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INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW

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

SUB-COMMITTEE FOR THE PREPARATION OF A FIRST DRAFT

PROPOSALS FOR A FIRST DRAFT

(drawn up by the Chairman and a member of the
sub-committee on the basis of the provisional conclusions
reached by the sub-committee at its first session):

COMMENTS

(by Mr Jan-Hendrik RÖVER)

Rome, November 1994

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INTRODUCTION

Subsequently to the comments to the small drafting group's proposals for a first draft of the proposed Unidroit Convention on International Interests in Mobile Equipment grouped together in paper LXXII-Doc. 14 and Doc. 14 Add. 1 and 2, the Unidroit Secretariat received additional comments from Mr Jan-Hendrik Röver, representative of the European Bank for Reconstruction and Development on both the study group and the sub-committee. This paper reproduces these comments, set out hereunder.



MR JAN-HENDRIK RÖVER (1)

The Convention has now taken shape with a first draft. This draft is very promising and I would like to congratulate the drafting team on its excellent work. I set out below some comments which may be helpful for the future development of the Convention. (2)

Re Article 1 (1):

The use of the term "interest" implies a certain understanding of property rights. Common law understands, for example, ownership not "as absolute right (*dominium*) but sees it rather as a better or longer right in terms of possession, use or enjoyment and always in relation to the right of others". (3) It is suggested that the more neutral expression "security right" (4) be used or alternatively an interest be defined as "a security right giving entitlement to satisfaction from mobile equipment".

According to Article 1 (1), the Convention governs "recognition and effects" whereas Article 5 mentions "recognition of validity and effects". The two provisions should be harmonised. A possible solution is presented in the comments to Article 5.

Re Article 1 (2) (a):

The definition links the notion of "mobile equipment" to a (double) test (5) of internationality. (6) Mobile equipment is defined only by its quality of being (internationally) mobile; the definition is, however, not complete, as becomes clear in Article 4 which lists criteria of internationality. One wonders whether Articles 1 (2) (a) and 4 (2) could be merged with each other or alternatively Article 1 (2) (a) could only refer to the mobility of equipment and Article 4 (2) to the international factors. As the purpose of registration under the Convention is to receive recognition of a security interest, the parties will always look to Article 4 and Article 1 (2) (a) becomes superfluous.

(1) The author would like to thank John Simpson and Jonathan Bates, London, for their help in preparing this paper.

(2) See for previous comments by the European Bank for Reconstruction and Development: Simpson and Röver: *Initial comments on the Report of the Unidroit restricted exploratory Working Group*, Study LXXII - Doc. 6 Add. 2; Simpson and Röver: *Discussion paper for a model law on secured transactions*, Misc.2; Röver: *Comments on a Proposed Unidroit Convention on Security Interests in Mobile Equipment*, Study LXXII - Doc. 11; *European Bank for Reconstruction and Development: Model Law on Secured Transactions*, Misc. 4. See also Röver: *Preparation of a Unidroit Convention on security interests in mobile equipment*, in: *Law in Transition*, Summer 1994, pp. 15-16.

(3) Dalhuisen: *Security in Movable and Intangible Property. Finance Sales, Future Interests and Trusts*, in: *Towards a European Civil Code*, 1994, p. 377. See also Goode: *Commercial Law*, London, 1982, pp. 52-61.

(4) See already Röver: *Comments on a Proposed Unidroit Convention on Security Interests in Mobile Equipment*, Study LXXII - Doc. 11, para. 2.1.2.

(5) Equipment is mobile when it moves (1) normally and (2) in the course of business. The second element is wider than the ordinary course of business.

(6) Internationality is also referred to in Articles 1 (2) (c) and 4. See comments below.

As the Article reads now it covers equipment which moves as part of its *normal use* (e.g. transportation vehicles) as well as equipment which moves as a result of *trade*. The working group should take a decision whether this consequence is intended.

The term "equipment" seems to be limitative but it is not explained in which way. It seems that "equipment" is used in the wide sense as meaning any (mobile) property or (tangible) thing and one wonders whether the expressions "property" or "thing" are not a better expression than "equipment". (7)

Article 1 (3) contains a limitation as to the equipment which falls under the Convention. It may, therefore, be considered to place it closer to the definition of "mobile equipment".

