II. INTERNATIONAL PAYMENTS

A. Report of the Secretary-General: study on security interests (A/CN.9/131)*

1. At its third session the Commission requested the Secretary-General to make a study of the law of security interests in the principal legal systems.[1] At the request of the Secretary-General, this study was prepared by Professor Ulrich Drobnig of the Max Planck-Institut für Ausländisches und Internationales Privatrecht (Max Planck Institute for Foreign and Private International Law) of the Federal Republic of Germany. It was presented to the Commission at its eighth session.[2]

2. During the discussion of the study at it eighth session the Commission noted that it did not include references to the law of security interests in socialist countries and requested that it be completed by including such references.[3] Furthermore, it was requested that, because of its importance, the study, which had appeared in English only, be published in all the languages of the Commission.

3. In conformity with the request of the Commission, references to the law in socialist countries have been added. One other minor change has been made to indicate a recent change in the law in the United States of America in respect of security interests in railroad rolling stock.[4] Otherwise the study is reproduced in the annex hereto as it was originally prepared by Professor Drobnig.

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* 15 February 1977.

[1] Yearbook . . . , 1968-1970, part two, III, A, document A/8017, para. 145.

[2] International Payments: Study on Security Interests, ST/LEG/11.

[3] *Official Records of the General Assembly, Thirtieth Session, Supplement* No. 17 (A/10017), para. 63. (Yearbook . . . , 1975, part one, II, 1).

[4] See section 2.5.3.3 of the study.

ANNEX

Legal principles governing security interests

CONTENTS

CONTENTS (*continued*)

1. Preface

1.1 *The assignment*

The Secretariat of the United Nations Commission on International Trade Law (UNCITRAL) has requested me to submit a study on the legal principles governing security interests in the various legal systems of the world, with special reference to those aspects which have particular relevance for international trade. I have been asked to take existing studies in this area into account and to make use of replies given by 19 Governments in response to a request for information prepared by UNCITRAL.

The conclusions of this study may serve to promote international trade law at two different levels. They may be used in the first place to suggest possible improvements in the rules of individual national systems—perhaps by the elaboration of one or more model laws. But the study may also help to consider the necessity or desirability of framing rules in this field on an international level, especially for the international movement of goods subject to security interests.

1.2 *Scope of study*

Since a study of comprehensive and all-embracing scope was neither feasible nor intended, a number of limitations have had to be made as regards the subject-matter, and the geographical scope of legal systems covered.

(*a*) As regards the subject-matter, the study deals almost exclusively with *non-possessory security interests*. This limitation is justified by the fact that under present-day conditions such a security is by far the most important, especially in international trade relations (see *infra* 2.1.1).

However, non-possessory security interests affecting ships and aircrafts have been excluded because these, to some extent, have already been unified by certain international conventions.

Also excluded from consideration are the special rules relating to instalment sales. These do not, in general, relate to transactions between merchants—or are otherwise inapplicable to mercantile transactions because of a maximum limit as to the purchase price. Moreover, they affect primarily the contract of sale rather than any security aspect that may also be involved.

Even within the remaining vast field further limitations have had to be made. Thus only those issues have been emphasized which comprise, in the view of the author, the key problems for the elaboration of improved national laws or international rules.

(*b*) Because of the limited time at my disposal it became necessary to use *legislative material* as the primary source of information regarding individual legal systems. I have attempted, where practicable, to check this material as to its practical application. Indeed, the replies given by the various Governments to the UNCITRAL questionnaire rely mainly on this source, mostly even omitting any reference to special provisions.

Existing studies on security devices proved, contrary to earlier expectations, to be of little assistance since only a very few exist and these, moreover, are of limited coverage. Inevitably therefore much more reliance has had to be placed on primary sources of legislation than had originally been envisaged.

(*c*) *Geographically*, an attempt has been made to cover all material which seemed worthy of note, wherever to be found. Special emphasis has been placed on the more important legal systems of Europe, the Americas and Australia; unfortunately material from the other continents has not proved easy of access.

2. National systems of security interests

2.1 *Introduction*

2.1.1 *Major types of security interests covered*

Despite the innumerable variations in security interests existing in the various countries of the world, a basic distinction may be discerned virtually everywhere between possessory and non-possessory security interests. These terms describe respectively whether possession of the encumbered property is or is not passed to the *creditor*.

2.1.1.1 *Possessory security interests*

The most typical possessory security interest in the *pledge*, which probably exists in all countries of the world. It is based upon an agreement between debtor and creditor. Possessory security interests may also arise by operation of law. We shall deal with statutory *liens* and statutory rights of *retention* only incidentally.

Under the traditional rules of pledge, the debtor hands over the goods to be encumbered, either to the creditor himself or to a third person who holds them for the creditor, the debtor retaining ownership in the goods. The transfer by the debtor of possession of the goods pledged is justified by two major considerations: firstly, it protects the secured creditor against unauthorized dispositions by the debtor of the goods encumbered; secondly, it protects third persons, especially other (existing or potential) creditors of the debtor, against erroneous assumptions as to the extent of property owned by the debtor and thus (indirectly) as to his ability to pay.

The practical importance of possessory security interests, especially the pledge, has, for decades, been steadily decreasing. In a purely commercial context (where both the creditor and the debtor are merchants), one will find today only a few exceptional situations in which the pledge is still being used as security. The most important of these is in sales against documents; it is also employed when valuables are used as security (see *infra* 2.2.2).

Apart from these special situations, the fundamental drawback of possessory security interests is the requirement of handing over the goods encumbered. The primary disadvantage falls upon the debtor, who is normally the owner of such goods, since these goods are often indispensable to his business, as equipment, raw materials or merchandise. If the debtor is not able to use, and/or dispose of, these objects, his ability to repay the credit granted will be seriously impaired.

But also the secured creditor will usually be unwilling or unable to receive and store the debtor's equipment, raw materials or merchandise. These practical drawbacks of the pledge have led to the development of a wide variety of non-possessory security interests.

2.1.1.2 *Non-possessory security interests*

During the last 100 years, an amazingly broad spectrum of non-possessory security interests has been developed the world over. Both the practical results that can be achieved with these devices as well as the juridical mould into which they are cast, vary not only from country to country, but often even within one and the same country.

While the more important substantive rules and their practical effects will be discussed in detail later (*infra* 2.3), the major differences in construction and the relative weight to be accorded to each will be pointed out forthwith.

2.1.2 *Differences of legal construction*

If we survey the whole range of security interests, possessory and non-possessory, from the viewpoint of their juridical construction, the great variety of very different institutions can be reduced to a very few basic models. These basic patterns in conceiving of a security interest often recur under quite varied guises. The four basic models are pledge, mortgage, ownership and privilege.

2.1.2.1 *Pledge*

The pledge as the prototype possessory security interest arising from a contract between debtor and creditor is so universal and familiar as not to require further analysis at this point (see *supra* 2.1.1.1). It is most remarkable that the central element of pledge, the handing over of possession by the debtor, has, in essence, withstood all attacks.

It may be mentioned, though, that by means of certain special devices the pledge has been adapted to a few non-possessory

situations. Austria and some South American countries (such as Brazil and Panama) allow a so-called "*symbolical handing over*". This is limited in Austria to heavy equipment and similar objects whose physical delivery would be very difficult; no comparable restriction seems to exist in the aforementioned South American countries. In some Eastern European countries the pledge may be non-possessory if specifically stated in a special statute or in the contract (USSR) or if it is in favour of a specific credit institution (Hungary). Another example is the (former) American *field-warehousing* system where the encumbered goods remain on the debtor's premises, although guarded by a detached employee of the secured creditor. A third and most common exception is the pledging of *goods represented by a document* where only the document is handed over by the debtor, while the goods themselves remain in his possession. These examples show that the pledge in certain cases no longer fits the description of a possessory security interest. In marginal situations it may serve practically as a non-possessory security interest.

2.1.2.2 *Mortgage*

The real estate mortgage, a non-possessory security interest in immovables, has served in several countries as a model for developing a non-possessory security interest in movables. Terms such as the American "chattel mortgage" or the Spanish "*hipoteca mobiliaria*" demonstrate the attractive influence exerted by the real estate mortgage. More telling than the similarity in terminology are the substantive and formal analogies derived from the real estate mortgage. The most significant is the idea that the protection of third persons requires publicity of chattel mortgages and that this should be organized along the lines of the real estate mortgage recording system.

Although a general analogy to the real estate mortgage would appear to be a particularly fruitful starting point for the development of a non-possessory security interest in movables, only a relatively small number of countries have taken this direct approach. One of these countries is the United States where the chattel mortgage was used for many years before being absorbed by the unitary "security interest" of the Uniform Commercial Code. Another such group of countries includes Spain and the Spanish speaking countries of Latin America. In these States, the "*hipoteca mobiliaria*" and the "*prenda con registro*", respectively, have been very well developed by relatively recent legislation and play dominant roles as instruments of security.

Typically, mortgages of movables serve to secure advances made by lenders of money such as banks, mainly in those countries where sellers on credit have at their disposal other special security devices, such as the reservation of title or hire-purchase. Where, on the other hand, this "division of labour" does not exist (as in France and some South American countries), the mortgage is also used to secure the seller's purchase-price for the goods sold.

The mortgage is adapted and applied to movables may be called the only "full" non-possessory security interest in movable goods. In some countries, however, two other forms of non-possessory security interest, in fact, play a much more important role than the mortgage. One of these is ownership, the other privilege.

2.1.2.3 *Ownership*

The practical importance to be attributed to ownership as a tool for developing non-possessory security interests can hardly be overestimated. The use (or abuse) of ownership as a driving force for developing modern forms of security would make fascinating reading for a student of modern legal history as well as for an astute observer of contemporary practices in the field of secured financing.

In sharp contrast to this modern practice, some legal systems and a number of writers tend to negate the functional use of ownership for security purposes on the ground that ownership is outside the traditional categories of security interests. Even a recent *comparative* study of security interests in Europe has not hesitated to exclude on this ground all proprietary devices from its purview.

Conseil de l'Europe, *Aspects internationaux de la protection juridique des droits des créanciers* (cited as "French Study"), 47.

This would seem to be an unacceptable formalism. The paramount consideration both for a comparative study and in any attempt at regulation of security interests must be the functional uses to which different legal institutions are put. The legal character of these institutions must remain irrelevant to a proper delimitation. This working hypothesis is fully borne out by the conclusion which Goode and Ziegel have reached in their conceptual analysis of hire purchase, conditional sales and mortgages.

> "It is to be hoped that the title concept which remains so firmly embedded in the laws of the Commonwealth countries, and which is largely responsible for the anomalous differences in legal effect between one security device and another although both may have been intended to achieve the same result, will in due course be abandoned in favour of the functional approach embodied in the Code" (art. 9 of the American Uniform Commercial Code). Goode and Ziegel, *Hire-Purchase and Conditional Sale,* 146.

Recourse to ownership as a means of security is had in different forms.

The most famous is the *reservation of ownership* (retention of title, conditional sale, etc.). It was first used by sellers who allowed their buyers time to pay the purchase price, securing this credit by retaining title in the goods. This reservation of ownership appears to be most natural since it is but a modification of an ordinary contract of sale under which a buyer pays upon receipt of the merchandise and the seller simultaneously transfers title to the buyer.

While originally limited to the seller financing his own sales, reservation of ownership is today extended in many countries to sales financed by third parties.

Another form of secured financing of sales utilizes ownership in the form of *hire-purchase* (*location-vente*, etc.). A seller who sells on credit leases the goods to a person who intends to purchase them. The prospective purchaser receives possession of the goods and is obliged to pay hire charges (in practice a sum constituting the instalments of the purchase-price) to the seller/lessor. Upon completion of these payments, the hirer either receives, or has an option to call for, title to the goods.

This method is also easily adaptable to secured financing of sales by third parties.

Under certain circumstances, financed *leasing* may be viewed as a modern variation of hire-purchase.

A third major form of security through ownership is represented by the "*security transfer of ownership*" which has been developed in a few countries after the German "*Sicherungsübereignung*" model. The English bill of sale, the Mexican use of the "*fideo comiso*" and perhaps also the Anglo-American trust receipt are equivalent devices, as was the American chattel mortgage before it came to be regarded as a mortgage proper. The security transfer of ownership is typically used to secure loans. The debtor transfers to the creditor title, but not possession, of the goods to be encumbered. The creditor retains title until the secured credit is repaid, and then retransfers it to the debtor.

Two features are characteristic of all three major forms of ownership-security. First, the creditor as owner holds more rights than he requires for security purposes. This surplus of rights is a major source of conflict with the debtor as well as with third parties. Second and paradoxically, many countries are less suspicious of the more or less open recourse to ownership as security than they are of other forms of non-possessory security. While the latter are usually regulated rather strictly, ownership is often accepted as ownership pure and simple, irrespective of the concrete function it may be serving. The enormous attraction inherent in ownership-security in certain

countries springs from this liberality in disregarding the very different functions for which ownership is used.

2.1.2.4 *Privilege*

While ownership-security endows the secured creditor with a surplus of rights, privileges, a minor form of non-possessory security interest, grant less security to the creditor than the ordinary device of mortgage.

Two kinds of privileges should be distinguished both of which are relevant for security interests, namely general and special privileges.

A general privilege gives a preferred rank to certain classes of claims, which can be satisfied from the whole property of the debtor. Fiscal claims enjoy such a preference in very many countries. Since the applicable law determines the precise rank of such a general privilege, it may or may not take priority over a claim secured by a security interest. If it does take priority, the value of the security is of course diminished. We will deal with this problem in discussing the protection of a security interest as against third parties.

A special privilege gives a preferred rank to certain classes of claims which may be satisfied—in contrast to a general privilege—from only certain specific goods of the debtor. It thus resembles a conventional security interest.

This study will consider only the most important privilege, that acquired by the unpaid seller of movable goods, which is recognized in many, but by no means in all, countries. However greatly the conditions and especially the effects of the seller's privilege may vary from country to country, it has at least two features in common in all jurisdictions where it is recognized: it comes into existence by operation of law if a seller is not paid for the goods sold; and its effects are generally limited to the time during which the goods sold remain in the hands of the buyer. However, even during this period the privilege is generally not effective in the buyer's bankruptcy.

It is this lack of effectiveness vis-à-vis all third persons which diminishes the practical value of the seller's privilege, making it merely a second-rate security device. On the other hand, the fact that it comes into existence by operation of law makes it applicable to all sales contracts, irrespective of the agreement of the parties. This feature facilitates its treatment within general legal principles since it eliminates the need to take into account the multifarious deviations of individual contract terms.

It should be pointed out, though, that in a few instances, sometimes with the help of registration, privileges have achieved the status of a full security interest. The most notable example is the statutory privilege of automobile sellers in Italy, which is subject to registration and is effective against third persons. It co-exists with a contractual privilege that may be granted by an owner to any other creditor, under the same conditions and with the same effects. Fifteen years after its birth, this combined statutory and contractual privilege was reclassified by the Italian legislature as a mortgage.

Italy: See Decreto-legge 15 March 1927 art. 2 and Codice civile of 1942 art. 2810 para. 3.

The curious ambivalence of this particular security interest, both in substance and in classification, proves that the gap between mortgage and privilege is not unbridgeable.

This leads us to a consideration of the real value of the various types of security interests and of the general legal construction underlying their differentiation.

2.1.2.5 *Actual and artificial distinctions*

In evaluating the four basic types of security interests presented here in general terms (pledge and mortgage, ownership and privilege), we must begin by inquiring into the extent to which the distinctions and delimitations between the four types correspond to modern commercial realities. Only those differentiations which comply with this criterion can be accepted as inherently sound. All others, for whatever constructive reason or historical accident imposed, must be deemed spurious and therefore unhelpful.

The basic cleavage underlying the pledge-mortgage dichotomy proceeds from whether or not the secured creditor has possession of the encumbered goods. It stands to reason that the locus of possession is a highly relevant factual circumstance from which important legal consequences may ensue. On the other hand, we have seen that the pledge cannot always be identified as a possessory security interest since the term covers certain instances of a non-possessory nature (*supra* 2.1.2.1). Therefore, we shall substitute in our study for the term "pledge" the more fact-orientated term "possessory security interest".

The range of non-possessory security interests may thus be seen to include all the four basic devices, with the pledge occupying a marginal position. We shall expect a qualitative distinction between the full security devices on the one hand and the lesser device, the privilege, on the other. However, even here we have to be guided not by the name of a concrete institution, but by its real effects.

There remains the question as to the validity of the distinction between the (exceptional) non-possessory pledge, the mortgage and ownership-security. Historically and functionally speaking, it is obvious that all three devices serve but one purpose, namely to give real security to a creditor who is not in possession of the encumbered goods. Although their identity of purpose does not imply that the effects of all three constructions are identical, a broad comparison of non-possessory security interests would be impossible if the functional identity of purpose were not placed above the more or less accidental legal constructions. We will therefore gather all devices, creating a full non-possessory security, whatever their designation, under this functional name. It is necessary to emphasize that all "proprietary" devices based upon the utilization of ownership for purposes of security will also be covered under this head. Only those institutions which do not achieve the full status of a security interest will be called by their traditional name, i.e. privilege.

2.1.3 *Outline and approach*

The three classes of security interests which result from the functional approach to the subject-matter (see *supra* 2.1.2.5) determine the basic scheme of the following analysis. Our discussion of the infinite variety of national security interests will thus be conducted in three major parts:

(1) possessory security interest (*infra* 2.2);

(2) non-possessory security interests on a contractual basis (*infra* 2.3);

(3) statutory non-possessory security interests in favour of the seller (*infra* 2.4).

This scheme gives rise to two other issues of methodology.

In the first place, we shall have to disregard the concrete economic situations in which security is demanded and granted. Certainly one would expect differences to exist between security granted by a consumer and that by a trader, or between security offered by an industrial enterprise and one by a farmer, etc. Even the security offered by the same person, like an importer may vary at different stages of an import transaction, e.g. during shipment, subsequent to arrival, etc. Our disregard of these innumerable, varied economic situations is based on two grounds. For one, most of the national rules do not differentiate along such lines. But even where they do, recent codifications tend to establish a uniform régime, the most notable example being the *United States*' Uniform Commercial Code art. 9 which has created a uniform security interest.

Our discussion will, in general, also remain detached from the nature of the encumbered goods. Thus we will not differentiate as to whether the encumbered goods are staple goods, like grain or oil, or manufactured or semi-manufactured goods, or whether the latter serve industrial, trade or household purposes. This detachment from the nature of the charged items is again justified by the observation that on the whole neither do the national legal rules differentiate in this respect. One exception, however, has been made in deference to national experiences: the means of transport dealt with here, namely

automobiles and railway rolling stock, will be treated separately (see *infra* 2.5).

2.2 *Possessory security interests*

We have already pointed out the major drawbacks of the pledge, the lien and the right of retention, the most typical possessory security interests (*supra* 2.1.1.1).

2.2.1 *Reasons for decline*

The above-noted practical disadvantages of possessory devices, both for the debtor and the secured creditor, are primarily responsible for the decline of possessory security interests in contemporary commercial practice. The decline in significance of the pledge has been balanced by the tremendous increase in the practical role of non-possessory security interests.

2.2.2 *Residual applications*

Despite the general decline of possessory devices, however, they continue to play an important role in a few special areas. By far the most significant of these is the giving of secured credit in connexion with *sales against documents*. Typically this situation arises in connexion with a letter of credit. A bank which has issued a letter of credit on the account of an importer (or a domestic buyer) will often be willing to extend credit to him until such time as he will be able to reimburse the bank from the resale proceeds of the acquired goods (self-liquidating credit). The documents of title representing these goods (such as bills of lading or warehouse receipts) are usually endorsed and handed to the bank. The latter than delivers the documents under precautions to the buyer to enable him to receive the goods from the ship, submit them to customs inspection and sell them. The security interest under which the bank holds the documents (and the goods represented by them) is a pledge. This classification may not be so obvious since the bank's possession of the goods is only indirect. The goods are "represented" by documents of title, i.e., special documents which by virtue of commercial usage or express legislation are the exclusive embodiment of the goods for which they have been issued. This exclusive character is guaranteed by the obligation of the issuer to deliver the represented goods only to the holder of the document and upon its presentation.

Another instance in which possessory security is utilized, although of comparatively modest importance, is the pledging of *valuables and investment securities*. Gold and jewels as well as bonds and share certificates are the items most frequently pledged in a commercial context. They are also used in the lending practices of international banks.

See Delaume, *Legal Aspects of International Lending and Economic Development Financing (Dobbs Ferry, 1967) 234-236.*

The advantages of such collateral are threefold: they are not usually necessary to the debtor's ecnomic existence; the creditor can easily store and thus secure them against disloyal dispositions by the debtor; and they are easily marketable.

Only the happy coincidence of these elements, especially the first two, makes the pledging of these objects economically practicable. But these items' special characteristics also demonstrate a negative point. Possessory security covering other items is generally impracticable if and in so far as the debtor cannot dispense with possession, and the creditor cannot accept it.

This analysis of the two commercially useful applications of the possessory security device thus explains at the same time why possessory devices in general do not meet modern business requirements. Our attention will therefore centre upon the non-possessory security interests.

2.2.3 *Legal régime*

In addition to the very limited commercial utility of possessory security interests, another factor also militates against the discussion of these devices. A very rough survey indicates that the conditions for the creation of possessory security interests are very similar everywhere. The same is true of the effects that attach to these devices. Some divergencies arise only when it comes to their enforcement. Thus the relevance and utility of a comparative analysis of possessory security devices would be very limited.

2.3 *Contractual non-possessory security interests*

The interests in this category may be broadly divided into security interests created by agreement between a creditor and a debtor (contractual interests) and other security interests or privileges arising by operation of law (statutory interests). The presence or absence of an agreement in this respect gives rise to so many different legal consequences that it is best to discuss the two classes separately.

It is not always easy to say when a security interest is contractual or statutory. Sometimes an interest is regarded as statutory for one class of creditors, but as contractual for all other creditors; interests of this dual nature are discussed twice, in the appropriate category of creditors. Some ambiguity is also created by statutory interests, the effects of which vary according to whether or not the secured creditor provides for registration of the interest. Although this *onus* to register is akin to a feature of contractual security interests, the essential element of a contractual interest, viz. the agreement between the creditor and the debtor, is lacking. These interests will therefore be classified as statutory.

The discussion which follows will deal only with what one may call "full security interests", i.e., security interests having legal consequences which affect third persons as well as the immediate parties. Such an enlarged effect is particularly relevant in cases of conflict with the other creditors of a debtor. It is generally accepted that it is this capacity of a security interest to affect the position of persons other than the contracting parties which distinguishes a proprietary interest from a purely contractual arrangement affecting only the immediate parties thereto.

2.3.1 *Typical purposes*

Underlying the various objects of individual security agreements are a few general aims which are typical for certain recurring situations.

Generally it may be said that all non-possessory security interests permit the debtor to retain possession of the encumbered goods with freedom to utilize or dispose of the same.

In many situations the parties, or at least the creditor, envisage that the debtor will retain the encumbered goods because he has acquired them for his own needs. These may be of a private or of a business character. Durable household goods such as refrigerators or television sets would fall into the private category. Utilization for business purposes may relate to fixed and mobile equipment such as cars, cranes and machines of various kinds. In all these cases the creditor will usually oblige the debtor not to dispose of the encumbered goods. Should the debtor, by abusing his right of possession of the encumbered goods, dispose of the latter, he would break his contractual obligations and may even incur penal sanctions.

The situation is quite different if both parties envisage that the debtor shall have the right to dispose of the encumbered goods. This happens when a trader encumbers his stock of merchandise or an importer charges acquired goods as security, either during transit or after arrival. The declared intention of the debtor to sell these goods at some time or other introduces an important new element.

The debtor's right to utilize or dispose of the encumbered items is primarily of economic significance. Many legal rules which take a very broad view of the subject disregard this distinction. There are, however, other legal systems, especially those which impose limitations upon security devices, which invest this factual distinction with important legal consequences (see *infra* 2.3.2.3.2 sub (b)).

2.3.2 *Restrictions on security interests*

The various restrictions on non-possessory security provide a clear illustration of the widespread distrust with which these arrangements are viewed in many countries. A possible reason

for this may be the desire to protect unsecured creditors and other third persons whose chances of obtaining satisfaction from the debtor may become jeopardized as a result of the preferential treatment of secured creditors (see *infra* 2.3.2.5). Such restrictions may affect either the parties involved, the secured claims, or the encumbered goods. Since these restrictions are sometimes quite extensive, and may thus present a serious obstacle to international trade, the three types of restrictions deserve careful attention.

2.3.2.1 *Restrictions as to parties*

The restrictions as to parties may apply to creditors or debtors.

(*a*) Most frequent are rules which limit the category of *secured creditors*. Thus *Argentina* restricts the category of the possible creditors of a *"prenda con registro"* to the state or its autonomous subdivisions, banks, co-operatives, agricultural and industrial companies, merchants listed in the commercial register, and registered money-lenders. International financing institutions of which Argentina is a member and foreign exporters were added to this list by an amendment of 1963.

Argentina: Ley no. 12, 962 on prenda con registro of 1947, as amended in 1963, art. 5. Similarly *Venezuela*: Ley de hipotecas mobiliaria of 1973, art. 19.

In certain other countries the permissible creditors form a much smaller group and the security interest concerned is at the same time more specialized (see on this more particularly *infra* 2.3.2.2.). Thus *Belgium, Egypt* and *Luxembourg* only allow banks approved by the Government to become creditors of mortgages on business enterprises (*fonds de commerce*),

Belgium: Loi of 25 Oct. 1919, as amended, art. 7; *Egypt*: Loi no. 11 of 29 Feb. 1940, art. 10; *Luxembourg*: Arrêté 27 May 1937, art. 12.

while *France* imposes no personal limitation on this kind of security interest. Some countries, such as *Federal Republic of Germany, Japan, Switzerland, Turkey* and *Uruguay*, restrict the category of creditors qualified to accept certain agricultural security interests,

Federal Republic of Germany: Law on credits for agricultural leases of 1951, 1; *Japan*: Farming Movables Credit Law of 29 March 1933, art. 3; *Swiss* Civil Code art. 885 para. 2; *Turkish* Civil Code arts. 868-869; *Uruguay*: Ley No. 5.649 of 21 March 1918 sobre prenda rural, art. 4,

with the obvious purpose of protecting farmers as debtors against unscrupulous money-lenders.

In some Eastern European countries only certain banks or other organizations can take a security interest.

German Democratic Republic: Civil Code of 1975, para. 448; *Hungary*: Civil Code of 1959, para. 262; *Poland*: Civil Code of 1946, art. 308.

A few other countries restrict the category of permissible creditors even further by authorizing one specific bank to accept certain security interests, thus impliedly barring all other creditors. Examples of such a limitation are furnished by *Egypt, Greece, Norway* and *Venezuela*, and relate to an agricultural bank.

Egypt: Loi no. 28/1940, on certain derogations from the rules of the Civil Code on pledges of 25 May 1940, art. 1 para. 2; *Greece*: Legislation on the Development Bank; *Norway*: Law of 5 Feb. 1965 on the State Agricultural Bank, § 16 no. 1 para. 2; *Venezuela*: Ley del Banco agrícola y pecuario of 29 May 1946, arts. 51 *et seq.*

It is possible and even probable that there are many other instances of "privileges" of this kind which are difficult to trace since they may be hidden away in specialized statutes.

(*b*) Express restrictions as to *debtors* are rare. Many restrictions of this kind are implied in the limitations on goods suitable as security (*infra* 2.3.2.3.2). We shall therefore mention only those subjective restrictions which apply irrespective of the nature of the thing encumbered.

Most noteworthy because of its widespread use is the restriction on the *English* (fixed or floating) charge. This may only be created by an incorporated company, not by an individual debtor. There does not seem to be any rational explanation for this discrimination against natural persons (to whom only the ill-reputed bill of sale is available as a security device for loans).

Paraguay furnishes another example. A chattel mortgage (*prenda con registro*) may only be created by industrial entrepreneurs, artisans, farmers and cattleraisers as well as legal entities created by these persons; by private persons only if the goods encumbered are automobiles or machines in general.

Paraguay: Decreto-Ley no. 896 on prenda con registro of 1943, art. 4.

In *Czechoslovakia* the provisions on security interests in the International Trade Code of 1963 apply only to entities which engage in international trade transactions.

2.3.2.2 *Restrictions as to secured claims*

Of fundamental importance to the economic function of non-possessory security interests are the limitations as to the types of claims these interests may secure. The limitations imposed vary considerably among the various legal systems.

The world may be divided under this topic into three groups: countries which allow security interests only for purchase money claims; countries which allow security interests for purchase money claims and some other claims; and finally countries which do not restrict the nature of the claim to be secured.

A claim for purchase money, as used here, connotes primarily the seller's claim to the purchase-price of the goods, but may also consist of a loan granted to the buyer with which the latter may pay the purchase-price of some item.

The term and its definition are derived from *United States* law, see Uniform Commercial Code s. 9-107.

For the purposes of the following survey the specific legal form in which a non-possessory security interest may appear has been disregarded. On the other hand, only those security interests which are full security interests having effect in the buyer's bankruptcy, are taken into account.

(1) The first group comprises those countries which in effect admit only security interests for purchase money claims without imposing restrictions on the thing sold:

Austria, Egypt, Ethiopia, Italy, Lebanon, Switzerland, Syria and Turkey.

(2) The second group encompasses countries which, like the first, admit security interests for purchase money claims, irrespective of the item sold. In addition, however, they also permit security for a limited number of other claims. The limitations may be imposed upon the parties to the transaction (see *supra* 2.3.2.1) or upon the things encumbered (see *infra* 2.3.2.3):

Argentina, Finland, Greece, Japan, Norway, Sweden, Thailand and Uruguay.

(3) Into the third and largest group fall most of the other countries. In general they do not draw distinctions based on the type of the secured claim (although they may impose other restrictions, see *supra* 2.3.2.1 and *infra* 2.3.2.3.2).

2.3.2.3 *Permitted subject-matter of security*

The possible subject-matter of a *possessory* security interest is usually not limited. However, in some Socialist countries, such as the *USSR*, items that are exempt from being taken in execution may not be the subject-matter of any kind of security interest. These include mainly fixed assets and equipment belonging to State organizations, co-operatives, trade unions and other public organizations. In addition, a relatively large number of countries restrict the availability of non-possessory security by limiting the category of the items that may be encumbered.

Two problems require separate discussion: first, the technical question of the form in which these limitations are presented; second, the substantive question as to the physical items which

are either specifically included in enumerative catalogues or excluded from general clauses of admission.

2.3.2.3.1 *Typical general approaches*

At the technical level three approaches to such limitation may be distinguished: a *numerus clausus* of admissible items, the general admission of all items, and a mixed approach.

(*a*) *Numerus clausus.* The more tenaciously the security law of a country clings to possessory security, the more vigorously it will resist non-possessory security and limit the latter as strictly as possible to selected items. Countries which restrict non-possessory security interests in this way allow their creation only if, and in so far as, a statutory rule admits specific items as suitable objects of security. Some countries go so far as to establish a special statutory régime for each permitted category. A typical example of this extremely reserved approach to non-possessory security is found in *France* where one finds no fewer than nine special statutes, enacted at different dates, for varying reasons, and with differing contents for more or less narrowly defined categories.

France: Law of 17 March 1909 on the pledging of a business enterprise; Law of 8 Aug. 1913 on the hotel warrant; Law of 21 April 1932 on the petrol warrant; Law of 28 Sept. 1935 on the agricultural warrant; Décret of 24 June 1939 on the war material warrant; Law of 22 Feb. 1944 on the industrial warrant; Law of 18 Jan. 1951 on the pledging of machinery and professional equipment; Décret of 30 Sept. 1953 on credit sales of motor vehicles; Code of cinema industry of 27 Jan. 1956, arts. 31 s.

Similar collections of diverse special statutes of restricted application—although with a more modest catalogue of items covered—can be found in the neighbouring countries of *Belgium* and *Luxembourg*, as well as in some Near-Eastern countries influenced by France, such as *Lebanon*.

A higher degree of technical perfection has been achieved in numerous *South American* countries. While these countries also enumerate the permitted items of security, all such items are governed by one (or two) unified set(s) of rules, sometimes with slight variations for particular items.

As to the types of items covered, see the list offered *infra* 2.3.2.3.2.

(*b*) *The general admission of all objects* is the solution at the other extreme. This approach is followed notably in the Anglo-American legal systems, especially in the *United Kingdom* and the former and present members of the *British Commonwealth* inspired by England and in the *United States of America*, but also in *Argentina, Costa Rica, Mexico, Panama* and the *Philippines*. It is also utilized in essence in a few Central European countries, such as *Denmark, Federal Republic of Germany, Liechtenstein* and the *Netherlands*. *Colombia* admits a security interest for purchase money (see *supra* 2.3.2.2) without restriction, but limits security for other loans to those items connected with an economic activity.

Colombia: Commercial Code of 1971, art. 1207 para. 1. A similar general formula, supplementing a catalogue of specific items, is employed in *Chile*: Law No. 5687 on the contract of "prenda industrial" of 17 Sept. 1935, art. 24 in fine; *Guatemala*: Civil Code of 1963, art. 904 para. 2.

Sometimes one may find that in these legal systems a few specified items are excluded as possible objects of security.

(*c*) *A mixed system* combining general admission and *numerus clausus* has been adopted in many other States. In these countries two types of security interest exist side by side: one type places no limitation upon the permitted items, save perhaps an occasional exclusion, viz. the reservation of ownership for the purpose of securing the seller's purchase-price; the second is applicable only to selected items of property, viz. a chattel mortgage for the purpose of securing a loan creditor. This intermediate position has been adopted on a large scale, attaching great weight even to the chattel mortgage, in such countries as *Brazil, Egypt, Finland, Greece, Japan, Peru, Portugal, Spain, Sweden* and *Venezuela* (first group). In other countries, the scales are clearly tipped in favour of reservation of title, the chattel mortgage being allowed only for very few, selected items. The latter situation prevails in *Austria, Italy, Norway, Switzerland* and *Turkey* (second group).

