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Draft legislative guide on secured transactions

Report of the Secretary-General

Addendum

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III. Basic approaches to security

A. General remarks

1. Introduction

1. Over time, a broad variety of practices have been developed in different countries to secure a creditor's claims (usually for monetary payment) against its debtor. It is the purpose of this chapter to provide a broad survey of the various major approaches for affording the creditor effective means of security; the advantages and disadvantages of each approach to both the immediate parties involved, i.e. creditor and debtor, and third parties; and the major policy options for legislators.

2. In general terms, it is possible to distinguish three major types of instruments that are used for the purposes of security. These are, first, instruments designed for and openly denominated as security (see section A.2); second, the recourse to title (ownership) for purposes of security combined with various types of contractual arrangements (see section A.3); and, third, an integrated comprehensive security (see section A.4).

2. Instruments traditionally designed for security

a. Security rights in tangible movable property

3. Traditionally, most countries distinguish between proprietary security rights in tangible movable property ("tangibles"; see section A.2.a) and those in intangible movable property ("intangibles"; see section A.2.b). In fact, the tangible nature of an asset gives rise to forms of security that are not available for intangibles (see paras. 8 and 25-26).

4. With respect to security rights in tangibles, most countries draw a distinction between possessory security (see section A.2.a.i) and non-possessory security (see section A.2.a.ii). Possessory is the security in which the encumbered assets are transferred into the possession of the creditor or a third party. Non-possessory is the security in which the grantor, who is usually the debtor but can also be a third party, granting the security retains possession.

i. Possessory security

(a) Pledge

5. By far the most common (and also ancient) form of possessory security in tangibles is the pledge. A pledge requires for its validity that the grantor effectively give up possession of the encumbered tangibles and that these be transferred either to the secured creditor or to a third party agreed upon by the parties (e.g. a warehouse). The actual holder may also be an agent or trustee who holds the security in the name, or at least for the account, of the creditor or a syndicate of creditors. The required dispossession of the grantor must not only occur at the creation of the security right but it must be maintained during the life of the pledge; return of the encumbered assets to the grantor usually extinguishes the pledge.

6. Dispossession need not always require physical removal of the encumbered assets from the grantor's premises, provided that the grantor's access to them is excluded in other ways. This can be achieved, for example, by handing over the keys to the warehouse in which the encumbered assets are stored to the secured creditor, provided that this excludes any unauthorized access by the grantor.

7. The grantor's dispossession can also be effected by delivering the encumbered assets to, or by using assets that are already held by, a third party. Examples are merchandise or raw materials stored in a warehouse or a tank of a third party. An institutional (and more expensive) arrangement may be involving an independent "warehousing" company, which at the grantor's business premises exercises control over the pledged assets as agent for the secured creditor. For this arrangement to be valid, there cannot be any unauthorized access by the grantor to the warehouse in which the pledged assets are stored. In addition, the warehousing company's employees must not work for the grantor (if they are drawn from the grantor's workforce, because of their expertise, they may no longer work for the grantor).

8. In the case of assets of a special nature, such as documents and instruments (whether or not negotiable), that embody rights in tangible assets (e.g. bills of lading or warehouse receipts) or intangible rights (e.g. negotiable instruments, bonds or share certificates), dispossession is effected by transferring the documents or instruments to the secured creditor. However, in this context, the line between possessory and non-possessory security may not always be easy to draw.

9. In view of the grantor's dispossession, the possessory pledge presents three important advantages for the secured creditor. First, the grantor is unable to dispose of the pledged assets without the secured creditor's consent. Second, the creditor does not run the risk that the actual value of the encumbered assets will be reduced through the grantor neglecting upkeep and maintenance. Third, if enforcement becomes necessary, the secured creditor is saved the trouble, time, expense and risk of having to claim delivery of the encumbered assets from the grantor.

10. Possessory security also has advantages for third parties, especially the grantor's other creditors. The required dispossession of the grantor avoids any risk of creating a false impression of wealth and also minimizes the risk of fraud.

11. On the other hand, the possessory pledge has also major disadvantages. The greatest disadvantage for the grantor is the required dispossession, which precludes the grantor from using the encumbered assets. The disadvantage is acute in situations where possession of the encumbered assets is necessary for commercial grantors to generate the income from which to repay the loan (as is the case, for example, with raw materials, semi-finished goods, equipment and inventory).

