Secured transactions law reform and the modernisation of personal property law.

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SECURED TRANSACTIONS LAW REFORM AND THE MODERNISATION OF PERSONAL PROPERTY LAW

By

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SUMMARY

This thesis deals with the legal reform of secured credit law regimes. Particularly, it considers to what extent the modernisation of secured credit laws could be achieved through approximation of law methods. Although, a justification of secured lending continues to be a topic of debate amongst economic scholars, the case for the modernisation and approximation of secured credit law regimes is now clearly established and now represents a general consensus amongst academics and commercial actors. The archaism and divergences of national secured credit law regimes have become too cumbersome and inadequate to meet the requirements of modern commerce. Accordingly, the question is addressed of whether the modernisation of secured credit law regimes could be successful using approximation of law methods such as legal transplantation, legal harmonisation and legal unification. A comparative law approach is retained in the thesis in order to assess whether a modernisation using approximation of law methods could be successful. Fundamental divergences are identified between the law of personal property in Civilian jurisdictions such as France and Common Law jurisdictions such as England. It is argued that secured credit law regimes are well entrenched in 'legal culture' which constitutes one of the major obstacles to the successful modernisation of secured credit law regimes in the light of an approximation of law. It is thus further questioned whether the modernisation of secured credit could occur outside the framework of the state. The recognition of an independent legal framework to regulate secured transactions can however be challenged as not being entirely feasible nor desirable.

DECLARATIONS AND STATEMENTS

This work has not previously been accepted in substance for any degree and is not being concurrently submitted in candidature for any degree.

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STATEMENT 1

This thesis is the result of my own investigations, except where otherwise stated. Where correction services have been used, the extent and nature of the correction is clearly marked in a footnote(s).

Other sources are acknowledged by footnotes giving explicit references. A bibliography is appended.

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STATEMENT 2

I hereby give consent for my thesis, if accepted, to be available for photocopying and for inter-library loan, and for the title and summary to be made available to outside organisations.

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CHAPTER ONE

IN PURSUIT OF A RATIONALE FOR SECURED CREDIT

INTRODUCTION

The pursuit of the basis of a coherent rationale for secured credit has been at the heart of major debates, particularly within the economic literature. Economic scholars and academics challenged the institution of secured credit using the economic analysis of the law. Essentially, it is argued that the rationale for secured credit will be established if one can show that the gains from issuing security will exceed the costs. Other scholars departed from this methodology and opted for a much more radical position according to which secured credit, or at least the priority system, should be eradicated. In support of their recommendation, it is argued that secured credit would unfairly redistribute wealth from unsecured creditors to the debtor itself and to other secured creditors. Nonetheless, recent empirical evidence tends to show substantial inconsistencies with the theories exposed within this quest to find a rationale for secured credit. Thus, and at a time where legal reforms in the field of secured credit are rising, it is to be observed that the debate still remains inconclusive. In this study, it will be attempted to resolve the debate and determine whether a justification of the institution of secured credit can be established. It will be further examined whether the growing importance of the economic analysis in the law making process should dictate the substance of secured credit law regimes. In effect, the emergence of recent financial and economic literature in the field introduced a new debate on the use of the economic analysis as a method to assess national secured credit law regimes.

The creation of a security provides protection to the creditors against the debtor's default. The primary function of a security is thus to reduce credit risks for creditors by providing priority over other creditors in the event of the debtor's insolvency[1]. The granting of priority constitutes the principal purpose of secured credit with any

[1] Goode, R. M., *Legal Problems of Credit and Security*, (3rd ed. 2003), at p. 1.

jurisdictions which have implemented a type of secured credit law regime. For instance, Civilian jurisdictions such as France recognise the priority of the first in time creditor pursuing the famous Latin adage of '*prior tempore, potior jure*'[2]. Similarly, the American Article 9 of the UCC provides a similar rule embodied in the 'first to file' principle which respects the first in time, first in right principle[3]. While the principle is well established within secured credit law regimes, its desirability is the subject of an ongoing theoretical debate[4]. The problem is that the priority granted to secured creditors derogates to the *pari passu* principle, which is defined as a principle of equality and constitutes a central theme of any legislations on insolvency[5]. Hence, it became necessary to question why the legislator introduced such a system based on the distributive justice logic together with a system based on

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[2] The principle of first in time, first in right" is embodied in Article 2424 of the French Civil code and provides that: "[w]here several registrations are required on the same day as to the same immovable that which is required by virtue of the instrument of title bearing the remotest date shall be deemed of prior rank, whatever the order resulting from the register provided for in Article 2453 may be."

[3] Article 9 UCC, Part 3.

[4] Jackson, T.H., Et al. "Secured Financing and Priorities Among Creditors" (1979) 88 *Yale Law Journal*, at p. 1143; Schwartz, A. "Security Interests and Bankruptcy Priorities: A Review of Current Theories" (1981) 10 *Journal of Legal Studies*, at p. 1; Levmore, S. "Monitors and Freeriders in Commercial and Corporate Settings" (1982) 92 *Yale Law Journal*, at p. 49; Schwartz, A. "The Continuing Puzzle of Secured Debt" (1984) 37 *Vanderbilt Law Review*, at p. 1051; White, J.J. "Efficiency Justifications for Personal Property Security" (1984) 37 *Vanderbilt Law Review*, at p. 473; Buckley, F.H. "The Bankruptcy Priority Puzzle" (1986) 72 *Virginia Law Review*, at p. 1393; Scott, R.E. "A Relational Theory of Secured Financing" (1986) 86 *Columbia Law Review*, at p. 901; Shupack, P.M. "Solving the Puzzle of Secured Transactions" (1989) 41 *Rutgers Law Review*, at p. 1067; Triantis, G.G. "Secured Debt Under Conditions of Imperfect Information" (1992) 21 *Journal of Legal Studies*, at p. 225; Picker, R.C. "Security Interests, Misbehavior, and Common Pools" (1992) 59 *University of Chicago Law Review*, at p. 645; Adler, B.E. "An Equity-Agency Solution to the Bankruptcy Priority Puzzle" (1993) 22 *Journal of Legal Studies*, at p. 73; Schwartz, A. "Taking the Analysis of Security Seriously" (1994) 80 *Virginia Law Review*, at p. 2073; Triantis, G.G. "A Free-Cash-Flow Theory of Secured Debt and Creditor Priorities" (1994) 80 *Virginia Law Review*, at p. 2155; LoPucki, L.M. "The Unsecured Creditor's Bargain" (1994) 80 *Virginia Law Review*, at p. 1887; Steven L. H., Et al. "A Property-Based Theory of Security Interests: Taking Debtors' Choices Seriously" (1994) 80 *Virginia Law Review*, at p. 2021; Kanda, H., Et al. "Explaining Creditor Priorities" (1994) 80 *Virginia Law Review*, at p. 2103; Hudson, J. "The Case Against Secured Lending" (1995) 15 *International Review of Law and Economics*, at p. 47; Arye, L., Et al. "The Uneasy Case for the Priority of Secured Credit in Bankruptcy" (1996) 105 *Yale Law Journal*, at p. 857; Baird, B. "The Importance of Priority" (1997) 82 *Cornell Law Review*, at p. 1420; Schwarcz, S.L. "The Easy Case for the Priority of Secured Claims in Bankruptcy" (1997) 47 *Duke Law Journal*, at p. 425; Schwartz, A. "Priority Contracts and Priority in Bankruptcy" (1997) 82 *Cornell Law Review*, at p. 1396 ; Warren, E. "Making Policy With Imperfect Information: The Article 9 Full Priority Debates" (1997) 82 *Cornell Law Review*, at p. 1373; Scott, R. "The Truth About Secured Financing" (1997) 82 *Cornell Law. Review*, at p. 1436; Arye, L., Et al. "The Uneasy Case for the Priority of Secured Credit in Bankruptcy: Further Thoughts and a Reply to Critics"(1997) 82 *Cornell Law Review*, at p. 1279; Mann, R.J. "Explaining the Pattern of Secured Credit" (1997) 110 *Harvard Law Review*, at p.625; Harris, S.H., Et al. " Measuring The Social Costs And Benefits And Identifying The Victims Of Subordinating Security Interests In Bankruptcy" (1997) 82 *Cornell Law Review*, at p. 1349; Carlson, D.G. " Secured Lending as a Zero-Sum Game" (1998) 19 *Cardozo Law Review*, at p.1635.

[5] In England, this principle is embodied in Section 107 of the Insolvency act 1986.

the *pari passu* principle. In other words, the question emerged to determine whether the difference of treatment of creditors generated by the creation of a security could be justified. To this question, proponents of the redistributive theories answered in the negative[6]. The priority system could not be justified because it would unfairly redistribute wealth from unsecured creditors to the debtor itself and secured creditors. However, and as it will be evidenced later in this analysis, recent empirical research would tend to contradict the arguments derived from the redistributive theories. The second aspect of the creditor's prerogative corresponds to the notion of control. The asset given as security for a loan will confer exclusive control to the secured creditor over that asset. Upon the debtor's insolvency, the asset will be liquidated to the benefit of the secured creditor. Particularly, it is arguable that borrowers would have greater incentives to repay their secured creditors before becoming insolvent if the asset given as security is strategically essential to the functioning of the debtor's business. In addition, creditors with a broader security will also enjoy a certain degree of influence over the debtor's business. This is particularly true where the creditor has obtained a security over a large amount of the debtor's assets such as with the floating charge in England[7].

