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STUDY GROUP FOR THE PREPARATION OF UNIFORM RULES  
ON CERTAIN INTERNATIONAL ASPECTS OF  
SECURITY INTERESTS IN MOBILE EQUIPMENT

MEMORANDUM

on a proposed Unidroit Convention on Security Interests  
in Mobile Equipment

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Rome, November 1993



**MEMORANDUM ON A PROPOSED UNIDROIT  
CONVENTION ON SECURITY INTERESTS IN MOBILE EQUIPMENT**

**TO: The Members of the Ad hoc Drafting Committee,  
UNIDROIT Working Group on a Convention on Security Interests  
in Mobile Equipment**

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**Date: November 5, 1993**

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**I. INTRODUCTION**

**1. The Context of this Memorandum**

The purpose of this memorandum is to provide a possible discussion guide for the February meeting of the drafting group. I have attempted through the memorandum to display the range of issues that might be addressed in a convention dealing with certain types of international security interests in mobile equipment.

I have included "drafted" provisions which reflect the tentative conclusions *I have reached* in the light of the discussion that occurred at the March 1993 meeting of the Working Group. Where appropriate, I have included alternative suggestions that reflect the opinion of a significant minority of the members of the Working Group. These draft provisions do not represent an attempt on my part to record or to put in legislative form the conclusions of the Working Group or to anticipate the final form of the convention. Their principal role is to take the analysis beyond generalities.

**2. The Approach: A Substantive Law Convention**

In a short memorandum which I presented to the March 1993 meeting I noted that there are two possible approaches to an international convention on security interests in moveable property. One is to create an international code that would provide for a complete regulatory regime for international security agreements providing for security interests in mobile equipment. The other is to create a system of international law

designed to provide for interjurisdictional recognition of "security interests" in mobile equipment created under municipal law that meet specified criteria.

The first approach was the one most favoured by the members of the Working Group at the March 1993 meeting. While this approach does not preclude the use of choice of law rules for certain matters, it does not defer to municipal law where basic conceptual and structural matters are involved. Of necessity, it involves a much more complete, almost self-contained, legal regime. Indeed, as is clear from what is set out below, what is required is something very close to the type of statutory code that is found in North American jurisdictions that have modern, consolidated personal property security law.

## **II. SCOPE**

### **1. Who Can benefit from the Convention?**

An important matter that was not discussed at the March 1993 meeting of the Working Group was whether the benefits of the convention are to be made available only to persons domiciled in convention States or whether they should be available to any person with a security interest in mobile equipment of the kind described in the convention. It is my view that the convention should be given as broad a scope as is consistent with the effective implementation of its provisions.

The *raison d'être* of the convention is to provide an international regime that would eliminate the more significant legal risks associated with financing on the security of mobile equipment. Central features of the convention would be a set of priority rules, an accompanying international registry for security interest and, possibly, a set of basic rules dealing with *inter partes* enforcement. There is no necessary connection between these aspects of the regime and the domicile of the secured party or the debtor. Ultimately, what is important to a secured party is the power, in the event of default by the debtor, to seize the collateral in priority to some other claimant to it. All that is required in this context is that the equipment be physically located in a State that recognizes the priority status given to a secured party and the right of the secured party to enforce its security interest. This being the case, the factor that defines this aspect of the scope of the convention would be the presence of the equipment at the time of enforcement of the security interest against third parties or the debtor in a State that is party the convention or that otherwise recognizes convention law as the applicable law.

### **2. Defining Scope**

Elsewhere in the paper, I suggest that the convention should provide for the possibility that the parties to a security agreement may want to ignore the otherwise applicable law and assume that the only relevant applicable law is the convention. If this approach were

to be adopted, the convention would apply to any security agreement that meets the requirements of the convention with the result that a registration statement relating any security interest in mobile equipment could be registered in the international registry established under the convention. However, merely because a security agreement falls within the scope of the convention in that it provides for a security interest in mobile equipment, it does not follow that the rights arising under the agreement or third party rights acquired in the mobile equipment after the security interest arises are affected by the convention. All that it means is that there is a potential that priority disputes involving the collateral or enforcement of the security interest against the debtor will be regulated by the convention rules. This potential will be realized only if the conditions set for the application of the convention to priority disputes or enforcement of the security agreement have been met.

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**Article \_\_\_\_\_**

***This convention applies to a security agreement providing for a security interest in mobile equipment.***

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### **3. Types of Movables: "Mobile Equipment"**

There appeared to be general agreement among the members of the Working Group that the proposed convention would apply to "mobile equipment". There was also agreement as to the approach to be used in determining what constituted "equipment". The term "equipment" would be used, as it is used in North American personal property security law, to mean goods used by the debtor principally in a trade or business but would not include goods held for resale. This would exclude goods of any kind held by the debtor as inventory or used by the debtor as consumer goods. Under this approach, it would not matter what the goods were in the hands of the seller (in the case of a secured instalment sale); they may be inventory, equipment and, possibly, consumer goods. What matters is the use to which the debtor makes of them.

One obvious difficulty with this approach is that it would exclude certain types of high value goods that are held by the debtor as consumer goods. Obvious examples would be large pleasure boats and aircraft used principally for non-business purposes. It would be necessary to supplement this test (as tentatively proposed below) if these items were to be included in the convention.

Another difficulty endemic to this approach is that a change in use of the movables by the debtor after the security interest comes into existence will not be apparent to third parties

who must make the decision whether or not to conduct a search at the International Registry. Under the North American legislation, characterization of goods is made at the date the security interest is created. A subsequent change in use of the goods by the debtor from inventory to equipment or from consumer goods to equipment does not impose on the secured party new obligations to comply with registration requirements otherwise applicable to goods used by the debtor for a different purpose. Unless a post-creation change in the use of the goods by the debtor is to be treated as invoking or excluding further application of the convention, it will be necessary to accept that the characterization of the goods at the date of creation of the security interest is all that is relevant. This puts third parties who want to be assured that all prior security interests are disclosed in the position of having to obtain a search result from the International Registry and having to take whatever measure available under the otherwise applicable law to protect themselves when taking interest in goods that might have been equipment at some earlier time.

There are at least three possible approaches to the determination as to which kinds of "mobile equipment" the convention should apply:

*A Mobility Test:* One approach is to focus on "mobility" as a defining factor. Under this approach, mobility is determined, not on the basis of what has happened to a particular item of equipment, but on the basis of what generally happens to equipment of this kind. Consequently, the Convention would apply to "equipment" of a kind that is "generally taken by users from one State to another".

A difficulty with this approach is that it may be too broad. Without qualification, it would include "small value" items held by debtors as "equipment" (as defined above) such as automobiles, small trucks (lorries), small boats and construction equipment of relatively small value owned by business enterprises. It would not be practical or politically acceptable to expect secured parties taking security interests in this type of collateral or buyers of it to be aware of the existence of and the need to comply with the requirements of the International Registry. This difficulty might be addressed by including in the convention a restrictive definition of mobility and a schedule of specified kinds of excluded goods (as proposed below). It might also be addressed through a special priority rule that would protect buyers of small value items. (Not proposed). A combination of these measures may be required.

*A Schedule:* An alternative approach is to specify in generic terms the kinds of equipment that can be collateral to which the convention would apply.

There is an obvious difficulty with this approach. It would be very difficult to list all of the kinds of equipment that should be within the scope of the convention. Any attempt to use broad descriptors carries with it the likelihood of inappropriate application of the convention to small value items.

**A Via Media:** Another approach would be to use a combination of the two above-noted approaches. Under this approach, the convention would employ a restricted mobility test supplemented by (i) a schedule of specific kinds of movables that otherwise do not fit into the restricted mobility test, (ii) a schedule of high value consumer goods that would be included in the convention and (iii) a schedule of goods that otherwise meet the test but which for some reason (e.g., goods of low unit value or goods such as sea-going vessels subject to another international regime) are not included in the convention.

Set out below is a definition of "mobile equipment" that embodies this approach. The definition contains a mobility test which, however, is qualified by a general requirement that the equipment be capable of self-propulsion. This qualification is designed to limit the scope of the definition to high value equipment. It is based on the assumption that, if the equipment is capable of self-propulsion, its value will likely be sufficiently high to justify having security interests in it brought within the scope of the convention. However, it must be recognized that there are kinds of equipment that are of high value but which are not capable of self-propulsion. These kinds would be enumerated in generic terms.

The definition accommodates the suggestion that the convention should apply as well to specified kinds of high value consumer goods. Here again, the kinds of goods would be enumerated in generic terms.

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**Article \_\_\_\_\_**

**"Mobile Equipment"**

**(a) means goods, and accessories attached to goods, used by the debtor principally in a trade or business, other than goods held for resale, which are of a kind generally taken from one State to another State for use in the other State and which are**

**(i) capable of self-propulsion; or**

**(ii) one of the following:**

- **shipping container,**
- **oil or natural gas drilling equipment,**
- **railway rolling stock,**

**\*.....,**

**(appropriate additions to the list)**

**(b) and includes:**

• **an aircraft,**

• **a vessel having a displacement in excess of \_\_\_\_\_ tons, but not greater than \_\_\_\_\_ tons,**

**\*.....,**

*appropriate additions to the list)*

**used by the debtor principally for non-business purposes,**

**(c) but does not include:**

**•an automobile,**

**•a truck (lorry) having a gross vehicle weight of less than \_\_\_\_\_ pounds,**

**•a vessel having a displacement of more than \_\_\_\_\_ tons,**

**•.....,**

**(appropriate additions to the list)**

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#### **4. Collateral Other Than "Mobile Equipment"**

##### **-Intangibles**

During the deliberations of the Study Group the suggestion was put forward that the convention might apply to certain types of intangible interests such as accounts. However, since the matter was not pursued, I have not addressed in any detail the implications of the suggestion. A pre-condition to any attempt to bring accounts within the scope of the convention would be steps to determine whether or not there is any need for an international legal regime to regulate successive assignments of accounts.

##### **-Proceeds**

There was mention of the concept of proceeds at the March 1993 meeting of the Working Group; however, the matter was not discussed in any detail.

It has been recognized in North American jurisdictions that a legal regime which regulates only security interests in original collateral is inadequate. What is required is a regime that recognizes that a security interest in original collateral carries over to (continues in) property received by the debtor as a result of the disposition of the original collateral. Recognition of security interests in proceeds is of primary significance in the context of security interest in inventory since, of necessity, the security agreement providing for the security interest (or the applicable statutory rules) expressly or impliedly gives power to the debtor to sell the inventory collateral in the ordinary course of business. However, North American personal property security legislation does not limit the concept of proceeds to property received from the sale of inventory; it applies as well to property received from the sale of equipment (and consumer goods).