12. For the secured creditor, the possessory pledge has the disadvantage that it has to store, preserve and maintain the encumbered assets, unless a third party assumes this task. Where secured creditors themselves are neither able nor willing to assume these tasks, entrusting third parties will involve additional costs that will be directly or indirectly borne by the grantor. Another disadvantage is the potential liability of the secured creditor in possession of encumbered assets (e.g. pledgee, holder of a warehouse warrant or a bill of lading) that might have caused damage. This is a particularly serious problem in the case of liability for contamination of the environment (see chapter IV, paras. … and chapter VII, paras. …).

13. However, where the parties are able to avoid the aforementioned disadvantages (see paras. 11-12), the possessory pledge can be utilized successfully. There are two major fields of application. First, where the encumbered assets are already held by or can easily be brought into the possession of a third party, especially a commercial keeper of other persons' assets. The second field of application is where instruments and documents, embodying tangible assets or intangible rights, can be easily kept by the secured creditor itself.

(b) Right of retention of possession

14. Statutory rights of retention are not discussed since, with few exceptions, statutory rights are outside the scope of this Guide (see A/CN.9/WG.VI/WP.6/Add.1, para. 8). A right of retention created by agreement allows a party whose contractual partner is in breach of contract to withhold its own performance and, in particular, an asset which, under the terms of the contract, the withholding party is obliged to deliver to the party in breach. For example, a bank need not return documents of title, such as bills of lading, or negotiable instruments, such as bills of exchange or promissory notes, it holds for its customer or allow withdrawals from the customer's bank account, if the customer is in default on repayment of a credit and had agreed to grant the bank a right of retention. Where such a right of retention is reinforced by a valid power to sell the retained item, some legal systems regard such a reinforced right of retention as a pledge, although the method of its creation deviates from that of the pledge proper (see paras. 5-8). Alternatively, a reinforced right of retention may be regarded as having some of the effects of a pledge. The most important consequence of such an assimilation to a pledge is that the creditor in possession has a priority in the assets retained, unless they are subject to an earlier created and effective non-possessory security right.

ii. Non-possessory security

15. As noted above (see para. 11), a possessory pledge of tangibles required for production or sale (such as equipment, raw materials, semi-finished goods and inventory) is economically impractical. These goods are necessary for the entrepreneurial activity of commercial grantors. Without access to, and the right and power of disposition over those assets, the grantor would not be able to earn the necessary income to repay the loan. This problem is particularly acute for the growing number of commercial grantors who do not own immovables that can be used as security.

16. To address this problem, laws, especially in the last fifty years, began providing for security in movable assets outside the narrow confines of the possessory pledge. While some countries introduced a new security right encompassing various arrangements serving security purposes, other countries created by legislation non-possessory pledge type of security rights with respect to certain specified assets. Most countries, however, continued the tradition of the nineteenth century (which disregarded an earlier, more liberal attitude) and insisted on the pledge as the only legitimate method of creating security in movable assets. In the twentieth century, legislators and courts in many of those countries have come to acknowledge the urgent economic need to provide for non-possessory security.

17. Individual countries attempted to find appropriate solutions according to particular local needs and in conformity with the general framework of their legal system. The result is a diverse range of solutions. An external indication of the existing diversity is the variety of names for the relevant institutions, sometimes differing even within a single country, such as: "fictive" dispossession of the grantor; non-possessory pledge; registered pledge; *nantissement*; warrant; *hypothèque*; "contractual privilege"; bill of sale; chattel mortgage; and trust. More relevant is the limited scope of application of the approaches taken. Only a few countries have enacted a general statute on non-possessory security (for a more comprehensive approach, see section A.4). Some countries have two sets of legislation on non-possessory security, one dealing with security for financing of industrial and artisan enterprises, the other with security for financing of farming and fishing enterprises. In most countries, however, there is a variety of statutes on non-possessory security, covering only small economic sectors, such as the acquisition of cars or of machinery, or the production of films.

18. In some countries, there is even some reluctance to allow non-possessory security rights in inventory. This is sometimes based upon an alleged inconsistency between the creditor's security right and the grantor's right and power to sell which is indispensable for converting the inventory to cash with which to repay a secured loan. Another reason is that the disposition of inventory will often give rise to difficult conflicts between multiple transferees or multiple secured creditors. Yet another possible reason for not permitting non-possessory security rights in inventory may arise from a policy decision to reserve inventory for the satisfaction of the claims of the grantor's unsecured creditors (see A/CN.9/WG.VI/WP.9/Add.6, para. …).

