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INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW

INTERNATIONAL REGULATION OF ASPECTS OF SECURITY INTERESTS IN MOBILE EQUIPMENT:

STUDY

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I. BACKGROUND TO THE STUDY

Mr T. B. Smith Q.C., the Canadian member of the Governing Council of the International Institute for the Unification of Private Law (Unidroit), placed before the June 1988 session of the Council a proposal under which Unidroit would examine the need for and feasibility of a convention on international aspects of security interests in mobile equipment. The following is an excerpt from the Canadian proposal:

> It is clear from the success of efforts to develop the Convention on International Financial Leasing that, notwithstanding the great divergence of treatment accorded to security interests under the national laws of States, it is possible to address in the form of an international convention the subject of international regulation of aspects of this area of the law. It is also clear that the Conventions on International Financial Leasing and International Factoring are only a first step toward providing comprehensive international harmonization of laws relating to security interests in personal property.
>
> It is now open to consideration whether Unidroit should take another step in the movement toward this goal. It is suggested that the momentum that has been developed in the context of the Leasing and Factoring Conventions should not be allowed to dissipate and that the Governing Council of Unidroit should consider a further project in the area of international regulation of aspects of personal property security law. Such a project should be narrow in scope and should be undertaken only if it can be demonstrated that there is a commercial need for further international regulation in this area. It is suggested that there is sufficient evidence to support an exploratory study of the need for and feasibility of a Unidroit convention on the regulation of certain international aspects of security interests in mobile equipment.
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> [...]
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> It is proposed that the Governing Council of Unidroit authorize the Secretary-General to convene a Working Group composed of experts in the area of personal property security law to examine the feasibility of a Unidroit project directed toward the preparation of a convention on certain international aspects of security interests in mobile equipment. The Working Group would be asked to consider the following matters:
>
> **1. the extent to which international elements are involved in the various types of secured transactions used to finance mobile equipment;**
>
> **2. the types of problems that are encountered when the rights of secured parties in mobile equipment arising under security agreements created under the laws of one State come into conflict with rights created under the laws of another State, including the rights of unsecured creditors of debtors in possession of the equipment, buyers of the equipment or other secured parties who take security interests in the equipment;**

3. the likelihood of being able to develop a convention that addresses the kinds of problems referred to in item 2 without at the same time attempting to affect directly bankruptcy laws and lien laws of the State parties to such a convention;

4. the level of international support for the type of convention mentioned in item 3.

While the Working Group would be free to determine what sources of information it would rely upon, it is suggested that the Group give special attention to experience under the Convention on the International Recognition of Rights in Aircraft, 1948.

The Governing Council considered the Canadian proposal and accepted the recommendation of the Secretary-General that "a study be commissioned and made available to the Council at its next session so that a decision might be taken on that occasion on the inclusion of the item in the Work Programme, as well as one regarding the degree of priority to be accorded it." (excerpt from the minutes of the June 1988 session of the Governing Council).

II. FOCUS OF THE STUDY

This study has been designed to provide to the Unidroit Governing Council information that will assist it in determining whether or not the Unidroit Secretariat should undertake in the immediate future a project, the ultimate object of which would be the formulation of a draft convention on the international regulation of certain aspects of security interests in mobile equipment.

While some international regulation of security interests in movable property does exist, generally this area of the law remains substantially under the aegis of national legal systems. The complexity and diversity of the law relating to security interests in movable property accounts for this fact. Past efforts to secure international agreement as to the form and content of a broadly based model law on security interests have not resulted in success. Accumulated experience demonstrates that, if any further significant progress is to be made in developing internationally accepted rules for the regulation of security interests that have international implications, it will occur only incrementally and in the context of specific areas of commercial activity that will benefit substantially from such regulation. It is because of the complexity of this area of the law and the evident difficulty of reaching agreement among nations as to the form and content of an international system for the regulation of security interests in movable property that this study has been designed with a narrow focus.

The recent success of Unidroit in securing agreement among a large number of nations as to the form and content of a Convention on International Financial Leasing encouraged some of the more active participants in the elaboration of that Convention to believe that further efforts to secure international regulation in the area of international financing transactions were warranted. The experience acquired in the context of the Leasing Convention was instructive. It demonstrated the growing interest in international financing

transactions and the increased recognition of the need for a system of law to facilitate their use. It also demonstrated that widespread international agreement can be obtained in a very complex, but discrete, area of commercial law.

In substance, the Unidroit Convention on International Financial Leasing provides a legal structure to facilitate and regulate secured financing for the acquisition of equipment. The Convention deals with only one type of secured financing technique. However, there are others. This being the case, the Unidroit Convention on International Financial Leasing can be seen as a first step toward the development of an integrated system for the international recognition and regulation of security interests in equipment.

It will be a matter of debate as to what the next step should be. The principal focus of the Convention on International Financial Leasing is on the *inter partes* rights and obligations of the parties to a tripartite international leasing arrangement. The problem addressed is the need for international recognition of the legal status of financial leases in cases where the lessor and lessee are in different countries. While one might conclude that the next logical step is a convention providing for the creation of an international chattel mortgage or some other specific type of secured financing device or a convention establishing some form of generic international security interest in movables, necessity and pragmatism and not logic must be the driving forces in the further development of this area of the law. It may well be that, because of the lack of sophistication in national systems of law in some countries or the overly-complex and excessively parochial nature of such systems in other countries, a case can be made for some international rationalization of law dealing with all types of financing devices that provide for security interests in movable property of any kind. However, past experience teaches that such an undertaking is likely to fail.

This study seeks to test the assumption that the next appropriate, if not logical, step is the development of rules of international law that focus only on aspects of security interests in mobile equipment. The basis for this assumption is that there is greater need for, and therefore a greater likelihood of, securing rules of international law to address legal problems arising when equipment subject to a security interest in one jurisdiction is moved into another jurisdiction and legal issues associated with the validity and efficacy of that security interest arise in the new *situs*. That very valuable equipment is frequently moved across international frontiers is an uncontroverted fact. Because of its high value, it can be assumed that in many situations this equipment is collateral under a security agreement between its owner and a financing organization. The great variety of national approaches to the recognition of foreign security interests in movable property almost ensures that financing organizations will encounter difficulties when issues of recognition and enforcement of their security interests arise in the new *situs*. The extent and seriousness of these difficulties must certainly condition the willingness of such organizations to extend secured financing facilities.

If these assumptions are correct, a convention that provides a consistent, predictable and balanced approach to the recognition and enforcement of security interests in mobile equipment that is moved from one country to another will facilitate secured financing in all nations that are parties to such a convention. This being the case, there should be general support for a project designed to develop such a convention.

In summary, the focus of this study is to test the following assumptions:

(i) that valuable mobile equipment subject to security interests taken under national law is moved across national frontiers;

(ii) that, for the most part, the laws, including conflict of laws rules, of most nations that deal with security interests in movables are inadequate in that they do not provide sufficient flexibility, predictability or fairness between foreign security interests and domestic interests in mobile equipment;

(iii) that because of the difficulties encountered, financing organizations are less willing to provide financing for high cost mobile equipment than would be the case if the incidence and severity of such difficulties were reduced as a result of the implementation of new, internationally accepted rules dealing with international aspects of security interests in mobile equipment;

(iv) that the problems of providing the necessary flexibility, fairness and balance can be adequately addressed through a Unidroit convention;

(v) that there is support among international experts in this area of the law for the undertaking by Unidroit of an initiative designed to lead ultimately to a draft convention on certain international aspects of security interests in mobile equipment.

The findings and conclusions of the author of this study are summarized under the heading: IX. FINDINGS AND CONCLUSIONS, *infra*.

III. THE APPROACH

In a study of this kind, empirical investigation is very important. In an ideal setting, the study would involve extensive data collection measures designed to accumulate the factual information that is needed to test the assumptions set out above. In particular it would involve interviews with representatives of finance organizations in a large number of countries in order to determine the nature and extent of the legal difficulties (if any) they encounter in connection with secured financing of mobile equipment that is taken across national frontiers. These interviews would also disclose the level of support for a convention on international aspects of security interests in mobile equipment. Information obtained from financing organizations would be verified and supplemented by information obtained from both academic and practicing legal experts.

Time and circumstances did not permit the collection of this type of empirical data. Something less than a scientific testing of the assumptions had to be accepted. In this study it has been necessary to rely heavily on responses provided by commercial law experts in several countries. As soon as the study was commissioned, a letter was sent to experts resident in and having detailed knowledge of the commercial laws of the following countries: Argentina, Australia, Canada, France, Federal Republic of Germany, Mexico, New Zealand, Sweden, Switzerland, the United Kingdom and the United States. The letter was designed not only to elicit opinion as to the need for international regulation of security interests in mobile equipment, but also to secure reaction to a "proposal" for a system that would entail a substantial departure from the approach embodied in the conflict of laws rules of most jurisdictions. However, the experts were asked not to view the "proposal" as an indication that the validity of the assumptions being tested had been

prejudged by the author of the study. Rather, it was thought that if these experts were presented with a specific proposal, responses would be more focused and, therefore, more useful.

Other sources of information useful in testing at least some of the above-mentioned assumptions have been relied upon and recorded in this study. These include published works[1] on the conflict of laws, extant international conventions dealing with the recognition of security interests in particular types of mobile equipment, and proposals for international measures to address the need for recognition of security interests in movables.

There are two distinct features of this study. One is the summation of the responses received from experts. The other is the author's assessment of the current state of law dealing with security interests in mobile equipment that is taken from the territory of one jurisdiction to another. This assessment contains the author's suggestions as to what factors will have to be addressed in any undertaking to provide an international legal structure designed to facilitate secured financing of mobile equipment.

No attempt has been made to define with precision the scope of the term "mobile equipment". Should a decision be taken to prepare a draft convention, it will be a matter for the participants in that undertaking to determine on the basis of empirical information what types of movables should be included in the definition. For example, an important question that will have to be addressed in this context is whether or not the draft convention should apply to automobiles held as consumer goods or as assets of a business enterprise. Nor has any attempt been made by the author of this study to define the scope of the terms "security interest" and "security agreement". For the purposes of the study, these terms should be viewed in a functional, rather than a technical, legal context.

IV. THE TREATMENT OF SECURITY INTERESTS IN MOBILE EQUIPMENT UNDER NATIONAL CONFLICT OF LAWS RULES

1. Introductory comment

The measures that currently exist or that have been proposed as methods to regulate international aspects of security interests in movable property fall within a spectrum. At one end of the spectrum are proposals for a model code of law that, if adopted by nations as part of their domestic law, would provide a uniform or harmonized approach to the treatment of both domestic and foreign security interests in movable property. At the other end of the spectrum there exists no international agreement as to the recognition of foreign security interests in movable property. As a substitute there are the national laws of States (conflict of laws rules) that dictate the extent to which foreign security interests in movable property that is brought into the territory of a State are given recognition and efficacy. Between these ends of the spectrum are various proposals which generally entail combinations of different measures.

International uniformity of law dealing with security interests in movables involves by far the most dramatic change in national laws. This explains the great scepticism as to its practicability. Indeed the difficulty of overcoming national parochialism in this area of the law induces reformers to look first to the other end of the spectrum, since it involves the

least disruption of national law. If the conflict of laws rules of nations are substantially similar, there is no need to have substantive international law to secure uniformity of approach. Of course, uniformity is not the only goal. Uniformly inappropriate conflict of laws rules are of no assistance to those whose economic interests depend upon commercially reasonable and fair treatment under the laws of nations in which those interests are being asserted. It is no consolation to a secured party to be told that, while its security interest in mobile equipment will not be recognized if the equipment is moved to another State, the same unfavourable treatment is meted out to foreign security interests in equipment brought into its State. Clearly what is required in addition to uniformity of approach are conflict of laws rules that give to foreign secured parties a reasonable measure of assurance that their interests in equipment will not be easily lost when the equipment is taken across national frontiers and that at the same time provide a reasonable measure of protection to persons who acquire interests in the equipment in the State to which the equipment is taken.

In the following paragraphs of this portion of the study, the conflict of laws rules generally applied by the courts of Western European countries are briefly surveyed with a view to exposing their adequacy, or lack thereof, as a method to meet the perceived need for a system providing for the recognition of security interests in mobile equipment that is taken across international boundaries. The Western European approach is contrasted with that contained in Article 9 of the U.S. Uniform Commercial Code and the Personal Property Security Acts of some Canadian provinces. The concentration on conflict of laws rules of Western Europe and North America should not be taken as a suggestion that only the legal systems of these areas of the world are relevant to this study. The purpose behind the brief discussion of conflict of laws rules contained in this study is not to provide a survey of conflict of laws rules of all countries; rather it is to demonstrate the difficulties associated with any attempt to provide an adequate system for the international recognition of security interests in mobile equipment through conflict of laws rules *simpliciter*.

2. Treatment of security interests in movable property under the law of Western European States.

(a) The law applicable to rights *in rem*: The *lex situs* rule

While complete consistency has never been a characteristic of conflict of laws rules, most experts assert that, according to the overwhelming majority of European decisions, the law governing rights *in rem* in movables is the *lex situs*.[2] This includes the creation or loss of security interests in movables.[3] The rationale for this approach is commercial certainty.

> In the realm of domestic law, the sphere of property relations is regarded as a domain of human activity where the intervention of the community is particularly required. If insecurity and excesses are to be prevented, the freedom of the owner to transfer his property at his pleasure must be subject to some limitations. In every country today the law of property is, to a large extent, a system of compulsory rules (e.g. as to publicity of transactions and other formalities), whereas the law of contract still admits of considerable liberty of choice. In the field of Private International Law, for analogous reasons, the choice of the law governing transfers

> *inter vivos* cannot be left to the parties themselves or be determined with the help of some changing and subjective criterion (such as the owner's intention to submit to a particular system of laws); it must be definitely and imperatively settled. As this need for certainty and security is fulfilled, in domestic law, by obligatory rules on publicity, delivery, or by presumptions (resulting for instance from possession), so it is achieved, in Private International Law, by the existence of a precise and clear conflict rule. The physical location of a chattel constitutes an objective criterion, which is easily ascertainable, and the *lex situs* is the only law, the application of which people may reasonably be taken to expect. ... The *lex situs* ... is not only simpler and more convenient than any other to apply, but it is better suited to protect the interests both of the owner and of other parties.(4)

(b) Application of the rule when movables change *situs*

The apparent simplicity of the *lex situs* rule disappears when the movables subject to a security interest validly created under the law of State A are moved to State B and, thereby, acquire a new *situs*. Two questions immediately present themselves. Does a security interest acquired in State A have extra-territorial effect outside of State A, even though the security interest, if taken in State B, would be invalid? If the security interest is recognized as valid under the law of State B, is it displaced by *in rem* rights acquired in the collateral under the law of State B, the new *situs*? Most experts give an affirmative, but qualified, answer to both questions.(5)

(c) The conceptual limits to recognition

Recently it has been suggested that there is a fundamental difference in approach between the common law and the continental European systems with respect to the recognition of foreign security interests in movables brought into a jurisdiction.(6) Under the common law approach, the foreign security interest is treated as valid in the new *situs* unless and until it is displaced by a new title acquired in accordance with the law of the new *situs*.(7) By contrast, the approach of some continental European legal systems appears to be that the continued existence of rights in the form of a security interest created under the original *situs* is dependent upon whether or not the foreign security interest can be accommodated to the municipal law of the new *situs*.(8) This difference in approach means that, conceptually at least, the common law recognizes forms of security interests not fitting within the traditional common law categories, whereas under the continental European approach the parties are restricted to a *numerus clausus* of *in rem* interests prescribed by municipal law.(9) The continental approach often results in a refusal to recognize mortgages on movables.(10) This is not to say, however, that common law jurisdictions do not require that foreign security interests fit into the common law conception of what a security interest is. However, common law courts would appear to be more willing to look to the original *lex situs* in order to determine the essential characteristics of a foreign security interest before reaching a conclusion as to how it is to be treated in the forum.(11) In any event, common law courts should have less difficulty in accommodating most foreign security interests because of the flexible approach taken by Equity to the requirements for a valid security interest in the form of an equitable mortgage or equitable charge.

The more rigid continental European approach may well lead in some cases to a refusal on the part of the law of the second *situs* to recognize the validity of a security interest that

does not have a directly or closely analogous counterpart under the law of the second *situs*. One expert has pointed out that in recent Austrian and Swiss decisions the courts refused to recognize the validity of German *Sicherungseigentum* on the ground that, under the laws of Austria and Switzerland, possession of the collateral by the debtor was incompatible with a valid chattel mortgage.[12] The expert concludes:

> The reason for these problems may well lie in the fact that all European legal systems start out with a principle of non-recognition of non-possessory rights, but have developed means of circumventing that principle. Because of the relatively recent history of this development, these means differ widely between the individual countries. This in turn makes it easier for legal opinion and courts alike to maintain that their legal system is still committed to the principle and to refuse recognition to foreign security rights on the ground that they contravene that principle.[13]

(d) Transposition - A threat to efficacy

The law of the second *situs* may well be prepared to recognize that a security interest in movables created under the law of the first *situs* is valid. However, this does not end the difficulties for the holder of that interest. It remains to be determined what efficacy the courts of the second *situs* are prepared to give to the foreign security interest. There are two possibilities. The first is to recognize that the security interest has the same *inter partes* effect and priority status in the second *situs* that it has under the law of the *situs* of the movables when the security interest was taken. The second is to attempt to transpose the foreign security interest. This involves giving it a status that "similar" types of security interests have under the municipal law of the second *situs*. The second approach appears to be the one employed in many countries.[14]

The second approach, at least as it applies to the priority status to be afforded foreign security interests, is the most natural of the two and the one that is dictated by public policy considerations. Courts faced with the issue of giving substance to a foreign security interest will be inclined to do so by analogy to concepts with which they are familiar. Decisions as to the priority position of a foreign security interest will generally involve competition between the holder of the foreign security interest and the holder of an interest acquired under municipal law. In these cases, courts will feel compelled to apply the extant priority structure of municipal law if for no other reason than that the domestic interest was acquired in reliance on the priority structure of the municipal law. In order to do this it is necessary to attempt to fit the foreign security interest into this structure by searching for an equivalent security interest that is a part of that structure.

