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FOR DETERMINING THE DESIRABILITY AND FEASIBILITY
OF THE PREPARATION BY UNIDROIT OF A MODEL LAW
IN THE GENERAL FIELD OF SECURED TRANSACTIONS

Outline of a modern legal regime
for the regulation of secured financing transactions

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OUTLINE OF A MODERN LEGAL REGIME
FOR THE REGULATION OF SECURED FINANCING TRANSACTIONS

I. INTRODUCTION

There is growing recognition of the importance of secured financing to modern business development and the expansion of markets for consumer goods. The availability of credit is a central feature of all modern economies, and states which hope to encourage strong domestic markets and maintain or develop strong internationally competitive economies must have legal infrastructures that facilitate secured financing transactions. This has been recognized by international lending organizations such as the World Bank and the European Bank for Reconstruction and Development which are showing increased interest in secured financing laws of countries in which they provide loans.

Because of the internationalization of commercial activity which has occurred in recent years, there is reason to expect that modernization of national secured financing laws\(^1\) will involve a significant degree of interjurisdictional harmonization. This is likely to be induced by several factors. One such factor is recognition of the importance of harmonized law as a vehicle for encouraging transborder credit transactions. Another is the availability of suitable models either in the form of extant law of other States which have modernized their secured financing law or model laws prepared and sponsored by an international law reform or lending organizations. The success of efforts such as that undertaken by Unidroit to develop a body of international secured financing law applicable to security interests in large mobile equipment that is generally taken from one State to another can be expected to influence national development in this area of the law.

Anyone acquainted with the recent history of efforts to develop a model designed to provide the basis for modernization of national secured financing law might be forgiven for harbouring some scepticism as to the chances of developing such a model in an international context. The inability in 1980 of the United National Commission on International Trade Law to arrive at a consensus as to the form and usefulness of a model secured financing law provides little basis for optimism. However, it would

\(^1\) References in this paper are to legal systems dealing with charges on personal (movable) property and not to system providing for charges on real (immoveable) property.
be a mistake to assume that failure of the UNCITRAL project demonstrates that international cooperation in the development of interjurisdictional harmonization of secured financing law is unrealistic. The world has changed dramatically since 1980. Further, one might conclude that the failure of the UNCITRAL undertaking can be attributed as much as anything to the approach that was used. It was, perhaps, overly ambitious to attempt to prepare a model secured financing law that would gain acceptance by a body composed of member States, including States with socialists economies, with very differing views of the relevance of secured financing law to national or international economic activity.

The Governing Council of the International Institute for the Unification of Private Law at its June 1993 meeting authorized the Secretariat to proceed to a study of the feasibility and desirability of Unidroit preparing a model law on secured financing transactions. This mandate was discussed at the February 1994 meeting of the Drafting Subcommittee of Study Group for the Preparation of Rules on Certain International Aspects of Security Interests in Mobile Equipment. The Subcommittee concluded that the first step of the feasibility study, apart from establishing close liaison with other organizations such as the World Bank and the EBRD which are also involved in developments in this area, should be the preparation of a "check list" of issues that would have to be addressed when preparing such a model law.

An important feature of recent approaches to reform of secured financing law is the recognition that pragmatism is more important that faithfulness to legal traditions. This led some jurisdictions, such as the states of the United States and several of the provinces of Canada, to discard traditional structures that no longer had functional significance. For examples, modern personal property legislation in these jurisdictions gives no significance to the traditional forms of financing transactions such as chattel mortgages, conditional sales contracts, trust receipts and floating charges. While there are many important benefits associated with this approach, one of its most important, if not intended, by-products is that it permits the development of concepts and structures that can be applied in other States which have different legal traditions.

II. FUNDAMENTAL CONSIDERATIONS

Scope of the System
Secured credit is used by both business enterprises and consumers. Many, but not all, aspects of a regulatory regime can apply with equal efficacy in both contexts. However, a model law must reflect the difference in bargaining power and commercial sophistication between commercial borrowers and consumers.

Non-possessory Charges
Modern secured financing arrangements generally require that the debtor retain possession of the collateral. Consequently, a model secured financing law must recognize the existence and efficacy of non-possessory charges. Indeed, a strong
argument can be made for the elimination of the pledge as a form of security device except in cases where the collateral is negotiable property. The traditional view is that possession of the debtor’s property by the creditor gives notice to third parties that the property is charged. However, this approach is robbed of its raison d’être by business practices that look not to physical possession of goods but to documentation and public registries as evidence of ownership or freedom from encumbrances.

A Unitary Concept: A Charge on Property of the Debtor
Many national legal systems which recognize that a creditor can have an *in rem* interest in or possession of personal (movable) property of his debtor in order to provide an alternative source of payment in the event of default by the debtor have failed to develop a unitary conceptual structure for the various security devices that they regulate. Secured financing occurs in the context of a range of differing legal devices. For example, under the common law, a chattel mortgage, a floating charge, a hire-purchase contract, a conditional sales contract, an assignment of accounts and an equipment lease conceptually have little in common yet they all serve essentially the same function—the securing of debt obligations.