19. Varied as the legislation providing for non-possessory security might be, it shares one common feature, namely that some form of publicity of the security right is usually provided for. The purpose of publicity is to dispel the false impression of wealth which otherwise may be derived where the security right in assets held by the grantor is not apparent (for a detailed discussion of this matter, see A/CN.9/WG.VI/WP.9/Add.2, paras. …). It is often argued that, in a modern credit economy, parties may assume that assets may be encumbered or may be subject to a retention of title. Such general assumptions, however, are bound to increase the cost of credit, even in cases where the person in possession is the owner and the assets are not encumbered (a risk that can be only partially avoided at the cost of an extensive and costly search). In addition, such assumptions fail to sufficiently protect the secured creditor or other third parties, since they do not reveal the name of the owner or previous secured creditor, the amount secured, or provide information as to the asset encumbered. Furthermore, in a system based on such general assumptions, there is no objective basis for a priority system to rank security rights in the same assets and thus grantors may not be able to use the full value of their assets to obtain credit.

20. There appears to be a need to bridge the gap between the general economic demand for non-possessory security and the often limited access to such security under current law. A major purpose of legal reform in the area of secured transactions is to develop suggestions for improvement in the field of non-possessory security and in the related field of security in intangibles (see section A.2.b).

21. While modern regimes demonstrate that difficulties can be overcome, experience has shown that legislation on non-possessory security is more complicated than the regulation of the traditional possessory pledge. This is due mainly to the following four key characteristics of non-possessory security rights. First, since the grantor retains possession, it has the power to dispose of or create a competing right in the encumbered assets, even against the secured creditor's will. This situation necessitates the introduction of rules concerning the effects and priority of such dispositions (see A/CN.9/WG.VI/WP.9/Add.3 on priority). Second, the secured creditor must ensure that the grantor in possession takes proper care of, duly insures and protects the encumbered assets to preserve their commercial value, matters which must all be addressed in the security agreement between the secured creditor and the debtor (see A/CN.9/WG.VI/WP.9/Add.4 on rights and obligations of parties before default). Third, if enforcement of the security becomes necessary, the secured creditor will usually prefer to obtain the encumbered assets. However, if the grantor is not willing to part with those assets, judicial and extra-judicial proceedings may have to be instituted. Proper remedies and possibly an accelerated proceeding may have to be provided for (see A/CN.9/WG.VI/WP.9/Add.5 on default and enforcement). Fourth, the appearance of false wealth in the grantor which is created by "secret" security rights in assets held by the grantor may have to be counteracted by various forms of publicity. However, in modern credit economies, this problem is of declining importance to the extent that it is commonly known that possession does not imply that the person in possession is the owner or that the asset is unencumbered (this, however, has a cost; see para. 19) or to the extent that security rights are subject to publicity (see A/CN.9/WG.VI/WP.9/Add.2 on publicity).

22. In light of the generally recognized economic need for allowing non-possessory security and the basic differences between possessory and non-possessory security mentioned above (see para. 21), new legislation will be necessary in many countries.

23. In view of earlier legislative models (see paras. 16-19), legislators may be faced with three alternatives. One alternative may be to adopt integrated legislation for both possessory and non-possessory security rights (see section A.4). This is the well-considered approach of the Model Inter-American Law on Secured Transactions, adopted in February 2002. Another alternative may be to adopt integrated legislation for non-possessory security rights, leaving the regime on possessory rights to other domestic law. Yet another alternative may be to adopt special legislation allowing non-possessory security for credit to debtors in specific branches of business. The prevailing trend of modern legislation, both at the national and the international level, is towards an integrated approach at least as far as non-possessory security is concerned. A selective regulation of specific types of non-possessory security rights is likely to result in gaps, overlaps, inconsistencies and lack of transparency, as well as in discontent in those sectors of the industry that might be excluded. In addition, such selective regulation makes it more difficult to address conflicts of priority between possessory and non-possessory security rights.