There are two reasons why no attempt should be made to import into the convention the North American approach to proceeds. One of these is that there is not the same need to have an elaborate regime for protecting interests in proceeds where the collateral involved is not inventory. Most types of equipment subject to a registered convention security interest will be of a very substantial nature with result that, in most cases, the secured party will be able to recover it from a third party to whom it has been transferred. The second reason is that any attempt to provide in the convention a sophisticated regime for security interests in proceeds would necessitate having to develop an elaborate set of priority rules to deal with competing interests in all types of proceeds property including goods other than equipment, intangibles and negotiable property such as money and shares. However, the concept of an automatic security statute-created security interest in proceeds should not be entirely dismissed since proceeds can be important to equipment financiers in some situations.

There is an alternative approach that embodies a limited recognition of the concept of proceeds without the need to deal with difficult priority issues. Under this approach, a security interest in "proceeds" other than mobile equipment would automatically be created by the convention but its recognition would depend upon finding a similar type of interest under the applicable law. The convention security interest in proceeds would be analogized to equivalent security interests (if any) under the applicable law (assuming this is the law of a convention State) and would be subject to the registration and priority rules of that law. For example, if equipment subject to a registered convention security interest is sold by the debtor on account without the consent of the secured party and, for some reason, cannot be seized by the secured party, the secured party would have a convention proceeds security interest in the account owing by the buyer (account debtor) which would be enforceable by the secured party. However, if the seller of the equipment (the original debtor) has assigned the account to someone else, the priority position of the secured party *vis-à-vis* the competing assignee would be determined according to (for example) the law of the place where the account debtor resides.

While it would be possible to set out in the convention choice of law rules for determining the applicable law, it might be difficult to get agreement as to what these rules would be. Perhaps the matter is best left to the forum court.

This approach provides only limited protection for security interests in proceeds. Only if the applicable law is that of a convention State that recognizes security interests in personal property in the form the proceeds will the convention proceeds security interest be enforceable. Further, if the secured party is to have priority over competing interests in the proceeds collateral, it must comply with the perfection (registration) requirements of the applicable law.

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Article \_\_\_\_\_

**"Proceeds" means:**

**(a) moveable property derived from any dealing with the mobile equipment or proceeds of it and in which the debtor acquires an interest,**

**(b) a right to an insurance payment or any other payment as indemnity or compensation for loss of, or damage to, the mobile equipment or proceeds of the mobile equipment.**

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Article \_\_\_\_\_

**(1) Articles \_\_\_\_\_ (registration and priority rules) do not apply to a security interest in proceeds, other than mobile equipment.**

**(2) A security interest in proceeds, other than mobile equipment, is treated as a corresponding kind of security interest under the applicable law and, except as provide in this convention, is governed by the applicable law.**

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See also the definition of "security interest," *infra*.

## **5. The "Debtor" and the "Obligation Secured"**

There was general support at the March 1993 meeting of the Working Group for the suggestion that there be no restrictions on the types obligations secured by a convention security interest. North American personal property security legislation provides for securing non-monetary obligations; however, this aspect of the legislation has received little attention and gives rise to some difficult issues. [ For example, can a buyer take a security interest in specific goods to be supplied by the seller and use the enforcement system to obtain specific enforcement of the contract of sale by seizure of the goods from the seller?]

An issue that was briefly discussed at the March 1993 meeting of the Working Group was whether or not a convention security interest should secure obligations of the debtor (or a third party) arising after the security agreement is executed. Future advances under an instalment loan arrangement or costs incurred by the secured party on behalf of the debtor (e.g. the payment of unpaid insurance premiums on the equipment) would fall within this category. There was support in the Working Group for the position that a convention security interest should be broad enough to secure future obligations of the kind specified in the security agreement (and, possibly, the registration statement registered in the International Registry). I have addressed this matter more fully below in

the portion of the paper dealing with priorities since it is in this context that issues associated with future advances will arise.

There was support at the March meeting of the Work Group for the view that the convention should recognize that a security interest can be taken to secure a third party debt. In practice a two debtor situation is likely to arise where one person gives a security interest in its equipment to secure a debt owing by the someone else to the secured party. In effect, there are two debtors: one debtor who owns the equipment but who may be secondarily liable to the secured party only to the value of the collateral; and one debtor who does not own the equipment, but who is the principal debtor. A two debtor situation may arise as well where a person gives an unsecured guarantee of the debt of another person who has given a security interest in its equipment. Unless there is support for extending the convention to include provisions dealing with the debt obligation *simpliciter*, there is no need to be concerned about "debtors" who do not own equipment that is subject to a security interest.

It is my view that the convention should treat both natural and artificial persons as "debtors."

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**"Debtor" means:**

***(a) a person who as principal debtor or as a surety owes payment of performance of an obligation secured and who has right in (owns) the equipment subject to the security interest, and***

***[(b) a lessee under a security lease].***

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## **6. A "Security Interest"**

**-A conceptual definition of "security agreement" and "security interest".**

The Working Group concluded that "security interest" should be defined in functional terms, thus avoiding the problems created by differing conceptions among national legal systems of what constitutes a security interest. Under this approach, it does not matter that the security interest would not be recognized as valid under the law of the *situs* of the equipment, the State of residence of either of the parties to the agreement or of a third party who acquires an interest in the collateral. If the interest falls within the convention definition, convention States would recognize its validity in the context of the convention regime.

There was general agreement among the members of the Working Group that the concept of a convention security interest should be confined to interests created by agreement between a secured party (lender or seller) and a debtor (borrower or buyer). There was also agreement that the concept would encompass title-retention agreements where the commercial purpose for the seller's retention of title is to secure payment of the purchase price of the equipment and related obligations arising under the sales agreement.

Later in this memorandum I describe two scenarios to which the convention would apply. The first is one in which a security interest arising under the municipal law (but at the same time meeting the requirements of the convention) is taken in mobile equipment and, thereafter, an international element is introduced that invokes the convention regime. For the purposes of situations arising in jurisdictions other than the states of the United States and most Canadian provinces, it can be assumed that the municipal law will be the *lex situs* of the mobile equipment when the security interest comes into existence, since this is the law that courts in most States of the world would apply. This scenario reflects the majority view of the member of the Working Group that, in order for the convention priority and enforcement rules to apply, there must be a supervening international element. The convention rules would not apply to purely domestic matters arising in the context of security interests in mobile equipment.

Under this approach the supervening international event may give additional (or, perhaps, diminished) scope and characteristics to the security interest arising under the original *lex situs*. Accordingly, the fact that the *lex situs* of the equipment when the security interest comes into existence does not give to the security interest attributes such as scope to secured future obligations of the debtor or to attach to after-acquired equipment or does not recognize an automatic security interest in proceeds, has no effect on the operation of the convention to the extent that it gives these attributes.

Some of the attributes that are offered by the convention are matters of contract between the secured party and the debtor. This being the case, a security agreement drawn solely in the context of the law of the *situs* of the equipment at the date the security interest arose may not be adequate to invoke these attributes. A secured party wishing to have the full benefits of the convention must be aware of the need to have an properly drawn security agreement.

#### **-Security Interests in After-acquired Equipment**

Support was expressed at the March 1993 meeting of the Working Group for the suggestion that a convention security interest be viewed as "attaching" to after-acquired equipment (i.e., equipment in which the debtor obtains rights (or ownership) after the security agreement is executed). Under this approach, a security agreement could be drafted so as to provide for a security interest in all equipment (of specified kinds)

acquired by the debtor during the life of the agreement. I have addressed this matter more fully below in the portion of the paper dealing with priorities since it is in this context that issues associated with security interests in after-acquired property will arise.

### **-Security Leases**

Several members of the Working Group recognized the practical problem of having the convention apply only to security agreements formally identified as such when, in very many cases, the purchase price of mobile equipment is financed under so-called equipment leases. These members suggested that it would be desirable (or, perhaps, necessary) to extend the definition to include transactions, such as leases of movables, that are functionally, although not conceptually, security agreements. The problem of characterizing equipment leases as true leases or security agreements has been a very difficult one in most North American jurisdictions. It has resulted in a great deal of litigation and considerable confusion. This should be avoided in the context of the convention.

While further study of the matter is required, it is my view that the problem cannot be ignored. If it is not addressed directly in the convention, the efficacy of the convention would be reduced to the point that it would not be attractive to many States. If equipment buyers and financiers are told that the registry and priority rules of the convention are not available to a wide range of *de facto* financing transactions in the form of equipment leases, they are likely to have little interest in supporting implementation of the convention in their States. Further, there would be considerable uncertainty and unevenness in the application of the convention among States that do implement the convention. Courts in some States may take a formalistic approach and refuse to go beyond the labels that the parties put on their agreements, while courts in other States may apply a "substance" or "functional" test and conclude that transactions labelled "leases" by the parties are in substance or are functionally security agreements falling within the convention.

In order to avoid these problems, it will be necessary to bring financing leases within the scope of the convention. There are two approaches from which to choose. One approach is to make it clear that the substance test of "security interest" is intended to include security agreements in the form of leases. The other approach is to include in the definition of "security interest" a set of quite specific tests for determining what types of "leases" fall within the convention. The first approach is more flexible, but results in considerable uncertainty and unevenness of application. For this reason, I prefer the second approach. While, of necessity, there will be an element of arbitrariness in this approach in that some transactions that are functionally security devices are left out, the certainty that it gives is the greater good. See Alternative 1, *infra*.

It is clear from comments made by some members of the Working Group at the March 1993 meeting that extension of the convention to include security leases that are viewed

in some states as true leases might not be acceptable. It will be important to explore this issue further to determine the basis for the objection. There are two possible approaches that might be explored.

If some States find it objectionable to treat these types of security leases as security agreements for all purposes, they might be prepared to have them treated as security agreements only for the purposes of registration and priorities but not for the purposes of regulating rights *inter partes*. (This would be a variation on the approach used in several Canadian provinces under which all leases for a term of more than one year are brought within the conflict of laws, perfection and priority rules of the Personal Property Security Acts.) This approach is set out below as Alternative 2.