The preceding trichotomy indicates three (or more accurately four) general approaches to non-possessory security by the various countries of the world. If we arrange these four types on a scale according to their permissiveness of non-possessory security, the following picture emerges:

Least permissive is the French system of the *numerus clausus* with a special régime for each kind of item. More permissive are the mixed systems, admitting the reservation of ownership for all items, but restricting more or less severely the goods that may be subject to a chattel mortgage. Most liberal is the system generally admitting all goods for purposes of security.

It does not appear, as one might have supposed, that a country's position on this scale is determined by its degree of economic development, since countries with quite different levels are to be found in almost every group. A better explanation is probably offered by the dates of national legislation. It appears that in general a country's security rules tend to be more liberal, the more recent its legislation in this area has been enacted, and vice-versa. This observation would indicate that the admission of a large number of, or potentially all items as suitable objects of security is to a considerable degree a matter of technical modernization of this branch of the law.

2.3.2.3.2 *Permitted and excluded items*

The category of permissible items of security in those legal systems which employ a *numerus clausus* (either exclusively or side by side with a general clause, see *supra* 2.3.2.3.1) are not selected entirely by accident, but converge to a large degree. A demonstration of this phenomenon may help to reveal possible directions of reform to countries with very restrictive régimes. This applies equally to those systems which, whilst generally admitting all items as objects of security, have attempted to exclude specific items.

(*a*) *Enumerations of permissible items of security.* The folfowing catalogue is offered because it is highly indicative of the economic relevance of non-possessory security interests in the *numerus-clausus* countries. The enumeration does not purport to be exhaustive, either as to the category of permitted items or as to countries. But it may well qualify to illustrate the trend of all *numerus clausus* legislation. Finally it should be emphasized that the precise legal form of the security interest (whether it be a reservation of title, a chattel mortgage or any other contractual interest) is entirely irrelevant in this context.

It seems convenient to divide all the items into six major groups, each with certain subgroups.

(1) *Agricultural items*:

(*a*) Comprehensive objects clause, comprising in particular crops, produce, timber, livestock and agricultural machines:

Brazil, Canada (Quebec), Chile, Cuba, Ecuador, Egypt, El Salvador, Finland, Greece, Guatemala, Honduras, Luxembourg, Mexico, Nicaragua, Norway, Paraguay, Peru, Portugal, Spain, Turkey, Uruguay, Venezuela.

(*b*) Farm inventory only: Belgium, France, Japan.

(*c*) Fishing equipment: Japan, Norway.

(*d*) Livestock: Austria, Switzerland, Turkey.

(*e*) Grain: Norway.

(*f*) Tobacco: Greece, Turkey.

(2) *Raw materials*:

(*a*) In general: Chile, El Salvador, Finland, Guatemala, Nicaragua, Norway, Peru, Portugal, Sweden, Uruguay, Venezuela.

A geographical peculiarity is to be noted in El Salvador: only raw materials for use in national industries are covered (see *infra* (*b*)).

(*b*) Coal: Belgium.

(*c*) Petrol stock: France.

(*d*) Salt: Brazil.

(3) *Industrial equipment:*

(*a*) In general: Brazil, Canada (Québec), Chile, Cuba, Ecuador, El Salvador, Finland, France, Greece, Guatemala, Honduras, Korea (South), Lebanon, Nicaragua, Norway, Paraguay, Peru, Portugal, Spain, Sweden, Thailand, Uruguay, Venezuela.

(*b*) Construction machinery: Japan.

(*c*) Vehicles: Chile, Panama, Spain, Venezuela; see also automobiles, *infra* (*e*).

(*d*) Salt production equipment: Brazil.

(*e*) As to automobiles, see *infra* 2.5.1, and as to railway rolling stock, see *infra* 2.5.2.

(4) *Industrial products*:

(*a*) In general: Chile, Ecuador, El Salvador, Finland, Guatemala, Nicaragua, Norway, Portugal, Uruguay, Venezuela.

A geographical peculiarity is to be noted in Costa Rica, El Salvador, and Uruguay: these countries cover only industrial products of national origin (see *infra* (*b*)).

(*b*) Films: Egypt, France, Greece.

(5) *Funds*:

(*a*) Business enterprises (*fonds de commerce*): Belgium, Egypt, France, Lebanon, Luxembourg, Spain, Tunisia, Venezuela.

(*b*) Hotel inventory: France, Portugal.

(*c*) Collections of art and historical works: Spain, Venezuela.

(6) *Incorporeal property*:

(*a*) Industrial property and copyright: Spain, Sweden, Uruguay, Venezuela.

(*b*) Investment securities: Chile.

This catalogue is instructive in two respects. It illustrates, in its smaller subgroups, the economic specialities of individual countries. Even more significant—because they indicate general trends of economic development—are the major subgroups, especially (1) (*a*) and (3) (*a*). These two subgroups demonstrate clearly two main areas in which the demand for non-possessory security interests has been particularly strong. These are, first, agriculture in general, notably agricultural crops, produce, timber, livestock and agricultural machines; and secondly, industrial equipment.

(*b*) *Exclusion of objects of security.* The preceding enumeration of items suitable as security impliedly excludes for the respective countries all other items as unfit for this purpose.

More interesting for present purposes, however, are the express exclusions. The list is much shorter and probably less complete since it is based on express statutory clauses and does not take into account unwritten general principles that may lead to an identical result.

This observation applies especially to the exclusion of certain goods because of their *economic function.* Thus, goods for resale are expressly excluded in *Colombia* and *Venezuela.*

Colombia: Commercial Code 1971, art. 954;

Venezuela: Decreto No. 491, on sales under reservation of ownership of 1958, art. 2.

The need for precise identification is in many countries the reason for excluding fungible goods or other goods that are not identifiable as individual items.

Chile: Law No. 4702, on instalment sale of movables of 1929, art. 1 para. 1; *Colombia*: Commercial Code of 1971, art. 951 para. 1, 953 para. 2; *El Salvador*: Commercial Code of 1970, art. 1039; *Panama*: Civil Code art. 1567 No. 3 (chattel mortgage); Decreto-Ley No. 2, on chattel mortgages of 1955, art. 12 para. 4 (sale under reservation of ownership); *Peru*: Ley No. 6565, on instalment sale of 1929, art. 1; *Venezuela*: Decreto No. 491, on sales under reservation of ownership of 1958, art. 4.

Similarly, goods to be subjected to a manufacturing process or other transformations and which are not identifiable, are sometimes excluded.

Venezuela: Decreto No. 491, art. 2.

These three related exclusions are obviously motivated by both technical and economical considerations. The legal reason for adopting the exclusionary rule is the desire to avoid the difficulties which are bound to arise if a security interest upon goods undergoing resale, manufacture or transformation is recognized. A more flexible approach, which has been adopted by many countries, would be to allow the creation in such cases of a security interest, but to terminate it upon resale, manufacture or transformation. The economic effect of the strict rule is to ban security interests in most of the commercial transactions and to limit them to consumer transactions.

A few Latin American countries have a *geographical limitation* restricting the items suitable as security to raw materials acquired for use in national industries or to industrial products of national origin.

El Salvador: Commercial Code 1970, art. 1144 No. I, or to industrial products of national origin;

Uruguay: Ley 8.292 of 24 Sept. 1928 on *prenda industrial,* art. 2 No. 5.

2.3.2.4 *Conclusions*

The analysis of the various restrictions imposed on the parties to, the claims secured by, and the subject-matter of, non-possessory security interests suggests a number of conclusions. Since the various restrictions in part overlap and their imposition can probably be explained by one or two all-pervading motives, they may all be analysed together.

(a) *Motives.* The contrast to the possessory security interest where no comparable restrictions are apparent, makes it quite clear that the distrust of non-possessory security interests is the decisive reason for the existence of the various restrictions. This is confirmed by the geographical limitations placed on the subject-matter of security by a few Latin American countries (*supra* 2.3.2.3.2 sub (*b*)). Obviously these countries regard the admission of items as suitable objects of security as a privilege which should be restricted to goods of national origin or destination. Apart from these "nationalistic" restrictions, what are the reasons which render non-possessory security interests suspect? Perhaps one can identify two main sources. One is the novelty of the phenomenon and a consequent lack of legal expertise in handling it. This, of course, is only a provisional stage of development which today has passed in general, but the traces of which are still lingering on.

Another possible source of the dissatisfaction are apparently, at least in certain countries, economic and legal reasons, especially the desire to protect unsecured creditors against the preferential treatment of secured creditors. However, whether this problem is optimally solved by the outright exclusion of persons, claims or things, appears to be doubtful.

(b) *Discussion and suggestions.* The preceding exposition of three different motives for the restrictions imposed upon non-possessory security interests suggests certain ideas and recommendations.

(1) *Geographical limitations* restricting the items suitable as security to goods of national origin or destination are certainly an obstacle to the promotion of international commerce and ought to be removed.

(2) Restrictions as to persons, claims or things which stem from the *initial distrust* of the novel phenomenon of non-possessory security are outdated by now. Our present knowledge, especially the comparison with, and evaluation of, practical experience gained in many countries, enables legislation to be drafted which can satisfactorily solve all substantive and technical problems posed by non-possessory security interests. For these reasons all restrictions which are merely traditional and therefore outdated should be lifted.

(3) A more difficult problem is posed by the restrictions based on *protective considerations*. The latter, of course, are still valid today. It is merely doubtful whether the outright exclusion of persons, claims or things is the most appropriate means of achieving the desired end. The exclusion of certain categories of non-possessory security does not solve the problem directly and is therefore, as most indirect answers, not liable to be fully adequate. Firstly, an artificial distinction is introduced which may not correspond to economic necessities. Secondly, it seems difficult to justify the privileged position of those categories of non-possessory security that are admitted as against those that are excluded. Thirdly and conversely, unsecured creditors subordinated to admitted non-possessory security interests are at a disadvantage as against those who compete *pari passu* with creditors who, for one reason or other, have been excluded by law from obtaining non-possessory security.

For these reasons it seems to be more appropriate if the protection of unsecured creditors be achieved by a more direct route and not by the inadequate means of general exclusions from non-possessory security.

2.3.3 *Creation of security interest*

The first step for the creation of a contractual security interest is obviously the conclusion of an agreement between debtor and creditor providing for the creation of a security interest by the debtor. This agreement will then serve, in different ways, as the basis for creating the security interest itself. We need not deal here with all the various requirements for the conclusion of a valid agreement since this is a matter of general contract law. Nor shall we discuss the interesting question in which way in general, on the basis of a valid agreement, the security interest itself is brought into existence.

Rather we shall concentrate on one particular problem of great practical importance, i.e. *formalities*, both as required for the underlying contract and for the creation of the security interest itself. National legal systems are amazingly varied in this respect. In a few countries no particular formalities have been prescribed. In others only one step, namely the drawing up of a formal contract, is necessary. In many, if not most countries, two steps are required, before full effect can be given to a security interest: in addition to the drawing up of a proper document, its registration or registration of the security interest is necessary. In some cases, registration only is required, without a formal document. Finally, in a small number of instances an additional third step may be prescribed, such as physical marking of the encumbered items.

We shall see moreover that most of these four variations are themselves quite complex since some of them cover a wide variety of different requirements and effects.

2.3.3.1 *Absence of formalities*

Fewer than a dozen countries, most of them situated in central and northern Europe, dispense altogether for all or at least for certain kinds of security interests with formalities.

The most radical in this respect are *Germany* and the *Netherlands* which admit security interests both for purchase money (see *supra* 2.3.2.2) and for non-purchase money, without any formal requirements. It is to be noted, however, that the new draft Dutch Civil Code envisages a system of registration.

Netherlands: Government draft of book 3 of the new Civil Code (Zitting 1970-1971 no. 3770 no. 8), art. 3.1.2.1 ff. and 3.4.2.2 para. 3.

In the next class are those countries which, in general, have a security interest only for purchase money, but allow this without formality. *Austria* appears to be the only representative of this group.

The largest category comprises those countries which, like the first group, admit security interests both for purchase money and for non-purchase money, but dispense with formalities only in the case of purchase money security interest. Into this group fall the four Scandinavian countries (*Denmark, Norway, Sweden and Finland*) as well as *England* (and the *Commonwealth* countries in general), *Greece, Japan and South Africa.*

It should be mentioned, however, that in almost all cases of some commercial importance the parties do in fact draw up a written contract in order to avoid doubts and uncertainties as to their mutual rights and obligations.

2.3.3.2 *Formal contract*

In discussing the requirements of a formal contract it is useful in the first place to distinguish between rules requiring the writing as the only formality and other rules requiring a second formal step, especially registration.

(a) *Formal contract as the only formality.* Only very few countries are satisfied with a formal contract as the exclusive requirement either for all security interests or for one of several types.

Iran represents the former approach. It provides for a notarial instrument to be drawn up in order to constitute a non-possessory "pledge".

Iran: *Devel*, Iran p. 3.

In *Czechoslovakia and Hungary*, a contract embodying a reservation of ownership need only be in writing.

Czechoslovakia: International Trade Code of 1963 s. 324 para. 1;

Hungary: Civil Code of 1959, para. 370.

In *Egypt, Italy, Poland and Spain*, security interests for purchase money are effective as against third persons only if the contract creating the security interest is dated in such a way that it may be said to have a "certain date".

Egypt: see Civil Code art. 395; *Italy*: Codice civile art. 1524 para. 1; *Poland*: Civil Code art. 590 para. 1; *Spain*: see Civil Code art. 1227.

This technical requirement is designed to prevent frauds which could be committed against (other) creditors of the debtor by antedating the seller's security interest. According to three of the legal systems mentioned, the certainty of the date may be fixed by registration of the document, by certification by a public official, by the death of the signatory or by other events establishing with certainty the date of the instrument.

Egypt: Civil Code art. 395 para. 1; *Italy*: Codice civile art. 2704 para. 1; *Spain*: Civil Code art. 1227.

It should be pointed out that in Italy the effects as against third persons of a security interest for purchase money in machines exceeding certain sums can be increased by registration and other forms of publication (see *infra* 2.3.3.3 and 2.3.3.4).

The situation in *Venezuela* is for reservations of ownership very similar to that in the aforementioned group of countries. A security interest for purchase money must be created by a public document or in a private document with certain date. But the certainty of the date can only be achieved by the deposit of a signed copy of the contract with a notary or a judge at the seller's domicile.

Venezuela: Decreto no. 491 on sales under reservation of ownership of 1958, art. 5 lett. b).—*Quaere*, how the certainty of a private contract can be achieved where the seller resides outside Venezuela?

In addition, *Venezuela* also provides that the contract must contain certain basic details; these are the parties' names, description and location of the encumbered goods, purchase price and terms as to payment.

Venezuela: Art. 5 lett. a).

The *USSR* also requires the written contract between the parties to include similar information in respect of the parties and the goods which are the subject of the agreement.

USSR: Civil Code of the RSFSR of 1964, s. 195.

Perhaps *Chile* can also be mentioned here. The contract for a *prenda industrial* becomes perfected both *inter partes* and as against third persons as soon as it is embodied in a public document or the signatures of the parties on a private writing are certified by a notary and the date indicated.

Chile: Law no. 5687 on the contract of *prenda industrial* of 1935, art. 27 paras. 1 and 2.

The contract, in addition, requires registration.

Chile: Art. 27 para. 3.

It would seem, however, that such registration does not further increase the effects of the security interest as against third persons.

As regards third persons against whom the formal contract takes effect, a slight variation in wording is to be observed. While the cited provisions in *Chile, Egypt, Spain* and *Venezuela* speak of third persons generally, the *Italian* rule is limited to the creditors of the debtor.

Italy: Codice civile art. 1524 para. 1.

(b) *Formal contract as a preliminary formality.* In the vast majority of countries, a formal contract, whilst necessary, does not exhaust the legal requirements; it must be supplemented by other means of publication. Although the contract is thus a preliminary step towards the creation of a security interest, many legal systems impose strict requirements even as regards the contract; others, however, pay little attention to this. The statutory requirements primarily deal with the form of the contract, but occasionally also with its terms.

As regards *formalities* strictly so called, some countries demand a *public document*, that is a notarial act, even for "ordinary" security interests.

Lebanon: Loi of 1935, art. 4; *Peru*: Ley no. 2402 on registration of agricultural pledges of 1916, art. 7 para. 1; *South Africa* (province of Natal): Notarial Bonds (Natal) Act, no. 18 of 1932, s. 1-2; *Spain*: Ley sobre hipoteca mobiliaria of 1954, art. 3 para. 1.

Japan requires a notarial deed only for the creation of a major security interest, namely the hypothecation of an enterprise.

Japan: Enterprise Hypothecation Law of 1958, art. 3.

Similarly, *Italy* and *Panama* draw a distinction based on the amount of the secured claim. *Italy* demands a public document or a private writing with certified signatures only for new machines with a purchase price of at least L. 500,000 (approximately $US 860) and *Panama* a public document only if the secured claim exceeds B. 4,000 (approximately $US 4,000); in other cases, a private writing with certified signatures suffices.

Italy: Law no. 1329 providing for the acquisition of new machines of 1965, art. 2 para. 1; *Panama*: Decreto Ley no. 2 on chattel mortgages of 1955, art. 21.

Many other countries, especially in Latin America, offer a choice between a public document and a *"qualified" private writing*, which appears as an equivalent to a public document. The equivalence depends upon either the presence of two witnesses or the certification of the signatures by a public official.

Brazil: Law no. 492 on rural pledges of 1937, art. 2; Decreto-Ley no. 1271 on pledges of industrial machines of 1939, art. 2 para. 1; *Chile*: Law no. 4702 on the instalment sale of movables of 1929, art. 2 para. 1; *Costa Rica*: Commercial Code of 1964, art. 537 para. 1; *Egypt*: Loi no. 11 sur la vente et le nantissement des fonds de commerce of 1940, art. 11 para. 1; *El Salvador*: Commercial Code of 1970, art. 1154 (prenda); *Nicaragua*: Law on agrarian and industrial pledge of 1937, art. 5; *Tunisia*: Code de Commerce 1959, art. 238 para. 1 (mortgage of an enterprise).

In *Ecuador*, to have an effect similar to a public document, the signatures to a private writing must be acknowledged before a judge.

Ecuador: Commercial Code 1959, art. 581 para. 1; similarly *Venezuela*: Ley de hipotecas mobiliaria of 1973, art. 4.

Philippine law requires that the document be attested by two witnesses and supported by affidavits showing the *bona fides* of the parties.

Phillppines: Chattel Mortgage Act of 1906, s. 5.

English law makes it mandatory that a statutory contract form be followed for a security bill of sale. The bill also requires attestation by at least one credible witness.

England: Bills of Sale Act 1882, ss. 9, 10.

In adopting the English bill of sale, most jurisdictions in the *British Commonwealth* seem to have attenuated the rigid English formalism. Typically they require one witness and an affidavit of good faith by the secured creditor, but do not demand recourse to the statutory contract form.

Canada: The (Uniform) Bills of Sale Act of 1928, revised 1955, amended 1959, ss. 5 (2), 6, 7, 8 (3), 19 and 20; *Kenya*: Chattel Transfer Ordinance 1930, ss. 5 and 15; *New Zealand*: Chattels Transfer Act 1924, ss. 5 and 20.

Statutory forms of contract are also prescribed in *Argentina, Paraguay* and *Uruguay*.

Argentina: Ley no. 12 962 on prenda con registro of 1947, art. 6; *Paraguay*: Decreto-Ley no. 896 on prenda con registro of 1943, art. 10; *Uruguay*: Decreto containing regulations on the Law on Agrarian Pledge of 1918, art. 3; Decreto containing regulations as to the Law of Industrial Pledge of 1928, art. 11 para. 1.

The law in most other countries, especially in Europe, as also the more recent Latin American legislation, is, however, content with a *simple written contract*.

Brazil: Law no. 4 728 of 1965 (as amended by Decreto-Lei no. 911 of 1969), art. 66 § 1 (fiduciary transfer for security); *Colombia*: Commercial Code of 1971, art. 1 208 (prenda); *Czechoslovakia*: International Trade Code of 1963, ss. 163 and 324; *Denmark*: Tingslysningslov of 1926, § 47 para. 1; *France*: Loi relative au nantissement de l'outillage of 1951, art. 2 para. 1; Loi relative à la vente et au nantissement des fonds de commerce 1909, art. 10 para. 1; *Guatemala*: Civil Code of 1963, art. 884; *Lebanon*: Décret-Législatif no. 11 of 1967, art. 3 para. 1 (mortgage of enterprise); *Norway*: Law amending the legislation on pledges of 1895, § 3 para. 1; Law on mortgages for industrial credits of 1946, § 2 para. 1; *Panama*: Law no. 22 on agricultural pledge of 1952, art. 4; *Poland*: Civil Code of 1964, art. 308 para. 3; *Thailand*: Civil and Commercial Code s. 714; Registration of Machinery Act of 1971, s. 5 *juncto* Civil and Commercial Code s. 1299 para. 1; *United States*: Uniform Commercial Code s. 9-203 (1) sub (*b*).

It may moreover be assumed that in those States in which the registration of security interests is obligatory (*infra* s. 2.3.3.3) a written copy of the contract must be produced for registration even if this is not expressly provided.

A number of countries also lay down the basic details which a valid security agreement should include. This is most marked in those States which prescribe the use of a statutory form of contract (see *supra*). In other cases, the parties themselves are responsible for complying with the statutory requirements in a manner best suited to the circumstances. The list of requirements is particularly long in many Latin American countries. Typical of such requirements are:

(1) the parties' names, civil status, nationality, profession and domicile;

(2) amount, due date of payment and rate of interest for the claim secured;

(3) description of the goods encumbered enabling their precise identification, and the place where they are kept by the debtor.

See *Brazil*: Law no. 492 on rural pledges of 1937, art. 2 § 2; Decreto-Lei no. 1 271 on pledges of industrial machines of 1939, art. 2 § 1; *Colombia*: Commercial Code of 1971, art. 1 208; *Lebanon*: Loi relative à la vente à crédit des autovéhicules, machines agricoles et industrielles of 1935, art. 4; *Nicaragua*: Law on agrarian and industrial pledge of 1937, art. 6; *Panama*: Decreto-Ley no. 2 on chattel mortgages of 1955, art. 7 and 16; Law no. 22 on agricultural pledge of 1952, art. 5; *Paraguay*: Decreto-Ley no. 896 on *prenda con registro* of 1943, art. 11; *Spain*: Ley sobre hipoteca mobiliaria of 1954, art. 13; *Uruguay*: Decreto containing regulations on the Law on Agrarian Pledge of 1918, art. 3;

Venezuela: Decreto no. 491 on sales under reservation of ownership of 1958, art. 5 lett. a).

Certain additional requirements concerning other existing charges on the encumbered goods and insurance of these goods will be discussed below at the appropriate place (see *infra* s. 2.3.4.1 and 2.3.5).

Some of the more recent enactments have considerably shortened the statutory requirements and have reduced them in essence to details of the secured claim and the encumbered goods.

Brazil: Law no. 4728 of 1965 (as amended by Decreto-Lei no. 911 of 1969), art. 66 § 1; *Canada*: (Uniform) Conditional Sales Act of 1922, revised 1955, amended 1959, adopted in six provinces, s. 4 (1).

Even more lenient are those countries which insist only on a specific description of the encumbered goods.

France: Loi relative au nantissement de l'outillage et du matériel d'equipement of 1951, art. 2 para. 5; *Guatemala*: Civil Code of 1963, art. 884; *Philippines*: Chattel Mortgage Act of 1906, s. 7 para. 1; *United States of America*: Uniform Commercial Code s. 9-203 (1) sub (*b*).

A number of exceptional statutory requirements merit at least a brief mention. *Chile* and *France*, both countries with a *numerus clausus* of admitted security interests (see *supra* 2.3.2.3.1 sub *a*), with a view to preventing the abuse of certain devices provide for the mandatory inclusion in the contract of certain clauses. In *Chile* a contract for sale by instalments must contain a confirmation that the goods, the subject-matter of such a sale, have been delivered to the buyer.

Chile: Law no. 4702 on instalment sale of movables of 1929, art. 3.

In *France* the contract must contain a statement that the purchase money paid by the creditor is to be appropriated in payment of the purchase price of the goods acquired; the absence of this clause nullifies the contract.

France: Loi relative au nantissement de l'outillage et du matériel d'equipement of 1951, art. 2 para. 4.

Of some importance to international trade, especially in the case of long-term contracts, are rules regulating the *currency* in which the secured claim must be expressed. *Spain, Sweden, Thailand* and *Venezuela* expressly require this to be in the national currency.

Spain: Ley sobre hipoteca mobiliaria of 1954, art. 13 no. 4; *Sweden*: Law on enterprise mortgage of 1966, § 7; *Thailand*: Civil and Commercial Code s. 708; *Venezuela*: Ley de hipotecas mobiliaria of 1973, arts. 22 no. 3 and 53 no. 3.

This may well be the general rule, at any rate in those countries requiring registration.

Argentina, on the other hand, permits a charge (*prenda con registro*) securing an amount expressed in foreign currency provided that the security relates to the purchase price in respect of imported goods or a loan by an international finance institution of which Argentina is a member.

Argentina: Ley no. 12.962 on *prenda con registro* of 1947, as amended, art. 1 para. 2.

Before concluding this survey of the formal and substantive requirements of a contract creating a security interest, the reader should be reminded that the formal contract in all these cases serves merely as a preliminary step preceding some additional requirement—generally registration. A relevant question is whether the formal contract merely has this preparatory function or whether its conclusion in fact gives rise to *certain legal rights and duties*. On this question one seldom finds an answer in express statutory rules. Rather, this must be impliedly derived from those provisions which circumscribe the effect of registration (see *infra* s. 2.3.3.3).

Anticipating the results of this survey, one may state as a general principle, that subject to certain exceptions, registration is the condition precedent for giving effect to a security interest vis-à-vis third persons. It would seem to follow that, generally speaking, a security agreement otherwise in accordance with the appropriate requirements has the effect of giving rise to a legal relationship between the contracting parties even before registration.

Expressly *Argentina*: Ley no. 12.962 of 1947, art. 4; *Australia*: State of *Queensland*: Bills of Sale and other Instruments Act, 1955, s. 7 (1). The same results follow where, as between the parties, a written contract is prescribed (*Lebanon*: Décret-Législatif no. 11 of 1967 on mortgaging of an enterprise, art. 3 para. 1), or where this is required as a prerequisite for the enforcement of a security interest against the debtor (*United States*: Uniform Commercial Code s. 9-203 (1)).

But even as against third persons an unregistered security agreement which is otherwise proper may, in certain circumstances, be effective. This will depend on any applicable rules dealing with the protection of a security interest as against third persons. This protection does not always depend upon effective registration (for details, see *infra* s. 2.3.5 *et seq.*).

2.3.3.3 *Registration*

In most countries registration of a security interest is a prerequisite for giving full force and effect to it. In a few instances there is even a further step prescribed in addition to registration (*infra* s. 2.3.3.4). What follows cannot deal with the technical aspects of registration. Rather it is limited to some of the more substantive aspects, namely the duty to register, the place of registration, its duration, and its effect.

(a) *The duty to register* is rarely provided for as such. More usually it takes the form of an onus resting on the secured creditor, by describing the effects which follow registration. Instances where an express obligation to register, as opposed to an onus of this sort, is imposed, are:

Brazil: Decreto-Lei no. 1271 on pledges of industrial machines of 1939, art. 2 para. 1; *Finland*: Chattel Mortgage Act of 1923, § 1 para. 1; *El Salvador*: Commercial Code of 1970, art. 1155, deviating from other provisions of the Code; *Guatemala*: Civil Code of 1963, art. 912 (with certain exceptions); *Luxembourg*: Arrêté portant réglementation de la mise en gage du fonds de commerce of 1937, art. 4 para. 1; *Peru*: Law no. 2402 on registration of agricultural pledges of 1916, art. 7 para. 2; *Poland*: Civil Code of 1964, art. 308 para. 3; *Sweden*: Law on enterprise mortgage of 1966, § 1; *Venezuela*: Ley de hipotecas mobiliarias of 1973, art. 4.

In all these cases, the effect of registration must be gathered from the legal rules as to the protection of the security interest vis-à-vis third persons (*infra* s. 2.3.5 *et seq.*).

(b) *Place of registration.* Although this may seem on the surface a rather technical question, the place of registration raises various issues of practical importance. In particular the question whether the special needs of international trade have always been borne in mind merits attention. A survey of the existing systems shows three main approaches: registration at the location of the encumbered goods, at the debtor's domicile, and central registration. Occasionally these approaches are combined in various ways.

(1) Most countries prefer the *location of the encumbered goods*: if the goods are located in various places, multiple filing is usually prescribed.

Chile: Law no. 5687 on the contract of *"prenda industrial"* of 1935, art. 28; *Colombia*: Commercial Code 1971, art. 1210; *Ecuador*: Commercial Code art. 581 paras. 1 and 2; *Egypt*: Loi no. 11 sur la vente et le nantissement des fonds de commerce of 1940, art. 11 para. 3-5; *France*: Loi relative à la vente et au nantissement des fonds de commerce of 1909, art. 10 paras. 2-3; *Italy*: Codice civile art. 1524 para. 2 (for valuable machines); *New Zealand*: Chattels Transfer Act 1924, s. 5; *Nicaragua*: Law on agrarian and industrial pledge of 1937, art. 11 para. 1; *Paraguay*: Decreto-Ley no. 896 on *prenda con registro* of 1943, art. 12; *Peru*: Law no. 2402 on registration of agricultural pledges

of 1916, art. 7 para. 2 and art. 8; *Spain*: Ley sobre hipoteca mobiliaria of 1954, arts. 69 and 70; *Venezuela*: Ley de hipotecas mobiliaria of 1973, arts. 81 and 82.

It is not clear whether a change of *situs* of the encumbered goods necessitates fresh registration. Only *Canada* expressly requires a fresh registration at the new location. This has to take place within 30 days after the secured creditor has received notice of the place to where the chattels have been removed.

Canada: (Uniform) Bills of Sale Act of 1928, revised 1955, amended 1959, s. 12; see also (Uniform) Conditional Sales Act of 1922, revised 1955, amended 1959, s. 4 (5).

(2) A considerable number of States require registration at the *debtor's domicile*, mostly in the case of sales under reservation of ownership.

Brazil: Decreto-Lei no. 1027 on the register of sales contracts with reservation of ownership of 1939, art. 1; *Denmark*: Tingslysningslov of 1926 (for chattel mortgage); *Ethiopia*: Civil Code art. 2387 para. 1; *Switzerland*: Civil Code art. 715 para. 1; *Turkey*: Civil Code art. 688.

A change in the debtor's domicile has no effect in *Canada*,

Canada: According to (Uniform) Conditional Sales Act of 1922, revised 1955, amended 1959, s. 4 (2) (a), the decisive factor is the buyer's residence at the time of making the contract,

while the *Swiss* and *Turkish* rules make applicable the debtor's present domicile, so that a change implies the necessity of re-registration. An additional problem is created if the debtor's domicile is abroad. *Canada* and the *Philippines*, which combine registration at the debtor's domicile with that at the *situs* of the goods (see *infra* (5)), rely in this case exclusively on the location of the encumbered goods.

Canada: (Uniform) Conditional Sales Act of 1922, revised 1955, amended 1959, s. 4 (2) (b); *Philippines*: Chattel Mortgage Act of 1906, s. 4.

In the *American* Uniform Commercial Code which adopts in two of its alternative versions of s. 9-401 (1) the debtor's residence, the location of the goods is made the applicable criterion for non-residents.

United States: Uniform Commercial Code 1962, s. 9-401 (1) (second and third alternatives, see *infra*).

Denmark, which also relies exclusively on the debtor's domicile, provides in this case for registration in the country's capital.

Denmark: Tingslysningslov of 1926, § 47 para. 2.

In the other countries of this group it seems to be impossible to register security interests in goods held by a person living abroad. Whether this affects merely the possibility of registration or in fact excludes altogether the possibility of creating a valid security interest, is not clear.

(3) Registration at the *domicile of the secured creditor* is prescribed in *Brazil*, but for only one kind of security interest and in *Poland* for loans made by a State bank.

Brazil: Law no. 4 728 of 1965 (as amended by Decreto-Lei no. 911 of 1969), art. 66 § 1. *Poland*: Civil Code of 1964, art. 308 para. 3.

(4) Certain countries are satisfied with one registration in a *central registry*.

Australia: *New South Wales*: Bills of Sale Act, 1898-1938, s. 4 (1); *Victoria*: Instruments Act 1958, s. 33; *Western Australia*: Bills of Sale Act, 1899-1957, s. 8 (3); *Dominican Republic*: Law no. 1608 on conditional sales of movables of 1947, art. 2; *Lebanon*: Loi relative à la vente à crédit des autovéhicules, machines agricoles et industrielles of 1935, art. 5.

(5) The three main criteria so far mentioned are sometimes also *combined* in various ways. The simplest combinations involve merely the *situs* of the goods and the debtor's domicile. In *Argentina*, a mortgage of fixed chattels is registrable at the place of location, whereas a floating charge at the debtor's domicile.

Argentina: Ley no. 12 962 on *prenda con registro* of 1947, as amended in 1963, arts. 12 and 16.

Canada, Kenya and the *Philippines* cumulate registration at the situs and the debtor's domicile.

Canada: (Uniform) Conditional Sales Act of 1922, revised 1955, amended 1959, s. 4 (3) and (5); *Kenya*: Chattels Transfer Ordinance 1930, s. 7 (4); *Philippines*: Chattel Mortgage Act of 1906, s. 4.

In *England*, a chattel mortgage granted by a company is registrable centrally in London and in addition at the company's, i.e. the debtor's, office.

England: Companies Act, 1948, ss. 95 (1) (c) and 104.

A similar rule may be expected in all jurisdictions of the British Commonwealth which have adopted English company law.

In the second place, three criteria are combined, namely *situs*, debtor's domicile and central registration. All three are cumulated in *England* for bills of sale.

England: Bills of Sale Act, 1878, s. 13, and Bills of Sale Act (1878) Amendment Act, 1882, s. 11. These provisions have not been taken over in *Canada* and *Australia*, see *supra*.