The provisions do not as yet deal with the question of how property is dealt with which is attached to other property. Appurtenances provide an example. It is assumed that the Convention has to link with domestic law at this place. The Convention should, however, itself point to this problem.

Re Article 1 (2) (b):

Two types of security interest are distinguished: those arising under a security agreement and those arising under a title reservation agreement. It is, however, doubtful whether a retention of title agreement creates an interest. Seen in the light of the functional approach⁽⁸⁾ taken by Article 9 UCC and the laws of some Canadian provinces, retention of title clauses create a security interest.⁽⁹⁾ The effect of a retention of title clause under most laws is, however, that title is not transferred but remains with the vendor as long as the agreed condition precedent has not occurred, i.e. the purchaser has not paid the purchase price.⁽¹⁰⁾ Under some continental legal systems the purchaser may obtain an expectancy right but does not obtain title until the condition has materialised.⁽¹¹⁾ This is, however, an asset the purchaser can deal in and is not a security right for the benefit of the *vendor* as referred to under the Convention. The concept of an interest arising under a title reservation agreement should, therefore, be carefully considered.

Re Article 1 (2) (c):

An interest must comply with *two* requirements to be an international interest⁽¹²⁾ which falls under the Convention. It must be registered in a register (Article 1 (2) (c)) and it must comply with the substantive requirements under Article 4 (whereas Article 1 (2) (a) does not serve a function as far as the test of internationality is concerned, see comment to Article 1 (2) (a) above). It seems to be misleading to define the internationality of an interest in Article 1 (2) (c) only by reference to the first element.

Re Article 1 (2) (d):

Only a money obligation⁽¹³⁾ can be a secured debt.⁽¹⁴⁾ The wording implies that the security interest is dependent on the secured debt although the relationship needs to be explained further. It is, however, not

(7) Such a broad approach was questioned in a previous paper (see Röver: *supra* note 4, para. 3.3) as the acceptability of a Convention may be enhanced by a more limited scope. Cf. already the recommendation of Simpson and Röver: Study LXXII - Doc. 11, para 3, where it was envisaged that a Convention would at least initially be limited in scope.

(8) As opposed to a formal approach.

(9) § 1-201 (37) UCC. This solution has also been adopted under Article 9 of the European Bank's Model Law on Secured Transactions (MLST) (published London, 1994).

(10) The Convention defines a retention of title clause in broader terms by also making reference to lease agreements. See comment to Article 1 (2) (e) below.

(11) E.g. *Anwartschaftsrecht des Vorbehaltskäufers* under German law.

(12) As opposed to a domestic one. The test of internationality limits the application of the Convention whereas it does not necessarily limit the application of national law.

(13) Which may be interpreted as being narrower than an "obligation which is capable of expression in money terms" (Article 4.2 MLST) as this may comprise obligations arising under suretyships, guarantees, etc.

quite clear why the security agreement is defined by reference to the secured debt (and not to the security interest) and why it is the agreement which is securing the secured debt and not the security interest.⁽¹⁵⁾ In addition, it is possible to omit "performance of" and would be sufficient to say that the security interest "secures a money obligation".

The proposal envisages that existing and future obligations can be secured.⁽¹⁶⁾ The question in relation to security interests for future obligations is whether the security interest is created immediately⁽¹⁷⁾ or only when the secured debt comes into existence.⁽¹⁸⁾

The proposal makes reference to the debtor and thereby implies that a third party can give security for another debt under the Convention.

Re Article 1 (2) (e):

Title reservation agreements are defined in such a way that they comprise conditional sales as well as leasing agreements. The working group has taken the policy decision to make lessor's rights security rights under the Convention.⁽¹⁹⁾ It seems, however, to be confusing to define reservation of title as including leasing agreements as both are normally distinguished from each other.⁽²⁰⁾ It should also be noted that it is only understandable from a North American perspective that a leasing agreement creates a security interest in mobile equipment⁽²¹⁾ as it should normally only give the lessee the right to use the leased equipment.

Re Article 1 (3):

This exclusion clause should be placed close to the definition of mobile equipment (see comment to Article 1 (2) (a) above).

Re Article 1 (4):

It is unfortunate that proceeds do not fall under the Convention. The exclusion of an extension of the security interest to proceeds reduces the Convention's use particularly for suppliers to traders. Traders are selling charged property in the ordinary course of their business. Security interests in property of traders have been described as being dynamic in nature⁽²²⁾ and the holder of the security interest only receives adequate protection if he is protected also in relation to the proceeds. Exclusion of security interests in proceeds of sale will leave the Convention incomplete in an important area.⁽²³⁾ However, it is probably realistic to exclude proceeds of sale from the Convention.