b. Security rights in intangible movable property

24. Intangibles comprise a broad variety of rights (e.g. right to the payment of money or the performance of other contractual obligation, such as the delivery of oil

under a production contract). They include some relatively new types of asset (e.g. uncertificated securities, held indirectly through an intermediary) and intellectual property rights (i.e. patents, trade marks and copyrights). In view of the dramatic increase in the economic importance of intangibles in recent years, there is a growing demand to use these rights as assets for security. Intangibles, such as receivables and intellectual property rights, are often part of inventory or equipment financing transactions, and form often the main value of the security is in those intangibles. Furthermore, intangibles may be proceeds of inventory or equipment. This Guide does not deal with securities, since they raise a whole range of issues requiring special treatment and these issues are addressed in texts being prepared by the International Institute for the Unification of Private Law (UNIDROIT) and the Hague Conference on Private International Law. The Guide does, however, discuss security in receivables, i.e. rights to claim payment of money, and rights to claim performance of non-monetary contractual obligations, as well as security in other types of intangibles as proceeds of tangibles or receivables.

25. By definition, intangibles are incapable of (physical) possession. Nevertheless, most codes of the so-called "civil law" countries have dealt with the creation of possessory pledges (see paras. 5-13) at least in monetary claims. Some codes have attempted to create the semblance of dispossession by requiring the grantor to transfer any writing or document relating to the pledged claim (such as the contract from which the claim was derived) to the creditor. However, such transfer does not suffice to constitute the pledge. Rather, the grantor's "dispossession" is, in many countries, replaced (quite artificially) by requiring that a notice of the pledge be given to the grantor of the pledged claim.

26. In some countries, techniques have been developed that achieve ends comparable to those attained by the possession of tangibles. The most radical method is the full transfer of the encumbered right (or the encumbered share of it) to the secured creditor. However, this goes beyond creation of a security right and amounts to transfer of title (see section A.3.a). Under a more restrained approach, title to the encumbered rights is not affected but dispositions by the grantor that are not authorized by the secured creditor are blocked. In the case of a bank account, if the grantor (the creditor of the encumbered account) as holder of the account agrees that its account can be blocked in favour of the secured creditor, the latter has the equivalent of possession of a tangible movable. That is even more true if the bank itself is the secured creditor.

27. In modern terminology, such techniques of obtaining "possession" of intangible property are appropriately called "control". The degree of control though may vary. In some cases, the control is absolute and any disposition by the grantor is prevented. In other cases, the grantor is allowed to make certain dispositions or dispositions up to a fixed maximum, as long as the secured creditor has access to the account. Control may be a condition for the validity of a security right (see A/CN.9/WG.VI/WP.6/Add.3, paras. 66 and 68) or priority (see A/CN.9/WG.VI/WP.9/Add.3, para. …).

28. In the context of efforts to create comprehensive regimes for non-possessory security in tangibles (see section A.2.a), it is common for security in the most important types of intangibles (e.g. receivables) to be integrated into the same legal regime. This serves consistency since the sale of inventory results, as a rule, in receivables and it is often desirable to extend the security in inventory to the

resulting proceeds. The publicity system used for security in tangibles can perform its salutary functions (for details, see A.CN.9/WG.VI/WP.9/Add.2 on publicity) for security in intangibles, such as receivables, as well. This may have the additional benefit of dispensing with notification of the debtor of encumbered receivables, which in certain security transactions involving a pool of assets that are not specifically identified may not be feasible. Even if such notification is feasible, it may not be desirable (e.g. for reasons of cost or confidentiality).

3. The use of title for security purposes

29. In addition to instruments for security proper (see section A.2), practice and sometimes also legislation has in many countries developed an alternative approach for non-possessory security rights in both tangible and intangible assets, namely title (or ownership) as security (*propriété sûreté*). Title as security can be created either by transfer of title to the creditor (see section A.3.a) or by retention of title by the creditor (see section A.3.b). Both transfer and retention of title enable the creditor to obtain non-possessory security (for the economic need for, and justification of, non-possessory security, see para. 15).

a. Transfer of title to the creditor

30. In the absence of a regime of non-possessory security rights, or to fill gaps or address impediments, courts and legislators in some countries have taken recourse to transfer of title of the assets to the secured creditor.