The most complicated combinations occur in the *American* Uniform Commercial Code which provides the adopting states with no fewer than three alternative versions of the relevant provision. Further modifications have been separately introduced by a number of states. If we keep to the official text of UCC s. 9-401 (1), the states have the following choices: (1) generally central registration, but local filing for fixtures; only five small states have opted for this solution. (2) As in (1), but for various farming assets and consumer goods in the county of the debtor's residence; 24 states have adopted this version. (3) As in (2), but in addition to filing in a central registry at the debtor's place of business or residence also; 17 states have preferred this approach.

United States: Uniform Commercial Code 1962, s. 9-401 (1).

(4) Some states have stressed local filing at the debtor's residence.

(c) *Effective duration of registration.* In many countries a registered security interest automatically lapses at the expiration of a fixed period unless registration is renewed. In this sense registration offers a convenient way of terminating a security interest, and very many countries with systems of registration have availed themselves of this opportunity. There seems to be only one State where even an unregistered security terminates, namely *Venezuela*.

Venezuela: Decreto no. 491 on sales under reservation of ownership of 1958, art. 10 (time-limit of five years).

The life of a security interest after registration varies generally from one to 10 years; usually prolongations are possible. The very short period of *one year* (or 15 months) is often prescribed for agricultural mortgages, especially in *Australia*, on those on crops, livestock and wool.

Australia: mortgages for the next ensuing crop, etc. in *New South Wales*: Liens on Crops and Wool and Stock Mortgages Act of 1898, ss. 9 and 17; *Queensland*: Bills of Sale and other Instruments Act, 1955, ss. 33 and 13; *Victoria*: Instruments Act 1958, s. 79; *Western Australia*: Bills of Sale Act, 1899-1957, s. 40. See also *Costa Rica*: Commercial Code of 1964, art. 543 (fruits and other products). See generally *Australia*, state of *Victoria*: Instruments Act 1958, s. 44 (as amended by the Instruments (Bills of Sale) Act, 1958, s. 5); *Peru*: Decreto Supremo of 13 May 1953.

A *two-year* period is somewhat rare and applies again mostly to agricultural security.

Brazil: Law no. 492 on rural pledges of 1937, art. 7 para. 1 (as amended); *Uruguay*: Ley no. 5649 sobre prenda rural of 1918, art. 10.

Some countries specify a life-span of *three years*.

Australia: state of *Western Australia*: Bills of Sale Act, 1899-1957, ss. 14 and 15; *Brazil*: Law no. 492 on rural

pledges of 1937, art. 13 para. 1; *Canada*: (Uniform) Bills of Sale Act of 1928, revised 1955, amended 1959, s. 11 (1) and (7); (Uniform) Conditional Sales Act of 1922, revised 1955, amended 1959, s. 12 (1) and (7); *Dominican Republic*: Law no. 1608 on conditional sale of movables of 1947, art. 9; *Paraguay*: Decreto-Ley no. 896 on prenda con registro of 1943, art. 17 paras. 1-2 (five years for machines); *Spain*: Ley sobre hipoteca mobiliaria of 1954, art. 79 (six years for chattel mortgages).

The period is *four years* in two *Central American* countries and in *Venezuela*:

Costa Rica: Commercial Code of 1964, art. 542 (with the exception of fruits and other products); *Panama*: Decreto-Ley no. 2 on chattel mortgages of 1955, art. 7 last par. and art. 17 last par.; *Venezuela*: Ley de hipotecas mobiliaria of 1973, art. 85 (six years for chattel mortgages).

Many countries have settled for a five-year period.

Argentina: Ley no. 12 962 on prenda con registro of 1946, art. 23; *Australia*, states of *New South Wales*: Bills of Sale Act, 1898-1938, s. 5, and *Queensland*: Bills of Sale and other Instruments Act of 1955, s. 12; *England*: Bills of Sale Act, 1878, s. 11; *France*: Loi relative au nantissement de l'outillage et du matériel d'équipement of 1951, art. 11; *Kenya*: Chattels Transfer Ordinance 1930, s. 10; *Lebanon*: Loi relative à la vente à crédit des autovéhicules, machines agricoles et industrielles of 1935, art. 8; *New Zealand*: Chattels Transfer Act 1924, s. 14; *Switzerland*: Decree of the Federal Tribunal of 1939, art. 3; *United States*: Uniform Commercial Code of 1962, s. 9-403 (2).

In a few cases a time-limit of *10 years* is provided.

Denmark: Tingslysningslov of 1926, § 47 para. 3; *Finland*: Chattels Mortgage Act of 1923, § 15; *France*: Loi relative à la vente et au nantissement des fonds de commerce of 1909, art. 28 para. 1 (as amended); *Luxembourg*: Arrêté portant réglementation de la mise en gage du fonds de commerce of 1937, art. 19.

Finally, one Latin American State expressly provides for registration to remain in force for an *unlimited* duration.

Chile: Law no. 5687 on the contract of *prenda industrial* of 1935, art. 30.

It may be assumed that countries other than those mentioned above do not fix a time-limit either.

(*d*) *Effects of registration.* Where a code imposes a duty to register, it is only in exceptional circumstances that the consequences of registration or non-registration are not set out (for a few exceptions, see *supra* (a)).

According to the legislative texts of most countries registration is a condition for the security interest to become effective vis-à-vis *third persons* in general.

Detailed references would be too numerous to indicate here. Suffice it to mention the countries: Argentina, Brazil, Canada, Chile, Colombia, Denmark, Dominican Republic, Ethiopia, Honduras, Japan, Lebanon, Mexico, Nicaragua, Panama, Philippines and Portugal.

A few statutes curtail the above principle by limiting it either to bona fide third persons,

Costa Rica: Commercial Code of 1964, arts. 542, 558; *Denmark*: Tingslysningslov of 1926, § 47 para. 1,

or to creditors of the debtor,

England: Companies Act, 1948, s. 95 (1),

or to bona fide creditors of the debtor.

Israel: Pledges Law, 1967, s. 4 (3).

Whether apart from creditors the category of third persons includes other persons, particularly purchasers, is doubtful; this will be examined later (*infra* s. 2.3.5.1 and 2.3.5.2). Only one country extends the effects of a registered security interest as against purchasers.

Italy: Codice civile art. 1524 para. 2 and Law no. 1329 providing for the acquisition of new machines of 1965, art. 3 para. 4 (reservation of ownership in machinery exceeding a certain purchase price).

A very flexible definition of third persons exists in the *United States*.

United States: Uniform Commercial Code of 1962, s. 9-301 to 9-304.

Some countries declare registration to be a condition precedent to the security interest taking effect even *inter partes*.

Ecuador: Commercial Code art. 581 para. 4; *Egypt*: Loi no. 11 sur la vente et le nantissement des fonds de commerce of 1940, art. 12 para. 1; *England*: Bills of Sale Act, 1882, s. 8, see Heseltine v. Simmons, [1892] 2 Q.B. 547 at 552 (C.A.); *France*: Loi relative à la vente et au nantissement des fonds de commerce of 1909, arts. 10 para. 2, 11 para. 1; Loi relative au nantissement de l'outillage et du matériel d'équipement of 1951, art. 3; *Japan*: Enterprise Hypothecation Law of 1958, art. 4 para. 1; *Poland*: Civil Code of 1964, art. 308 para. 3; *Spain*: Ley sobre hipoteca mobiliaria of 1954, art. 3 para. 4; *Switzerland*: Civil Code art. 715 para. 1; *Tunisia*: Commercial Code art. 239 para. 2 (enterprise mortgage); *Turkey*: Civil Code art. 688; *Uruguay*: Ley no. 5649 sobre prenda rural of 1918, art. 6; *Venezuela*: Ley de hipotecas mobiliaria of 1973, art. 4 para. 2.

Registration, however, has probably nowhere the effect of curing defects in the contract concluded between the parties, although this is only rarely expressly laid down.

Australia: state of *Queensland*: Bills of Sale and other Instruments Act 1955, s. 7 (3); *Costa Rica*: Commercial Code of 1964, art. 559; *Spain*: Ley sobre hipoteca mobiliaria of 1954, art. 3 para. 5.

2.3.3.4 *Other formalities*

Formalities other than a formal contract or registration mainly take the form of marking the encumbered goods or of advertising the security interest.

(*a*) Marking of the encumbered goods with the secured creditor's name is usually either in addition to, or in place of, registration; rarely is it still the exclusive method of publication.

(1) Marking is required *in addition to registration* in a few scattered statutes concerning machinery. *France, Japan* and *Thailand* provide for the affixing of marks on the mortgaged machinery by a State office.

France: Loi relative au nantissement de l'outillage et du matériel d'equipement of 1951, art. 4; *Japan*: Construction Machinery Hypothecation Law of 1954, art. 4 para. 1 and art. 3 para. 1; *Thailand*: Registration of Machinery Act of 1971, Ministerial Regulation no. 2, art. 5 para. 2 *juncto* art. 3.

Cyprus also requires registration and marking for certain agricultural instruments, but leaves it to the debtor to affix the ironplate with the owner's name.

Cyprus: Agricultural Instruments (Hire-Purchase) Law of 1922, ss. 4, 6 and 7.

In a few countries special marks (other than the creditor's name) are also required for cattle which has been encumbered. A specific mark has to be attached to cattle in some countries and be included in the particulars presented for registration.

Ecuador: Commercial Code art. 582; *El Salvador*: Commercial Code of 1970, art. 1156 para. 2.

In Austria the validity of the special security interest in cattle is dependent upon the designated mark being affixed to the animal; the additional registration has only limited significance.

Austria: Regulation on credits for fattening cattle of 1932, §§ 1, 5 paras. 1, 7.

(2) A remainder of the earlier efforts to publicize security interests are those statutes which provide for *marking without registration.*

In some *Canadian* provinces the two methods are alternate. Reservations of ownership are exempt from the requirement of registration if the encumbered goods are marked with the

seller's name. Of the additional conditions, the most common is a duty imposed on the secured creditor to answer within a defined short period third party inquiries regarding the amount of the secured claim for the time being still outstanding.

See, e.g., the Conditional Sales Act of *Alberta*, s. 11; *New Brunswick*, s. 4; *Ontario*, s. 2 (5) (b); *Saskatchewan*, s. 5 (7) and (8).

In *Austria* heavy items the physical handing over to the creditor of which would be difficult, may be pledged without transfer, provided they are marked in some obvious way.

Austria: Civil Code of 1811, § 452.

In *Czechoslovakia* an item which is mortgaged must be physically marked so as to make it clear that it is mortgaged unless it is physically delivered to the mortgagee or a third person or unless the fact that it is mortgaged can be indicated on documents without which the item cannot be used, such as a motor vehicle.

Czechoslovakia: International Trade Code of 1963, s. 169.

(3) In *Italy* the validity of a security interest is made conditional upon the affixing of marks in the case of more valuable new machinery the purchase price of which exceeds L. 500,000 = about $US 860, registration in this case being optional.

Italy: Law no. 1329 providing for the acquisition of new machines of 1965, art. 1.

The Canadian province of *Manitoba* requires marking as the only means of publication.

Manitoba: Lien Notes Act, s. 2.

(*b*) The *advertising* of a security interest seems to be obligatory only in *Sweden* and then only for a "chattel mortgage".

Sweden: Regulation on "chattel mortgages" of 1845, as revised 1970, § 1. Publication must be in a newspaper circulating in the place of the debtor's residence; it must contain the names and professions of the parties, the date of the contract and particulars of the amount secured.

It may however be pointed out that in *England* and some other Commonwealth countries it is usual for commercial trade journals to publicize details of bills of sale which have been tendered for registration, so that in fact bills receive considerable publicity—at any rate in the commercial sector.

2.3.3.5 *Protection of third persons*

Many jurisdictions consider it necessary to protect third persons from the intended creation of a security interest. The various approaches are motivated by the desire to improve the chances of third persons of obtaining full satisfaction from the debtor's property in spite of it becoming encumbered by a security interest. Unfortunately, relatively little systematic thought seems to have been devoted to this aspect of security interests so far. In many countries, especially the highly industrialized ones, the pressure to accommodate the secured creditors has clearly prevailed.

One may distinguish a general protection of third persons from protection of specific interests of third persons.

(*a*) *A comprehensive protection* of third persons, especially of unsecured creditors of the debtor, is achieved through various general limitations on the creation of security interests.

Important general limitations are implicit in the various restrictions discussed earlier as to secured claims and admissible objects of security (*supra* 2.3.2.2 and 2.3.2.3).

Another form of indirect, but nevertheless comprehensive protection is provided by the fixing of a ceiling, expressed as a percentage of the value up to which certain objects may be encumbered. Such percentage limits are rather rarely imposed in the case of individual objects.

An exception for instance is the *Brazilian* provision permitting a charge up to 50% only upon products of swine-industry, Decreto-Lei no. 1625 of 1938, art. 8.

Slightly more frequent is a form of restriction by means of numerical limits in connexion with security interests created upon an amalgam of objects. Thus some countries permitting the mortgaging of an enterprise including the stock-in-trade limit the encumbrance on the latter to 50 per cent of its value.

Belgium: Loi sur la mise en gage du fonds de commerce ... of 1919, art. 2 para. 2; *Luxembourg*: Arrêté portant réglementation de la mise en gage du fonds de commerce of 1937, art. 2 para. 2; see also *Spain*: Ley sobre hipoteca mobiliaria of 1954, art. 22 para. 2, and *Venezuela*: Ley de hipotecas mobiliarias of 1973, art. 30 para. 2.

(*b*) The techniques designed to achieve protection of *specific persons* are of two kinds. One is a notice directed to the public at large, of the proposed registration. The other is the necessary consent of specific persons.

One form of a *general notice* is used in a special case by *Switzerland*. If the owner of a railway or shipping enterprise intends to mortgage his enterprise, he requires the consent of the Federal Council. The latter publishes the application in the Federal Gazette setting out a time-limit for objections. If an objection is filed, the objector is required to commence a lawsuit in the Federal Tribunal within 30 days.

Switzerland: Federal Law on hypothecation and forced liquidation of railway and shipping enterprises of 25 Sept. 1917, art. 2. It seems that in practice no objection has ever been filed!

Thailand has recently introduced the possibility of objecting to the mortgaging of machines; however, the details of this procedure, especially the admissible grounds therefore and the method for their ascertainment remain vague.

Thailand: Registration of Machinery Act of 1971, Ministerial Regulation no. 2 of 1971, art. 5 para. 2.

Very detailed, although slightly divergent rules have been enacted for bills of sale (chattel mortgages) in some *Australian* states. *New South Wales* and *Victoria* prescribe that a bill of sale may only be registered two weeks after an application for registration has been lodged,

New South Wales: Bills of Sale Act, 1898-1938, s. 5 E (1); *Victoria*: Instruments Act, 1958, s. 37,

while *Western Australia* requires a separate notice of intention to register a bill of sale in a statutory form.

Western Australia: Bills of Sale Act, 1899-1957, ss. 17 B and 17 C.

In *New South Wales* this procedure is limited to a trader's bills of sale, that is those where the debtor is a retail merchant.

New South Wales: ss. 5 E (1) and 5 B (1).

Publicity for the entries is in fact assured by credit agencies which supply daily listings of bills lodged for registration.

In all three states certain persons may file a *caveat* against the intended registration of the bill of sale.

Such an objection may be filed by any secured or unsecured creditor of the debtor in *Victoria* and *Western Australia*,

Victoria: s. 40; *Western Australia*: s. 17 H (3),

while in *New South Wales* only an unsecured creditor is entitled to object.

New South Wales: s. 5 G (1).

The parties to the bill of sale may thereupon summon the caveator before a judge to show cause why the caveat should not be removed. If the judge finds the caveator's claim to be well-founded he may order that registration of the bill of sale shall not take place until the debt due to the caveator is satisfied.

New South Wales: ss. 5 H (2), 5 I (1); *Victoria*: ss. 40-41; *Western Australia*: ss. 17 H (2), 17 J.

In *New South Wales* the judge has power upon an ex parte application to order the removal of a caveat on such terms as he thinks fit.

New South Wales: s. 5 J.

Australian procedure seems to be an interesting attempt at protecting the interests of the debtor's other creditors, especially the unsecured, against adverse effects that may arise upon the

creation of an intended security interest. Apparently, however, it is not used very much.

The second method of protecting third persons against the adverse effects of the registration of a security interest relies upon the *express consent* of specified persons, usually preceding secured creditors. This method amounts to a voluntary subordination (or postponement) of an existing security interest to a subsequent new security interest. It will therefore be more conveniently discussed in the general context of priorities (*infra* s. 2.3.5 *et seq.*).

2.3.3.6 *Conclusions*

The seemingly innocuous question of whether the creation of a security interest should be subjected to formalities, and if so, to which, has found an incredibly wide range of differing answers. Our concluding analysis can, of course, deal only with the more basic issues of this spectrum of varying solutions.

(*a*) *Functions of formalities.* Our analysis should be introduced by ascertaining the various functions which the major forms of formalities perform.

One peculiar task of the *formal contract* is to fix clearly and immutably the date of creation of the security interest in order to prevent subsequent fraudulent antedating by the creditor. Minimum requirements as to the contents of the contract may serve both parties as well as third persons, but the emphasis is probably on obtaining a registrable instrument. The obligatory use of a statutory form of contract will be designed for the debtor's protection.

Both *registration* of security interests and marking of encumbered goods are to warn third persons against the existence of security interests; they may also help to prevent unauthorized dispositions by the debtor.

(*b*) *Informality v. formality.* The first major controversial issue can be circumscribed by the question of whether statutory formalities are necessary at all or whether the experiences of the "informal" countries (*supra* 2.3.3.1) are outright negative. The question can probably best be answered by ascertaining how the major functions of formalities are solved in the informal countries.

The precise date of the creation of a security interest can only be ascertained by circumstantial evidence, which may sometimes be vague or contradictory. But fraudulent antedating is probably in most countries a relatively rare occurrence. Much more pertinent is the warning function of registration; this will be discussed *infra* (c).

The only recommendation for improving the informal system would be to require for the contract a simple writing, in accordance with general commercial practice. This would reduce the risk of fraud, without imposing an undue burden.

(*c*) *Formal contract v. registration.* As our survey has indicated, registration of security interests has spread over most parts of the globe and is today the most popular formality. How is the warning function of registration performed in countries requiring no formalities or merely a formal contract, but no registration? In these countries the warning function is largely performed by a general knowledge, at least in commercial circles, of which goods usually are bought on credit and which debtors are most likely to do so. Of course, this rather general knowledge requires additional ascertainment in each individual case. However, the modern systems of notice-filing do not offer much more precise information. Even though modern registration systems may be simple and cheap to operate,

Goode and Ziegel, *op. cit.*, 161

they require additional paper work, time, costs and offices.

Council of Europe, *Sales of Movables by Instalment and on Credit in the Member Countries of the Council of Europe* (cited as UNIDROIT) 253

The advantages to be gained thereby appear to be slim in general.

Do these considerations apply to international trade as well? Foreign creditors will often be ignorant about the credit habits of a particular country or of their specific debtor. However, foreign creditors will require local advice in any event. Without it they would not even know to which registration office they should turn in order to obtain precise information on their debtor's property. They will need local advice even more for the creation of the security interest if the encumbered goods are situated in the foreign debtor's country and therefore subject to its law (*infra* 3.2.1). Requisite local advice can easily be extended to cover the legal position of the debtor's property. Registration therefore is not necessary to facilitate international trade.

The scepticism heretofore expressed about registration does not, of course, imply any objection to existing schemes of registration. These are certainly most useful where they function properly.

(*d*) *The system of registration.* Of the numerous technical aspects of registration, the most important is that of the proper place of registration. Goode and Ziegel have convincingly shown the advantages of one central registration. Most important, it facilitates searches by third persons. It also avoids, on the part of the creditor, all doubts about the proper place of registration, and refiling in case of removal of the debtor's domicile or the location of the goods.

Goode and Ziegel, *op. cit.*, 162.

(*e*) *Marking and advertising v. registration.* If a public warning against existing security interests is desired, *marking* is clearly inferior. The more aggravating disadvantages of marking have been aptly summarized as follows: (1) the necessity of close, physical inspection of the goods to be encumbered; this is particularly burdensome if all the assets of an enterprise have been purchased or if distances between the business places of the parties are great. (2) The marks may be fraudulently (or negligently) removed by the debtor or they may wear off in the course of time.

See Goode and Ziegel, *op. cit.*, 160 who indicate additional objections. *Contra*: UNIDROIT 253, who does not, however, offer any discussion or reasons.

Also *advertising* is less effective than registration, although better than marking. It provides wide publicity at the time of creating the security interest, and interested persons such as credit agencies may use this as a basis for collecting permanent information. However, the emphasis is probably on avoiding conflicts with existing (secured or unsecured) creditors.

(*f*) *Interaction of registration and advertising.* The optimal form of publication, namely a combination of registration and advertising, is apparently nowhere prescribed. But in some countries private systems of collecting and publishing information on security interests seem, in effect, to combine both methods. Thus in some countries the registration of security interests is published in private trade journals. Conversely it may be expected that the prescribed advertisement of security interests will serve as the basis of private registers kept by credit agencies.

(*g*) *Issue of certificate.* Serious consideration should be given to the UNIDROIT proposal to extend the use of certificates, following the various models of certificates for motor vehicles (see *infra* 2.5.1.3).

UNIDROIT 253.

The certificate, be it official or private, is held by the secured creditor. Any disposition by a debtor who cannot produce the certificate is, since a purchaser under these circumstances is not *bona fide*, ineffective as against the secured creditor. Of course, this system works only with durable goods of some size that can be individualized. Also, it is exposed to the fraudulent practices of debtors who may be able to procure themselves substituted "clean" documents. In spite of these limitations the use of certificates should be seriously considered.

(*h*) *Final conclusion.* The preceding discussion has shown that no single formality for security interests is clearly superior to all others. A written security agreement, registration of the

security interest or its advertisement seem to be, generally speaking, on a *par*. The least cumbersome, but most effective publicity can probably be achieved by certificates over the encumbered goods and retained by the secured creditor.

On the other hand, a formalized written contract appears to be too formalistic, while marking of the encumbered goods does not provide sufficient formal publicity, if such is desired.

2.3.4 *Extension of security interests*

The extension of a security interest may affect its "active" or "passive" side: the debt secured may become increased by the admission of new claims under the cover of the security; or there may be alterations in, or additions to, the goods encumbered. We shall first deal with the "active" side because it is relatively simple, before proceeding to the more complicated questions of changes in the encumbered items.

2.3.4.1 *Extension of the secured claim*

Legislative rules permitting or prohibiting an extension of the secured claim are rare; but two examples of the opposing views can be furnished.

The *Israeli* Pledges Law of 1967 requires that, where the parties agree to enlarge the extent of the obligation, the security shall not cover any additional obligation unless an increase is effected in the encumbered goods for that purpose.

Israel: Pledges Law of 1967, s. 7 lett. (b).

In *Czechoslovakia, Hungary, Poland* and the *United States* the law expressly recognizes that a security interest may cover future advances or other value.

Czechoslovakia: International Trade Code of 1963, s. 162; *Hungary*: Civil Code of 1959, para. 253 (3); *Poland*: Civil Code of 1964, art. 306 para. 2;

United States: Uniform Commercial Code s. 9-204 (5); see also *Venezuela*: Ley de hipotecas mobiliarias of 1973, art. 14.

Unlike *Israel* there seems to be no restriction here concerning future advances subsequently agreed upon.

Future claims are also very liberally admitted by court practice in the *Federal Republic of Germany* and the *Netherlands*. In both countries it also seems possible to enlarge the secured obligation by a subsequent agreement without the need of furnishing additional security.

In other countries the situation is not entirely clear since information is not easily available.

2.3.4.2 *Extension of the encumbered goods*

An increase in the goods encumbered is, to a limited degree, admitted by the traditional rules on pledge, especially with regard to natural (or "legal") fruits or products. The demand for such extensions is, however, much stronger in the case of non-possessory security interests since the debtor as the holder of the encumbered goods may have a much greater interest in their disposal than has the creditor in the case of a pledge. In discussing these extensions one may distinguish three categories, namely substituted monetary claims, and additions to, and substitutions of, encumbered goods. A special group is formed by "complex units" of the goods charged (explained below, 2.3.4.3).

(*a*) *Substituted monetary claims.* Such substitutions may be either voluntary or involuntary on the part of the debtor.

The chief examples of *involuntary substitutions* are claims to the proceeds of an insurance against the loss of, or damage to, the encumbered goods; and other claims against a tortfeasor, an expropriating State or another debtor for reimbursement for loss of, or damage to, the charged goods. The statutory extension of a security interest to such monetary claims which arise involuntarily as substitutes of the destroyed or damaged goods meets with little resistance. Neither the debtor nor his creditors suffer a disadvantage since the extension does not cover additional items of the debtor's property, but something of value furnished by a third person. A number of countries therefore expressly extend the scope of the security interest to cover monetary claims substituting the originally encumbered items.

Argentina: Ley no. 12 962 on prenda con registro of 1947, art. 3 para. 2; *Chile*: Law no. 4702 on instalment sale of movables of 1929, art. 7, and Law no. 5687 on the contract of prenda industrial of 1935, art. 31; *Colombia*: Commercial Code of 1971, art. 961 (for reservation of ownership); *Ecuador*: Commercial Code of 1959, art. 589; *Finland*: Chattel Mortgage Act of 1923, § 11; *Guatemala*: Civil Code of 1963, art. 902; *Israel*: Pledges Law of 1967, s. 9 lett. (a); *Japan*: Construction Machinery Hypothecation Law of 1954, art. 12; *Nicaragua*: Law on Agrarian and Industrial Pledge of 1937, art. 3 para. 2; *Paraguay*: Decreto-Ley no. 896 on prenda con registro of 1943, art. 17 para. 3; *Peru*: Law no. 2402 on Registration of Agricultural Pledges of 1916, art. 5; *Spain*: Ley sobre hipoteca mobiliaria of 1954, arts. 5 and 62 para. 2 (the secured creditor may even pay the insurance premiums on which the debtor defaults, which are then covered by the security, art. 6); *Uruguay*: Ley no. 5649 of 1918 sobre prenda rural, art. 10; see also art. 19; *USSR*: Civil Code of the RSFSR of 1964, s. 200; *Venezuela*: Decreto no. 491 on sales under reservation of ownership of 1958, art. 12; Ley de hipotecas mobiliaria of 1973, art. 7.

In order that the secured creditor may be effectively assured the opportunity to avail himself of the most frequently substituted monetary claim, i.e. that for the insurance proceeds, some of the aforementioned statutes require the parties to state details of such insurances in their contract.

Argentina: art. 11 lett. f and art. 15 lett. f; *Chile*: Regulation for the special pledge register under the law on instalment sale of movables of 1929, art. 3 no. 8; Regulation for the register of "prenda industrial" of 1928, art. 3 no. 9; *Nicaragua*: art. 6 lett. e; *Paraguay*: art. 11; *Spain*: art. 57 no. 4; *Uruguay*: Decreto containing regulations on the Law on agrarian pledge of 1918, art. 3 para. 1; *Venezuela*: Ley de hipotecas mobiliarias of 1973, arts. 22 no. 6 and 59 no. 8.

Much less favoured are extensions of a security interest to monetary claims which may arise upon an *intentional* substitution of the encumbered goods. The most important example here is the claim to the purchase-price of the goods if the debtor should sell them to a third person. The reluctance on this point is apparently due to the belief that any such extension of necessity constitutes an implicit permission to the debtor freely to dispose of the subject-matter of the security. It is submitted that, although understandable, this assumption is wrong. But only few countries have overcome this misunderstanding. Some of these provide for a statutory extension of the security interest.

Colombia: Commercial Code of 1971, art. 1218 para. 2; *Costa Rica*: Commercial Code of 1964, art. 548 (fruits in season); *Japan*: Construction Machinery Hypothecation Law of 1954, art. 12; *Nicaragua*: Law on Agrarian and Industrial Pledge of 1937, art. 27 para. 1 (for unavoidable sale of perishable fruits); *United States*: Uniform Commercial Code s. 9-306 (2) — (5).

And one other country sanctions such extension only where the parties have so agreed.

Federal Republic of Germany: standing court practice.

(*b*) *Additions to, and substitutions of, encumbered goods.* As regards *additions* to encumbered goods, these may take at least two different forms, namely fruits or progeny, and after-acquired goods.

An extension of a security to fruits or progeny of animals is provided by statute in a few agricultural states.

Australia: "stock" (i.e., cattle) mortgages in the states of *Queensland*: Bills of Sale and other Instruments Act of 1955, s. 27 (1); *Victoria*: Instruments Act 1958, s. 75; *Western Australia*: Bills of Sale Act, 1899-1957, s. 38; *Kenya*: Chattels Transfer Ordinance 1930, s. 25; *Mexico*: Ley gen-

eral de títulos y operaciones de crédito of 1932, art. 322, 324 (certain special credits); *New Zealand*: Chattels Transfer Act 1924, s. 29. See also *Czechoslovakia* International Trade Code of 1964, s. 159.

The status of *after-acquired items* (apart from substituted goods) is less certain since later acquisitions usually lack any connexion with the originally encumbered goods. A few legal systems expressly exclude in general from the coverage of the security any assets which have been acquired by the debtor subsequent to the creation of the security interest.

Australia, state of *Queensland*: Bills of Sale and other Instruments Act of 1955, s. 21; *England*: Bills of Sale Act (1878) Amendment Act, 1882, s. 5; *Kenya*: Chattels Transfer Ordinance 1930, s. 18; *New Zealand*: Chattels Transfer Act 1924, s. 24 (1).

The principle however is merely established in order that certain exceptions may be grafted thereon. One exception, more apparent than real, relates to a purchase-money loan with which the goods to be encumbered are to be acquired in future.

Australia, state of *Queensland*: Bills of Sale and other Instruments Act of 1955, s. 21 first proviso; *Guatemala*: Civil Code of 1963, art. 911; *New Zealand*: Chattels Transfer Act 1924, s. 24 (2).

Much more important is another exception extending the security interest to goods of the same class brought to the place or business premises where, according to the agreement of the parties, the originally encumbered goods are being kept. Some jurisdictions provide for such an extension by statute, subject to any agreement to the contrary between the parties.

Australia: generally state of *Queensland*: Bills of Sale and other Instruments Act of 1955, s. 21 second proviso sub (ii) and (iii); for "stock" (i.e., cattle) mortgages: *Queensland*, s. 27 (1); *Victoria*: Instruments Act 1958, s. 75; *Western Australia*: Bills of Sale Act, 1899-1957, s. 38; *Kenya*: Chattels Transfer Ordinance 1930, s. 25 (1) for stock (of animals); *New Zealand*: Chattels Transfer Act 1924, s. 26 lett. (c) and 29 for machines, vehicles, implements and stock (of animals).

The trend of present-day law would seem to be more reserved. The parties are empowered to conclude an appropriate agreement, but this is a necessary prerequisite to the extension.

Australia, state of *Western Australia*: generally, apart from "stock" mortgages, s. 7 A; *Federal Republic of Germany* and the *Netherlands*: judicial practice, *United States*: Uniform Commercial Code s. 9-204 (3) with exceptions as to crops and consumer goods in subs. (4).

The *substitution* of encumbered goods poses quite different problems, which are somewhat related to voluntarily substituted monetary claims (*supra* (*a*)). Should the debtor be enabled to replace worn-out machinery, the subject-matter of a security interest, by new or modern equipment? The interests at least of the debtor and secured creditor are clearly in favour of such a solution. A similar question arises in a slightly different context if the goods encumbered consist of cattle, crops or raw materials which the debtor intends to use for producing finished or semi-finished goods. Such substitution would seem to be not only in the interest of the parties, but also beneficial to any interested third person.

As one would expect only a few countries provide expressly for the extension of a security interest to substituted goods, subject to contrary agreement by the parties.

Australia: generally and for cattle in the state of *Queensland*: Bills of Sale and other Instruments Act of 1955, s. 21 second proviso sub (i) and s. 27 (1); *Brazil*: Law no. 492 on rural pledges of 1937, art. 12 §§ 2, 3 providing however that to become effective against third persons, a corresponding amendment of the contract be made; Decreto-Lei no. 1697 extending the provisions of Decreto-Lei no. 1271 of 1939, art. 2, requiring the secured creditor's written consent; *England*: Bills of Sale Act (1878) Amendment Act, 1882, s. 6 sub (2); *Kenya*: Chattels Transfer Ordinance 1930, s. 20 lett. (b) for certain items; *Mexico*: Ley general de títulos y operaciones de crédito of 1932, art. 335; *New Zealand*: Chattels Transfer Act 1924, s. 26 lett. (b) for certain items; *Uruguay*: Ley 8 292 of 1928 on prenda industrial, art. 2 no. 3.

In one country the substitution of fungible goods by assets of the same class may be agreed by the parties.

Guatemala: Civil Code of 1963, art. 909.

In others, such agreement is presumed.

Honduras: Commercial Code of 1950, art. 1294; to like effect *Kenya*: Chattels Transfer Ordinance 1930, s. 42 and Third Schedule no. 4; *New Zealand*: Chattels Transfer Act 1924, s. 50 and Fourth Schedule no. 4.

In a class of their own are substitutions of encumbered materials with products. In particular a number of Latin American states provide for this kind of extension of a security interest.

Argentina: Ley no. 12 962 on prenda con registro of 1947, art. 3 para. 2, subject to any contrary agreement between the parties, art. 8 para. 2; *Chile*: Law no. 5 687 on the contract of "prenda industrial" of 1935, art. 25 para. 2; *Colombia*: Commercial Code of 1971, art. 1218 para. 2; *Mexico*: Ley general de títulos y operaciones de crédito of 1932, arts. 322, 324; *Paraguay*: Decreto-Ley no. 896 on prenda con registro of 1943, art. 20 para. 1, requiring the previous consent of the secured creditor; *Venezuela*: Ley de hipotecas mobiliarias of 1973, art. 8 para. 2.

It goes without saying that a statutory or valid contractual clause providing for after-acquired property will cover substituted goods.