Finding a coherent justification for secured credit is not an easy task. It is generally argued that secured lending would enable firms to borrow more easily and would enable creditors to issue loans they would otherwise decline[8]. From the debtor's perspective, it is arguable that secured lending would promote access to credit at lower costs. Further, modern legislations on secured credit generally entitle borrowers to use a large range of assets such as tangible, intangible, and even future assets to secure their debts, which considerably enlarge the pool of assets available for financing. For creditors, the grant of security reduces their risks in the event of the debtor's default. Secured credit significantly enhances the probabilities of recovery for creditors. Accordingly, it is often assumed that creditors would reduce their interest rates and costs when lending on a secured basis.

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[6] See *e.g.*, LoPucki *op. cit.* fn. 4.

[7] See *e.g.*, Mokal, R.J. "The Floating Charge – An Elegy" (2006) *bepress Legal Series, Working Paper 1380*, at p. 6, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=386040 (last checked 22/04/2010).

[8] Schwartz "Security Interests and Bankruptcy Priorities: A Review of Current Theories" *op. cit.* fn. 4.

There are of course a plethora of other reasons and justifications for issuing a security that will be considered in this study. Notwithstanding the widespread use of secured credit within commercial transactions, there are some situations where creditors will still choose to lend on an unsecured basis. This would suggest that in some situations, creditors would not always consider secured lending as an attractive financing tool. Thus, what explains that some creditors will choose to lend on a secured basis and others on an unsecured one? How can we justify the institution of secured credit? In light of these questions, legal scholars and academics challenged the *raison d'être* of the institution of secured credit using the economic analysis of the law.

According to the economic literature, the desirability of recognising secured credit law regimes could only be established if one can show that the gains from issuing a security will exceed the costs. It is explained that:

"[e]fficiency of secured transactions will be demonstrated by creating a model showing that the availability of security enables debtors to increase wealth by an amount greater than is lost by others as a result of these transactions."[9]

This is the so called Kaldor-Hicks efficiency criterion[10]. The question has strongly been discussed and debated in the United States under the auspices of Article 9 of the UCC[11]. In the light of this debate, economists challenged legal academics and lawyers to justify secured lending using the economic analysis of the law. Further to these theories based on economic efficiencies, other analysis also developed against the institution of secured credit promoting arguments based on the unfairness of the priority system towards unsecured creditors, particularly, towards non-adjusting or involuntary unsecured creditors. The theories developed by economists have however extensively been criticised as not corresponding to the reality of commercial activities. In effect, recent empirical research tends to contradict theoretical

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[9] *Ibid.*

[10] Kaldor, N. "Welfare Propositions of Economics and Interpersonal Comparisons of Utility" (1939) 49 *The Economic Journal*, at p. 549; Hicks, J.R. "The Valuation of the Social Income" (1940) 7 *Economica,* at p. 105, and "The Foundation of Welfare Economics" (1939) 49 *The Economic Journal*, at p. 696. In order to demonstrate the efficiency of secured transactions, the Kaldor-Hicks criterion requires the demonstration that the gains obtained by secured creditors exceed the loss of unsecured ones.

[11] See bibliography on secured credit above at fn. 4.

arguments and tends to show that secured credit law regimes are desirable as social benefits are likely to outweigh social costs[12].

The inability to establish a general theory of secured credit using the economic analysis of the law further questions the relevance of the use of this method within the pursuit of a rationale for secured credit. Particularly, the uncertain use of the economic analysis to account for the institution of secured credit begs the question of the use of economics as a norm for challenging the substance of the law and policy choices. Following substantial modernisation efforts and legal reforms in the field of secured credit at national and international level, a financial literature has recently emerged assessing the quality of national business legislations using the economic analysis of the law. This assessment method has largely been criticised and its adequacy put under extensive scrutiny. Thus, the question is not solely to determine whether the economic efficiency of the institution of secured credit needs to be proven but also whether the economic analysis should dictate the content and substance of secured credit law regimes. In this respect, the theories of secured credit will first be analysed in subsequent developments. The question of the use of the Law and Economics as a new norm for challenging the law will then be considered.

THE PUZZLE OF SECURED CREDIT: CURRENT THEORIES

Resolving the 'puzzle of secured credit'[13] is not an easy task. A myriad of theories have been advanced in an attempt to justify the institution of secured credit, particularly within the Law and Economics literature. The first wave of theories mainly emerged from the Law and Economics movement which attempted to prove

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[12] On this point see Davydenko, S. A., Et al. "Do Bankruptcy Codes Matter? A Study of Defaults in France, Germany and the UK" (2006) EFA *2005 Moscow Meetings Paper, ECGI - Finance Working Paper No. 89/2005, WFA 2005 Portland Meetings Paper, AFA 2005 Philadelphia Meetings Paper,* available at SSRN: http://ssrn.com/abstract=647861 (last checked 22/04/2010); Booth, J.R., Et al. "Loan Collateral Decisions and Corporate Borrowing Costs" (2006) 38 *Journal of Money, Credit and Banking,* at p. 67; Benmelech, E., Et al. "Collateral Pricing" (2007) *Working Paper, Harvard University Department of Economics/MIT Sloan School of Management,* available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1106600 (last checked 22/04/2010); Listokin, Y.J. "Is Secured Debt Used to Redistribute Value from Tort Claimants in Bankruptcy? An Empirical Analysis" (2008) 57 *Duke Law Journal,* at p. 1037 and Armour, J. "The Law and Economics Debate About Secured Lending: Lessons for European Lawmaking?"(2008) 5 *European Company and Financial Law Review*, available at http://ssrn.com/abstract=1118030 (last checked 22/04/2010).

[13] Schwartz *op. cit.* fn. 8.

that secured lending could theoretically be economically efficient[14]. These theories use the economic analysis to challenge the efficiency of the law by attempting to predict the effects of the legal rules in question. Essentially, academics, referring to the Kaldor-Hicks criterion[15], attempted to determine whether the gains obtained from secured transactions would exceed the losses. In order to determine whether the costs of issuing secured debts would exceed the losses, the economic literature makes a series of assumptions that have severely been criticised as not representing the reality. Theories based on the economic analysis generally derive their analysis from the Modigliani and Miller irrelevance theorem according to which the issuance of secured credit would amount to a zero sum game in perfect markets[16]. In effect, the early literature posits that the operation of secured credit would generally be seen as value neutral "... if capital markets are perfect, information is perfect, all actors have homogeneous expectations, bankruptcy costs are zero, and no taxes exist ..."[17] By relaxing the assumptions of the perfect markets, a justification of secured credit would become possible by showing that the gains obtained from the issuance of secured credit would outweigh the loss borne by unsecured creditors. A second school of thought, also known as the *Sympathetic Legal Scholars*[18] departed from the Law and Economics movement. This second wave of theories based on the 'exploitation hypothesis' provides that wealth would be unfairly transferred from non-adjusting and involuntarily creditors to debtors and other secured creditors[19]. Although, redistributive theories appeared to create substantial threats to the institution of secured credit, empirical evidence tends to show that these theories are difficult to sustain.

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[14] Carlson, D. G. "On the Efficiency of Secured Lending" (1994) 80(8) *Virginia Law Review*, at p. 2179.

[15] See above fn. 10.

[16] See Modigliani, F., Et al. "The Cost of Capital, Corporation Finance and the Theory of Investment" (1958) 48 *American Economic Review*, at p. 261; Miller, M.H. "Debt and Taxes" (1977) 32 *Journal of Finance*, at p. 261; Modigliani, F., Et al. "Corporate Income Taxes and the Cost of Capital: A Correction" (1963) 53 *American Economic Review*, at p. 433. The reference to the Modigliani and Miller irrelevance theorem to justify secured credit can be found in Schwartz "The Continuing Puzzle of Secured Debt" *op. cit.* fn. 4, at pp. 1052-55 and pp.1066-68.

[17] Jackson, T.H., Et al. "Vacuum of Fact or Vacuous Theory: A Reply to Professor Kripke" (1985) 133(5) *The University of Pennsylvania Law Review,* at p. 987.

[18] McCormack, G., *Secured Credit under English and American Law*, (2004) at p. 22.

[19] For an overview of the exploitation hypothesis arguments, see Symposium reported at 82 *Cornell Law Review* (1997).

The first point of this analysis will thus focus on some of the major theories that have challenged the economic efficiency of secured credit. The second point of this analysis will aim to provide an analysis of the redistributive theories and of the objections and counter arguments that have been raised against them.

The theories measuring the economic efficiency of secured credit

The first theory that challenged the economic efficiency of secured lending appeared in 1979 with Jackson and Kronman who developed a theory based on a monitoring costs explanation[20]. It was then followed by an Article of Schwartz in 1981, where the author challenged academics to 'solve the puzzle of secured debts'[21]. Following this study, academics attempted to develop other theories, using the economic analysis of the law, in order to prove the efficacy of secured lending[22]. The next developments will therefore focus on some of the major theories and arguments that have been advanced to challenge the economic efficiency of secured credit.

