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

COMMENTS

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to the Memorandum by Professor R.C.C. Cuming
on a proposed Unidroit Convention on Security
Interests in Mobile Equipment

Rome, February 1994

Comments

on a Proposed UNIDROIT Convention on Security Interests in Mobile Equipment

in Preparation of the Drafting Committee Meeting
on 14 to 16 February 1994 in Rome

by

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Professor Ronald C C Cuming has set out in his "Memorandum on a proposed UNIDROIT Convention on security interests in mobile equipment" of 5 November 1993² the problem areas to be addressed by the Drafting Committee and given a great many notable drafting suggestions. His study will certainly be an invaluable source of inspiration for the forthcoming meeting of the Drafting Committee. I would like to supplement Professor Cuming's thoughts with this paper and raise some of the issues which may concern the Committee during its proceedings.

1. Approach

1.1 I base my comments on the assumption that the Committee will draft mainly substantive provisions and not a conflict of laws convention.³

1.2 It would be desirable to take a comprehensive and not a skeleton approach. The convention should as far as possible deal with all questions related to a newly established security right over mobile equipment and not refer too often to national law.⁴

1.3 The rules adopted under the proposed convention should be as simple as possible to enhance the chance of its adoption.

¹The author would like to thank Dr Thomas A Frick, London, for his help in preparing this paper.

²UNIDROIT 1993 Study LXXII - Doc. 8.

³Cf. Cuming, *supra* note 2 p 1-2; also the recommendation in Simpson and Röver, Initial Comments on the Report of the Unidroit restricted exploratory Working Group (Study LXXII - Doc. 5), Study LXXII - Doc. 6 Add. 2 para 1.

⁴A comprehensive approach was not chosen for the Unidroit Convention on International Financial Leasing which is not comprehensive neither in scope nor in substance, cf. Carsten Dageförde, Internationales Finanzierungsleasing, Deutsches Kollisionsrecht und Konvention von Ottawa (1988), Mit dem Text des UNIDROIT-Übereinkommens vom 28. Mai 1988, München: C.H. Beck'sche Verlagsbuchhandlung, 1992.

2. General Conceptual Problems of a Convention on International Security Rights

Before I discuss the scope of the proposed convention and some substantive aspects I want to identify some of the conceptual problems the drafting of such a convention faces because of the different approaches to security rights in legal systems. The goal of creating an international convention must be to establish a legal text which is acceptable to different legal systems. This is, however, extremely difficult because legal systems differ considerably. In the field of security rights I find the following conceptual differences to be the most intricate ones.

2.1 Secured Transactions, Security Interests or Security Rights as Conceptual Foundation?

2.1.1 Security can be given by way of personal rights and by way of proprietary rights. Both ways of creating security are sometimes summarised as "secured transactions" in a non-technical use of this notion, although they are governed by different rules.

The use of the term "secured transactions" is different under Article 9 of the American Uniform Commercial Code and the provisions of some of the Canadian Provinces. These rules are generally designed to cover all secured transactions and to submit them to one legal regime.⁵ However, as secured transactions under these systems mainly cover proprietary transactions such as creation of security interests, assignment of claims and retention of title clauses and obligations to give security are mostly outside their scope. These systems do not include all aspects of security under one legal regime. What a secured transaction is depends under these systems on a definition like Article 9-102 UCC. The term "secured transactions" seems not to be a proper foundation for a particular security right as envisaged by UNIDROIT.

2.1.2 Another conceptual question is whether the convention should refer to security interests (the provisional title to date) or security rights. The question is interwoven with the question of which concept of ownership should underlie the convention. Common law recognises the distinction between legal and equitable interests.⁶ Both types of interests are interests in rem⁷ although equitable interests create only effects between parties ("equity acts in personam") and are, therefore, from a civil point of view indistinguishable from rights in personam. The essence of an interest seems to be that several persons can have interests of a different nature in the same property. On the other hand, the essence of a right seems to be that property is related to one person or several persons exclusively.

⁵ See for a similar discussion in the field of assignment of claims Röyer, Unification Work by UNCITRAL on Assignment of Claims, Law in Transition Spring 1994 (to be published).