2.3.4.3 *"Complex units" of charged goods*

Instead of permitting additions to, or substitutions of, individual encumbered goods or claims, a legislator may take another course of action in order to achieve the extension of a security. He may empower a debtor to encumber a number of items designated as a unit and treated collectively as a fluid compound in which the individual components may fluctuate (referred to herein as a "complex unit"). A major obstacle to such an arrangement is the principle recognized in most legal systems of admitting the creation of rights *in rem* as a rule only in specific individual items. Any exception to this principle usually requires special legislative authority. By permitting the creation of a security interest in a complex unit, the legislator often impliedly allows the substitution and addition of individual items in the complex unit. He also impliedly grants the debtor power to dispose of the encumbered items.

The complex units thus created by legislation have taken different forms, and each must be analysed separately in order to assess the degree to which it implies the substitution of encumbered goods.

Probably the simplest case, and a rather special one, is the Spanish rule on collections of works of art and of historical works which may be encumbered as a whole.

Spain: Ley sobre hipoteca mobiliaria of 1954, art. 54, mentioning expressly pictures, sculptures, porcelain and books; similarly *Venezuela*: Ley de hipotecas mobiliarias of 1973, art. 51 first paragraph.

This example is rather unique because of its non-commercial context. Typically, complex units of goods are only found in the business field.

The first model of a commercial nature is the *Argentine* floating pledge (*prenda flotante*). Its subject-matter is goods and raw-materials belonging to a commercial or industrial firm, provided, however, that the secured claim does not exceed a maximum duration of 180 days. The security interest covers the goods produced by the transformation of the originally encumbered goods as well as those acquired by the debtor in replacement of them.

Argentina: Ley no. 12 962 on prenda con registro of 1947, arts. 14-16.

The restriction of this security interest to short-term advances and the little practical use that is being made of it prove its limited utility.

The second commercial model is the *Finnish* chattel mortgage. It may cover machines, inventory, raw-materials, and finished and semi-finished products and also animals and agricultural products of industrial, certain artisanal, or agricultural enterprises.

Finland: Chattel Mortgage Act of 1923, § 2.

All items of the above classes are subject to the security, as long as they are kept on the business premises or in another specifically registered location (§ 4 par. 1). This rule obviously also embraces additions and substitutions. The statute expressly permits the debtor to withdraw items from the ambit of the charge, provided this is done in the regular course of business or for the purpose of replacement or if the residual goods are obviously sufficient to satisfy the secured creditor (§ 4 par. 2).

The connexion between encumbered goods and a specific business enterprise is even more emphasized in the third commercial model. Here it is a *business undertaking* as such which is encumbered. One may distinguish in essence two approaches which are derived from the French enterprise mortgage on the one hand and the English floating charge on the other.

The *French* enterprise mortgage is more restricted in scope. It has been adopted, with certain variations, by a number of Latin, African and Asian countries and one may distinguish between two types, one narrow and the other more liberal.

The narrow type is found especially in *France* itself. The French law of 1909 in the first place circumscribes the goods which may be covered: first, the business sign and trade name; second, the rights under a lease (of the business premises); third, the goodwill and custom; fourth, the commercial installations; and fifth, industrial property rights and copyright.

France: Loi relative à la vente et au nantissement des fonds de commerce of 1909, art. 9 para. 1. Corresponding provisions in *Egypt*: Loi no. 11 sur la vente et le nantissement des fonds de commerce of 1940, art. 9 para. 1; *Lebanon*: Décret-Législatif no. 11 of 1967, art. 23 para. 1; *Tunisia*: Commercial Code of 1959, art. 237 para. 1.

This catalogue emphasizes incorporeal values; it excludes especially merchandise (stock in trade),

Expressly *Lebanon* art. 23 para. 4

and money claims. The emphasis on incorporeal values is underlined by the presumption that only the first three items of the catalogue are deemed to be included in an enterprise mortgage, unless the parties expressly and specifically include additional items.

France: art. 9 para. 3; *Egypt*: art. 9 para. 2; *Lebanon*: art. 23 para. 2; *Tunisia*: art. 237 para. 3. In *Denmark* the lessor of business premises may mortgage the inventory and, in case of an agricultural lease, also the animals, crops and other products, Konkurslov of 1872, § 152 para. 2.

Somewhat broader is the coverage of enterprise mortgages in *Belgium*, *Luxembourg* and probably also *Argentina*. These countries do not enumerate the items that may be charged, but offer merely an illustrative list from which the parties may deviate and to which apparently they may also add.

Argentina: Ley no. 12 962 on prenda con registro of 1947, art. 11 lett. (*d*); *Belgium*: Loi sur la mise en gage du fonds de commerce of 1919, art. 2 para. 1; *Luxembourg*: Arrêté portant réglementation de la mise en gage du fonds de commerce of 1937, art. 2 para. 1.

The latter is true in particular for merchandise which, while primarily excluded

Expressly *Argentina* art. 11 lett. (d),

can be included by the parties, although subject to limitations in some countries.

Belgium: art. 2 para. 2, and *Luxembourg*: art. 2 para. 2: up to 50 per cent of its value.

Considerably broader in its coverage is the modern, liberal type of enterprise mortgage. It comprises or may comprise, apart from incorporeal interests such as trade name, lease, goodwill and industrial property rights, tangible values such as installations, machines, raw-materials and merchandise.

Colombia: Commercial Code of 1971, arts. 532 para. 2, 516; *El Salvador*: Commercial Code of 1970, art. 557; *Guatemala*: Commercial Code of 1970, art. 657; *Honduras*: Commercial Code of 1950, arts. 648, 1315; *Mexico*: Ley general de instituciones de crédito of 1941, art. 124; *Spain*: Ley sobre hipoteca mobiliaria of 1954, arts. 20-22; *Sweden*: Law on enterprise mortgage of 1966, § 4; *Venezuela*: Ley de hipotecas mobiliaria of 1973, arts. 27-30.

In most countries, the catalogue of chargeable items comprises money claims also, except in Spain. But only few statutes provide expressly for the regrouping of the encumbered goods. A *Spanish* provision includes implicit permission for the debtor to sell his merchandise,

Spain: art. 22 para. 2; also *Venezuela*: art. 30 para. 2

but he is obliged (vis-à-vis the secured creditor) to maintain the quantity and value at the same level as specified in the contract with the creditor. In *Mexico*, the debtor is empowered to dispose of money claims and to substitute them in the ordinary course of business, unless the parties have agreed otherwise.

Mexico: art. 124 para. 1.

Only *Colombia* expressly provides that encumbered assets which have been alienated or consumed shall be deemed to be replaced by those which, in the course of business, have been produced or acquired.

Colombia: Commercial Code of 1971, art. 532 para. 3.

It may be assumed, however, that a corresponding rule applies in all the other countries.

The *English* floating charge, a most remarkable "invention" of business and judicial practice and essentially uncodified to this day, is considerably broader than its French and Latin counterparts. It has been taken over by all former and present members of the British Commonwealth which have adopted British company law. It is available only to incorporated companies, and not to individuals. The debtor company may create, apart from a fixed charge which comprises specific items a charge covering the whole business undertaking and all present and future assets of any kind. In the life of a floating charge two phases have to be distinguished. At the beginning and as long as it "floats", the charge is not yet a true right *in rem* encumbering any specific item of the business assets. Consequently the company is free to dispose of its assets in the ordinary course of business, and other creditors may levy execution on them. It is only upon the happening of the events specified in the security agreement (which generally includes the levy of execution by another creditor), or if the secured claim falls due and the creditor appoints a receiver or if the company becomes insolvent, that the charge "crystallizes' and becomes a true right *in rem*.

England: See *Gower*, The Principles of Modern Company Law (ed. 3, 1969) 78-80, 420-425.

The English model has inspired *Japanese* legislation. The Japanese Law of 1958 follows in most respects the English rules, although "translated" into a civil law system.

Japan: Enterprise Hypothecation Law of 1958.

Subject-matter of the security are the total assets of a limited company from time to time belonging to the company "as a single unity".

Art. 1 para. 1; art. 2 para. 1.

The right qualifies as a right *in rem* (art. 1 para. 2), but is subordinated to specific rights *in rem* and general and specific preferences (arts. 6 and 7). Enforcement by the secured creditor is subject to court supervision and is effected by a receiver appointed by the court.

Arts. 19-21, 30-36.

2.3.4.4 *Conclusions*

The problems surrounding the extension of security interests affecting either the secured claims or the encumbered goods, are of relatively recent origin and have therefore not yet been very well considered. Accordingly, the illustrative rules adduced in the foregoing discussion represent a smaller number of countries than in other fields. Due to this narrower basis of comparison the following conclusions are also of a more tentative nature.

(*a*) *Extension of the secured claim.* The restrictive *Israeli* rule under which an extension of the secured obligation must be made up by an increase in the encumbered goods, is not persuasive. It is apparently based on the idea that the secured claim and the security ought to be balanced, but for good reason this idea is not recognized anywhere else in the law of security interests and it is equally unacceptable here. The appreciation of the interests of debtor and creditor is definitely best left to themselves. As regards third persons, especially other creditors, it is more than doubtful whether their interests are promoted by an invitation to encumber more goods. Extensions of the secured claim should therefore not be restricted.

(*b*) The *involuntary substitution of monetary claims* for the loss of, or damage to, encumbered goods does not meet with objections from any side. The widespread and increasing recourse to insurance makes it desirable to lay down an express rule on such substitutions, especially with respect to the insurance claims themselves.

(*c*) An *intentional substitution of monetary claims* for the disposition of encumbered goods poses some difficult problems. In the first place it should be clearly spelt out that any statutory or contractual provision granting such a substitution does not imply an otherwise unavailable permission to the debtor freely to dispose of the encumbered goods. The substitution takes place if and when the debtor has disposed of the encumbered items, irrespective of whether the disposition was permitted or not.

Difficulties are bound to arise if the substituted monetary claim, especially that for the purchase-price of the encumbered goods, had already been charged by the debtor prior to his disposition of the encumbered goods. The resulting conflict between two secured creditors arises frequently since the assignment of present and future claims of money is very popular in many countries. The proper resolution of the conflict is controversial and is outside the scope of this paper.

(*d*) *Additions to the encumbered goods.* The extension of the security interest to *fruits or progeny of animals* gives a windfall to the secured creditor and diminishes the free assets available to the debtor's unsecured creditors. While there is certainly reason to allow a contractual extension of this nature, a statutory extension appears to be too favourable for the creditor.

The same considerations militate against a statutory extension of the security interest to *after-acquired goods* of the debtor.

(*e*) *Substitutions of encumbered goods* pose problems similar to those raised by intentionally substituted monetary claims (*supra* (*c*)). However, their factual importance is less pressing since the substitution of goods for goods is less attractive for the parties and is therefore likely to be better justified economically. The replacement of worn-out encumbered machinery or the substitution of the products for encumbered raw materials does not seem to meet any objection.

In the context of these substitutions it would even seem permissible to imply a permission to effect such substitutions from an express statutory or contractual provision regulating the effects of a substitution.

There is a risk of conflicting security interests in the substituted items. However, the general rules on the effects of a security interest against third persons, especially against other secured creditors (see *infra* 2.3.5.3) supply a proper solution to such conflicts.

While detailed statutory rules on the subject do not appear to be indicated, legislation should expressly empower the parties to make corresponding arrangements where their right to do so is doubtful.

(*f*) *Complex units of charged goods.* The institution of "complex units" like the business enterprise is the most refined form of a global security interest as distinct from one on specific items. It implies the debtor's power to dispose of the charged goods and to substitute or add new items. One may probably say that such complex units are the extreme consequence of the idea of a non-possessory security interest, a consequence accepted so far in few instances only.

It would seem that the English distinction between two phases in the life of a floating charge, namely pre-crystallization and crystallization, is sound. Crystallization, in effect, amounts to the enforcement of the security interest by the secured creditor.

Before the enforcement has been effected, the debtor has power, on the one hand, to dispose of the encumbered assets, and on the other to extend the security interest to new assets acquired in substitution of, or in addition to, those originally encumbered. It may be wise to restrict these two powers, in the interest of the secured creditor and of third persons, respectively. The secured creditor need not suffer a permanent depletion of the encumbered items; this could be prevented by a flexible formula admitting only dispositions of the debtor in the ordinary course of his business or by demanding that a stated value must be maintained. Executions by other creditors of the debtor should also be permitted. On the other hand, in the interest of third persons, especially the debtor's unsecured creditors, a restriction should also be placed on additions to the complex unit; a maximum limit to be determined by the parties should not be exceeded. The latest additions exceeding this limit would not be affected by the security interest.

If, upon the happening of certain specified events, the secured claim falls due, the security interest crystallizes. Thereafter, the debtor has no longer power to dispose of, and execution by other creditors may not be levied on, the encumbered assets. (Of course, the crystallized global security interest ranks after rights which the debtor may have validly created, or executions levied, before crystallization.)

To which economic units the above rules should be applied, must be left to the decision of the national legislations. It would seem that business enterprises should be selected in the first place.

2.3.5 *Protection against third persons*

The main purpose of security interests is to achieve for the secured creditor preferential treatment in obtaining satisfaction from the encumbered goods of the debtor, as against the competing claims of third persons. For this reason the legal value of a security interest is directly proportional to the protection which it affords as against the claims of the various categories of third persons. The four most important categories of competing third persons will be considered in turn here, viz. unsecured creditors of the debtor, purchasers from the debtor, secured creditors of the debtor whose security rests on movables, and real estate mortgagees of the debtor.

2.3.5.1 *Protection against unsecured creditors*

The broadest category of persons against whom a secured creditor seeks protection are the debtor's general creditors, i.e. those who have neither a contractual security interest nor a statutory privilege securing their claims.

In most countries the protection afforded the secured creditor against the claims of the debtor's unsecured creditors is determined by rules regarding security interests in general, and by those on execution by way of attachment and on bankruptcy. Of these three sets of rules, only the former can be analysed in detail here since limitations of time and space do not permit an exhaustive analysis of the specific rules on execution and bankruptcy.

The two main avenues of attack for the debtor's unsecured creditors are by execution on the property of the debtor and by participating in his bankruptcy. The extent of the protection

granted to the secured creditor in these two types of proceedings, will be examined in turn.

(*a*) Against *execution* on the encumbered goods of the debtor, the secured creditor will in general be protected. However, the extent of this protection varies, frequently depending on the legal form in which the security interest has been created (see *supra* 2.1.2).

Where it has been cast into the form of ownership (reservation of ownership by the creditor or security transfer of ownership to him), this usually bars executions by the debtor's unsecured creditors. The bar is generally not automatic, but depends upon the secured creditor's objection.

Reservation of ownership: *Brazil*: see Mertens *op. cit.*, p. 85; *Colombia*: Commercial Code of 1971, art. 964; *Dominican Republic*: Law No. 1608 on conditional sale of movables of 1947, art. 10; *Federal Republic of Germany*: see *Devel*, Allemagne p. 14; *Italy*: see *Mertens* p. 153-154; *Poland*: Civil Code of 1964, art. 590; *Venezuela*: Decreto No. 491 on sales under reservation of ownership of 1958, art. 20 para. 1.

Security transfer of ownership: *Germany*: judicial practice; *Sweden*: Regulation on the sale of goods which the buyer leaves in the seller's possession of 1845, § 1.

Where the security interest takes the form of a mortgage (as a limited right in another's good), the secured creditor cannot object to seizure of, and execution against the encumbered good. He is limited to a claim for priority in the distribution of the proceeds of sale.

Finland: Chattel Mortgage Act of 1923, § 12; *Mexico*: Civil Code of 1928, art. 2873 para. 1; *Peru*: Ley No. 6 565 on instalment sales of 1929, art. 8; *Sweden*: Law on enterprise mortgage of 1966, § 13 para. 1; *Venezuela*: Ley de hipoteca mobiliarias of 1973, art. 68.

Exceptionally in case of reservation of ownership *Switzerland*: see *Mertens* pp. 202-203.

The secured creditor thus loses his security interest in the encumbered goods and is perforce merely entitled to a preferential share in the distribution of the proceeds (which may or may not cover his claim).

An interesting alternative to the seizure and sale of the encumbered goods is provided in *New Zealand*. The execution officer may instead sell the judgement debtor's interest in the encumbered goods. In this case the secured creditor may take possession of these goods, but holds them in trust for the purchaser of the debtor's interest, subject of course to his own prior interest.

New Zealand: Chattels Transfer Act 1924, s. 47; see also *Kenya*: Chattels Transfer Ordinance 1930, s. 39.

However, it appears doubtful whether this procedure is of great practical importance since there will hardly be a market for the sale of such interests.

(*b*) In the debtor's *bankruptcy*, the protection of the secured creditor is even more questionable since he faces not only one execution creditor, but competes with all the unsecured creditors of the debtor. Nevertheless, most countries protect the secured creditor effectively while certain countries deny protection. One may distinguish between three types of positive and one type of negative protection.

Comparable to the bar against execution by an unsecured creditor is the secured creditor's right to *claim the encumbered goods* from the bankrupt debtor's estate. This claim is in many countries granted irrespective of the legal form which the security interest takes.

For reservation of ownership: *Brazil*: see Mertens, *op. cit.*, p. 85; *Federal Republic of Germany*: see Devel, Allemagne pp. 14-15; *Italy*: see Mertens *op. cit.*, pp. 153-154; *Japan*: see Devel, Japon p. 5 quoting the Bankruptcy Act of 1922, art. 87; *Lebanon*: see Devel, Liban p. 4; *Netherlands*: see Devel, Pays-Bas p. 6; *Switzerland*: see Mertens, *op. cit.*, p. 204;

For security transfer of ownership: *Brazil*: Decreto-Lei No. 911 of 1969, art. 7; *Sweden*: Regulation on the sale of goods which the buyer leaves in the seller's possession of 1845, § 1;

For mortgages: *Brazil*: Law No. 492 on rural pledges of 1937, art. 3 § 1; *Nicaragua*: Law on agrarian and industrial pledge of 1937, art. 26; *Spain*: Ley sobre hipoteca mobiliaria of 1954, art. 10 para. 2.

In cases of reservation of ownership the secured creditor's right of repossession may in some countries in effect be emasculated by an objection made available to the trustee in bankruptcy. The latter may elect between performing the contract of sale concluded between secured creditor and debtor or cancelling this contract.

See *Austria*: Konkursordnung of 1914, as amended, § 21; *Denmark*: Konkurslov of 1872, § 16 par. 1 No. 2; *Federal Republic of Germany*: Konkursordnung of 1877, as amended, § 17; *Sweden*: see Devel, Suède p. 6; *Switzerland*: see Devel, Suisse p. 16; *Venezuela*: Decreto No. 491 on sales under reservation of ownership of 1958, arts. 17-18.

Only where the trustee elects to cancel the contract does the secured creditor remain entitled to reclaim the encumbered goods. If, on the other hand, the trustee elects to perform the contract, the secured creditor is not entitled to reclaim the goods and is relegated to an unabridged claim for the unpaid purchase-price from the estate. Thus, in effect, the secured creditor obtains full satisfaction.

Some countries deny the secured creditor a right of repossession. The encumbered goods are left in the bankrupt estate and liquidated, but the secured creditor may claim priority in the proceeds of sale, without being relegated to a dividend. This corresponds to the treatment of mortgages upon execution.

Chile: Law No. 4702 on instalment sale of movables of 1929, art. 32; *Sweden*: Law on enterprise mortgage of 1966, § 13 para. 1.

For a security transfer of ownership, *Federal Republic of Germany*: see Devel, Allemagne p. 26.

Some countries deny protection to certain security interests for which no registration has been provided. These security interests have no effect in the debtor's bankruptcy. This is especially the fate of a reservation of ownership in France and certain countries inspired by France.

France: see Devel, France pp. 4-5; *Belgium*: see Sepulchre, Belgique p. 3; *Egypt*: see Devel, Egypte p. 3; *Luxembourg*: see Sepulchre, Luxembourg p. 1.

Legally speaking, a security interest which does not withstand the severe test of bankruptcy, can hardly qualify as a true and full security. It should be noted, however, that under the laws of the above-mentioned countries as a rule only merchants can go bankrupt. Therefore security interests in goods sold to individual consumers cannot be affected.

2.3.5.2 *Protection against purchasers*

The term "purchasers" must be understood in a wide, generic sense. It comprises not only a buyer who by virtue of a sales contract purports to obtain ownership in the encumbered goods, but also a person who intends to acquire a limited right, such as a (second) mortgagee.

See the broad definition of "purchase" in the *United States* Uniform Commercial Code s. 1-201 (32).

However, in the forefront of practical concern and most legislative rules stands a buyer of the encumbered goods, and it is with him that we shall deal primarily. Conflicts with certain other secured claims will be discussed separately (*infra* 2.3.5.3-4).

The debtor is usually (unless he is a dealer trading in the encumbered goods or the encumbered goods form a "complex unit", see *supra* 2.3.4.3) prohibited from disposing of the encumbered goods.

See, e.g., *Argentina*: Ley No. 12 962 on prenda con registro of 1947, art. 9; *Brazil*: Decreto-Lei No. 1271 on pledges

of industrial machines of 1939, art. 3; *Colombia*: Commercial Code of 1971, art. 957; *Panama*: Decreto Ley No. 2 on chattel mortgages of 1955, arts. 6 and 15; *Spain*: Ley sobre hipoteca mobiliaria of 1954, art. 4; *Venezuela*: Decreto No. 491 on sales under reservation of ownership of 1958, art. 9; Ley de hipotecas mobiliaria of 1973, art. 6.

This prohibition is, however, lifted if a sale of the encumbered goods provides the means for repaying the secured loan. Some *South American* statutes provide so expressly, sometimes adding precautions designed to ensure the speedy transfer of the proceeds of sale to the secured creditor.

Guatemala: The sale must be against cash, must cover the whole amount of the outstanding indebtedness, and must be previously notified to the secured creditor. After sale, payment must be effected within 24 hours and upon immediate notice to the secured creditor (Civil Code of 1963, art. 914). See also *Panama*: Law No. 22 on agricultural pledge of 1952, art. 12 para. 1; *Peru*: Law No. 2402 on registration of agricultural pledges of 1916, art. 9; *Uruguay*: Ley No. 5 649 sobre prenda rural of 1918, art. 16 (delivery of the goods only after payment to the creditor); *Venezuela*: Ley del Banco agricola y pecuario of 1946, art. 58; Regulations of the Corporación Venezolana de Fomento of 1947, art. 38.

Panama and *Peru* also envisage the case where the proceeds of sale cover part only of the secured claim. Here the secured creditor has a pre-emptive right to acquire the encumbered goods for the agreed price.

Panama: art. 12 para. 2; *Peru*: art. 9.

Argentina expresses as a condition what in most countries is the consequence of an unauthorized disposition, i.e. the security interest (and also the secured claim itself!) must be taken over by the buyer.

Argentina: art. 9.

An unauthorized disposition of the encumbered goods by the debtor is, generally speaking, in most countries without effect as against the secured creditor. Under general rules this would mean that the buyer may have acquired a good title to the encumbered items, but subject to the secured creditor's continuing security interest.

Australia, Western Australia: Bills of Sale Act, 1899-1957, s. 27; *Czechoslovakia*: International Trade Code of 1964, s. 327; *Dominican Republic*: Law No. 1608 on conditional sale of movables of 1947, art. 10; *El Salvador*: Commercial Code of 1970, arts. 1041 para. 2 and 1156 para. 2 sub III; *France*: Loi relative à la vente et au nantissement des fonds de commerce of 1909, art. 22 para. 1; Loi relative au nantissement de l'outillage et du matériel d'équipement of 1951, art. 7 para. 2 (provided, the optional marking has been affixed, see *supra* 2.3.3.4); *Guatemala*: Civil Code of 1963; art. 892 para. 2; *Italy*: Law No. 1329 providing for the acquisition of new machines of 1965, art. 3 para. 4; *Japan*: Construction machinery hypothecation law of 1954, arg. arts. 19 and 20; *USSR*: Civil Code of the RFSFR of 1964, s. 202; see also *United States*: Uniform Commercial Code, s. 9-307 with s. 1-201 (9).

However, where the secured creditor's interest is based upon ownership, the purchaser does not acquire a good title.

See for *English* and *Commonwealth* countries' hire-purchase: Goode and Ziegel, *op. cit.*, 172.

In very few countries does the creditor's security interest remain intact vis-à-vis the buyer, if the secured creditor agrees to the sale.

Chile: Law No. 4702 on instalment sale of movables of 1929, art. 11 para. 2 (the buyer becomes also a co-debtor of the secured claim); *Colombia*: Commercial Code of 1971, art. 1216 para. 2.

Some laws imply the ineffectiveness of the debtor's attempted disposition by spelling out expressly an aggravated consequence. The secured creditor may reclaim the encumbered goods from the buyer, occasionally within a limited period of time only.

Argentina: Ley No. 12 962 on prenda con registro of 1947, art. 41; *Belgium*: Loi sur la mise en gage du fonds de commerce of 1919, art. 11 para. 2 (reclamation within six months); *Colombia*: Commercial Code of 1971, art. 957; *Finland*: Chattel Mortgage Act of 1923, § 5 (reclamation within 30 days); *Lebanon*: Loi relative à la vente à crédit des autovéhicules, machines agricoles et industrielles of 1935, art. 21; *Mexico*: Civil Code of 1928, art. 2873 para. 2; Ley General de títulos y operaciones de crédito of 1932, art. 330; *Nicaragua*: Law on agrarian and industrial pledge of 1937, arts. 20 and 27 para. 4; *Peru*: Law No. 2402 on registration of agricultural pledges of 1916, art. 10; Ley No. 6565 on instalment sales of 1929, art. 4; *Venezuela*: Decreto No. 491 on sales under reservation of ownership of 1958, art. 9 para. 1.

The general principle is to maintain the secured creditor's security interest in spite of the debtor's disposition. There is one major exception to this rule recognized in many countries. If the buyer did not know of the existing security interest and also was not obliged to know of it, such *bona fide* acquisition extinguishes the security interest.

Belgium: Loi sur la mise en gage du fonds de commerce of 1919, art. 11 para. 2; *Denmark, Finland* and *Federal Republic of Germany*: see Devel, Danemark p. 4, Finlande p. 5 and Allemagne p. 13; for *Finland* see also Chattel Mortgage Act of 1923, § 4 par. 1; *Hungary*: Civil Code of 1959, par. 370 (2); *Japan*: see Devel, Japon p. 4; *Netherlands*: see Devel, Pays-Bas p. 5; *Paraguay*: Decreto-Ley No. 896 on prenda con registro of 1943, art. 27; *Peru*: Law No. 2402 on registration of agricultural pledges of 1916, art. 10; *Venezuela*: Ley de hipotecas mobiliarias of 1973, arts. 64 and 65 (good faith and delivery of the goods required; but secured creditor may repurchase the goods from the buyer).

In some countries, this exception is limited to acquisitions made in shops, markets, auction sales, etc.

Chile: Law No. 4702 on instalment sale of movables of 1929, art. 18; *England* and other *Commonwealth countries*, market overt: Goode and Ziegel *op. cit.*, 1972.

The buyer's good faith even in these situations is necessary in *Colombia*: Commercial Code of 1971, art. 960; *Venezuela*: Decreto No. 491 on sales under reservation of ownership of 1958, art. 11.

It is relevant to inquire whether the buyer's good faith is affected by the widespread recourse to registration of security interests. Only a few statutory rules deal with this question. One extreme solution is quite generally to impute knowledge of the security interest from its registration and thus to exclude *bona fide* acquisition in the case of duly registered security interests.

Australia: *Queensland*: Bill of Sales and other Instruments Act of 1955, s. 8 (1); see also *Western Australia*: Bills of Sale Act, 1899-1957, s. 27; Kenya: Chattels Transfer Ordinance 1930, s. 4; for *Lebanon* see Devel, Liban p. 3; New Zealand: Chattels Transfer Act 1924, ss. 4 and 19.

A half-way approach is to take registration into account as one of several factors in determining whether the buyer ought to have known about the security interest.

Thus apparently *Peru*: Law no. 2402 on registration of agricultural pledges of 1916, art. 10; *Switzerland*: see Devel, Suisse pp. 13-14.

It would seem that this rule prevails in most countries with registration of security interests which have not expressly provided otherwise.

In sharp contrast to these simple rules is the involved regulation in the *United States*. The Uniform Commercial Code grants protection to buyers of encumbered goods in two situations: First, a buyer who acquires encumbered goods from a person in the business of selling the specific goods takes free of the security interest, even though it is registered and even though he knows of its existence. Free acquisition is merely excluded if the buyer knows that the sale by the debtor is in

violation of the latter's agreement with the secured creditor (such knowledge will be very exceptional). Second, a buyer of encumbered consumer goods or of encumbered farm equipment (with an original purchase-price of less than $2,500) takes free of the security interest if the latter has not been registered.

In the case of purchase money security interests for these items registration is only optional, s. 9-302 (1) (*c*) and (*d*).

The buyer must not have known of the security interest and must have bought the goods for his personal or family purposes or his own farming business.

United States: Uniform Commercial Code, s. 9-307 with s. 1-201 (9).

In all other cases a secured creditor is protected by virtue of registration against *bona fide* acquisition of the encumbered goods. Of the two exceptions, only the first relating to sales from a dealer is of far-reaching importance.

2.3.5.3 *Protection against (other) secured creditors*

The term "secured creditors" must be understood in a wide sense. It does not only include holders of the same type of security interest as that of the secured creditor, but also holders of other types of security interests and quite generally any person who is entitled to preferred satisfaction from the encumbered goods (such as a creditor with a statutory privilege). Excepted from the present discussion are merely real estate mortgagees whose position will be considered separately (*infra* 2.3.5.4).

(a) *Avoidance or attenuation of conflicts.* Conflicts between secured creditors may sometimes pose difficult problems, if not of legal regulation, then certainly in fact (especially for the secured creditor whose right is subordinated to that of another secured creditor and who thus stands to lose the security for his claim against the debtor). A few legal systems, therefore, strive to avoid or at least minimize such conflicts by restricting the creation of more than one security interest in the same goods.

Restrictions of this kind are sometimes directed against the coexistence of a security interest with *earlier* security interests. Thus *Panama* declares the creation of any security interest to be absolutely void, if the encumbered goods have already been encumbered in favour of another secured creditor.

Panama: Decreto Ley no. 2 on chattel mortgages of 1955, arts. 3, 5 and 13; Law No. 22 on agricultural pledge of 1952, arts. 3 and 5 no. 9; see also *Spain*: Ley sobre hipoteca mobiliaria of 1954, arts. 2, 13 no. 3; see also arts. 21 para. 2 and 22 para. 1; similarly *Venezuela*: Ley de hipotecas mobiliarias of 1973, arts. 2, 22 no. 5 and 59 no. 5.

Other countries are less rigid and merely take various special precautions. *Argentina* and *Costa Rica* require that prior encumbrances must be disclosed by the debtor in the contract relating to the new security interest.

Argentina: Ley no. 12 962 on prenda con registro of 1947, arts. 11 lett. e) and 15 lett. e); but see *infra, Costa Rica*: Commercial Code of 1964, art. 541 para. 1.

In *Costa Rica* the registry is obliged to search the register for pre-existing registrations.

Costa Rica: art. 541 para. 2. But it is not provided what is to happen if an earlier registration does in fact exist.

In *Argentina* the registry has to notify the holders of earlier security interests of any new registrations within 24 hours.

Argentina: art. 20.

More frequently restrictions against multiple encumbrances are directed against *subsequent* charges. Several *South American* States prohibit the creation of additional security interests in the encumbered goods.

Argentina: Ley no. 12 962 on prenda con registro of 1947, art. 7; *Chile*: Law 4702 on instalment contracts of 1929, art. 10; *El Salvador*: Commercial Code of 1970, art. 1158; *Paraguay*: Decreto-Ley no. 896 on prenda con registro of 1943, art. 18; *Uruguay*: Ley no. 5 649 sobre prenda rural of 1918, art. 3 no. 5 para. 3; Ley no. 8 292 on prenda industrial of 1928, art. 2 no. 4.

Panama, in addition to the above-mentioned prohibition against charging goods that are already encumbered, also prohibits the creation of subsequent security interests.

Panama: Decreto-Ley no. 2 on chattel mortgages of 1955, art. 6.

In reality, the two forms of prohibitions against coexisting security interests in identical goods, the one retrospective, the other prospective, amount to one and the same principle. What changes, is the point of view; in the former rule, the prohibition is pronounced from the view-point of the later security interest; in the latter rule, the prohibition proceeds from the view-point of the earlier security interest. Underlying both rules is the same principle, i.e. to avoid creation of a second security interest in goods that are already encumbered. If this prohibition prevents, in effect, the creation of a subsequent security interest, it obviates the necessity of solving conflicts between several security interests.

This radical effect is not achieved by the less rigid rules of those countries which merely take precautionary steps in case of multiple charges.

(b) *Priorities.* All countries which do not effectively prevent the creation of several security interests in encumbered goods must solve the resulting conflict.

The general principle for determining priorities is well expressed by the time-honoured maxim *prior tempore, potior iure*. Priority is determined by the order in time of the creation of security interests. This principle is expressly confirmed by many statutory rules.

Australia: *Queensland*: Bills of Sale and other Instruments Act of 1955, ss. 8 and 32 (2); *Western Australia*: Bills of Sale Act, 1899-1957, ss. 34 and 41; *Brazil*: Law no. 492 on rural pledges of 1937, art. 4 § 1; *Colombia*: Commercial Code of 1971, art. 1211; *Costa Rica*: Commercial Code of 1964, art. 581; *Czechoslovakia*: International Trade Code of 1964, s. 176; *Ecuador*: Commercial Code of 1959, art. 595; *Guatemala*: Civil Code of 1963, art. 908 last phrase, *Israel*: Pledges Law, 1967, s. 6; *Japan*: Construction Machinery Hypothecation Law of 1954, art. 14; *Spain*: Ley sobre hipoteca mobiliaria of 1954, arts. 56 and 85 no. 4; *Sweden*: Law on enterprise mortgage of 1966, §§ 19-22; *United States*: Uniform Commercial Code, s. 9-312 (5); *Venezuela*: Ley de hipoteca mobiliaria of 1973, art. 71 no. 4.

It would seem that the principle prevails also in all other countries, even if express statutory authority is lacking.