A model law should eschew conceptual fragmentation by focussing on function rather than form. Any transaction, whatever its form, that has as its principal function the securing of an obligation should be brought within its scope and be subjected to a common set of rules. Not only does this approach permit the creation of an internally consistent, highly integrated system, but it gives to the parties freedom from the need to force their relationship into one or other of the prescribed legal moulds.

All that is required in this context is to recognize that all forms of financing transactions create a charge on the property which the debtor has offered as security. This is not to suggest that different incidents (e.g., priority consequences) cannot be allocated to financing transactions that arise in particular contexts or that have special functions. However, these incidents should reflect policy choices based on pragmatic considerations.

The Property That May Be Charged
Except where consumer protection is thought necessary, there is little justification for limiting the types of personal property that can be charged. So long as the legitimate commercial expectations of all claimants to property are recognized in the priority structure of the model law, all types of personal property can be charged.

Modern secured financing law designed to facilitate business inventory financing generally accommodates the fact that inventory will be sold in the ordinary course of business of the debtor and, unless replacement collateral is acquired by the debtor, the creditor will lose its security. In order to address this, it recognizes that the charge on the inventory can carry over to property received by the debtor in exchange for the sale of the inventory.
The needs of modern secured financing forces reconsideration of the time-honoured conclusion that, when personal property is attached to land, it looses its separate existence and becomes itself land. It is quite possible to recognize that personal property attached to land can be charged with a personal property charge and at the same time meet the legitimate expectations of persons who have interests in the land to which the personal property is attached.

Conditions for the Creation of the Charge
Since the model law assumes a consensual relations between the debtor and the secured party, it should require minimal evidence of the existence of the contract that provides for the charge. This would include not only evidence of the fact of agreement and an intention to create the charge, but as well a record of the property or kinds of property charged.

A charge can come into existence only when the debtor acquires an in rem interest in property of the kind described in the agreement. However, full realization of the wishes of the parties may necessitate recognition that, when the agreement so provides, the charge arises automatically on property acquired by the debtor any time during the currency of the agreement. This feature is of crucial importance where the property charged is a ever-changing stock of inventory or accounts generated in the debtor’s business.

The Obligation Secured by the Charge
Many business financing transactions involve on-going relationships between the chargeholder and the debtor under which the amount of the debt obligation is not static or predetermined but varies depending upon the financing needs of the debtor’s business. This being the case, the law must recognize that the charge can secure amounts owing to the chargeholder as a result of advances made to the debtor any time during the life of agreement between them. A corollary of this is that, in relation to other charges on the property, the priority status of the first charge extends to all amounts owing by the debtor to the holder of that charge and not just those amounts owing prior to the creation of the competing charges.

A Simple Priority Regime that Provides Predictable Outcomes
The priority structure of a model law should reflect appropriate policy choices based on the need for fairness and balance in the market the regime is designed to serve. Some of policy choices are obvious. Good faith buyers of goods sold in the ordinary course of the business of the debtor should take free from a charge on the goods, whether or not they are aware of the charge or could with minimal effort discover that the goods purchased are charged. Good faith transferees of negotiable property who take possession of it through negotiation must be given priority over non-possessory charges on the property. Creditors who provide loans or credit to permit the debtor to acquire personal property should be given priority over prior creditors whose charges apply automatically to the newly-acquired personal property.
Other policy choices may not be so obvious. For example, the relative priority positions of charge holders and unsecured creditors or the debtor's trustee in bankruptcy can be expected to vary from one State to another.

The relative priority position of successive charge holders (not including one who has provide a loan or credit to acquire the collateral) raises few significant policy considerations. It is not obvious that the applicable priority rule must be based on the truism that a subsequent charge only the uncharged interest of the debtor (first-in-time-first-in-right). Where the debtor does not own the property at the date two competing charge agreements are executed, a first to charge priority rule does not provide an acceptable outcome. Both charges arise at the same time -- when the debtor acquires ownership of the property to be charged. However, what is required in order to ensure commercial reasonableness is that any potential creditor who would be allocated a subordinate status should he give credit to the debtor, be given the facility to assess the legal risk he undertakes. Extant or potential charges on the property or a debtor and the identity of potential creditors allocated a earlier priority by the system must be readily discoverable.

An Efficient, Accessible Registry System
The acceptance of the primacy of non-possessory charges brings with it the need for public disclosure of charges or potential charges. A registry system can be manual or computerized; however, the registry must be efficient and accessible to the general public.

A registry system that offers the flexibility necessary for modern business financing transactions would provide for notice registration and not agreement registration. The registered notice would contain only minimal information: the name of the secured party, the name of the debtor and a description of the collateral. It does not contain any of the details of the transaction or transactions to which it relates. A qualifying searching party would be entitled to obtain these details directly from the secured party.