The monitoring costs explanation

A theory based on a monitoring costs explanation was developed by Jackson and Kronman[23] to justify the effectiveness of secured lending. According to the demonstration, the creation of a security would reduce the monitoring costs for all creditors[24], thus rendering the operation of secured credit economically efficient. The theory posits that the creation of a security lowers the risks for creditors in the event of the debtor's default. Thus, the use of the debtor's asset as security for the loan would reduce the monitoring costs[25]. Indeed, by concentrating its attention on the asset securing the loan, the creditor would not need to monitor all of the assets of the debtor. By opposition, it is arguable that unsecured creditors would need to incur higher costs for their loan because of higher requirements in their monitoring tasks[26].

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[20] Jackson, T. H., Et al., *op. cit.* fn. 4, at p. 1143.
[21] Schwartz, *op. cit.* fn. 8.
[22] See bibliography on secured credit above, fn. 4.
[23] Jackson, T. H., Et al., *op. cit.* fn. 4, at p. 1143.
[24] *Ibid.* at pp. 1158-64.
[25] *Ibid.* at p. 1153.
[26] Schwartz, *op. cit.* fn. 8.

By monitoring specific assets, secured creditors would diminish their monitoring responsibilities and, consequently, save time and money over the credit transaction costs. As a result, it is argued that the creditor who lends on a secured basis would charge lower interest rates than if the loan was not secured. Hence, it is concluded that:

"... the rule permitting debtors to encumber their assets by private agreement is therefore justifiable as a cost saving device that makes it easier and cheaper for the debtor's creditor to do what they would do in any case."[27]

It is however arguable that if the issuance of secured credit may lower the transaction costs, unsecured creditors may increase their interest rates in response to the increase in risks. To this objection, it is argued that the increase in costs charged by unsecured creditors would still be inferior to the reduction in costs offered by secured creditors. For example, consider creditor A and creditor B who have lent $100 each to a debtor. Creditor A decides to lend on a secured basis with an interest rate of $5 and monitoring costs of $1. Creditor B, taking into account the prior interest of creditor A, also decides to lend secured with an interest rate of $9 and monitoring costs of $4. The total debtor's costs for his $200 loan are $19. If creditor A decides to lend unsecured, the risks of non repayment are higher and therefore decides to charge a higher interest rate of $7 and monitoring costs of $3. Creditor B will charge similar costs for the loan. In this situation, the total costs for the two loans reach $20. Thus, the debtor would be better off borrowing the funds on a secured basis.

The recognition that this scenario could support an explanation based on the monitoring costs is questionable. In effect, this analysis could not constitute the basis for a viable theory of secured lending. This scenario may justify the effectiveness of secured credit on this particular instance but could not constitute the basis for a general theory of secured lending. This example used as an illustration of the monitoring costs explanation is based on assumptions that might not correspond to the reality. The economic analysis often assumes that interest rates will be reduced if creditors lend on a secured basis. However, empirical evidence has shown that on certain instances, it will be more beneficial for the parties to opt for unsecured

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[27] Jackson, T. H., Et al. *op. cit.* fn. 4, at p. 1157.

credit[28]. For example, creditors and debtors might opt for an unsecured loan when the credit constitutes a small credit loan repayable in the normal course of the debtor's business.

Further critics were addressed to an explanation based on the monitoring costs explanation[29]. It is argued that lending on a secured basis might lower the secured creditors' monitoring costs but, adversely, may increase them for unsecured creditors. In effect, the granting of a security will generally increase the risks for unsecured creditors who will accordingly increase their monitoring responsibilities[30]. Consequently, it is argued that the "... debtor's total interest bill is ... unaffected by the existence of security"[31]. Nevertheless, it is admitted that the viability of the monitoring costs explanation could be plausible in one situation[32]. Following Article § 9-306 (2) of the UCC, a "... security interest continues in collateral notwithstanding sale, exchange or other disposition thereof unless the disposition was authorized by the secured party in the security agreement or otherwise, and also continues in any identifiable proceeds including collections received by the debtor." According to this disposition, the issuance of secured credit would prevent misbehaving debtors from reselling or substituting some of their assets after a loan is made which would benefit all creditors.

The issuance of a security would deter purchasers from buying assets from misbehaving debtors and would consequently reduce risks for secured and unsecured creditors. It is argued that in this situation, the monitoring costs incurred by secured creditors would be reduced without a corresponding increase from unsecured ones. The increased monitoring costs incurred by unsecured creditors would still be less that the monitoring costs incurred by secured creditors. Unsecured creditors would rely on the monitoring efforts of secured creditors. Nevertheless, it is admitted that the validity of this analysis would only be conceivable in respect of long term loans as assets substitution would appear more unlikely in relation to short term loans[33].

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[28] On this point, see Armour *op. cit.* fn. 12 and Davydenko, S.A., Et al. *op. cit.* fn. 12, at p. 565.
[29] See *e.g.*, Schwartz *op. cit.* fn. 8.
[30] *Ibid.* at p. 9.
[31] *Ibid.* at p. 7.
[32] Schwartz, *op. cit.* fn. 8, at p. 11.
[33] *Ibid.* at p. 12.

Notwithstanding the recognition of the viability of the theory in this particular context, it is to be concluded that a theory based on the monitoring costs explanation is difficult to sustain as it only managed to justify a limited types of secured transactions.

The signalling theory

The signalling theory posits that secured lending would constitute a signal to other prospects creditors that the debtor is a 'better risk' than others. Secured lending would inform creditors about the risk level of debtors. The theory assumes that the cost of issuing debts is greater on a secured basis for debtors. Accordingly, high risks debtors would not opt to issue secured debts if the costs of doing so, that is the risk of losing their assets, would exceed the advantage of obtaining lower interest rates. Accordingly, it is exposed that:

"[f]irms have an incentive to issue secured debt as a way of sorting themselves out by risk class if creditors take the existence and level of secured debt as indicia of firm profitability. Creditors may hold such beliefs because secured debt is more costly for firms to issue when their projects are of low quality. Further, profit maximizing firms have an incentive to signal in a way that confirms creditors' beliefs about the relationship between the existence and the level of security and the prospects of firms."[34]

In other words, in an imperfect information credit market, the issuance of secured debt would act as a signal showing the debtor's creditworthiness which would in turn reduce the screening costs of other potential creditors. Pertaining to the theory, only creditworthy debtors would issue secured debts. This conclusion becomes questionable in light of the examination of empirical evidence. In effect, empirical research tends to show that secured debts is often granted by small and young companies which are often categorised as being less creditworthy[35].

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[34] *Ibid.* at p. 17.

[35] On this point, see *e.g.,* Berger, A.N., Et al. "Collateral, Loan Quality, and Bank Risk" (1990) 25 *Journal of Monetary Economics,* at p. 21; Chen, S.S., Et al. "Further Evidence on the Determinants of Secured Versus Unsecured Loans" (1998) 25 *Journal of Business and Finance and Accounting,* at p. 371; Lasfer, M.A. "Debt Structure, Agency Costs and Firm's Size: An Empirical Investigation"(2000), *Working Paper,* City University Business School available at http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.15.2011&rep=rep1&type=pdf (last checked 22/04/2010) and Armour *op. cit.* fn. 12.

An empirical investigation run by Lasfer confirmed that:

"[t]he reported results show that secured debt is negatively related to firm size; small firms hold more than three times secured debt than do larger companies."[36]

The signalling theory has been further challenged as not providing a satisfactory explanation for the institution of secured credit[37]. It is argued that the use of secured lending as a signal might be uncertain unless firms assess the risks in a similar way. To illustrate this objection, consider that firm A and firm B are identical with same financing projects. On one hand, Firm A wishes to keep the costs of its credit low and decides to take a security accordingly. On the other hand, Firm B is willing to take higher risks and decides to issue a broader security than A. Although Firm A and B are identical, their dissimilar attitudes towards risks have led to the issuance of a doubtful signal that does not reflect the reality. The occurrence of this potential scenario would significantly undermine the recognition of an explanation based on the signalling theory to justify secured credit. The impossibility to discern high risk from low risks debtors' thus raises the question of the effectiveness of recognising secured credit as a signal.

In order for the signalling theory to be effective, that is to only signal creditworthy debtors, the costs of issuing secured debt should exceed the advantage of obtaining lower interest rates for high risks firms. In this situation, only low risk debtors would signal, and their signal would consequently show creditworthiness. In this context, the signal could assist creditors to screen creditworthy firms which would significantly reduce the costs[38]. The problem is that the theory assumes that it is more costly for debtors to borrow on a secured basis as they may lose the asset offered as collateral upon default. It further assumes that the cost of issuing secured debt would be higher for high risks debtors as the risk of losing their assets is greater. Following these assumptions, only low risk debtors would issue secured debt because they believe that their likeliness of default is low. This signal would suggest creditworthiness to other creditors. High risks debtors would not issue secured debt because of the costs represented by the risk of losing the assets would be higher than the low interest rates offered if they were borrowing on a secured basis.