But the principle of determining priority between conflicting security interests by reference to the time of their creation does not apply without exception. Some countries have granted priority to certain claims which appear to deserve preferential treatment for a variety of reasons. An exhaustive catalogue of such preferences cannot be offered here. However, a choice of some typical preferred claims may be instructive.

In the *German Democratic Republic* a possessory security interest prevails over a non-possessory security interest which is not a purchase money security interest.

German Democratic Republic: Gesetz über internationale Wirtschaftsverträge of 1976, art. 238(1).

A typical conflict arises in the case of the *landlord's lien* where the encumbered goods are on premises rented by the debtor. Many countries, especially in *South America*, accord a preference to the landlord's claim for outstanding rent, at the same time limiting the amount of the preference.

Argentina: Ley no. 12 962 on prenda con registro of 1947, art. 42 (two months of rent for urban and 12 months for rural immovables); *Australia*: *Victoria*: Instruments Act 1958, s. 63 (rent for one year); *Chile*: Law no. 5687 on the contract of prenda industrial of 1935, arts. 26 and 45; Law no. 4702 on instalment sale of movables of 1929, art. 9; *Costa Rica*: Commercial Code of 1964, arts. 535 and 573 lett. d); *Nicaragua*: Commercial Code art. 34 para. 1 lett.

b); *Panama*: Law no. 22 on agricultural pledge of 1952, art. 2 para. 2; *Paraguay*: Decreto-Ley no. 896 on prenda con registro of 1943, arts. 7-9, 32 and 33 no. 3; *Peru*: Law no. 2402 on registration of agricultural pledges of 1916, arts. 6 and 13 para. 1 no. 2; *Spain*: Ley de hipoteca mobiliaria of 1954, art. 66 no. 2; *Uruguay*: Ley no. 5649 sobre prenda rural of 1918, art. 8.

The attitude of the *European* countries in the case of a reservation of ownership seems to be divided. Some would not grant the preference for the landlord's lien in cases of reservation of ownership.

Expressly *Venezuela*: Decreto no. 491 on sales under reservation of ownership of 1958, art. 16. See also *Germany*: court practice.

In other countries the landlord's lien prevails either absolutely

Egypt: see Devel, Egypte p. 3

or at least if the landlord does not know and is not obliged to know of the secured creditor's reservation of ownership.

Switzerland: see Devel, Suisse p. 14.

Socialist countries often confer priority upon security interests securing credits of State-banks.

USSR: Code of Civil Procedure of the RSFSR of 1964, s. 424.

A few statutes expressly confer priority upon certain *fiscal claims*.

Australia: *Western Australia*: Bills of Sale Act, 1899-1957, s. 28; *England*: Bills of Sale Act (1878) Amendment Act, 1882, s. 14; Companies Act, 1948, ss. 94 and 319; *France*: Loi relative au nantissement de l'outillage et du matériel d'équipement of 1951, art. 9 para. 1 no. 1, but see para. 2.

This is probably only a rather incomplete catalogue of fiscal privileges existing in the various countries which claim priority over security interests.

A similar preference is granted by some countries to *claims of labourers* and related "social" claims.

England: Companies Act, 1948, ss. 94 and 319; *France*: Loi relative au nantissement d'outillage et du matériel d'équipement of 1951, art. 9 para. 1 no. 3, but see para. 2; *Spain*: Ley de hipoteca mobiliaria of 1954, art. 10 para. 1; *USSR*: Code of Civil Procedure of the RSFSR of 1964, ss. 419 and 424.

Apart from these preferential rights established to secure certain economic or social interests, there are certain priorities to be found which are created in favour of specific classes of secured creditors.

The most interesting of these is the priority of purchase money security interests (see *supra* 2.3.2.2) in the *United States*. The Uniform Commercial Code s. 9-312 distinguishes between two situations: A purchase money security interest in "inventory"

i.e., goods held for sale or lease, raw materials, work in process, or materials used or consumed in a business, Uniform Commercial Code s. 9-109 (4)

and in other goods. A purchase money security interest in the latter "general" goods has priority, provided only that the interest is "perfected" (i.e., as a rule, filed) at the time the debtor receives possession or within 10 days thereafter.

United States: Uniform Commercial Code s. 9-312 (4). A purchase money security interest in inventory requires: (1) perfection of the interest at the time the debtor receives possession and (2) prior notification of any other holder of a security interest in the encumbered goods showing that the purchase money creditor has acquired or expects to acquire a purchase money security interest in specified inventory.

Uniform Commercial Code s. 9-312 (3).

The official comment states (no. 3) that the preference for purchase money security interests is an American tradition. The distinction between the two situations is justified by the observation that only inventory financers usually pay by periodic advances, so that the notification can warn them against further payments.

The technique of notification is also used in *France* to obtain a preference.

France: Loi relative au nantissement de l'outillage et du matériel d'équipement of 1951, art. 9 para. 2 and 3 (copy of security agreement to be notified to holder of security interest in business enterprise).

Guatemala requires notification to a prior secured creditor in order to offer him the chance of granting the credit which the new creditor has promised to the debtor. If, however, the first secured creditor refuses to grant this credit, his priority as against the second secured creditor is not affected.

Guatemala: Civil Code of 1963, art. 908.

Some countries require not only notification, but *consent* of the prior secured creditor. But only in one case does such consent clearly imply that the agreeing secured creditor is subordinated to the rights of the new secured creditor.

Brazil: Decreto-Lei no. 1271 on pledges of industrial machines of 1939, art. 2 § 2 and Decreto-Lei no. 4 191 on pledges of industrial machines which have been installed in immovables of third persons of 1942, art. 1.

In other instances the consent of the prior secured creditor is necessary, but apparently only in order to protect his interests and without adverse effects on his security interest.

Brazil: Law no. 492 on rural pledges of 1937, art. 9 (rural pledge of tenant requires owner's consent); *Nicaragua*: Law on agrarian and industrial pledge of 1937, arts. 6 lett. f) and 21 para. 1 (consent of prior secured creditor); *Uruguay*: Ley no. 5649 sobre prenda rural of 1918, art. 13.

2.3.5.4 *Protection against real estate mortgagees*

Conflicts between creditors with a security interest in movable goods and the holders of real estate mortgages are of a special character and therefore deserve separate discussion. Conflicts between these two groups of secured creditors are apt to be brought about by movable goods which become affixed to immovables and thus may pass from one class of goods to another (fixtures, *"immeubles par destination"*). The most frequent example is machinery which is more or less permanently fixed to a building.

A precise delimitation of this group of goods cannot be offered here. We must accept for the purposes of our inquiry that most legal systems treat certain goods which in some specific manner have become affixed to immovables as immovable property. Precisely under which conditions this occurs, is determined by the applicable property law.

We shall deal here only with the effects which follow if certain goods have obtained the status of fixtures.

It seems useful to distinguish clearly between two situations. First, encumbered movable goods become affixed to realty. What consequences follow for the rights of the holder of the security interest on the one hand and of (a) real estate mortgage(s) on the other? Second, under what conditions can fixtures that are subject to (a) real estate mortgage(s) be encumbered with a security interest in movables?

(a) *Encumbered movables become fixtures.* In most countries a security interest in movables is preserved and retains priority as against existing real estate mortgages.

Australia as to goods under hire-purchase: state of *Queensland*: Hire-purchase Act 1959, s. 32 (1); *Victoria*: Hire-Purchase Act 1959, s. 27 (1); *Belgium*: Cour de Cassation 26 May 1972, *Pasicrisie* 1972.1.889; *Canada*: (Uniform) Conditional Sales Act of 1922, revised 1955, amended 1959, s. 15 (upon registration in the land register); *Chile*: Law no. 4702 on instalment sale of movables of 1929, art. 8; *El Salvador*: see Commercial Code of 1970, art. 1144, para. 2; *France*: Loi relative au nantissement de l'outillage et du matériel d'équipement of 1951, art. 8; *Federal Republic of Germany*: see Devel, Allemagne, p. 19; *Italy*: see Civil Code art. 819; Law no. 1329 providing for the acquisition

of new machines of 1965, art. 5; *Japan*: see Devel, Japon pp. 5-6; *Lebanon*: Loi relative à la vente à crédit des autoévéhicules, machines agricoles et industrielles of 1935, art. 6; *Netherlands*: see Devel, Pays-Bas, pp. 8-9; *New Zealand*: Chattels Transfer Act 1924, s. 57 (7) for customary, i.e. unregistered, hire-purchase agreements; *Norway*: see Devel, Norvège, pp. 5-6 (upon registration in the land-register); *Panama*: Decreto Ley no. 2 on chattel mortgages of 1955, arts. 4 and 5; *Paraguay*: Decreto-Ley no. 896 on prenda con registro of 1943, art. 6 para. 1 sent. 2; *Peru*: Law no. 2402 on registration of agricultural pledges of 1916, art. 20 para. 1; *Spain*: Ley sobre hipoteca mobiliaria of 1954, art. 75 paras. 1 and 2 (upon registration in the land-register); *Sweden*: Immovables Law of 1970, chap. 2 § 4 para. 1 (for machines); *Switzerland*: see Mertens p. 205; *Venezuela*: Ley de hipotecas mobiliarias of 1973, art. 52 (but see *infra* the special rule for industrial machinery).

Only few countries adhere to the opposite view that the security interest in movables is extinguished by affixing the movables to realty.

Denmark: Tingslysningslov of 1926, § 38, and see Devel, Danemark p. 6; *England* and *Commonwealth* countries under the common law: Goode and Ziegel 173-174; *Venezuela*: Decreto no. 491 on sales under reservation of ownership of 1958, art. 3.

Finland avoids the problem for chattel mortgages by providing that these do not comprise fixtures.

Finland: Chattel Mortgage Act of 1923, § 3 para. 1.

The reverse rule is adopted in Venezuela where real estate mortgages do not comprise industrial machinery subject to one form of chattel mortgage, unless the contrary is provided.

Venezuela: Ley de hipotecas mobiliarias of 1973, art. 42 para 2.

Special rules have been developed in some other countries. The *United States* follow, under present law, the general rule stated above, at least in general.

United States: Uniform Commercial Code s. 9-313 (2). An exception only occurs if a real estate mortgagee advances money after the movables have become fixtures without knowing of this security interest and before it is perfected, s. 9-313 (4).

However, this rule has not satisfied real estate creditors and will be amended in the revision of the Code that is presently under way. Under the proposed new version of s. 9-313, the present general rule will be considerably restricted. As against existing real estate mortgagees, a security interest in movables will only prevail: first, if it secures purchase money (*supra* 2.3.2.2) and is filed in the office where real estate mortgages are filed; or, second, if the movables are easily removable machines or replacements of domestic appliances.

Final Report of Proposals for Changes in art. 9 Uniform Commercial Code, April 1971, s. 9-313 (4) (a) and (c).

In *Austria* a special provision has been enacted relating to the most important species of fixtures, i.e., machinery. The secured creditor is permitted, with the consent of the landowner, to enter an annotation of his security interest in the land register which then prevails against real estate mortgagees.

Austria: Civil Code § 297 a.

However, in practice little use has been made of this possibility and the provision itself is widely regarded as obnoxious and in need of repeal.

(b) *Can fixtures be encumbered like movables?* If movables that have become fixtures are encumbered by a real estate mortgage, the latter has, in general, preference against any security interest subsequently created in these fixtures. It follows that the creation of such a security interest requires the consent of the real estate mortgagee(s), if priority is to be achieved. The one or the other of these two supplementary rules is recognized in most countries.

Argentina: Ley no. 12 962 on prenda con registro of 1947, art. 10, sent. 2; *Belgium*: Cour de Cassation 26 May 1972, Pasicrisie 1972.1.889; *Brazil*: Law no. 492 on rural pledges of 1937, art. 4 para. 1; *Colombia*: Commercial Code of 1971, art. 1214; *Denmark*: Tingslysningslov of 1926, § 38; *Ecuador*: Commercial Code of 1959, art. 580; *Nicaragua*: Law on agrarian and industrial pledge of 1937 (arts. 4 and 6 lett. f); *Panama*: Decreto Ley no. 2 on chattel mortgages of 1955, art. 4; *Paraguay*: Decreto-Ley no. 896 on prenda con registro of 1943, art. 6 para. 1; *Peru*: Law no. 2402 on registration of agricultural pledges of 1916, art. 20 para. 2; *Uruguay*: Ley no. 5649 on prenda rural of 1918, art. 5; *Venezuela*: Ley de hipotecas mobiliarias of 1973, art. 51, second paragraph.

The two basic rules for goods that become fixtures and for those that are fixtures, can be reduced to one general principle: *prior tempore, potior jure*. It is the same basic rule that underlies the solution of most conflicts relating to priority. This general rule is found in at least two countries.

Egypt: Loi no. 11 sur la vente et le nantissement des fonds de commerce of 1940, art. 16 para. 2; *Lebanon*: Décret-Législatif no. 11 (on the sale and mortgaging of an enterprise) of 1967, art. 25 para. 2.

However, a few countries dissent and prefer the creditor of a subsequent security interest. *El Salvador* regards fixtures, after they have been charged with a security interest in movables, as separate from the immovable to which they are affixed; this would seem to imply priority of the newly created security interest.

El Salvador: Commercial Code of 1970, art. 1144 para. 2.

France achieves a similar result, but on condition that the subsequent security interest be notified to the real estate mortgagee.

France: Loi relative au nantissement de l'outillage et du matériel d'équipement of 1951, art. 9.

This latter idea has been enlarged in two *South American* countries. These also require notification of the real estate mortgagee who has thereupon the option to grant the credit offered by the second creditor; if he refuses to make this offer, the security interest for the new creditor has priority over the real estate mortgage.

Guatemala: Civil Code of 1963, art. 905; see also *Nicaragua*: Law on agrarian and industrial pledge of 1937, art. 42 (limited to certain credits for the promotion of new agricultural or industrial ventures).

2.3.5.5 *Conclusions*

Our conclusions on the secured creditor's protection against third persons must perforce follow the categorization of the various problems laid down in the preceding sections.

(a) *Protection against unsecured creditors* may be positive or negative. We can dispose quickly of the latter. Where security interests are denied any protection in bankruptcy, their character as a security interest is in effect negated. In other words, some positive protection in the debtor's bankruptcy is a necessary prerequisite of a security interest.

Security interests are protected both in the case of execution against, and in the bankruptcy of, the debtor in two forms, with an intermediate third form in bankruptcy: first, immunity from seizure of the encumbered goods; this implies, in the case of bankruptcy, the secured creditor's right to reclaim the goods from the debtor's estate. Or second, liability to seizure and forced sale of the encumbered goods, but priority in the proceeds of the sale. Or third, in the case of bankruptcy of a debtor who had purchased the encumbered goods under a reservation of ownership, liability to seizure of the goods, but against full payment of the balance of the purchase-price by the debtor's estate. Alternatives (1) and (3) are at the option of the debtor's trustee in bankruptcy.

Looking at the practical results, alternatives (1) and (3) are almost equal in their effect, with (3) being slightly more effective because it provides the secured creditor with the money bargained for rather than the encumbered goods. However, al-

ternative (3) is limited to purchase money security interests, where the debtor has agreed to acquire the encumbered goods. Alternative (2) is liable to provide the weakest protection, if the proceeds from the forced sale of the encumbered goods do not fully cover the secured claim. This is a real risk since prices on forced sales are usually rather low; however, the creditor can in part protect himself by fixing a sufficient margin when demanding security.

The choice between alternatives (1) and (2) should—contrary to present rules—certainly not depend upon the legal form in which the security interest is cast. This external factor cannot be relevant to the issue.

Neither of the two alternatives is fully convincing. The drawback of alternative (1) is that the secured creditor retains in executions the full value of the encumbered goods and, in bankruptcy, even obtains them physically, although the debtor is either their owner or at least has an expectancy in acquiring ownership in them. Thus the debtor or his other creditors are put at a disadvantage. On the other hand, a forced sale of the encumbered goods in alternative (2) is uneconomical and is therefore liable to violate the interests of both creditor and debtor.

The dilemma should be solved by developing an intermediate solution. The secured creditor ought to choose between alternative (2) and an amended form of alternative (1): the creditor may only claim the encumbered goods against payment of their fair value which has to be fixed by an objective valuer. The creditor's payment, of course, may be set off against the debtor's secured debt, either party being obliged to pay out any remaining surplus. This amended version of alternative (1) will often lead to the same result as may follow from the liquidation of the underlying contractual relationship between secured creditor and debtor. But it would seem to be preferable to achieve this result on the level of the security interest rather than to derive it from the vagaries of the contractual relationship between the parties.

(b) *Protection against purchasers* is attempted at several levels. The most direct method is to prohibit the debtor from disposing of the encumbered goods, unless he is a merchant or the sale provides the means for repaying the secured loan and is in fact used for this purpose.

However, the secured creditor really requires protection only on the next level, i.e. against unauthorized dispositions by the debtor which are not combined with repayment of the loan. Such an unauthorized disposition is generally held to be ineffective vis-à-vis the secured creditor. The only major exception is made in favour of a *bona fide* purchaser, i.e. a purchaser who did not know of the existing security interest and ought not to have known of it. The principle and the exception correspond to the general rules of the various countries relating to the treatment of *bona fide* acquisitions. It will not be desirable to disturb these general rules, unless there are compelling reasons to depart from them for security interests.

The only feature peculiar to security interests arises from the widely used systems of registering them. Does registration affect the good faith of purchasers? It would seem that no general reply, affirmative or negative, is appropriate. Probably one should start from the proposition that registration, in general, destroys good faith because this is precisely its main function. However, an exception is to be made where the debtor is explicitly or impliedly empowered to sell, especially if he trades in the encumbered goods.

In this sense also Goode and Ziegel *op. cit.*, 171.

(c) *Protection against (other) secured creditors.* Understandably some countries attempt to avoid conflicts between several secured creditors by declaring second charges on goods already encumbered to be void. It would seem that such a prohibition of double charging can effectively only be realized under a system of registration. But even if this condition is fulfilled, the question must be asked whether this simplistic solution is economically feasible and desirable. This may be true for countries with a relatively restricted credit system or, more specifically, where credit is usually supplied by a single source. It would seem that neither of these two factors is present in the more industrialized countries. In the latter, in fact, there is a sound practice of multiple financing of an enterprise which calls for securing the credits; but since the items to be charged are limited, multiple security interests in individual items are often unavoidable, if not necessary. Therefore a modern security system cannot prohibit multiple charges, but has to face them.

Conflicts between several security interests are, as a rule, solved by the universally recognized principle *prior tempore, potior iure.* Priority is determined by the sequence in time in which the security interests have been created.

However, many countries prefer certain claims by excepting them from the time-priority-rule. No uniform pattern can be established for these exceptions which are based upon various economic or social considerations. Typical examples are the preferences conferred upon the landlord's claim for rent, fiscal claims and wage claims, including related "social" claims. However, whether and if so, which of these privileged claims has priority to a security interest, differs from country to country. In the absence of universal trends it would hardly be realistic to submit recommendations as to possible uniform rules in this particular area.

Matters are different as regards preferences granted to specific classes of secured creditors. The most prominent example is the priority enjoyed by purchase money security interests in the United States. This is just one expression of the widespread idea that purchase-money-creditors deserve better treatment than mere money-creditors. However, it may be doubted whether any such inborn preference for one class of secured creditors over another is still justified. It would seem that all classes of secured creditors should be treated alike. Therefore the American model does not appear to be recommendable.

Better balanced is the rule which grants priority to a subsequent creditor only upon notification of the preceding secured creditor. This solution also is prejudiced in favor of the second creditor; but the first creditor is at least given a chance to defend his prior rights.

(d) *Protection against real estate mortgages.* In most countries a security in chattels that are firmly affixed to realty and therefore become fixtures, will be preserved as against the competing claims of existing real estate mortgagees. The reverse rule is also generally recognized: real estate mortgages that have been created after movable goods have been affixed to the realty, take priority over security interests subsequently created in the fixtures.

Both rules can be reduced to the general principle *prior tempore, potior iure.*

Similarly Goode and Ziegel *op. cit.*, 174, who demand, however, registration in the land-register as a condition for protection against holders of real estate mortgages created after the affixing of the encumbered items (p. 175).

2.3.6 *Enforcement*

The stage at which a security interest must prove its final value arrives when the debtor, after the secured claim has become due, is unable or unwilling to make payment. Then the creditor must enforce his security interest. The effectiveness of the latter depends in no small measure on the effectiveness, speed and low cost of the enforcement procedure. In this area, which borders on procedure, the various national legal systems again show a broad spectrum of variations. As regards certain special rules for enterprise mortgages see *supra* 2.3.4.3.

(a) *Forfeiture clause.* Any clause in the security agreement in effect providing that after the secured claim has fallen due, full title to the encumbered goods is to vest in the secured creditor, is generally prohibited.

Argentina: Ley no. 12962 on prenda con registro of 1947, art. 36; *Belgium*: Loi sur la mise en gage du fonds de commerce of 1919, art. 12, in conjunction with Commercial Code, title VI art. 10; *Brazil*: Law no. 4728 of 1965 as

amended, art. 66 § 6; *Colombia*: Commercial Code of 1971, art. 1203; *Costa Rica*: Commercial Code of 1964, art. 536; *Guatemala*: Civil Code of 1963, art. 882 para. 2; *Mexico*: Civil Code art. 2887; *Panama*: Ley no. 22 sobre prenda agraria of 1952, art. 21; *Paraguay*: Decreto-Ley no. 896 on prenda con registro of 1943, art. 31.

One country emphasizes that a forfeiture clause is objectionable only if contained in the original security agreement. An agreement transferring title to the encumbered goods upon the creditor, if made after the secured claim has fallen due, is valid.

Mexico: Civil Code art. 2883; Ley general de titulos y operaciones de credito of 1932, art. 344.

(b) *Private v. public enforcement.* The most important distinction between the various general approaches to enforcement centres round the question whether enforcement should be left to the secured creditor or whether public authorities should be involved in it.

The intervention of public authorities is intended to guard against the risk that the secured creditor, in enforcing his security interest, will primarily look to his own interests which coincide only in part with those of the debtor. The creditor is only interested in recovering from the proceeds an amount equivalent to his claim and expenses, whereas the debtor is anxious to realize as much as possible, since he will be entitled to any surplus over the secured creditor's claim.

On the other hand, the intervention of public authorities in the enforcement procedure inevitably involves delays and additional expenses and is thus less welcome to both the secured creditor and the debtor.

It remains to be seen how the various legal systems strike a balance between these conflicting principles during the successive phases of enforcement. If a particular legal system provides for several alternative methods of enforcement, as happens sometimes, we shall merely mention the most liberal one, i.e. that in which the creditor's position is the strongest.

(c) *Preservation of the encumbered goods.* In non-possessory security interests the encumbered goods are in the custody of the non-paying debtor. The first objective of the secured creditor is, therefore, to obtain possession of the goods or, at least, to withdraw them from the debtor's possession.

Under the "private enforcement" approach, the secured creditor himself is entitled to take possession of the encumbered goods, without judicial intervention.

Belgium: Loi sur la mise en gage du fonds de commerce of 1919, art. 11 para. 1; *Canada*: (Uniform) Conditional Sales Act of 1922, revised 1955, amended 1959, s. 13 (1); *United States*: Uniform Commercial Code s. 9-503.

However, such self-help is only permitted if it can be carried out "without breach of the peace"; otherwise a judicial action must be instituted.

Expressly *United States*, s. 9-503.

This leads to a second group of countries which always require an action to be filed before the goods can be removed, unless the debtor voluntarily surrenders the encumbered goods. Thus self-help is excluded.

Costa Rica: Commercial Code of 1964, art. 567; *Lebanon*: Loi relative à la vente à crédit des autovéhicules, machines agricoles et industrielles of 1935, art. 10; *Panama*: Decreto Ley no. 2 on chattel mortgages of 1955, arts. 27 and 29 (provided the debtor has paid less than half of the secured debt); Ley no. 22 on agricultural pledge of 1952, art. 17; *Spain*: Ley sobre hipoteca mobiliaria of 1954, art. 84 rule 3; *Venezuela*: Decreto no. 491 on sales under reservation of ownership of 1958, art. 22 (judicial discretion); Ley de hipotecas mobiliarias of 1973, art. 69 rule 2 para. 2.

In a third group of countries the court, on the application of the secured creditor, orders the debtor to deposit the encumbered goods with a third person, but not with the creditor himself.

Brazil: Law no. 492 on rural pledges of 1937, art. 23 para. 1 and § 3; *Chile*: Law no. 4702 on instalment sale of movables of 1929, art. 20; *Ecuador*: Commercial Code of 1959, art. 596 paras. 2 and 3; *Uruguay*: Ley no. 12 367 of 1957, art. 26 para. 2.

To a similar effect probably *Argentina*: Ley no. 12 962 on prenda con registro of 1947, art. 29, and *Nicaragua*: Law on agrarian and industrial pledge of 1937, art. 28 para. 2.

(d) *Judicial intervention before disposition of the encumbered goods.* Under the "public approach" to enforcement, usually some judicial intervention takes place before the encumbered goods can be disposed of for the creditor's benefit. However, the forms of such intervention vary considerably.

The classical, although most cumbersome form is the bringing of an action against the debtor by the secured creditor in order to obtain a judgement entitling him to enforcement. It must be assumed that this rule prevails wherever no special forms of judicial intervention have been devised.

One variation consists in modifying normal judicial procedure with a view to speeding up final determination of the litigation. This object is achieved, first, by limiting the objections which the debtor may raise.

Argentina: Ley no. 12 962 on prenda con registro of 1947, art. 30; *Brazil*: Decreto-Lei no. 911 of 1969, art. 3 § 2; *Chile*: Law no. 5687 on the contract of "prenda industrial" of 1935, art. 44; *Costa Rica*: Commercial Code of 1964, art. 565 (payment is the only objection admitted); *Panama*: Ley no. 22 on agricultural pledge of 1952, art. 19; *Paraguay*: Decreto-Ley no. 896 on prenda con registro of 1943, art. 25 (only payment).

In addition, a few countries limit the time within which objections may be raised, to three days!

Brazil: Decreto-Lei no. 911 of 1969, art. 3 § 1; *Mexico*: Ley general de títulos y operaciones de crédito of 1932, art. 341 para. 2.

In another group of countries, the creditor must apply to the court for a decree authorizing the sale of the encumbered goods. This amounts in effect to a summary non-contentious procedure instead of a litigated action.

Ecuador: Commercial Code of 1959, art. 596; *Finland*: Chattel Mortgage Act of 1923, § 14; *France*: Loi relative à la vente et au nantissement des fonds de commerce of 1909, art. 16; *Israel*: Pledges Law, 1967, s. 17 (except in the case of banks); *Mexico*: Civil Code art. 2881; Ley general de títulos y operaciones de crédito of 1932, art. 341; *Spain*: Ley sobre hipoteca mobiliaria of 1954, art. 84 rule 2; *Venezuela*: Ley de hipotecas mobiliarias of 1973, art. 70 rule 2.

In two countries, the judicial order of public sale is preceded by an order for payment emanating from the court and directed to the debtor.

Nicaragua: Law on agrarian and industrial pledge of 1937, art. 28 para. 2; *Peru*: Ley no. 6565 on instalment sales of 1929, art. 6.

Still more liberal are those countries which do not require the creditor to obtain any judicial permission for his disposition of the goods. He derives his power from the law in general.

This is the position, e.g., in the *United States* and in *Germany*.

(e) *Sale.* Disposition of the encumbered goods must be made in most countries by way of *public* sale.

Argentina: Ley no. 12 962 on prenda con registro of 1947, art. 31; *Ecuador*: Commercial Code of 1959, art. 596 para. 1; *Finland*: Chattel Mortgage Act of 1923, § 14; *France*: Loi relative à la vente et au nantissement des fonds de commerce of 1909, art. 17; Loi relative au nantissement de l'outillage et du matériel d'équipement of 1951, art. 14 para. 1; *Mexico*: Civil Code art. 2881; *Nicaragua*: Law on agrarian and industrial pledge of 1937, art. 28 para. 2 lett. b); *Panama*: Decreto-Ley no. 2 on chattel mortgages of 1955, art. 34 (provided the debtor has paid more than half of the debt secured); Ley no. 22 on agricultural pledge of 1952, art.

19; *Peru*: Law no. 6565 on instalment sales of 1929, art. 6; *Philippines*: Chattel Mortgage Act of 1906, s. 14 (1); *Spain*: Ley de hipoteca mobiliaria of 1954, art. 84 rule 4; *Uruguay*: Ley no. 12 367 of 1957, art. 26 para. 2; *Venezuela*: Ley de hipotecas mobiliarias of 1973, art. 70 rule 4.

Certain countries permit disposition by *private* sale.

Australia: states of *New South Wales*: Bills of Sale Act, 1898-1938, s. 4 C (1); and *Queensland*: Bills of Sale and other Instruments Act of 1955, s. 45 and Fifth Schedule no. (4); *Brazil*: Law no. 4728 of 1965, as amended, art. 66 § 4, and Decreto-Lei no. 911 of 1969, art. 2; *Czechoslovakia*: International Trade Code of 1964, s. 174 (express agreement necessary unless the encumbered goods are in the possession of the creditor); *Federal Republic of Germany*: See Devel, Allemagne p. 25; *Mexico*: Civil Code art. 2884 (express agreement necessary); Ley general de títulos y operaciones de credito of 1932, art. 341 para. 3 (commercial pledge); *United States*: Uniform Commercial Code s. 9-504 (3).

In cases of reservation of ownership the seller's rescission of the contract of sale will entitle him to reclaim the goods and keep or dispose of them in any manner whatsoever. One country, however, requires sale of the repossessed goods by the seller himself. The sale may be private if the seller does not insist on reimbursement by the debtor of any shortfall between the amount secured and the proceeds of sale; if the seller wishes to preserve this claim, he must proceed by way of public sale.

Canada: (Uniform) Conditional Sales Act of 1922, revised 1955, amended 1959, s. 13 (2) and (3).

Apparently everywhere the debtor must be given prior notification of the sale of the encumbered goods. He is usually granted some time before disposition of the goods in order to give him a last opportunity to redeem the goods for himself by making payment to the creditor. The "grace period" varies between five days in Chile and Spain to 20 days in Canada and Panama.

A few countries also provide for notification of later-ranking secured creditors. In effect, such a rule appears to be limited to countries with a registration system, although, on the other hand, only very few of these have established this requirement.

Many countries prescribe notification in the case of disposal of a mortgaged enterprise:

France: Loi relative à la vente et au nantissement des fonds de commerce of 1909, art. 17 para. 1; see also, following this model, *Egypt*: Loi no. 11 sur la vente et le nantissement des fonds de commerce of 1940, art. 14 para. 3; *Lebanon*: Décret législatif no. 11 (on sale and mortgaging of an enterprise) of 1967, arts. 30 para. 2 and 32; *Tunisia*: Commercial Code of 1959, art. 245 para. 1.

Very few countries prescribe this notification in other cases: *France*: Loi relative au nantissement de l'outillage et du matériel d'équipement of 1951, art. 10; *Spain*: Ley sobre hipoteca mobiliaria of 1954, art. 84 rule 2 para. 3; *United States*: Uniform Commercial Code s. 9-504 (3).

The purpose of notifying subordinated secured creditors is to give them an opportunity to preserve the encumbered goods in the hands of the debtor. They may, by paying off the first-ranking secured creditor, save the encumbered goods as security for their own outstanding claims.

(f) *Conclusions.* The value of any security interest is put to a final test when its enforcement becomes necessary. Justice, efficiency, speed and low cost are the criteria for an effective enforcement procedure.

(1) A *forfeiture clause* in the security agreement is generally prohibited and void. But the prohibition does not cover an agreement between debtor and creditor concluded after the former has fallen in default and by which he transfers title to the encumbered goods upon the creditor.

(2) *Reclamation of the encumbered goods* from the debtor is in some countries left to the creditor's self-help, provided this is peaceful. Most countries require a judicial action by the creditor, while others provide for a judicial decree ordering the debtor to deposit the encumbered goods with a third person.

It would seem that these three basic solutions do not exclude each other. Peaceful self-help, i.e. removal without objection by the debtor, is the most efficient, swift and cheap method of preserving the encumbered goods. Abuses by the creditor should be sanctioned by providing damages and possibly a fine for unjustified removal. Judicial intervention becomes necessary where the debtor resists removal by the creditor. A special speedy proceeding for sequestration of the encumbered goods is important if continued use of dispositions by the debtor is likely.

(3) *Steps preceding disposition of the goods.* Wherever no special forms of judicial intervention have been devised, the creditor will usually have to bring an action against the debtor; the resulting judgement entitles the creditor to enforcement. Some countries facilitate this procedure by limiting the debtor's grounds of objection and/or the time for bringing them. Even speedier is a summary non-contentious proceeding resulting in a decree which authorizes the creditor to sell the encumbered goods. The simplest method is to dispense with any judicial intervention, the creditor's permission to dispose of the encumbered goods being contained in the law itself.

Upon a comparative evaluation of the various approaches, the last-mentioned liberal solution seems to be optimal. It is speedy and saves costs. The debtor's interest in obtaining a fair determination of the parties' mutual rights can be sufficiently protected by obliging the creditor to pay damages for an unjustified disposition of the encumbered goods.

(4) *Disposition of the goods.* Disposition is dominated again by the dichotomy between public and private, here of the sale. The only criterion ought to be the practical one, which of the two methods achieves the better results. Perhaps the answer must vary from country to country. It is a fact that in some countries public sales are attended by only few people and that consequently prices are notoriously low. Here public sales are not practicable. The necessary initiative of the creditor to achieve a good price on a private sale must be sanctioned by an obligation to pay damages for any unreasonable disposition.

Disposition by the creditor will be the rule, but should not be obligatory. If the creditor wants to retain the encumbered goods, but cannot agree with the debtor upon a price, the latter should be fixed by a court-appointed expert.

The creditor must notify both the debtor and, if he knows of them, subordinate secured creditors of the proposed sale.

The above rules should be extended to cover also reservations of ownership. Their security purpose prevails over their legal form of ownership. The "reserved owner" is as much a secured creditor as any other. Moreover, the liberal and flexible rules proposed here accommodate sufficiently the interests of the "reserved owner".