Efficient, Balanced Enforcement Measures
The efficacy of a charge on personal property is directly affected by the speed and efficiency with which it can be enforced. A charge is of little value to a creditor if upon default the available enforcement remedies entail expensive, prolonged judicial proceedings during which the value of the collateral is consumed by costs or lost through depreciation.

On the other side of the coin is the need to ensure that the interests of the debtor in the charged property are not squandered through failure on the part of the secured party to act in good faith and in a commercially reasonable manner when enforcing the charge against the property.
Rules of Private International Law

An aspect of reform of modern secured financing law is the recognition that it is no longer possible to proceed on the assumption that private international rules are of only peripheral significance. Nor is it adequate to accept traditional choice of law rules which, for the most part, do not accommodate the realities of modern financing transactions. Of course, the efficacy of any system of private international law rules is influenced by the degree to those rules are compatible with the private international rules of neighbouring states.

III. SOURCES

The pioneering effort in the reform on secured financing law occurred in the United States over 35 years ago with the preparation of Article 9 of the Uniform Commercial Code (United States). The drafters of this model law employed concepts and approaches designed to facilitate modern business financing. The system embodied in Article 9 has worked very well in states of the United States.

Over the last two decades, Canadian law reformers in common law provinces and in the civil law province of Quebec have taken the best conceptual features of Article 9 and have adapted them to function in the context of computerized central registry systems. Experience with these systems has been very positive from the point of view of users of the systems and government organizations responsible for their operation.

Set out below is an overview of the central features of a modern system for secured financing. The concepts and approaches set out below draw heavily, but not exclusively, on North American innovations (including those employed in the Canadian province of Quebec) in this area of the law. Most experts would agree that registration of security interests is fundamental to a system that focusses on non-possessory security devices involving collateral in the form of inventory and highly mobile collateral. While computerization of the requisite registry is not a sine qua non of modernization, a central, computerized, remote access registry system offers dramatically increased efficiency with concomitant high quality of service provided to its users and low cost of operation of the system.

There are five central distinct features of the system described below that display its origins:

- It involves a functional rather than a formal approach to characterizing the transactions that fall within its scope

- The existence of a security interest does not depend upon its registration
- No substantive distinction is drawn between various types of security agreements (for example, there is no special category of "enterprice charge").

- Self-help is the predominant feature of enforcement of security interests.

- Contract created receivership is a method of enforcing broadly-based security interest in business assets.

IV. CONTEXT

The legal structure described below does not purport to be a code that contains all of the general infrastructure upon which secured financing law depends. It assumes a background of contract, agency and property law drawn from Roman Law or the English Common Law. For example, it assumes that a security interest is merely ancillary (an accessory right) and that the relationship of the parties to a security agreement as debtor and creditor are otherwise appropriately regulated; it assumes freedom on the part of owners of property or limited interests in property to charge or otherwise deal with the property; it assumes that the concept of "charge" or hypothec is understood; it assumes that a charge (security interest) is recognized as a type of property that is transferable; it assumed the existence of a system of law which recognizes property rights in intangibles and the possibility of charging and transferring these rights; and it assumes a complete legal structure dealing with negotiable instruments and corporate debt and equity securities.

No attempt has been made to bring into the regime described below charges and liens that are non-consensual in that they arise by operation of law and not pursuant to an agreement between a secured party and a debtor.

The relationship between security interests and insolvency is only peripherally addressed. It is assumed, however, that a registered security interest will be recognized in insolvency proceedings, at least the extent of giving the holder of it priority over unsecured trade creditors of the debtor.

No reference has been made to what is described in North American as "chattel paper" financing. This generally involves the sale and transfer (discounting) of security agreements providing for security interests in specific items of consumer goods or equipment. The Canadian Personal Property Security Acts and Article 9 of the United States Uniform Commercial Code contain a separate set of rules dealing with conflicting interests in chattel paper.

While the system described below focusses principally on business financing on the security of equipment, inventory and intangibles, it is applicable as well to secured transactions in which consumer goods are collateral. However, most jurisdictions in
which similar systems exist provide supplementary consumer protection legislation 
some of which modifies in the consumer debtor's favour the collection right 
exercisable by the secured party when the debtor defaults. (For example, in several 
Canadian provinces, the secured party must elect between seizing the collateral in full 
satisfaction of the obligation or bringing action to collect the balance of the debt and 
leaving the collateral with the debtor).

No attempt has been made to integrate rules dealing with security interests in real 
(immovable) property. There are many important functional differences between 
financing on the security of real (immovable) property and financing on the security 
of personal (movable) property. The most important of these is that real property is 
seldom treated as inventory with the result that there is no need for special 
substantive law and registry measures designed to facilitate inventory financing. 
References in this outline to "property" are references to personal (movable) property.