It will be seen, however, that in cases where analogies between foreign security interests and security interests recognized under the municipal law of the second *situs* are only very approximate, the process of transposition introduces a great deal of uncertainty into the position of the holder of a foreign security interest. In rare cases it may end up with rights in the second *situs* greater than those afforded to it under the law of the jurisdiction where the movables were situated when it took its security. However, in many other cases its security interest will be seen as having a status considerably less favourable to it than would be the case under the law of the *situs* of the goods at the date of creation of the interest. This will be particularly so in situations where the law of the first *situs* is more willing to give scope to non-possessory security interests than the law of the second *situs*.[15]

(e) Transposition and public notice requirements

The practice of transposition may well result in a court of the second *situs* concluding not only that the *in rem* effects of a foreign security interest are to be determined by analogy to a similar type of security interest under municipal law (if one can be found), but also that a foreign security interest is subject to the same public disclosure laws that are applicable to the domestic counterpart of the foreign security interest. Again, this approach appears to be dictated by public policy considerations. Generally, the legislative policy underlying public disclosure requirements for security interests is to provide protection to those who might deal with the debtor in possession or control of the movable. Public disclosure is designed to work prophylactically to avoid loss to those who take advantage of it and who might otherwise suffer as a consequence of the principle of *nemo dat quod non habet*. To conclude that a foreign security interest is not subject to the municipal system for public disclosure of security interests would be to place the interests of foreign secured creditors higher than those of domestic buyers and secured or unsecured creditors.

The common law approach to the recognition of foreign security interests, however, does not appear to embody the same degree of parochialism when dealing with foreign security interests. Under the common law, the validity of the foreign security interest would appear to to be less dependent upon identification of a domestic equivalent. This being the case, it is much harder to conclude that statutory registration requirements that expressly apply to domestic security interests extend to foreign security interests of a different "kind". Indeed, both United States and Canadian courts have gone further and have held that chattel mortgages created under the law of foreign common law jurisdictions were not subject to statutory registration requirements for chattel mortgages since the legislation did not expressly refer to foreign chattel mortgages.[16]

To insist that the holder of a foreign security interest comply with the domestic public notice requirements often means that its security interest is denied the status of equivalent domestic security interests. The reason for this is that in very many cases the secured party will not become aware of the need to comply with domestic registration requirements of the second jurisdiction in time to meet those requirements. This may result from the fact that it is unaware that its collateral has been moved to the second *situs*[17] or because it was not made aware of this fact at a time that would allow it to comply with such requirements. Under the law of some jurisdictions, public notice requirements must be met within a specified period of time from the date that the security interest is created. In many cases, this period will have expired before the collateral has left the jurisdiction where it was situated when the security interest was created. The principal difficulty in this respect results from the fact that the registration requirements of many jurisdictions were designed with only domestic security interests in mind.

3. Treatment of security interests in movable property under the law of North American common law jurisdictions

(a) The context

For conflict of laws purposes, the United States is composed of 52 separate jurisdictions and Canada of twelve. This fact and the early popularity and widespread use

of secured transactions, such as conditional sales contracts and chattel mortgages, in both countries as devices to secure both consumer and business credit forced courts and legislatures in these countries to address conflict of laws problems involving security interests in movables long before they were encountered on a significant scale in other parts of the world. These problems were generally associated with the movement of goods subject to a security interest created under the law of one province or state to another province or state where the issue of recognition and enforcement of the security interest arose.

As early as 1908 the Bills of Sale Act of the Province of Saskatchewan provided for the registration of chattel mortgages "executed or created without Saskatchewan" where the goods taken as security under such mortgages were permanently removed into Saskatchewan. The holder of such a mortgage was required to register its mortgage in the appropriate Saskatchewan registry within three weeks of the removal of the goods into the province. Failure to do so resulted in the mortgagee being precluded from setting up any right of property or right of possession in the mortgaged goods "against the creditors of the mortgagor or against any subsequent purchasers or mortgagees in good faith and for valuable consideration."[18] A similar provision was included in the Conditional Sales Act of Nova Scotia as early as 1909.[19] Both the 1928 Canadian Uniform Bills of Sale Act[20] and the 1947 Canadian Uniform Conditional Sales Act[21] provided for registration of foreign security interests.

The 1924 U.S. Uniform Conditional Sales Act provided that where goods being purchased under a conditional sale contract were "removed from another state into a filing district in this state"... "the reservation of the property in the seller shall be void as to ... purchasers and creditors ... unless the conditional sale contract or a copy thereof shall be filed in the filing district to which the goods are removed, within ten days after the seller has received notice of the filing district to which the goods have been removed".[22] The American model legislation was more favourable to the position of the foreign conditional seller than its Canadian counterparts. Under the American approach, the goods could be in the second *situs* for a long period of time before the conditional seller was required to comply with the public disclosure requirement of the second *situs*. The result was to increase substantially the likelihood that a third party in the second *situs* which acquired interests in the goods would be subordinated to a foreign, undisclosed conditional seller's rights.

These early attempts to address the problem of striking a balance between the need to recognize the efficacy of foreign security interests and the need to protect domestic buyers and creditors were further refined in many North American jurisdictions. However, until the publication of Article 9 of the U.S. Uniform Commercial Code, the basic approach remained largely unaltered. A foreign security interest was valid and enforceable in a jurisdiction for a period of time after the collateral was brought into the jurisdiction. Under the law of some jurisdictions, this period of time started to run from the date the collateral was brought into the jurisdiction. Under the law of others, the period did not start to run until the secured party became aware that the collateral had been brought into the jurisdiction. Failure to file a copy of the security agreement in the new *situs* before the expiry of the specified period of time resulted in the security interest being treated as "void" as against buyers, mortgagees or creditors who acquired interests or who took proceedings against the collateral while it was in the jurisdiction.

As might be expected, the designers of these systems were not particularly concerned about the need to accommodate foreign security interests that were significantly different in nature from those in use in their jurisdictions. Nevertheless, while the systems were designed to apply to interests arising under conditional sales contracts and chattel mortgages, the terms "chattel mortgage" and "conditional sale" were generally given a broadened statutory definition so as to encompass security agreements that were functionally, but not conceptually, similar to conditional sales contracts and chattel mortgages.[23]

These systems did not make special provision for security interests in mobile equipment. However, they did provide very generous accommodation to foreign security interests in mobile equipment in cases where the equipment did not remain in any particular jurisdiction for a long period of time. Under most of the systems a foreign conditional sales contract or chattel mortgage, in effect, was deemed to be filed in the jurisdiction for a period of time after it came into the jurisdiction. Any sale,[24] mortgage or seizure of the goods during this period of time would pass the debtor's interest subject to the foreign security interest.

(b) Contemporary conflict of laws rules in the United States

The modern era in the development of conflict of laws rules for security interests in North America began with the release of Article 9 of the U.S. Uniform Commercial Code in 1952. The original text has been revised on several occasions. For the purposes of this study it is relevant to focus particular attention on the 1972 Official Text and incidentally on the 1962 Official Text. Article 9 of the Uniform Commercial Code represents the accumulated experience of a country in which inter-jurisdictional conflict of laws problems have been encountered on a massive scale and over a long period of time.[25] It contains statutory measures designed to address directly the various issues associated with the recognition of "foreign" security interests in mobile equipment.

The 1962 version of Article 9 purported to address issues of "validity and perfection of a security interest and the possibility and effect of proper filing" with respect to it. A considerable amount of academic debate developed around the meaning and scope of the term "validity" in the context of Article 9-103, particularly as it relates to the issue of *inter partes* enforceability of a security interest.[26] This matter was addressed in the 1972 Official Text by the removal of any reference to the issue of validity of a security interest, thereby leaving the matter of *inter partes* rights to be governed by the general Code conflict of laws provisions.[27] Since all but one state had adopted the Uniform Commercial Code by 1972, the need for a choice of law rule to determine the essential validity of a security interest had, for the most part, disappeared.

The two Official Texts of the Uniform Commercial Code embody different approaches to the choice of law applicable to the creation of a security interest and its efficacy in cases where collateral, other than mobile equipment, has been removed from one *situs* to another. Article 9-103(3), 1962 Official Text, adopts the *lex situs* at the date of attachment as the law applicable to validity. In this context, validity apparently includes perfection and effect of perfection.[28] A security interest perfected under the *lex situs* at the date of attachment continues perfected in a second *situs* for four months "and also thereafter if within the four month period it is perfected" in the second *situs*. Under the 1972 (now 1978) Official

Text of Article 9-103(1)(b) (see Appendix B), perfection and the effect of perfection and non-perfection are governed by the law of the jurisdiction where the collateral is where the last event occurred on which is based the assertion that the security interest is perfected or unperfected. A period of temporary perfection is afforded to a security interest in goods brought into and kept in the jurisdiction if the security interest was perfected in the former *situs* and if it is perfected under the law of the jurisdiction before the expiry of four months from the date it came into the jurisdiction or the expiry of perfection in the former *situs*, whichever is earlier.

A special choice of law rule is provided in cases where it is understood by the parties to a security agreement that the collateral will be kept in another jurisdiction and it is in fact taken to that jurisdiction within a specified period of time. In such cases the law applicable to perfection and the effect of perfection and non-perfection is the law of the jurisdiction to which the collateral is taken.[29]

Of particular relevance to this study is the treatment of security interests in mobile equipment. The 1972 Official Text prescribes the most refined set of rules in this respect (see Appendix B). Under Article 9-103(3), the law, including the conflict of laws rules, of the jurisdiction where the debtor is located governs the perfection and the effect of perfection and non-perfection of a security interest in "goods which are mobile and which are of a type normally used in more than one jurisdiction, such as motor vehicles, trailers, rolling stock, airplanes,[30] shipping containers, road building and construction machinery and commercial harvesting machinery and the like" if the goods are equipment or inventory held for lease. The debtor is deemed to be located at his place of business if he has one, at his chief executive office if he has more than one place of business, otherwise at his residence.[31] When the debtor changes his location, perfection continues until the expiry of four months after the change or until perfection ceases in the first jurisdiction, whichever period expires first.[32] Article 9-103(2) makes special provision for choice of law rules and perfection requirements where the collateral is goods covered by a certificate of title. This is an important feature of the American system because of the fact that certificates of title to motor vehicles are issued by most states of the United States.

(c) Contemporary conflict of laws rules of common law jurisdictions in Canada

In recent years several Canadian jurisdictions have enacted Personal Property Security Acts modelled on Article 9 of the U.S. Uniform Commercial Code. In most respects, the Canadian legislation mirrors the conflict of laws provision of the 1972 Official Text of Article 9. However, there are some major differences.

Under Canadian Acts, the *lex situs* governs the validity and effect of perfection of a security interest in non-mobile goods.[33] The periods of temporary perfection where goods are moved into a jurisdiction are calculated differently from their American counterparts. The period is the shorter of 60 days from the goods being brought into the jurisdiction, 15 days from the date the secured party discovers that this has occurred or the expiry of perfection under the original *situs*.[34] Under the laws of some jurisdictions, where the goods are sold to a good faith buyer in the second *situs*, the foreign security interest has priority only if it is in fact registered in the jurisdiction in which the sale took place before the date of the sale.[35]

A few of the Canadian Acts include departures from the U.S. legislation where mobile equipment is involved (see e.g. Appendix C). In all cases, the law applicable to the validity and effect of perfection or non-perfection is that of the debtor's location at the date that the security interest attached. Both the change of location of the debtor and the transfer of the debtor's interest in the collateral to someone in another jurisdiction invoke the necessity to reperfect within a specified period of time. The period is the shorter of 60 days from the date that the debtor changes its location, 15 days from the date the secured party discovers that this has occurred or the expiry of perfection under the law of the original location of the debtor. Failure to reperfect in the new location results in the security interest becoming unperfected and not, as is the case under United States law, just subordinated to purchasers.(36) If the jurisdiction in which the debtor is located does not provide for public registration or recording of security interests in mobile equipment and the collateral is not in the possession of the secured party, a security interest in the collateral must be registered in the jurisdiction if it is to have priority over rights acquired in it in the jurisdiction.(37)

(d) A closer look at the North American approach

Several features of the approach to the recognition of security interests in mobile equipment contained in Article 9 of the U.S. Uniform Commercial Code and the Canadian Personal Property Security Acts warrant careful consideration.

A problem endemic to any system of conflict of laws rules is to identify the types of foreign security interests that will be given recognition. Once recognition is granted there remains the further problem of determining what priority status is to be given to such interests. As noted in an earlier section of the study, many systems address these problems through the use of transposition. The recognition and status afforded to a foreign security interest are conditioned by its similarity to a domestic security interest.

This problem is of only peripheral significance under the North American systems. The reason for this is that these systems apply to all "security agreements" without regard to their form.(38) A security agreement is an agreement that provides for a security interest in personal property. A "security interest" is any proprietary interest which secures payment or performance of an obligation.(39) In order to gain recognition, a foreign security interest must meet this test. However, because it is a generic test that encompasses all types of security interests that secure payment or performance of a debt or other obligation and that are created or provided for by contract, there will be few interests arising under contemporary secured financing transactions that will be excluded.(40)

It will be noted that under this legislation the law applicable to the issues associated with the validity(41) of a security interest in mobile equipment is not the *lex situs* of the equipment at the date the security interest is created, but the law, including the conflict of laws rules, of the location of the debtor. In a commercial context, this will generally be the law of the chief executive offices of a corporate debtor. The legislation represents a rejection of the *lex situs* as the law applicable to issues associated with the validity of security interests in mobile equipment.

The North American systems do not stop there, however. The law of the debtor's location governs not only issues associated with the validity of a security interest in mobile

equipment, but also the priority and public disclosure of such an interest. An assumption of these systems is that a third party who deals with the debtor in possession of the equipment will appreciate the need to conduct a search in the jurisdiction where the debtor is located rather than the jurisdiction where the equipment happens to be situated at any particular time. This may not be an unreasonable assumption in view of the fact that this special choice of law rule applies only where mobile equipment or goods held for lease are involved. Consumer goods are excluded. Accordingly, cases in which legally unsophisticated domestic buyers are likely to be involved are governed by the *lex situs* rule with the result that such buyers will be able to rely on information relating to security interests in the goods that must be contained in the registries of the *situs*.(42) Except for the period of temporary exposure that third parties must endure in cases where the debtor has moved its location to another jurisdiction, the system provides a reasonable measure of assurance that security interests will be discoverable or that an interest in the equipment acquired by third parties will not be subject to security interests.(43)

The growing homogeneity of secured lending arrangements and applicable law among North American common law jurisdictions permits the implementation of conflict of laws rules that results in the wholesale application of foreign law to issues of priorities and public notice arising in a state or province. However, these systems also apply with respect to security interests created under the law of Quebec and Louisiana, jurisdictions that do not have common law systems. Clearly, in traditional terms, the approach contained in Article 9 of the U.S. Uniform Commercial Code and the Canadian Personal Property Security Acts is quite radical.(44) The Official Comment to Article 9-103(3) of the Uniform Commercial Code describes these systems as ones under which "each state other than that of the debtor's location in effect disclaims jurisdiction over ... mobile chattels even though they may be physically located within the state much of the time".(45)

V. EXISTING INTERNATIONAL REGULATION OF SECURITY INTERESTS IN MOBILE EQUIPMENT

1. The Unidroit Convention on International Financial Leasing, 1988

The Unidroit Convention on International Financial Leasing prescribes a series of rules for the regulation of the *inter partes* rights and obligations of parties to a tripartite international financial leasing transaction. These rules override the national law otherwise applicable to the transaction. In addition the Convention contains provisions that deal with third party rights.

While not all financial leases to which the Convention applies will be treated as security agreements under the applicable law, many of them will be so characterized under the law of those jurisdictions that have developed sophisticated systems of personal property security law which focus on substance rather than form when characterizing transactions. In such cases, lessors will be required to comply with the public notice requirement of the applicable law if their interests in the leased equipment are to be protected from subordination to the claims of unsecured creditors of lessees or trustees in bankruptcy.

The drafters of the Convention eschewed any suggestion that a complete set of priority rules or choice of law rules for determining the law applicable to priorities be included in the document. However, concern of international lessors that the domestic law of lessees' States may not always respect their ownership rights when unsecured creditors and bankruptcy trustees of lessees make claims to leased equipment, led to the conclusion that the Convention should contain measures designed to protect those rights. Accordingly, the Convention provides that the lessor's "real rights" in the equipment shall be valid against the lessee's trustee in bankruptcy and creditors (Art. 7(1)(a)-(b)).

It is not possible to deal with any aspect of priorities without taking into consideration the fact that, under the law of some jurisdictions, priority determinations involving, *inter alia*, execution creditors and trustees in bankruptcy are directly affected by public disclosure requirements. In other words, a pre-condition for the recognition of the supremacy of the real rights of a lessor may be compliance with the registration requirement of the applicable law. Consequently, necessarily incidental to the decision to give protection to lessors' real rights was the requirement that the Convention contain a set of choice of law rules for determining the law applicable to the question as to whether or not lessors must give public notice of their interests as a pre-condition to priority over execution creditors and trustees in bankruptcy.