⁶ See Goode, Commercial Law, London: Penguin Books, 1982, pp 52-61.

⁷ Hebrich, Einführung in das englische Privatrecht, Darmstadt: Wissenschaftliche Buchgesellschaft, 2nd ed. 1993, p 32.

If the Drafting Committee has to choose between the two notions the word "security right" seems to be preferable. Whereas it is possible to speak of rights under common law it seems to be difficult to accommodate the concept of a security interest under civil law systems.

2.2. Distinction of Legal Relationships

Some civil law jurisdictions make intricate distinctions between different legal relationships not followed by common law countries nor by other civil law countries. One example is the distinction between agency as a contract and agency as an authority.⁸

Another example which is close to the subject of a convention on security interests is the distinction between an agreement creating or transferring a proprietary right and the underlying agreement.⁹ The agreement creating or transferring a proprietary right is only of minimal content: nothing more than the creation or the transfer itself is dealt with in this agreement.

Under many other legal systems the agreement creating or transferring proprietary rights,¹⁰ however, contains two elements: an agreement relating to the creation or the transfer of the right in rem and at the same time the obligation to create this right. It, therefore, comprises proprietary and obligational elements. Although the agreement comprises an obligational element this does not prevent entry into separate obligations related to this agreement.

To facilitate understanding between different legal systems it would be desirable to refer explicitly to the part of a transaction which is in question. For example, the European Bank's Model Law for Secured Transactions refers to "transfers of title in charged property" or "transfers of title in charged property" where a proprietary aspect is dealt with.¹¹

2.3 Common Law Doctrine of Privity of Contract

The doctrine of privity of a contract says that the rights arising under a contract can be enforced or relied upon only by the parties to the contract ("as between the parties").¹² This applies regardless of whether a contract shall create rights in personam or rights in rem.¹³ Effects as against third parties are not created by an agreement itself but by an additional act such as registration. This view of common law is elegantly conceptualised in the distinction between attachment and perfection under Article 9 UCC.¹⁴

⁸Zweigert and Kötz, *An Introduction to Comparative Law*, Oxford: Clarendon Press, 2nd ed. 1992, p 46.

⁹Zweigert and Kötz, *supra* note 4, pp 474-475, 477 in the context of assignment of debts.

¹⁰E.g. by way of sale.

¹¹Articles 17 and 18 of the European Bank's Model Law for Secured Transactions (MLST).

¹²Treitel, *An Outline of the Law of Contract*, London: Butterworths, 4th ed., 1989, p 208.

¹³The doctrine of privity of contract should, therefore, not be confused with the distinction between obligations and proprietary rights drawn above.

¹⁴Goode, *supra* note 6 p 734, suggests to use the same terminology for security under English law.

Civil law, however, prefers to distinguish: either a contract is of effect between the parties and therefore creates rights in personam, or it is of effect against third parties and therefore of proprietary nature. For example registration is, therefore, not only a means to enlarge the effects of a right against third parties. It is necessary to create the right.

2.4 Doctrines of Specificity and Certainty

The doctrines of specificity and certainty are not always separated clearly enough.¹⁵

2.4.1 The doctrine of specificity which is known, in particular under civil law systems says that a property right basically can only relate to one single, legally separate asset and cannot cover, for example, a library as a whole. Examined more closely the doctrine of specificity comprises two meanings: firstly it may refer to the legal relationship between a holder of a property right and an asset. In this respect it is certainly true that a legal relationship must exist between a holder of a right and a certain asset. In the end every legal relationship must be a "specific" one. A second aspect of specificity is whether or not several legal relationships which are "specific" in the sense just mentioned, may be summarised in one agreement and in one right. Although the doctrine of specificity under some civil law systems requires that an agreement can only refer to one single asset, there are obviously exceptions made for fiduciary assignments and fiduciary transfers of title in movables (for security purposes) which may cover classes of assets defined in a general manner. It is submitted that the whole doctrine of specificity is not of great use in the context of security rights (except for specificity in the sense that there is always a specific legal relationship between the holder of a right and a certain right). It should, therefore, be possible to create one security right not only in a single item of property but also in several items within one security agreement.

