"the pledgor can only demand the return of the pledged asset once they have paid both the principal and ancillary amounts of the liability in exchange for which the asset was pledged as a security in full*".

Article 50 of the Law on Security Interests in Movable Assets confirms the rule in these terms: "*Up until perfection, the pledgor or any interested third party has the right to obtain the release of the pledge in exchange for payment of the guaranteed liability, and of the perfection expenses that have already been mentioned*".

VIII. Enforcement and perfection

The fundamental distinction as to whether the pledgor is a consumer within the meaning of Article 2.3 of the Law of 6 April 2010 regarding Market Practices and Consumer Protection applies in relation to the enforcement and perfection of the pledge.

If the pledgor is a consumer, the perfection process shall be in keeping with the previous legislation, although a distinction will no longer be made between a civil pledge and a commercial pledge: the pledgee may have ownership of the asset assigned to them, or have it sold at auction or privately, in order to settle the guaranteed receivable. The stages of this process are specified in Articles 46, 50, 55, 57 and 58 of the Law on Security Interests in Movable Assets.

In addition, according to the terms of Article 46 of the Law on Security Interests in Movable Assets,
"If the pledgor is a consumer within the meaning of Article 2.3 of the Law of 6 April 2010 regarding Market Practices and Consumer Protection, the pledgee cannot dispose of the pledge in any way, unless payment has been made; otherwise, they shall need to obtain a court order to assign the pledge to them up until the full amount has been paid, according to an estimate drawn up by experts, or it has been sold at auction or privately.
The pledgee is not entitled to act as a purchaser in the event of a private sale.
Any clause that authorises the pledgee to take ownership of the pledge, or to dispose of it without the above formalities shall be void.
Articles 50 and 55 shall apply".

Accordingly, specific binding agreements that are concurrent with pledge agreements remain prohibited, as was already the case pursuant to Article 2078.2 of the Belgian Civil Code.

Article 50 of the Law on Security Interests in Movable Assets authorises the pledgor or any interested third party to obtain the release of the pledge in exchange for payment of the guaranteed liability and of the perfection expenses that have already been mentioned.

Article 55 of the Law on Security Interests in Movable Assets settles the allocation of the perfection proceeds, although it does not set out any specific procedures. The Article specifies that: *"The perfection proceeds shall be deducted from the guaranteed receivable, along with reasonable perfection expenses. If there are several pledgees, the net proceeds shall be shared between them according to their rank, in accordance with Articles 57 and 58".*

The last two articles include rules for conflicts between specific ranks, which remain applicable regardless of whether the procedure involves a pledgor who is a consumer.

If the pledgor is not a consumer, contractual freedom shall prevail, subject to a court-ordered audit performed during or after the perfection process by the enforcement judge.

Pursuant to Article 47 of the Law on Security Interests in Movable Assets, the pledgee may exercise their pledge in accordance with Articles 48 to 56, failing payment, by *"selling or leasing all or part of the assets encumbered by the pledge, in order to settle the guaranteed liability"*.

Even when a Register pledge is involved, it has been provided that "*The pledgee shall be entitled to ownership of the asset encumbered by the pledge following the debtor's default. If the pledgor or any person in possession of the encumbered asset objects, the pledgee must take legal action in accordance with Article 54.*
The perfection must be carried out in good faith and in a way that is financially justified.
The pledgee cannot limit or avoid their liability in this respect.
The responsibility for proving a breach by the pledgee lies with the pledgor.
The parties may agree on the perfection method at the time when the pledge agreement is entered into, or at a later date".

Articles 48 to 54 of the Law on Security Interests in Movable Assets, which arrange the perfection process, provide a few cross-guarantees in order to protect the parties' rights in a balanced manner.

Article 48 of the Law on Security Interests in Movable Assets requires a pledgee who wishes to perfect a pledge "*to give notice at least 10 days in advance (or only three days in advance if the goods are perishable), while Article 49 of the Law on Security Interests in Movable Assets specifies that this notice must be given to the debtor, and to the third-party pledgor, where applicable, by registered letter*", as well as to the other pledgees or creditors who have seized the encumbered assets, where applicable.