2.4 *Statutory non-possessory security interests in favour of the seller*

2.4.1 *Purpose*

The chief purpose of the seller's statutory interests is obviously to secure payment from the buyer of the purchase-price. The interest will only come into operation if a seller is not paid before or contemporaneously with delivery of the goods sold. Since it is a statutory right, no contractual agreement or other formality is, as a rule, required for the creation of the statutory interests.

Wherever the legislator has created a protection of this nature in favour of sellers, the assumption obviously is that the voluntary extension of trade credit by sellers is a frequent and desirable phenomenon and that the credit-extending seller deserves special protection. This protection is particularly important in those countries which are, or at least were, reluctant to make contractual security interests available to sellers, such as France and many other Latin countries. The existence of a seller's statutory protection appears to be less called for in

countries where sellers can easily create contractual security interests, especially by reservation of ownership.

Quite different considerations must underlie the protection of a second class of sellers, namely those who have contracted the sale on a cash basis, but have nevertheless not been paid. Again this type of seller is often regarded as deserving protection — sometimes even more so than the credit-seller. This is obviously based upon the assumption that the legislator must take steps to protect the unpaid seller against the risk of the buyer's insolvency.

2.4.2 *Two situations of seller's protection*

Even a cursory survey of the various rules on the seller's protection reveals that most of the provisions clearly envisage two different situations. One set of rules seeks to protect the unpaid seller during transit of the goods from the seller to the buyer. The other seeks to protect the unpaid seller subsequent to delivery of the goods to the buyer.

These two differing sets of rules correspond to two successive stages in the performance of the seller's duty to deliver the goods sold. The factual situation during transit, before the goods have reached the buyer, differs considerably, as is obvious, from that after receipt of the goods by the buyer.

2.4.3 *Stoppage* in transitu

Very many countries entitle the seller to prevent delivery of the goods while these are in the course of transit to the buyer. This right is derived variously: from a right of stoppage *in transitu* properly so-called, from the seller's ownership in the goods sold or from some other source. All these rules, however designated, are analysed here under the functional criterion of how effectively they enable the unpaid seller to regain possession of the dispatched goods.

2.4.3.1 *Conditions*

The two main factors upon which the seller's right of stoppage *in transitu* depends, are the location of the goods sold and the buyer's financial position.

(*a*) Stoppage of the goods in transit presupposes that the goods have been dispatched by the seller, but have not yet reached the buyer (or his agent). This is required almost everywhere.

Argentina: Ley de concursos no. 19 551 of 1972, art. 143 no. 1; *Austria*: Konkursordnung of 1914, § 45; *Chile*: Ley de quiebras of 1931, art. 92; *England*: Sale of Goods Act, 1893, s. 45; *France*: Loi no. 67-563 of 1967, art. 62 para. 1; *Federal Republic of Germany*: Konkursordnung of 1877, § 44 para. 1; *Hungary*: Civil Code of 1959, para. 281; *Italy*: Decreto sul fallimento of 1942, art. 75; *Portugal*: Code of Civil Procedure of 1961, art. 1237 para. 5; *Scandinavia*: (Uniform) Sales Law of 1905/1907, § 39; *Spain*: Commercial Code art. 909 para. 1 no. 9; *Switzerland*: Schuldbetreibungs- und Konkursgesetz of 1889, art. 203 para. 1; *United States*: Uniform Commercial Code, s. 2-705 (2) (a).

For international commercial transactions it is important to know whether delivery to the buyer of a negotiable document of title, especially a bill of lading, affects the seller's position. In general it does not have an adverse effect.

Czechoslovakia: Law on International Trade of 1963, § 364 para. 1; *England*: Sale of Goods Act, 1893, s. 47 (2); *German Democratic Republic*: Gesetz über internationale Wirtschaftsverträge, art, 231 (1); *Scandinavia*: (Uniform) Maritime Law of 1891/1893, art. 166 para. 1; *Spain*: Commercial Code art. 909 para. 1 no. 9.

This rule has also been adopted by the (Hague) Uniform Sales Law of 1964, art. 73 para. 2.

In the *Federal Republic of Germany* and the *United States* the position is somewhat different. In the former country, the courts require presentation by the seller of all the copies of the negotiable document of title. In the United States negotiation to the buyer of a negotiable document of title to the goods terminates the seller's right of stoppage as against the buyer.

United States: Uniform Commercial Code, s. 2-705 (2) (d). Correspondingly, a carrier or other bailee of the goods need not obey the seller's stop order until surrender of the document. S. 2-705 (3) (*c*).

The effect of negotiation of documents to a third person is considered later (*infra* 2.4.3.3 sub (*b*)).

(*b*) The *buyer's financial position* on which may depend the unpaid seller's right of stoppage is defined in different ways.

The narrowest criterion, and one employed mainly by continental European and Latin American countries, is the buyer's bankruptcy.

Argentina: Ley de concursos no. 19 551 of 1972, art. 143; *Austria*: Konkursordnung of 1914, § 45; *Chile*: Ley de quiebras no. 1 297 of 1931, art. 90 para. 1; *France*: Loi no. 67-563 of 1967, art. 62 para. 1; *Federal Republic of Germany*: Konkursordnung of 1877, § 44 para. 1; *Italy*: Decreto sul fallimento of 1942, art. 75; *Netherlands*: Commercial Code art. 232 para. 1; *Portugal*: Code of Civil Procedure of 1961, art. 1237 para. 5; *Spain*: Commercial Code art. 909 para. 1 no. 9; *Switzerland*: Schuldbetreibungs- und Konkursgesetz of 1889, art. 203 para. 1.

In England, the Scandinavian countries and the United States insolvency of the buyer suffices.

England: Sale of Goods Act, 1893, ss. 44, 62 (3); *Scandinavia*: (Uniform) Sales Law of 1905/1907 § 39; *United States*: Uniform Commercial Code ss. 2-705 (1), 1-201 (23) (however, mere delay in payment is held sufficient where a carload, truckload, planeload or larger shipment of express or freight has been promised, s. 2-707 (1)).

Even more liberal are the (Hague) Uniform Sales Law of 1964 and Czechoslovakia. Here it suffices if the economic situation of the buyer appears to have deteriorated to a point where there is good reason to fear non-payment of the purchase-price.

See (Hague) Uniform Sales Law of 1964, art. 73 para. 2; *Czechoslovakia*: Law on International Trade of 1963, §§ 364 para. 1, 363 para. 1.

Dutch law has a very exceptional provision under which the seller is deprived of the right of stoppage even where the buyer has become bankrupt if the seller has drawn a bill of exchange for the purchase-price on the buyer who has accepted the same for payment. Apparently the bill here is regarded as sufficient security.

Netherlands: Commercial Code art. 236.

2.4.3.2 *Consequence*

The right of stoppage entitles the seller to prevent delivery and to reclaim possession of the goods.

Argentina: Ley de concursos no. 19 551 of 1972, art. 143; *Austria*: Konkursordnung of 1914, § 45; *Chile*: Ley de quiebras of 1931, art. 90 para. 1; *England*: Sale of Goods Act, 1893, s. 46; *France*: Loi no. 67-563 of 1967, art. 62 para. 1; *Federal Republic of Germany*: Konkursordnung of 1877, § 44; *Italy*: Decreto sul fallimento of 1942, art. 75; *Portugal*: Code of Civil Procedure of 1961, art. 1237 para. 5; *Spain*: Commercial Code art. 909 para. 1 no. 9; *Switzerland*: Schuldbetreibungs- und Konkursgesetz of 1889, art. 203 para. 1; *United States*: Uniform Commercial Code s. 2-705 (3) (b).

The seller is entitled to retain the goods until he has received payment.

Expressly *Chile*: Ley de quiebras of 1931, art. 90 para. 2; *England*: Sale of Goods Act, 1893, s. 44.

Some countries which permit the right of stoppage only in the event of the buyer's bankruptcy, allow the trustee in bankruptcy to object to the seller's repossession, provided the purchase-price of the goods is being (fully) paid to the latter.

Argentina: Ley de concursos no. 19 551 of 1972, art. 144 no. 2; *Chile*: Ley de quiebras of 1931, art. 96; *Federal Republic of Germany*: Konkursordnung of 1877, §§ 44 par. 2, 17; *Italy*: Decreto sul fallimento of 1942, art. 75;

Netherlands: Commercial Code art. 239; *Spain*: Commercial Code art. 909 para. 2; *Switzerland*: Schuldbetreibungs- und Konkursgesetz of 1889, art. 203 para. 1.

The seller's interests are not thereby adversely affected since under normal circumstances he is more anxious to receive the purchase-price than the goods.

2.4.3.3 *Effect vis-à-vis third persons*

(*a*) The unpaid seller's right of stoppage avails as against the *buyer's creditors*. This rule is obvious in countries which do not allow stoppage until the buyer's bankruptcy.

See *supra* 2.4.3.1 sub (*b*).

But also a few other countries make it reasonably clear that the buyer's bankruptcy does not affect the seller's right of stoppage.

England: Sale of Goods Act, 1893, s. 62 (3); *Scandinavia*: (Uniform) Sales Law of 1905/07, § 39.

(*b*) The position of a *purchaser* from the original buyer is not entirely easy to describe.

Some countries clearly make the seller's right of stoppage subject to prior rights which third persons may have acquired in the goods during their transit.

Argentina: Ley de concursos no. 19 551 of 1972, art. 143 no. 3; *Federal Republic of Germany*: judicial practice; *Italy*: Decreto sul fallimento of 1942, art. 75.

Other legal systems seem to start with the proposition that sales by buyers during transit do not, as a rule, affect the unpaid seller's right of stoppage.

Expressly only *England*: Sale of Goods Act, 1893, s. 47 (1); *Poland*: Commercial Code of 1934, art. 521.

This principle, however, is then cut down by a major exception in favour of purchasers in good faith. If the seller has issued and transferred a negotiable document of title to the buyer who, on the faith of it, resells to a bona fide purchaser, the seller's right of stoppage is lost.

Chile: Ley de quiebras of 1931, art. 91 para. 1; *Czechoslovakia*: Law on International Trade of 1963, § 364 para. 2; *England*: Sale of Goods Act, 1893, s. 47 para. 2; *France*: Loi no. 67-563 of 1967, art. 62 para. 2; *Netherlands*: Commercial Code art. 238 para. 1; *Scandinavia*: (Uniform) Maritime Law of 1891/93, art. 166 para. 2; *Switzerland*: Schuldbetreibungs- und Konkursgesetz of 1889, art. 203 para. 2; (Hague) *Uniform Sales Law* of 1964, art. 73 para. 3. In effect also *United States* where even delivery of the negotiable document to the buyer excludes the seller's right, see *supra* s. 2.4.3.1 sub (a).

The seller may effectively exclude the buyer's right of disposition until payment by a note to that effect on the documents of title.

See (Hague) Uniform Sales Law of 1964, art. 73 para. 3; *Scandinavia*: (Uniform) Maritime Law of 1891/1893, art. 166 para. 2.

However, in practice such a note seems to be very rare.

Where the seller's right of stoppage is lost, some countries provide a subsidiary recourse. If the subpurchaser has not yet paid the purchase-price to the original buyer, the unpaid seller may himself claim payment from the subpurchaser.

Argentina: Ley de concursos no. 19 551 of 1972, art. 145; *Chile*: Ley de quiebras of 1931, art. 91 para. 2; *Netherlands*: Commercial Code art. 238 para. 2.

2.4.3.4. *Practical importance*

It would appear that for some time now the seller's right of stoppage *in transitu* has lost much of its earlier practical importance. This is primarily due to the modern commercial practice of sales against documents. The seller does not now part with the documents of title to goods until he has either received payment or an acceptable letter of credit has been opened for him. The documentary sale thus effectively reduces the problem of the unpaid seller. However, it is not eliminated altogether. According to the trade usages in some countries, the buyer may ask for provisional handing-over of the documents on trust. If the buyer retains the documents, but fails to pay, the unpaid seller may have to fall back on the right of stoppage.

The right of stoppage has also preserved its importance in sales otherwise than under documents.

2.4.3.5 *Conclusions*

The conditions and effects of the seller's right of stoppage *in transitu* are by and large very similar.

(a) *Conditions.* Two conditions are usually required, one relating to the location of the goods, the other to the financial status of the buyer. There is unanimity that the goods must have been dispatched by the seller, but must not yet have reached the buyer or his agent. Delivery of a negotiable document of title, especially a bill of lading, does not affect the seller's right of stoppage in most countries. This is also the better rule since it is not intelligible why delivery of such a document should adversely affect the seller.

Three different criteria are used to define that financial position of the buyer which creates the seller's right of stoppage, namely the buyer's bankruptcy, his insolvency or a serious deterioration of his economic position. It would seem that the middle solution is the best because it turns on a highly relevant fact situation which is, in general, easy to determine.

(b) *Effects.* Everywhere the right of stoppage entitles the seller to prevent delivery of the goods to the buyer and to reclaim their possession.

If the buyer is in bankruptcy, the trustee in bankruptcy should be allowed to object to the seller's repossession, provided the outstanding purchase price for the goods is fully paid to the seller.

Clearly, the seller's right of stoppage should be effective as against the other creditors of the buyer.

As regards purchasers from the buyer, it would seem that these should be protected against the seller's right of stoppage if they have acquired the goods sold from the buyer without knowledge that the seller had not yet been paid. This should be so in particular, but not only, if the seller has delivered a negotiable document of title to the buyer and the purchaser has acquired on the faith thereof.

2.4.4 *Seller's protection after delivery of goods*

The degree of protection, if any, of the unpaid seller after the buyer has obtained delivery of the goods sold, differs considerably in the various legal systems.

The legal bases of any protection granted also vary considerably. They range between the seller's ownership (which under the so-called cash-sale-doctrine does not pass before payment of the purchase-price); a right to reclaim the goods; and a mere privilege.

As in other parts of this study, all these various rules, however designated, are analysed here from a functional point of view, i.e. we analyse the practical results which ensue from their application.

2.4.4.1 *Lack of protection*

In several legal systems there is no statutory protection available to the unpaid seller after delivery to the buyer of the goods sold:

Especially *England*, but essentially also *Austria*, *Federal Republic of Germany*, *Scandinavia* and *Switzerland*.

It is probably no accident that most of these countries at the same time liberally permit the seller to create contractual security interests, like reservation of ownership or hire purchase, without imposing burdensome formal requirements such as the drawing up of formal documents or registration.

Only *Switzerland* requires registration of a contractual reservation of ownership.

Thus the credit-extending seller is in a position to provide easily for his own protection.

The unpaid cash seller, on the other hand, who will not go to the trouble of creating a security interest, is left without any assistance.

2.4.4.2 *Conditions of protection*

Where the seller is protected, this protection depends upon several factors which are differently handled and variously combined in each legal system. Of these factors the most prominent are the location of the goods sold, the buyer's financial position, and the terms of the sale.

(a) *Location of goods.* The special régime of seller's protection after delivery of the goods presupposes that the buyer (or his agent) has obtained possession of the goods.

Brazil: Decreto-Lei no. 7 661 on bankruptcy of 1945, art. 76 § 2; *France*: Civil Code art. 2102 no. 4; *Italy*: Civil Code art. 1519 para. 1; *Mexico*: Nueva ley de quiebras of 1942, art. 159 no. III (impliedly); *Netherlands*: Civil Code art. 1190; Commercial Code art. 232 (in case of bankruptcy); *Portugal*: Code of Civil Procedure of 1961, art. 1237 para. 5; *Scandinavia*: (Uniform) Sales Law 1905/07, § 41 para. 1; *Spain*: Commercial Code art. 909 no. 8; *United States*: Uniform Commercial Code s. 2-702 (2).

In some cases, special time-limits govern the buyer's obtaining of possession. Thus in certain Central and North European States this must be *after* the buyer has been declared a bankrupt.

See the *Austrian, German* and *Swiss* provisions cited *supra*, 2.4.3.1 sub (a); *Scandinavia*: (Uniform) Sales Law of 1905/07, § 41.

The seller's protection here is obviously treated as a prolongation of his right of stoppage *in transitu*.

Brazil, on the other hand, requires that the buyer must have received the goods within the fortnight immediately preceding the presentation of the application for bankruptcy of the buyer.

Brazil: Decreto-Lei no. 7 661 on bankruptcy of 1945, art. 76 § 2.

The underlying idea is probably to protect only credit-sellers who have delivered during the critical 15-day period immediately preceding bankruptcy who are likely to have been deceived about the buyer's solvency.

Possession by the buyer need not necessarily persist at the time the seller invokes his protection. How a subsequent disposition of goods to a third person affects the seller's protection is examined separately (*infra* 2.4.4.4).

(b) *The buyer's financial position* on which may depend the seller's protection is defined in different ways.

Many Latin countries, but also some in Central Europe, use the narrowest and at the same time most specific criterion, i.e. the buyer's bankruptcy.

See the provisions of *Brazil, Mexico, Portugal, Scandinavia* and *Spain*, cited *supra* (a); see also *Mexico*: Civil Code of 1932, art. 2993 no. VIII; see also the *Austrian, Dutch, German* and *Swiss* provisions, referred to *ibidem*.

In the *United States*, insolvency of the buyer suffices.

United States: Uniform Commercial Code ss. 2-702 (2), 1-201 (23).

Even more liberal are *France, Italy* and the *Netherlands*. These countries require no more than non-payment of the purchase-price.

See the *French, Italian* and *Dutch* provisions cited *supra* (a).

This, of course, is but a general prerequisite of the seller's protection.

(c) Many laws differentiate between *cash* and *credit sales*. As a rule, the protection afforded to a seller who has sold on credit is less than that afforded to a cash seller. Many Latin countries entitle the cash seller to reclaim possession of the goods from the buyer,

France: Civil Code art. 2102 No. 4 para. 2; *Italy*: Civil Code art. 1519 para. 1; *Mexico*: Nueva ley de quiebras of 1942, art. 159 no. III; *Netherlands*: Civil Code art. 1191 para. 1; *Spain*: Commercial Code art. 909 para. 1 no. 8,

while a credit seller either has no remedy

As in *Italy* and *Spain*

or enjoys a mere privilege.

France: Civil Code art. 2102 no. 4 para. 1; *Mexico*: Civil Code art. 2993 no. VIII; *Netherlands*: Civil Code art. 1190.

However, another group of countries has opted exactly for the opposite position. Here the credit-seller only is accorded protection.

Brazil: Decreto-Lei no. 7 661 on bankruptcy of 1945, art. 76 § 2; *Portugal*: Code of Civil Procedure of 1961, art. 1237 para. 5; *United States*: Uniform Commercial Code s. 2-702 (2).

Again, in the Central and North European countries no distinction is made between cash and credit sales.

Austria, Federal Republic of Germany, Netherlands and *Scandinavia*.

2.4.4.3 *Forms of protection*

The two main remedies are the seller's right to reclaim possession of the goods sold and a privilege entitling him to satisfaction of the purchase-price from the proceeds of the goods.

As was pointed out earlier (*supra* 2.4.4.2 sub (c)), a right to reclaim possession of the goods is in some countries available only in the case of cash sales, in others in the case of credit sales, and occasionally in both cases.

The seller's statutory privilege is less efficient than the right to reclaim and it exists only side by side with (and never without) a right to reclaim, but only in a minority of countries.

France: Civil Code art. 2102 no. 4 para. 1; *Mexico*: Civil Code art. 2993 no. VIII; *Netherlands*: Civil Code art. 1190.

As in the case of stoppage *in transitu*, the buyer's trustee in bankruptcy may in some countries oppose the seller's claim for repossession, provided he pays the purchase-price of the goods in full to the seller.

Federal Republic of Germany: Konkursordnung of 1877, § 44 paras. 2, 17; *Mexico*: Nueva ley de quiebras of 1942, art. 162; *Scandinavia*: (Uniform) Sales Law of 1905/07 § 41 para. 1; *Spain*: Commercial Code art. 909 para. 2; *Switzerland*: Schuldbetreibungs- und Konkursgesetz of 1889, art. 203 para. 1.

Some legal systems establish a *time-limit* for the seller to invoke his protection.

The time-limit is in some countries relatively short if the seller has the *right to reclaim* the goods. The period runs from the date of delivery to the buyer and is 8 days in *France*, 10 days in the *United States*, 15 days in *Italy* and 30 days in the *Netherlands*.

France: Civil Code art. 2102 no. 4 para. 2; *United States*: Uniform Commercial Code s. 2-702 (2) (however, there is no limit if a written misrepresentation of the buyer's solvency has been made to the seller within three months prior to delivery); *Italy*: Civil Code art. 1519 para. 1; *Netherlands*: Civil Code art. 1191 para. 1; Commercial Code art. 232 para. 2 (in the case of bankruptcy).

In most of the Latin countries no time-limit has been prescribed.

Thus in *Brazil, Mexico, Portugal* and *Spain*.

Only one country seems to impose a time-limit in the case of a seller's *privilege;* it is liberally fixed at 60 days after the purchase-price becomes due.

Mexico: Civil Code art. 2993 no. VIII.

2.4.4.4 *Effect vis-à-vis third persons*

While the unpaid seller's protection is effective in many countries as against the buyer's creditors, its position as against purchasers from the buyer is more controversial.

(a) Protection as against the buyer's *bankruptcy creditors* is obvious in countries which do not grant protection until (or as well as in) the buyer's bankruptcy.

See *supra* 2.4.4.2 sub (b). See in addition, specifically as regards the seller's privilege, *Netherlands*: See Devel, Pays-Bas p. 10; *Spain*: Commercial Code art. 913 no. 3 and Civil Code art. 1922 no. 1.

Some Romanic countries, on the contrary, follow the French lead and deny protection to the seller in the buyer's bankruptcy.

Expressly *Belgium*: Commercial Code art. 546 para. 1; see also *France*: Loi no. 67-563 of 1967, art. 60. Also *Italy*.

It must be noted, however, that in Belgium and France only merchants can be declared bankrupt.

However, two of these countries enable the sellers of specified goods to achieve protection in the buyer's bankruptcy, but only where he takes the trouble to provide the required publication of his statutory privilege. *Belgium* permits such increased protection for sales of machinery and equipment used in industrial, commercial or artisanal enterprises. The deposit of a bill or any other contract document at the court of the buyer's residence is necessary. The protection inures for five years.

Belgium: Commercial Code art. 546 para. 2-4, as amended in 1957.

In *Italy* only machinery with a sales price in excess of 30,000 Lire (today about $US 51) qualifies for special protection, provided the sales documents are filed with the court at the location of the goods. This protection inures for three years.

Italy: Civil Code art. 2762.

It may be extended to six years if machinery with a purchase-price exceeding 50,000 Lire (about $US 850) is marked with a sign indicating the seller's name, some characteristics of the machine and the name of the court where registration has taken place.

Italy: Law no. 1329 providing for the acquisition of new machines of 1965, art. 6 para. 1.

In the *United States* it is doubtful whether the seller enjoys protection in the buyer's bankruptcy. The text of the original official version of the Uniform Commercial Code s. 2-702 (3) had apparently the (possibly unintended) effect of effacing the seller's protection. About 10 states have therefore amended the text to rectify the position; in 1966 also the official text was changed accordingly.

(*b*) Protection against the buyer's *attachment creditors* is, of course, only relevant in the few countries which grant the seller protection prior to bankruptcy (*supra* 2.4.4.2 sub (*b*)). According to *French* practice the seller cannot, by virtue of his privilege, prevent attachment of the goods sold, but he is entitled to be paid from their proceeds in advance of the unsecured attaching creditors.

France: see Devel, France p. 9.

Italy has expressly provided that the seller's right to reclaim possession of the goods sold is subject to the rights of the buyer's attaching creditors unless it is proved that the latter knew, at the time of attachment, that the purchase-price of the goods was in arrears.

Italy: Civil Code art. 1519 para. 3.

(*c*) A similar rule prevails with respect to the *buyer's landlord*. A few Romanic countries expressly give preference to the landlord's claim for rent, unless it is proved that the landlord knew the buyer had not yet acquired title to the goods in question (or that the purchase-price had not yet been paid).

France: Civil Code art. 2102 no. 4 para. 3; *Italy*: Civil Code art. 1519 para. 2; *Netherlands*: Civil Code art. 1192.

(*d*) More practical and more difficult is the seller's position as against *real estate mortgages* of the buyer, if the goods sold have become fixtures. At least three different solutions can be found.

In *France* and the *Netherlands* the seller's privilege remains unaffected. Yet it appears that an existing mortgage has priority unless the mortgagee, at the time the goods were affixed, knew of the existence of the seller's privilege.

France: see Devel, France p. 9; *Netherlands*: see Devel, Pays-Bas p. 12.

In *Mexico*, on the other hand, the seller's privilege is extinguished.

Mexico: Civil Code art. 2993 no. VIII.

Belgium and *Italy* begin with the same premise.

Expressly *Belgium*: Loi hypothécaire of 1851, art. 20 no. 5 para. 2.

However, they provide for the avoidance of this effect where the sales contract has been publicized. The publicity which is required is the same as that needed to make the seller's privilege effective in the buyer's bankruptcy (see *supra* (*a*)).

Belgium: Loi hypothécaire of 1851, art. 20 no. 5 paras. 2-5, as inserted 1957; *Italy*: Civil Code art. 2462 para. 1; Law no. 1329 providing for the acquisition of new machines of 1965, art. 5.

(*e*) The effect of the seller's privilege as against a *purchaser* varies.

According to *French* practice the privilege ceases upon a disposition by the buyer of the goods sold, even if the purchaser knew of the existing privilege.

France: see Devel, France p. 8.

In the *Netherlands* and the *United States* only a bona-fide purchaser extinguishes the seller's protection.

Netherlands: Civil Code art. 1192a para. 1; *United States*: Uniform Commercial Code s. 2-702 (3).

In *Italy* even a good-faith acquisition will not avail in the case of machines with a purchase-price of more than 500,000 Lire (about $US 850) if these are marked in a special way (*supra* (*a*)).

Italy: Law No. 1329 providing for the acquisition of new machines of 1965, art. 3 para. 4.

France and the *Netherlands* provide a small measure of consolation to the seller where the latter loses his privilege to a subpurchaser: the seller's privilege is made to attach to the buyer's claim against the subpurchaser for the purchase-price.

France: see Devel, France p. 8; *Netherlands*: Civil Code art. 1192a para. 2.

2.4.4.5 *Conclusions*

There is very considerable divergency of opinion as to whether the seller should by statute be protected after delivery of the goods to the buyer at all, and if so, in which form.

(a) *Protection or not?* The first question is whether the unpaid seller should be granted statutory protection even after he has delivered the goods sold to the buyer.

Such statutory protection clearly expresses a prejudice of the legislature in favour of sellers as distinct from any other class of creditors. Such preference offends the general principle of equality. There do not seem to exist any special reasons which would justify the preferential treatment of sellers. These should be referred to the possibility of agreeing on a contractual security interest.

This brings us to a necessary consequence of any abolition of a statutory interest in favour of the seller. Access to the contractual security interests must be facilitated, especially by doing away with any limitations as to the permissible parties and items of security and by eliminating burdensome formal requirements. The credit-extending seller must be enabled to provide easily for his own protection.

We shall now discuss the conditions and effects of a statutory interest in favour of the seller under the assumption that such statutory protection should be preserved.

(b) *Conditions of statutory protection.* The seller's statutory protection depends on three conditions, the location of the goods sold, the buyer's financial position, and the terms of the sale.

The seller's statutory protection presupposes everywhere that the buyer must have received possession of the goods sold. If

a general protection of the seller is intended, qualifications as to the time of receipt are not useful.

Criteria for the buyer's financial condition are either his bankruptcy or his insolvency, while some Latin countries do not require either. The latter solution appears to be indicated if the seller's statutory protection is to have a board coverage.

An interesting cleavage exists with regard to the protection of cash and credit sales. Some countries prefer the cash-seller, leaving the credit-seller with less protection or none at all. Some other countries, on the contrary, only protect the credit-seller. These differences depend upon the scope to be given to the statutory protection. If this is designed as a general protection of any unpaid seller, no distinction at all as to the terms of the contract of sale should be made. If, on the other hand, this régime is to be co-ordinated with the possible contractual security interests of the seller, the statutory régime might well be restricted to cash sales, while credit-sellers can be referred to the possibility of creating a contractual security interest. The decision on this point is also reflected in the fixing of a time-limit for the seller's remedy (see *infra* (*c*)).

(c) *Forms of protection.* The seller has two remedies, viz. the right to reclaim possession of the goods sold and a privilege entitling him to satisfaction of the purchase-price from the proceeds of sale of the goods. In some countries both remedies exist concurrently, while in most countries the seller has only the more effective right of reclamation. It would seem that the latter, as the *majus*, also includes the former, as the *minus*, and that the seller can always opt for this, even if the relevant statute does not say so expressly. Thus, in effect there is no diversity as to the two remedies.

As in the case of stoppage *in transitu*, there is no objection to the buyer's trustee in bankruptcy opposing the seller's reclamation, if he pays the outstanding purchase-price.

The stronger remedy, the seller's right of reclamation, is in some countries limited to a short period of time (between 8 and 30 days) after delivery to the buyer. Other countries do not have such a restriction. In most cases the time-limit on the right of reclamation coincides with the restriction of the seller's protection to cash sales (*supra* (*b*)). At any rate, these two aspects must be co-ordinated.

(d) *Effect as against third persons.* The seller's statutory protection after delivery of the goods sold to the buyer is, in general, weaker than that under the right of stoppage *in transitu*.

Thus some Latin countries deny the seller protection even vis-à-vis other (unsecured) creditors of the buyer; but two of these countries allow the seller at least to obtain immunity in the buyer's bankruptcy by means of filing the sales documents with a court. The seller's position is, of course, most precarious if he has no protection, in the buyer's bankruptcy. To require a filing of the seller's interest is an unwarranted limitation on his *statutory* right.

The same considerations should apply as against attachment creditors of the buyer.

The seller's rights vis-à-vis real estate mortgages are weak, if the goods sold have become fixtures. In most countries the seller's rights become ineffective, at least as against existing mortgages. Two Latin countries permit validation by filing of the sales documents. This solution appears to be appropriate in view of the full publicity that governs rights in real estate.

The seller's protection as against purchasers from the buyer varies from *nil* in one country to protection against *mala fide* purchaser in some countries. The latter solution appears to be in keeping with the general rules of property law.

2.5 *Non-possessory security interests in means of transport*

Since security interests in ships and aircraft are subject to widely accepted international conventions, the present study will be limited to automobiles, containers and railways. It will only deal with special rules deviating from the ordinary rules on security interests.

2.5.1 *Automobiles*

2.5.1.1 *Introduction*

Motor vehicles of all kinds, employed extensively in most countries for business purposes as well as for personal use, are very often acquired upon credit. In many countries automobiles are registered for purposes of inspection or taxation or for general police supervision, and often special documents are also issued for each vehicle. For all these reasons one might well expect that special rules on security interests in automobiles would have developed that differ at least in certain respects from the provisions and rules on security interests in general.

Unfortunately, the special problems connected with security interests in motor vehicles have so far attracted scant attention on a transnational level. Only a study by UNIDROIT on instalment sales in the member countries of the Council of Europe has collected some interesting material.

UNIDROIT p. 122-247.

As far as can be ascertained, a special régime for security interests in automobiles prevails in only a few countries. Most of the special rules that do exist are based upon the aforementioned unique features of automobiles, namely their registration and documentation.

The reasons for special legislation vary from country to country. The *Italian* Decree-Law of 1927 on contracts for the sale of motor vehicles and the original *French* statute of 1934 were passed in order to promote the domestic motor industry by facilitating and securing the selling of automobiles on credit. Perhaps the same reason prompted the enactment of the *Japanese* statute. But none of these Acts was or is restricted to automobiles of domestic production. In other countries, and especially in *South America*, the primary purpose was apparently the desire to protect secured creditors against fraudulent transactions with respect to the encumbered automobile by the debtor.

2.5.1.2 *Admission of other security interests*

Certain countries which provide a special régime for security interests in motor vehicles have in addition a non-possessory security interest of general coverage (especially reservation of ownership). In these countries the question has been debated whether a motor vehicle may still be made the subject of this general non-possessory interest. In both *Italy* and *Japan* court practice has solved this dispute in the affirmative.

Italy: Cass. 10 Sept. 1969, Foro it. 1970.I.149; *Japan*: *Yamada*, Japanische Gesetzgebung auf dem Gebiete des Privatrechts 1945-1958: Rabels Zeitschrift für ausländisches und internationales Privatrecht 26 (1961) 713-730 (722).

Japan, *Portugal* and the *Republic of Korea* (*South Korea*) expressly exclude the pledge of a motor vehicle.

Japan: Law of 1951, art. 20; *Republic of Korea*: Law no. 868 on hypothecation of automobiles of 23 Nov. 1961, § 8; *Portugal*: Decreto-Lei no. 40 079 of 1955, art. 10.

Most other countries are silent on this point. Such silence must be understood as directed against an exclusivity of the non-possessory security interest. Registration and the other means of publication are designed to substitute for the creditor's possession because it is usually impracticable; but it is not to be excluded altogether.

2.5.1.3 *Restrictions as to secured claims*

In keeping with the general restrictions imposed by many countries upon non-possessory security interests (*supra* 2.3.2), the type of monetary claim that may be secured by motor vehicles is sometimes narrowly circumscribed. In *France* and the French-influenced statutes of *Lebanon*, *Morocco* and *Tunisia* only the seller's claim for the purchase-price can be secured.

France: Décret of 1953, art. 1; *Lebanon*: Loi relative à la vente à crédit des autovéhicules ... of 1935, art. 1; *Morocco*: Dahir réglementant la vente à crédit des véhicules

automobiles of 1936, art. 1; *Tunisia*: Décret relatif à la vente à crédit des véhicules ou tracteurs/automobiles of 1935, art. 1.

Except in *Lebanon*, a purchase money loan by a third person may also be registered.

France: Décret of 1953, arts. 1 and 2; *Morocco*: Dahir art. 13 (payment of purchase-price for the buyer by third person after registration); *Tunisia*: Décret art. 1 para. 1.

It is a consequence of this limitation to claims for purchase money (see *supra* 2.3.2.2) that no other contractual security interest in the vehicle may be registered.