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[36] Lasfer *ibid.* at p. 5.
[37] Schwartz *op. cit.* fn. 8, at p. 14.
[38] *Ibid.*

It is arguable that, from the debtor's point of view, borrowing on a secured or unsecured basis does not make any difference upon default. Creditors will seize the debtor's assets in any case if he becomes insolvent. For creditors, however, lending on a secured basis will ensure a repayment in priority and will offer them a certain degree of control over the debtor's assets. In this perspective, it is arguable that borrowing on a secured basis should signal high risks debtors rather than creditworthiness[39]. Further, empirical evidence tends to show that younger and smaller firms are more likely to issue secured debts, despite being less creditworthy, than bigger companies which tend to be more creditworthy and which tend to borrow more frequently on an unsecured basis[40]. Again, and as for the monitoring costs explanation, it is to be concluded that the signalling theory fails to provide convincing grounds for a justification of the institution of secured credit. Parallel arguments can be found with the free riding theory[41] and the relational theory[42].

The free riding theory and the relational theory

The free riding theory suggests that the issuance of secured credit would solve the problems of under monitoring and over monitoring. Creditors all have the same fear that the debtor might misbehave. Therefore, one creditor should be allocated the task to monitor the debtor so that other creditors would not need to do so. They would follow the signal of the secured creditor's monitoring and free ride on his monitoring efforts. In order to compensate the secured creditor for the monitoring responsibilities and for the free riding situation, the secured creditor would be given priority over all other creditors[43]. The debtor would therefore benefit of lower interest rates from other creditors as they would not need to incur monitoring costs. It is arguable however, that this situation would only be plausible if the secured creditor had a broad security such as the American floating lien or the English floating charge over all of the debtor's assets. In effect, a secured creditor with a security on a specific asset would only monitor this specific asset and would not monitor the general business 'wealth.

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[39] Armour, *op. cit.* fn. 12, at p. 5.
[40] *Ibid.* at p. 11. See also Chen *op. cit.* fn. 35.
[41] Levmore, *op. cit.* fn. 4.
[42] Scott "A Relational Theory of Secured Lending" *op. cit.* fn. 4.
[43] Levmore, *op. cit.* fn. 4, at p. 57.

The arguments developed in the free riding theory have been criticised. It is argued that in a world without security, the avoidance of over monitoring or under monitoring could similarly be achieved by creditors. In the situation where there would be an under monitoring situation, it is explained that it is because it would not be in the interest of any creditor to monitor or, because there would be a lap of time during which there would be an incentive for any existing creditor to initiate monitoring[44]. The issuance of security may solve the problem of coordinating monitoring efforts by providing the secured creditor with some compensation. However, the free riding explanation cannot constitute a basis for a general theory of secured credit. In effect, the theory essentially works if monitoring is needed or if there's a risk that the debtor misbehaves. It is arguable that the risk of asset substitution is unlikely to occur in relation to specific asset, such as with inventory, or in relation to assets peculiar to certain types of businesses. The loss borne from reselling such assets may outweigh the benefits of the borrower being able to enter in riskier projects. In this situation, monitoring would not be needed.

It is further argued that the issuance of security would provide a guarantee of good behaviour from the debtor because of this bond between the floating lienee and the debtor. Scott recognises the validity of the 'relational theory' as a justification for the efficiency of secured lending. It is argued that a deeper analysis of the relationship creditor-debtor will permit to better understand the parties' objectives. Contractual agreements, in opposition to security agreements, would not permit creditors and debtors to achieve their mutually beneficial objectives[45]. It is recognised that both debtors and creditors have a common interest to see the business succeeds. However, it is often observed that in order to do so, the debtor might enter in riskier projects to maximise his profits. This type of misbehaviour is likely to go against all creditors' interests. In the event of the debtor's default, secured creditors will rely on their security to recover their capital. Therefore, the success or failure of the debtor's business is of little interest for them. By opposition, unsecured creditors do not have any of the debtor's assets to rely on upon insolvency and, therefore, essentially need to rely on the success of the debtor's business in order to be repaid. It is argued that

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[44] Schwartz "The Continuing Puzzle of Secured Debt" *op. cit.* fn. 4, at p. 1058.
[45] Scott *op. cit.* fn. 42, at p. 901.

this divergence of interests between secured and unsecured creditors would disappear when secured creditors take a floating lien. Secured creditors, as part of their long credit relationship with their debtors, would expect to be paid from the wealth of the debtor's ongoing business. The grant of secured credit would thus constitute a bond between debtor and creditor and a promise by the debtor not to misbehave by entering in riskier projects[46].

According to the relational theory, a secured creditor with a floating lien and an unsecured creditor have both similar interests in seeing the debtor's business succeeds. Naturally, the secured creditor should monitor the debtor's behaviour. As unsecured creditors will gain from this monitoring, they will accept the priority accorded to secured creditors. The theory proposes two main functions of the relational security arrangement. First, the existence of the floating lien compels and influences the debtor's decision making, which will in turn promote the success of the business. In effect the relational security arrangement involves the function of control which includes the task of monitoring the debtor's misbehaviour[47]. By restricting their behaviour *a priori*, debtors could arguably increase their borrowing potential *a posteriori*[48]. Secondly, the relational theory provides that the arrangement would also include the commitment from the debtor that he will do everything he can to make the business successful[49]. By taking all of the debtor's assets 'hostages', the secured creditor can better control the debtor in the situation where he would default upon the agreement[50].

It is further argued that the relational security arrangement provides two external benefits that would offset the increased risks imposed on unsecured creditors. First, it is assumed that the granting of a security will generally increase the value of the debtor's business[51]. Secondly, the secured creditor's monitoring efforts will benefit other creditors by acting as a signal. These creditors will not need to incur monitoring costs. The creation of this long term relationship between the floating

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[46] Armour *op. cit.* fn. 12, at p. 6.
[47] Scott *op. cit.* fn. 42, at p. 926.
[48] Armour *op. cit.* fn. 12, at p. 6.
[49] Scott *op. cit.* fn. 42, at p. 926.
[50] *Ibid.* at p. 928.
[51] *Ibid.* at p. 931.

lienee and the debtor would create a bond. This would entitle the debtor to access credit *a priori* at lower interest rates and the opportunity to extent credit *a posteriori* by ensuring good behaviour to his creditors. Nevertheless, the relational theory has been the subject of criticisms[52]. It has been argued that the relational theory only manages to demonstrate the benefits of having a lead creditor. However, the existence of this lead creditor does not in itself justify secured lending[53]. It was further suggested that the relational security theory was simply a variation of the monitoring costs and of the free riding theories[54]. Likewise, a monitoring costs explanation is based on the benefits of obtaining a security on specific assets in order to discourage the debtor's misbehaviour. Nevertheless, it has been suggested that such finding would only seem to be plausible in relation to long term loans and in relation to specific tangible assets such as equipments rather than inventory and account receivables.

Following the analysis of some of the theories advanced to justify the institution of secured credit, it is to be concluded that the signalling theory, the monitoring costs explanation and other explanations analysed in this paragraph did not manage to provide for a comprehensive account of secured credit. The recognition of a theory that would account for secured credit in general terms would therefore appear to be uncertain. The debate over the question of secured credit has not been conclusive within the early literature using the economic analysis of the law. On the eve of the reform of Article 9 of the UCC in the United States, the debate reappeared. The revision of Article 9 of the UCC presented the opportunity for many American scholars and academics to re-analyse and reassess the rationale behind a secured credit law regime. Even though there were many arguments advanced in favour of a reform of Article 9 of the UCC, American scholars needed to think about it deeper. Does the archaism and inefficiency of the law justify on its own a reform? A reform would confirm that the institution of secured credit is necessary and legitimate in modern economic life because it increases the capability of the debtor to borrow.

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[52] See *e.g.*, Shupack *op. cit.* fn. 4.
[53] *Ibid.* at p. 1082.
[54] Buckley *op. cit.* fn. 4.

Beyond these questions over the rationale for reform of the law, it was important to focus on a more fundamental question: Why does the law permit secured lending in the first place? What is the validity and legitimacy of this outstanding institution? What explains that some creditors will choose to secure their debts and other will choose not to do so? Accordingly, a new wave of theories attempted to demonstrate the ineffectiveness of the institution of secured credit by showing that the issuance of secured credit would act to the detriment of unsecured creditors. Redistributive theories posit that the issuance of secured debt would unfairly retransfer wealth from unsecured creditors to the debtor itself and secured creditors. LoPucki materialised the argument in an Article entitled the 'Unsecured Creditor's Bargain'[55] which attempted to demonstrate that the issuance of secured credit would create economic inefficiencies, especially in relation to non-adjusting creditors. Hence, it is suggested that the priority system should be abolished[56].

The redistributive theories

The theories developed from the exploitation hypothesis differ from the methodology adopted under the theories that used the economic analysis of the law. This current of thought does not use the economic analysis of the law but asserts that the issuance of secured credit would act to the detriment of other unsecured creditors whether voluntarily or involuntarily. Although, the arguments appear to constitute a substantial threat to the institution of secured credit, counter arguments based on empirical evidence would undermine the viability of the exploitation hypothesis as it will now be examined.