The notice must meet requirements regarding its format and contents. It must mention the updated amount of the guaranteed receivable, describe the encumbered assets, specify the planned perfection method, and the right of the debtor or pledgor to release the encumbered assets by settling this guarantee. In fact, Article 50 of the Law on Security Interests in Movable Assets reminds us that "*Up until perfection, the pledgor or any interested third party has the right to obtain the release of the pledge*

in exchange for payment of the guaranteed liability and of the perfection expenses that have already been mentioned".

Article 51 of the Law on Security Interests in Movable Assets offers a wider range of enforcement methods, namely public auction, private sale, and leasing, while the financial income from these transactions will obviously be assigned to settling the guaranteed receivable. Article 52 of the Law on Security Interests in Movable Assets prohibits the pledgee from acting as a buyer in the event of a private sale. Accordingly, this avoids the risk of the asset reverting to the pledgee at a derisory price, leaving the debtor of the guaranteed receivable responsible for an unjustifiably high balance.

However, the pledgor may authorise the pledgee to take ownership of the assets encumbered by the pledge pursuant to Article 53 of the Law on Security Interests in Movable Assets. This agreement may be entered into as soon as the pledge agreement has been signed, or at a later date, as long as the agreement provides that *"the value of the goods shall be determined by an expert on the day ownership is transferred, and in reference to the market price for assets that are traded on a market"*.

The court-ordered audit of all these transactions shall be organised in accordance with Article 54 of the Law on Security Interests in Movable Assets:

"The pledgee, the pledgor and the interested third parties may initiate proceedings at any time in order to obtain a decision on any dispute that may arise as part of the implementation of the perfection process.
The proceedings shall suspend the perfection of the pledge.
The action shall be initiated via a summons or a joint application, in accordance with Articles 1034 bis et seq. of the Belgian Legal Code.
The judge shall rule without delay.
They shall rule on a temporary basis, which means that their ruling shall not have the authority of a final verdict.
Their decision shall not be open to an objection or appeal.
It shall be immediately notified to the parties via a letter from the Court. This notice will mark the beginning of the period for lodging an appeal with the Supreme Court".

Lastly, following the perfection of the pledge, a retrospective audit shall be organised as follows:

"(…) any interested party may take legal action where there is a dispute regarding the perfection method or the allocation of the proceeds.

The proceedings shall be initiated within a period of one year at most as from notice of the end of the perfection process, which shall be given to the persons referred to in Article 48.1 and 48.2 by the pledgor.
Notice shall be given by registered letter.
The action shall be initiated via a summons or a joint application, in accordance with Articles 1034 bis et seq. of the Belgian Legal Code".

The persons referred to in Articles 48.1 and 48.2 are the debtor and the third-party pledgor, where applicable, as well as the other pledgees or creditors who are seizing encumbered assets.

The procedures set out above govern the perfection of a Register pledge as well as the perfection of a pledge with dispossession, subject to two specific features relating to pledges of cash amounts and pledges of receivables.

According to Article 59.3 of the Law on Security Interests in Movable Assets, in the event of a pledged cash amount,
"If the pledgor defaults, the pledgee is authorised to offset the amount against the guaranteed receivable, and must return the balance to the pledgor".

Even as part of this simplified process, nothing prevents the retrospective audit conducted by the enforcement judge being carried out after the offset.

According to Articles 67.1 and 67.2 of the Law on Security Interests in Movable Assets,
"Unless agreed otherwise, the pledgee shall be within their rights to demand execution of the pledged receivable either via the courts or outside the courts.
The pledgee may exercise all rights ancillary to the receivable in this regard.
The pledgee shall deduct the amounts received on the guaranteed receivable where such receivable is due, and shall pay the balance to the pledgor.
If there are several pledgors, the power provided for in Sub-Paragraphs 1 and 2 shall only be available to the highest ranking pledgee.
If the pledged receivable has been the subject of means of execution or a protective attachment, the third-party debtor shall be required to pay the amount to the court bailiff, who shall act in accordance with Articles 1627 et seq. of the Belgian Legal Code.
If the guaranteed receivable is not yet due, the pledgee shall pay the amounts received into a separate bank account opened for this purpose, and shall be required to pay the balance to the pledgor when the guaranteed receivable has been executed".

The cash amounts received under such conditions will not be combined with the pledgee's assets, as payment into a special bank account enables them to be segregated.