Alternatively, these States might be prepared to have specified types of leases that have the same function as security agreements brought within the perfection and priority provisions of the convention if these transactions are not identified as security agreements, but as registerable leases. The effect of this approach is no different than that of Alternative 2; however, the cosmetics are very different. This approach is set out below as Alternative 3

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**Alternative 1:**

**"Security Agreement" means an agreement that provides for a "security interest" and includes a security lease.**

**"Security Interest"**

**(a) means an in rem interest in mobile equipment and proceeds that secures payment or performance of an obligation**

**and includes**

**(b) the interest of a seller who has retained title to or an interest in moveable property to secure the purchase price of the property,**

**(c) the interest of a lessor under security lease,**

**but does not include a lien, charge or interest arising other than by agreement.**

**"Security Lease" means an agreement, however labelled, whatever the parties are called and without regard to whether or not title to the equipment transfers under the agreement from one party to the other which**

**(a) provides that the person identified as lessee is required to purchase the equipment or is required to renew the agreement for one or more terms that in total amount to all or substantially all of the remaining economic life of the equipment,**

**(b) provides for automatic vesting of title in the person identified as lessee upon payment of all or a specified number of periodic payments,**

**(c) provides, other than through negotiated extensions of the agreement, for a right to possession by the person identified as lessee for all or substantially all of the remaining economic life of the equipment,**

**(d) provides that the person identified as lessee is entitled to purchase the equipment for a price set at the date of the agreement or under a formula in the agreement that is substantially below the market value of the equipment at the date the right to purchase is exercised; but a lease is not a security lease merely because the lessee is given a right to purchase the equipment,**

**(e) provides that the person identified as lessee is entitled to renew or extend a right to possession of the equipment for a price set at the date of the agreement or under a formula in the agreement that is substantially below the market rental cost of the equipment at the date the right to renew or extend the lease is exercised.**

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**Alternative 2:**

**"Security Agreement" means an agreement that provides for a "security interest," and, except for the purposes of Articles \_\_\_\_\_ (provisions dealing with inter partes rights on default by the debtor) includes a security lease.**

**"Security Interest"**

**(a) means an in rem interest in mobile equipment and proceeds that secures payment or performance of an obligation**

**and includes**

**(b) the interest of a seller who has retained title to or an interest in moveable property to secure the purchase price of the property,**

**(c) except for the purposes of Articles \_\_\_\_\_ (provisions dealing with inter partes rights on default by the debtor) the interest of a lessor under security lease,**

**but does not include a lien, charge or interest arising other than by agreement.**

**"Security Lease" means an agreement, however labelled, whatever the parties are called and without regard to whether or not title to the equipment transfers under the agreement from one party to the other which**

**(a) provides that the person identified as lessee is required to purchase the equipment or is required to renew the agreement for one or more terms that in total amount to all or substantially all of the remaining economic life of the equipment,**

**(b) provides for automatic vesting of title in the person identified as lessee upon payment of all or a specified number of periodic payments,**

**(c) provides, other than through negotiated extensions of the agreement, for a right to possession by the person identified as lessee for all or substantially all of the remaining economic life of the equipment,**

**(d) provides that the person identified as lessee is entitled to purchase the equipment for a price set at the date of the agreement or under a formula in the agreement that is substantially below the market value of the equipment at the date the right to purchase is exercised; but a lease is not a security lease merely because the lessee is given a right to purchase the equipment,**

**(e) provides that the person identified as lessee is entitled to renew or extend a right to possession of the equipment for a price set at the date of the agreement or under a formula in the agreement that is substantially below the market rental cost of the equipment at the date the right to renew or extend the lease is exercised.**

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**Alternative 3**

**"Security Agreement" means an agreement that provides for a "security interest."**

**"Security interest" means an interest in moveable property that secures payment or performance of an obligation, and includes the interest of a seller who has retained title to or an interest in moveable property to secure the purchase price of the property, but does not include a lien, charge or interest arising other than by agreement.**



Articles \_\_\_\_\_ (registration and priority rules) apply to a lease of mobile equipment which

(a) provides that the lessee is required to purchase the equipment or is required to renew the agreement for one or more terms that in total amount to all or substantially all of the remaining economic life of the equipment,

(b) provides for automatic vesting of title in lessee upon payment of all or a specified number of periodic payments,

(c) provides, other than through negotiated extensions of the agreement, for a right to possession by the lessee for all or substantially all of the remaining economic life of the equipment,

(d) provides that the lessee is entitled to purchase the equipment for a price set at the date of the agreement or under a formula in the agreement that is substantially below the market value of the equipment at the date the right to purchase is exercised,

(e) provides that the lessee is entitled to renew or extend a right to possession of the equipment for a price set at the date of the agreement or under a formula in the agreement that is substantially below the market rental cost of the equipment at the date the right to renew or extend the lease is exercised.

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### III. THE SECURITY AGREEMENT

There appears to have been general agreement at the March 1993 meeting of the Working Group that the convention should specify minimum requirements for a security agreement providing for a security interest in mobile equipment. Given the approach that is suggested elsewhere in this memorandum, a security agreement may be in a form dictated by the applicable law (*lex situs* at date of execution or the law of the debtor's location) so long as the additional requirements (if any) of the convention are met; or it may be a truly international security agreement designed to comply with the convention without regard to whether or not it is adequate to meet the requirements of municipal law.

There appeared to be general agreement that the convention should require a written agreement containing:

- (i) identification of the parties,
- (ii) a charging clause (which could be a title retention clause, a title transfer clause or any other indication that the parties intend to create a security interest),

- (iii) a description of the collateral sufficient to enable it to be identified, and
- (iv) the signature of the debtor.

Given the growing use of electronic communication in international business transactions, it will be necessary to accept other than the traditional forms of written agreements and signatures on agreements.

If the transaction is initially a domestic financing agreement, contract formalities of the applicable law must be met if the agreement is to be enforceable in that jurisdiction. When, however, the parties are not concerned with municipal law because the equipment is to be moved immediately to and kept in other States, there is no need to meet municipal law requirements.

There was no discussion among the members of the Working Group as to the consequences of failure to meet the writing requirements of the convention. There is precedent for two quite different approaches. One is to treat the agreement as being totally unenforceable. This is the approach contained in *Article 9* of the *American Uniform Commercial Code*. The other approach is that contained in the *Canadian Personal Property Security Acts* which provide that non-compliance with statutory writing requirements results in a security agreement being unenforceable against third parties but remaining enforceable *inter partes*. The choice between the two approach is dictated by the policy basis for requiring any form of written agreement. The *Article 9* approach reflects the thinking that induced the *Statute of Frauds*. A written record is necessary to deal with problems of proof between the parties as to the terms of the agreement between them. The Canadian approach is designed to limit the possibilities for using last minute, sham security agreements designed to defraud other claimants (particularly execution creditors and the trustee in bankruptcy). Set out below are two versions of an article dealing with writing requirements. One embodies the Canadian approach, while the other embodies the US approach. Both versions may have to be modified to accommodate the position ultimately taken with respect to the application of the convention to security leases.

It will be very difficult for the parties to a security agreement to predict at the date of the agreement what form proceeds might take. Indeed, most agreements will prohibit sale of the equipment by the debtor and, consequently, no thought will be given to the form that proceeds will take should this term of the agreement be violated. This being the case, it would make little sense for the convention to require that proceeds collateral be described in the security agreement (or the registration statement, except where the proceeds are mobile equipment). If the issue is enforcement of the security interest against a person not party to the agreement (i.e., a priority issue), the applicable law would stipulate any writing requirements.

A very lively debate developed at the March 1993 meeting of the Working Group concerning the relevance of registration in the International Registry as a formality in the

creation of a security agreement. The difference in approach reflected the different legal traditions. Civil law experts in the Group took the view that registration should be an aspect of creation of the agreement equivalent to notarizing an agreement for the transfer of land under civil law. Common law experts took the position that registration should not have any *inter partes* significance; it should relate only to the issue of priorities.

It is my view that the common law approach should be embodied in the convention. The priority structure set out below (and, presumably, any priority structure that functions properly) draws a distinction between those security interests that are registered and those that are not. However, security interest that are not registered should still be within the legal regime creating the priority structure. It would nullify a significant aspect of the priority system to accept that non-registration takes a security interest out of the convention and, consequently, out of its priority structure. The purpose of the convention is to give legal certainty to secured financing on the security of mobile equipment. It does not serve this function to accept that a secured party, simply by failing to register its security interest, can essentially opt out of the convention and have convention States recognize that some other priority regime governs the priority of its security interest.

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Alternative 1:

**Article**

**(1) A security interest is only enforceable against a person other than a party to the security agreement creating it when the debtor has signed an agreement that provides for the security interest and that contains a description of the equipment subject to the security interest.**

**(2) A security interest in proceeds is enforceable whether or not the security agreement contains a description of the proceeds.**

**(3) For the purposes of this Article, a security agreement and the signature of the debtor may be in any form, including electronic representation, that is permitted under the law where the agreement is executed or that is acceptable in international financing transactions.**

Alternative 2:

**[Article**

**(1) A security interest is only enforceable when the debtor has signed an agreement that provides for the security interest and that contains a description of the equipment subject to the security interest.**

**(2) A security interest in proceeds is enforceable whether or not the security agreement contains a description of the proceeds.**

**(3) For the purposes of this Article, a security agreement and the signature of the debtor may be in any form, including electronic representation, that is permitted under the law where the agreement is executed or that is acceptable in international financing transactions.]**

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#### **IV. THE TEST OF INTERNATIONALITY**

##### **1. The Approaches**

Two quite separate approaches to internationality were put forward by members of the Working Group. One approach embodied the conclusion that the convention should apply to all security interests in "mobile equipment" without regard to whether or not an international element is involved. The effect of this approach would be to create a separate international regime for secured financing of all "mobile equipment" whether or not the legal issues involved arose in an international or a purely domestic context.

The other approach was based on the conclusion that, while the convention should apply *ab initio*, its priority rules (and accompanying registration requirements) and its rules for enforcement against the debtor should come into play only when an international element is involved. Under this approach, the convention would apply as soon as the security agreement is executed but only to the extent that the secured party would be entitled to effect a registration in the International Registry. Indeed, the security agreement might be drawn so as to ignore the municipal law of the *situs* of the equipment at the date the agreement is executed. However, until the international element comes into the picture, the municipal law chosen under the appropriate choice of law rule (e.g., *lex situs*) would govern all priority and *inter partes* issues. As soon as the international element is introduced, the convention registration requirements and priority rules and regime regulating enforcement rights *inter partes* would apply and displace the otherwise applicable municipal law.

While no vote was taken at the March 1993 meeting, there appeared to be significant majority support for the second approach. This support was induced by the view that there would be few States prepared to have an international legal regime govern secured financing transactions that had no international element other than that they involve mobile equipment that is capable of being moved from one State to another.