2.4.2 The doctrine of certainty requires a certain degree of description of assets in an agreement creating or transferring property rights. An agreement which does not comply with the requirements of certainty is not valid. Whereas certainty is required for any agreement¹⁶ and normally a question for the interpretation of an agreement, the degree of certainty may be modified depending on the time when certainty is required.¹⁷ The earliest time is the time of entering into the agreement; later times are such times when the agreement becomes effective (e.g. with registration) or of the transfer of title in the property given as security in the case of future property; the latest time is at the enforcement of the security right.

¹⁵Cf. Baur, Lehrbuch des Sachenrechts, München: C.H. Beck'sche Verlagsbuchhandlung, § 4 III and Medicus, Bürgerliches Recht, Köln, Berlin, Bonn, München: Carl Heymanns Verlag, 15th ed. 1991, paras. 26 and 521, who both define certainty as specificity and vice versa; a clear distinction draws Manfred Wolf in his outline Sachenrecht, München: C.H. Beck'sche Verlagsbuchhandlung, § 2 III and IV.

¹⁶Obviously certainty is also a prerequisite for legal agreements which are not related to property rights.

¹⁷Medicus, supra note 9 § 62 I 2 a.

If the doctrine of specificity is rejected and it becomes possible to create one security right over several items of property (cf. 2.4.1 above) then it should be possible in relation to the certainty of the agreement to describe property given as security specifically or generally (cf. Article 4.3.2 of the European Bank's Model Law for the identification of a secured debt and Article 5.3 for the identification of charged property). The extent of a security right is, therefore, dependent on the definition by the parties to the agreement and they should be given as much freedom as possible.

3. Scope of the Convention

3.1 Nature of the Security Right under the Convention

The discussions of the Study Group and the proposal of Professor Cumming point to a security right having the nature of a limited right in rem. The security right is a right in rem because it is of effect against third parties. It is a limited right because it essentially gives to the person receiving security the right to only enforce against the property given as security.

3.2 Contractual Security Rights

It is not envisaged to cover security rights by way of operation law of judicial or administrative act.

3.3 Definition of Mobile Equipment

A convention for only certain types of property given as security is envisaged. The question of how to define mobile equipment is the most intriguing question of the whole exercise and determines the outcome of many other question. Professor Cumming has opted for a comprehensive scope of the proposed convention.

However, one may also argue in favour of a more restricted scope which is focused on the types of equipment for which problems are most pressing.¹⁸ The advantage of such an approach is that the drafting exercise is facilitated and the adoption of the convention is politically more likely. It became clear from the proceedings of the Study Group that ships, aircraft and probably also space objects would not be suitable for any kind of international regulation as legal rules already exist. The past proceedings of the Study Group in March 1993 seemed to indicate that in particular security rights over containers and rolling stock (Eurofima) are vulnerable to any crossing of borders. Trucks were also put forward as a type of mobile equipment in need of an international convention. However, the need to include trucks in the convention was not put forward by a specific institution and one can imagine that the interests of truck owners and users vary considerably. It is not yet clear if trucks should be included in the convention.

¹⁸Cf. already the recommendation in Simpson and Röyer, supra note 3 para 3 where it was envisaged that a convention would at least initially be limited in scope.

The suggested limitation of the definition of mobile equipment under the convention bears further advantages. It solves the problems inherent in the definition of mobile equipment under the Article suggested by Professor Cuming:¹⁹ "goods ... used by the debtor principally in a trade or business .. which are of a kind generally taken from one State for use in the other State ..".²⁰ The scope of such a definition must vary from one contracting state to another according to their size: whereas in Luxembourg almost everything would come under the Convention, its scope would be comparatively minimal in Brazil. The definition envisaged seems also problematic because of the several limitations it contains (e.g. only vessels of a certain medium size shall fall under the convention).

3.4 Commercial Equipment

The convention should only cover equipment used for commercial purposes. This limitation is already contained in the definition of mobile equipment because containers and rolling stock are only used in commercial contexts.