Expressly the *French* Ministerial Instruction of 1956, II-C-1.

Italy also covers claims for purchase money and even gives them a preferential treatment by granting a *statutory* security interest in the vehicle.

Italy: Decreto-Legge of 1927, art. 2 paras. 1-2.

But the courts permit a seller to conclude a conditional sale and have the reservation of ownership entered in the register.

Italy: Cass. 10 Sept. 1969, Foro it. 1970.I.149.

In addition, a *contractual* security interest may be created in favour of any other creditor.

Italy: Decreto-Legge of 1927, art. 2 para. 3.

2.5.1.4 *Special systems of registration*

Some countries, irrespective of whether they provide for registration of security interests in general (*supra* 2.3.3.3) or not, have established special forms of registration for automobiles. "Registration" in this context means an entry in a record maintained by some public office that is more or less accessible to public inspection. Entries on documents relating to individual vehicles are dealt with separately (*infra* 2.5.1.5). Registration of security interests either constitutes a prerequisite to their validity, or is simply a means of affording some measure of protection to the secured creditor and third parties.

2.5.1.4.1 *Registration as a condition of validity*

France, Italy, Japan, Lebanon, Morocco, Portugal, South Korea, Tunisia and certain *South American* countries require registration of all security interests in automobiles as a condition of their valid creation. *Finland* and *Norway* require it only for security interests in buses. In these countries registration is a pre-condition for the legal effectiveness of a security interest either vis-à-vis third parties, or sometimes even between creditor and debtor.

(*a*) With regard to the place of registration most countries do not provide for central registration in one single office for the whole country. Rather it is decentralized in offices on the province or district level. Each vehicle that has been licensed in one of these territorial subdivisions must be registered in that subdivision's office. Vehicles licensed abroad are thus impliedly excluded. In some countries, certain public automobiles, those belonging to foreign diplomats and consuls and those circulating duty-free are excluded.

France: Décret of 1953, art. 1 para. 2; *Italy*: Executive regulations of 1927, art. 26.

(*b*) Some countries fix a *time-limit* for registration. This period, which generally runs from the acquisition of the vehicle, varies from 15 days in *Morocco*, two months in *Tunisia*, and three months in *France* to one year in *Italy*.

Morocco: Dahir of 1936, art. 4; *Tunisia*: Arrêté of 1935, art. 8 para. 2; *France*: Décret of 1953, art. 5; *Italy*: Decreto-Legge of 1927, art. 2 para. 7.

(*c*) The *duration* of the registration is limited in many countries to five years, subject to renewal for the same period.

France: Décret of 1953, art. 2 para. 5; *Italy*: Decreto-Legge of 1927, art. 2 para. 5, art. 18; *Tunisia*: Décret of 1935, art. 4.

In other countries, there is apparently no time-limit.

(*d*) Certain countries provide for *double publication*. In addition to registration, they also require an entry in a document which remains with the vehicle. Thus in *Italy*, a notation corresponding to that in the register is entered into a supplement to the vehicle licence which stays with the vehicle.

Italy: Decreto-Legge of 1927, art. 16.

In *Lebanon, Morocco, Spain* and *Tunisia*, the security interest is also annotated on the vehicle licence (*carte grise*).

Lebanon: Law of 1935, art. 23; *Morocco*: Dahir of 1936, arts. 4 and 5 para. 1; *Spain*: Ley sobre hipoteca mobiliaria of 1954, art. 35 para. 4; *Tunisia*: Décret of 1935 art. 5.

Spain emphasizes the intimate relation between the two registrations by entering the class and number as well as date and place of issue of the vehicle licence in the register.

Spain: Executive regulation of 1955, art. 20 no. 1.

In *Argentina* and *Portugal*, a "certificate of title" is issued, in which registered security interests must also be entered.

Argentina: Decreto-Ley no. 6582 sobre régimen legal de los automotores of 1958, art. 7, 19 para. 2 sub *a*; *Portugal*: Decreto-Lei no. 40 079 of 1955, art. 20.

(*e*) The *effects* of registration are limited, in general, to the relations between the secured creditor and third persons. In most countries, the *French* rule prevails according to which the security interest is ineffective vis-à-vis third persons unless and until registered.

France: Décret of 1953, art. 5; to the same effect; *Brazil*: Lei no. 2931 of 1956, art. 2; *Japan*: Law of 1951, art. 5 para. 1; *Lebanon*: Law of 1935, art. 8 para. 1; *Morocco*: Dahir of 1936, art. 4; *Portugal*: Decreto-Lei no. 40 079, art. 13; *Tunisia*: Décret of 1935, art. 1 para. 1.

In *Italy*, the effect of registration seems to be slightly narrower. According to the statute, registration is effective only as against any subsequent owner or possessor of, or holder of any right in, the vehicle, provided the latter's rights are, if necessary, also duly registered.

Italy: Decreto-Legge of 1927, art. 2 para. 6; art. 6 para. 1.

Thus, registration does not seem to affect unsecured creditors of the debtor who wish to enforce a money-claim against an encumbered car.

Argentina, on the other hand, clearly spells out that the very existence of the encumbrance depends upon its registration.

Argentina: Decreto-Ley no. 6582 of 1958, art. 7 sent. 2.

Countries are divided as to the effect of registration on transactions concerning the vehicle by the owner. On the one hand, in *France* registration of the security interest does not prevent the transfer of title to the encumbered automobile and registration of this transfer.

France: Ministerial Instruction 1956, no. VI-A.

On the other hand, in *Bolivia* registration precludes any transfer of the vehicle by the debtor to another person. Any transfer may only be registered if a certificate of "no encumbrances" has been issued by the registration office.

Bolivia: Decreto 5608 of 1960, art. 12.

This strict rule is to be explained by the general purpose of the South American statutes to prevent fraudulent transfers of encumbered vehicles.

2.5.1.4.2 *Registration as a protective device*

As distinct from its objective of being a condition of validity, registration may merely serve a protective function, the emphasis being on protecting either the secured creditor or third parties. Thus under some systems, registration of a security interest merely adds to the protection which the secured creditor enjoys against inroads by third parties under the law generally. Registration is of even lesser import in other systems where it merely serves to apprise third parties of existing security interests, without improving the secured creditor's position.

The protective function of registration appears to be particularly well developed in *Cyprus*. The names of automobile owners must be entered into the register of motor vehicles. Rule 14 of the Motor Vehicles Regulations, 1959 and 1965

permits entry not only of the "registered owner" (the actual possessor) of the car, but also of its "absolute owner" (i.e. the legal owner who may be a seller or a lending bank). The absolute owner may apply for registration and will be registered unless the "registered owner", who is informed of the application by the registrar, objects. In case of such an objection the registrar, after investigating the facts, makes a ruling thereon. In practice, the registration of the absolute owner in effect prevents any voluntary or forced transfer of rights in the car without his consent.

Malta's system differs slightly in that only one person may be registered as the owner. In practice, usually the credit seller is entered in the register and on the licence. If the seller/creditor wishes to avoid liability for traffic offences of the buyer/debtor, the latter's name may be entered in both the register and the licence, but with a notation in the register that the creditor's agreement is required for a transfer of the vehicle. In both cases, a purchaser's good faith as to the debtor's title is destroyed. The system of entering the buyer with a notation in favour of the creditor is also followed in *Turkey* (where it exists in addition to the general registration of seller's security interests).

The system of private registration in *England* is of even lesser consequence. The great majority of companies engaged in financing automobiles report any hire purchase transaction to a private information centre, "H.P. Information, Ltd.", which in turn offers this information for a small fee to anybody requesting it. However, this registration has no *legal* effects. Acquisition of title from a non-owner by a private purchaser is only excluded by actual notice of a security interest in an automobile (s. 27 para. 2 Hire-Purchase Act 1964, c. 53), whereas registration constitutes constructive notice at most. "Trade and finance purchasers", on the other hand, cannot acquire *bona fide* status at all. Thus registration is not intended to improve the secured creditor's position, but helps to warn commercial purchasers and lenders against the acquisition of, or lending upon, a motor vehicle already encumbered. It is obvious that this system can only work as between commercial lenders because the benefit of registration inures to the potential third parties and not to the registrant. Indirectly, of course, the secured creditor also benefits from the restraint against the acquisition of encumbered vehicles.

Chile permits the annotation of security interests affecting an automobile that are entered in their respective registers.

Decreto no. 1.151 approving the regulations of the Motor Vehicle Register of 1963, art. 13 para. 2.

This also seems to be a purely protective entry, without affecting the validity of the security interest.

2.5.1.5 *Vehicle documents as means of publication*

The various documents issued for automobiles are used in rather different ways for the purpose of giving notice of security interests. As in the case of registration (see 2.5.1.4), the documents may be instrumental in either creating a valid security interest or in simply affording some protection to the secured creditor and/or third parties.

In more than 35 states of the *United States*, the relevant document issued for an automobile is a "certificate of title" which must be distinguished from the registration card which is required for use of the vehicle on the highways. Certificates are usually not issued for new cars until they are sold to a person other than a dealer. Entries on the certificate are usually conclusive evidence of ownership and of other rights existing in the vehicle. All kinds of security interests can thus be noted on a certificate. In the so-called full-title States, a security interest is not perfected unless it is noted on the certificate. The certificate—as distinct from the registration card—does not remain with the encumbered car, but is delivered by the issuing office to the best ranking secured creditor. Thus the certificate provides much less publicity than the Uniform Commercial Code's general register of security interests—but nevertheless, under UCC s. 9-302 (3) (*b*), notation on a certificate of title is deemed equivalent to filing under the Code. In fact, the mere absence of a certificate will put a purchaser or lender on notice that the car may be subject to a security interest.

In *India*, a security interest may be entered in the certificate of registration. As long as this registration stands, a transfer of ownership of the vehicle may only be registered with the creditor's written consent.

Motor Vehicles Act, 1939, s. 31 A (added by Act of 1969).

The Motor Vehicle Rules of the various states expressly state that such registration does not affect the title of any party.

E.g., *Assam* Motor Vehicle Rules, 1940, s. 55 (*a*).

Very different is the use made of vehicle documents in the Federal Republic of Germany and Austria. In *the Federal Republic of Germany*, both a licence and a "motor vehicle letter" are issued, each of which states the owner's name. However, neither transfer of the letter nor entry of a new name are preconditions for a valid transfer of ownership or the creation of a security interest in a car, although under administrative rules the letter must be handed over to a new owner. Nevertheless, the practice has developed that a secured creditor will retain or demand possession of the letter as "security". The courts have concluded from this practice that a purchaser or a lender who does not demand the letter from the present holder of the car, or does not obtain it upon such a demand, must be regarded as being grossly negligent in believing the possessor to be the owner. A *bona fide* acquisition of title to, or of a new security interest in, the car is thus excluded. The *Austrian* procedure is very similar. An analogous solution had also been envisaged for the English Hire-Purchase Act of 1964, but was rejected by the finance companies as being more expensive than the losses sustained through unauthorized sales by their debtors to private purchasers.

In certain countries (especially *Argentina, Italy, Malta, Morocco, Portugal, Spain* and *Tunisia*) a security interest is both registered and annotated in the vehicle documents (*supra* 2.5.1.4.1 and 2.5.1.4.2).

2.5.1.6 *Special rules unrelated to publication*

Apart from rules on publication one finds in some countries different special statutory rules relating to other aspects of security interests in automobiles. These rules do not show any uniform pattern or trend. Rather, they appear to be *ad hoc* provisions designed to remedy specific shortcomings of the general rules on security interests, as applied to motor vehicles. Nevertheless, a cursory glance at the more significant of these special rules is appropriate.

2.5.1.6.1 *Extension of the security interest*

In keeping with the general rules (*supra* 2.3.4.2) several statutes extend the security interest in an automobile to insurance claims of the debtor that may arise from destruction of or damage to the encumbered vehicle.

Italy: Decreto-Legge of 1927, art. 3; *Japan*: Law no. 187 of 1951, art. 8; *Finland*: Law of 1950, § 6; *Spain*: Ley de hipoteca mobiliaria of 1954, arts. 5 and 6; *Venezuela*: Ley de hipotecas mobiliarias of 1973, art. 7.

In *Italy* this rule also covers a claim arising from the requisitioning of the vehicle, and in *Japan* it extends to the purchase price for a transfer of the car.

The rules extending the security interest to insurance claims of the debtor are of particular relevance for the creditor if the encumbered car is by force of law brought under the coverage of insurance. Such obligatory insurance exists especially in *Italy, Portugal, Spain* and *Venezuela*, although with rather different characteristics.

The *Italian* rules have two peculiarities. First, the obligatory insurance does not cover the car, but the debtor's liability towards third persons for damage caused by the vehicle. The insurance must be at least as high as the creditor's secured claim and must be taken out for the duration of the security interest. Second, it is the creditor who is obliged to take out the insurance for the debtor (although he may require the

debtor to reimburse him for the premiums paid). If the creditor fails to take out the insurance, the creditors of damage or injury claims may disregard the security interest.

Italy: Decreto-Legge of 1927, art. 4.

Clearly, this whole regulation is designed to protect victims of traffic accidents by making available to them an unencumbered fund at least equivalent to the value of the car. In view of the widespread modern tendency to require by statute that all car owners carry liability insurance, the Italian regulation seems to be outdated. Only for countries without obligatory liability insurance is this approach still of interest.

More in keeping with present-day conditions is the *Spanish* regulation which demands that every vehicle be insured against loss or damage, at least in the amount of the secured claim.

Spain: Ley sobre hipoteca mobiliaria of 1954, art. 36; similarly *Venezuela*: Ley de hipotecas mobiliarias of 1973, art. 37.

The number of the insurance policy as well as its amount must even be entered in the register.

Spain: Executive regulation of 1955, art. 20 no. 2.

In view of the risks to which all cars are subjected, this obligatory insurance effectively increases the secured creditor's security.

Portugal combines the Italian and the Spanish approach by requiring both liability and loss and damage insurance, however without establishing minimum limits.

Portugal: Decreto-Lei no. 40 079 of 1955, art. 8.

Apart from statute, many secured creditors will insist in their contract upon such insurance of the car by the debtor.

2.5.1.6.2 *Enforcement of the security interest*

Numerous special provisions relate to the enforcement of security interests in automobiles.

Italy has the most comprehensive scheme of enforcement, which operates as follows. After the secured claim has fallen due, the creditor may apply for a judicial attachment and fixing of a date for public or private sale. If the debtor at the first hearing—which takes place within a short time after attachment—does not produce written proof of payment of the amount due, the enforcement sale is judicially decreed (Decreto-Legge of 1927, art. 7 paras. 2-3). Elaborate rules are to be observed in case of a *private* sale (Executive regulations of 1927, art. 27).

In *France*, art. 3 of the Decree of 1953 refers for enforcement of the creditor's rights to art. 93 Commercial Code, whether or not the debtor is a merchant. Under this provision the creditor may proceed, eight days after having given notice to the debtor, with a public sale of the vehicle. However, the creditor may also follow the more cumbersome general procedure set up for the enforcement of a "civil" pledge which is sometimes more advantageous for him.

In *Morocco*, the judge, upon non-performance by the debtor, orders return of the car to the creditor. If the parties are not satisfied with the price-estimate by the judicially appointed appraiser, the car must be sold at public auction.

Morocco: Dahir of 1936, art. 8.

Rather elaborate provisions exist in *Lebanon*. Execution may only be demanded after two consecutive instalments have fallen due and the debtor has been formally put in default. The creditor may demand either return of the car or its public sale. In the former case, a judicially appointed expert has to fix the present value of the car.

Lebanon: Law of 1935, arts. 10-20.

Ireland has enacted two special rules designed to facilitate recovery of an automobile by the secured creditor. First, in derogation of the general rules, the buyer may authorize the creditor to enter buildings (except those used for dwelling purposes) in order to repossess a vehicle. Second, a creditor who has applied for a court order for repossession of a car (which is necessary if the buyer has paid one third of the purchase price) may personally repossess the car before issuance of the order, if the buyer has abandoned the vehicle or has left it unattended and damage has resulted or is likely to result therefrom.

Hire-Purchase (Amendment) Act, 1960, (no. 15), s. 16.

In the Canadian province of *British Columbia* the seller of an automobile under reservation of title may fix for the public auction at which the car is to be sold after the buyer's default a so-called "reserve price" (which must not surpass the buyer's outstanding debt). If no bid at the auction meets this price, the seller may withdraw from the auction and demand payment of the reserve price, plus the cost of the auction from the buyer within seven days. If the buyer does not pay, his rights in the car are extinguished, and the seller becomes its absolute owner.

Conditional Sales Act, s. 14 para. 8.

2.5.1.7 *Comparative analysis*

An analysis of the various special rules existing in certain countries on security interests in automobiles reveals that some of these rules are more or less accidentally connected with motor vehicles, while others are intimately bound up with them.

It would seem that all the rules unrelated to publication of security interests (*supra* 2.5.1.6) are designed to remedy specific shortcomings of a particular country's general rules. They do not derive of necessity from the nature of a car as an object of security. This conclusion is supported both by the very few countries that have adopted any of these rules and by the fact that many of them are identical with rules which in other countries belong to the general body of security law (*supra* 2.3). Thus we need not deal further with these rules here.

The situation is different for the special rules relating to publication of security interests in motor vehicles. The fact that public authorities in many countries, for purposes of taxation, inspection and supervision, register automobiles and/or issue documents in connexion with this registration, is an obvious point of departure for the publication of security interests. A considerable number of countries have made use of this possibility, either (1) in place of an existing system of registration for movables in general (*United States*); (2) as one of several other specialized systems of registration (*France*); or (3) as a unique specialty as compared with the unpublicized creation (*Italy, Finland*) or protection (*Austria, Cyprus, Germany, Federal Republic of, Malta*) of security interests in other movables. The simplest method is certainly the use of existing vehicle documents as a protective device, as exemplified in *Austria* and the *Federal Republic of Germany*. It requires no administrative investment by the authorities and hardly any effort by the parties and is thus particularly inexpensive. Slightly more administrative effort is connected with registration for protective purposes, as practised in *India, Cyprus, Malta* and *Turkey*. Both of these protective measures guard against the greatest risk of the creditor, namely disposal of the vehicle by the debtor. Where registration or documentation are conditions of validity of a security interest (as in *Bolivia, Finland, France, Italy, Japan, Lebanon, Morocco, Portugal, Spain* and *Tunisia*, as well as in the *United States*), the administrative expenses and therefore the cost of the security are considerably higher. It is doubtful, however, whether this higher price is matched by better protection of the creditor (except in a country with a general system of registration of security interests, as the *United States*).

It would thus seem that utilization of existing forms of registration and documentation of vehicles for purposes of policing is a simple and relatively effective means of providing some publicity to security interests in motor vehicles. However, as will immediately be seen, an effective protection of security interests against unauthorized border-crossings with the consequent risk of loss is only possible on the basis of a somewhat refined system of documentation.

2.5.1.8 *International aspects*

The special provisions on security interests in automobiles described thus far assume a purely domestic transaction in

which no foreign elements come into play. However, worthy of mention are the provisions of a few countries which have anticipated the influence of international aspects.

Several very narrow provisions envisage the fact that probably millions of automobiles annually cross international borders. *Finland* and *Venezuela* forbid the debtor to take an encumbered vehicle over the borders of the country without the written permission of the secured creditor.

Finland: Law of 24 Nov. 1950, § 8 para. 4; *Venezuela*: Ley de hipotecas mobiliarias of 1973, art. 37.

It is doubtful whether the creditor can effectively assure the observation of this prohibition. *Morocco*, *Portugal*, *Spain* and *Argentina* have accordingly refined this approach. *Spain*, like *Finland*, requires the creditor's permission. But Spanish law adds the requirement that customs must demand the vehicle licence in which the security interest is annotated (*supra* 2.5.1.4.1) in order to ascertain whether the creditor has consented.

Spain: Ley sobre hipoteca mobiliaria of 1954, art. 37.

A similar solution is envisaged by the *Argentine*, the *Moroccan* and *Portuguese* statutes.

Argentina: Decreto-Ley sobre régimen legal de los automotores of 1958, art. 29; *Morocco*: Dahir of 1936, art. 14, inserted in 1957; *Portugal*: Decreto-Lei no. 40 079 of 1955, art. 29.

All these provisions are obviously inspired not only by the desire to preserve a certain physical control by the creditor, but also by the fear that a national security interest may not be recognized abroad. It should also be noted that both the Argentine and the Spanish rules require a document relating to security interests that can be presented to the custom authorities.

Italy has provided for another possible international aspect of a security transaction, namely the formation in a foreign country of the contract which gives rise to or creates the security interest. Such a document must be authenticated before it can be submitted for registration in Italy.

Decreto-Legge of 1927, art. 17 para. 3.

One may well doubt whether such a case occurs frequently.

Apart from these statutory rules envisaging a foreign element in connexion with a security interest in an automobile, the other special rules probably assume impliedly a purely domestic transaction. However, it would not seem impossible that they are also applicable if certain foreign elements were involved. Thus, certainly the nationality of creditor and debtor is irrelevant as are, theoretically at least, the residences of the parties. In reality, at least the residence of the debtor who holds the motor vehicle will be in the country in which the vehicle is registered. In practice, moreover, the creditor's residence will also be in that country because neither sales nor credit transactions "over the border" occur in fact, at least in relations with private persons. In the marketing of new cars for distribution in countries outside that of the car manufacturer, the cars themselves are not used as the object of a security interest to secure the manufacturer or other seller.

Different and difficult problems arise if a car subject to a security interest created in one country is afterwards brought to another country and the recognition or enforcement of the security interest then becomes necessary. These problems raise issues of conflict of laws and will be dealt with elsewhere (*infra* 3.3).

2.5.2 *Containers*

Containers which are today used to facilitate the international traffic of goods, are endowed with a high degree of mobility. Their acquisition is frequently financed by the container manufacturers or distributors. Since many containers, particularly those transported by aircraft or ship, continually cross national borders, the question of the international status of security interests in containers would seem to be a highly relevant problem. Apparently, however, this question has not yet attracted much public attention. In the present context we can merely draw attention to this new problem and intimate that a uniform régime would seem to be desirable.

2.5.3 *Railway rolling stock*

2.5.3.1 *Introduction*

While railways had been the primary means of transportation in many countries for decades, their economic role has declined in many parts of Europe and North America since the Second World War. But in other countries of vast distances they still are the most important means of transportation. In most countries the vast majority of railways are today state-owned. These factors diminish in some countries present need for secured financing of railways.

On the other hand, certain factors indicate that the financing of railway rolling stock has retained some importance, not only in national perspectives, but also on the international level. One factor is the acute demand for expansive new rolling stock which is often imported and bought on credit. Another factor is the relatively significant number of "private" railway cars, particularly freight cars with special equipment. These cars are very often not owned by the state railways or the private railroad companies, but by companies which use them for their own needs or hire them to users.

The share of "private" freight cars amounted to 16 per cent in France (1960) (see Rodière, *Droit des transports* III 2 (1962) no. 1423) and to 13 per cent in the United States (1948) (*Encyclopaedia Britannica* XVIII 923).

Both the sale of rolling stock, which is often on credit, and its utilization very often have international aspects. In the *socialist* countries of Eastern Europe, however, there are no private cars nor is there any need to secure the credit, if any, for the acquisition of rolling stock.

The special treatment of railroad rolling stock for other countries is both justified and necessitated by the rather specialized legal rules that exist in many countries and the special practices that have developed in others. Unfortunately, national literature in this specific area is extremely sparse, and is practically non-existent on a comparative level. The picture must, therefore, of necessity be incomplete.

2.5.3.2 *Application of the general rules*

Unless the encumbrance of railroad rolling stock is subject to special rules (*infra* 2.5.2.3), or is expressly prohibited or restricted (*infra* 2.5.2.4), it must be assumed that the general rules on security interests apply (*supra* 2.3).

Specific authority for this assumption is difficult to adduce. Suffice it to mention two provisions of the *Spanish* statute on mortgages in movables. One includes, among the objects that may be encumbered, privately owned railway cars. The second sets out the identifying characteristics of such cars to be entered in the register.

Spain: Ley sobre hipoteca mobiliaria of 1954, art. 34 para. 2 and art. 35 para. 2; similarly *Venezuela*: Ley de hipotecas mobiliarias of 1973, art. 35 para. 2.

2.5.3.3 *Special rules*

The only country which produced a special body of rules for security interests in railroad rolling stock appears to be the *United States*. In keeping with the general formation of the unwritten common law, the American rules evolved in practice using the general framework of the trust and were only later codified in state statutes. These rules were thought to be so original and peculiar that, until 1972, even the Uniform Commercial Code (originally adopted 1952) has expressly refrained from regulating this particular security interest. UCC s. 9-104 (e) of the 1962 edition of the Code excluded "an equipment trust covering railway rolling stock" from the general provisions of the Code.

The most important financial and legal aspects of the equipment trust in railroad rolling stock are briefly as follows. Upon delivery of new rolling stock by the manufacturer, the railway makes a payment of 20-25 per cent. The rest of the purchase

price is paid by a finance corporation which receives title to the equipment as trustee and sells to the public certificates representing *pro rata* shares of the equipment. The latter is leased by the finance corporation to the railway. Within 10 to 15 years the railway repays capital and interest on the certificates. Upon complete payment it receives title to the equipment.

See *Duncan*, Equipment Obligations (New York, London 1924).

All the states of the *United States* enacted legislation affirming the validity of these equipment trusts, on condition of their being filed in the appropriate state (or local) registry office. In 1952, the *United States*, following the example of *Canada*, established the possibility of federal registration, to be effective for the whole country.

Canada: Railway Act, s. 86; *United States*: Interstate Commerce Act § 20c, as added 1952.

The Federal Government has made equipment trusts privileged in other respects as well. Contrary to all other securities, equipment trusts are not affected by railroad reorganizations in bankruptcy nor by modifications of the financial structure of railroads by the Interstate Commerce Commission.

United States: Bankruptcy Act Section 205 (*j*) last sentence; Interstate Commerce Act § 20b (*l*).

By 1972 exclusion of the railway equipment trust from the all-comprehensive security interest rules in article 9 UCC (*supra*), which apparently rested originally on reasons of convenience rather than necessity, was no longer deemed useful. Therefore, this exclusion was eliminated and the railroad equipment trust was brought under the coverage of the general provisions on security interests (maintaining, however, the federal registration).

2.5.3.4 *Restrictions upon security interests*

The laws of many countries place restrictions upon security interests encumbering railway rolling stock. These restrictions are generally imposed in the public interest in order that the operation of a railway may not be hindered by disputes concerning creditors' rights. The restrictions affecting security interests relate partly to their creation and partly to their enforcement.

2.5.3.4.1 *Restrictions upon creation of security interests*

A typical example of a regulation issued for the protection of public interests is to be found in *Italy*. The movable property of the state railways which is indispensable for their operation has been declared "immovable by destination" and thus indisposable.

Italy: Mocci, Ferrovie dello Stato: *Novissimo digesto italiano* VII (1961) 237 no. 14.

It is likely that a similar rule prevails in many countries of the Latin orbit.

In a number of other countries there is a more juridical obstacle to the creation of security interests in rolling stock. These countries do not exclude outright the creation of such security interests. However, they offer a special scheme for encumbering the whole railway, especially its immovable property, but including the rolling stock, through creation of a "railway estate". The estate that has to be registered comprises all the rolling stock existing at the time of its creation and including after-acquired equipment.

Austria: Law of 1874, § 5 para. 2 litt. c); in parts of the *Federal Republic of Germany*: Prussian law on railway estates of 1902, § 4 para. 1 no. 3; *Japan*: Railway Hypothecation Law (no. 53) of 1905, as amended, art. 3, no. 6, art. 11 para. 1; *Norway*: Law amending legislation on pledges of 1895, § 2 para. 3 (for railways serving the public); *Sweden*: Law on introduction of the new Immovables Law of 1970, § 9 para. 1 in connexion with Regulation of 1880, § 1 para. 2 sent. 1; *Switzerland*: Federal Law on Hypothecation and Forced Liquidation of Railway and Shipping Enterprises of 1917, art. 9 para. 2 litt. b), art. 11 para. 1.

After such a railway estate has been mortgaged, the creation of security interests in rolling stock appears to be excluded, as in the case of the *Italian* prohibition.

The "railway estate" in the above-mentioned countries is rather similar to a floating charge of the English type established on the undertaking of a railway company and comprising all, or almost all, of its immovable and movable property (see *supra* 2.3.4.3). Such floating charges are expressly authorized for railway companies in *Canada*.

Canada: Railway Act, ss. 75-77. Section 78 declares federal registration to be effective for all Canada, unless a (provincial) Act expressly requires an additional form of publication.

However, even without such authorization they would seem to be valid wherever the rules of the English Common Law are applicable in this respect.

Another question is whether both in *Italy* and in the countries just mentioned a security interest, especially a purchase money security interest, that already existed when the equipment was acquired by the railway, would remain valid even after the acquisition. Lacking special rules or judicial authority it would seem under general principles of law that the answer must be in the affirmative. The acquisition and putting into operation of rolling stock cannot result in an expropriation of acquired rights, unless the contrary is clearly enunciated.

2.5.3.4.2 *Restrictions upon enforcement of security interests*

The Federal Republic of Germany requires authorization by the supervisory state agency for the secured creditor to enforce his security interest in rolling equipment of private railways which serve the public traffic.

Federal Republic of Germany: Law of 7 March 1934, as amended, § 4 para. 1.

This provision clearly limits the secured creditor's rights.

A related protective rule, found in *England* and the *Federal Republic of Germany*, may indirectly inure to the benefit of a secured creditor. In both countries any execution against the rolling stock of a railway that is open to the public is prohibited.

England: Railways Companies Act, 1867, s. 4; similar statutes exist in many Commonwealth countries, see e.g. *India*: Indian Railways Act, 1890, s. 136; *Australia*: state of *Victoria*: Railways Act 1958 s. 199.

Federal Republic of Germany: Law of 3 May 1886; see also Federal Railways Law of 1951, as amended, § 39 par. 1 (an execution against the Federal Railways is subject to authorization by the Federal Government).

However, in the absence of special statutory rules of this protective character one must assume that no restrictions are imposed upon the execution of rolling stock.

France: see Thévenez, d'Hérouville, Bleys, *Législation des Chemins de Fer* (Paris, 1930) I 432.

2.5.3.5 *Conclusion*

The legal rules governing security interests in railway rolling stock emphasize the restrictions imposed on these interests. These restrictions are dictated by the superior interest of the public in the proper and uninterrupted operation of the public railways, to which the "merely" private financial interests of an individual secured creditor are subordinated.

2.6 *Uniform rules of substantive law*

Having noted in our analysis of security interests on a national basis the vast divergencies in the different systems, the question arises whether any legislative attempts have been made, or other proposals submitted, to achieve some measure of uniformity in this field.

2.6.1 *Legislative attempts at unification*

We shall first consider the attempts at achieving some uniformity through legislation; up to now, none of them have succeeded.

2.6.1.1 *Scandinavian conditional sales act*

The three Scandinavian countries Denmark, Norway and Sweden enacted during 1915-1917 a (uniform) conditional sales

act elaborated within the general framework of Nordic legal co-operation.

English text of the Swedish statute in Zweigert/Kropholler, *Sources of International Uniform Law I* (1971) E 159.

However this uniform act does not deal with the proprietary aspects as against third persons of conditional sales, but is restricted to relations between seller and (instalment) buyer *inter se*. The statute therefore regulates essentially the instalment aspects of conditional sales and has little relevance for commercial sales.

2.6.1.2 *UNIDROIT draft of 1939/1951*

In the course of its efforts to unify the law of international sales, the International Institute for the Unification of Private Law in Rome (UNIDROIT) has also for some time considered the possibility of elaborating uniform rules on sales with reservation of ownership in goods. Appendix I to the 1939/1951 Draft of a Uniform Law on International Sale of Goods (Corporeal Movables)

See *L'Unification du Droit/Unification of Law 1948*, p. 102 ss. 149-151, submitted to the Hague Conference of 1951,

Actes de la Conférence ... sur un projet de convention relatif à une loi uniforme sur la vente d'objets mobiliers corporels 1951 (1952) p. 53,

contained nine provisions dealing with this subject.

The draft is limited to international sales as defined by the main text (art. 1). In essence it covers only international sales of machines (art. 2), all other goods being made subject to the law of the country of importation. The agreement as regards reservation of ownership was required to be in writing (art. 3). The publicity measures, especially any registration requirements of the country of importation necessary to give validity to the reservation or to enable it to be set up against third parties, were required to be observed (art. 4).

Where the seller knows that the goods have been purchased for resale, the reservation of his ownership is to lapse as soon as the subpurchaser has received the goods or a document of title covering them (art. 5). The reservation of ownership is to be effective in the buyer's bankruptcy or as against attachment creditors of the buyer (art. 6). Apart from the aforementioned cases, the "competent national law" shall determine whether and in what circumstances third persons can acquire rights over the goods which have priority over the seller's ownership (art. 7).

In the event of the buyer's default in payment the seller is permitted to retake the goods only if he is both entitled to rescind the contract of sale and has done so (art. 8). Privileges created by the national law in favour of the seller are preserved and shall coexist with the agreed reservation of ownership (art. 9).

The Draft is thus a combination of uniform rules of substantive law (form of the agreement, art. 3; effects upon items for resale, art. 5; effects in bankruptcy and upon attachment, art. 6; retaking by the seller, art. 8), conflict rules proper (in general, the law of the country of importation, art. 2; registration and other publicity according to that law, art. 4) and gap-filling rules which refer merely to the "competent national law" (priority otherwise than in the case of goods for resale, bankruptcy and attachment, art. 7; preservation of privileges, art. 9).

During the Hague Conference on the Uniform Sales Law of 1951 only one delegate made a brief reference to the rules on reservation of ownership. He expressed the view that arts. 4 and 6 of the Draft required reconsideration but gave no reasons.

Gutzwiller in *Actes de la Conférence*, p. 230.

He also proposed reconsideration of the "conflict rules" in arts. 7 and 9 (in truth the gap-filling rules) in the light of the planned conventions on private international law relating to sales and the transfer of ownership.

Gutzwiller, *ibid.*, p. 234.