## 2. Invocation of the Convention

There are two basic situations to which the convention would apply. The first is one in which a security interest arising under the municipal law (but at the same time meeting the requirements of the convention) is taken in mobile equipment and, thereafter, an international element is introduced that invokes the appropriate convention rules. For the purposes of situations arising in jurisdictions other than the states of the United States and most Canadian provinces, it can be assumed that the municipal law will be the *lex situs* of the equipment when the security interest comes into existence since this is the law that courts in most States of the world would apply. The situation is quite different in most common law jurisdictions of North America. Under *Article 9* of the *American Uniform Commercial Code* and the *Canadian Personal Property Security Acts*, the law applicable to perfection of a security interest in mobile equipment and to priority issues involving it (and, in Canada at least, the validity of the security interest) is the law of the location of the debtor at the date the security interest attaches and not the *lex situs* of the equipment at the date of attachment.<sup>1</sup>

The second situation to which the convention would apply is one in which, for some reason, the parties decide to ignore (or treat as a quite separate matter) the requirements of the *lex situs* of the equipment (or, in a North American context, the location of the debtor) at the date the security agreement is executed, and design the security agreement so as to comply only with convention requirements. This would be done, for example, where the *lex situs* does not recognize a non-possessory security interest in equipment or where it is clear that the equipment will be moved immediately to a

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<sup>1</sup> Indeed, the approach employed by North American jurisdictions eliminates, at least among those jurisdictions, the need for the convention. The law of the location of the debtor provides a commonly accepted alternative to an international regime of priority rules and an international registry. At the March 1993 meeting of the Working Group, the North American approach was put forward as one which could be basis for the convention; however, the group opted for a substantive code of international personal property security law. It is very unlikely that North American jurisdictions would be prepared to abandon, at least as between themselves, the law of the location of the debtor in favour of the convention as the law applicable to perfection and priority of security interests in mobile equipment. On the other hand, there appears to be considerable interest in North America in having a workable international regime applicable in other contexts. This being the case, the convention will have to accommodate the North American peculiarities and North American legislators can be expected to accept the convention approach where the issue is priority of competing interests, one or more of which arose in a State that does not recognize or apply the North American choice of law rule or where enforcement of a security interest is sought in such a State.

convention State (again, in a North American context, to a convention State outside North America).

### **3. The International Factors**

A number of possible "international factors" that invoke aspects of the convention were suggested at the March 1993 meeting of the Working Group. In addition, it was recognized that there may be different international factors depending upon whether the legal issue involved was one of priorities or simply enforcement of the security agreement against the debtor.

#### **-Invocation of Convention Priority Rules**

There was significant support among Working Group members for the position that the convention rules applicable to priority disputes would be invoked upon the coincidence of two events: (1) mobile equipment subject to a security interest arising under applicable law or created in compliance with the convention requirements is taken from a State to a convention State, and (2) a competing interest in the equipment arises in the second State.

The effect of applying the convention in this context is that the priority rules of the convention and not those of the original or new *situs* of the mobile equipment would govern the priority conflict arising in the second State. Under this approach, it would not matter where the debtor and the competing parties are located when the subsequent interest arose, how many third party interests arise, that the equipment has been taken to several convention or non-convention States before being brought into a convention State or that the equipment is brought back to the State where the equipment was located when the security interest arose. However, the Working Group expressed the view that the convention should not displace municipal law where the issues involved are seen as being completely domestic in origin. Accordingly, it would matter that the equipment did not acquire a new *situs* in a convention State before the competing interest arose or that the equipment is brought back to the original *situs* (a convention State) and the competing interest arose there.

If a financier is uncertain as to the location of the equipment in which it intends to take a security interest, (a problem that is not likely to arise where purchase money financing is involved) it would draw its security agreement so as to comply with the convention and would immediately take the necessary steps to register its security interest as required by the convention. If this is done, the legal risk the financier faces are that another

interest in the equipment arises before the equipment is moved to a convention State,<sup>2</sup> or that the equipment is taken back to the State where it was when the security interest was taken and another security interest was taken in that State. In either of these situations priority can be lost to the competing interest as a result of failure to comply with the requirements the *situs* pertaining to validity or perfection of the security interest.

The following scenarios demonstrate the approach described above:

**Scenario 1:**

SP1 (secured party) and D (debtor) enter into a security agreement providing for a security interest in equipment which at the time of the agreement is located in State A (whether or not a convention State). Thereafter the equipment is taken to State B, a convention State, and D gives a security interest in it to SP2. D defaults under both security agreements and both SP1 and SP2 compete for priority to the equipment.

The validity<sup>3</sup> of both security interests would be tested against the requirements of the convention. It would not be important that one or both of the security interests were valid under the municipal law of State A or State B. Accordingly, it would not matter that the type of security interest that SP1 acquired would not be recognized under the law of either State.

**Scenario 2:**

SP1 (secured party) and D (debtor) enter into a security agreement providing for a security interest in equipment which at the time of the agreement is located in State A, (whether or not a convention State). While the equipment is in State A, D gives a security interest in it to SP2. Thereafter the equipment is taken to State B, a convention State, where it is located when D defaults and both SP1 and SP2 compete for priority to the equipment.

The validity<sup>4</sup> of both security interests and their priority positions would be determined under the law of State A and not under the convention.

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<sup>2</sup> Of course, additional risks will arise if the equipment is moved to a non-convention State and the priority issue arises in that State.

<sup>3</sup> In this context, "validity" refers to the legal question as to whether or not a security interest has been created. It does not refer to matters of contracting such as capacity to contract and illegality (public order). It does, however, include formalities of contracting as prescribed by the convention.

<sup>4</sup> See, *supra*, note 3.

**Scenario 3:**

SP1 (secured party) and D (debtor) enter into a security agreement providing for a security interest in equipment which at the time of the agreement is located in State A, a convention State. Thereafter the equipment is taken to State B, not a convention State, and D gives a security interest in it to SP2. The equipment is then taken to State C, a convention State, and a security interest is given to SP3. D defaults under all three security agreements and SP1, SP2 and SP3 compete for priority to the equipment.

The fact that State B is not a convention state and would address the creation and priority status of SP1's and SP2's security interests differently from the treatment they would receive under the convention is of no significance. The courts of State C would apply the convention rules without regard to the validity and priority of SP1's or SP2's security interest under the law of State B.

As noted above, a modified approach will have to be adopted to address the special North American choice of law rule. This approach might involve treating North American jurisdictions (or, more accurately, those jurisdictions that look to the location of the debtor as the source of law for security interests in mobile equipment) as being a special legal zone for the purposes of the operation of the convention. Security interests taken in equipment in this zone would continue to be governed by the North American choice of law rule which ignores the location of the equipment. The creation of successive interests in the equipment in different jurisdictions within the zone would not result in the invocation of the convention regime. (In effect, the zone would be the *situs* of the equipment for convention purposes). However, when equipment subject to a security interest is taken from the zone to a convention jurisdiction outside the zone and a competing interest arises, the convention would apply. Similarly, when equipment subject to a security interest taken while the equipment is located in a convention State outside the zone is brought into the zone, the convention would apply. This approach would necessitate amendment to the conflict of laws rules of most North American jurisdictions so as to limit the effect of the location of the debtor choice of law rule to situations where the equipment is located in one of these jurisdictions or a State that is not party to the convention. This should not be a difficult step to take since, as a practical matter, a court in a jurisdiction that applies a *lex situs* rule to priority issues will not recognize the rulings of a court which has applied the North American choice of law rule where at least one of the competing interests arose in that jurisdiction. In other words, the North American choice of law rule works only so long as the State where the equipment is located is prepared to recognize this as the appropriate rule. I suggest that few courts outside North America would be prepared to do this.

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**Article \_\_\_\_\_**

**Except as otherwise provided in this convention, Part (registration and priority rules) applies where a security interest that arose when the equipment was in a State is in competition with an interest referred to in Articles (the articles that set out the priority rules) that arose after the equipment was moved to another State which is a contracting state.**

**This article does not apply where the private international law of both States provides for the application of the law of the location of the debtor as the law applicable to perfection and priorities of interests in mobile equipment.**

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**-The Role of Non-Convention Law in the Priority Structure**

It will very likely be necessary to address specifically the issue as to the extent to which interests arising in non-contracting States are to be recognized when applying the convention priority rules. Consider the following scenarios:

**Scenario 4:**

SP1 (secured party) enters into a security agreement with D (debtor) providing for a security interest in equipment which at the time of the agreement is located in State A (whether or not a convention State). Thereafter the equipment is taken by D to State B, which is not a convention State, and sold by D to X. Under the law of State B, X gets ownership free from SP1's security interest (because State B does not recognize the type of interest held by SP1, because of the failure on the part of SP1 to comply with B's registration rules or because of the operation of the principle of *en fait meubles, la possession vaut titre*). X then takes the equipment to State C, a convention State, and gives a security interest in it to SP2. Both D and X defaults under their respective security agreements and both SP1 and SP2 compete for priority to the equipment. Assume that both SP1 and SP2 registered their security interests in the International Registry shortly after execution of the security agreements.

SP2 claims priority on the basis that SP1's security interest was cut-off as a result of the operation of the law of State B. In response, SP1 argues that the priority dispute should be addressed entirely within the context of the rules of the convention (or, at least, without regard to interests arising in State B).

It is my view that SP1 should prevail. If the convention is to be effective, it must give assurance to secured parties that their security interests cannot be eliminated simply through a disposition of the equipment by the debtor in a State that is not party to the

convention.<sup>5</sup> In any event, there is no commercial reason for giving priority to SP2 who could have discovered the existence of SP1's security interest through a search of the International Registry using the identification number of the equipment.<sup>6</sup> The doctrinal basis for giving priority to SP1 is that, so far as the convention law is concerned, the sale by D to X does not affect SP1's security interest since it was not authorized by SP1.<sup>7</sup> The fact that the sale took place in a non-convention State does not affect the application of the convention priority rules. In other words, in this respect, the convention displaces the *lex situs*.

If SP1 failed to register its security interest with the result that under the priority rules of the convention (set out below) X takes free from SP1's security interest, SP2 would have priority since SP1's security interest would have terminated on the sale of the equipment. This would be so, whether or not the law of State B provides that X acquired its interest free from SP1's security interest. Again, it is the convention law that governs and not the law of State B.<sup>8</sup> In effect, the convention priority rules would be applied to interests arising in State B even though State B is a not party to the convention. To this extent, persons acquiring those interests are getting the benefit of the convention even though they are domiciled in a non-convention State. This, however, is consistent with the position taken earlier in this paper that the domicile of the persons acquiring rights under the convention is not significant.

A much more difficult issue arises in a situation where two of the competing interests arise when the equipment is in a contracting State. Consider the following scenarios:

Scenario 5:

SP1 (secured party) enters into a security agreement with D (debtor) providing for a security interest in equipment which, at the time of the

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<sup>5</sup> Of course this assurance cannot be given if the forum court is that of a non-contracting State.