Accordingly, the pledge shall not turn into a cash pledge, which leads to perfection via offset. It only enables the deduction of the assets held in this bank account, which are not subject to a right of recourse by the pledgor's creditors, performed when the guaranteed receivable falls due and its non-enforcement has been proven, for the benefit of the separation of assets arranged until the payment date of the receivable encumbered by the pledge [2].

Article 68 of the Law on Security Interests in Movable Assets specifies that:
"If the object of the pledge receivable is the delivery of assets, and if the pledgee recovers the receivable, the pledge shall be transferred to these assets".
The rules to be followed in such situations are the rules applicable to enforcement involving such assets.

IX. Conflicting ranks

Articles 57 and 58 of the Law on Security Interests in Movable Assets include several rules regarding conflicts, both via adjustments to the existing legal or case law solutions, and via the creation of a new ranking.

Following the repeal of Article 20.3 of the Mortgage Act, which granted preferred status to the pledgee – and thereby reaffirmed the preferential right that the latter enjoys in some ways – Article 57.1 of the Law on Security Interests in Movable Assets specifies that the pledgee shall be granted the status of carrier as far as determining their rank is concerned, as referred to in Article 20.7 of the Mortgage Act, while stating that:
"The pledgee shall be paid from the proceeds of the assets encumbered by the pledge ahead of all the creditors (…)".

This principal corresponds to the wording of Article 20.3 of the Mortgage Act, which makes up Title XVIII of Book III of the Belgian Civil Code, and has been repealed by Article 100 (a) of the Law on Security Interests in Movable Assets.

2 E. Dirix, *La réforme des sûretés réelles mobilières*, Kluwer, 2013, p. 39, No. 62.

However, Article 57 of the Law on Security Interests in Movable Assets reserves *"Articles 21 to 26 of Title XVIII of Book III of this Code"*, on the understanding that Articles 24 and 25*bis* are repealed by Article 100 (d) of the Law on Security Interests in Movable Assets. Accordingly, the following provisions of the Mortgage Act still need to be taken into consideration.

Under the terms of Article 21 of the Mortgage Act, *"legal fees shall take precedence over all the receivables in the interest of which they have been incurred"*.

Article 22.1 of the Law on Security Interests in Movable Assets goes further, by stating that: "*expenses incurred in order to protect the item shall take precedence over prior claims*", which actually means that a receivable arising from the fact that protection expenses have been incurred shall take precedence over other preferred receivables, depending on a timing criterion relating to the respective dates when the existing receivables were created, and shall take precedence over a receivable guaranteed by a pledge if it arose before the arrangement of such pledge.

Article 22.2 of the Mortgage Act specifies that expenses incurred in order to protect the asset *"shall take precedence over the claim mentioned in the last three paragraphs of Article 19 in all circumstances"*, namely if we reposition this provision within its timeframe and in light of Article 19.2 of the Mortgage Act, which states that *"The periods mentioned in the three previous paragraphs are those prior to death, divestment or seizure of movable property"*, only the two claims respectively mentioned in Article 19.1.3 of the Mortgage Act, which guarantees *"terminal illness expenses for one year"*, and in Article 19.1.5 of the Mortgage Act, which guarantees *"the supplies and means of subsistence provided to the debtor and their family for six months"*.

Article 23.1 of the Mortgage Act, as amended by Article 92 of the Law on Security Interests in Movable Assets, reads as follows:
"The carrier shall take precedence over the vendor of the movable asset that they are using as a pledge, unless they were aware that the price of the asset was still due when they received it".

Meanwhile, Article 23.2 of the Law on Security Interests in Movable Assets provides as follows, in an identical manner: *"The vendor's claim shall only be exercised after the claim by the owner of the house or farm, unless the vendor informed the landlord that the price had not been paid when transporting the movable property to the leased premises"*.

Article 25 of the Mortgage Act has been amended pursuant to Article 93 of the Law on Security Interests in Movable Assets, and now reads as follows:
"The claim for funeral expenses shall take precedence over all other claims, except for the claim relating to legal costs, the claim relating to the expenses incurred subsequently in order to protect the item, and the carrier's claim, as long as the vendor of the pledged object does not take precedence".

The above provisions have created an inconsistency, which is the result of (i) the fact that Article 57.1 of the Law on Security Interests in Movable Assets assimilates the pledgee with the carrier for the purpose of determining their rank – which results in the pledgee taking precedence over the vendor in the event that they are unaware that the sale price for the re-pledged asset has not been paid – and (ii) the unconditional precedence of the vendor's claim over the pledgee (see above).