Under the Convention leases of ships and aircraft are treated separately. The applicable law in the case of a lease of a registered ship is the law of the State in which the ship is registered in the name of the owner (Art. 7(3)(a)), and, in the case of a lease of an aircraft, it is the law of the State where the aircraft is registered under the Convention on International Civil Aviation, Chicago, 1944 (Art. 7(3)(b)). For leases of all other types of equipment it is necessary to determine whether the equipment is stationary or mobile. In the case of a lease of equipment of a kind normally moved from one State to another, the applicable law is that of the State where the lessee has its place of business (Art. 7(3)(c)). In the case of a lease of any other type of equipment, it is the law of the State where the equipment is situated (Art. 7(3)(d)).

There are several features of the Convention on International Financial Leasing that are of relevance in the context of this study. One of these is the fact that it is a recent convention that deals with security interests in movable goods. It demonstrates that international regulation of this area of the law is a matter of growing importance. Another of these features is the fact that the Convention embodies what might be described as a mixed approach to the regulation of this area. It provides international substantive rules dealing with certain aspects of *inter partes* and third party rights. However it does not purport to be a definitive code of law dealing with all aspects of international financial leases. Many matters are left to be regulated by the applicable law. With respect to some of these, it specifies what is the applicable law. The third important feature of the Convention is that it provides a priority rule regulating the relative rights of lessors (as secured parties) and execution creditors and trustees in bankruptcy of lessees. Finally, it is relevant to note that the choice of law rules of the Convention do not prescribe the *lex situs* where public notice of a security interest in mobile equipment is involved. This represents a dramatic departure from the traditional approach embodied in the conflict of laws rules of most nations applicable to interests in movable goods other than ships and aircraft.

2. The Geneva Convention on the International Recognition of Rights in Aircraft, 1948

Aircraft are items of very high unit cost. A single airplane can cost as much as $50,000,000. This being the case, it is necessary to ensure that secured financing arrangements along with other financing devices are available to facilitate the acquisition of aircraft by airline operators. Further, aircraft are the most mobile of movable property. In the space of a few hours a modern aircraft can enter and leave the territory of several States. It is clear that the traditional choice of law rule relating to proprietary interests in movable property, the *lex situs*, is entirely inappropriate in the context of security interests in aircraft. These factors were recognized shortly after World War II. As a consequence, the Convention on the International Recognition of Rights in Aircraft was elaborated in Geneva in 1948. Fifty-three States have ratified or acceded to the Geneva Convention.

One of the purposes of the Convention is to provide a choice of law rule for determining validity and place of registration of security interests in aircraft.[46] The Convention provides for the recognition of "mortgages, hypothèques and similar rights in aircraft which are contractually created as security for payment of an indebtedness" provided that "such rights have been constituted in accordance with the law of the Contracting State in which the aircraft is registered as to nationality at the time of their constitution" and "are regularly recorded in a public record of the Contracting State in which the aircraft is registered as to nationality" (Art. 1(1)(d)(i)-(ii)). Generally, the effect of the recording of such rights is determined according to the law of the State where the aircraft is registered (Art. 2(2)). Under the Convention, a Contracting State is free to refuse recognition of foreign types of security interests which do not fit into municipal categories of security interests, provided that they do not prohibit the recording of a right which could be validly constituted according to national law (Art. 2(3)).[47] However, the Convention does provide that no transfer of an aircraft from the nationality register or record of one Contracting State to that of another Contracting State shall be made unless holders of recorded rights have been satisfied or consent to the transfer (Art. 9).

Security interests in spare parts taken along with a security interest in an aircraft are subject to the same treatment as that of the aircraft even though they are situated outside the territory of the State in which the aircraft is registered as to nationality. This treatment is conditional upon the secured party providing, along with the registration, a record of the parts and the place where they are stored and posting a notice where the parts are situated "specifying the description of the right, the name and address of the holder of this right and a record in which such right is recorded" (Art. 10(1)-(2)).[48]

The relevance of the Geneva Convention to this study is the fact that it provides international recognition of the inappropriateness of the *lex situs* as a source of law for determining the validity and efficacy of security interests in mobile equipment. The central purpose of the Convention is to identify a source of law that is constant. The result is that finance organizations involved in secured financing of aircraft have a greatly reduced risk of loss of their security as a result of refusal on the part of forum courts to recognize the validity and enforceability of their security interests.

In addition, the Convention employs a choice of law rule and prescribes priority rules. While the central aspect of the Geneva Convention is the requirement that Contracting

States undertake an international obligation to recognize the validity and enforceability of security interests in aircraft that have been created in compliance with the law of the State where an aircraft is registered as to nationality, it does contain several substantive law provisions. Some of these deal with priority issues. Although, generally, priorities are determined under the law of the State of registration (Art. 2(2)), the Convention provides for tacking of future advances, but limits the amount of interest that can be claimed by a secured party (Art. 5). In addition it determines the relative priority position of owners or secured parties and buyers at an execution sale (Arts. 7(4) and 8, 10(3)). It also provides for the priority of certain liens (Art. 4).

3. The Brussels Conventions for the Unification of Certain Rules of Law relating to Maritime Liens and Mortgages, 1926 and 1967

The essential purpose of these Conventions is to provide for a priority system for competing interests in ships. Of primary concern were the relative priority positions of mortgagees and holders of the various types of liens constituted under national law.

Under the 1926 Convention, "mortgages, hypothecations, and other similar charges upon vessels, duly effected in accordance with the law of the Contracting State to which the vessel belongs, and registered in a public registry either at the port of the vessel's registry or at a central office, shall be regarded as valid and respected in all other Contracting States" (Art. 1). The Convention stipulates five classes of maritime liens which take priority over mortgages (Art. 2).

Only twenty-two States are bound by this Convention. Its unpopularity is due largely to the great diversity in the various national laws providing for maritime liens. Many countries have taken the position that the Convention allows for the recognition of too many categories of maritime liens.

The relative failure of the 1926 Convention led some maritime nations to explore the possibility of securing broader agreement on the terms of a convention dealing with mortgages and liens. The product of this effort is the 1967 Convention. This Convention contains a shorter list of liens that are given priority over mortgages. It also gives to Contracting States the right to rank certain liens above mortgages. It provides a more detailed set of prerequisites for international recognition of "mortgages and hypothèques". They must have been effected and registered in accordance with the law of the State where the vessel is registered. The registry must be open to public inspection and the public record must contain the name and address of the mortgagee or holder of the hypothèque (or indicate that it is to bearer), the amount secured and "the date and other particulars which, according to the law of the State of registration determine the rank as respects other registered mortgages and hypothèques" (Art. 1).

This Convention was less popular that its predecessor. It has been accepted by only five States. There are several reasons for this. However, the most important objection appears to have been the requirement that the public records disclose the amount secured by a mortgage. Several common law jurisdictions that have followed the British model for the creation and recording of mortgages on vessels have taken the position that this requirement reflected civilian thinking and does not facilitate national systems under which this type of information is not on public record.[49]

The efficacy of the place of registration of the ship as the source of law for determining priorities is affected by the extent to which there exists international agreement or understanding as to what constitutes the proper place of registration of ships. The growing use of "flags of convenience" registration has threatened the usefulness of the law of the flag as the appropriate source of law to determine priorities where security interests are involved. The 1958 Geneva Convention on the High Seas prescribes a test for determining the State in which a ship may be registered. The Convention requires that there exist "a genuine link between the State and the ship; in particular, the State must effectively exercise its jurisdiction and control in administrative, technical and social matters over ships flying its flag" (Art. 5(1)). The United Nations Convention on Conditions for Registration of Ships, 1986 provides for greater amplification as to what constitutes a "genuine link" between a ship and a flag State. In this respect the Convention attacks the practice of using flags of convenience and the opportunistic use of more than one national registration.

4. The Geneva Convention on the Registration of Inland Navigation Vessels, 1965

This Convention, which came into force in June 1982, was designed to unify national laws and practices with respect to the registration of inland navigation vessels, and to harmonize certain international aspects of rights *in rem* among the Contracting States. Six States have ratified it. The Convention applies to rights in a "vessel" which is defined as including "hydroplanes, ferryboats, dredges, cranes, elevators and all other floating appliances or plant of similar nature." (Art. 1(1)(b)). Structurally, the Convention is composed of a set of articles prescribing rules for the registration of interests in vessels and two Protocols, one dealing with the recognition of ownership, usufruct, mortgages and liens, and the other with rights of attachment.

Each Contracting State undertakes to keep a register for the registration of inland navigation vessels (Art. 2). The registry of a Contracting State may include registration information concerning a vessel if one of the following conditions is met: (i) the place from which the operation of the vessel is habitually directed is situated in that State; (ii) the owner, being an individual, is a national of or habitually resident in the State; or (iii) being a corporation, its registered office or principal place of business management is situated in the State (Art. 3(1)). Where it is possible under these criteria that a single vessel could be registered in two States, the owner must choose one of the two countries in which the vessel is to be registered (Art. 4(1)). A Contracting State may not force the owner of a vessel to register it in the State's registry if the vessel is registered in a non-Contracting State under circumstances prescribed by the Convention unless the owner has its habitual residence or principal place of business in the State and owns more than a one-half interest in the vessel (Art. 4(2)-(3)). Provision is made for cancellation and transfer of a registration from the registry of one Contracting State to the registry of another (Arts. 10 and 11).

Protocol No. 1 to the Convention deals with registration and recognition of rights of "ownership, usufruct, mortgage and liens" (Art. 4). The "rules relating to [these] rights *in rem* ... shall be determined by the law of the country of registration" (Art. 10). When one or more of these rights have been registered in the registry of one Contracting State, they must be recognized in the territory of all other Contracting States (Art. 5). The order of priority of *in rem* rights is the order of their registration (Art. 6). A registration of a

mortgage must disclose at least the name and address or domicile of the mortgagee and the details of the debt obligation secured (Art. 7). Chapter III of the Convention provides rules for the recognition and priority of certain liens against vessels.

For the purposes of this study it is relevant to note that the Convention employs a mixture of prescribed choice of law and substantive priority rules to ensure the international recognition and enforcement of security interests in vessels. For obvious reasons, the choice of law rule of the Convention eschews the *lex situs* of the vessel. The law applicable to the validity of ownership claims (presumably this includes a security interest in the form of retained title) and mortgages is the law of the country where the vessel is registered. The Convention prescribes the conditions under which registration is to be effected in a State and ensures that a vessel is registered in one State only. The result of these conditions is that the law applicable will be the location of the debtor (residence of an individual and principal place of business or registered office of a corporation) or "the place from which the operation of the vessel is habitually directed". A very simple first-in-time priority rule is prescribed by the Convention in cases where multiple *in rem* claims are made with respect to the same vessel.

5. Other Conventions

The Montevideo Treaty on International Commercial Terrestrial Law, 1940, which has been ratified by three countries, provides that where goods are encumbered by a "pledge", in order to preserve rights acquired in the first *situs*, both the formal and the substantive requirement of the second *lex situs* must be observed (Arts. 21 and 22).

The Hague Convention on the Law Applicable to Transfer of Ownership in the International Sale of Goods, 1958, which is not in force, prescribes the *lex rei sitae* as the law applicable to conflicting claims of an ownership retaining seller and creditors of the buyer (Art. 4).

6. In summary

Existing international regulation of security interests in movable property focuses primarily on three types of movables: aircraft, ships and vessels.[50] There are two characteristics of these types of property that have resulted in them being singled out for special treatment. All three have very high unit cost. As a result, some form of secured financing is generally involved in the construction or acquisition of ownership rights in them. An important aspect of any secured financing arrangement is the assurance that, should it become necessary, the secured party's rights in the collateral will be recognized by the applicable law. Aircraft, ships and vessels are highly mobile and as such are very likely to cross national frontiers with considerable frequency. Generally, the various national laws applicable to the recognition and enforcement of security interests created under the laws of foreign jurisdictions are grounded in parochialism and totally outdated perceptions as to nature of modern international business activity. In the absence of an international approach to the recognition and enforcement of security interests in these types of equipment, the fact of their mobility produces a threat to the legal stability and predictability that secured financiers require if they are to commit very large sums of money to financing the acquisition of aircraft, ships and vessels.

The approach embodied in the conventions on recognition of security interests in aircraft, ships and vessels involve two distinct elements: (i) the displacement of the *lex situs* in favour of a single, easily identifiable source of law applicable to the validity and public disclosure of security interests and (ii) the prescription of denationalized priority rules to deal with situations in which resort to the law otherwise applicable would produce inconsistent or otherwise unacceptable results. The second element, however, appears only on a limited scale.

The Convention on International Financial Leasing represents a modest, but nevertheless important, extension of the first element mentioned in the previous paragraph as it applies to public disclosure of security interests. Under the Convention, a single law is designated as the source of publicity requirements for leases of all types of mobile equipment other than ships and aircraft. The law applicable to public disclosure of a lessor's interest in mobile goods is that chosen, not by reference to the *situs* or the "nationality" of the goods, but by reference to the place of business of the lessee. In this respect the Convention parallels the Geneva Convention on the Registration of Inland Navigation Vessels. The Leasing Convention's embodiment of the second element noted above is confined to a single, but commercially significant, priority rule: the supremacy of the lessor's real rights over the claims of the lessee's execution creditors or trustee in bankruptcy. This important question is not left to the law otherwise applicable, but is addressed in the Convention.

VI. PROPOSALS FOR INTERNATIONAL REGULATION OF SECURITY INTERESTS IN MOVABLE PROPERTY

1. Introductory comment

The international recognition of security interests in mobile equipment has not been the exclusive focus of any of the studies dealing with security interests in movable property carried out by international organizations. Nevertheless, these studies do address some of the issues germane to this study. Consequently, they cannot be ignored.

2. The UNCITRAL project

The United Nations Commission on International Trade Law (hereafter referred to as UNCITRAL) in 1968 authorized the Secretary-General to make a study of the law of security interests in the principal legal systems of the world. At the request of the Secretary-General, Professor Ulrich Drobnig of the Max-Planck Institute for Foreign and Private International Law prepared in 1975 a report for the Commission which examined in the context of the legal systems of many countries of the world the major issues involved in modern security financing law at both national and international level. In addition it provided a description and assessment of proposals for remedying existing deficiencies in the law relating to international recognition of security interests in movable property. Minor changes were made in the report and it was resubmitted to the Commission in 1977.[51] Between 1977 and 1980, the possibility of developing model rules for security interests in movables based on a functional approach and encompassing domestic as well

as international transactions was further examined by the Secretariat and the Commission. In 1979 the Secretary-General submitted to the Commission a report entitled: *Security Interests; feasibility of uniform rules to be used in the financing of trade.*(52) In his report, the Secretary-General noted that, after considerable study and an extensive exchange of views, several conclusions had been reached. The conclusions relevant to this study are summarized hereafter in point form.

1. Personal property security laws of many countries are inadequate to meet the contemporary needs of the business community. While it is difficult to demonstrate in a verifiable manner that this results in adverse effects on economic development, there is sufficient evidence to establish that the availability of modern, efficient laws in this area has the effect of providing sources of capital which would otherwise not be available. This should be a matter of particular interest to developing countries.

2. The most prevalent problem is the number of statutes governing different aspects of this area of the law. These statutes were adopted (in most countries prior to World War II) to solve specific problems existing at the time of enactment. Consequently they are not well suited to current patterns of trade and finance. Typically, priorities between secured creditors and other claimants of the collateral are obscure and procedures for realizing the value of the collateral in case of default by the debtor are slow and expensive and do not encourage the sale of the collateral at prices similar to those that would be received at a commercial sale of similar goods.

3. So long as the law of security interests differs significantly in different countries, the legal problems which arise when goods subject to a non-possessory security interest are moved from one State to another are difficult to solve satisfactorily. It is obviously undesirable if the receiving State refuses to recognize the security interest created abroad. However, it is equally undesirable if the foreign creditor has rights not available to a domestic creditor, or if the foreign creditor is not required to give the same degree of publicity to the existence of the security interest as would a domestic creditor. In order to alleviate this situation, the law must be sufficiently similar to that of the State where the security interest was originally created and the State where it would be enforced so that the rights of the debtor, creditor and third parties would not be seriously affected by the movement of the goods. Once this has been accomplished, it would be possible to devise rules of conflict of laws which would make it possible to enforce a security interest in a State other than that in which it was created without upsetting the expectations of other claimants against the debtor.

The Secretary-General concluded that the necessary degree of interjurisdictional similarity might be obtained through the use of a model code of law that would be adopted by States as the basis for reform of national laws dealing with security interests in movable property.

At the request of the Commission the Secretary-General prepared and submitted to the thirteenth session of the Commission held in 1980 a further report designed to present in a concrete form the manner in which the essential issues involved might be addressed.(53) In this report the Secretary-General described an approach to this area of the law that adopts function as the central consideration in the formulation of rules which would provide the basis for unification of domestic and international law dealing with security interests in movable property.