V. SCOPE OF SYSTEM

It is necessary to determine the basic characteristics of transactions falling within the 
system. This can involve two quite separate matters. One is defining what constitutes 
a security agreement and the other is determining the extent (if at all) to which the 
registration and priority structure of the system are to apply to certain types of non-
security transactions where the separation of interest from possession (or control) 
requires public disclosure of their existence for the protection of third parties.

Two approaches are available to define the scope of system:

- Enumeration of the established kinds of security transactions that fall within 
the system. For example, a jurisdiction having a common law background might 
provide that the new system applies to the following types of established 
secured financing transactions and to specified non-security transactions (all 
referred to as security agreements): chattel mortgage, conditional sale, hire-
purchase, floating charge, pledge, trust indenture, trust receipt, assignment of 
an intangible to secure a debt, [a lease of goods for a term of more than ___
years and a transfer of an account]²

² Wording in square brackets refers to transactions that are not technically security 
agreements since their role is not to secure performance of an obligation. Since these 
are not security agreements, the enforcement provisions of the regime would not 
apply to them.
Provide a test which focusses on the functional role of transactions that fall within the system and enumerate the non-security transactions that are to be included. For example, the system might apply to a transaction (security agreement) that in substance provides for an interest in personal property that secures performance of an obligation. Application of the law is dependent upon neither the form of the transaction nor the person who has title to the property taken as security.\footnote{It also applies to a lease of goods for a term of more than \underline{\hspace{1cm}} \text{years and a transfer of an account}.\footnote{\textit{Supra}, note 2.}}

It is also necessary to determine which transactions do not fall within the scope of the regime (e.g., an interest in rights to payment that arise in connection with an interest in land; \[\text{a transfer of an account made solely for the purpose of collecting the account; a lease where the lessor is not regularly engaged in the business of leasing goods; a lease of household furnishings or appliances as part of a lease of land where the goods are incidental to the use and enjoyment of the land}] etc.)

Whatever approach is used, it is important to develop a unifying terminology (set of definitions) that can be used throughout. For the purpose of this outline the following terminology has been used:

"security agreement" - an agreement falling within the regime including agreements noted above that are not designed to secure an obligation.

"security interest" - the interest in property of a debtor that the secure party acquires under a security agreement.

["deemed security interest" - the interest of a lessor or a transferee of an account.]\footnote{\textit{Supra}, note 2.}

"secure party" - the creditor who acquires a security interest

\footnote{Some jurisdictions will find it objectionable to treat title retention sale of goods contracts as security agreements under which the buyers are treated as the owners of the goods and the sellers as the holders of "security interests." Where this is the case, it will be necessary to provide a separate, substantially parallel regime for these types of transactions or to deem them to be security agreements for all or specified purposes.}

\footnote{\textit{Supra}, note 2.}
\footnote{\textit{Supra}, note 2.}
"debtor" - the person who owes the obligation secured or who owns the collateral and may include both depending upon the context [and includes a lessee under a lease of goods for the term of more than ___ years and a transferee of an account].

"collateral" - property charged by a security interest.

VI. THE NATURE OF A SECURITY INTEREST

It is necessary to identify the nature of the interest that is encompassed by the term "security interest."

If the first approach noted above were used, it would be necessary to provide that the interest the creditor has pursuant to a chattel mortgage, conditional sale, floating charge, pledge, trust indenture, trust receipt, assignment is to be treated under the system as a fixed charge referred to as a "security interest." [The interest of a lessor under a lease of goods for a term of more than ___ years and the interest of a transferee of an account are deemed to be security interests].

If the second approach were used it would be necessary to provide that the interest that a secured creditor acquires pursuant to a security agreement is an in rem interest (referred to as a "security interest) in the form of a charge (a real right) on the property taken as security. [The interest of a lessor under a lease of goods for a term of more than ___ years, and the interest of a transferee of an account are deemed to be security interests].

VII. THE SCOPE OF A SECURITY INTEREST

In order to meet the needs of modern secured financing, the scope of the concept of security interest must include the following:

-A security interest in collateral extends to any identifiable property, referred to as "proceeds," received by the debtor through any dealing with the collateral and to any rights of the debtor to an insurance payment as indemnity or compensation for damage to the collateral. A reference "collateral" includes proceeds unless the context indicates otherwise.

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6 Supra, note 2.
7 Supra, note 2.
8 Supra, note 2.
- A security interest can secure obligations owing at the date of the creation of the security interest or obligations provided for in the agreement and arising at any time while the security agreement is in effect.

VIII. CREATION OF THE SECURITY INTEREST

It is necessary to specify the circumstances in which an enforceable security interest comes into existence. A security agreement is treated as coming into existence when the following conditions have been met (without regard to the order in which they are met):

- The secured party is obligated to loan money or otherwise give value to the debtor,

- The debtor has signed a security agreement providing for an existing or future security interest in collateral that is described in the agreement specifically, generically or in any other manner that permits it to be identified, and

- The debtor has an in rem right in the collateral.