31. There are two features that make the security transfer of title attractive for creditors in certain jurisdictions. First, the formal and substantive requirements for transferring title in tangibles or intangibles to another person are often less onerous and, therefore, less costly than the requirements for creating a security right. Second, in the case of enforcement and in the debtor's insolvency, a creditor often has a better position as an owner than as a holder of a mere security right, especially where the owner's assets, although in the grantor's possession, do not belong to the insolvency estate whereas the grantor's assets, if merely encumbered by a security right for the creditor, are part of the estate. In other jurisdictions though the formal difference between title for security purposes and security rights with respect to the requirements for creation or enforcement has been levelled to the extent that title devices are subject to the same creation requirements as security rights proper. In yet other jurisdictions, security transfers are subject to the rules applicable to transfers of title while, in the case of enforcement and insolvency, they are treated as security devices.

32. The security transfer of title has been allowed by law in some countries and by court practice in other countries. In some countries, its creation is subject to the less demanding rules governing transfers of title and it has the effect of a full transfer of title. In other countries, its creation is subject to the more cumbersome rules governing security rights and it has only the effect of a secured transaction. In yet other countries, especially from the civil law world, such transfers of title are regarded as a circumvention of the ordinary regime of security instruments proper and are, therefore, held to be void. In countries with a comprehensive and workable regime for non-possessory security, transfer of title is available but is treated as a security device (see section 4). This means that its creation, publicity, priority and enforcement is subject to the same requirements applicable to security rights (in the

case of insolvency, the assets are part of the estate; see A/CN.9/WG.VI/WP.9/Add.6, para. …).

33. Legislators are faced with two policy options. One option is to admit security transfers of title with the (usually) reduced requirements and the greater effects of a full transfer (in the case of insolvency, the assets are not part of the estate; see A/CN.9/WG.VI/WP.9/Add.6, para. 11), thus avoiding the general regime for security rights. This option results in enhancing the secured creditor's position (although at the risk of increasing the liability of the creditor, see chapter IV, para. …), while weakening the position of the grantor and the grantor's other creditors. This solution may make sense if the ordinary security regime for non-possessory security is underdeveloped.

34. The other option is to admit security transfers of title, but to limit either the requirements or the effects or both to those of a mere security right. Under the second option, a graduated reduction of the secured creditor's advantages and of the other parties' corresponding disadvantages is possible, especially if the requirements of a transfer or its effects or both are limited to those relating to a security right. This is the approach followed in countries with an integrated, comprehensive security regime, in which transfer of title is available but is subject to the same rules governing security rights (see section 4).

b. Retention of title by the creditor

35. The second method of using title as security occurs in the context of what is often called "purchase money financing" (see description and example in A/CN.9/WG.VI/WP.6/Add.1, paras. 16-19) and is effected by contractual retention of title (reservation of ownership). The seller or other lender of the money necessary to purchase tangible or even intangible assets may retain title until full payment of the purchase price (a simple retention of title arrangement).

36. In some countries, simple retention of title arrangements may be varied through various clauses, including: "all monies" or "current account" clauses, in which the seller retains title until all debts owing from the buyer have been discharged and not just those arising from the particular contract of sale; and proceeds and products clauses, in which title is extended to the proceeds and the products of the assets in which the seller retained title.

37. An alternative to a retention of title arrangement with the same economic result is achieved by combining a lease contract with an option to purchase for the lessee (for a nominal value), which may only be exercised after the lessee has paid most of the "purchase price" through rent instalments (see example in A/CN.9/WG.VI/WP.6/Add.1, para. 20). In some cases, where the lease covers the useful life of equipment, it is equivalent to a retention-of-title arrangement even without an option to buy. In the following paragraphs, at least with respect to leases that serve a security function, the term "seller" covers also the term "lessor", and the term "buyer" covers the term "lessee".

38. Economically, a retention of title arrangement provides a security right which is particularly well adapted to the needs of, and therefore is widely used by, sellers for securing purchase money credit. In many countries, this kind of credit, which is typically made available by suppliers, is widely used as an alternative to general bank financing and is given preferential status in view of the importance of small-

and medium-size suppliers for the economy. In other countries, banks also provide on a more regular basis purchase money financing, for example, where the seller sells to a bank and the bank sells to buyer with a retention of title or where the buyer pays the seller in cash from a loan and transfers title to the bank as security for the loan. In those countries, this source of credit and its attendant specific security is given special attention.