(14) It should be noted that under some continental systems one is accustomed to speak of the secured *claim (Forderung)* and not the secured *debt or obligation*. This should be taken into account in respect of any translation of the Convention.

(15) Where, however, a security interest *attaches* upon the parties entering into a security agreement as is the case under North American law and is sometimes assumed to be the case under English law (Goode: *supra* note 3, pp. 28 to 31) it becomes understandable why an *agreement* secures the debt.

(16) This is also possible under the Model Law, see Art. 4.3.4 MLST.

(17) This is the situation for a pledge under German law (§ 1204 (2) German *Bürgerliches Gesetzbuch* makes reference to future claims), Palandt/Bassenge: *Bürgerliches Gesetzbuch*, Munich, 52nd ed. 1993, § 1204 note 8.

(18) This is the situation for a mortgage under German law (§ 1113 (2) German *Bürgerliches Gesetzbuch* makes reference to future claims), where, however, a non-accessory security right (*Eigentümergrundschild*) exists in the interim.

(19) In favour of a more restricted approach Röver: *supra* note 4, para. 7.1.5.

(20) Not necessarily under English law. Goode: *Legal Problems of Credit and Security*, London, 1988, p. 5, states that legal title can be reserved under a sale, hire purchase or leasing agreement.

(21) See § 1-201 (37) UCC. Under English law, however, a reservation of legal title "does not constitute a *security interest*", see Goode, *supra* note 20, p. 5. If anything it creates an equitable *interest* for the debtor.

(22) Serick: *Eigentumsvorbehalt und Sicherungsübertragung. Neue Rechtsentwicklungen*, Heidelberg, 2nd ed. 1993, pp. 114-123.

(23) For a possible approach see Röver: *supra* note 4, para. 6.4.

Re Article 2 (2):

It seems to be impracticable that the Governing Council should determine the registration body and place "from time to time". The Convention's success will depend on its reliability and the creation of corresponding market expectations. Careful consideration should, therefore, be given in advance as to the registration body and place.

Re Article 3:

It remains to be seen whether the Convention merely extends security interests created under national law ("an interest ... may be registered") or whether new security interests can be created under the Convention. It is assumed that the latter approach is taken.

The Article states that the "interest ... may be registered" and thereby implies a formal (procedural) requirement. However, an interest cannot be *created* ⁽²⁴⁾ unless there is a security agreement so that at least Article 3 (a) - (c) describe substantive requirements. The draftsmen tried to avoid the issue of whether registration of the security interest is necessary for its creation. To achieve this aim, it would suffice if the requirements in Article 3 (a) - (c) are separated from the requirement in Article 3 (d).

Re Article 3 (a):

"The agreement to which it relates" in Article 3 (a) may be interpreted as being the debt instrument, particularly as the provision refers to "lessee and buyer". The provision should refer to the *security* agreement under which the international interest is created.

It is clear that "writing" is to be defined by the Convention and not by domestic law. However, domestic systems may define "writing" differently, e.g. by requiring in addition to mere writing the signature of an instrument by the creator of the instrument. ⁽²⁵⁾

Re Article 3 (b):

The Article makes a distinction between the specific and the general description of mobile equipment which is similar to the distinction between specific and class charges under the European Bank's Model Law. ⁽²⁶⁾ It separates clearly the concepts of description and identification which assist in understanding the difference between these concepts. ⁽²⁷⁾

Re Article 3 (c):

The Convention should state that the money obligation must be described either specifically or generally and must be identified.

It is doubtful whether the Convention needs to say that a security interest can secure money obligations "arising under [the agreement]". ⁽²⁸⁾ It would be easier to state that the *security right* ⁽²⁹⁾ (and not the agreement) secures money obligations. ⁽³⁰⁾

⁽²⁴⁾ For an explanation of the relationship between creation on the one hand and attachment, perfection and the doctrine of privity of contract on the other hand, see Röver: *supra* note 4, para. 2.3. See also note 16 above where the notion of attachment is used to explain Article 1 (2) (d) of the Convention.

⁽²⁵⁾ E.g. § 126 German *Bürgerliches Gesetzbuch*.