[-A deemed security interest comes into existence when the lease of goods for the term of more than ____ years is executed or a transfer of an account occurs.]

More than one security interest may be taken in a single item of collateral.

IX. THE PRIORITY STRUCTURE

Described below are two different priority structures and related registry systems. The first of these embodies a more traditional approach; the second embodies an approach to registration and priorities designed to provide maximum flexibility for business financing.⑨

⑨ A third approach which must now be considered to be obsolete is one based on the simple property law principle of nemo dat quod non habet qualified by registration requirements. Under this approach, priority is determined on the basis of first to acquire an interest in the collateral. In other words, a security interest that is registered (or otherwise disclosed to the public) has priority over any subsequent in rem interest acquired in the collateral. This approach does not facilitate modern business financing. It requires the execution of a new security agreement and a new registration each time a security interest is to be taken in property newly-acquired by
Alternative 1
The basic characteristics of this approach are as follows:

-Priority is determined on the basis of the principle of first-in-time, first-in-right subject, however, to the requirements of registration and to special priority rules. The "first-in-time" aspect of this approach relates to the date of execution of the security agreement and not the date of registration (or equivalent public disclosure of the existence of the security agreement) or the date the debtor acquires an in rem interest in the collateral.

-The security agreement may provide for the security interest to charge automatically property acquired by the debtor after the date of execution of the agreement. Priority with respect to all collateral described in the agreement dates from the execution of the security agreement.

-The priority that execution of the agreement affords applies to all advances made by the secured party under the terms of the agreement and other amounts (e.g., seizure and sale expenses) deemed secured by the security interest. The agreement must specify the amount to be advanced to the debtor. Consequently, identification of the amount to be loaned by the debtor would be a required feature of the written security agreement referred to under heading VIII.

-A notice of the existence or potential existence of the security agreement is registered; the security agreement itself is not registered. A registry notice can be registered within a specified period of time (e.g., 3 years) prior to execution of the security agreement. The notice can relate to one or more than one agreement. The notice must contain the following basic information: the name of the debtor, the name of the secured party and a description of the collateral.

Alternative 2
The basic characteristics of this approach are as follows:

-Priority is determined on the basis of the principle of first-in-time, first-in-right subject, however, to the requirements of registration and to special priority rules. The "first-in-time" aspect of this approach relates to the date of the debtor. It does not accommodate security interests in property acquired by the debtor after the security agreement is executed. Nor does it work well within the context of transactions providing for advances made to the debtor after another interest is acquired in the collateral.
registration of a registry notice\textsuperscript{10} (or equivalent public disclosure of the existence of the security agreement) and not the date of execution of a security agreement or the date the debtor acquires an \textit{in rem} interest in the collateral.

- The security agreement may provide for the security interest to charge automatically property acquired by the debtor after the date of execution of the agreement. Priority with respect to all collateral described in the agreement and the registry notice dates from date of registration of the notice. This same priority applies with respect to all security agreements, whenever executed, between the same secured party and debtor and involving security interests in the collateral described in the registry notice.

- A notice of the existence or potential existence of the security agreement is registered; the security agreement itself is not registered. A registration notice can be registered prior to execution of the security agreement. The notice must contain the following basic information: the name of the debtor, the name of the secured party and a description of the collateral.

- The priority that registration of a registry notice gives applies to all advances made by the secured party under the terms of any security agreement with the debtor involving collateral falling within the collateral description on the registry notice and other amounts (e.g., cost of seizure and sale of the collateral) deemed secured by the security interest.

\textbf{Alternatives 1 and 2}

Both types of systems have the following characteristics:

- Failure on the part of the secured party to register a registry notice relating to a security agreement results in the security interest arising under that agreement being subordinated to the following subsequent \textit{in rem} interests acquired in the collateral:

  - the interest of a good faith transferee (other than a secured party) of the collateral (whether the transferee must be without notice of the existence of the unregistered security interest is a matter with respect to which there will be disagreement);

  - another security interest in the collateral with respect to which a registry notice has been registered;

\textsuperscript{10} This is the feature that distinguishes Alternative 2 from Alternative 1.
-the interest of a judgment creditor who has caused the collateral to be seized under judicial process to enforce a judgment;

-the interest of the debtor's trustee in bankruptcy (depending upon prevalent bankruptcy law).