A major threat to the institution of secured credit

The redistributive theories posit that the institution of secured credit would unjustifiably advantage secured creditors over voluntarily and involuntarily unsecured creditors. The issuance of secured debts would unfairly retransfer wealth from 'non adjusting creditors' to the debtor itself and secured creditors. This is what

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[55] Lopucki *op. cit.* fn. 4.
[56] *Ibid.* at p. 1891.

Lopucki refers to as the 'secured creditor's bargain'. By failing to 'adjust' unsecured creditors would bear the costs of the debtor's low interest rates following the issuance of secured debts.

Involuntarily creditors, such as tort victims, are disadvantaged by the existence of secured creditors. As the debtor's pool of asset is diminished, tort victims might not satisfy their compensation claims. Involuntarily unsecured creditors appear to be in effect bound to an agreement to which they did not consent in the first place. Voluntarily unsecured creditors are also loosing from secured credit because they do not get the necessary information to accurately evaluate the risks and their probability of recovery. Ill-informed creditors would bear the costs of failing to adjust following the issuance of secured debts. Accordingly, it is argued that unsecured creditors would be subject to an entirely 'fictitious bargain'[57].

It is explained that because the institution of secured credit together with the priority of secured creditors over involuntarily unsecured creditors could not be justified by any theories, it should be eradicated[58]. It is further suggested that involuntary creditors, such as tort victims, should in fact have priority over voluntary creditors whether secured or unsecured[59]. The theory opts for quite a drastic and radical position in relation to the institution of secured credit. Although, it is correctly reiterated that no theories have actually managed to recognise the economic efficiency of the institution of secured credit and of the priority system, these arguments should not be used to promote the eradication of the priority system. In effect, the above analysis established that, in specific situations, the issuance of secured debts can be beneficial. Further, empirical research has generally shown that "... the legal institution of secured credit is, on the whole, socially beneficial, and that such benefits are likely to outweigh any associated social costs."[60]Nonetheless, the theory concludes that security cannot be economically efficient because it benefits secured creditors to the detriment of other unsecured creditors. It is further argued that the institution of secured credit is not needed and that creditors who would opt

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[57] *Ibid.* at p. 1895.
[58] *Ibid.* at p. 1963.
[59] *Ibid.* at p. 1896.
[60] Armour *op. cit.* fn. 12, at p. 1.

for unsecured lending could obtain similar advantages as if they had opted for secured lending. It is explained that, on certain occasions, 'sophisticated creditors' would choose to lend on an unsecured basis without being a 'mistake'[61]. In order to explain the 'unsecured creditor's bargain', the author distinguishes between two types of unsecured lending which will now be considered. It is first referred to asset-based unsecured lending which can achieve similar functions with similar advantages for creditors and debtors than with secured lending. A study on bankruptcy reorganisations of large, publicly held companies in the 1980's carried out by Whitford and Lopucki[62] found that unsecured lending was frequent with larger companies[63]. In the event of their insolvency, it was observed that unsecured creditors were still in the position to recover their credit, in view of the large size of the insolvent firm[64].

In the same way as secured creditors would recover their credit following the exercise of their priority in the debtor's assets, asset-based unsecured lending would provide similar results by using "... the combination of negative covenant against competing debts and priorities, and active monitoring to prevent competing debts from arising."[65] Subsequent perfected security interests would still rank ahead of the unsecured debt notwithstanding the negative covenant. Nonetheless, it is recognised that the risk for a subsequent secured creditor to gain priority over the negative covenant was small in relation to large companies[66]. Accordingly, it is admitted that

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[61] Lopucki *op. cit.* fn. 4, at p. 1924.
[62] Lopucki, L., Et al. "Patterns in the Bankruptcy Reorganization of Large, Publicly Held Companies" (1993) 78 *Cornell Law Review,* at p. 597.
[63] Lopucki explained that 55% of all lending by commercial banks is unsecured. The borrowers who receive asset-based unsecured loan tend to be the largest financially strongest companies. Lopucki *op. cit.* fn. 4, at p. 1925.
[64] *Ibid.* See footnote 146: "... Among the 43 reorganizations of large, publicly held companies that Professor Whitford and I studied the liquidation of Baldwin-United yielded 54 cents on the dollar for unsecured creditors. That distribution totaled $239 million, over $100 million of which was paid in cash within three years after confirmation. Similarly, the liquidation of White Motors yielded 61 cents on the dollar for unsecured creditors. That distribution totalled $174 million, over $100 million of which was paid in cash within six months after confirmation. In at least five cases in which the debtor did not liquidate, the liquidation value of the assets exceeded the secured debt by a sufficient amount that it was clear beyond argument that unsecured creditors would have substantial recoveries in liquidation. See Lynn M. LoPucki & William C. Whitford, Bargaining Over Equity's Share in the Bankruptcy Reorganization of Large, Publicly Held Companies, 139 U. Pa. L. Rev. 125, 171-72 (1990) (quoting disclosure statements on projected recoveries in liquidation and explaining the context in which the projections were made)."
[65] *Ibid.* at p. 1926.
[66] *Ibid.* at p. 1926.

a secured creditor who lends to small companies would be in a similar situation than a sophisticated unsecured creditor with a negative covenant who would lend to larger companies[67]. The 'creditor's bargain makes sense'[68]. In effect, such a model would provide similar advantages for creditors to the ones obtained under a security agreement. Nonetheless, the author admits that the sudden emergence of tort claimants might reduce the negative covenant lender's hope of repayment. In effect, as unsecured creditors, they will be repaid *pari passu* upon the company's insolvency. This situation would not occur with secured lending, which priority system enables secured creditors to rank ahead of torts claimants. In this situation, the sudden emergence of a large amount of tort claims would make unsecured creditors to switch to secured lending. Further, it is arguable that unsecured creditors do not have the same power of control over the debtor's assets as secured creditors do. Thus, unsecured creditors would also bear the risk of the debtor's misbehaving. This eventuality could also diminish negative covenant creditors' expectations upon the debtor's insolvency.

The second unsecured credit mechanism is referred to as 'cash flow surfing'. When debtors have used all of their assets as collaterals, creditors will sometimes accept to extend credit facilities by accepting small unsecured loans in order to save the debtor's business. Creditors are willing to lend on an unsecured basis because they believe in the strong incentives of the debtor to repay his debts. However, they will usually lend small credit over a small period of time. Unsecured creditors expect to be repaid in the ordinary course of the debtor's business and before other secured creditors, as long as the debtor's business remains wealthy. In this situation, unsecured creditors are not expecting to get repayment upon the debtor's liquidation value. If the debtor fails to pay its unsecured creditors, this will constitute a signal to other creditors who might refuse to deal with the debtor in the future, and which could ultimately cause the failure of the debtor's business[69]. In this respect, criticisms were addressed to Article 9 of the UCC filing system as it only serves the information needs of secured creditors and completely ignores cash flow surfers unsecured creditors needs. Cash flow surfing unsecured creditors should not be

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[67] *Ibid.* at p. 1927.
[68] *Ibid.* at p. 1930.
[69] *Ibid.* at p. 1941.

bound to security agreements to which they are not parties. These unsecured creditors should only be presumed to know or assume only what reasonable persons similarly situated would know or assume[70]. Moreover, if secured creditors wish to grant further secured credit to the debtor, they should ensure that their intentions are accurately communicated to unsecured creditors[71]. To this end, it is argued that the filing system embodied in Article 9 of the UCC should be amended. It is suggested that once the information needed by unsecured creditors will be better communicated, "... the unsecured creditor's bargain will cease to be a figment of the legal and economic imagination and will become a bargain in fact."[72] Despite a powerful demonstration, Lopucki admits with resignation that:

"[w]e are rooting against security. But even as we dislike that harsh institution, we respect it. The debtor agreed to it expressly and the unsecured creditor did so implicitly. How could it be unfair?"[73]

The redistributive theories constitute a significant threat to the institution of secured credit. Nevertheless, the arguments analysed in this section have been actively criticised and contested, especially in the light of recent empirical researches as it will now be presented.

The uncertainty of the exploitation thesis

The fact that the issuance of secured credit may create economic inefficiencies cannot suffice to support the idea of eradicating the institution of secured credit and the priority system. Inefficiencies may be produced when secured credit is issued but legal reformers will generally attempt to mitigate them through legal reforms. For example, insolvency law regime in England created a ring fenced funds for the repayment of unsecured creditors in priority over other secured creditors[74]. Further, Section 386 and Schedule 6 of the Insolvency Act 1986 set out the categories of preferential creditors which include, for instance, the remuneration of employees. In

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[70] *Ibid.* at p. 1963.
[71] *Ibid.* at p. 1964.
[72] *Ibid.* at p. 1965.
[73] *Ibid.* at p. 1889.
[74] Gullifer explains that: [t]he percentage is 50% of the first £10,000 and 20% of any assets above that figure with a ceiling of £600,000 for the prescribed part." Gullifer, L. "The Reforms of the Enterprise Act 2002 and the Floating Charge as a Security Device" (2008) 46 *Canadian Business Law Journal,* at p. 410. See also, The Insolvency Act 1986 (prescribed part) Order 2003 S.I 2003/2097.

addition, it is arguable that larger businesses are likely to undertake insurance in order to cover their potential tort liabilities. This possibility would hinder the argument according to which larger companies are likely to issue secured credit so as to transfer wealth from involuntarily creditors to other secured creditors and the debtor itself. The suppression of the priority system, as suggested by Lopucki, would seem to be an extreme solution to solve the problem[75]. Moreover, as many authors have argued in the past, the eradication of the priority system would lead creditors and debtors to find an alternative system of priority[76]. The conclusion that the institution of secured credit together with the priority system should be eradicated, following potential inefficacies, is thus not sustainable.