3.5 Equipment of an International Character

The proposed convention will have to determine under which circumstances mobile equipment is regarded as being international in character. The international character of equipment may derive (1) from the internationality of the transaction or (2) from different residences or places of business of the parties. As the convention wants to cover situations where equipment is moving from one country to another it is advisable to include situations of the latter category as this is an indicator for potentially moving equipment.²¹

It may be possible to co-ordinate the definition of international elements with Article 1 of the United Nations Convention on International Sales of Goods 1980 (CISG). This would lead to a wide definition for internationality which includes cases of potential internationality.²²

3.6 Local Application

A different question is whether or not the convention should apply only when the property given as security is located in one of the contracting states. The convention's scope and usefulness would be enlarged if parties could create a security right under the convention whether or not the property given as security is located in a contracting state. Although the security right could therefore be created, rights under the security right could be exercised only from the time the charged property is moved into a contracting state unless a non-contracting state would recognise international security rights created under the convention.

¹⁹Cuming, *supra* note 2 p 5.

²⁰Cf. Cuming, *supra* note 2 p 5.

²¹The international factors should therefore not only focus on the international character of the transaction which may be suggested by the conflict of law rules for movables which often refer to the law of the place where the movable is located.

²²Cf. also the recommendation in Simpson and Röver, *supra* note 3 para 2.i.

3.7 Convention as Optional or Compulsory Legal Regime

As to the choice between the optional or the compulsory approach of the proposed convention, the first one seems to be politically preferable. The parties should be able to opt out from the convention.

3.8 Relationship to Other Conventions

If the view were adopted that leasing agreements should be covered by the proposed convention there would be a potential overlap with the Unidroit Convention on International Financial Leasing 1980 which had to be taken into account.

4. Persons

The text of the convention should not exclude that three persons can be involved in relation to a security right: (1) the person owing the secured debt, (2) the person giving the security right and (3) the person receiving the security right. Problems of representation must be left to the applicable local law.

5. Secured Debt

The convention deals with international security rights. The secured debt is, however, primarily governed by the applicable law as determined by the rules of conflict of laws. The convention must, nevertheless, address several issues.

5.1 The secured debt may be limited only to debts capable of expression in money terms. Then the questions will have to be addressed (1) in which currency the secured debt must be expressed and (2) in which currency it is payable.

5.2 The convention should allow for the parties of the security agreement to define the secured debt according to their specific needs. It is therefore suggested to provide for "specific and general identification" of the secured debt.²³ In addition, it seems to be very difficult indeed to mark the necessary degree of identification in the convention. However, it is not desirable for the convention to have to rely on the applicable national law in this respect.

5.3 The convention should allow for conditional or future debts to be secured.

6. Property Given as Security

6.1 Ownership

Following the comments on the concept of ownership to be adopted by the convention (cf. 2.1.2 above) it will not be advisable to allow security rights on equitable interests as they are difficult to recognise under civil law systems.

²³Cf. also the recommendation in Simpson and Röyer, *supra* note 3, para 4.11.

6.2 For property given as security the convention should again allow for the parties to define it according to their requirements. One may distinguish in this respect a specific and a class security right.²⁴ For the degree of certainty (cf. already 2.4.2 above) it will be difficult to find general standards which could be incorporated in the convention.

6.3 It should be possible to take security over future property. This will allow for the creation security rights over after-acquired property.

6.4 It is not necessary that the convention provides for a security right by operation of law for proceeds of sale of property given as security. In fact, complicating rules on tracing may overload the convention. An easy, practical means to achieve security over proceeds may be to take a second, separate security right over the proceeds. This gives the parties maximum freedom and avoids difficult legislation. In any case it should be avoided that proceeds are governed by local law.

7. Types of Security Rights and General Rules of Creation

7.1 Types of Security Rights

7.1.1 Unitary Security Right²⁵

The convention should establish one type of security right for all kinds of mobile equipment covered by it.²⁶ This would be in line with the general modern tendency to simplify the traditional distinction between mortgages, pledges and pledges on rights, transfers of title by way of security and retention of title, to name only a few of the traditional ways to create security. This simplification process is best illustrated by the development of Article 9 American Uniform Commercial Code which follows a wide diversification of security interests in pre-code times.²⁷

However, as for the creation of security rights (with consequences on other substantive questions such as priorities) one may envisage several modes of creation of a security right under the proposed convention. One may distinguish between a possessory, a registered, an unpaid vendor's and a lessor's security right.

