

Some Thoughts about Registration with Respect to Security Rights in Movables

Harry C. Sigman *

This article does not pretend to be a comprehensive essay on the subject of registration with respect to security rights in movables. It originated in the context of the Third UNCITRAL Colloquium on Secured Transactions, the purpose of which was to gather experts and develop a basis for the consideration by the United Nations Commission on International Trade Law (UNCITRAL) of possible future work projects. One of the panels at the Colloquium discussed the topic of registration with respect to security rights in movables. This article summarizes certain of the matters discussed by that panel and presents the views of this writer on those and related matters. It should be read together with the papers prepared by the other panelists. In all events, this article reflects the views of this author only.

The *UNCITRAL Legislative Guide on Secured Transactions* (the *Guide*) includes an entire chapter, consisting of 75 recommendations, on the registry system. The registry is a key element to the attainment of the *Guide's* overarching goal of providing an effective and efficient secured transactions law that fulfills the key objectives spelled out in the *Guide*, and it is clear that a well-designed modern registry, carefully tailored to achieve that goal, is a *sine qua non* to the success of that law.

The panel on registration unanimously expressed the views that there is a need for UNCITRAL to undertake further work on this topic and that the need is urgent. The view was strongly expressed that while the chapter in the *Guide* on registration is sound in its recommendations of a grantor-based, comprehensive coverage (as to types of transactions and types of assets), "notice filing" system and in its elaboration of those concepts, the chapter is in certain respects somewhat cryptic, is not quite complete, does not propose model language for either statutory or regulation provisions and lacks sufficient detail

* Juris Doctor, Harvard Law School, 1963; member of the California Bar for over 45 years, specializing in commercial law; U.S. delegate to UNCITRAL in formulation of the Legislative Guide on Secured Transactions; visiting professor and guest lecturer at law faculties around the world; consultant to governments and NGOs on law reform projects around the world.

to be directly usable by those not already familiar with those concepts and lacking expertise in the operational aspects of registries. Indeed, in the discussion concerning whether future work should involve the preparation of a Model Law on secured transactions, the point was made that many countries lack the capacity to prepare an effective and efficient secured transactions law without guidance. This is no less true with respect to the law and the regulations relating to the registry. Thus, the panel agreed that substantial supplementation to the material in the *Guide* on registration is desirable and the question was not whether but how, *i.e.*, what form the product should take.

It was stressed that very substantial guidance is needed because the most familiar model is the land registry, and that due to the important differences in purpose and governing policies, the notice filing model recommended in the *Guide* for security over movables would otherwise not be sufficiently understood and, consequently, the efficiency, simplicity, low cost and speed to be derived from that model would be lost, or at least significantly reduced. It was also noted that the notice filing model, unlike most land registries, easily allows for exploitation of the newest technology, is better adapted to preserve privacy with respect to the business terms of the secured transaction and involves a major difference in the role of the registry personnel, which must not act as a gatekeeper but essentially as an efficient and accessible recaptacle, allowing the registry to facilitate filing and searching without interference. This is fundamental to the design of the registry, as it is not a matter of "public faith", registration does not create the security right, a registration may cover assets that may not even exist at the time of registration or might come into the patrimony of the grantor only after registration. Indeed, a registration may be made even before a security right has been created and may serve to "perfect" multiple security rights created at different times and by different security agreements. Thus, registration, in this regard, serves only as a warning flag that a security right may at some time exist in the assets referred to (which may be described even in very general terms, even in jurisdictions where specificity is significant in the context of transfers of property) should the grantor at some time have an interest in them and should there in fact be an obligation secured by those assets. The differences between such a notice filing registry and the classic land register are readily apparent, and these differences must be acknowledged not only in the applicable substantive law but also in the design of the registry, lest registration be needlessly, and counter-productively, burdened with unnecessary rules and practices.