Where conflicts between security interests are concerned, Article 57.2 of the Law on Security Interests in Movable Assets logically provides that *"if there are several pledgees, their order of rank shall be determined according to the date of registration or effective possession".*

In keeping with the same thought process, Article 57.3 of the Law on Security Interests in Movable Assets specifies that *"Pledgees who have registered their pledge or obtained possession on the same day shall hold the same rank".*

This so-called *pari passu* principle reflects the prevailing order when dealing with a dispute between mortgage holders, pursuant to Article 81.2 of the Mortgage Act, according to which: *"All the creditors registered on the same day shall jointly exercise a mortgage with the same date, with no distinctions between registration in the morning and registration in the evening, where this difference is noted by the Registrar".*

Lastly, Article 57.3 of the Law on Security Interests in Movable Assets provides that *"If the pledged assets have become immovable, the order of rank between the pledgee and a mortgage holder or preferred creditor in relation to the immovable assets shall be determined according to the date of registration and the date when the mortgage or claim was entered".*

This possibility has long been handled in the same way by case law, since the ruling principle issued by the Belgian Supreme Court on 26 May 1972[3], which specifies that, where movable property that is considered as

3 Pas., 1972, I, 889; J.T., 1972, p. 624; R.W. 1972–1973, p. 295, Note by Dubois.

immovable due to its purpose, and that forms part of business assets has been the subject of both a pledge and the arrangement of a mortgage, the preferred status enjoyed either by the pledgee or by the mortgage holder specifically in terms of being paid from the proceeds of the sale of said movable property shall be determined according to the order of registration.

Such disputes are likely to occur more regularly under the Law on Security Interests in Movable Assets, since the registration technique generalises and simplifies the pledging of movable assets with no dispossession, which encourages their immobilisation both in terms of their purpose and via incorporation. In addition, Article 19 of the Law on Security Interests in Movable Assets removes the obstacle relating to the alteration of the nature of the committed assets, by admitting that, "*The immobilisation of the encumbered assets does not affect the pledgee's right to receive preferential payment from the proceeds of those assets*".

Lastly, under the "*Super-Priority*" heading, Article 58 of the Law on Security Interests in Movable Assets specifies that:
"A pledge based on a right of retention for a receivable incurred to protect the item shall take precedence over all the pledgees.
Subject to Sub-Paragraph 1, an unpaid vendor who has reserved ownership, a preferred vendor and a sub-contractor's claim shall take precedence over the pledgees for these assets".

If we systematically examine each of the assumptions encountered in the aforementioned legal provisions, the solutions to conflicting preferential rights appear as follows:

- conflict between pledgees: precedence is determined based on the timing criterion;
- conflict between a pledgee and a mortgage holder: precedence is determined based on the timing criterion;
- conflict between a pledgee and a preferred creditor relating to legal expenses: the latter shall take precedence in terms of repaying the expenses from which the pledgee has derived a direct and tangible interest;
- conflict between a pledgee and a preferred creditor relating to protection expenses: the latter shall take precedence if a receivable arose prior to the arrangement of the pledge;
- conflict between a pledgee and an unpaid vendor: the latter shall take precedence in terms of payment of the sale price, subject to the pledgee being assimilated to the carrier, which results in only granting

precedence to the latter on condition that they are unaware of the fact that the committed item has not been fully paid for;
- conflict between a pledgee and a preferred creditor relating to funeral expenses: in principle, precedence shall be assigned to the pledgee, except if the dispute involves not only both these creditors but also a vendor, and if the pledgee is aware of the fully or partially unpaid nature of the receivable relating to the price of the encumbered object (see above);
- conflict between the pledgee and the person holding the asset: precedence is determined on the basis of the timing criterion, except if the right to hold the asset guarantees the recovery of the protection expenses, as these expenses enjoy absolute preference;
- conflict between the pledgee and a sub-contractor: the latter shall have precedence;
- conflict between a pledgee and a vendor who benefits from an ownership reservation clause: the latter has precedence where payment of the sale price of the committed object is concerned;
- conflict between a pledgee and a creditor other than the ones referred to above: the pledgee shall have precedence.

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