It is further argued that if tort creditors had priority over secured creditors, they would have to impose the payment of risk premium on debtors in order to compensate creditors for their additional risks. This objection is acknowledged by Lopucki who suggested that a secured creditor insurance should be payable in advance by the debtor[77]. This could impose extra costs and extra burden on the parties but it is argued that it would only be small. This insurance would cover the secured creditor against losses born from tort claims. Nevertheless, it is to be admitted that the proposition according to which priority should be given to involuntarily unsecured creditors over secured creditors would fail. It is arguable that secured creditors and debtors would always find an equivalent system to favour the payment of secured creditor before tort victims[78].

The exploitation hypothesis has particularly been challenged in an Article entitled "The Search for Someone to Save: A Defensive Case for the Priority of Secured Credit."[79] Although, the major threat to the institution of secured lending is recognised to be the arguments developed in the redistributive theories[80], the conclusions according to which the institution of secured credit together with the

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[75] Lopucki *op. cit.* fn. 4, at p. 1963.
[76] *Ibid.*
[77] *Ibid.* at p. 1906.
[78] On this point see White *op. cit.* fn. 4.
[79] Mokal, R.J. "The Search for Someone to Save: A Defensive Case for the Priority of Secured Credit" (2002) 22(4) *Oxford Journal of Legal Studies,* at p. 687.
[80] *Ibid.* at p. 690.

priority system should be eradicated are rejected. Indeed, it is explained that the factors used in support of the exploitation hypothesis can be challenged, particularly referring to arguments based on empirical data.

As explained in the above section, the redistributive theories posit that the issuance of secured credit would facilitate the exploitation of involuntary creditors, and creates economic inefficiency through its ability to retransfer insolvency value from non-adjusting to secured creditors and debtors. A similar wealth transfer would also be observed in relation to uninformed unsecured creditors who would fail to re adjust following the issuance of secured debts. In respect of involuntarily creditors such as tort victims, the theory posits that debtors would issue secured debts in order to redistribute wealth to the detriment of tort claimants. The argument was based on an empirical research on 'the largest reorganization of the 1980's'[81]which would tend to confirm the assumption that larger companies are most likely to issue unsecured debts than smaller companies. Indeed, following the LoPucki and Whitford study, it was established that for two of the companies considered in the study, more than two third of the unsecured debt was involuntary. It is further provided that:

"[i]n the United States, large, publicly traded firms tend not to borrow on a secured basis ... most commercial secured debt ... is issued by small- and medium-sized companies."[82]

Additionally, it has been observed that "... the strongest companies in our economy ordinarily do not secure their debts"[83] and that "[t]he reported results show that secured debt is negatively related to firm size; small firms hold more than three times secured debts than do larger companies."[84]

This assumption would seem to go against the core argument developed by the exploitation hypothesis that secured credit is used to transfer wealth from involuntarily unsecured creditors such as tort claimants to the debtor itself and secured creditors. Indeed, the empirical investigation referred to by Lopucki in order to support the argument was based on the largest reorganizations of the 1980's. The

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[81] Lopucki, L., Et al. "Corporate Governance in the Bankruptcy Reorganization of Large, Publicly Held Companies" (1993) 141(3) *University of Pennsylvania Law Review,* at p. 738.
[82] Bebchuk, L.A. "The Uneasy Case for the Priority of Secured Claims in Bankruptcy" (1996) 105 *Yale Law Journal,* at pp. 859-860.
[83] Mann *op. cit.* fn. 4.
[84] Lasfer *op. cit.* fn. 35, at p. 5.

restriction of the analysis to large companies would tend to suggest that they are likely to incur more business interests and create more involuntarily debts[85]. For example, reference is made to one company in particular, the Johns-Manville Corporation, which filed for reorganisation and had over two billion Dollars in Asbestos related person injury claims[86]. Following the exploitation hypothesis, such large companies should have the best incentive to issue secured debts so as to shift the costs onto unsecured creditors such as tort claimants. Yet, empirical investigations showed that larger companies issue little secured debt and often have sufficient assets to meet their liabilities[87]. Thus, it would seem difficult to support the argument according to which secured debt would be issued in order externalise involuntarily liabilities. It has been shown that large firms do not generally issue secured debts and thus, secured debts could not be used to externalise costs as they are not likely to happen.

If the exploitation of involuntarily creditors is unlikely to occur in respect of larger companies, the question emerged to determine whether the exploitation theory could still apply in the context of smaller firms which are, *a contrario,* more likely to issue secured debt[88]. In this respect, it can be argued that smaller firms may decide to issue secured debt in order to externalise their tort liabilities on involuntarily creditors. In order to do so, the debtor's company would have to be liquidated. The costs of liquidation can be considerable for small businesses[89]. The debtor will have to determine whether the benefits obtained from liquidating the company, that is the benefits from the externalisation of tort liabilities, would outweigh its costs such as those incurred from job losses, equity stake and other legal liabilities. This is unlikely to be the case. Indeed, it would be quite unusual for small companies to incur enough tort claims that would make the liquidation process wholly beneficial for the debtor. Small firms are not likely to be issuing considerable tort liabilities such as the ones generated by larger companies as mentioned above.

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[85] Mokal *op. cit.* fn. 79, at p. 694.
[86] Lopucki *op. cit.* fn. 4, at p. 1906 (see footnote 81).
[87] Mokal *op. cit.* fn. 79, at p. 696.
[88] *Ibid.* at p. 697.
[89] *Ibid.*

In light of these arguments, it can be concluded that larger companies which incur substantial involuntarily debts do not appear to issue secured debts as a way to externalise these costs. Further, smaller companies which are generally more likely to issue secured debts would not do so as a way to externalise tort liabilities because the costs of liquidation are likely to exceed the benefits of externalising such costs. As a result, the exploitation thesis is difficult to sustain, particularly in light of these latest observations.

Further objections also substantially weakened the proposition according to which secured credit would unfairly prejudice other unsecured creditors such as ill informed or non adjusting creditors. The exploitation hypothesis further posits that some unsecured creditors would not react appropriately following the issuance of secured debts by their debtor. They would fail to increase their interest rates accordingly because of informational asymmetries[90]. As a result, these uninformed unsecured creditors would be exploited by secured creditors. Ill informed and ill equipped creditors would be exploited by failing to adjust their interest rates following the issuance of secured debts. This argument can be challenged. It is arguable that the aptitude to deal with risk is not a function of secured credit law regimes. Whether secured or unsecured, creditors would have to assess the degree of likelihood of the debtor's default. Further, firms are now generally well advised by a wide range of professional agencies[91]. Ill informed unsecured creditors would eventually get the necessary information and raise their interest rates accordingly and failure to do so would force them out of business[92].

The argument could not be used to defeat the institution of secured credit. Indeed, it is arguable that ill equipped unsecured creditors would also face similar difficulties in a world without the existence of secured credit law regimes. Similar subsidy created by ill equipped creditors would benefit well equipped and adjusting unsecured creditors. The ability to deal with risk is not related to secured credit law regimes. Even if similar information would be provided to unsecured creditors, it is

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[90] *Ibid.*
[91] Bank of England "Finance for Small Firms: A Sixth Report" (January 1999) cited by Mokal *ibid.* at p. 704.
[92] Mokal *Ibid.* at p. 706.

likely that similar subsidy would still persist following the ignorance and inability of certain creditors to deal with risk. Further, the law generally ensures that commercial participants are given the possibility to enter in commercial activities of their choice with their correlative risks. Commercial participants must face the consequences of their choices and this has nothing to do with the institution of secured credit. Other areas of law also involve similar situations for ill informed and ill equipped participants that cannot be imputed to the legal regime in question[93]. Thus, the argument according to which secured credit would exploit involuntarily or uninformed creditors could not provide a rational basis in support of the eradication of the institution of secured credit. The issuance of secured credit is not used as a means to transfer wealth from involuntarily or non adjusting creditors to debtors and other secured creditors. On the contrary, it is now widely recognised that the priority of secured credit is universally value enhancing[94].