39. Due to its origin as a term of a contract of sale or lease, many countries regard the retention of title arrangement as a mere quasi-security, and, therefore, not subject to the general rules on security, such as requirements of form, publicity or effects (principally priority). Further advantages are that it can be created in a cost-effective way since, in many countries, it is not subject to publicity. It is also well suited to short-term financing and, in some countries, it gives rise to a proprietary right of the buyer. In countries that permit the creation of non-possessory rights only in certain types of assets, but not in inventory, retention of title is used for inventory financing. Another advantage is that the seller retaining title has, in many countries, a privileged status. This may be justified by the desire to support normally small- and medium-size suppliers and to promote purchase money financing by suppliers as an alternative to general bank credit. This privileged status may also be justified by the fact that the seller, by parting with the sold goods without having received payment, increases the grantor's pool of assets and requires protection.

40. At the same time, retention of title arrangements presents certain disadvantages. The position of the buyer and the buyer's creditors is weakened and, in the absence of publicity, third parties have to rely on the buyer's representations or take the time and cost so as to collect information from other sources. Another disadvantage is that it may prevent or, at least, impede the buyer from using the purchased assets for granting a second-ranking security to another creditor. Yet another disadvantage is that enforcement by the buyer's other creditors is impossible or difficult without the seller's consent. For these reasons, in some countries, retention of title arrangements are treated in the same way as security rights in every respect, while, in other countries, they are treated as security rights in some but not in all respects (e.g. they are subject to publicity but they are given a special priority status). In yet other countries, retention of title clauses are ineffective as against third parties in general or only if they relate to certain assets, especially inventory, on the theory that the seller's retention of title is incompatible with the seller granting to the buyer the right and power of disposition over the inventory.

41. Several policy options may be considered. One option is to preserve the special character of the retention of title arrangement as a title device. Under such an approach, retention of title would not be subject to any form requirement or publicity. It could secure claims other than the purchase price and be extended to products and proceeds of the asset in which it is created. The seller could, in the case of non-payment of the outstanding price, reclaim the assets from the buyer and dispose of them as the owner, without having to account to the buyer, except for any parts of the purchase price paid). Similarly, if the buyer becomes insolvent, the insolvency administrator would have to pay the outstanding purchase price to obtain title. If the insolvency administrator chooses not to pay, the seller could reclaim the assets as the owner or insist on payment of the outstanding purchase price (see A/CN.9/WG.VI/WP.9/Add.6, para. …). Another, slightly different option would be

to preserve the special character of the retention of title arrangement but to limit its effect to: securing only the purchase price of the respective asset to the exclusion of any other credit; and to restricting it to the purchased asset to the exclusion of proceeds or products.

42. Yet another option might be to integrate the retention of title arrangement into the ordinary system of security rights. In such a case, the creation, publicity, priority and enforcement, even in the buyer's insolvency (see A/CN.9/WG.VI/WP.9/Add.6, para. …), of a retention of title arrangement would be subject to the same rules applicable to non-possessory security rights. Under such an approach, for the policy reasons mentioned above (see para. 38), it would be possible to grant the seller certain advantages (e.g. priority as of the time of the conclusion of the sales contract in which the retention of title was contained or as of the time of delivery of the goods). Yet another option might be to place the retention of title fully on a par with any other non-possessory security (i.e. without granting the seller any privileges).

43. The first two options mentioned above (see para. 41) would preserve or create a special regime for retention of title outside a comprehensive system of non-possessory security rights. Retention of title arrangements would be implemented by special clauses in sales contracts and the seller would have a privileged position as against the buyer's creditors in the case of enforcement actions or the buyer's insolvency. In particular, the first option provides the seller (or other purchase money financier) with extensive privileges, a result that has consequential disadvantages for competing creditors of the buyer, especially in the case of enforcement and insolvency. In the absence of any publicity requirement, however, potential creditors would have to factor into their credit terms the risk of assets offered to them as security being subject to a retention of title arrangement, a result that could have a negative impact on the availability and the cost of credit.

44. The last two options mentioned above (see para. 42) are more in line with a comprehensive system of security rights. For the purposes of such secured transaction legislation, retention of title would be treated as a security device. For the purposes of other legislation (e.g. taxation law), retention of title could preserve its character as a title device. The first option, in particular, recognizes that the seller selling on credit deserves a certain privileged position (e.g. may have priority as of the time the relevant sales transaction is concluded), since it parts with the sold goods and sales on credit terms should be promoted for economic reasons (i.e. increased trade and economic growth). On the other hand, in the interest of competing creditors, the statutory privilege could be limited to the purchase price for the specific asset and to the sold goods as such. For the same reason, rights in proceeds or products of the purchased goods, or sums owing from the buyer other than those arising from the particular contract of sale with a retention of title clause, would not enjoy such a privilege and would be subject to the rules applicable to ordinary security rights (e.g. have priority as of the time the relevant transaction is registered).