<sup>6</sup> The scenario demonstrates the value of using equipment identification numbers as registration-search criteria.

<sup>7</sup> By the same reasoning, if rather than selling the equipment in State B to X, D gave a security interest to SPX, the convention priority rules would apply to determine the priority status of all three secured parties.

<sup>8</sup> If the prior interest that is in competition with SP2 is other than a security interest to which the convention applies, the private international law rules of State C (other than the rules of the convention) would determine whether or not X has ownership of the equipment and, consequently, whether there is anything to which SP2's security interest can attach.

agreement, is located in State A, a convention State. Thereafter, but before the equipment is moved from State A, it is sold by D to X. Under the municipal law of State A, X gets ownership free from SP1's security interest (because State A does not recognize the type of interest held by SP1, because of the failure on the part of SP1 to comply with A's registration rules or because of the operation of the principle of *en fait meubles, la possession vaut titre*). X then takes the equipment to State B, a convention State, and gives a security interest in it to SP2. Both D and X default under their respective security agreements and both SP1 and SP2 compete for priority to the equipment. Assume that both SP1 and SP2 registered their security interests in the international registry shortly after execution of the security agreements.

This scenario differs from Scenario 4 in that X acquired its interest in State A which is a convention State and the State in which the equipment was located when SP1 took its security interest. This difference does not permit a mechanical application of the approach that was suggested for Scenario 4. Elsewhere in this memorandum it is recognized that priority issues arising solely within a convention State should be left to the municipal law of that State. If this principle is applied here, the conclusion must be that the law of State A determines whether or not X acquires the equipment free from SP1's security interest. On the facts of the scenario, it did. The complicating factor is that the equipment was moved to State B with the result that the international element that, in other contexts invokes the convention, is present. What must be determined is the interface between these competing rules of application.

It is my view that SP2 should prevail. In other words, the law of State A must be left to determine the rights of X since the sale to X occurred in that State. Consequently, SP1's security interest was lost under the law of State A with the result that SP2 gains priority over SP1 notwithstanding that SP1 registered first and its security interest could have been discovered by SP2 through a search of the International Registry.

There is no *via media* here. In other words it is not acceptable to conclude that, as between SP1 and X, the latter has priority because this is a matter that is purely domestic to State A but to conclude that, as between SP1 and SP2, the convention applies. On the surface a bifurcated approach might appear attractive as one that appears to permit the application of both the law of State A and the convention. However, on closer analysis it proves to be less than satisfactory. To give priority to SP1 over SP2 is to recognize that X is denied one important aspect of the ownership that it acquired under the law of State A: the right to charge the equipment. In effect, this is a denial of the efficacy of the law of State A.

The same principle properly applies in the following scenarios:

**Scenario 6:**

SP1 (secured party) enters into a security agreement with D (debtor) providing for a security interest in equipment which, at the time of the agreement, is located in State A, a convention State. Thereafter the equipment is taken by D to State B where D gives a security interest to SP2. State B is also a convention State. Under the municipal law of State B, X gets ownership free from both SP1's and SP2's security interest (because State B does not recognize the type of interest held by SP1 and/or SP2, because of the failure on the part of SP1 and/or SP2 to comply with A's registration rules or because of the operation of the principle of *en fait meubles, la possession vaut titre*). D then sells the equipment to X. D defaults under its security agreements and both SP1 and SP2 claim the right to enforce their security interests by seizure of the equipment from X. Assume that both SP1 and SP2 registered their security interests in the International Registry shortly after execution of the security agreements.

Consistent application of the approach suggested above for Scenario 5 would lead to the conclusion that SP1, but not SP2 is entitled to seize the equipment from X. The priority dispute involving SP2 and X is purely a matter of domestic concern since both interests arose when the equipment was in State B. However, the dispute between SP1 and X is governed by the convention since the relevant international event occurred between the time SP1's interest arose and X's interest arose.

**Scenario 7:**

SP1 (secured party) and D (debtor) enter into a security agreement providing for a security interest in equipment which at the time of the agreement is located in State A, a convention State. Thereafter the equipment is taken to State B, a convention State, and D gives a security interest in it to SP2. The equipment is then moved back to State A and D gives a security interest in it to SP3. D defaults under all three security agreements and SP1, SP2 and SP3 compete for priority to the equipment. Assume that SP1, SP2 and SP3 registered their security interests in the International Registry shortly after execution of the security agreements.

The priority competitions between SP1 and SP2 and between SP2 and SP3 would be determined under the priority rules of the convention. However the priority competition between SP1 and SP2 would be determined under the law of State A. Accordingly, in the context of this priority dispute it would be necessary to determine whether or not the security interests of both SP1 and SP3 are valid under the law of State A. However, in the context of the SP1 v. SP2 priority dispute or the SP2 v. SP3 priority dispute it is not

relevant that the type of security interest that the parties held were not be recognized under the law of State A or State B.<sup>9</sup>

**Scenario 8:**

SP1 (secured party) and D (debtor) enter into a security agreement providing for a security interest in equipment which at the time of the agreement is located in State A (whether or not a convention State). Thereafter the equipment is taken to State B (a convention State) and D gives a security interest in it to SP2 and to SP3. D defaults under all three security agreements and SP1, SP2 and SP3 compete for priority to the equipment.

The priority competitions between SP1 and SP2 would be determined under the priority rules of the convention. However the priority competition between SP2 and SP3 would be determined under the law of State B. Accordingly, in the context of this priority dispute it would be necessary to determine whether or not the security interests of both SP2 and SP3 are valid under the law of State B. However, in the context of the SP1 v. SP2 priority dispute or the SP1 v. SP3 priority dispute it is not important that the type of security interests held by the parties were not be recognized under the law of State A or State B.<sup>10</sup>

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<sup>9</sup> Where two separate priority systems are applied in tandem it is quite possible to end up with a circular result. See the brief discussion of circular priorities in note 10, *infra*.

<sup>10</sup> There is an argument to be made for application of the convention to all the priority issues that arise in this and similar scenarios. Assume that SP1's security interest is registered in the International Registry after SP2's security interest is taken but before SP3's security interest is taken. Assume also that SP3's security interest has priority over SP2's security interest because of failure on the part of SP2 to comply with the law of B dealing with perfection. In this situation, a circular priority problem arises: SP2 has priority over SP1, SP1 has priority over SP3 and SP3 has priority over SP2.

A policy choice must always be made where there is potential for circular priorities. Should an attempt be made to prevent them from occurring by changing the priority structure, or should the courts be handed the task of "breaking the circle"? The practical reality is that it is likely impossible to design a set of priority rules that precludes all possibilities for circular priorities particularly, where, as in Scenario 8, the circularity results from applying two separate priority systems in tandem. As a general rule, the Canadian approach has been to attempt to eliminate the potential for circular priority problems only where the likelihood of their occurrence is high.

**Article \_\_\_\_\_**

**When applying the priority rules of this convention to a competition between two or more persons referred to in Part \_\_\_\_\_ (the priority rules),**

**(a) no regard shall be had to the law of a State that is not party to the convention when determining whether or not a debtor owned the equipment or held the equipment free from a prior charge,**

**(b) the priority rules of this convention shall be applied subject to the law of the State where the equipment was located when a security interest arose to the extent that those laws affect the validity and enforceability of the security interest in relation to other interests arising when the equipment is located in that State. This provision applies only where such State is party to this convention.**

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**-Enforcement of the Security Interest (Inter partes Issues)**

Selecting the law applicable to enforcement of a security interest upon default by the debtor is a matter that received considerable attention by the Working Group. However, no clear consensus emerged from the discussions.

If the convention were to contain rules dealing with enforcement upon default by debtors, secured parties would have some assurance that they would be able to enforce their security interests in another convention State in an expeditious and efficient manner.

A compelling argument can be made that the convention enforcement rules should apply when, at the time of enforcement, the equipment happens to be in the State where the equipment was located when the security interest was created. If the convention rules applied in such cases, the nature of the enforcement rights of secured parties would not depend upon the fortuitous location of the equipment at the date of enforcement or upon the caprice of the debtor who may otherwise be induced to forum shop for the most favourable system. If this approach were to be adopted, it would be necessary to avoid imposing the convention enforcement system on what would be viewed as purely domestic situations. This could be done through an intention test to determine whether or not the transaction has a significant international element. If the parties intended that the equipment would be used principally in the State where the security interest arose, but occasionally used elsewhere, the international element is weak, and, perhaps, the convention enforcement system should not apply. However, if the parties understand that the equipment would be used principally in States other than the State in which the equipment was situated when the security interest arose, the fact that enforcement happens to occur in the original *situs* is completely fortuitous and should not be the basis for applying the law of that State to issues of enforcement.

The enforcement system of the convention should be applicable even though the security interest being enforced arose when the equipment was located in another State that is not a party to the convention. Otherwise the certainty that the convention is designed to give to secured financiers would be lost. Of course, a defaulting debtor may be induced to move the equipment to a non-convention State in order to escape the rules of the convention. There is nothing that can be done about this; the only solution is to maximize the number of States that are parties to the convention.

The following scenarios demonstrate the approach described above:

**Scenario 9:**

SP1 (secured party) and D (debtor) enter into a security agreement providing for a security interest in equipment which at the time of the agreement is located in State A, (whether or not a convention State). While the equipment is in State B, a convention State, D defaults.

The enforcement rules of the convention apply.

**Scenario 10:**

SP1 (secured party) and D (debtor) enter into a security agreement providing for a security interest in equipment which at the time of the agreement is located in State A, a convention State. The circumstances indicate that the intention of the parties is that the equipment will be used by the debtor primarily in State A but infrequently it will be used for short periods of time in other States. While the equipment is in State A, D defaults.

Even though State A is a convention State the enforcement rules of the convention would not apply. However, if at the date of default the equipment happens to be in State B, a convention State, State B would apply the convention enforcement rules.

**Scenario 11:**

SP1 (secured party) and D (debtor) enter into a security agreement providing for a security interest in equipment which at the time of the agreement is located in State A, a convention State. The circumstances indicate that the intention of the parties is that the equipment will be used by the debtor primarily in States other than State A, but infrequently it will be used for short periods of time in State A. While the equipment is in State A, D defaults.

Even though State A was the *situs* of the equipment at the date of both creation of and enforcement of the security interest, the convention enforcement rules of the convention would apply.