This report focused specifically on the conflict of laws in situations where property that is subject to a security interest created in one State is moved to another State. It was noted that

> [t]he general rule where the secured property is neither mobile nor intangible, would probably be that the validity of the security agreement, the actions to be taken by the secured creditor in order to be protected against third parties and the degree of protection to be given against third parties would all be governed by the law of the State where the secured property was located. If the secured property was subsequently moved to a second State, the validity of the security agreement should, in principle, continue to be governed by the law of the first State. However, the second State may wish to subject the security agreement to the same requirements of formality as would otherwise be required of a security agreement concluded under the model law... .
>
> If the goods were mobile goods, it could happen that the secured property was temporarily out of the State where it would normally be located at the time the events in question took place. In this case, it might be considered desirable for the law of the State where the debtor has his principal place of business to be the applicable law with respect to all questions. Alternatively, if the secured property were of such a nature that its ownership were registered with the State, as in the case with automobiles and trucks, it may be thought desirable that the governing law be the law of the State of registration. This would normally be the same State as the State where the debtor has his place of business, but some debtors might own vehicles in other States as well... .
>
> Whether the model law should require some form of publicity and the nature of the publicity to be required are among the more difficult questions to be decided. It may be that the only adequate solution would be to leave these matters to each State but to include in the provisions on conflict of laws that secured property which has a protected status in the first State continues to have a protected status in the second State for a restricted period of time. If by the end of that period of time the secured creditor has taken the action required by the second State, the protection would continue. If actions taken in the first State were also those required by the second State (for example, notation on the certificate of title which moved with the secured property or fixing of a notice to the secured property itself), no further actions would be needed to be taken in the second State.(54)

After receiving and considering the report, the Commission concluded that "world-wide unification of the law of security interests in goods ... was in all likelihood unattainable ... [and] ... that no further work should at present be carried out by the Secretariat ...".(55) While the records of the discussion of the Commission members indicate that several factors influenced the decision of the Commission to proceed no further, it appears that the complexity of this area of the law was the single most important reason why the Commission concluded that there could be no reasonable expectations that uniform rules might be developed. It was suggested that "if any further work were to be undertaken in the future, emphasis should be placed on the practical problems in respect of security interests in international trade".(56)

While the UNCITRAL project did not result in the formulation of a model law for the international regulation of security interests in movable property, its contribution to further development in this area of the law should not be overlooked. For the purposes of

this study, it is important to note that the project involved a careful study and assessment of both domestic and international personal property security law. The Secretariat of UNCITRAL came to the conclusion that, for the most part, this law is inadequate to meet the needs of modern commercial activity. The research findings of the Secretariat were particularly critical of the treatment of foreign security interests under national legal systems.

As noted above, the Secretary-General went beyond criticism of the current state of the law. The 1980 Report set out in general terms approaches that would appear to offer some hope for improvement. Ultimately these proposals failed to gain the support of the Commission, not because any one of them was seriously flawed, but because implementation of a code of law that embodies them would involve massive conceptual and administrative changes in the national laws of many countries of the world. This being the case, it is relevant in the context of the much more limited scope of this study to consider the approaches suggested by the Secretary-General dealing specifically with the treatment of security interests in mobile equipment.

The Secretary-General concluded that there was a need to have a degree of similarity of treatment for security interests under the law of the State where the security interest is created and the law of the State where it is enforced. He also suggested that this would be supplemented by uniform conflict of laws rules that at the same time would provide for the recognition of foreign security interest in movables that cross international boundaries and protect the interests of persons who might acquire interests in movables in the jurisdiction to which they have been removed. While the Secretary-General saw this approach as one to be implemented through a model code of law dealing with most aspects of security interests in movables, it is clear that this method is not the only one available. It is the purpose of this study to determine whether or not it could be implemented through an international convention that deals exclusively with security interests in mobile equipment.

3. Projet de Convention relative aux effets extraterritoriaux des sûretés mobilières sans dessaisissement, Fédération bancaire, EEC, 1970

The Fédération bancaire of the European Economic Community prepared in 1970 a draft Convention designed to overcome some of the more significant legal impediments to the interjurisdictional recognition and enforcement of security interests in movable property. The proposed Convention was thought to be an important element in the further integration of the economies of the countries of the Common Market. While it was not confined in its application to mobile equipment, its central effect would be to provide for a system under which a security interest in commercial goods and motor vehicles taken under the law of one Contracting State is recognized under the law of another Contracting State should the goods come into the territory of that State.

> Or, la progression de l'intégration économique du Marché Commun rendra ces problèmes de plus en plus fréquents. Un bien mobilier grevé d'une sûreté sans dessaisissement pourra passer d'un pays de la C.E.E. à un autre à la suite d'une vente, du transfert du siège d'une société, du déplacement d'une activité commerciale ou industrielle temporaire, par exemple dans le cas d'entreprises de construction. En

vertu des règles légales actuelles, le créancier gagiste perdrait son gage - ce qui aurait pour conséquence de réduire le crédit accordé au constituant de la sûreté à moins d'accepter le risque résultant de l'introduction du bien dans un autre pays ou encore de constituer une sûreté sans dessaisissement, selon le droit de ce pays avec les frais qui en découleraient.(57)

In order to obtain the international recognition provided by the proposed Convention, a security interest would have to have been constituted in accordance with the *lex rei sitae* at the date of creation and have been registered in a central, supranational, European registry constituted under the Convention (Art. 1, para. I and Section II). Priority between successive security interests in the same movable property would be determined by the date of registration of each in the registry (Art. 3, para. II). The proposed Convention adopts the *lex rei sitae* as the law which governs the priority of a security interest in relation to the interest of a good faith buyer (Art. 3, para. IV).

The proposed Convention identifies a type of security agreement in each Contracting State to which a foreign security interest is assimilated for the purposes of determining the applicable priority rules other than those specifically prescribed by the Convention (Art. 3, para. I). Likewise, realization procedures for foreign security interests are analogized to specified procedures in each Contracting State (Art. 4).

The approach contained in the proposed Convention is a mixture of prescribed priority rules, choice of law rules and recognition of and priority for foreign security interests based on analogy to specified secured transactions constituted under the laws of the recognizing State. Recognition of and priorities among successive security interests would be directly connected to a central, supranational registry.

Features of the approach embodied in the proposed Convention render it unsuited as an adequate response to the need for an international system for the recognition of security interests in mobile equipment. A single, central, international registry for security interests is unrealistic. Further, any attempt to specify in a convention, designed for ratification by a large number of countries throughout the world, a type of security agreement in each Contracting State to which foreign security interests would be analogized for priority purposes would be unworkable.

4. Unidroit study on sales of movables by instalment and on credit in the Member States of the Council of Europe, 1968

The Committee of Ministers of the Council of Europe authorized in 1963 a study relating to certain aspects of sales by instalment. The study, which was entrusted to Unidroit, was published in 1968.

Those aspects of the Unidroit study that are relevant here focused almost exclusively on the international recognition of security interests in automobiles that have been taken from one jurisdiction to another. The researchers who prepared the study could find no empirical evidence of significant problems in this respect. The recommendations set out in the study were based on speculation that "the development of mass motoring may, despite everything, make all these problems acute. This has been shown by the example of American...".(58)

The authors of the study concluded that the greatest potential for legal difficulties could be found in situations where an automobile subject to a security interest created under the law of one State is taken to another State and sold to or seized (distrained) by someone in the second State. The chances that the law of the second State would deny efficacy to the security interest were viewed as significant.

The authors of the study explored a number of possible approaches to address the need for securing international recognition of foreign security interests in this context. They rejected as impractical any undertaking to secure unification of municipal security law. They also doubted whether the approach contained in the Geneva Convention on the International Recognition of Rights in Aircraft, 1948 would be workable in the context of security interests in motor vehicles since it would involve asking States to introduce a system of publication by means of registration and to recognize the law of the place of registration instead of the *lex rei sitae*.

While the study did not set out specific recommendations, its authors clearly favoured a certificate of title system for motor vehicles.

> The solution in question would be to provide each motor vehicle with a special official document that would faithfully reflect its legal status in addition to the various administrative documents that are required everywhere. It should be prepared by the responsible national authorities in accordance with an internationally recognised model, showing information relating to the vehicle's status, i.e. its ownership, any restrictions thereon, and any security constituted by the vehicle. In the event of sale on credit or by instalment any provision in the agreement concerning ownership, hire-purchase, lien, hypothecation, etc., in accordance with national legislation should be shown.[59]

5. The European Committee on Legal Cooperation study on international aspects of the legal protection of rights of creditors, 1972

The Service de Recherches Juridiques Comparatives, Paris, prepared in 1972 for the European Committee on Legal Cooperation of the Council of Europe a "preliminary study" on international aspects of the legal protection of the rights of creditors. While the principal focus of the study was the general position of creditors under the national laws of European States, it did address, albeit very briefly, the problems associated with the international recognition of retention of ownership by sellers of machinery. However, issues associated with security interests in highly mobile types of machinery did not receive special treatment in the study. Only inferentially did the study address the special considerations involved where these types of machinery are involved.

The authors of the study noted three possible approaches to address the need for international recognition of security interests in the form of title retention agreements in cases where machinery subject to such an interest is taken across national frontiers. The maximum solution was the unification of national laws dealing with security interests through national adoption of an internationalized version of Article 9 of the U.S. Uniform Commercial Code. An intermediate solution would be some form of mutual international recognition of certain aspects of security interests. As a possible minimum solution, the authors of the study proposed a standard form of contract containing a title retention clause.[60]

VII. SOME INFERENCES DRAWN FROM ACCUMULATED EXPERIENCE

1. The inadequacy of the *lex situs* choice of law rule

The existence of the conventions, proposals for conventions, studies and modern reformulations of conflict of laws rules noted above is convincing testimony as to the inadequacy of the *lex situs* as an appropriate choice of law rule for determining the validity and priority status of security interests in mobile equipment. Financiers who provide secured financing for the acquisition of mobile equipment require more legal predictability than that afforded by traditional conflict of laws rules applicable to interests in such equipment.

As noted in an earlier section of the study, the policy basis for choosing the *lex situs* of goods as the source of law to regulate issues of validity and priority of a security interest in goods is that "the physical location of a chattel constitutes an objective criterion, which is easily ascertainable, and the *lex situs* is the only law, the application of which people may reasonably be taken to expect. .... The *lex situs* is not only simpler and more convenient than any other to apply, but it is better suited to protect the interests both of the owner and of other parties".[61] However, it is clear that in the context of security interests in mobile equipment, the *lex situs* of the goods does not meet these objectives. The *situs* of the equipment at the time the security interest comes into existence will, in many cases, be either casual or fortuitous. For example, equipment may be bought from a supplier in State A by a buyer which has its place of business in State B, but which intends to use the equipment initially in State C and, thereafter, in other States where contracts can be made. The fact that the equipment was located in State A when the purchase was made is of little significance to the issues associated with validity and priority of the security interest that might arise in State B, State C or any other State where the equipment is used. In the case of a non-purchase money security interest, the fact that at the time that the security interest is created the equipment is temporarily in one State or another is completely fortuitous.

The most disruptive effects of a *lex situs* choice of law rule surfaces when the equipment is moved from one *situs* to another. Under the *lex situs* choice of law rule a new legal regime is introduced as soon as the *situs* of the equipment changes. It is only a matter of chance that the security interest created under the original *situs* will be given sufficient recognition in the new *situs* to ensure the economic efficacy of the security agreement between the debtor and the secured party. Associated with the *lex situs* choice of law rule is the tendency of courts of a second or subsequent *situs* to recognize foreign security interests created under a former *situs* only by analogy to familiar security interests created under the law of the forum or to subject foreign security agreements to public disclosure requirements designed for domestic security agreements. The result is that it is likely to be legally impossible or commercially impractical for the holder of a foreign security interest to count on having his security interest recognized in some jurisdictions to which his collateral has been taken by the debtor. Little is gained in an international context greater than that of a small regional area through efforts to secure a list of analogous or comparable types of security agreements constituted under municipal law as proposed in the EEC Fédération bancaire study. Even if agreement is secured among States as to the contents of the list, the agreement would have to be constantly changed and updated as new financing techniques are developed and as additional States become parties to the agreement. While the problem of loss of recognition or status for a security interest through

transposition could be eliminated through international acceptance of common forms of security interests for both domestic and international secured financing transactions as proposed in the UNCITRAL Report, it is most unlikely that such an agreement could be secured in the near future.

2. A more appropriate choice of law rule

The approach that is embodied in the statutory conflict of laws rules of North American jurisdictions and in the conventions on security interests in aircraft, ships and vessels addresses some of the more objectionable consequences associated with the use of the *lex situs* choice of law rule. Under this approach the law of registration of the equipment, in the case of aircraft and ships, or the location of the debtor, in the case of mobile equipment in North America and vessels in Europe, governs the validity, priority status and public disclosure of security interests in the equipment. The change of registration or change of location of the debtor results in a new law being applicable to interests in the equipment acquired after the change. However, the frequency with which this occurs is very small compared with the number of times that the *situs* of mobile equipment changes.(62)

Endemic to this approach are two features that might be viewed as troublesome to some States. The first of these features is that the approach involves the relinquishment of the power that a state otherwise has under the *lex situs* choice of law rule to prescribe priority rules to deal with conflicting claims of a person who acquired an interest in the equipment when it was located in that State and a secured party holding a security interest in the equipment constituted under the law of the place of registration or the location of the debtor. The second feature of this approach that may well be a source of objection is the fact that persons who acquire interests in the equipment may not appreciate the necessity to search the public records and determine the priority rules of a State other than that of the *situs* of the goods. In the case of very expensive mobile equipment such as aircraft, ships, vessels, containers, power units and trailers (lorries), oil drilling equipment and construction equipment neither of these features is likely to be a significant problem since the acquisition of interests in these types of equipment generally involves persons who will have available to them sophisticated legal advice as to what measures are necessary to protect their interests from the possibility of subordination to prior security interests. However, where other types of mobile equipment such as automobiles held as equipment(63) are involved, buyers and other secured creditors may not have the legal sophistication necessary to protect themselves.(64) Consequently, States may feel compelled to retain some control, either through municipal law or international agreement, over rules of priority and public disclosure of foreign security interests in order to provide protection to their nationals.

Regional international registries for security interests in certain types of equipment, such as motor vehicles, as proposed in the ECC Fédération bancaire study, may provide a solution to the need for public disclosure of foreign security interests in a form that is readily available to the general public of the States in the region. However, the creation and maintenance of such a registry would require the involvement of a supranational agency of some kind. In many parts of the world, it would be entirely unrealistic to contemplate establishing such an agency. An international system for the recognition of certificates of title to motor vehicles may provide another solution, but again, one that involves significant national bureaucracies.

3. Beyond national conflict of laws rules

There is general agreement among those who have undertaken studies focusing on the need for an improvement in the law relating to the international recognition of security interests in mobile equipment that new approaches must go beyond proposals for minor changes in conflict of laws rules of national legal systems. While aspects of an international system designed to provide a legally adequate basis for security interests in mobile equipment must involve national conflict of laws rules, the important changes that will be required are likely to be secured, if at all, through international agreement.

As a minimum, an internationally oriented approach to the recognition of foreign security interests should contain two elements. The first is a general acceptance of a different approach to the recognition of foreign security interests. The North American approach should be considered as a possible precedent. As noted above, the personal property security systems of many North American jurisdictions adopt a generic and not a *numerus clausus* definition of the transactions that fall within their scope. Article 9 of the U.S. Uniform Commercial Code and the Canadian Personal Property Security Acts apply to any transaction, without regard to its form, that involves the recognition that a person has a proprietary interest in movable property of another person in order to secure payment or performance of an obligation owing by the latter (or someone else) to the former.(65) The great merit in this approach is that it reduces dramatically the need for transposition, the fatal flaw in the current European systems. While it is unrealistic to expect States to reformulate their entire systems of law dealing with security interests in movable property, an undertaking to recognize all foreign generic security interests in mobile equipment would appear to be a *sine qua non* of a new international structure designed to accommodate modern mobile equipment financing. Agreement as to what constitutes a "security interest" in this context would be necessary.

The second basic element is the common acceptance of a workable choice of law rule. Here again the North American experience is instructive. While not without difficulties, the law of the location of the debtor appears to provide the necessary stability and predictability that is required in modern mobile equipment financing.(66) A corollary of this and the generic approach to the recognition of foreign security interests is agreement that when the debtor changes its location to another State or transfers its interest in the equipment to someone located in another State, that State will recognize the continuing validity of a security interest created under the law of the former location of the debtor whether or not it is of a type otherwise recognized by the municipal law of the State. The lack of such a provision in the Convention on the International Recognition of Rights in Aircraft, 1948 is seen as a major deficiency in that Convention.(67)

4. The need for substantive international law

As was noted above, the selection of a choice of law rule that does not result in the application of new law every time mobile equipment moves from one jurisdiction to another involves the implicit acceptance by a State where the equipment is *pro tempore* situated, of a set of priority rules and public notice requirements that might be thought unduly prejudicial to the persons who acquire interests in the equipment in that State. As is pointed out in the next section of this report, it is highly likely that some States will take

the position that either national or international measures will be required to address this issue. Should this be the case, an effective international system for the recognition of security interests in mobile equipment must make provision for a commonly accepted set of basic priority rules and for the registration of foreign security interests in registry systems of the *situs* of the equipment.