It is worthwhile to digress briefly here to discuss the notion of “publicity”, often used to explain the legitimacy of registration. While it is true that the registry records do provide information, it must be kept in mind that this is of a highly limited nature. At best, as explained above, it provides a warning flag, by signaling that there may be, presently or at a later time, an encumbrance on the covered assets, and, thus, negates to some extent the appearance of “false wealth”. (Indeed, in this sense, the registry system benefits the grantor, who might otherwise suffer from an assumption of “false poverty”, *i.e.* that the assets are not held free and clear of ownership or security rights in favor of others.) The registry record, however, provides no assurance that the grantor now does, or at any subsequent time will, own any interest in the covered assets, nor does it provide any information as to the present or future existence of a security right, or the present or future existence or the extent of, or the identity of the actual holder of, a secured obligation (although some contend for a mandatory statement of a maximum secured obligation, an issue I leave for another day). Thus, the notion of publicity should not lead to a requirement that the underlying documents should be made a matter of public record, or to any requirements of detailed information, just as the mere fact that X has possession of Y’s asset gives no information about whether any secured debt exists or its extent, or whether Y’s possession is in the capacity of a pledgee (as contrasted with, *e.g.*, holding the asset as a lessee or as a temporary user or for the purpose of repairing it).

Of course, the fact that the registry provides only minimal information, to be supplemented by due diligence, does not mean that the registry is not of great value. On the contrary, by establishing an objective, publicly available point in time, it precludes fraudulent back-dating without the necessity for incurring the delay and expense of a notary or other similar preventative, it provides a simple, inexpensive user-friendly technique for establishing effectiveness against third parties or priority under rules that use time of registration as the reference point, and significantly reduces the likelihood of litigation. The registration system promotes certainty, predictability and transparency. The notice filing approach enables the registration system to be cheap, quick, simple and less prone to error.

As to the form of the end-product of such future work, it was asserted that even a set of detailed regulations (such as those prepared recently by the Organization of American States for use with the *Inter-American Model Law*, which is similar in many respects but certainly not identical to the secured transactions law recommended in the *Guide*), while a step forward, would not be sufficient.

The panel consensus was that, at the very least, an elaborate introductory text, explaining all the key concepts and how they can best be implemented, should be provided. This might, *inter alia*, result in international minimum standards for rules, procedures and operational capabilities. The product should include, in addition, both an explanation and a model text for the legal rules relevant to the registration system (e.g., the effect of erroneous data in the registry) and its administrative structure and a set of model Regulations (including alternatives), and accompanying commentary explaining policy choices and consequences.

It was pointed out that, given the simple nature of the notice filing concept and the availability of technology at a fairly low capital cost (particularly since most potential operators of the registry, governmental or private, would likely already have some hardware that might be utilized for the registry as well), even a registry expected to handle a high volume of transactions can be set up at relatively low capital cost and can be operated by a very small staff, augmented by occasional information technology support and some public information capabilities. Moreover, electronic filing and online searching minimizes the risk of errors by registry personnel, essentially reducing registry operational mishaps to the possibility of computer glitches.

There was strong support for a set of model regulations as a major part of the ultimate product. It was recognized that countries, particularly those at early stages of development, might have somewhat differing needs and might make somewhat differing choices, so a single set of regulations – one size fits all – would not be sufficient; thus, alternative regulations should be provided to enable varying modes of implementation and varying policy choices. Only such an approach would lead to the level of guidance needed by countries that lack the capacity to develop appropriate registries by themselves. Further, in each country, both the substantive law and the registry regulations would have to take into account the existence of registries for specific types of collateral (e.g., various types of intellectual property; this is likely to be highly non-uniform – in some countries registries exist for patents but not for copyrights, and some registries are simply records of the issuance by the government of the right while others are ownership registries, which might or might not encompass security rights).

While the basic element of registration indexed and searchable under the specific grantor (as contrasted with under the specific asset) would be common to all countries, the particular grantor identifier(s) to be used might well differ from one country to another. In many countries, it might be

possible to use numbers instead of names as the key identifier, at least for the overwhelming majority of grantors, both entities and individuals.