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Article \_\_\_\_\_

Part \_\_\_\_\_ (provisions dealing with enforcement against the debtor) applies where

**(a) the equipment is moved from a State where it was located when the security interest being enforced arose to another contracting State and enforcement of the security interest occurs there,**

**(b) at the time the security agreement was executed, the parties intended that the equipment would be used principally in one or more States, other than the State where the equipment was located when the security interest arose, and enforcement of the security interest occurs in a contracting State, including the State where the equipment was located when the security interest arose.**

**For the purposes of (b), the intention of the parties is determined by reference to the terms of the security agreement or any related agreement, the business of the debtor and other circumstances existing at the date the security agreement is executed.**

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## **V. PRIORITY RULES**

### **1. The Operational Principles**

It is assumed that the convention will provide for an international registry (or some other effective system for giving public disclosure to convention security interests). This being the case, the principal features of the priority system of the convention can be built around the basic rule that the *in rem* rights in the equipment (i.e., the security interest) that a secured party acquires under a security agreement are subordinated to other specified *in rem* interests if the appropriate steps to give notice of the security interest have not been taken by the secured party before a competing interest arises, in the case of interests other than security interests, or before a competing security interest takes such steps.



An underlying issue important to the functioning of the system embodied in the convention is the determination as to when the security interest comes into existence. While the general priority system of the Act (i.e., competition between competing security interests) is not based on a first-to-come-into-existence rule, but a first-to-register rule, the date of creation of a security interest is important for other purposes.

One of the conceptual issues that must be settled is whether the convention will recognize security interests in *in rem* interests less than full ownership. It is my understanding that civilian lawyers have a great deal of trouble with the concept of divided ownership and would not be prepared to accept the common law concept of a security interest in a limited interest (e.g., the interest of a lessee under a long term lease).

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**Article \_\_\_\_\_**

**(1) For the purposes of Part \_\_\_\_\_ (the rules dealing with enforcement), a security interest comes into existence when**

- (a) the parties have entered into a security agreement, and**
- (b) the debtor acquires rights in (ownership of) the equipment.**

**(2) For the purposes of Part \_\_\_\_\_ (the rules dealing with priorities), a security interest comes into existence when**

- (a) the parties have executed a security agreement meeting the requirements of Article \_\_\_\_\_, and**
- (b) the debtor acquires rights in (ownership of) the equipment.**

**(3) Where a security agreement provides for a security interest in equipment to be acquired by the debtor at a later time, the security interest comes into existence in accordance with the terms of the agreement without the need for appropriation of the equipment to the agreement.**

(NOTE: This Article is drafted so as to accommodate what is described above as the Canadian approach to the writing requirement. Under this approach a security agreement is enforceable *inter partes* without the need for a written agreement. Consequently, all that is needed for the creation of a security interest enforceable *inter partes* is an oral security agreement and the debtor's acquisition of rights in the equipment. Where enforcement against third parties is involved, the writing requirements of the convention are a prerequisite to the creation of a security interest. If the decision is taken to adopt what is described above as the American approach to the writing requirement, clause (1)

would be deleted and creation for all purposes, not just priorities, would require compliance with the writing requirements of the convention.

## **2. The Position of Specific Kinds of Interests**

### **-Competing Security Interests**

In a simple competition between two security interests, priority should go to the first to be registered, whether or not the holder of that interest had knowledge of the existence of the other unregistered interest before it acquired its interest or before it registered its security interest. While this approach appears to be somewhat clinical and one that rewards persons acting with knowledge of a pre-existing interest, experience under the North American systems has demonstrated the value of it. It gives certainty to secured financing by precluding protracted and unpredictable litigation involving the difficult issues of proof of knowledge that are endemic to a system that gives priority only to someone who acquired the interest without knowledge of the prior security interest.

The Working Group favoured the suggestion that a convention security interest be able to secure obligations of the debtor arising after execution of the security agreement and registration of the registration statement. If this is to be a feature of the convention, it is necessary to make it clear that the date of registration of the registration statement is the date for priority for all obligations of the debtor incurred under the security agreement. An important policy issue arises in this context. In several North American jurisdictions the decision has been made to protect execution creditors who have caused collateral to be seized from being affected by advances made by the secured party after the seizure has occurred and with knowledge of it. I suggest that this same policy be included in the convention.

There was considerable support among the members of the Working Group for extending the scope of a convention security interest to include after-acquired equipment. If this decision is to be reflected in the priority regime of the convention, it will be necessary to recognize that a registration statement can be registered in the International Registry before the debtor acquires the equipment, and that the priority status of the security interest that arises when the equipment is acquired dates from the date of registration of the registration statement and not from the date the debtor acquires rights in (or ownership of) the equipment. At most, the preconditions to registering a registration statement would be an executed security agreement and an ability to provide on the registration statement a description of the equipment. (See the discussion of equipment identification number, *infra*).

The decision to recognize that a convention security agreement can provide that the security interest attaches to after-acquired equipment and the rule that priority dates from

the date of registration of the registration statement cumulatively create the need for a special priority rule. Consider the following scenario:

**Scenario 12:**

SP1(secured party) takes a security interest in a truck(lorry) owned by D (debtor). The agreement provides that the security interest will extend to a second truck to be purchased by the debtor some time thereafter. SP1 registers a registration statement relating to this agreement. (Assume that in some way SP1 is able to describe the second truck with sufficient particularity to satisfy the requirements of the International registry.<sup>11</sup>) D purchases the second truck from SP2 under a title retention sales agreement which provides for deferred payment of the purchase price. SP2 registers a registration statement relating to the sales agreement.

Without a special priority rule giving priority to SP2, SP1 would have priority to the second truck since SP1's security interest would attach to the truck and, as between, SP1 and SP2, the former was the first to register a registration statement relating to the security interest in the truck. This is very likely to be seen as being a commercially unreasonable result. SP2, not SP1, supplied the credit to D to acquire the second truck. If SP2 was aware before it entered into the sales agreement with D of the existence of SP1's security interest, it would very likely have refused to sell the vehicle to D other than for cash. This would deny D an additional source of credit and place it under at the mercy of SP1 so far as concerns D's ability to get additional funding for the acquisition of a second truck.

The solution that has been adopted in most North American jurisdictions to deal with these difficulties is to recognize a special priority for any financier who has provided money or credit through which the debtor acquires an interest in (ownership of) the equipment in which a security interest. The interest of the purchase money financier is labelled a "purchase-money security interest" («sûreté en garantie du prix d'acquisition»). Under this special rule, the holder of a purchase money security interest has priority over a prior registered security interest in the same equipment.

It is, of course, possible to have two purchase money security interests in the same equipment. It would be necessary to provide a special priority rule to deal with such a situation.

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<sup>11</sup> This may be difficult, but not impossible, to do if an identification number of equipment is a mandatory feature of a properly registered registration statement.

**Article \_\_\_\_\_**

**"Advances" means the payment of money, the provision of credit and obligations of the debtor to pay interest, credit cost or other costs payable by the debtor in connection with an advance or the enforcement of the security interest; and includes advances whether or not made pursuant to an obligation, reasonable costs incurred and expenditures made for the protection, maintenance, preservation or repair and disposition of the mobile equipment.**

**Article \_\_\_\_\_**

**A security interest may secure advances made at any time during the currency of the security agreement, but a contractual obligation owing to a debtor to make advances is not binding on a secured party if the rights of persons mentioned in Article \_\_\_\_ (execution creditors and representative of creditors) have arisen and the secured party has knowledge of this fact before making the advance.**

**Article \_\_\_\_\_**

**(1) Where no other method for determining priority between security interests in the same mobile equipment is provided in this convention, the following priority rules apply:**

**(a) priority between security interests in the same mobile equipment is determined, without regard to the date where the security interests came into existence, by the order of the occurrence of the following:**

**(i) the registration of a registration statement relating to the security interest, and**

**[(ii) by taking of possession, other than by seizure, of the mobile equipment by the secured party],**

**whichever is the earlier;**

**(b) a security interest with respect to which the steps mentioned in clauses (a)(i) [or (a)(ii)] have been taken has priority over a security interest with respect to which [neither of] the step[s] has been taken,**

**(c) where [neither of] the step[s] mentioned in clause (a)(i) [or (a)(ii)] has been taken with respect to any of the security interests, priority is determined by the order that the security interests came into existence,**

**(d) a security interest to which this convention applies has priority over any other interest in mobile equipment arising under a financing agreement or retained by a seller of the equipment to secure an obligation of the debtor.**

**[(2) For the purposes of clause (1)(a)(ii), a secured party has not taken possession of the equipment that is in the apparent possession or control of the debtor or the debtor's agent.]**

**(3) The priority that a security interest has under clause (1) applies to all advances.**

**(4) A registered security interest [or a security interest in equipment in the possession of the secured party] has priority the persons mentioned in Articles \_\_\_\_\_ (buyers, lessees, execution creditors and a representative of creditors) only to the extent of advances made**

**(i) before the interest of such persons otherwise arise, or**

**(ii) before the secured party acquires knowledge the interests of such persons,**

**(iii) in accordance with a statutory requirement or a legally binding obligation owing to a person other than the debtor entered into by the secured party before the secured party acquires the knowledge referred to in paragraph (ii), or**

**(iv) for the protection, maintenance, preservation or repair and disposition of the mobile equipment.**

**Article \_\_\_\_\_**

**"Purchase money security interest" means:**

**(a) a security interest taken in equipment to the extent that it secures payment of all or part of the purchase price of the equipment, and**

**(b) a security interest taken in equipment by a person who gives value for the purpose of enabling the debtor to acquire rights in (ownership of) the equipment, to the extent that the value is used for this purpose,**

**but does not include interests arising under a transaction providing for the sale of equipment to secured party by the debtor and sale or lease back of the equipment to the debtor, and, for the purposes of this definition, "purchase price" and "value" include credit charges or interest payable for the purchase or loan credit.**

**Article \_\_\_\_\_**

**(a) Subject to clause (b), a registered purchase money security interest [or a purchase money security interest in equipment in the possession of the secured party other than as a result of seizure] has priority over any other security interest**

***In the same equipment given by the same debtor, and clause (a) of Article \_\_\_\_ (the residual priority rule) applies where two purchase money security interests given by the same debtor in the same equipment are in competition.***

***(b) A purchase money security interest referred to in clause (a) of the definition of "purchase money security interest" has priority over a purchase money security interest referred to in clause (b) of the same definition if both security interests are registered [or one security interest is registered and the equipment is in the possession of the holder of the other security interest other than as a result of seizure].***

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### **-Security Interests and Other Competing Interests**

I have proceeded on the assumption that an effective registry system eliminates the need for the civil law principle of *en fait meubles, la possession vaut titre*. If a potential buyer can discover the existence of a security interest in the equipment by obtaining a search result from the International Registry, there is no need to give it protection from prior security interests. It follows that where the security interest is not registered (or the equipment is not in the possession of the secured party), the buyer takes free from the security interest.