45. Converting retention of title to a security right for the purpose of secured transactions legislation would enhance the position of the buyer since the buyer would be enabled to create a second-ranking (non-possessory) security right to secure a loan from another creditor. It could also improve the position of other creditors of the buyer in the case of enforcement with respect to the encumbered asset and in the case of the buyer's insolvency. The supplier's position would not

necessarily be weakened, at least, to the extent that retention of title clauses would enjoy a privileged position with respect to priority (with a few exceptions, in principle only simple retention of title enjoys a privilege). The supplier's position would not change in the case of the buyer's insolvency since, whether or not the retention of title is assimilated to a security right, the supplier is protected (see A/CN.9/WG.VI/WP.9/Add.6, para. …). However, the supplier would need to register (see A/CN.9/WG.VI/WP.9/Add.3, para. …), and "all sums" clauses, proceeds and products would enjoy priority only as of the time of their registration.

4. Integrated comprehensive security

46. The institution of a single, integrated, comprehensive security right in all types of movable property is inspired by the observation that the different types of non-possessory security rights but also the traditional possessory pledge are all based upon a few identical guiding principles. The main theme is that substance must prevail over form. It is no accident that this idea first developed in federal states, such as the United States of America and Canada. Thus the American Uniform Commercial Code ("UCC"). The UCC, a model law adopted by all fifty states, created a single, comprehensive security right in movables unifying numerous and diverse possessory and non-possessory rights in tangibles and intangibles, including transfer and retention of title arrangements, that existed under state statutes and common law. The idea spread to Canada, New Zealand and a few other countries. The Inter-American Model Law on Secured Transactions follows in many respects a similar approach. The EBRD Model Law follows a similar approach to the extent it creates a specific "security interest" which can work side by side with other security devices (e.g. leasing) and recharacterizes retention of title as a security right.

47. An integrated comprehensive security system presents certain advantages. First, all relevant (which are often great in number) statutes dealing with non-possessory security rights may be merged into one text which ensures comprehensiveness and consistency of the rules. Second, the rules on possessory security rights, especially the possessory pledge may be covered and at the same time adapted to contemporary requirements (e.g. by introducing the notion of control). Third, title devices such as the security transfer and the retention of title may be integrated into the system. Fourth, contractual arrangements that fulfil a security function, such as leasing contracts, sale and resale, may also be included and covered.

48. Consistency is generally desirable with respect to the security transfer of title and the security assignment of receivables. More controversial may be the integration of the retention of title to the extent it is aimed at favouring suppliers' credit as an alternative to general bank credit. However, these policy objectives may be achieved even in the context of an integrated comprehensive regime through special rules governing the creation, publicity, priority, enforcement and status in the case of insolvency (or any of these aspects) of a retention of title arrangement.

49. The main feature of a broad approach is that substance prevails over form in order to make available to parties all possible forms of security for credit. While this approach may require recharacterization of certain transactions (e.g. transfer of title for security purposes or retention of title), at least for the purpose of secured transactions laws, is to the benefit of grantors, secured creditors and third parties, including the insolvency representative in the grantor's insolvency. Otherwise,

parties could evade publicity requirements and invoke remedies that would give them an undue advantage over other secured creditors.

50. In addition, under this approach, a creditor who envisages granting a secured loan, need not investigate various alternative security devices and evaluate their respective prerequisites and limits as well as advantages and disadvantages. Correspondingly, the burden borne by the grantor's creditors or the insolvency representative for the grantor who must consider their rights (and duties), vis-à-vis the secured creditor is lessened if only one regime, characterized by a comprehensive security right, has to be examined rather than several different regimes. Further, this will reduce the cost of creating security and, concomitantly, the cost of the secured credit.

51. In cross-border situations, the recognition of security rights created in another jurisdiction will also be facilitated if the jurisdiction of the new location of encumbered assets has a comprehensive security right. Such a system can much more easily accept a broad variety of foreign security rights, whether of a narrow or an equally comprehensive character.