The institution of secured credit generally contributes to the survival of businesses, which is value enhancing for debtors and creditors. If the recognition of a theory that could justify the institution of secured credit is uncertain, recent empirical research has evidenced situations where the issuance of secured credit will be beneficial. It is recognised that companies will borrow on a secured basis in two situations, which will now be considered. First, some companies will decide to borrow on a secured basis in order to reduce their risks of becoming insolvent notwithstanding their ability to borrow on an unsecured basis. The issuance of secured debts will generally incur lower interest rates for them. Firms will opt to borrow on a secured basis only when the benefits of doing so would outweigh the costs. The lending decision will thus depend upon the circumstances of the case. Secondly, some firms will decide to borrow on a secured basis because they do not have the choice at all. The only option for this kind of companies is to borrow on a secured basis or not to obtain funds at all. The injection of new funds in this type of firms will often mean for them the difference between solvency and insolvency[95]. The issuance of secured debts, on this

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[93] Mokal states that "... if the argument is that some business people cannot comprehend how security operates, can they understand and comply with tax and VAT, health and safety, consumer and environmental protection requirements, which are unlikely to be any less complicated?" *ibid.* at p. 708.
[94] *Ibid.* at p. 721.
[95] *Ibid.* at p. 721.

occasion, would also reinforce the probability of repayment to unsecured creditors and increase the chance of survival of the business. All creditors, including involuntarily creditors are better off if the company is kept afloat by issuing secured debts than if it was made insolvent. Accordingly, the issuance of secured debt would be value enhancing for all. Nevertheless, and in view of the above arguments, it has to be concluded, similarly to Schwartz, that: "[t]he case for restricting the secured debt priority in bankruptcy has yet to be made."[96]

Although the exploitation hypothesis can be challenged, it is to be acknowledged that in some specific factual contexts, the grant of secured credit can lead to unfair wealth transfers to voluntarily and involuntarily unsecured creditors[97]. In order to mitigate the impact of these inefficiencies resulting from the creation of security on voluntarily and involuntarily unsecured creditors, it is suggested that some improvements could be made through legal reforms. Unfair wealth transfers could be mitigated through the recognition of a better information system for unsecured creditors, at least for those who are in the position to adjust. For those unsecured creditors who cannot adjust, it is suggested a 'fixed fraction rule'. The law could provide for a percentage of the debtor's estate that would be reserved to unsecured creditors for repayment in priority of secured creditors. The recommendation is founded on considerations of distributional justice and fairness rather than economic efficiency. In England, the Enterprise Act 2002 created this ring fenced fund for unsecured creditors following the abolition of the Crown preference[98]. Further, the law could provide for a system of insurance against tort liabilities. When non-adjusting unsecured creditors can be identified within a group of creditors, it is proposed that they could be compensated through a system of insurance.

The recognition of a theory that would account for the institution of secured credit is uncertain following the analysis of the economic efficiencies theories and the exploitation hypothesis arguments. The arguments developed using the economic analysis of the law did not manage to provide for a rationale of secured credit. The

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[96] Schwartz "Priority Contracts and Priority in Bankruptcy" *op. cit.* fn. 4, at p. 1398.
[97] Finch, V. "Security, Insolvency and Risk: Who Pays the Price?" (1999) 62 *Modern Law Review,* at p. 644.
[98] On this point, see *e.g.,* Gullifer *op. cit.* fn. 74.

exploitation hypothesis raised a significant threat to the institution of secured credit by asserting that the issuance of secured debts may shift wealth from involuntarily creditors to secured creditors and the debtor himself. However, the recognition that economic inefficiencies may arise from the operation of secured credit is not enough to justify the abolishment of the priority system as it has been explained in this development.

Although economists did not manage to establish a theory justifying the existence of secured lending in general terms, it cannot be concluded that the institution of secured credit is economically inefficient. Economic inefficiencies, such as potential wealth transfer from non-adjusting unsecured creditors to debtors and secured creditors, can occur in specific contexts. However, these inefficiencies can be mitigated through law reforms as suggested above. The establishment of a theory that would provide for a general account of the institution of secured credit is difficult to reach because it is an empirical question. The question of why people choose to lend on a secured basis will depend upon a wide array of empirical data that cannot be translated in legal or economic theories. The answer to the question of the pursuit of a rationale for secured credit will not rise from the Law and Economics theorems or from the exploitation hypothesis. Nevertheless, it cannot be denied that the power of the Law and Economics movement to interfere with the law making process has recently become significant, especially in the context of legal reforms in the field of secured credit[99]. This situation, thus begs the question of the use of the economic analysis as a new norm for policy decision making. Should the Law and Economics dictate the substance of the law of secured credit?

[99] See *e.g.* the Reports issued by the World Bank which assess and rank national laws according to their performances for facilitating business. The "Doing Business" World Bank Reports are available at http://www.doingbusiness.org/ (last checked 22/04/2010).

THE ECONOMIC ANALYSIS: A NEW CHALLENGE FOR THE LAW OF SECURED CREDIT

The analysis of the theories did not provide for a satisfactory account of secured credit. The use of the economic analysis of the law to justify the institution of secured credit has particularly been criticised as not corresponding to the reality. Carslon states that:

"[In fact], it is easy to show that secured lending has at least the potential to create social good. Naturally, the global efficiency of secured lending cannot be known on an a priori basis. No mere contractual arrangement can be viewed as per se efficient. Contracts, by their very nature, involve externalities because they always foreclose other opportunities that might have been exploited. As a result, the social utility of any given consensual arrangement - or any human institution - is always an empirical question."[100]

Further criticisms were addressed to the theories. It is advocated that economic theories have developed "... in a vacuum of facts." [101] It is argued that the unpersuasiveness of these theories essentially rests on the unrealistic assumptions made by economists to support their analysis. Accordingly, empirical research studies have since emerged which would tend to demonstrate that secured lending is generally beneficial. It is argued that the question of why people issue secured credit remains an empirical question and cannot be proved using the economic analysis of the law. In addition, the lack of theories to justify the institution of secured credit did not prevent national legislations to recently enter into an era of reforms in the field of secured credit law. This would confirm that secured lending is a necessary and efficient tool of credit within the commercial community[102]. Further to national legal

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[100] Carlson *op. cit.* fn. 14.

[101] Kripke, H. "Law and Economics: Measuring the economic efficiency of commercial law in a vacuum of fact" (1985) 133 *University of Pennsylvania Law Review*, at p. 929.

[102] Some provinces of Canada adopted Personal Property Security Acts modelled on the American Article 9 UCC. Ontario was the first Canadian province to adopt a PPSA modelled on Article 9 UCC. It was adopted in 1967 but the Act did not come into effect until 1973. See *e.g.*, Ziegel, J. "The Draft Ontario Personal Property Security Act" (1966) 44 *Canadian. Bar Review*, at p. 104. New Zealand reformed its Personal Property Security Law with the enactment of the Personal Property Security Act 1999, available on www.ppsr.gov.nz (last checked 22/04/2010). PPSA 1999 was amended by the Personal Property Securities Amendment Act 2000 and the Personal Property Securities Act 2001. In England, a proposal for reform was also introduced. The Law Commission considered the need for reform with respect to company charges, and issued a Consultation Paper in June 2002 (Registration of Company Security Interests: Company Charges and Property other than Land , Law Commission Consultation Paper No 164), available at http://www.lawcom.gov.uk/closed_consultations.htm (last checked 22/04/2010). This was followed by a Consultative Report published in August 2004 (Company Security Interests: A Consultative Report, Law Commission Consultative Report No176),

reforms, international initiatives in the field of secured credit law regimes also launched considerable modernisation legislative efforts[103]. Accordingly, a financial literature emerged at the international level assessing the quality of national business legislations using the economic analysis of the law. The question of whether the Law and Economics should be used as a norm for challenging the effectiveness of a particular national legislation on secured credit, thus, becomes important in light of this analysis on the modernisation of secured credit law regimes.

The use of the economic analysis to account for the institution of secured credit

The debate over the *raison d'être* of secured credit remains largely inconclusive. Essentially, it has been argued that the theories based on an economic analysis of the law have failed "... because they contain implicit assumptions which make the theories implausible and unable to inform our understanding of every day events."[104] The theories have mainly derived from the perfect market assumptions, according to which, the issuance of secured debts would amount to a zero sum-game. Following the eliminations of certain assumptions such as information symmetries, the case for the effectiveness of secured credit would emerged by showing how the gains from issuing secured debt would exceed the loss of other creditors. The main criticism addressed to the theories based on an economic analysis of the law is that they are based on assumptions that are not reflective of the reality such as the assumptions of the 'perfect market'. It is arguable that the question of the justification of secured credit essentially remains an empirical question. Further, In the light of recent

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available at http://www.lawcom.gov.uk/closed_consultations. htm (last checked 22/04/2010). A final Report was published in 2005 (Company Security Interests, Law Commission Report No 296, Cm 6654), available at http://www.lawcom.gov.uk/lc_reports.htm (last checked 22/04/2010). Finally, France also reformed its secured credit Law in 2006 with the Ordinance No 2006-346 du 23 Mars 2006 art.13 Journal Officiel du 24 Mars 2006.

[103] See *e.g.* UNCITRAL Legislative Guide on Secured Transactions available at http://www.uncitral.org/pdf/english/texts/security-lg/e/09-82670_Ebook-Guide_09-04-10English.pdf (last checked 22/04/2010); the Convention on International Interests in Mobile Equipment (Cape Town, 2001); Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment (Cape Town, 2001) and the Luxembourg Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Railway Rolling Stock (Luxembourg, 2007) available at http://www.unidroit.org/english/conventions/c-main.htm (last checked 22/04/2010) and the EBRD Model Law on Secured Transactions available at http://www.ebrd.com/pubs/legal/secured.htm (last checked 22/04/2010).