Any attempt to develop a set of internationally prescribed priority rules for foreign security interests will necessarily involve a difficult choice as to the approach to be applied to the task. One approach is to seek to accommodate in broad outline all of the basic priority rules of the various legal systems of the world. Even if it were possible, the product of this approach would be a crazy-quilt of rules that satisfies no one, least of all financiers and borrowers who have the greatest interest in a functional international system for the recognition of security interest in mobile equipment. Another approach is that employed in the development of the Convention on International Financial Leasing. This involves, as a first step, the identification of the legitimate needs of the parties to security agreements providing for security interests in mobile equipment and the interests of other persons, such as buyers and unsecured creditors who deal with the debtors in possession of mobile equipment, who are likely to be affected by prior security interests in the equipment. The next step is to develop a set of priority rules based on functional considerations including the provision of a commercially reasonable balance between these needs and interests. Since commercial convenience rather than the incorporation of municipal legal concepts would be the goal, the drafters of these rules would be free to incorporate rules dealing with matters such as a special priority for purchase-money security interests and the recognition of security interests in identifiable proceeds received by a debtor upon sale or other disposition of the equipment with or without the consent of the person holding a security interest in it. In this respect, the drafters might draw inspiration from the U.S. Uniform Commercial Code. This legislation is a product of a genuine attempt to draft commercial legislation that as much as possible breaks free from outmoded legal concepts and that reflects the contemporary needs of the commercial community. This aspect of Article 9 of the U.S. Uniform Commercial Code was recognized in the UNCITRAL Report described earlier in this study.[68]

A cursory examination of the current state of conflict of laws rules as they apply to the remedies of a secured party, other than the recovery of a judgment for an unpaid debt, and the rights of a debtor in the event of default by the debtor under a security agreement, will immediately suggest the necessity for an international agreement that will either provide consistent choice of law rules to determine the law governing such rights or a set of substantive rules dealing with default rights and remedies. Experience has demonstrated that little is to be gained by attempting to characterize these remedies and rights as contractual, proprietary[69] or, perhaps, procedural in nature. There are two overriding functional considerations in the determination as to what law or laws govern seizure, redemption and disposition of collateral in the form of mobile equipment. The first is whether the choice of one law over another will implement or frustrate the legitimate intentions of the parties as expressed in the security agreement. It must be assumed that the secured party calculated its costs and risks on the assumption that a predetermined law would apply in the event of default by the debtor. This is likely to be the law that governs the validity of the security interest or the law applicable to the contractual aspects of the security agreement. The second is whether or not it is reasonable to expect the State machinery of the *situs* of the equipment at the date that the secured party's remedies are exercised to facilitate enforcement of unfamiliar types of security agreements in accordance with foreign law.

VIII. POTENTIALLY TROUBLESOME AREAS AND POSSIBLE APPROACHES

1. *Nemo dat* or *la possession vaut titre*

Any undertaking to address in an international context an area that is as complex and multi-faceted as is the law regulating security interests in movables will encounter difficulties for which totally satisfactory solutions would appear to be unavailable. One of these may well be the law dealing with the relative priority positions of a secured creditor holding security interests in movable property and good faith buyers of that property. National legal systems often embody divergent approaches to the position of good faith buyers of goods subject to prior security interests. Under the law of some jurisdictions, particularly those which have common law traditions, the principle *nemo dat quod non habet* reigns almost supreme.[70] In other jurisdictions, including most continental western European nations, the principle *en fait de meubles, la possession vaut titre* holds sway.

The continental European approach is thought to be necessary in order to protect a good faith buyer[71] from suffering loss at the hands of the holder of a prior, undisclosed property interest in the goods acquired by the buyer. Clearly, however, the principle is a threat to the efficacy of non-possessory security interests in movables. By comparison, the common law approach reflects a very solicitous attitude toward property rights. The free flow of commerce dictates that undisclosed security interests should not be given priority over subsequent interests acquired for value and in good faith. Persons acquiring such interests must be given some reasonable method through which they can take prophylactic measures to avoid the unacceptable consequences of a strict application of the *nemo dat* principle.

It will be argued by supporters of the common law approach that it is the one that more readily facilitates the balancing of interests of secured parties and buyers. The personal property security systems of North American jurisdictions embody the most elaborate measures to provide this balance. Under these systems, persons who buy goods from sellers acting in the ordinary course of business take free from any security interest in the goods given by the seller.[72] In all other cases involving the sale of movables of significant value,[73] the *nemo dat* principle applies only when the security interest is registered (or deemed perfected without registration) or the goods are in the hands of the secured party. In this way, a potential buyer of the goods is given the ability to acquire information as to the existence of prior security interests in the goods and can take the necessary measures to protect himself, including refusal to buy the goods.

One of the obvious difficulties associated with this type of system is that very often full protection is not given to buyers. Under the North American systems, if buyers or subsequent secured parties are to protect themselves, they must be legally sophisticated enough to be aware of the necessity to identify the State in which the chief executive office of the owner-debtor in possession of the mobile equipment is located and to determine the priority rules and public notice requirements of that State. This may be considered not to be an unreasonably onerous requirement in situations where the type of equipment involved is such that the persons acquiring interests in it will almost inevitably be business corporations that have available to them the technical legal advice necessary to protect their interests. It would appear that the States which have ratified the Geneva Convention on the Registration of Inland Navigation Vessels, 1965 have concluded that their nationals

will not be unduly prejudiced by the fact that buyers or subsequent mortgagees of vessels are subject to the priority rules and disclosure requirements of the State where the owner is located.(74) Where, however, the mobile equipment is not of a kind that is customarily dealt with by large business enterprises, it might not be acceptable to some States to have the rights of persons who buy this equipment when it is located within their borders determined by the priority rules and registration requirements of the State where the owner-debtor is located.

Unless this apparent deficiency is addressed in an international agreement, a State that adopts the debtor location choice of law rule may well decide that it is necessary to retain the *possession vaut titre* rule at least for those situations in which the buyer of equipment is not likely to be legally sophisticated enough to appreciate the necessity to conduct a search of the public notice system of the State where the debtor is located. In any event, it will want to do so in cases where the State in which the debtor is located does not require the public disclosure of security interests in mobile equipment.(75)

There is another aspect to the problem of good faith buyer protection. Even if a State insists on having its own registration requirements for foreign security interests in some or all types of mobile equipment that come into its territory, it cannot escape the necessity of addressing the need to make the rules operate in a commercially reasonable way. Accordingly, it might be necessary to exempt from registration security interests in equipment that is only very temporarily in the territory of such State. Unless such exemption is granted, a secured party who is concerned to have complete protection will be forced to register in every such State, including States through which the equipment may be passing. In addition, most secured parties will assert that there is a need for a "grace period" after the equipment comes into a State before the protection afforded by registration in another State is lost. In these situations, the equipment will be in the territory of a State for a period of time during which there will be no record of its existence in the registry system of the State. For this period of time, buyers in States that do not accept the principle of *possession vaut titre* are subject to the *nemo dat* principle and run the risk of buying goods that are encumbered by an undisclosed security interest.(76) States which have long-standing traditions of buyer protection may find that this exposure period for buyers of mobile equipment unacceptable.

A superficially attractive solution to the problems associated with buyer protection is to leave the matter to municipal law. Each State would then be left to determine the extent to which it wishes to apply its domestic law to priority disputes between the holders of security interests in mobile equipment and buyers of the equipment who acquired their interests when the equipment was within the territory of that State. This approach, however, is not without major difficulties. These difficulties are a direct result of the fact that the approach involves the acceptance by that State of the *lex situs* as the law applicable to such priority disputes. Rather than having one choice of law rule for priority issues associated with security interests, there would be two such rules. Whether or not there is universal acceptance of a bifurcated choice of law system for security interests in mobile equipment, major difficulties will be encountered.

The types of problems that will be encountered are displayed in the following scenario. Assume that a security interest is taken in mobile equipment by SP1. The security interest is valid and has been registered under the law of State A, the State in which the debtor has

its chief executive offices. The debtor takes the equipment to State B and sells it to a buyer who acquires its interest for value and without actual notice of the security interest. Assume that under the law of State B the buyer acquires its interest in the equipment free from the prior security interest of SP1. Assume as well that the buyer gives a security interest in the equipment to SP2. So long as the equipment stays in State B, few legal problems will be encountered. However, since mobile equipment is involved, it is not unlikely that it will be kept permanently in State B. If it is taken to State A or to State C by the buyer, it will be important to both SP1 and SP2 to know whether or not State A or State C is prepared to recognize the buyer's title and SP2's security interest both of which were acquired under the law of State B. If either or both of them will not recognize the applicability of the law of State B to the sale between the original debtor and the buyer, SP2 faces a major element of uncertainty as to efficacy of its security interest in the equipment. SP2, who acquired a security interest the validity of which is governed by the law of State B, might reasonably expect that, because States A, B and C all accept the same choice of law rule for determining the validity of security interests in mobile equipment, when the equipment is taken to State A or C its security interest in it will be recognized as valid. However, since it has only a derivative interest arising under a transaction which, under the law of State A or State C, does not give to its debtor title to the equipment free from SP1's security interest, SP2's security interest would be treated as being subordinate to SP1's security interest, unless State A or State C accepted the bifurcated choice of law system of State A.

It would appear to be a less than adequate solution to accept an optional bifurcated choice of law structure under which the law of the location of the debtor governs the validity of security interests in mobile equipment and priority disputes involving subsequent security interests or rights acquired by unsecured creditors through seizure, but to leave to the *lex situs* priority disputes between security interests and the interests of good faith buyers. It is little consolation to SP1 that its security interest will be recognized as valid in States A, B and C, but will cease to have the priority initially afforded to it under the law of these States if the equipment is sold to a good faith buyer. In effect, the title to the equipment is "laundered" in such a sale with the result that SP1 not only loses priority over the buyer, but over other security interests in the equipment given by the buyer or by persons holding derivative titles from the buyer. By the same token it is little consolation to SP2 that its security interest will be recognized as valid in State B but not in State A or State C.

Should a solution to the problem of buyer protection be sought through international agreement, such an agreement might provide for separate treatment of security interests in types of equipment which, for the most part, are bought, sold or offered as security by commercial corporations, and types of equipment that are sold to legally unsophisticated buyers, such as automobiles, trucks (lorries) under a specified size and boats generally used as pleasure craft. Under this approach, the international agreement would make the law of the debtor's location applicable to the validity and priority status of security interests in all types of movable equipment, but would permit a State that is party to the agreement to impose public disclosure requirements, perhaps providing very short or no grace periods,[77] for security interests in those types of equipment that are generally sold to legally unsophisticated buyers.[78] The implicit priority rules associated with these requirements would not apply where the competing interest is other than that of a buyer. The public notice requirements of the location of the debtor would be the only ones

applicable to disputes involving other secured parties and execution creditors and to priority issues involving security interests in all other types of mobile equipment. An aspect of this approach would be to provide, as do some of the Canadian Personal Property Security Acts,[79] that where the law of the debtor's location does not provide a registration system (or a substitute) which meets specified minimum standards of accessibility and effectiveness, the *lex situs* governs the priority status of a security interest in all types of equipment sold to good faith buyers. The protection afforded by the *lex situs* in this respect might be extended to other secured parties and execution creditors.

2. The validity and priority status of security interests in bankruptcy proceedings

The failure of most attempts to secure international or regional uniformity or harmonization of national bankruptcy law[80] should convince even the most optimistic of internationalists that, if general harmonization of bankruptcy law is a prerequisite to or an integral part of a system for the international recognition of security interests in mobile equipment, further efforts to develop such a system would be a waste of time.[81] However, if the causes of this failure do not include significant disagreement as to the general priority status to be accorded to security interests in goods in the hands of bankrupts, there is no reason to be unduly pessimistic about the possibility of obtaining international agreement as to a common approach to the recognition of security interests in such goods in cases where debtors become bankrupt before the obligations secured are discharged.

Most experts agree that many of the difficulties associated with international recognition of bankruptcy proceedings arise out of the diversity among national laws as to the effect of bankruptcy beyond the borders of the State in which the bankruptcy proceedings have been invoked. A few States take the view that bankruptcy deprives the debtor of its legal capacity with the result that the bankruptcy is seen as having universal consequences. As a result, their law recognizes the validity of all foreign determinations, so long as these determinations have been made by courts having jurisdiction under the conflict of laws rules of the forum. Generally, this approach requires that bankruptcy proceedings be brought before courts of the domicile or principal establishment of the debtor. However, this approach is not followed by the great bulk of the nations of the world. More commonly, States take a territorial approach to bankruptcy. Under this approach, the effect of a bankruptcy determination is confined to the territory of the State where the bankruptcy proceedings are taken. Under this approach, recognition is confined to determinations made under the *lex situs* of the bankrupt's assets. A debtor or a creditor of a debtor can invoke bankruptcy proceedings in any State where its property is located. Some States borrow from both approaches. They recognize under prescribed circumstances the effect of foreign bankruptcy proceedings and they treat their bankruptcy law as having extra-territorial effect. The current situation was summed up in the Report of the Commission of the European Community:

> It follows from these differences that, outside the State in which it was given, a decision declaring a debtor bankrupt remains, in general, without effect or produces only limited effects until it has been rendered enforceable there.[82]

The issue as to whether or not bankruptcy determinations made by the courts of one State will be recognized by the courts of other States, while important to most aspects of

bankruptcy, is not central to the issue of recognition of security interests in movable property in bankruptcy proceedings, unless factors peculiar to bankruptcy law condition the decision as to whether or not a security interest will be recognized by the bankruptcy court.

Experts agree that under the bankruptcy law of most States, the validity of a security interest in movable property is determined under the law of the country in which the movables are situated at the time of bankruptcy.[83] This could be viewed as nothing more than an application of the basic *lex situs* rule to bankruptcy proceedings. On the surface, therefore, it might appear that a change in the choice of law rule from the *lex situs* to a rule that is more likely to reflect the realities of modern equipment financing practices and needs should create no major difficulties in the context of national bankruptcy systems of States which are party to the international agreement that brings about this change. However, matters are not so simple.

It is clear that the *lex situs* choice of law rule has special relevance in the context of some national bankruptcy systems. This is a product of the fact that most of these systems apply to any property of the debtor located in the forum at the date of bankruptcy. In such a situation, the bankruptcy law is part of the *lex situs*. This being the case, rules of bankruptcy may well have to be taken into consideration when determining whether or not a security interest is valid under the law of the forum. For example, the bankruptcy law of the United States extends to persons who have property in the United States, regardless of their nationality, domicile, residence or place of business.[84] While under state conflict of laws rules the validity of a security interest in mobile equipment is determined under the law of the location of the debtor, the United States Bankruptcy Code gives to the trustee a whole battery of powers which, under some circumstances, enable him to prevent the enforcement of or to invalidate completely security interests even though they are fully perfected and enforceable under the applicable state law.[85] In this context, it is clear that for certain purposes associated with United States bankruptcy law, the basic choice of law rule prescribed by the Uniform Commercial Code for determining the validity and priority status of security interests in mobile goods is displaced by a *lex situs* choice of law rule of bankruptcy law. While, of course, in the context of the United States law, federal bankruptcy law is also the law of each state, there is no reason to believe that a different approach would be taken with respect to a foreign security interest in goods that are situated in the United States at the date of the bankruptcy.

For the most part, the bankruptcy rules that affect the validity of security interests in mobile equipment are ones under which a trustee in bankruptcy is empowered to set aside security agreements that are viewed as being fraudulent as against general creditors or as having an unjustifiably preferential effect. The legislative policy underlying these rules is that secured transactions should not be used as a vehicle for the protection of the debtor's assets from the effect of bankruptcy proceedings or for the disruption of the basic policy of fair distribution of the bankrupt's assets among its unsecured creditors. In the great bulk of cases where these rules are invoked, the security interest under attack will have been taken when the collateral is in the forum. Even though the validity of the security interest may initially be determined under the law of some other jurisdiction, if that security interest was taken while the mobile goods were located in the bankruptcy forum, it may have the effect of withdrawing from the estate of the bankrupt, property that, under the law of the forum, should be made available for general distribution among creditors of the bankrupt.

The priority status of a security interest in property of a bankrupt will often be determined under the laws of the forum. The importance of this choice of law rule is noted in situations where the law of the forum provides for statutory liens or charges on the equipment that secure the payment of taxes or for preferential rights of certain types of creditors such as employees. Since the equipment is likely to have been used in the territory of the forum and, as a consequence, has become subject to the lien or charge, the State of the forum has a legitimate interest in ensuring that such liens or charges are recognized, both in the context of bankruptcy proceedings and otherwise.(86)

It is clear that any international agreement as to the law applicable to the validity and priority status of security interests in mobile equipment must take into account the *lex fori* of the equipment at the date of bankruptcy of the debtor to the extent that this law is designed to protect unsecured creditors of the bankrupt or to recognize preferential claims against equipment in the hands of debtors at the date of bankruptcy.(87)

There is a related feature of the bankruptcy law of some jurisdictions that presents an obstacle to efforts to obtain a system for the international recognition of security interests in mobile equipment that facilitates modern equipment financing practices. Under the laws of some States, contracts of sale with reservation of title are treated as invalid in bankruptcy because possession of the goods by the debtor has given an unjustified appearance of solvency. In other jurisdictions there are special statutory requirements that must be met by the seller if its right to reclaim the goods from the trustee in bankruptcy is to be recognized. The laws of these jurisdictions are peculiar in that they segregate title retention sales arrangements from other types of financing devices.

There can be little doubt that an international agreement providing for a system for the recognition of security interests in mobile property must provide a uniform approach to the issue of validity of title retention security devices in cases where the buyer has become bankrupt. This was recognized in the Report of the Commission of the European Community:

> The national bankruptcy laws are in radical opposition to each other with regard to the efficacy of clauses subordinating the transfer of ownership to payment in full of the price, included in contracts for the sale of goods.....
>
> The considerable development of sale of movable property on hire purchase or credit, in regard to which these clauses are most frequently encountered, as well as the economic advantages which certain laws attach to the full effectiveness of reservation of title in the event of bankruptcy, militate in favour of a unification of bankruptcy rules on this point since the conflict of laws solutions are uncertain and far too divergent on matters of substance.(88)

Notwithstanding the apparent need for a unified approach, the Working Party that prepared the draft EEC Convention was unable to reach any agreement with the result that it submitted three possible solutions from which a choice would be made by the Council.(89) It was noted in the Report, however, that the private international law solution set out in the draft Convention as one of the variants appeared to have been the most widely accepted.(90) Under this approach, the law applicable to the validity of the title retention clause as against the creditors of the purchaser would be the law of the State in which the object sold is situated at the time of the bankruptcy. This is currently the same choice of law rule that is applicable to the issue of validity of security interests in most movables.