In its resolutions the Conference took up the latter point.

Résolution IX (d), *Actes de la Conférence*, p. 277.

The Special Committee appointed by the Hague Conference for the revision of the Draft does not seem to have discussed the rules on reservation of ownership.

No reference is to be found in the mimeographed records of the five sessions held from 1952 to 1955.

But the Draft which emerged from these deliberations omits any rules on reservation of ownership, without a word of explanation. The most likely reason for the tacit removal of the provisions is the deletion, from the Draft, of uniform rules on the transfer of ownership because this topic apparently proved too difficult for uniform solution. Moreover, the Draft was intentionally limited to rules governing the relations between seller and buyer.

Commission spéciale nommée par la Conférence de la Haye sur la vente, *Projet d'une loi uniforme sur la vente internationale des objets mobiliers corporels* (1956) p. 29.

2.6.1.3 *The draft EEC-Bankruptcy Convention of 1970*

The most recent attempt at a uniform regulation of certain questions of clauses reserving ownership in the seller can be found in the draft bankruptcy convention elaborated by the six original member countries of the European Communities in 1970. Any attempt to harmonize the bankruptcy laws of the member countries must of necessity grapple with the widely diverging effect which the frequently used clauses reserving ownership have under the national laws in the event of buyer's bankruptcy.

The Draft of 1970 provides in art. 39, para. 1 that the effect of a reservation of ownership in the *buyer's* bankruptcy shall be governed, in general, by the law of the country where bankruptcy has been adjudicated. However, the sentences which follow prescribe two minimum requirements which that legal system (i.e. the national law of each member country) must fulfil. As to its form, the reservation of ownership relating to the good sold and securing the purchase price, is to be valid as against the creditors of the buyer if expressed in a simple writing issued before delivery. This writing is not to be subject to any formality. At the same time, the trustee in bankruptcy is given the right to prove by any means that the writing or its date are fraudulent or wrong. These rules are a compromise between the complete disregard of reservations of ownership in the buyer's bankruptcy according to Belgian, French and Luxembourg law on the one hand, and their very liberal admission (including all manners of extension) in Germany, on the other hand. It is quite possible that such a median line may also be acceptable on a broader international level.

As to the effect of the *seller's* bankruptcy, art. 39, para. 2 refers to Appendix I, art. 6. According to this latter provision, the seller's bankruptcy, if adjudicated after delivery of the goods sold, may not be used as a justification for rescinding the sales contract, corresponding to the trustee's right of rescission in the buyer's bankruptcy (*supra* 2.3.5.1 sub (*b*)). It shall likewise be no obstacle to the buyer's acquisition of ownership in the goods sold.

2.6.1.4 *ECE General Conditions*

A very limited unification may also be seen in a standard clause to be found in several General Conditions elaborated by the United Nations Economic Commission for Europe. The clause contains three rules.

The first rule provides that in the case of delivery before payment of the contract price in full plant and machinery shall, until payment, remain the property of the seller, to the extent permitted by the law of the country where the goods are situated following delivery.

Secondly, if this law does not permit such reservation of ownership, the seller is entitled to the benefit of such other rights as that law permits him to retain. And thirdly, the buyer is to give the seller every assistance in taking any measures required to protect the seller's right of ownership or such other right.

ECE General Conditions for the Supply of Plant and Machin-

ery for Export (no. 188 of 1953) no. 8.3; *idem* (no. 574 of 1955), no. 8.3; ECE General Conditions for the Supply and Erection of Plant and Machinery for Import and Export (no. 188 A of 1957), no. 11.3; *idem* (no. 574 A of 1957), no. 11.3. Zweigert/Kropholler, *Sources of International Uniform Law I* (1971) E 150 (pp. 90, 98, 120, 127).

Although the use of these conditions in international transactions is not infrequent, it should be stressed that their unifying effect is very limited. This is primarily due to the fact that the General Conditions, if agreed upon by the parties, constitute nothing but an agreement between seller and buyer, not binding upon third persons. Moreover, the clause is couched in such general terms that its content is relatively vague.

2.6.1.5 *Conclusion*

From the foregoing survey we must conclude that up to the present time no legislative rules are in force effectively unifying the divergent national rules on security interests. The only draft provisions with any prospect of becoming effective in the foreseeable future are those of the draft Bankruptcy Convention of the member States of the European Communities (1970). However, these are confined to a few aspects of reservation of ownership and do not even cover cases of attachment.

2.6.2 *Recent proposals*

Two proposals for unification of certain security interests in movables which have recently been submitted in Europe deserve particular attention. These proposals were made in two studies submitted to the Council of Europe, one in 1968 by UNIDROIT, the other in 1972 by the Service de recherches juridiques comparatives of the CNRS of Paris (referred to as French study).

2.6.2.1 *Need for unification*

For the areas in which the French study recommends unification efforts, it unfortunately does not deal with the question why such unification is necessary. Although from the context it is reasonably clear that such need is impliedly affirmed, no reasons are given to explicate this need.

The UNIDROIT study is more explicit on this point. With respect to rights securing to a seller the purchase price instalments, harmonization or unification of the various national security interests is not deemed necessary at present. This conclusion is based on the observation that in the absence of a single economic market in Europe, instalment sales necessarily remain local phenomena, circumscribed by the frontiers of a national economy. The absence of any element of internationality obviates the necessity for harmonization (p. 49).

A very similar line of thought is developed for the credit sale of motor vehicles. Here, local sales also prevail, largely for practical reasons, such as repairs, avoidance of customs problems, the attraction, if not necessity, of local servicing etc. It is foreseen that even after attaining a single European market, most of these practical difficulties will remain, so that "international sales of motor vehicles on credit will remain exceptional, if not a purely theoretical exercise" (p. 220).

Similar statement p. 235. However, harmonization or unification is recommended in the case of the realization of a common market. The Commission of the European Communities has recently confirmed that in the Common Market sales of used vehicles over the border of the member countries are rare because of many obstacles with respect to taxes and insurance (Reply of 22 Oct. 1974, *Official Journal of the European Communities* 1974 no. C 145, p. 1).

However, contrary to instalment sales in general, the credit sale of motor vehicles may subsequently obtain international aspects, even though the sale is local in its initiation. This subsequent internationalization may occur if the buyer takes the car abroad and leaves it there or disposes of it or the car is attached by the buyer's creditors. UNIDROIT recognizes a need (although not yet pressing) for a certain unification in this area (pp. 226, 228, 232, 236).

Instalment sales which are subject to special legislation are practically consumer transactions and therefore without major interest for international trade. But even instalment sales of motor vehicles may present an international aspect and are therefore worthy of some action aiming at unification. In the wide and important field of international trade, credit transactions crossing the borders are very frequent and steadily increasing in number. For this reason we would endorse the implied conclusion of the French study and the explicit (although limited) recommendation of UNIDROIT: there is a certain need to harmonize the conflicting security interests.

2.6.2.2 *Methods of unification*

The French and the UNIDROIT study put forward proposals for unification on four different levels.

(*a*) The "maximum" solution of the French study would be the creation of a *uniform security interest for international cases*. As a substantive model it is suggested to adopt a slightly modified version of the *United States* Uniform Commercial Code article 9 since this would integrate the many existing varieties of national security interests. For purely national situations existing national law would be preserved (pp. 73-74).

It appears doubtful, however, whether the dichotomy between national and international situations on which this proposal is based can be applied usefully to security interests. This distinction has frequently been used in the past in order to delimit the scope of application of conventions seeking to unify certain types of contracts, especially for transportation, sales, etc. The criterion used to determine the international character of a contract has been either the diversity of the business residence of the contracting parties in different States, or the necessity of a border-crossing movement of goods or persons for the performance of the contract.

The UNIDROIT draft on uniform rules for sales with reservation of ownership of 1939/1951 (*supra* 2.6.1.2), by referring to the definition of international sales in the Uniform Sales Law (art. 1), would have combined the two criteria as alternatives.

It is true that the latter criterion particularly would also cover many security transactions with an international character, especially in connexion with import or export transactions (due to the border crossing of the goods charged). More doubtful is whether international loans (from a creditor in country A to a debtor in country B) if no transnational movement of the goods charged by the debtor is involved, should be brought under the uniform international régime. Although the loan itself has an international character, the securing of the loan does not and should therefore remain subject to the national régime of country B.

The decisive objection to the French proposal, however, is the fact that, unlike contracts, goods (especially durable goods) do not have a single economic function which may be considered to be of either national or international scope. Rather, goods serve different purposes in the hands of different holders. These different purposes may or may not imply border crossings in successive stages. Thus some goods may pass from the uniform international régime to a national régime, and perhaps vice-versa; such changes may occur repeatedly. Any change of the applicable system of law, particularly repeated changes, would pose very involved legal problems of information about, and recognition and adaptation of earlier security interests for which no answers seem to be available as yet; this will be shown *infra* 3.2.2. Therefore the elaboration of a uniform international régime of security interests for international cases, as distinct from existing national rules that would continue to govern purely national situations, is not advisable.

Even if this objection could be overcome, it is highly doubtful whether the nations of the world, in view of their widely differing national systems, would be able to agree upon a uniform solution. Even for the limited region of Western and Central Europe this possibility has been denied by two expert bodies.

UNIDROIT study p. 238-239; Fédération Bancaire de la Communauté Economique Européenne, Rapport 1966-1968, p. 49.

Such pessimism is even more apposite for unification on a world-wide level.

(*b*) The "next radical" solution proposed by the UNIDROIT study is the unification of the *conflict rules* on security interests. This would leave national systems largely unaffected.

Those aspects of the proposal which pertain to conflict of laws will be dealt with at the proper place (*infra* 3.2.3.2.1). The proposal relating to substantive law will be discussed *infra* 2.6.2.3.

(*c*) The "minimum" solution of the French study proposes an interesting method, namely the elaboration of a *contract-form* providing for the unilateral rescission of a contract of sale by the unpaid seller (pp. 74-75). This would come as close as possible to a reservation of ownership, although some very substantial differences remain. The decisive formal objection which must be dealt with here is the limited effect of such a contractual clause. To become effective, an express agreement between the parties to the sales contract is required. It is very doubtful whether a broad international unification can be achieved on this voluntary basis, even if it is promoted by the appropriate organizations.

(*d*) The UNIDROIT study suggests another possible step that would amount to the unification of just one (although admittedly a major) point: to establish for *motor vehicles an accompanying document* in which security interests would also be entered (pp. 239-242). This would be a kind of special portable system of registration. Although it is not clearly spelled out, it would seem that the implementation of this proposal requires an international convention, especially since the national documents should follow an "internationally recognized model" (p. 239), obviously in order to make them helpful for, and understandable to, foreign authorities.

The French study also briefly alludes to this idea, commenting that in view of certain national precedents, its general adoption in Europe would not seem to be too difficult to accomplish (pp. 56-57).

Without going into a substantive discussion at this point, we may conclude that it is doubtful whether the realization of even such a modest proposal is feasible. The first reason would be the very fact of its modesty: it could be difficult to justify introducing such a system only for motor vehicles. Admittedly, however, this is really a special kind of chattel characterized by a particularly high degree of mobility, including over frontiers. A growing number of court cases also shows that, indeed, practical problems on the international level have arisen.

A related doubt pertains to the question whether only a uniform document should be established or whether the legal régime for entries on the document should also be regulated. It would seem preferable to cover at least the major problems connected with entries, such as the effects on the *bona fides* of third persons. More doubtful is whether the problems of the international recognition of the security interests entered on the document can be solved at this time. This is a question of the conflict of laws that will be discussed later in another context (*infra* 3.2.2).

2.6.2.3 *Substance of the proposals*

Looking at the substance of the proposals we find three different suggestions.

(1) The most far-reaching idea is that put forward by the French study in suggesting the creation of a uniform security interest for international (as distinct from purely national) transactions. The model to be followed in substance is a slightly modified version of the *United States* Uniform Commercial Code article 9 (pp. 73-74).

It is difficult to comment on this proposal since the details of the deviations from the American model are not specified. The American régime may indeed be considered as the most modernized, rational and comprehensive system of security interests in the present world. It is true that the language of the Code would have to be denationalized and that a few provisions of the Code may require revision in favour of the debtor's unsecured creditors. In addition, the international character of the new security interest poses some new problems. First, a system of registration adapted to the special needs of international trade movements would have to be invented. Further, the very difficult problems of transition of a security interest from one of the existing national systems to the international system, and vice versa, would have to be solved; this latter issue would seem to be especially difficult. However, the most serious objection is the distinction between national and international security transactions, see *supra* 6.2.2.2.

(2) The UNIDROIT study offers two suggestions relating to publication of security interests:

(*a*) Extremely far-reaching, the proposal to create a uniform conflicts rule for security interests would also introduce a major innovation into many national laws. As a kind of minimum standard of publication and as the central connecting point for the suggested uniform conflicts rules, all contracting States would be obliged to establish a system of registration for security interests (p. 239).

This would mean a major change for all countries in which registration is not yet provided for (see *supra* 2.3.3.1, 2.3.3.2, 2.3.3.4). The objections against such a system of general registration for all security interests in any item have already been set forth (*supra* 2.3.3.6 sub (c)). They are reinforced if the emphasis in introducing such a system is placed upon the international aspects of security interests which, after all, play only a minor role at present. It is hardly conceivable that any national legislator would introduce an expensive, time-consuming, and complicated system of registration only for the purpose of providing the requisite connecting factor for international transactions.

(*b*) Much more modest is another suggestion of the UNIDROIT study, namely the introduction of an accompanying document for motor vehicles in which security interests would also be entered (pp. 239-242). This proposal would satisfy a genuine need because the number of conflicts relating to security interests in border-crossing motor vehicles is steadily increasing, especially in regions with very high mobility, such as Europe. The need appears to be particularly pressing with respect to lorries because these represent relatively major investments which not only serve to secure the seller's claim for the outstanding purchase price, but also serve as security for banker's credits to the enterprise. This limitation also guarantees the feasibility of the proposal since the number of lorries that are permitted to cross borders is relatively restricted. If the system worked well in this limited area, the next step might be to consider its expansion to include other types of or even all motor vehicles.

As mentioned earlier, not only the (uniform) document itself should be introduced, but also, the legal consequences of entries thereon should be fixed in a uniform way (*supra* 2.6.2.2 sub (d)).

However, two facts suggest some caution. The experiences with certificates of title in many states of the United States have shown the risks of fraud to which such certificates are exposed, especially falsifications and fraudulent procurement of duplicates. Experience in the United States has also demonstrated the difficult problems that arise from the coexistence of certificate-states and non-certificate-states within one economic unit. The latter difficulty can probably be overcome, while the former can be managed only in part since the human factors involved cannot be completely controlled.

(*c*) In this context another proposal not emanating from UNIDROIT should be mentioned. Economic circles in the European Communities have suggested the setting up of a central register of security interests, to be kept by the Council of Ministers of the Communities.

governed by the law of this *situs*. A partial precedent for this general approach is to be found in a decision of the Supreme Court of the Federal Republic of Germany. It recognized a security interest created in France in a French lorry according to the decree of 1953 when the lorry was attached in Germany by a German creditor. The court did not attempt to transplant the French security interest into one of the German categories, but recognized it as supporting a claim for preferred satisfaction by the French creditor, presumably by virtue of French substantive law, but asserted according to the procedural rules of the *lex fori*.

Federal Supreme Court 20 March 1963, *BGHZ 39, 173, IPRspr. 1962/63 no. 60*. The decision has been supported unanimously by German writers.

The attachment by the local creditor, on the other hand, was certainly subject to the *lex fori*, both as to substance and as to procedure.

The rule outlined above is, however, not yet generally accepted.

A related exception concerns "res in transitu"; this refers mainly to goods sold for export which on their way to the import country may pass through various other countries. Here again it would be inappropriate to assume that each transit country impregnates the legal status of any security interest created in the country of exportation, unless the goods come into legal contact with a transit country. Opinions of writers are sharply divided,

see Rabel, *Conflict of Laws IV (1958)* 101,

but the problem seems to have little practical relevance, as is shown by the dearth of judicial decisions.

3.2.2.3 *Creation of security interest according to a future* lex situs

The major difficulties of adapting a security interest to a new *lex situs* would be avoided if it were possible to create a security interest according to the law of the country of importation while the encumbered goods are still in the country of exportation. This method avoids any attempt at complying with the rules of the first location of the goods because security is not needed there, but at the future location in the buyer's country. Therefore the difficulties of transforming a security interest from one legal system into another can be avoided.

Two examples of international business practice may be adduced. In one case General Electric sold television sets in New York to a Venezuelan firm under reservation of ownership. It was agreed that the sales contract was to be governed by New York law, the reservation of ownership by Venezuelan law. In the buyer's bankruptcy the American seller was allowed to reclaim the goods. The Venezuelan court held that the agreement between the parties submitting the reservation of ownership to Venezuelan law was valid on the ground (probably irrelevant) that the parties are free to select the applicable law. It further held that the certification of the parties' signature by a New York notary public complied with the requirements as to form of Law no. 491, art. 5 litt. (b).

See *supra* 2.3.3.2 sub (*b*). Decision of Juzgado Segundo de Primera Instancia en lo Mercantil (Distrito Federal) of 12 March 1970—unpublished.

In another case the Italian seller of certain machinery to be delivered to a German buyer in the Federal Republic of Germany had orally reserved ownership. According to Italian law such an agreement has no effect against third parties, but under German law is fully effective.

See *supra* 2.3.3.2 sub (*b*) and 2.3.3.1.

When the machines were attached in Germany by buyer's creditors, the Federal Supreme Court held the attachment to be invalid since the parties were deemed to have agreed upon a reservation of ownership under German law.

Federal Supreme Court 2 Feb. 1966, *BGHZ 45, 95, IPRspr. 1966/67 no. 54*.

The only statutory recognition of this practice is to be found in the *United States*. In derogation of the principle of the *lex rei sitae*, the validity of a security interest created abroad is governed by the law of the forum, subject to two conditions. First, the parties must have understood at the time of creating the security interest that the property would be kept in the forum state; and secondly, the encumbered goods must have been brought into this state within 30 days after creation of the security interest.

United States: Uniform Commercial Code s. 9-103 (3) sent. 2. The 1972 revision essentially maintains the rule, but with certain refinements:

(1) the provision is now limited to purchase money security interests (see *supra* 2.3.2.2);

(2) the rule is now bilateral, not unilateral as previously (when it was only for importations into the forum state);

(3) the law of the future *situs* is to govern only perfection (i.e. effects against third persons), not other aspects of validity;

(4) the 30 days period runs from receipt of the goods by the debtor; see s. 9-103 (1) (*c*).

An analysis of the case and statutory material reveals the following points. (1) As to the form of the conflicts rule, a bilateral rule is clearly better than a unilateral one. The latter covers only incoming property, whereas the former also extends to outgoing goods. Full security is, of course, only achieved if both countries affected by the transaction have a corresponding rule. (2) In countries without a special conflicts provision the basis of the rule is not derived from the party's autonomy, but the general *lex rei sitae*, although modified to the special circumstances of the situation. (3) The limitation to purchase money security interests appears to be justified. Goods encumbered for loans are usually not intended for international movement. (4) The new rule may pose the problem, as illustrated by the Venezuelan case, whether certain foreign public documents satisfy the provisions of the country of importation, if the latter's "perfection" depends upon such formalities rather than registration. (5) The practical effectiveness of this "forward-perfection" will mean that registration of incoming goods be made possible before the goods have entered the country of importation. (6) The status of third-party rights created in the goods before they leave the country of exportation is as yet uncertain. Perhaps considerations similar to those in the case of transient goods (*supra* 3.2.2.2) should apply.

3.2.2.4 *Obligation under the law of the exporting country*

In order to reduce the problems arising out of the existence in the buyer's country of mandatory rules as to the form of a contract which reserves ownership of goods sold, the *German Democratic Republic* requires the buyer to comply with such regulation in due time and to furnish proof to the seller of having done so.

German Democratic Republic: Gesetz über internationale Wirtschaftsverträge of 1976, art. 233 (2).

3.2.3 *Uniform conflicts rules*

One may usefully distinguish legislative attempts to achieve uniformity of conflicts rules from the more recent literary proposals for unification.

3.2.3.1 *Legislative unification of conflict rules*

The various attempts to unify conflicts rules relating to security interests, have met with little success so far.

3.2.3.1.1 *Bustamante Code of 1928*

According to article 111 of the Bustamante Code on Private International Law of 1928, pledged goods are deemed to be located at the place of the creditor's residence.

League of Nations, *Treaty Series*, vol. LXXXVI, p. 113. In force in 15 Latin American countries.

This rule is obviously based on the principle that a pledge requires transfer of possession to the creditor. In the title "Contracts", arts. 214-217 declare certain provisions relating to

pledges to be "territorial". This probably means that the law of the place of the creditor's residence applies.

Since the Code makes no reference to non-possessory security interests, it is hardly relevant for present-day purposes.

3.2.3.1.2 *Montevideo Treaty on International Commercial Terrestrial Law of 1940*

Four provisions of this treaty

United Nations (ed.), *Register of Texts of Conventions and other Instruments concerning International Trade Law* (1971), p. 254. In force in Argentina, Paraguay and Uruguay

deal with commercial "pledges". Article 20 subjects the contractual relations between creditors and debtors to the *lex situs* at the time of creation of the "pledge". Arts. 21 and 22 deal with international movement of the encumbered goods. In order to preserve rights acquired under the first *lex situs*, both the formal and the substantive requirements of the second *lex situs* must be observed (art. 21). Apparently rights acquired at the new location by bona fide third persons are governed by this law (art. 22, para. 1). These latter provisions correspond to the unwritten general conflicts rules set out above (see 3.2.1.2).

3.2.3.1.3 *Hague Convention on the Law Applicable to Transfer of Ownership of 1958*

This convention which is (as yet) not in force (and probably never will come into force) determines which law governs the transfer of ownership in international sales.

Conférence de la Haye de Droit International Privé, *Recueil des Conventions de la Haye* (1970), p. 16.

The convention therefore affects only reservations of ownership in international sales transactions. Art. 2 No. 4 of the convention provides that as between the parties the law governing the sales contract determines the validity of a reservation of ownership by the seller. As against the creditors of the buyer, any rights of the unpaid seller, such as a statutory privilege or a claim for possession or ownership arising in particular by virtue of a reservation of ownership, are subject to the law of the place where the goods are situated at the time a claim is first asserted, or an attachment levied against the goods (art. 4, para. 1). This rule of the *lex rei sitae* is further made applicable to a sale by documents representing the goods; in this case the location of the documents rather than that of the goods is decisive (art. 4, para. 2).

These are the only rules applicable to one of the various types of non-possessory security interests. As regards their content, the remarkable feature of the rules is the form in which they adhere to the principle of *lex rei sitae*. By fixing as *situs* the place where the goods are located when a claim is first asserted, or an attachment levied against the goods, the Convention supports the thesis developed above with respect to the treatment of transient goods: by the assertion of a claim, or the levying of attachment against the goods, these clearly come into legal contact with the *lex situs* (*supra* 3.2.2.2). On the other hand, a *situs* without these contacts is not relevant under the Convention. At least for transient goods this restrictive interpretation of the *lex rei sitae* is very reasonable.

3.2.3.2 *Recent proposals*

Some of the more salient proposals put forward in recent years deserve discussion here.

3.2.3.2.1 *The draft of the "Fédération bancaire" of the European Economic Community (EEC)*

Apart from its proposals concerning single international filing (*supra* 2.6.2.3 sub (2) (c), the "Fédération bancaire" of the EEC has also elaborated certain conflicts rules for non-possessory security interests (excluding reservations of ownership).

Fédération bancaire de la Communauté economique européenne, *Projet de Convention relative aux effets extraterritoriaux des suretés mobilières sans désalssissement* (undated).

Under the draft, priority of the security interests as well as acquisition by third persons of the encumbered goods, is governed by the *lex situs* (art. 3, par. I and IV).

Uniform rules of substantive law determine priority *inter se* as between several security interests. They also provide that encumbered goods shall not become fixtures, and further contain provisions subrogating the secured creditor to his debtor's claim for the purchase-price where the latter has sold the goods to a *bona fide* third person (art. 3, para. II, III and VI).

A third category of rules specifies the equivalent rule in each domestic system applicable to security interests which, from the standpoint of that system, are foreign-created. As mentioned, article 3, paragraph I submits questions of priority to the *lex situs;* subparagraph 2 then proceeds specifically to name one particular type of security interest in each country, the priority rules of which are made applicable to any question of priority which may arise in that country in connexion with any category of foreign-created security interests. Article 4 makes similar provision for enforcement and insolvency procedures. This rule tacitly assumes that such procedures follow the law of the respective forum. If such a procedure affects a foreign-created security interest, the equivalent category of domestic security device is indicated, and its rules made applicable.

3.2.3.2.2 *Reservations as to utility of conflict rules*

The French study (p. 73) evinces great scepticism as to the utility of conflict rules. It points out that these work reasonably well between countries whose substantive laws are similar (as those of Austria and Germany). But conflict rules have proved inadequate in the case of countries whose internal laws differ considerably since in these cases the emergency clause of public policy is frequently invoked. It is therefore recommended that attention be directed primarily to a harmonization of the substantive law of the various countries.

This general conclusion does not take into account the possibility of unifying the conflict rules on security interests and therefore does not evaluate the possible utility of such unification.

Curiously enough, among the three possible solutions proposed for unifying the substantive law of security interests, the "median" solution is expressed as consisting of conflict of laws. The French study refers (p. 74) to the draft convention on bankruptcy of the member countries of the European Communities of 1970 which is said to provide, *inter alia*, for the mutual recognition of reservations of ownership (*supra* 2.6.1.3). As a matter of fact, the relevant provisions of the draft convention establish uniform rules of substantive law (see *supra* 2.6.1.3). The French study recommends the extension of the scope of such provisions beyond the field of bankruptcy.

3.3 *Security interests in automobiles*

Special conflicts rules for automobiles may be envisaged for two reasons. First, because vehicles are much more mobile than ordinary goods. And further, the official documents issued for automobiles and used, at any rate in some countries, for the registration or at least proof of security interests (*supra* 2.5.1.5), may assume relevance in the international movement of vehicles.

At present, no special rules affecting the truly international movement of automobiles seem to exist.

3.3.1 *United States*

Interesting special rules have been developed within the United States largely to regulate the heavy volume of interstate movements, although not restricted in law to these.

The Uniform Commercial Code at first had contented itself with one simple rule. If under the applicable provisions perfection of a security interest in goods covered by a certificate of title required indication thereof on the title, perfection of a security interest was to be governed by the law of the state which issued the certificate.

Uniform Commercial Code s. 9-103 (4).

This provision has turned out to be too simple because of its failure properly to take into account the difference between those American states which have certificates of title and those

which do not. More particularly, it failed to envisage the movement of automobiles from one category to the other. In the 1972 revision of the Code, a complicated new rule has been substituted.

The main rule has been preserved: the law of the state issuing the certificate governs perfection of security interests (s. 9-103 (2) (b)). Where the encumbered vehicle is moved, the former law remains applicable until either surrender of the certificate of title or new registration of the vehicle (s. 9-103 (2) (*b*). If vehicles are removed from a non-certificate state, the general rule affecting removal of encumbered goods is declared to be applicable.

Ibid., s. 9-103 (2) (*c*), see *supra* 3.2.2.1.2.

The rights of *bona fide* buyers are also strengthened. A buyer who does not trade in the respective kind of goods and who buys the vehicle and receives delivery of it without knowledge of the security interest, may have priority over a security interest created abroad. This is so if the security interest is not indicated in the certificate or if the certificate does not mention that the vehicle may be subject to security interests not shown on the certificate (s. 9-103 (2) (*d*)).

These new rules indicate adequately the problems that have to be anticipated by special conflicts rules relating to the international movement of automobiles.

3.3.2 *Proposals of the UNIDROIT study*

In its study, UNIDROIT recommends the adoption for automobiles of the system of international recognition of security interests as it has been established by international conventions for security interests in ships and aircraft. This would imply, according to the study (pp. 223, 239), the necessity of instituting a registration system for motor vehicles in each country, of harmonizing the rules on transfer of ownership and of introducing a single security interest. In the field of conflict of laws a uniform conflicts rule would have to be created under which the law of the place of registration would govern security interests in the vehicle. It is admitted, however, that court practice does not yet seem to have sensed a need to break away from the general rule of the *lex rei sitae* (p. 226).

We have recorded elsewhere our objections against instituting a special system of registration for the purpose of serving as a connecting point of a conflict rule (*supra* 2.6.2.3 sub (2) (*a*)).

However, this objection does not go to the substance of the proposed conflict rule. On the contrary, this rule in essence accords well with our own views on the legal status of transient goods (*supra* 3.2.2.2). The proposed conflict rule does not really depend on the existence of a registration system of the traditional nature in each country. "Registration" may be understood to relate to the administrative registration of motor vehicles—a procedure which probably exists everywhere. The same idea may also be expressed by referring to the law of the state which has issued the registration plate assigned to the vehicle.

Occasionally the UNIDROIT study also alludes to the "plate" as determining the applicable law (p. 223).

3.4 *Security interests in railway rolling stock*

No special conflicts rules appear to have evolved for railway rolling stock.

However, one rule indirectly affects security interests in these means of transport. Rolling stock of a railway as well as private wagons are exempted from attachment outside the home State.

International Convention Concerning the Carriage of Goods by Rail (CIM) of 1961, art. 56, para. 3; International Convention Concerning the Carriage of Passengers and Luggage by Rail (CIV) of 1961, art. 56, part 3 (Zweigert/Kropholler, *Sources of International Uniform Law II (1972)* p. 267, 316).

On a limited geographical scale recognition of foreign-created security interests is achieved within the member countries of the "Eurofima" (an "international" company for the joint financing and acquisition of railway rolling stock).

Convention of 20 Oct. 1955, United Nations, *Treaty Series*, vol. 378, p. 225.

According to article 3, lett. (a) "Eurofima" remains owner of the rolling stock financed by it until the full purchase price has been paid to it. This ownership will be recognized, by virtue of the convention, in all member States.

4. Recommendations

4.1 *Substance of the proposals*

Our specific proposals for a harmonization of the substantive rules relating to security interests as gathered from the preceding comparative analysis have been summarized in the conclusions appended to the various subdivisions of part 2. The detailed suggestions concerning the conflict rules governing security interests are contained in the analysis and discussion of part 3.

4.2 *Method of implementation*

The question to be discussed at this point concerns the best method for the implementation of the various proposals aimed at the improvement of the existing law. Three major methods appear to be available: a uniform law convention; a model law; and recommendations.

4.2.1 *Uniform law convention*

It would seem that international legislation in the form of a convention providing uniform rules of substantive and conflicts law is not appropriate in this case. As against international sales or international transportation or the international circulation of negotiable instruments, transnational incidence of security interests is as yet relatively moderate. It would probably be difficult to obtain sufficient government support for an international conference dealing with the relatively technical topic of security interests; and even if the text of an international instrument could be agreed upon, national parliaments would probably be slow and perhaps even reluctant to ratify such a text.

4.2.2 *Model law*

An alternative to a uniform law convention would be a model law or perhaps on a lesser scale model rules. The distinctive difference lies in the fact that a model law does not impose upon contracting States the heavy obligation to introduce unified rules in their national legislation which would result from ratification of, or adherence to, an international convention. Another advantage may be that model rules are more easily adapted to the general framework of the national law. This consideration is particularly relevant in the case of model rules on security interests which will probably never aspire to cover all aspects of the field, but will merely supplement or amend a relatively limited number of existing national rules.

Of course, the informality and flexibility of the model law which may only require signature also threatens to undermine the success of such a measure. Perhaps moral persuasion or intellectual insight into the virtues of the model rules will move some States to adopt them. Others may need persuasion by more effective means such as insistence on the part of international financing institutions.

This last consideration stresses the desirability of enlisting the assistance of such institutions at an early stage in the process of elaborating model rules. This would also secure the expertise of financers with broad international experience and an outlook accustomed to steering a balanced course between the opposing interests of creditors and debtors.

4.2.3 *Recommendations*

Mere recommendations, even if emanating from an international organization of the highest repute, will not command sufficient moral or other support for adoption by any sizeable number of States.

4.2.4 *Conclusion*

Our suggestion is therefore that the rules be framed in the

form of a model law, or model rules. In so doing the advice and assistance of the great international financial institutions should be sought, both for the elaboration and for propagation of such rules.

Appendices

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Decreto no. 9722 of 18 Aug. 1960 (*Ibid.*, 1019)

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Liens on Crops and Wool and Stock Mortgages Act of 1898 (*New South Wales Statutes 1824-1957*, vol. VI, p. 302)

Queensland

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Hire-Purchase Act 1959 (*Queensland Statutes 1959-1960*, p. 12)

Victoria

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Instruments Act of 1958 (*Victorian Statutes 1958*, vol. IV, p. 151), as amended by Instruments (Bills of Sale) Act 1958 (*Victoria Acts of the Parliament 1958* no. 6438)

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Decreto-Lei no. 1697 extending the provisions of Decreto-Lei no. 1271, of 23 Oct. 1939 (*Ibid.*, p. 375)

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Decreto-Lei no. 7 661 on bankruptcy and compositions of 21 June 1945 (*Ibid.*, p. 725)

Lei no. 2931 sobre o penhor industrial de veículos automotores ... of 27 Oct. 1956 (*Ibid.*, p. 377)

Law no. 4 728 of 14 July 1965 (as amended and supplemented by Decreto-Lei no. 911 of 1 Oct. 1969) (Orlando Gomes, *Alienação fiduciária em garantia* (2nd ed. 1971), 175)

Canada

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(Uniform) Conditional Sales Act of 1928, revised 1955, 1959 (Conference of Commissioners on Uniformity of Legislation in Canada, *Model Acts Recommended from 1919 to 1961 inclusive, 1962*, p. 15). The Act or equivalent provisions have been adopted in nine out of 12 provinces (although with modifications)

(Uniform) Conditional Sales Act of 1922, revised 1955, amended 1959 (*Ibid.*, p. 45). The Act has been adopted, partly with slight modifications, in six out of 12 provinces

Alberta

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British Columbia

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Manitoba

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New Brunswick

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Ontario

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