⁽²⁶⁾ See Article 5.5 MLST.

⁽²⁷⁾ For an examination of the corresponding concepts of specificity and certainty, see Röver: *supra* note 4, para. 2.4.

⁽²⁸⁾ "Arising" seems to be intended to cover retention of title and leasing agreements which come under the Convention, see Article 1 (2) (b), (e).

⁽²⁹⁾ In this note the term "right" is preferred to the term "interest"; see comment to Article 1 (1) above.

⁽³⁰⁾ See also comment to Article 1 (2) (d) above.

Re Article 4:

This provision deals with the criteria for internationality of a security interest⁽³¹⁾ as do Article 1 (2) (a) and (c) and enables a distinction between international and domestic issues. However, it deals with the substantive elements as opposed to the formal element which is dealt with in Article 1 (2) (c). Article 1 (2) (a) is superfluous if the reasoning of this note is followed (see comments to Article 1 (2) (a) above).

The Convention does not yet state⁽³²⁾ which relationship must exist to a Contracting State to make it applicable. A model provision may be found in Article 1 of the United Nations Convention on the International Sale of Goods 1980.⁽³³⁾

In Article 4 (2) (a) it is not clear whether "parties" refers only to the parties to the security agreement or to creditor, debtor and owner of the property where debtor and owner are different persons.

Article 4 (2) (c) may be extended in such a way that the Convention applies even where the equipment has crossed borders although (1) a movement took place only before the parties entered into a security agreement or (2) the equipment has returned to the country where it was situated at the time of the agreement.

Re Article 5:

Article 5 contains the central recognition rule of the Convention. Whereas Article 1 (1) refers to "recognition and effects", Article 5 speaks of "[recognition of] validity and effects". The wording should be harmonised (see comment to Article 1 (1) above). It may be that one should distinguish clearly between the creation, the validity and the enforceability of security interests.⁽³⁴⁾

Defences relating to the validity or enforceability of a security interest may arise because of defects of (1) the security interest itself or (2) the secured debt which in turn affect the security interest.⁽³⁵⁾ Defences against a security interest are, however, difficult to regulate under the Convention as the defences are governed by domestic law. A highly hypothetical example may demonstrate this. In country X the law provides that people are minors until they are 16 and in country Y until they are 18. The parties to the security agreement have their places of business in country X (party is aged 17 and national of X) and in country Y (party is aged 19 and national of Y). To determine whether or not the parties may enter into the security agreement one has to determine the law applicable to their contractual capacity which may be the law of their nationality.⁽³⁶⁾ As both parties have passed the relevant age the security agreement is perfectly valid. It is clear, however, that the Convention will link closely with the applicable domestic law in the area of defences.⁽³⁷⁾ The question is then whether the Convention should contain some basic conflict of laws rules to determine the applicable law for issues of domestic law.

The recognition rule extends to interests arising under retention of title agreements which comprise leasing agreements. It is, however, doubtful whether these agreements create "security interests" at all (see comments to Article 1 (2) (b), (e) above). The question should be considered by the working group.

(31) It embraces a wide definition of security interests as encouraged in the note by Simpson and Röver: Doc. 6 Add. 2 (*supra* note 2), pp. 1-2.

(32) Except in Article 5 which provides that only the court of a *Contracting State* can recognise a security interest.

(33) See already recommendation Röver: *supra* note 4, para. 3.5.

(34) See Article 14 MLST.

(35) The relationship between secured debt and security interest under the Convention is, however, not yet fully determined; see comment to Article 1 (2) (d) above.

(36) Article 7 (1) German *Einführungsgesetz zum Bürgerlichen Gesetzbuch* which is in conformity with the Rome Convention.

(37) There will also be other areas in which domestic law is not excluded by the Convention.

Article 5 does not specify which "effects" are recognised. It is assumed that the security interest is recognised in its effects between the parties as well as against third parties. As against third parties it is recognised in relation to priorities, transfer of the security interest,⁽³⁸⁾ transfer of charged property, protection of the security interest against third parties and in enforcement. The position of the security interest is, however, not protected in insolvency proceedings⁽³⁹⁾ which could be a drawback of the future Convention.

(38) In case the security interest can be transferred and it is not necessary to transfer the *secured debt*; the latter is the solution under Article 18 MLST.

(39) See Unidroit Study LXXII - Doc. 13, note to Article 5.