-A secured party who has registered a registration notice and who is party to a security agreement executed by the debtor:

-has priority over the holder of any subsequent,\(^{11}\) competing in rem interest (including a security interest, the interest of a buyer and the interest of a judgment creditor) in property of the debtor that falls within the collateral description in the security agreement and the registry notice unless the competing interest qualifies for priority under a special priority rule;

-does not have priority over a buyer of inventory who acquires his or her interest in a transaction entered into by the debtor in good faith and in the ordinary course of his or her business (whether or not the buyer has notice of the security interest);

-does not have priority over a buyer of low value consumer goods collateral when the buyer did not have actual notice of the existence of the security interest;

-does not have priority over the interest of a good faith transferee for value of collateral in the form of money, a negotiable instrument, a negotiable document of title or negotiable security;

-does not have priority over another secured party who has complied with the registration requirements and who has provided a loan with which the collateral was purchased or whose security interest (or deemed security interest) is in the form of a title retention sale of goods contract or a lease (whether these transactions are treated as providing for security interests or deemed security interests), and

-does not have priority with respect to advances (other than enforcement costs and expenditures to protect the collateral) made after the secured

\(^{11}\) "Subsequent" in the context of Alternative 1 means subsequent to the execution of a security agreement and in the context of Alternative 2 means subsequent to the registration of a registry notice.
party becomes aware that the collateral has been seized under judicial process to enforce a money judgment against the debtor.

X. THIRD PARTY ACCESS TO INFORMATION

Under both Alternatives described above, what is registered is a registry notice and not a copy of the security agreement. The registry notice contains basic information concerning existing or potential relationships between the identified secured party and debtor and provides a description of the collateral in either generic or specific form. This feature offers the following advantages:

- A registry notice can be registered before a security agreement is executed by the secured party and the debtor. This is of only marginal advantage in the context of Alternative 1, but is very significant in the context of Alternative 2 under which priority dates from the date of registration of the registry notice and not execution of a security agreement.

- A registry notice can relate to one or more than one agreement between the secured party and the debtor so long as all of the agreements involve collateral that falls within the collateral description on the notice.

However, since the registry notice contains only skeletal information about the relationship between the secured party and the debtor, it is necessary to give third parties access to all of the features of this relationship that are important to them when assessing the risk of dealing with the debtor. A competing policy is the protection, to the extent possible, of the confidentiality of this information. These policies can be served by requiring full disclosure by the secured party and by restricting the persons who are entitled to this disclosure. The details of the relationship between the secured party and the debtor are made available only at the demand of the debtor, a sheriff or trustee in bankruptcy or someone who has an in rem interest in property described in the registry notice (e.g., a subsequent secured party).

XI. THE REGISTRY SYSTEM

The following features are generally characteristic of a modern secured financing registry system (whether manual or computerized):

- Notice registration, not document registration is involved (see description, supra)
Registration is available without regard to the type of collateral that is involved. However, as noted above, registration will not necessarily give priority over good faith transferees of negotiable collateral.

All registrations relating to transactions governed by the law of a jurisdiction are effected at a central location in the jurisdiction (regional registries are not used).

Registry notices can be registered before a security agreement exists between the persons named as debtor and secured party in a registry notice. However, the system provides measures through which abuse of pre-agreement registration can be avoided.

The general public has ready access to the registry for the purposes of registering and searching the registry. This access is possible through the mails, personal attendance at the central registry office and, in some cases, by telephone and telecopier.

Registry records are current so that a search will reveal the extent to which a named person's property is encumbered. The system restricts to a very few the situations in which a security interest is deemed to be registered but is not discoverable through a registry search. In any event, a security interest that is deemed registered cannot be enforced against a good faith buyer.

An objective test to applied to determine in the validity of a registration where there has been an error in recording information (e.g., the debtor's name) on a registry notice.

Registrations can be amended so as to reflect transfer of either the debtor's or the secured party's interest or to reflect changes in collateral descriptions. However, changes that add new types of collateral are effective (for the purposes of priorities) only from the date of the change.

Subordination agreement can be registered.

The registry guarantees the proper registration of tendered registry notices and the accurate disclosure of registered information to searching parties. (Fees for registration are sufficient to provide an insurance fund available to cover losses). However, the registry assumes no responsibility for matters not under its control. It assumes no responsibility for the veracity or accuracy of the information on a registry notice.
- The registry registers all properly completed registry notices and amending or discharge forms and does not provide assurance that there is full authorization for the registration, amendment or discharge.

- Registration fees are such that almost anyone can afford them.

- The collateral is described generically or specifically on the registry notice. Some registry systems require specific asset collateral descriptions (e.g., serial numbers of motor vehicles and government issued licence numbers or markings for boats and aircraft) on registry notices except where the collateral is held by the debtor as inventory. Serial number registration is used to deal with the following problem. Assume that debtor B gives a security interest in his automobile to A. A registers his security interest. B, who is not a commercial seller of automobiles, then fraudulently sells the automobile to C who then resells it to D (or gives a security interest in it to D). Before buying the automobile (or taking a security interest in it), D searches the registry. If the basis for A's registration is B's name, since D will unlikely be aware of B, he will not be able to discover A's registration. If the basis for A's registration is the serial number of the automobile, D should have no trouble in discovering A's registration by using the serial number. Serial number registration protects both A and D.