An important policy question arises as to whether or not the buyer must be unaware of the prior security interest in the equipment in order to have priority. It will be noted that lack of such knowledge is not a requirement of priority for a competing security interest. Strangely enough, the North American systems make it a requirement for buyers, but not other secured parties. In my opinion, the reason for this inconsistency has not been convincingly articulated.

There was a brief, but inconclusive discussion at the March 1993 of the Working Group concerning the position of a holder of a security interest where the debtor becomes a bankrupt (or some form of insolvency system is invoked). There are two quite separate issues involved. The most difficult one is whether the convention should specifically state that a registered security interest is not subject to subordination to a trustee in bankruptcy or liquidator. If such a provision were included, this feature would certainly make the convention more attractive to equipment financiers. The second, and clearly subsidiary issue, is whether an unregistered security interest should be subordinated to a trustee in bankruptcy or liquidator.

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**Article \_\_\_\_\_**

**(1) Subject to clause (2), when public notice of the existence of a security interest has been given by registration of a registration statement relating to the security interest [or by taking of possession, other than by seizure, of the mobile equipment by the secured party] the security interest remains enforceable notwithstanding the bankruptcy or insolvency of the debtor.**

**(2) Nothing in clause (1) shall affect bankruptcy or insolvency laws relating to fraudulent preferences or conveyances, protection of worker's interests, ....., .....**

**(3) A security interest is subordinate to a trustee, liquidator or similar representative of creditors of an insolvent debtor if, at the time the insolvency proceedings are commenced, public notice of the existence of a security interest has not been given by registration of a registration statement relating to the security interest [or by taking of possession, other than by seizure, of the mobile equipment by the secured party].**

**Article \_\_\_\_\_**

**A security interest is subordinate to**

**(a) a buyer or lessee of the equipment whether or not the buyer or lessee knew of the security interest at the time of the sale or the lease,**

**(b) a creditor who has caused the equipment to be seized under legal process to enforce a judgment against the debtor,**

**if, at the time of the sale, lease or seizure, public notice of the existence of a security interest has not been given by registration of a registration statement relating to the security interest [or by taking of possession, other than by seizure, of the mobile equipment by the secured party].**

**V. THE REGISTRY SYSTEM**

Set out below are some draft provisions describing the skeleton of a possible registry system for the convention. Here again, the purpose for including rather precise provisions is not to present a draft convention, but to highlight the details of a central, computerized registry. I am presuming that most of the members of the Working Group do not have experience with registries and will be unaware of at least some of the factors involved.

For the purposes of the draft article set out below, I have assumed that the registry will be created and maintained by UNIDROIT.

A matter that will have to be examined in detail is whether it is necessary or desirable to make exceptions for security interests in those types of equipment that are registered as to nationality and provide for registration of such security interests in a registry maintained by the home State of the equipment. In my view a strong argument can be made for the elimination of State run registries in favour of an international registry. If, for example, aircraft are brought into the convention, countries, which for some reason have found it difficult to establish a national registry for security interests in aircraft, would not be able to become parties to the convention. This may well be a particularly important consideration for States that have no tradition of registries for security interests and are not willing to establish one just for this purpose. It is relevant to note in this context that, while most states of the world provide a nationality registry for aircraft, only a minority are parties to the 1948 *Geneva Convention on Recognition of Rights in Aircraft*.

While it is assumed that the great bulk of registrations will be effected electronically through remote computer terminals, it should be possible for someone to send a written registration statement to the registry.

The type of registry set out below assumes two separate (but not equally efficacious) registration-search criteria: the debtor's name and an identification number for the equipment. The identification number must be treated as the most important of the two since it is the one that is constant. The debtor can change its name or may transfer the equipment to someone else and third parties may not be aware of the name change or that the person in possession is not the debtor. For example, if A takes a security interest in an item of equipment owned by B, and B then sells the item to C, who offers it as collateral to secure a loan from D, unless D can use the identification number of the collateral as the search criterion, all it can do is to obtain a search result using C's name as the search criterion. Since B, not C, is the debtor named in the registration statement, D's search will not reveal A's security interest. If D can use the identification number of the equipment as a search criterion, its search will reveal A's security interest if A has complied with the requirements that this number be recorded on its registration statement. It will be noted that X (a person who deals with B) is in a different position than that of D. If X wants to determine whether or not there exists a perfected security interest in the item, two search criteria are available: the debtor's name and the collateral identification number. D has only the identification number.

If the debtor's name is to be available as a reliable search criterion (something not included in the following formulation), it would be necessary to include in the convention elaborate provisions dealing with change of the debtor's name or transfer of the collateral to someone else either with or without the consent of the secured party.



Article \_\_\_\_\_

**"Registry" means the International Registry for Security Interests established pursuant to Article \_\_\_\_\_**

**"Registration statement" means:**

- (1) a printed registration statement as prescribed by the Rules, and**
- (2) data authorized to be transmitted electronically to the data base of the registry to effect a registration**

**and where the context permits, registration statement includes a registration amendment statement.**

**"Registration Amendment Statement" means:**

- (1) a printed registration statement as prescribed by the Rules, and**
- (2) data authorized to be transmitted electronically to the data base of the registry to effect a registration.**

**"Rules" means rules promulgated as provided in Article \_\_\_\_\_**

Article \_\_\_\_\_

**(1) There shall be a registry known as the International Registry for Security Interests established for the purposes of registrations under this convention and for registrations that are permitted or required under any other international enactment to be made in the Registry.**

**[(2) The Governing Council of the International Institute for the Unification of Private Law shall appoint the registrar and promulgate rules for the administration of the Registry].**

A matter that will have to be addressed is whether or not it will be a requirement that a security agreement be executed before a registration relating to it can be effected. In most North American systems there is no such requirement. While this is a matter that is of primary importance in the context of inventory, there may well be situations in which it is commercially important to be able to register (and establish priority) before an

agreement is executed. As noted above, if the convention is to recognize security interests that attach to after-acquired property of the debtor, it will be necessary to permit registration in advance of the creation of security interests.

The registry system contemplated by the following provisions is one that is very flexible. A person can register a registration statement against the name and equipment of another person even though the other person has not yet executed a security agreement. (But see alternative clause (3)). Even if the registration occurs after the execution of the agreement, there is no requirement that the period of registration (registration life) selected by the secured party parallels the period of the agreement. If the Canada pattern is followed, the registration life could be up to twenty-five years or even infinity.

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**Article**

**(1) Registrations in the registry shall be effected by transmitting a registration statement to the registry in the manner provided by the Rules.**

**(2) Registration of a registration statement is effective from the time assigned to it by the registry, and where two or more registration statements are assigned at the same time, the order of registration is determined by reference to the registration numbers assigned to the registration statement by the registry.**

**(3) A registration statement may be registered before or after a security agreement is executed.**

**[(3) A registration statement may be registered any time after a security agreement is executed but may be registered before the security interest to which it relates comes into existence.]**

**(4) A registration statement may relate to more than one security agreement.**

**(5) The registrar may:**

**(a) reject a registration statement where, in the opinion of the registrar, it does not comply with the requirements of this convention or the Rules, or**

**(b) refuse to register registration statements, refuse to accept requests for search results or otherwise suspend one or more of the functions of the registry for a period of time during which, in the opinion of the registrar, circumstances are such that it is not practicable to provide one or more registry service.**

**(6) The validity of a registration is not affected by a defect, irregularity, omission or error in the registration statement unless the defect, irregularity omission or error is seriously misleading; but a registration statement can be seriously misleading even though no one was actually misled by it.**

**(7) An error in recording the name of the debtor is not seriously misleading if the equipment is described in such a manner as to not be seriously misleading.**

**(8) Subject to the Rules, a registration is effective for the period of time indicated on the registration statement and may be renewed at any time before the registration expires.**

**(9) An amendment to a valid and or invalid registration may be made by registering a registration amendment statement at any time during the period that the registration exists and the amendment is effective from the date the registration statement is registered to the expiry of the registration being amended.**

**(10) A registration may be discharged in whole or with respect to one or more items of equipment by registering a registration amendment statement.**

#### **Article \_\_\_\_\_**

**(1) Where a secured party with a registered security interest transfers the security interest or a part of it, a registration amendment statement may be registered disclosing the transfer.**

**(2) Where a registration statement is registered and an interest one or more than one, but not all items of equipment subject to a security interest is transferred, the registration amendment statement shall contain a description of the equipment in which the interest is transferred.**

**(3) Where a secured party transfers an interest in equipment and the security interest of the secured party is not perfected by registration, a registration statement may be registered in which the transferee is disclosed as the secured party.**

**(4) A registration amendment statement disclosing a transfer of a security interest may be registered before or after the transfer.**

**(5) After registration of a registration amendment statement disclosing a transfer of a security interest, the transferee is the secured party for the purposes of this Part.**

**(6) Where a security interest has been subordinated by the secured party to the interest of another person, a registration amendment statement may be registered to disclose the subordination at any time during the period that the registration of the subordinated interest is effective.**

**Article \_\_\_\_\_**

**Information in a registration may be removed from the records of the registry**

- (a) when the registration is no longer effective,**
- (b) on the receipt of a registration amendment statement discharging the registration or discharging it with respect to one or more items of equipment,**
- (c) on receipt of an order of a court compelling the discharge of partial discharge of a registration.**

**Article \_\_\_\_\_**

**(1) A person may request in the manner provided in the Rules one or more of the following**

- (a) a search according to the name of a debtor and the issue of a search result,**
- (b) a search according to an identification number of equipment and the issue of a search result,**
- (c) a search according to a registration number and the issue of a search result,**
- (d) a copy or certified copy of any printed registered document.**

**(2) A printed search result that purports to be issued by the Registry is receivable as evidence as prima facie proof of its contents including**

- (a) the date of registration of a registration statement to which the search result refers, and**
- (b) the order of registration of the registration statement as indicated by the registration number.**

**(3) A copy of a printed registered registration statement or other registered document bearing the certification of the Registrar is receivable in evidence as a true copy of the statement or document without proof of the signature or official position of the Registrar.**

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An unjustified registration against the name and equipment of a person can be very damaging to the interests of that person. At the very least, the person would have great difficulty in selling the equipment or obtaining credit on the security of it. Under these circumstances there is a need for some mechanism through which a person named as debtor in a registration or another person who has rights in the equipment described in the registration can force the secured party to discharge or amend a registration that does not reflect the relationship (or lack thereof) between the parties.