7.1.2 Possessory Security Right

The proposed convention should not concern itself with possessory security rights. Although entering into a security agreement and giving possession is a traditional way of giving security²⁸ it is only of residual importance nowadays (mainly in

²⁴Cf. also the recommendation in Simpson and Röver, supra note 3, para 4.1.

²⁵Notion used by Drobnig, First working draft of the Model Law on Security Rights for Eastern Europe, Law in Transition Autumn 1993, p 7.

²⁶Cf. also the recommendation in Simpson and Röver, supra note 3 para 6.

²⁷White and Summers, Uniform Commercial Code, St. Paul Minn.: West Publishing Co., 2nd ed. 1980, p 874.

²⁸Of perfection in the terminology of Article 9 UCC.

private contexts in relation to pawn brokers). There may be a scope of application for possessory security rights in relation to trade documents representing a movable in international trade (such as letters of credit). However, there seems to be only a need for a provision of possessory security rights under the convention if an urgent need would be expressed by a group promoting a specific type of mobile equipment to be covered by the convention.²⁹

7.1.3 Registered Security Right

The main way to create a security right should be to register with a special register. In this context, the conceptual question will arise of whether or not the effect of the registration is only to "perfect" the security right, i.e. to give effects against third parties or if registration is a requirement for the creation of a right between the parties and against third parties.³⁰

7.1.4 Unpaid Vendor's Security Right

Following the example of Article 9 UCC and the laws of some Canadian Provinces Professor Cuming has proposed to cover retention of title clauses under the convention. This view is supported.

7.1.5 Lessor's Security Right

Again following the example of Article 9 UCC Professor Cuming has also voted for leases to be covered by the convention. There are good reasons for that because leasing contracts have security-like advantages: ownership is generally not passed to the lessee.³¹ However, whereas retention of title clauses are always a way of giving security, this is not always the case with leases and a convincing distinction has to be drawn which is difficult. It is for this very reason that the European Bank's Model Law has refrained from dealing with leases in the context of security rights.

7.2 General Rules on Creation of a Security Right

7.2.1 It may facilitate the understanding of the provisions on creation of a security right if the convention would contain a provision summarising all general rules on creation.

7.2.2 It will be particularly important to define the time of creation of a security right. A difficult area in this respect is the question of the time at which a security right over future property is created. Under the Model Law it is provided in Article 6 that a charge becomes effective only when the person giving security becomes

²⁹A different decision was taken under the Model Law, cf. Article 9 MLST.

³⁰Cf. 2.3 above.

³¹Two types of agreements are called "leases" under common law systems: a lease of land creates a proprietary right, cf. Henrich, supra note 7 p 90, which may also be called "usufruct" in order to distinguish it from the second type of leases; the leasing contract referred to in this context is the agreement which creates obligations between the parties and gives the lessee the right to make use of the leased equipment.

owner. However, creation of security rights over future property is deemed to take place at the time it would take place in case of present property.

8. Registered Security Right

8.1 Security Agreement

Contractual rights are created per definitionem by agreement. The convention will have to define the content of the security agreement.

8.2 Registration

The main question connected with registration is the issue which function a registration shall serve. The main function can be described with the apparent wealth argument (Philip Wood):³² Creditors and potential creditors must be warned about the extent to which property apparently belonging to a person giving security is used as collateral as this is an essential information for future financing.³³

A registration may also be designed to serve an additional and much stronger function: registration or non-registration may be a way to prevent or to enable acquisition of good title in property given as security free from a charge. A registration system serving this additional function may further require that good title is only obtained if the purchaser has enquired with the register that a security right has not been registered and acquisition may even be independent from such enquiry.

9. Unpaid Vendor's Security Right

9.1 Agreement

For the unpaid vendor's security right it is not clear that the parties have to enter into a security agreement. It may be sufficient to require an agreement concerning the transfer of title by way of sale and not to require a formal security agreement.

9.2 Registration

Equipment subject to an unpaid vendor's security right may be sold within a very short period of time. It would, therefore, be too demanding for the parties to provide for registration in the case of an unpaid vendor's security rights. At least for a certain period of time the registration of an unpaid vendor's security right should not be required.