The following additional features are characteristic of a modern computerized registry:

- The registry notice can be in hard copy (paper forms supplied by the registry) or a screen of information transmitted by software supplied by the registry directly to the data base of the registry.

- Any users of the system can have remote computer terminal access to the registry data base for the purposes of registering notices, searching the registry and amending or discharging registrations. The user’s computer terminal can be located anywhere that has telecommunications connections to the registry. However, special arrangements must be made to ensure that unauthorized persons do not have access to the data base and to permit the collection of registration fees from remote users.

- Remote computer access to the registry is available to small businesses and consumers through government offices or private agencies that have direct computer connections to the registry.

- Other forms of remote access to the registry for the purpose of conducting searches is possible through the use of telephone or teletypewriter.

- The debtor does not sign the registry notice.
-The period of registration is selected by the registering party. Generally, the registering party can chose a registration period between one and twenty-five years or infinity. The registration fees are related to the period of registration.

-Once a registration is effected, a verification statement containing the details of the registration is automatically sent to the registering party.

X. SECURITY INTERESTS IN FIXTURES AND ACCESSIONS\textsuperscript{12}

Modern secured financing requires the recognition of the possibility of taking and retaining a security interest in goods that are attached to land. While under the land law of the jurisdiction goods may become part of the land when they are affixed to it, under the secured financing regime they retain their character as goods for the purposes of recognizing that a personal property security interest in them can exist.

A priority structure contains rules for determining the relative priorities of security interests in the goods and interests in the goods as part of the land. These rules generally provide as follows:

-A security interest in the goods that arises before the goods are attached to the land has priority over an interest in the land existing at the date the goods are attached to the land. There is an exception to this in the case where future advances are made under a prior charge on the land. (See, infra).

-A security interest in the goods that arises before the goods are attached to the land does not have priority over the holder of a prior charge on the land to the extent of advances made under the charge after the goods are attached to the land and before a notice of the security interest in the goods is registered in the appropriate land registry.

-A security interest in the goods that arises after the goods have been attached to the land is subordinate to any interest in the land existing at the date the goods are attached to the land.

-A security interest in goods that are attached to the land has priority over any subsequent interest acquired in the land only if a notice of the security interest has been registered in the appropriated land registry.

\textsuperscript{12} Most systems provide for parallel structures for security interests in fixtures and accessions. The structure applicable to fixtures is described.
The rules dealing with security interests in fixtures generally specify the procedures that must be followed by a secured party when enforcing a security interest in the goods by removing them from the land. These rules generally provide:

- The secured party must give notice to the owner of the land (other than the debtor) of his or her intention to remove the goods.

- The owner of the land must be given an opportunity to prevent the removal by paying to the secured party the value the goods would have if they are severed from the land and offered for sale.

- When removing the goods, the secured party must not cause any inconvenience to the occupants of the land than is not necessarily incidental to the proper removal of the goods.

XI. POSSESSION OF THE COLLATERAL BY THE SECURED PARTY AS A SUBSTITUTE FOR REGISTRATION

The traditional pledge is no longer of general significance as a financing method for the obvious reason that most business and consumer debtors need to have possession of the collateral. This is particularly so where inventory collateral is involved. It is very difficult for a seller to deal with inventory collateral that is under the control of the secured party.

There are exceptions to the generalization contained in the preceding paragraph. Where the collateral is in the form of a negotiable instrument or negotiable document of title, a secured party may decide that the only effective way to protect his or her security interest in the collateral is to take possession of it.

Rules prescribing the obligations of a secured party in possession of collateral generally contain the following features:

- The secured party must use reasonable care in the custody and preservation of the collateral and, unless the debtor agrees otherwise, this involves reasonable steps to protect the debtor's interest in collateral in the form of negotiable instruments and securities.

- The risk of loss to the collateral in the hands of the secured party (other than loss caused by the failure of the secured party to use reasonable care) is on the debtor unless the secured party has insured the collateral.
-The secured party may hold as additional collateral any increase or profit, other than money, received from the collateral. Money must be applied to the debt or remitted to the debtor.

-The secured party may commingle fungible collateral.

XII. ENFORCEMENT

There is general agreement among the designers of modern secured financing regimes that there are important competing interests that must be addressed in the context of enforcement of security interests in tangible personal property. On the one side is the need to ensure that the debtor’s and subordinate secured parties’ interests in the collateral in the collateral are protected. On the other side is the importance of recognizing that it is in the interest of both the secured party and the debtor that the collateral be disposed of in a cost-effective and expeditious manner. Long delays in disposing of the collateral generally result in its rapid depreciation.

These conflicting interests are generally accommodated in the following way:

- Upon default by the debtor, the secured party is entitled to seize the collateral so long as this can be accomplished without a breach of the peace. If breach of the peace is threatened, the secured party can make a summary application to a court to obtain an order against the debtor requiring peaceful surrender of the collateral. Refusal to obey the order is punishable as contempt of court.