While the particular choice of law rule set out in this variant would appear to be inappropriate in the context of mobile equipment, the application of a conflict of laws rule to the question of validity of security interests in movable property would appear to provide a more workable, consistent approach in an international context to the issue of validity of title retention sale arrangements whether the competing claim is that of an execution creditor or the trustee in bankruptcy of the buyer. This measure would involve legal recognition of the practical reality that these types of arrangements are security agreements and should be treated as other forms of security agreements at least for the purpose of determining the law applicable to them. Under this approach, the validity of an interest arising out of a title retention sales arrangement, along with the validity of other types of security interest, would be determined, for example, under the law of the location of the debtor at the time that the contract is entered into.(91) However, as noted above, the continued validity or priority position of the interest of the seller could still be affected by the bankruptcy law of the *situs* of the goods at the date of the invocation of bankruptcy proceedings. But bankruptcy law would not single out title retention sales arrangements for separate treatment.

3. Security interests in accessories

Given the nature of modern mobile equipment, there will be cases in which an item that is subject to a security interest held by one secured party is affixed to equipment which is subject to a security interest held by another secured party. Under the law of some States, when an item of movable property is affixed to other movable property, the item loses its separate existence and property in it vests in the owner of the movable property to which it is attached. Under the law of other jurisdictions, the separate legal existence of the item is maintained, at least for the purposes of permitting the recognition of a security interest in it. In situations of this kind, a number of characterization and choice of law problems arise. It is necessary to determine the law applicable to (i) the issue whether or not the item loses its separate legal existence when it is affixed, (ii) the characterization of the item as mobile equipment or as an ordinary movable, (iii) the validity and efficacy of a security interest in the item, and (iv) the law applicable to cases where the holder of the security interest in the item is in conflict with someone who has bought, seized in execution or taken a security interest in the item and the equipment to which it is attached.

In this context, the goal of an international agreement should be to facilitate the recognition of separate security interests in accessories.(92) However, in so doing it must ensure that persons who acquire interests in the equipment and accessories as a unit are not forced to treat the equipment and accessory as separate items for the purpose of determining the priority rules and public notice requirements that affect their legal position.

IX. FINDINGS AND CONCLUSIONS

1. A caveat with respect to the findings and conclusions

The purpose of this study has been to test the validity of the assumptions set out under the heading: **III. FOCUS OF THE STUDY** *supra*. Since the information accumulated in the

course of carrying out the study cannot be measured and assessed with scientific accuracy, inevitably the conclusion as to whether or not it establishes the validity of the assumptions will be a matter of opinion. In the following paragraphs of this study, the author has summarized his conclusions and those of the responding experts with respect to each of the assumptions.

It is clear that a major weakness in this report is the general lack of empirical information (testimonials from financing organizations and owners of mobile equipment) as to the need for a convention dealing with the international recognition of security interests in mobile equipment. Further investigations with respect to this information might be necessary. However, it is relevant to note that the support for preliminary work in this area that was expressed by the experts who responded cannot be viewed as representing only academic interest in the issues involved. Many of these experts act as advisors and consultants to financiers and equipment owners and, as such, are acutely aware of the problems that are encountered when it is important to secure international recognition of security interests in mobile equipment.

2. The expert respondents

Responses to the letter of inquiry were received from the following experts:

Professor Michael Bogdan, Lunds Universitet, Lund.

Professor Aubrey Diamond, Faculty of Law, Notre Dame University, London.

Professor Ulrich Drobnig, Max-Planck Institut für ausländisches und internationales Privatrecht, Hamburg.

Mr Alejandro Garro, Lecturer in Law, (Specialist in Latin American Law), Columbia University, New York.

Professeur Christian Gavalda, Professeur à la Faculté de droit de Paris, Panthéon-Sorbonne, Paris.

Professor Boris Kozolchyk, Member of the United States Study Team for International Trade Law, University of Arizona College of Law, Tucson, Arizona.

Professor Charles Mooney Jr., The Law School, University of Pennsylvania, Philadelphia, Pennsylvania.

Professor Bernd Stauder, Professeur à la Faculté de droit de l'Université de Genève, Genève.

Professeur Jean Stoufflet, Professeur de droit et de sciences politiques, Université de Clermont, Clermont-Ferrand.

Professor Dr. Wolfgang Wiegand, University of Berne, Berne.

Professor Jacob S. Ziegel, Faculty of Law, University of Toronto, Toronto.

3. Assumption (i): that valuable mobile equipment subject to security interests taken under national law is moved across national frontiers.

As noted above, it was not possible to structure this study in such a way as to conduct interviews with users of mobile equipment in order to determine the kind of equipment that is used in more than one jurisdiction and the frequency with which equipment subject to security interests is taken across national frontiers. Consequently, no direct evidence upon which this assumption can be tested was acquired. However Professor Drobnig provided some empirical evidence as to the incidence of transborder legal disputes as indicated in the records of cases that he maintains. Professor Drobnig pointed out that:

> On the basis of decisions which I collected during the past ten years, I asked an assistant to analyse the fact patterns and the legal issues involved in the trans-boundary situations. This survey is based upon 42 cases (11 Dutch, 6 German, 5 French, 4 Italian, 3 each from Austria, Denmark and Scotland, 2 each from the USA and Switzerland and 1 each from Belgium, Canada, and Ireland). All cases are truly international, and not inter-state or inter-provincial. Of course this is still a somewhat accidental selection but the total number and the geographical spread may allow some generalised conclusions... .
>
> The biggest group and the one which comes closest to mobile equipment are automobiles which were collateral in 13 cases; but of these, only 5 dealt with trucks; 5 others with private cars.
>
> Other major items in my sample were: "other" means of transportation - 2; machines and equipment - 7... .

Professor Gavalda gave a contemporary example of a situation in which international recognition of security interests in mobile equipment is a matter of commercial importance:

> Les difficultés rencontrées à cet égard pour l'édification du tunnel sous la Manche sont un bon exemple de l'utilité d'une telle Convention... .

4. Assumption (ii): that, for the most part, the laws, including conflict of laws rules, of most nations that deal with security interests in movables are inadequate in that they do not provide sufficient flexibility, predictability or fairness between foreign security interests and domestic interests in mobile equipment.

A significant portion of this report has been devoted to an assessment of the conflict of laws rules of Western European and North American jurisdictions. It is the opinion of the author that, for the most part, these rules are inadequate to meet the needs of those who engage in modern financing transactions involving collateral in the form of mobile equipment. It would not be inaccurate to conclude that the conflict of laws rules of most States were never designed to address these needs. They were developed at a time when the movement of goods of significant value from one State to another was not common.

The *lex situs* choice of law rule which is applied by most jurisdictions is inadequate,

even under optimum conditions. The *situs* of mobile equipment is often casual or fortuitous. This being the case, there is no particulary good reason to choose the law of the *situs* of the equipment at the date a security interest is created as that which governs the initial validity of a security interest. It is often stated that the principal role of the *lex situs* choice of law rule is to provide protection to persons who acquire rights in movables after the movables have been taken from their original *situs*. Too often, however, protection of such persons is secured through refusal to recognize the validity of a security interest created under the original *situs* rather than through legal mechanisms that facilitate both recognition of foreign security interests and protection of persons who acquire interests in the equipment under domestic law. The need for a different approach to the recognition of security interests in mobile equipment has been addressed in the context of aircraft, ships and inland vessels through international agreements that displace the *lex situs* choice of law rule.

Several North American jurisdictions have adopted conflict of laws rules designed to accommodate modern business financing practices. While not without difficulties of their own, these rules do overcome some of the more objectionable features of the more traditional approaches used elsewhere. These rules were developed as part of a radically new approach to all aspects of personal property security law of those jurisdictions. While it is unrealistic to expect other nations to effect fundamental, sweeping changes in their national laws dealing with security interests in movables, some of the principles and approaches contained in the North American systems as they affect security interests in mobile equipment might serve as a source of inspiration for changes that could be brought about through an international agreement among States.

5. Assumption (iii): that because of the difficulties encountered, financing organizations are less willing to provide financing for high cost mobile equipment than would be the case if the incidence and severity of such difficulties were reduced as a result of the implementation of new, internationally accepted rules dealing with international aspects of security interests in mobile equipment.

As was noted above, the design of this study and the time available to carry it out did not permit interviews with representatives of financing institutions or users of mobile equipment. One may well conclude that until financing organizations affirm that an improvement in the international legal environment for secured financing of equipment is necessary in order to facilitate financing of mobile equipment, a decision to proceed further with a project in this area should be withheld. However, the general support of the expert respondents for a project to address the international recognition of security interests in mobile equipment is some evidence that, in their opinion, the general inadequacy of current law in this area affects the willingness of financing organizations to provide secured credit to purchasers or owners of mobile equipment.

6. Assumption (iv): that the problems of providing the necessary flexibility and balance can be adequately addressed through a Unidroit convention.

It is the opinion of the author that the need for a new international regime for the recognition of security interests in mobile equipment can be met without the necessity to

develop a complete code of international secured transactions law and without the necessity to ask States to make fundamental or sweeping changes to their municipal law. It is most unlikely, however, that anything short of an international agreement can provide a legal framework within which financing of high-value, mobile equipment can efficiently function. A convention appears to be the only acceptable vehicle through which to bring about the necessary changes to existing national laws.

The range of issues that would be addressed in such a convention were discussed in detail earlier in this report. These include a change in the choice of law rule for determining the law applicable to the validity of security interests in mobile equipment and recognition of foreign security interests on the basis of generic characterization. The convention would most likely have to contain a system of substantive *inter partes* rules, priority rules and accompanying public disclosure requirements drawn in part from the applicable law, in part from the *lex situs* and in part prescribed by the convention. While such a convention would have to be more extensive than any existing international convention dealing with security interests in movable property, there is no reason to think that it must be so complex and intrusive as to be unacceptable to a significant number of States.

7. Assumption (v): that there is support among international experts in this area of the law for the undertaking by Unidroit of an initiative designed to lead ultimately to a draft convention on certain aspects of security interests in mobile equipment.

While most of the respondents questioned aspects of the detailed proposal contained in Appendix A, only one of the respondents, Professor Ziegel, questioned the need for an international convention in this area of the law. The following is a sampling of the expressions of support for further work in this area.

Professor Bogdan: "I find the idea of a Unidroit convention regarding international aspects of security interests in mobile equipment very interesting and support it fully."

Mr Garro: "Whether or not the Latin American countries would be interested in this convention is not likely to be determined by the possible obstacles posed by national law... It is precisely because of the lack of accommodation of domestic laws to deal with these issues that I find a commercial need with international aspects of mobile equipment."

Professor Gavalda: "En l'état de division des législations d'inspiration anglo-saxonne et continentale, les multiples déplacements dans les grands chantiers internationaux de matériel de plus en plus coûteux appellent à coup sûr une convention sûr cette thème, qui mérite donc l'attention d'Unidroit."

Professor Kozolchyk stated: "I think it is a feasible undertaking. I think that there is a need for a convention in the chosen area, particularly with the increasing use of electronic documentation in an indisputably global financial marketplace."

Professor Mooney: "My general view is that the proposed study is an excellent project and probably long overdue."

Professor Stauder: "The (Swiss) Ministry of Justice is favourable to the Canadian initiative and will look forward to finding an expert to help you to draft your report."

Professor Stoufflet: "*Utilité de la Convention*. Cette utilité me paraît certaine. Les quelques contacts que j'ai pris avec des praticiens du commerce international ont fait apparaître une réaction favorable. Je mentionnerais dans le même sens l'expérience qui a été faite avec le financement du tunnel trans-Manche (EUROTUNNEL). L'affectation en garantie des équipements des sociétés concessionnaires (matériel ferroviaire ...) aurait été notablement facilitée par une Convention internationale."

Professor Wiegand: "I agree with the main points of the argumentation described under this title [**The Need for a Convention**]. Especially for construction corporations as well as for financiers the uncertainty of the legal situation would be avoided. It might have the effect of promoting more flexibility and competition. All that, however, depends upon whether it is possible to find a clear definition of the goods to which the proposed Convention would apply."

NOTES

(1) Works published in English predominate.

(2) North and Fawcett, *Cheshire and North's Private International Law*, 11th ed. (London: Butterworths Ltd., 1987), p. 791; Rabel, *The Conflict of Laws: A Comparative Study*, (Ann Arbor: University of Michigan, 1958), Vol. 4, p. 30 *et seq.*; Lalive, *The Transfer of Chattels in the Conflict of Laws*, (Oxford: The Clarendon Press, 1955), esp. pp. 88-99. For some unimportant exceptions to this rule, see Lalive, pp. 99-102.

(3) Rabel, *supra* note 2, at pp. 60-64.

(4) Lalive, *supra* note 2, pp. 114-115.

(5) See e.g. Rabel, *supra* note 2, pp. 70-73, 76-78, 86 *et seq.* A possible exception to the basic rule that movables are subject to the laws of the new *situs* exists where the goods are being transported through State B and, consequently, are within the borders of that state for only a very short period of time. See North and Fawcett, *Cheshire and North's Private International Law*, *supra* note 2, at pp. 800-801.

(6) Shilling, "Some European Decisions on Non-possessory Security Rights in Private International Law" (1985), 34 International and Comparative Law Quarterly 87.

(7) See Morris, *Dicey and Morris on the Conflict of Laws*, 10th ed. (London: Stevens & Sons Ltd., 1980), Vol. 2, Rule 80, p. 562; Castel, *Canadian Conflict of Laws*, (Toronto: Butterworths Ltd., 1986), pp. 414-415.

(8) "The question asked by common lawyers is rather the question of which law governs the transfer of encumbered movables or their seizure on behalf of creditors. The latter question implies that the mere change of *situs* does not change the law governing the *jura in rem* in chattels but only the law applicable to a possible transfer or seizure of the chattel... . In contrast, it is the near-unanimous continental view that a change of *situs* is sufficient to bring about immediately a change of the law applicable to the *jura in rem* themselves." See Schilling, *supra* note 6 at 93.

(9) *Ibid.* Professor Rabel optimistically states: "That the present situs should not recognize foreign-created rights when their kind is unknown to the forum, is untenable as a general proposition." See *supra* note 2 at 72-73.

(10) See Venturini, "Property", Vol III, Private International Law, *International Encyclopedia of Comparative Law*, Chap. 21, p. 32.

(11) In *The Colorado* [1923] P. 102, the issue before the court was the efficacy of a French hypothèque on a ship. The hypothèque is unknown to English law; however, this did not result in a refusal to recognize it. The court referred to French law to ascertain its contents and decided that its nearest English counterpart was a maritime lien. The competing claim was by English necessaries men. The court held that the holder of the French security had priority because in English law necessaries men were postponed to maritime lienors, notwithstanding that in French law necessaries men had priority over hypothèques.

(12) Shilling, *supra* note 6, pp. 97-98.

(13) *Ibid.* p. 98.

(14) *Ibid.* at pp. 98-104. See Rabel, *supra* note 2, p. 73.

(15) For a brief examination of the European case law dealing with transposition, see *Report of the Secretary-General: Study on Security Interests*, Yearbook of the United Nations Commission on International Trade Law, 1977, Vol. VIII, Part Two, 171, pp. 213-216 (prepared by Professor Ulrich Drobnig of the Max-Planck Institute for Foreign and Private International Law). See also Shilling, *supra* note 6 *passim*.

(16) See Barron and O'Brien, *Chattel Mortgages and Bills of Sale*, 2d ed. (Toronto: Canada Law Book Co. Ltd.), 1914, pp. 104-106; Lalive, *supra* note 2, pp. 169-170.

(17) A "great majority" of American courts concluded that if the movable was taken to another jurisdiction without the consent of the secured party, the law of the second *situs* does not displace the *in rem* rights of the secured party acquired under the first *situs*. This rule was included in the American Restatement of Conflict of Laws (1934), s. 273. See Rabel, *supra* note 2, pp. 92-94. See also Lalive, *supra* note 2, pp. 175-184. This approach was never accepted in Canada.

(18) See An Act to amend the Bills of Sale Ordinance, 1908, Statutes of Saskatchewan, 1908, chapter 25. This legislation was enacted in response to the court rulings that a foreign chattel mortgage was valid in Saskatchewan without registration because the Bills of Sale Act applied only to domestic chattel mortgages. See *supra* note 16 and accompanying text.

(19) Statute of Nova Scotia 1909, c.10.

(20) Uniform Bills of Sale Act 1928, sec. 13, prepared by the Conference of Commissioners on Uniformity of Legislation in Canada.

(21) Uniform Conditional Sales Act, 1947, sec. 7.

(22) Uniform Conditional Sales Act, s. 14, Uniform Laws Annotated, Book 2A.

(23) The Canadian Uniform Conditional Sales Act, (1962 Consolidation) (s. 1(f)) and the U.S. Uniform Conditional Sale Act (s.1) defined the term "conditional sale" to include a lease or hiring contract under which it is agreed that the hirer will become or have the option of becoming the owner of the goods on compliance with the terms of the contract. The Canadian Uniform Bills of Sale Act (1962 Consolidation) (s. 1(h)) defined the term "mortgage" to include "an assignment, transfer, conveyance, declaration of trust without transfer, or an assurance of chattels, intended to operate as a mortgage or pledge, or a power or authority or licence to take possession of chattels as security, or an agreement, whether or not intended to be followed by the execution of any other instrument, by which a right in equity to charge or security on chattels is conferred ...".