With respect to entities doing business within a particular country (even those formed elsewhere), it is likely that every entity is issued a company number upon formation as a company, or an identification number upon registration of the entity to do business with a *Tribunal de Commerce*, Chamber of Commerce or the like, or a national tax number. Indeed, technologically-based error-detection might in many cases be possible. For example, the system could be designed to reject numbers comprised of more or fewer digits than the selected identifier should have; it might even be possible to provide an electronic link to the index of the selected identifier source (e.g., the companies registry index), showing the name corresponding to the number submitted, thereby allowing the party submitting the registration data to immediately become aware that the number submitted does not relate to the intended debtor entity.

With respect to individuals, in many countries, citizens (and, in some cases, all legal residents) are assigned a number, indicated on a secure governmentally issued national identity or residency permit card; this number usually remains constant even despite name changes. Those few prospective grantors not so covered might be identified by a number on a passport or the like. Where there is no single national identification number, an alternative set of sources, listed in a prescribed hierarchy, might be used (something like this will often be necessary even when names rather than numbers are used, when there is no single “legal” name determinant and there is often a discrepancy between names as shown on various source documents). The benefit of using a number rather than a name is that a number is alphabet-neutral (avoiding spelling and other issues found in countries where more than one language is in use) and avoids issues relating to what constitutes an individual’s “legal” name (consider, e.g., the case of multiple given names, when not all of them are routinely used; the determination of the family name (consider, e.g., the role of matronymics), whether a routinely used nickname constitutes an alternative “name”, etc.) It must, however, be borne in mind that a long string of digits is very frequently mis-keyed and an error in a string of digits is harder to detect than an error in a mistyped name; thus, use of a number does burden filers to build in a higher level of quality control in the grantor name submission process. Requiring that the registration provide both a name and a number necessitates the legislative policy decision whether both must be correct in order for the registration to be effective; if yes, this entails a significantly increased risk of fatal error, since the result will be lack of

effectiveness of the security right (against third parties or even against the debtor, depending on the substantive rule), and increases the likelihood of litigation; if not, then searchers must search under both name and number to be certain that they have located all effective registrations. The foregoing discussion serves to illustrate the kinds of decisions that are made, knowingly or not, in the design of virtually every aspect of the system, and these are often decisions that should be made by the legislator, not by administratively promulgated regulations, as they determine the measure of costs and risks involved and their allocation between filers and searchers.

A related issue is the indexing of registrations by serial number of the collateral, when the collateral is composed of a type of asset that might be susceptible to serial-number registration. This is a likely possibility in most countries, particularly with respect to security rights in motor vehicles. The rule must be very specific as to the definition of the types of assets subject to this regime (not always an easy task – consider the definition proposed for “motor vehicle” in the draft Regulations for Australia). In addition, the legislation must determine whether the use of the serial number is a condition of effectiveness in all cases or only vis-à-vis consumer buyers (or some other category of persons).

In addition, the panel also recognized that the allocation of rules between the underlying secured transactions law and the regulations might well vary in different countries. The difficulty of changing the law might point in the direction of expansive regulations. On the other hand, this approach might result in the shift from the legislator to the administrator of too many policy decisions better made at the legislative level, and the risk of potential abuse by secret, too frequent or otherwise inappropriate change by the administrator in charge might point toward putting more rules firmly into the underlying law. Confidence in the judiciary and speed of the litigation process or lack thereof might also influence the extent and detail of the legislation adopted in a particular country. Awareness concerning this issue, it is to be hoped, would influence the decision on a country-by-country basis.

Another important issue, this one being universal, is the matter of fees. While keeping the cost of registration low and in all events not viewing it as a government revenue source is fundamental to the recommended registry everywhere, which agency should collect fees (in many countries, systems are already in place at post offices and chambers of commerce to collect government fees), and whether to cover the registry’s costs from a single initial fee (which might simplify the processes and might encourage thorough searching by allowing free online searches) or to impose fees for particular

transactions (amendments, terminations, searches, etc.) might well vary from country to country.