52. Technically, two approaches can be used to achieve an integrated and comprehensive security right. Under one approach, the names of the old security devices, such as transfer of title, may be preserved and used. However, their creation and effects as security rights are made subject to an integrated set of rules, while they may continue to have their full title effects for other purposes (e.g, taxation or accounting). Under a slightly different approach, the rules applicable to certain basic types of contract that may be used for purposes of security, such as sales, leases or assignments, are supplemented by a general clause providing that, if a sale or lease is used for the purpose of securing claims, certain specified additional rules apply (e.g. with respect to publicity or enforcement). There is no substantive difference between the two approaches with respect to the effects they attribute to security rights.

B. Summary and recommendations

53. In certain, albeit limited, practical situations, the possessory pledge functions usefully as a strong security right (see para. 13).

54. A right of retention of possession created by agreement, if accompanied by the creditor's power of sale, functions as a possessory pledge (see para. 14).

55. Non-possessory security rights are of utmost importance for a modern and efficient regime of secured transactions. Grantors need to retain possession of encumbered assets and secured creditors need to be protected against competing claims in the case of grantor default and in particular insolvency (see para. 15).

56. In light of the growing importance of intangibles as security for credit and the often insufficient rules applicable to this type of asset, it would be desirable to develop a modern legal regime for security in intangibles. Such a regime should be as close as possible to that for non-possessory security rights in tangibles, since: often security is taken over the entirety of a debtor's assets, including both tangibles and intangibles; in the context of transactions relating to security in tangibles (e.g. inventory or equipment financing), security may be taken over intangibles

(e.g. intellectual property rights); and intangibles may be proceeds of tangibles. In particular with respect to receivables, the principles of the United Nations Assignment Convention (e.g. assignability of future receivables, validity of bulk assignments and assignments made despite contractual limitations on assignment, debtor protection) should be used as the standard to be followed. As to security rights in excluded intangibles, such as securities, reference could be made to the work of other organizations.

57. With respect to title devices, such as security transfer and retention of title of tangible assets, as well as security assignment of claims and other intangibles, there are two alternatives.

58. Under the first alternative, if a country chooses to adopt a comprehensive security system, subject to certain exceptions, the rules applicable to security rights would apply to title devices as well. Exceptions could refer to a special priority in favour of a supplier (or even a bank financing the purchase of an asset) with a retention of title, possibly subject, in certain cases, to a notice to creditors on the public record (see A/CN.9/WG.VI/WP.9/Add.3, paras. …).

59. Under the second alternative, if a country has already a developed legal regime for title devices but not for non-possessory security and does not wish to follow an integrated comprehensive approach, two separate systems could be envisaged, one for non-possessory security and another for title devices. Under such an approach, the creation of title devices would be subject to the currently existing rules. No publicity would be required, except with respect to assets for which registration is foreseen in currently existing legislation (e.g ships and aircraft). In the absence of any publicity requirement, however, potential creditors would have to factor the risk of the existence of a retention of title arrangement in their credit terms, a result that may negatively affect the availability and the cost of credit (see para. 43).

60. As to enforcement of a retention of title arrangement, under this alternative, the seller would be able to reclaim the assets from the buyer and to dispose of them as the owner, without having to account to the buyer (except for repayment of any parts of the purchase price paid). In the case of the buyer's insolvency, the insolvency administrator would have to pay the outstanding purchase price to obtain title. If the insolvency administrator chooses not to pay, the seller could reclaim the assets as the owner or insist as a general creditor on the payment of the outstanding purchase price (see para. 41).

61. In the case of enforcement of a security transfer of title under this alternative, at least two approaches are possible since, even in countries that do not follow an integrated comprehensive approach, transfer of title is usually treated either as a title device or as a security device (see para. 32). Where it is treated as a title device, the transferee may enforce its claim as the owner and does not need to account to the transferor for any surplus remaining after disposition of the encumbered assets and satisfaction of the transferee's claim. In the case of insolvency, the assets are not part of the estate but the insolvency administrator may exercise any related contractual rights. Where security transfer of title is treated as a security device, the creditor, after a public or private sale of the transferred assets and satisfaction of the claim secured, has to account for any surplus. In the case of insolvency, the assets are part of the estate and are treated as being subject to a security right (see paras. 33-34). A combination of these two approaches (in which security transfers

are treated with respect to creation and certain effects as transfers of title, while with respect to enforcement and insolvency they are treated as security devices) is also possible.

62. There are good reasons for replacing a regime of security rights consisting of a variety of specific security devices by a regime providing for an integrated, comprehensive security right (see paras. 46-52).