(24) This approach could be very hard on a legally unsophisticated buyer who proceeded on the assumption that the information contained in the registry of its jurisdiction could be relied upon when making the assessment as to whether there was a risk that the goods being offered to it were encumbered by a security interest. One American expert describes this aspect of the systems as "nothing short of madness". See Weintraub, *Commentary on the Conflict of Laws*, 2d ed. (Mineola N.Y.: Foundation Press, 1980), p. 475.

(25) See generally, Juenger, "Nonpossessory Security Interests in American Conflicts Law" (1978), 26 The American Journal of Comparative Law 145.

(26) See e.g. Weintraub, *supra* note 24 at pp. 465-472.

(27) See U.C.C. Art. 1-105(1).

(28) The term "perfection" is used in the U.C.C. to denote a status for a security interest that gives it priority over unsecured creditors and the trustee in bankruptcy of the debtor. See Gilmore, *Security in Personal Property*, (Boston: Little, Brown & Co., 1965), Vol. 1 at pp. 435-437.

(29) 1962 Official Text Art. 9-103(3); 1972 Official Text Art. 9-103(1)(c).

(30) Since the United States is party to the Convention on the International Recognition of Rights in Aircraft, 1948, to the extent that there is any conflict between the Convention and Article 9, the Convention prevails (U.C.C. Art. 9-302(3)).

(31) Art. 9-103(3)(c). If the debtor is located in a jurisdiction which is not part of the United States and which does not provide for perfection of the security interest by filing or recording, perfection issues are determined under the law of the jurisdiction in the United States where the debtor has its major executive office.

(32) Article 9-103(3)(e). Failure to perfect in the new jurisdiction makes the security interest vulnerable only to "a purchaser". This includes a buyer and another secured party, but not an unsecured creditor.

(33) See e.g. Personal Property Security Act, Revised Statutes of Ontario, 1980, c.375, s. 7.

(34) See e.g. Personal Property Security Act, Revised Statutes of Saskatchewan 1978, c. P-6.1, s. 5(2).

(35) *Ibid.*

(36) Personal Property Security Act, 1988, (Alberta), Bill 51, Third Session, 21st Legislature, 37 Eliz. II, s. 7(3) (Appendix C).

(37) *Ibid.* s. 7(4).

(38) Uniform Commercial Code Article 9-102(1); Personal Property Security Act, Revised Statutes of Saskatchewan, 1978, c. P-6.1, s. 3.

(39) Uniform Commercial Code Article 1-201(37); Personal Property Security Act, Revised Statutes of Saskatchewan, 1978, c. P-6.1, s. 2(nn).

(40) A security interest that arises by operation of law and not through agreement between the secured party and the debtor would not fall within the scope of these systems.

(41) In this context "validity" means creation; it does not encompass matters that are contractual in nature such as the *inter partes* enforcement of a security interest in the event of default by the debtor. See *supra* note 26 and the accompanying text. Section 8(4) of the Saskatchewan Personal Property Security Act provides that all substantive issues involved in the enforcement of the rights of a secured party against collateral are governed by the proper law of the contract between the secured party and the debtor.

(42) This generalization must be qualified, particularly with respect to jurisdictions that do not have certificate of title systems for motor vehicles. An automobile owned and used by a business organization is characterized as "equipment" under Article 9 of the Uniform Commercial Code and the Canadian Personal Property Security Acts. Should a business organization which has given a security interest in an automobile take the vehicle to another jurisdiction and offer it for sale, the buyer, whether he be a consumer or a used car dealer, must be aware of the need to search the registry of the jurisdiction where the seller has its chief executive office. However, as a practical matter, sales of this kind are usually made to used car dealers rather than consumers.

(43) This generalization could be attacked in the light of the fact that under most of these systems *renvoi* is involved. Accordingly, it is conceivable that the third party in State A will have to be legally sophisticated enough to be aware not only of the need to conduct a registry search in State B, but also of the need to determine whether or not under the conflict of laws rules of State B it is the law of another State that determines priority rights and public notice requirements.

(44) It might be argued that the approach dictated by this legislation involves a return to the principle of *mobilia sequuntur personam* that at one time was favoured by the common law over the *lex situs* rule as a source of law for addressing issues involving transactions in movable property. See Lalive, *supra* note 2 at p. 40 *et seq.* However, it would be a mistake to assume that the legislation is based on any doctrinaire or theoretical approach to the problems that arise in connection with security interests in

mobile equipment. Rather, it is the result of a very pragmatic decision based on extensive experimentation with a variety of approaches over a long period of time. This experimentation demonstrated the inadequacy of the *lex situs* rule to address priority problems in cases where mobile equipment is involved and the need for a rule that provides a better balance between the needs of modern secured financiers and persons who acquire interests in equipment in the possession of owner-debtors.

(45) *Uniform Commercial Code, 1978 Official Text*, Official Comment to Article 9-103, p. 637.

(46) The Convention also provides for the recognition of registered "rights of property in aircraft, rights to acquire aircraft by purchase coupled with possession of the aircraft and rights to possession of aircraft under a lease of six months or more" (Art. 1(1)(a)-(c)).

(47) This feature of the Convention puts in jeopardy security interests in aircraft when ownership of the aircraft is transferred from a national of one country to a national of another country that has a very different domestic law regulating security interests in aircraft. See Sundberg, "Rights in Aircraft, A Nordic Lawyer Looks at Security in Aircraft" (1983), Annals of Air and Space Law, Vol. VIII, 233 at pp. 238-239.

(48) To the extent that "spare parts" includes aircraft engines, Article 10(1)-(2) may well be obsolete. The system of Article 10 requires that a security interest in spare parts be an extension of, and be recorded as, part of the recorded security interest in an aircraft. It is now very common to have jet engines financed separately from aircraft. This feature of modern aircraft financing is recognized in the Convention on International Financial Leasing, 1988 which provides that the law applicable to the registration of leases of aircraft is the State where the aircraft is registered and the law applicable to the registration of leases of aircraft engines is the State in which the lessee has its principal place of business (Art. 7(3)).

(49) See Wood, *Law and Practice of International Finance* (London: Sweet & Maxwell, 1980), pp. 382-383.

(50) Hereafter, the term "vessel" is treated as having the extended meaning given to it in the Geneva Convention on the Registration of Inland Navigation Vessels, 1965.

(51) See Yearbook of the United Nations Commission on International Trade Law, 1977, Vol. VIII, Part Two, p. 171.

(52) See Yearbook of the United Nations Commission on International Trade Law, 1979, Vol. X, Part Two, p. 81.

(53) See Yearbook of the United Nations Commission on International Trade Law, 1980, Vol. XI, Part Two, p. 89.

(54) *Ibid.* pp. 92 and 94.

(55) See Yearbook of the United Nations Commission on International Trade Law, 1980, Vol. XI, Part One, p. 11.

(56) *Ibid.* p. 10.

(57) Fédération bancaire de la Communauté Economique Européenne, Projet de Convention relative aux effets extraterritoriaux des sûretès mobilières sans dessaisissement, 1970, pp. 9-10.

(58) Council of Europe, European Committee on Legal Cooperation, *Hire Purchase and Credit Sale of Corporeal Moveable Objects in the Member States of the Council of Europe* (1968), p. 236.

(59) *Ibid.*, pp. 239-240

(60) *Ibid.*, pp. 61-63.

(61) Lalive, *supra* note 2, pp. 114-115.

(62) However, the problems presented in this context, if infrequent, are not insignificant. See *infra*.

(63) It is important to bear in mind that none of the systems of conflict of laws, conventions or proposals noted earlier in this study involve the application of this approach to sales of consumer goods. In all cases, equipment is involved. However, see *supra* note 42.

(64) The national representatives who participated in the elaboration of the Unidroit Convention on International Financial Leasing, 1988 apparently saw little difficulty in prescribing the lessee's place of business as the appropriate source of law for public disclosure requirements to the extent that such requirements affected priority determinations involving the rights of lessors in mobile equipment and the claims of the execution creditors or trustees in bankruptcy of lessees. However, since the Convention does not contain priority rules affecting the rights of buyers or secured parties who deal with lessees in possession of mobile equipment, it cannot be seen as an instance of international acceptance of the location of the debtor as a source of law for public disclosure requirements applicable to all types of priority disputes involving interests in leased mobile equipment.

(65) See *supra* V. 3(d).

(66) Such agreement would probably have to include a definition of "mobile equipment" thereby displacing the accepted conflict of laws rule under which the *lex situs* of moveable property governs the classification of property. See generally, Lalive, *supra* note 2, p. 14 *et seq.* Because of the specialized nature of the system involved, little room for doubt should be left as to what constitutes "mobile equipment".

(67) See *supra* note 47.

(68) See generally, Yearbook of the United Nations Commission on International Trade Law, 1977, Vol. VIII, Part Two, pp. 222-231; and 1980, Vol. XI, Part Two, pp. 91-95.

(69) See generally, Rabel, *supra* note 2, pp. 85-88; Note, "Determination of Law Governing Power of Redemption in Conditional Sales of Chattels" (1933-34) 43 Yale Law Journal 323; Gilmore, *supra* note 28, p. 1264 *et seq.;* Ziegel, "Conditional Sales and The Conflict of Laws" (1967) 45 Canadian Bar Review 284 at pp. 313-334.

(70) This generalization must be modified in one context. Under the statutory law of most common law jurisdictions, when a person who has acquired possession of goods or documents of title to goods under a sales agreement sells or pledges the goods to someone who takes possession of the goods in good faith and without notice of the seller's title, the transferee takes free from the original seller's title if the sale or pledge took place under circumstances in which the buyer in possession appeared to be acting as a mercantile agent. See generally, *Benjamin's Sale of Goods*, 8th ed. (London: Sweet & Maxwell, 1974) pp. 244-543. Accordingly, title retention security interests are vulnerable to defeat or subordination in cases of sales or pledges by buyers in possession. Canadian jurisdictions that treat title retention sales agreements as security agreements governed by Personal Property Security Acts have in effect abolished this exception to the *nemo dat* principle. See e.g. The Sale of Goods Acts, Revised Statutes of Saskatchewan, 1978, c. S-1, s. 4 which provides that the "buyer in possession" exception to the *nemo dat* principle does not apply to a sale, pledge or other disposition of goods or documents of titles to goods by a person who has obtained possession of the goods pursuant to a security agreement under which the seller has a security interest as defined in The Personal Property Security Act.

(71) As is the case with the statutory modification to *nemo dat* found in Common Law jurisdictions, the *possession vaut titre* principle extends to pledges as well as sales.

(72) See e.g. Uniform Commercial Code Article 9-307; Saskatchewan Personal Property Security Act, *supra* note 34, s. 30(1). It is to be noted that the protection does not extend to deny priority to security interests given by someone other than a seller. Accordingly, a buyer in the ordinary course of business would take subject to a security interest given by the person from whom the seller bought the goods, unless the first seller was also acting in the ordinary course of business when he sold the goods.

(73) The Saskatchewan Personal Property Security Act, *supra* note 34, protects good faith buyers of consumer goods of a value less than $500 from the effects of registered security interests even though the goods are bought from someone selling other than in the ordinary course of business. See s. 30(2).

(74) See *supra* IV. 4.

(75) Some Canadian jurisdictions require registration under the *lex situs* in such situations. See *supra* note 36 and accompanying text.

(76) This problem is encountered even in situations where the State is prepared to accept the registration requirements of the State where the debtor is located. In these situations there is a need for a grace period to run from the time the debtor changes its location to a new State. Under Article 9-103(3)(e) of the Uniform Commercial Code, the law of the location of the debtor governs the priority position of a security interest in mobile equipment. However, when the debtor changes its location, the security interest remains perfected for a period of four months after the change even though the chances are significant that a buyer who acquires its interest during that four month period is unable to discover the existence of the security interest through a search of the registry in the new location. Execution creditors who seize the goods after the change of the location of the debtor receive no special consideration. They take subject to the foreign security interest even though it is never registered in the new location of the debtor.

Under the Alberta Personal Property Security Act the change of location of the debtor or the transfer of the debtor's interest in the collateral to someone in another jurisdiction invokes the necessity to reperfect within a specified period of time. The period is the shorter of 60 days from the date that the debtor changes its location, 15 days from the date the secured party discovers that this has occurred or the expiry of perfection under the original *situs*. Failure to reperfect in the new location results in the security interest becoming unperfected and not just subordinated to purchasers. See *supra* note 36.

(77) Under the Saskatchewan Personal Property Security Act, *supra* note 34, there is no grace period for the registration of foreign security interests in consumer goods where the goods have been sold to a good faith buyer. See section 5(2).

(78) As noted above, the common law exception to *nemo dat* and the European principle of *possession vaut titre* extend to pledges as well as to sales of goods. Theoretically this presents a major difficulty. However, from a practical point of view it is of little concern since mobile equipment is generally not taken in pledge.

(79) See *supra* note 36.

(80) For a list of bilateral and trilateral European bankruptcy treaties as well as proposals for multilateral conventions designed to address some of the more difficult problems in this area of the law, see Bulletin of the European Communities, "Bankruptcy, winding-up, arrangements, compositions and similar proceedings, Draft Convention and Report" Supplement 2/82, p. 49.

(81) The apparent failure of the proposal of the Commission of the European Communities for a European Economic Community Convention on Bankruptcy, Winding-up, Arrangements, Compositions and Similar Proceedings, 1982, *supra* note 80, is the most recent and, perhaps, the most dramatic demonstration of the intractability of the problems associated with international harmonization of bankruptcy law.

(82) *Supra* note 80 at p. 48.

(83) See Dicey and Morris on the Conflict of Laws 9th ed. (London: Stevens & Sons, 1973) p. 681; "Report on the draft Convention on bankruptcy, winding-up, arrangements, compositions and similar proceedings" *supra* note 80, pp. 97-98. Under Article 46 of the draft Convention, "the subject-matter, extent and ranking of secured rights ... shall be determined by the law of the Contracting State in which the property charged with such secured rights ... was situated when the bankruptcy was opened".

(84) 11 U.S.C.A. section 109(a).

(85) See e.g. 11 U.S.C.A. sections 362, 547 and 548.

(86) This would also be the case where the enforcement of the security interest (such as seizure and liquidation of the equipment) occurs in a State other than the one the law of which governs the validity of the security interest.

(87) It is relevant to note that while the draft European Communities Convention on Bankruptcy, Winding-up, Arrangements, Compositions and Similar Proceedings, 1982 adopts the principle that bankruptcy proceedings invoked in the centre of administration of the debtor have effect *ipso jure* in all Contracting States (Art. 2), unity had to be set aside when it came to the recognition and priority status of security interests and preferences. The "subject-matter, extent and ranking of secured rights and special rights of preference shall be determined by the law of the Contracting State in which the property charged with such a secured right or special right or preference was situated at the time when the bankruptcy was opened" (Art. 46). A similar rule is applied with respect to general preferences (Art. 45). However, "the ranking of secured rights over a ship or aircraft, such as hypothèques and mortgages, shall be determined by the law of the State in which the ship or aircraft is registered. [The same shall apply in the case of unregistrable special rights of preference and registered secured rights over an inland navigation vessel registered in a Contracting State..." (Art. 47, para. 2).]

(88) *Supra* note 80 at p. 55.

(89) See Article 41 of the draft European Communities Convention on Bankruptcy, Winding-up, Arrangements, Compositions and Similar Proceedings, 1982, *supra* note 80.

(90) *Supra* note 80 at p. 89.

(91) This approach appears to work well in the context of North American jurisdictions under the law of which title retention sales agreements are treated as security agreement providing for security interests. The law applicable to the validity of such security interests is the same as that applicable to any type of security interest in movables. See Uniform Commercial Code, Article 9-102(2) (which treats the interest of a seller under a conditional sales contract as a security interest and, therefore, one governed by Article 9-103 which prescribes the law of the location of the debtor as the law applicable to the priority status of a security interest in mobile equipment). See also Alberta Personal Property Security Act *supra* note 36, sections 3(1)(b) and 7.

(92) Article 7 of the Unidroit Convention on International Financial Leasing prescribes one choice of law rule (State of registration) for public notice requirements

applicable to lessors' interests in aircraft and a different choice of law rule (State of principal place of business of the lessee) for public notice requirements applicable to lessors' interests in aircraft engines (see Article 7(3)(b)-(c)). However, this approach reflects practices in the aircraft industry. Aircraft engines are not treated as an integral part of a modern aircraft. They are readily and frequently removed and replaced. They are often financed or leased separately from aircraft by finance or leasing organizations that do not have interests in the aircraft to which the engines are attached. This feature of the aircraft industry is not accommodated by the Geneva Convention on the International Recognition of Rights in Aircraft, 1948 which does not provide for the recognition of interests in engines other than as a part of an aircraft. See *supra* note 48.

APPENDIX A

SOME TENTATIVE CONCLUSIONS RELATING TO A PROPOSED UNIDROIT CONVENTION ON INTERNATIONAL ASPECTS OF SECURITY INTERESTS IN MOBILE EQUIPMENT

[It is to be noted that the conclusions set out herein are very tentative only and are designed to facilitate response from experts who have been consulted in the process of this study. Each conclusion will be assessed in the light of the empirical evidence and expert advice obtained in the course of carrying out the study. Respondents are invited to comment on the proposed structure set out below and the assumptions underlying it.]

The Need for a Convention

The need for a convention in this area arises out of the fact that high-cost mobile equipment is frequently used in a State other than the one in which it is acquired or in which the owner of the equipment has its principal place of business. Examples of this type of equipment are oil drilling equipment, shipping containers, large trucks (lorries), railway cars, road construction equipment and building construction equipment. Because of the large capital expenditure needed to acquire this type of equipment, the purchase of it is frequently financed under an agreement that provides to the financier a security interest in it. In other situations security interests are taken in the equipment by financiers that provide general financing for the business activities of the owners of the equipment.