- Prior to sale of the collateral (e.g., 20 days), the secured party must give a notice to the debtor (and to holders of subordinate interests in the collateral) informing him or her of the right to redeem the collateral (or reinstate the agreement) and information as to how this is to be accomplished. The period for exercise of this right is shortened if the collateral is highly depreciable or is of a kind that the market value of it will necessarily be realized on sale by the secured party.

- If the collateral is not redeemed (or the agreement is not reinstated) the secured party is free to proceed to sell the collateral by private or public sale. Throughout the realization process the secured party must act in good faith and in a commercially reasonable manner. Failure to do so can result in a court order

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13 Generally, these same problems do not arise in the context of intangible property such as accounts since enforcement of a security interest in an account usually involves nothing more that notifying the account debtor to make payment to the secured party.
to pay damages to the debtor or other affected person and loss or diminution of the right of the secured party to recover any further amounts from the debtor. Where a consumer debtor is involved, the secured party can be required to pay to the debtor an amount of deemed damages for failure to comply with the statutory requirements.

-After disposition of the collateral, the debtor or other affected person can demand from the secured party an accounting of the proceeds of the disposition.

-Prior to sale the secured party can propose to the debtor and to other affected persons that he or she will take the collateral in full satisfaction of the obligation secured. The debtor and other persons affected can reject the proposal and require that the collateral be sold.

Jurisdictions with systems based on the English common law provide another approach to enforcing broadly-based security interests in business assets: receivership. Receiverships are very common in situations where the secured party has a security interest in all or most of the assets of a business. While conceptually there is nothing to prevent the use of receiverships for small business defaults, the cost of receiverships is such as to make them unrealistic unless the debtor has significant business assets. The following are the basic features of this approach:

- The parties to a security agreement may provide for the appointment of a receiver (or receiver-manager) and prescribe his rights and duties. It is also possible in appropriate situations to get an order for a court appointed receiver. Receivership is not a method of circumventing the regulatory regime applicable when the secured party proceeds to enforce its security interest. Unless a court orders otherwise, a receiver must comply with most of the requirements of the regime that are applicable to secured parties. When a receiver-manager disposes of assets while carrying on the business of the debtor, he or she need not comply with the notice requirements applicable where the secured party is liquidating collateral.

-Upon default by the debtor a receiver has the power to take over control of the business of the debtor. The appointment of a receiver suspends the powers of the directors of an incorporated business to manage the business. A receiver-manager is given the power to operate the debtor’s business so as to preserve its commercial value prior to sale. Ultimately the business is sold by the receiver-manager and the proceeds distributed as prescribed by law. The principal value of a receivership is that it preserves the "going concern" value of the business.
-Measures are taken to ensure that only qualified receivers are appointed and that receivers and the secured parties who appoint them are accountable to the debtor and other persons with interests in the property subject to the charge.¹⁴

-The receiver is required to maintain records and prepare periodic reports all of which are made available to persons whose interests are affected by the conduct of the receiver.

-While the receiver is appointed by secured party pursuant to power contained in the security agreement, he or she is under the control of the court but is not an agent of the court. A receiver may apply to a court for directions in difficult cases. Where competing priority claims arise, the receiver can make application to the court for a summary determination of the rights of the various claimants. The receiver has the same rights as a secured party to seek the assistance of the court where the debtor or any third party interferes with the exercise of his powers.

-Failure to meet the statutory standards of conduct (good faith and commercial reasonableness) or to otherwise comply with statutory requirements results in the receiver being liable in damages to any person suffering a foreseeable loss. While the secured party is not automatically liable for the misconduct of a receiver he has appointed, on application of an interested person, the court can order the secured party to make good any default of the receiver.

The enforcement system described above does not operate as insolvency proceedings in the sense that enforcement of a security interest entails collecting and recognizing all in rem claims to the collateral so that the buyer from the secured party or the receiver acquires the collateral free from prior claims. Sale of the collateral pursuant to the enforcement of a security interest necessarily extinguishes all interests subordinate to that of the security interest being enforced. However, it does not affect interests, including security interests, that have a priority status above that of the security interest being enforced.

¹⁴ In Canada, receivers are generally professional managers who are employed by large accounting firms.
XIII. DETERMINATION OF LAW APPLICABLE TO THE VALIDITY, PRIORITY POSITION AND REGISTRATION REQUIREMENTS FOR SECURITY INTERESTS

Since it is very common for collateral subject to security interests taken in one jurisdiction to be located in or moved to another jurisdiction, it is important there exist a set of commonly accepted rules dealing with the following matters:

- The law governing the validity (the existence) of a security interest in various types of collateral (e.g., non-mobile goods, mobile goods, intangibles).

- The law providing the registration requirements applicable to security interests in the various types of collateral.

- The law governing enforcement of the security interests.