It was noted that while the Regulations should implement the *Guide's* recommendations, the *Guide* having been developed on the basis of consensus and the further work on the registration should not be the occasion for the re-examination of decisions already made, the product of the registration project should not be presented simply as a supplement to the *Guide*. Such a presentation might limit its influence to only those countries that had made a primary decision to adopt the *Guide's* content generally as its substantive law, while the product of this project, if not viewed as merely a supplement to the *Guide*, could be extremely useful to countries that were interested in improving their existing registries or converting to a registration system, even if their substantive law differed in some respects from the *Guide*.

Mention was made of concerns about fraudulent use of the registry and, on the other hand, the risk of corruption in the operation of the registry. While these risks should be taken into account, they should not be exaggerated lest they undermine the goals of the recommended registration system.

It was also recognized that the product must be accompanied by practical educational programs aimed at registry personnel, at bankers and other users of the system, as well as lawyers. Of course, the registry itself should be user-friendly and provide online step-by-step guidance.

While the product should not attempt to be a technical guide, it is important that the product should be conscious of the information technology issues that will arise in the development of a registry and be clear that there must be mutual involvement and constant communication between the IT experts and the legal coordinator throughout the development process. There are almost always numerous ways to solve any IT problem, and it is important that the registry expert be involved in the selection among them, lest what seems to be a purely IT choice have a deleterious impact on the functionality of the registry from the standpoint of serving its users and fulfilling its roles in the secured transactions context. Examples of issues that might seem to be purely technological yet could have important legal or functionality consequences include: size of the grantor's name field(s), in the aggregate and by element, if a name rather than a number is used as the grantor identifier; choice of Unicode or ASCII 256 or better, etc., for the quantum of characters cognizable by the system, again if a name rather than a number is used as the identifier; capability of the system to be accessible online by searchers without compromising the integrity of the database; whether there should be stripping

or ignoring of any elements of an entity-grantor's name if the name is used instead of a number (if not, mere abbreviation of a name element such as "Co." instead of "Company" would result in a fatal error); duration of maintenance of a record after its effectiveness has expired or otherwise has been terminated.

Finally, I close with a few words about Book IX of the *Draft Common Frame of Reference* (DCFR). While this article is not the place for a comprehensive description or a detailed analysis of the DCFR, it is noteworthy that that document, prepared by leading European scholars, accepts registration for both security rights and title retention. Section 3 of Chapter 3 is devoted to registration. It is in many respects aligned with the *Guide*. Under the DCFR: registration does not have a constitutive effect, *i.e.*, it is not an element of the creation of the right nor does it create the right; it deals only with effects of the right against third persons; it is recognized to be only one of several techniques for achieving those effects (*e.g.*, possession or control); it is to be electronic and publicly accessible online; and the registration system does not distinguish between security rights and retention of ownership devices. Some debatable aspects are the provisions requiring consent and authentication, which seem to be the product of a great fear of the abuse of the registry combined with a lack of confidence in the judicial systems of certain member States to provide speedy and effective relief against abuse. Experience with registry systems elsewhere in the world has not provided a strong basis for this fear. Further, even if appropriate for a registry covering the many member States of the European Union, it is not necessary or appropriate for most individual countries. Likewise questionable is the provision relating to the description of assets covered by a registration. Also somewhat troubling is the discussion in the Comments concerning constructive notice (asserted as necessary to provide for *bona fide* acquisition). Neither the *Guide* nor countries using the recommended notice filing system rely on the concept of constructive notice; they rely on clear rules based on the fact of registration, not on judicial inquiries into whether a competing person should or could have searched the record. While this writer would not accept the DCFR provisions *in toto*, comfort is drawn from the recognition of the need for, and key role of, a registry and the general alignment of the DCFR with the *Guide's* chapter on registration.