These security interests are most likely to be constituted according to the law of the State where the secured party and debtor carry on business or the law where the goods are situated at the time the security interest is created. The value of the security interest as a mechanism for protecting the position of the financier will be greatly affected by the extent to which the law of the State to which the equipment is taken by the debtor recognizes the efficacy of the security interest and its priority over interests acquired in the equipment while it is located in that State.

The existence of an international convention under which the Contracting States undertake to recognize the validity and enforceability of security interests in equipment brought within their territories should have an important, positive effect on the availability of credit to owners of equipment. In addition, it should encourage service and construction corporations that now carry on business within boundaries of a single State to offer their services, equipment and expertise in other States that are parties to the convention. It might be expected that this will result in greater competition for major construction contracts in developed countries and increase the supply of technical expertise and sophisticated equipment for construction projects in developing countries.

The Types of Goods to Which the Proposed Convention Would Apply

The proposed convention would apply to security interests in "mobile equipment" only. The term "equipment" in this context is used to describe the use to which the goods are being put by the debtor. It is not a generic description of a type of goods. Accordingly, oil drilling equipment held for sale by the debtor would not fall within the scope of the proposed convention since it would be held by the debtor, not as equipment, but as inventory.

This definition would exclude most automobiles and small trucks (lorries), since they are most often held by debtors as consumer goods and not as equipment. However, because there are situations in which automobiles and small trucks (lorries) are held as equipment, it may be necessary to exclude from the scope of the proposed convention all automobiles and small trucks (lorries) including those held as equipment by the debtor. Any attempt to draw a distinction between vehicles held as equipment and vehicles held as consumer goods would be unworkable in an international convention. Further, any attempt to bring within the scope of the proposed convention automobiles and small trucks held as consumer goods would introduce issues of public policy that are likely to be the source of disagreement among nations.

The proposed convention would apply only to "mobile" equipment as that term is used in the Convention on International Financial Leasing. Article 7(3)(c) of the Convention refers to "equipment of a kind normally moved from one State to another...". The characterization of the equipment as mobile would depend on the type of equipment involved and not on the factual determination as to whether or not a particular piece of equipment has or has not been moved frequently from one State to another by the debtor.

The Types of Interests to Which the Proposed Convention Would Apply

The proposed convention would apply to "security interests" in mobile equipment. The term "security interest" would be defined in the proposed convention so as to encompass any type of non-possessory interest in the goods created by contract that has been taken or retained so as to secure performance of an obligation owing by the debtor or a third party to the secured party. This would include an interest arising by virtue of:

(a) a contractual transfer of title to the secured party,

(b) a contractual creation of a charge or hypothèque in favour of the secured party,

(c) a contractual reservation of title or ownership by the seller of the equipment,

(d) a hire-purchase contract under which the seller "leases" mobile equipment to a buyer who intends to purchase it,

(e) a lease of equipment which under the applicable law is characterized as a security agreement,

(f) a contractual privilege in favour of an unpaid seller.

Further study will be required in order to determine whether or not the definition of the term should be expanded to encompass a specific privilege in favour of an unpaid seller that arises by operation of law and continues after delivery of the equipment to the debtor, and that is effective against the execution creditors of the debtor or a holder of a security interest in the goods granted by the debtor.

The term would not include liens, charges, general privileges or other interests that arise by operation of law in favour of repairers, governmental agencies or creditors.

Issues Addressed in the Proposed Convention

The proposed convention would address recognition, certain priorities and *inter partes* rights when they arise in connection with any security interest in mobile equipment,

whether or not the equipment is moved from one Contracting State to another Contracting State. Consequently, it would apply where issues of validity, priority or post-default rights arise in State A with respect to:

(1) a security interest in mobile equipment located in State A but constituted under the law of State B when the equipment was located in State B or some other State that is party to the convention; and

(2) a security interest in mobile equipment located in State A given by a debtor which has its principal place of business in State B while the equipment was located in State A.

However, the proposed convention would not apply to any matters arising in State A and involving a security interest in mobile equipment located in State A and created by a debtor which has its principal place of business in that State. [Nevertheless, it is not unrealistic to assume that many countries would eventually adopt the regime of the proposed convention as part of their national law.]

The core of the proposed convention would be agreement on the part of the Contracting States that:

1. security interests constituted in accordance with a specified system of law (see *infra*) would be recognized as valid under the law of each Contracting State,

2. the priority position ascribed to a security interest by the proposed convention in relation to unsecured creditors and other secured parties with competing interests will be recognized in a Contracting State under specified conditions, and

3. the substantive post-default *inter partes* rights of the secured party and the debtor prescribed by the proposed convention but as provided by the law of the principal place of business of the debtor will be recognized in a Contracting State under specified conditions.

While the objective of the proposed convention would not be to create a supra-national security interest, it would have the effect of giving to a security interest falling within its scope and constituted under the specified law, characteristics that may be different from those ascribed to it under such law. In this respect the proposed convention would parallel the Convention on International Financial Leasing. Under this Convention, parties to financial leasing transactions created under national law are given legal rights and obligations that differ from rights and obligations ascribed by the applicable national law.

The Law to Applicable to Validity

The proposed convention would apply to security interests in mobile equipment constituted under the law of the principal place of business of the debtor. The effect of the proposed convention would be to displace the *lex situs* as the law applicable to validity of a security interest.

By definition, mobile equipment is property of a type that is likely to be moved across international boundaries several times during its useful life. Any *situs* it has at any particular time is likely to be temporary. The law of the debtor's principal place of business is the most appropriate in this context because it is less arbitrary and more likely to be the law that not only the parties to the transaction, but also third parties who deal with the debtor in possession of mobile equipment, would expect to govern the transaction.

A State that is party to the proposed convention would be obligated to recognize the validity of a security interest in mobile equipment constituted under the law of the debtor's principal place of business. This would be so even though the equipment is located in such State or some other State at the time that the security interest is executed. Recognition entails acceptance of any restrictions or limitations on the type of property that may be taken as collateral or on the type of debtor that may incur secured obligations. It would entail recognition of restrictions on the type of financier only if the financier happens to be located in the State where the debtor has its principal place of business.

However, the proposed convention would permit a Contracting State to refuse to recognize the validity of a security interest which is in contravention of the mandatory rules of such State.

Priorities

The priority status of a security interest in mobile equipment and in certain types of proceeds in relation to other interests in the equipment or proceeds would be set by substantive rules of the proposed convention and not by reference to the law of the principal place of business of the debtor.

-General Priorities

A security interest in mobile equipment constituted under the law of the debtor's principal place of business would have priority over:

(1) a subsequent execution creditor seizing or causing the seizure or attachment of the mobile equipment when it is located in a Contracting State,

(2) a subsequent, non-purchase money security interest taken in the mobile equipment when it is located in a Contracting State.

The priority position ascribed to a security interest by the proposed convention would be negatively affected by any explicit or implicit provision in the security agreement that provides otherwise. Accordingly, in the case of the English floating charge, the priority position given by the proposed convention would be subject to the requirement that the charge must have crystallized.

-Future Advances

Future advances contemplated by the original security agreement would be treated for priority purposes as having been made at the date that the security agreement was executed, except where they are made after the equipment is seized by an execution creditor and with knowledge on the part of the secured party that the seizure has been made.

-Purchase money security interests

A purchase money security interest falling within the scope of the proposed convention would have priority over a prior non-purchase money security interest taken in mobile equipment. The special priority for purchase money security interests would not depend upon recognition of this type of interest or any special priority attaching to it under the law of the principal place of business of the debtor. The existence of a security interest would be a matter determined under the law of the principal place of business of the debtor; whether or not it is a purchase money security interest, and if so, what priority position it

has, would be determined under rules prescribed by the proposed convention. For the purposes of this feature of the convention, a purchase money security interest would include a security interest retained or taken by the seller of the equipment to secure its purchase price or taken by a financier to secure a loan of money used to acquire an interest in the equipment.

-Proceeds

If the security agreement so provides, the priority position of a security interest in mobile equipment would extend to "identifiable" proceeds in the following forms only:

(1) monetary proceeds resulting from involuntary disposition of the equipment. This would include a right to insurance payments or other payments made to compensate for loss or damage to the equipment,

(2) monetary proceeds resulting from a voluntary disposition of the equipment,

(3) proceeds in the form of replacement equipment acquired by the debtor as a result of a disposition of the original equipment. A special rule would be included in the proposed convention to address a priority conflict between a proceeds and a non-proceeds purchase money security interest in equipment. [A security interest in replacement equipment would be recognized as original (i.e. non-proceeds) collateral if the security agreement contains an after-acquired property clause.]

-Conditions

The international obligation to recognize the above-noted priority structure would be conditional. A Contracting State would not be required to recognize these priorities if:

(1) the secured party has not complied with the applicable public notice requirements of law of the State where the debtor has its principal place of business, or

(2) the secured party has not complied with the public notice requirements of the law of the recognizing State within a specified period of time: (i) in the case of mobile equipment brought into the state (e.g. 120 days) from the date this occurs; (ii) in the case of mobile equipment that is located in the recognizing State when the security interest is created, within (e.g. 30 days) from the date the security interest arose; and, (iii) in the case of proceeds, within (e.g. 30 days) from the date that the proceeds come under the control of the debtor.

However, in order for this condition to apply, the law of the recognizing State must not contain impediments that would make compliance with its public notice requirements impossible or commercially impracticable. For example, if the laws of such State require that a security interest in goods must be registered within 20 days from the date that the goods are purchased, and precludes registration thereafter, condition (2) would not be applicable.

-Good Faith Buyers and Trustees in Bankruptcy

The proposed convention would not deal in any way with the priority position of the holder of a security interest in mobile equipment in relation to a buyer of the equipment or the debtor's trustee in bankruptcy. These matters would be determined in accordance with established rules of private international law.

Post-default Remedies of the Secured Party

A party to the proposed convention would agree to recognize the enforceability of a security interest in mobile equipment as provided in the law of the debtor's principal place of business. But this would be subject to the following conditions:

(1) recognition need not extend to remedies other than seizure and sale of the equipment by the secured party or someone appointed to act on behalf of the secured party. (Further study will be required in order to determine whether or not it is practical to extend this recognition to unusual enforcement measures such as the appointment of a receiver-manager.)

(2) all procedural matters associated with the seizure and sale of the equipment would be governed by the law of the State in which the equipment is seized and sold. The proposed convention would contain a non-exhaustive list of items that are to be treated as procedural.

Except to the extent not inconsistent with the public policy of the State in which the equipment is seized and sold, the nature and extent of the debtor's rights of redemption would be set by the law of the debtor's principal place of business.

APPENDIX B

THE UNIFORM COMMERCIAL CODE (U.S.A)
1978 Official Text

§ 9—103. Perfection of Security Interest in Multiple State Transactions

(1) Documents, instruments and ordinary goods.

(a) This subsection applies to documents and instruments and to goods other than those covered by a certificate of title described in subsection (2), mobile goods described in subsection (3), and minerals described in subsection (5).

(b) Except as otherwise provided in this subsection, perfection and the effect of perfection or non-perfection of a security interest in collateral are governed by the law of the jurisdiction where the collateral is when the last event occurs on which is based the assertion that the security interest is perfected or unperfected.

(c) If the parties to a transaction creating a purchase money security interest in goods in one jurisdiction understand at the time that the security interest attaches that the goods will be kept in another jurisdiction, then the law of the other jurisdiction governs the perfection and the effect of perfection or non-perfection of the security interest from the time it attaches until thirty days after the debtor receives possession of the goods and thereafter if the goods are taken to the other jurisdiction before the end of the thirty-day period.

(d) When collateral is brought into and kept in this state while subject to a security interest perfected under the law of the jurisdiction from which the collateral was removed, the security interest remains perfected, but if action is required by Part 3 of this Article to perfect the security interest,

(i) if the action is not taken before the expiration of the period of perfection in the other jurisdiction or the end of four months after the collateral is brought into this state, whichever period first expires, the security interest becomes unperfected at the end of that period and is thereafter deemed to have been unperfected as against a person who became a purchaser after removal;

(ii) if the action is taken before the expiration of the period specified in subparagraph (i), the security interest continues perfected thereafter;

(iii) for the purpose of priority over a buyer of consumer goods (subsection (2) of Section 9—307), the period of the effectiveness of a filing in the jurisdiction from which the collateral is removed is governed by the rules with respect to perfection in subparagraphs (i) and (ii).

(2) Certificate of title.

(a) This subsection applies to goods covered by a certificate of title issued under a statute of this state or of another jurisdiction under the law of which indication of a security interest on the certificate is required as a condition of perfection.

(b) Except as otherwise provided in this subsection, perfection and the effect of perfection or non-perfection of the security interest are governed by the law (including the conflict of laws rules) of the jurisdiction issuing the certificate until four months after the goods are removed from that jurisdiction and thereafter until the goods are registered in another jurisdiction, but in any event not beyond surrender of the certificate. After the expiration of that period, the goods are not covered by the certificate of title within the meaning of this section.

(c) Except with respect to the rights of a buyer described in the next paragraph, a security interest, perfected in another jurisdiction otherwise than by notation on a certificate of title, in goods brought into this state and thereafter covered by a certificate of title issued by this state is subject to the rules stated in paragraph (d) of subsection (1).

(d) If goods are brought into this state while a security interest therein is perfected in any manner under the law of the jurisdiction from which the goods are removed and a certificate of title is issued by this state and the certificate does not show that the goods are subject to the security interest or that they may be subject to security interests not shown on the certificate, the security interest is subordinate to the rights of a buyer of the goods who is not in the business of selling goods of that kind to the extent that he gives value and receives delivery of the goods after issuance of the certificate and without knowledge of the security interest.

(3) Accounts, general intangibles and mobile goods.

(a) This subsection applies to accounts (other than an account described in subsection (5) on minerals) and general intangibles (other than uncertificated securities) and to goods which are mobile and which are of a type normally used in more than one jurisdiction, such as motor vehicles, trailers, rolling stock, airplanes, shipping containers, road building and construction machinery and commercial harvesting machinery and the like, if the goods are equipment or are inventory leased or held for lease by the debtor to others, and are not covered by a certificate of title described in subsection (2).

(b) The law (including the conflict of laws rules) of the jurisdiction in which the debtor is located governs the perfection and the effect of perfection or non-perfection of the security interest.

(c) If, however, the debtor is located in a jurisdiction which is not a part of the United States, and which does not provide for perfection of the security interest by filing or recording in that jurisdiction, the law of the jurisdiction in the United States in which the debtor has its major executive office in the United States governs the perfection and the effect of perfection or non-perfection of the security interest through filing. In the alternative, if the debtor is located in a jurisdiction which is not a part of the United States or Canada and the collateral is accounts or general intangibles for money due or to become due, the security interest may be perfected by notification to the account debtor. As used in this paragraph, "United States" includes its territories and possessions and the Commonwealth of Puerto Rico.

(d) A debtor shall be deemed located at his place of business if he has one, at his chief executive office if he has more than one place of business, otherwise at his residence. If, however, the debtor is a foreign air carrier under the Federal Aviation Act of 1958, as amended, it shall be deemed located at the designated office of the agent upon whom service of process may be made on behalf of the foreign air carrier.

(e) A security interest perfected under the law of the jurisdiction of the location of the debtor is perfected until the expiration of four months after a change of the debtor's location to another jurisdiction, or until perfection would have ceased by the law of the first jurisdiction, whichever period first expires. Unless perfected in the new jurisdiction before the end of that period, it becomes unperfected thereafter and is deemed to have been unperfected as against a person who became a purchaser after the change.

APPENDIX C

THE ALBERTA (Canada) PERSONAL PROPERTY SECURITY ACT BILL 51, 1988

Applicable law- mobile goods, intangible, etc.

7. (1) For the purpose of this section, a debtor is deemed to be located

(a) at his place of business, if he has a place of business,

(b) at his chief executive office, if he has more than one place of business, and

(c) at his place of residence, if he has no place of business.

(2) The validity, perfection and effect of perfection or non-perfection of

(a) a security interest in

(i) an intangible, or

(ii) goods that are of a kind that are normally used in more than 1 jurisdiction, if the goods are equipment or inventory leased or held for lease by the debtor to others, and

(b) a non-possessory security interest in chattel paper, a security, a negotiable document of title, an instrument or money,

shall be governed by the law, including the conflict of laws rules, of the jurisdiction where the debtor is located at the time the security interest attaches.

(3) If the debtor relocates to another jurisdiction or transfers an interest in the collateral to a person located in another jurisdiction, a security interest perfected in accordance with the applicable law as provided in subsection (2) continues perfected in the Province if it is perfected in the other jurisdiction

(a) not later than 60 days after the day the debtor relocates or transfers an interest in the collateral to a person in the other jurisdiction,

(b) not later than 15 days after the day the secured party has knowledge that the debtor has relocated or has transferred an interest in the collateral to a person located in the other jurisdiction, or

(c) prior to the day that perfection ceases under the law of the first jurisdiction,

whichever is the earliest.

(4) If the law governing the perfection of a security interest referred to in subsection (2) or (3) does not provide for public registration or recording of the security interest or a notice relating to it, and the collateral is not in the possession of the secured party, the security interest is subordinate to

(a) an interest in an account payable in the Province, or

(b) an interest in goods, chattel paper, a security, a negotiable document of title, an instrument or money acquired when the collateral was situated in the Province,

unless it is perfected under this Act before the interest arises.

(5) A security interest referred to in subsection (4) may be perfected under this Act.