³²The "apparent wealth" argument finds its origin in Roman law, see e.g. *Fritz*, *Aktuelle Probleme des Kreditsicherungsrechts*, Gutachten, Wien: Manz'sche Verlags- und Universitätsbuchhandlung, 1970, p 252.

³³The "apparent wealth" reasoning underlies the registration provisions of the Model Law.

9.3 Effect

Under the Model Law the idea was developed that the acquirer of the property transferred by way of sale, receives by way of operation of law title to the equipment whereas the vendor immediately receives a security right. The Model Law provides in other words for a legal fiction.

10. Lessor's Security Right

10.1 Leasing for Security Purposes

It was mentioned earlier that not simply any leasing agreement should be covered by the convention but only those entered into for security purposes (see 7.1.5 above).

10.2 Security Agreement

Parties to a leasing agreement covered by the convention should have to enter into a normal security agreement as in the case of a registered security right.

10.3 Registration

As leasing is a long term transaction there seems to be no reason not to ask for registration of the lessor's security right.

10.4 Effect

The concept developed in the European Bank's Model Law for the creation of an unpaid vendor's security right may be of help to draft provisions on a lessor's security right. The leasing agreement generally only creates obligations between the parties. One may, however, envisage that the lessee receives by way of operation of law title to the equipment whereas the lessor immediately receives a security right.

11. Additional Registration

It seems not to be necessary to provide for any additional registration for property given as security for which registration is required under the applicable national law because the convention intends to create an international security right. The types of equipment covered by the convention should be clearly defined and it should, therefore, be determinable for a potential creditor if property is possibly given as security or not.

12. Other Substantive Issues

Other substantive issues in relation to security rights will be dealt with during the proceedings of the Drafting Committee. In particular defences of the person giving a security right,³⁴ rights and obligations in relation to property given as security, priorities,³⁵ transfer of a secured debt, third parties acquiring property given as security, termination of the security right.

13. Enforcement

Discussions on enforcement proceedings will certainly consider the question of court involvement during the enforcement period. The provisions on enforcement may distinguish between protection and realisation of property given as security and distribution of proceeds.

To provide for recognition and enforcement of foreign judgements in the convention may leave its feasible scope. It also seems not to be possible to deal with insolvency issues within the convention. In these areas the convention will have to rely on other international conventions (e.g. Brussels Convention) or the applicable national law.

14. Registration Procedure

As an international security right shall be established by the convention it seems not to be possible to rely on existing registries. A new specialised registry will have to be set up.

It will be seen during the proceedings if there are technical ways to set up a central registry (possibly with Unidroit) or whether the system has to rely on local registries.

³⁴A difficult issue which interfaces with national law at least as far as the secured debt is concerned; cf. also the recommendation in Simpson and Röver, supra note 3 para 5.

³⁵It is recommendable to give an unpaid vendor's security right priority over other types of security rights.

15. Main Recommendations

- 15.1** The convention should refer to national law as little as possible and be as comprehensive as possible.
- 15.2** The convention should be based on simple rules.
- 15.3** The convention should avoid being conceptually biased in favour of common law, civil law or any other legal system.
 - 15.3.1** It should use the term "security right" to describe the legal position which can be created under the convention. Thereby it should refrain from making reference to the concept of legal or equitable ownership known under common law.
 - 15.3.2** The convention should clearly distinguish when it refers to obligational and when it refers to proprietary aspects.
 - 15.3.3** Proper consideration should be given to the doctrine of privity of contract (and the distinction between attachment and perfection) and differing views under civil law systems.
 - 15.3.4** The doctrines of specificity and certainty should be adapted to modern conditions.
- 15.4** A convention with maximal prospect of becoming adapted should clearly define its scope. This scope should be limited to mobile equipment for which a need for a convention is articulated. It may be that the convention, therefore, should only apply to containers and rolling stock.
- 15.5** As to the different ways to create a security right, the Drafting Committee may distinguish between registered, unpaid vendor's and lessor's security rights. It is not advisable to allow for possessory security rights as well.

**London
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