Set out below are two approaches. The first approach is the one that is used in the western provinces of Canada. It works very well and there is no evidence of abuse of the power it gives. The person named as debtor in a registration or another person who has rights in the equipment described in the registration has power to force discharge or amendment of a registration. The registering party can be forced to obtain a court order maintaining the registration. The alternative approach, which is employed in Ontario, requires that the person named as debtor in a registration or another person who has rights in the equipment make application to a court for an order requiring the discharge of the registration. Both approaches require the involvement of a court. Presumably this would be a court or tribunal of the jurisdiction in which the registry is located (Italy?).

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**Article \_\_\_\_\_**

**(1) In this Article,**

**(a) "debtor" includes any person named in a registered registration statement as a debtor, and**

**(b) "secured party" includes any person named in a registered registration statement as a secured party.**

**(3) Where a registration statement is registered and**

**(a) all of the obligations under the security agreement to which it relates have been performed,**

**(b) the secured party has agreed to release part or all of the equipment described in the registration statement,**

**(c) the description of the equipment on the registration statement includes an item that is not subject to a security interest arising under a security agreement between the secured party, or**

**(d) no security agreement exists between the secured party and the debtor,**

**the debtor or any person with an interest in equipment that falls within the equipment description on the registration statement may give a written demand to the secured party.**

**(4) The demand referred to in clause (3) may require that the secured party register a registration amendment statement,**

**(a) in a case within clause (3)(a) or (d), discharging the registration,**

**(b) in a case within clause (3)(b), amending or discharging the registration, as the case may be, so as to reflect the terms of the agreement, and**

**(c) in a case within clause (3)(c), amending the equipment description to exclude items that are not subject to a security interest arising under a security agreement between the secured party and the debtor,**

**and the secured party shall comply with the demand not later than 30 days after it is given.**

**Alternative 1:**

**(5) Where the secured party**

**(a) fails to comply with the demand referred to in clause (3) within 30 days after it is given or**

**(b) does not give to the Registrar an order of the Court confirming that the registration need not be amended or discharged,**

**the person giving the demand may register the registration amendment statement referred to in clause (4) on providing to the Registrar satisfactory proof that the demand has been given to the secured party.**

**(6) On application to a court by the secured party, the court may order that the registration**

**(a) be maintained on any condition, and subject to Article \_\_\_\_, for any period of time, or**

**(b) be discharged or amended.**

**Alternative 2:**

**[(5) When the secured party fails to amend or discharge the registration as required by clause (4) the person making the demand may apply to a court for an order directing that the registration be amended or discharged.]**

## **VI. ENFORCEMENT**

As noted above, there was considerable discussion but no agreement amongst the members of the Working Group as to whether convention should deal with enforcement of security interests. It is my view that the convention should specify basic enforcement rules. Private enforcement, with minimal involvement of courts, through seizure and sale of movables is permitted in both common law and civil law systems. This approach is the one that is likely to be supported by parties to security agreements providing for security interests in mobile equipment. A security interest in mobile equipment is of value only to the extent that the applicable law permits the secured party to enforce the security interest through an expeditious and efficient disposition of the equipment. Balanced against this is the need to recognize that the debtor or some one else may have a significant interest in the equipment which should not be sacrificed.

One of the issues that arises in the context of enforcement of security interests in equipment is whether or not the system should seek to ensure that the buyer from the secured creditor at the disposition sale acquires good title, or, at least, title free from any prior security interests in the equipment. It is my understanding that some civil law systems attempt to do this. In order to provide for this, an elaborate administration system is required under which the proceeds of sale are handed over to the court which determines how they are to be distributed so as to recognize appropriately the priority status of each claimant. Since all claims are extinguished on the sale, the proceeds must be correctly distributed to the holders of these claims. Generally, the common law systems do not work this way. The sale by the secured party passes whatever interest the secured party has the power to pass. If the secured party has a subordinate interest, its sale of the collateral passes title to the buyer subject to any interest having priority over the secured party. Of course, the sale cuts off any subordinate interest and, only in a situation where the proceeds are sufficient to satisfy the claim of the seller is there any obligation to account to the holders of subordinate interests for any portion of the proceeds of the sale.

The provisions set out below follow the common law pattern. This choice is not based on any suggestion of inherent superiority of the common law approach. The reason for its selection is that this approach involves the least amount of official intervention in the enforcement process. It is my view that it would be very difficult to create and administer in the context of an international convention a system following in this respect the pattern of the civil law.

Set out below is a set of enforcement provisions designed to provide the necessary balance between the interests of the secured party and those of the defaulting debtor or someone else with an interest in the equipment seized. An important policy question arises as to whether or not protection granted by these provisions to the debtor can be waived by agreement. Few States provide complete party autonomy with respect to enforcement of security agreements. This position is based on the assumption that, if significant party autonomy is allowed in this respect, any statutory provisions designed to protect the interests of debtors will almost always be negated through standard form provisions which will give to the secured party broad rights that might result in confiscation of the debtor's interest in the equipment.

A security interest is merely collateral to a debt obligation. The principal relationship between the parties is that of creditor and debtor and the security agreement does nothing more than to provide one method through which the secure party can obtain payment of the debt owing by the debtor. While the convention would apply to enforcement of the security interest, it would not deal directly with the debt. However, of necessity, it will affect the right to collect it. The obligation of the debtor is diminished *pro tanto* by the money realized from the sale of the equipment under the enforcement provisions. An election to keep the equipment in full satisfaction of the obligation secured extinguishes the obligation. Further, failure to meet the requirements of the convention produce losses that the debtor can set off against the debt.

The provisions set out below make specific reference to enforcement of a broadly based security interest (the equivalent of an English floating charge) that applies to collateral in addition to the mobile equipment and that, in some common law jurisdictions, would be enforced by a receiver. Whether or not there is need to accommodate this type of situation is a matter to be addressed by the Working Group.

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**Article \_\_\_\_\_**

**(1) *Excepts as otherwise provided, no provision of Part \_\_\_\_\_ to the extent that it give rights to the debtor or impose obligations on the secured party can be waived or varied by agreement or otherwise.***

**(2) *Where the equipment is collateral under a security agreement providing for a security interest in all or substantially all of the debtor's movable property, and the secured party has the right under the security agreement upon default by the***



**debtor to take control of the debtor's business and to sell the collateral as part of the sale of the business as a going concern, the following articles, other than Article (the article giving a right of redemption) do not apply and the rights of the secured party shall be determined by reference to the security agreement and the obligations of the secured party or agent of the secured party to proceed in a commercially reasonable manner.**

**Article \_\_\_\_\_**

**(1) On default under a security agreement,**

**(a) the secured party has, unless otherwise agreed, the right to seize the equipment, but in so doing may not contravene the laws of the State where the seizure is to take place designed to ensure public order,**

**(b) where the equipment is of a kind for which adequate alternative storage facilities are not readily available, the secured party may seize the equipment without removing it from the debtor's premises, and may dispose of it on the premises, but in so doing the secured party may not cause the person in possession of the premises any greater inconvenience and cost than is necessary incidental to the disposal.**

**(2) After seizing the equipment, a secured party may dispose of it in its existing condition or after repair or other preparation for disposition, and the proceeds of the disposition shall be applied consecutively to**

**(a) the reasonable expenses of seizing, repossessing, holding, repairing or preparing for disposition and disposing of the equipment and any other reasonable expenses incurred by the secured party, and**

**(b) the satisfaction of the obligations secured by the security interest of the party making the disposition,**

**and any surplus shall be paid over to the person entitled to it.**

**(3) Equipment may be disposed of by private sale or by public sale, including public auction or closed tender.**

**(4) The secured party shall give to**

**(a) the debtor,**

**(b) another secured party who, prior to the date notice is given to the debtor, has registered a registration statement relating to the equipment being sold,**

**[(c) another secured party who had possession of the equipment at the date of seizure by the secured party], and**

**(d) any other person who is known by the secured party to be an owner of the equipment,**

**reasonable notice of its intention to sell the equipment and the date, time and place of any sale by public auction, or the place to which closed tenders may be delivered and the date after which closed tenders will not be accepted, or the date after which any private disposition of the equipment is to be made.**

**(5) The notice referred to in clause (4) is not required where**

**(a) the secured party believes on reasonable grounds that the equipment will decline substantially in value if it is not disposed of immediately after default,**

**(b) after default, each person entitled to receive a notice of disposition consents in writing to the disposition of the equipment without compliance with the notice requirements of clause (4).**

**(6) When a secured party disposes of equipment to a purchaser who acquires the interest for value and in good faith and who takes possession of it, the purchaser acquires the equipment free from**

**(a) the interest of the debtor,**

**(b) an interest subordinate to that of the debtor,**

**(c) an interest subordinate to that of the secured party,**

**whether or not the requirements of this section have been complied with by the secured party, and all obligations secured by subordinate interests are deemed to be performed for the purposes of Article \_\_\_\_\_ (compulsory discharge of a registration).**

**(7) After default, the secured party may propose to take the equipment in satisfaction of the obligation secured by it, and shall give notice of the proposal to the persons referred to in Article \_\_\_\_\_ (the persons entitled notice of disposition)**

**(8) If, after a reasonable period of time, no objection to the proposal is given by a person entitled to receive notice of it, the secured party is thereafter deemed to have irrevocably elected to take the equipment in satisfaction of the obligation**

**secured by it, and is entitled to hold or dispose of the equipment free from all rights and interests of the debtor and any person entitled to receive the notice mentioned in clause (6) whose interest is subordinate to that of the secured party who has been given such notice, and all obligations secured by such interests are deemed performed for the purposes of Article \_\_\_\_\_ (compulsory discharge of a registration).**

**Article \_\_\_\_\_**

**At any time before the secured party has disposed of the equipment or contracted for disposition of it or before the secured party is deemed to have irrevocably elected to retain the equipment under Article \_\_\_\_\_, a person entitled to receive a notice of disposition under Article \_\_\_\_\_ may, unless that person otherwise agrees in writing after default, redeem the equipment by tendering fulfillment of the obligations secured by the security interest in the equipment together with a sum equal to the reasonable expenses of seizing, repossessing, holding, repairing and preparing the equipment for disposition if such expenses have actually been incurred by the secured party, and any other reasonable expenses incurred by the secured party in enforcing the security agreement.**

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## **VII. GENERALLY APPLICABLE STANDARDS**

Since the convention would function in an international context and not generally in the context of the municipal law of a particular state, it is important to provide a source of background principles that set standards and deal with matters not expressly addressed in the convention. The following provision is designed to provide this background.

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**Article \_\_\_\_\_**

**(1) All rights and obligations arising under a security agreement or specified in this convention or other law applicable to a security interest security agreement shall be exercised in a manner that is consistent with the standards of good faith and commercial reasonableness practiced in international financing transactions.**

**(2) Questions concerning matters governed by this Convention which are not expressly settled in it are to be settled in conformity with the general principles on which it is based.**