[104] Shupack *op. cit.* fn. 4, at p. 1071.

pragmatic and empirical researches, it has now been extensively demonstrated that, secured credit would tend to be generally socially efficient[105].

The theories developed from the economic analysis of the law such as the monitoring costs or the signalling theories have been criticised as not corresponding to the reality of commercial activities. Essentially, the economic analysis of the law has been rejected as a method to justify the institution of secured credit. Particularly, it is argued that the methodology based on the Modigliani & Miller irrelevance theorem used by economic scholars is not adequate[106]. In effect, participants to the debate on the effectiveness of secured credit founded their analysis on the Modigliani & Miller irrelevance theorem according to which in a perfect market, the issuance of secured debt would amount to a zero sum game. By relaxing the assumptions made, economists have attempted to determine the situations where the issuance of secured debts could be justified. Fundamentally, the economic analysis requires that a justification of secured credit should demonstrate how the advantages of issuing secured debts would exceed the loss of other creditors. Instead, it is suggested that a theory of secured lending should be based on conventional legal reasoning and on factual observations. It is further proposed that a justification of the institution of secured credit should follow the "... techniques that Robert Braucher [and he] applied as drafters of the present form of UCC Article 9" and with "... the kind of reasoning that [they] submitted to the Review Committee composed of practicing lawyers, judges, and academics of an older generation."[107]

It is explained that credit agreements have developed from the sale of goods as enacted in Section 2-507(1) of the UCC which provides that "[t]ender of the goods is a condition of the buyer's duty to pay." At the beginning, conditional sales permitted the seller to retain title in the goods until the full purchase price was paid. Despite, the important evolution of security mechanisms and Article 9 of the UCC, it is argued that the idea of allocating a favourable treatment to the seller in case of default has remained within the regulation of the security interest. Three main

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[105] Armour *op. cit.* fn. 12.
[106] Kripke *op. cit.* fn. 101, at p. 932.
[107] *Ibid.*

explanations are proposed to justify the institution of secured credit as it will be now envisaged.

The granting of security would be justified because it substantially reduces risks faced by creditors. There is the risk that the debtor might get rid of certain assets by selling them, using them for wages, general expenses or leave with them[108]. The reduction in risks for secured creditors would accordingly reduce the overall costs incurred in the credit transaction. Schwartz and Jackson do not deny that secured lending reduces the creditor's risks. However, it is objected that an efficiency theory should demonstrate how the advantages of issuing secured credit such as the reduction of the secured creditor's risks would exceed the loss incurred for other unsecured creditors such as the increase in risks[109]. Secondly, secured lending would be justified because it increases the value of the debtor's firm. Consequently, unsecured creditors would not be disadvantaged by the issuance of a securitybecause it contributes to the general welfare of the debtor's firm[110]. Thus, the assumption according to which the issuance of secured credit would amount to a zero sum game in a perfect market is rejected. Here again, economic scholars do not reject the assumption that secured lending will increase the debtor's assets value. However, the theory should explain how secured lending may enhance the debtor's wealth more that it would have been under an unsecured transaction[111]. The third reason advocated in favour of secured lending is that without secured lending, it would not be possible for the debtor to obtain new assets[112]. Secured lending would thus become economically efficient because it permits the acquirement of new assets and increases the debtor's welfare. Nevertheless, it has been objected that this argument fails to distinguish between 'acquiring the asset' and the 'way in which it is acquired'[113]. It is further objected that secured lending involves restrictions for creditors and debtors such as filing requirements. For instance, the grant of priority to a creditor without appropriate filing would not be permitted pursuing Article 9 of the

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[108] *Ibid.* at p. 949.
[109] Schwartz, A., Et al. "Vacuum of Fact or Vacuous Theory: A Reply to Professor Kripke" (1985) 133(5) *University of Pennsylvania Law Review*, at p. 993.
[110] Kripke *op. cit.* fn. 101, at pp. 937-941.
[111] Schwartz *op. cit.* fn. 109, at p. 994.
[112] Kripke *op. cit.* fn. 101, at pp. 960-61.
[113] Schwartz *op. cit.* fn. 109, at p. 997.

UCC. It is further observed that the explanation according to which creditors would not finance the acquisition of new assets without a security could not justify the *raison d'être* of secured lending unless it is shown that the institution of secured credit is desirable in the first place[114].

The demonstration does not pretend to provide an answer to the 'puzzle' of secured lending but advocates that current theories remain unpersuasive because they are not based on the reality of the commercial world. Accordingly, it is argued that a theory based on factual data would provide a better answer in the quest to find a rationale for secured credit. Proponents of the economic analysis do not find the arguments convincing and strongly reject a methodology based on factual data from the commercial world. Although, it has to be admitted that the question of the justification of secured credit remains an empirical question, a general theory of secured credit could not solely emerged from factual data. As Schwartz and Jackson concluded, "... operating in a vacuum of theory is a weak way to demonstrate that others have operated in a vacuum of fact."[115] At the most, empirical analysis will enable the justification of secured credit in specific factual circumstances as much as economic theories have managed to demonstrate that in specific circumstances the issuance of secured credit can be economically efficient.

The institution of secured credit cannot be justified with abstract theories. It has to be submitted that there are extra rational reasons leading to the decision of lending and borrowing on a secured basis. In effect, it is difficult to establish a theory that would recognise in general term the effectiveness of the institution of secured credit. However, it is possible to determine in a specific context whether lending on a secured basis would lead to efficient results. The key question is to determine whether the gains obtained from granting a security, in specific circumstances, would outweigh the loss of other unsecured creditors and outweigh other inefficiencies and distortions resulting from the issuance of the security. Accordingly, the answer will depend upon an array of factual data that will be considered such as "... individual circumstances, the balance between sophisticated and non expert creditors, the

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[114] *Ibid.*
[115] *Ibid.* at p. 1001.

duration and size of loans, the types of companies seeking loans, the numbers of non adjusting creditors and the transaction costs involved in negotiating unsecured loans and contractual schemes of priority."[116]The lack of theories that would justify in general terms the institution of security should not however lead to the decision of abolishing security. Abolishing the institution of security would leave all creditors on an equal step of repayment, *pari passu*, in relation to the distribution of assets. However, it is arguable that powerful lenders such as banks would always manage to reach similar contractual agreement with their debtors enabling them to a preferential repayment over unsecured creditors upon the debtor's default.

It has been demonstrated that the recognition of a theory justifying secured credit is difficult to establish. In effect, the question of the justification of secured credit will depend upon the factual data of a specific situation. The question, on this particular occasion will be to determine whether the gains obtained from issuing secured debts will outweigh the loss of unsecured creditors. Although the economic analysis of the law did not manage to establish a theory of secured lending, recent empirical researches would tend to show that the institution of security is generally beneficial[117]. The failure of the economic analysis to recognise the economic efficiency of secured credit begs the question of the relevance of such method to assess the law. If secured credit cannot be apprehended in terms of economic efficiencies, the use of the economic analysis in the law making process also becomes questionable. Accordingly, the controversial use of the economic analysis to assess the quality of national business legislations has launched a new debate in the financial literature as it will now be considered.

The economic analysis as new norm to challenge the law

The arguments and theories addressed above did not manage to provide for a satisfactory account of the institution of secured credit law using the economic analysis of the law. It is arguable that a justification of the institution of secured credit therefore remains an empirical question. In effect, an explanation of why

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[116] Finch, V., *Corporate Insolvency Law: Perspectives and Principles,* (2002), at p. 92.
[117] See Armour *op. cit.* fn. 12.

creditors and debtors will choose to lend on a secured basis will largely depend on pragmatic information about lenders and borrowers. For instance, it is arguable that if they could lend and borrow on an unsecured basis then they would. Lending on a secured basis would seem to occur more frequently for smaller businesses in order to offer them easier access to credit. Big healthy company would not generally borrow on a secured basis. However, with the expansion of cross-border transactions and the dismantlement of economic boundaries, other elements need to be added to the equation. In effect, it is arguable that the lack of information towards foreign companies and uncertainties of contractual enforcement at the international level would lead commercial actors to choose to lend on a secured basis. In that sense, secured credit law regimes would appear to be an essential tool to support and promote the growth of cross-border transactions.

The importance of secured credit law regimes has also been confirmed by recent legal reforms activities around the world. In effect, it is to be observed that national legislations have entered into an era of reforms in the field of secured credit law which would confirm that secured lending is a necessary and efficient tool of credit within the commercial community[118]. Accordingly, a financial literature has recently emerged at the international level assessing the quality of business legislations using the economic analysis of the law. For instance the World Bank admits that Common Law jurisdictions would provide more effective commercial laws than within Civil Law jurisdictions.

The law as an instrument of economic dominance

Following the significant growth in cross-border transactions and the elimination of economic boundaries, legislations on secured credit became the object of intensive scrutiny as to their quality to promote trade and generally as to their quality to promote economic growth. Thus, a new question emerged as to whether the economic analysis of the law should be used to challenge the quality of the law of secured credit. However, the use of the economic analysis to dictate the content of

[118] Kripke *op. cit.* fn. 101.

secured credit law regimes and business law at large has highly been criticised in a context of legal reforms[119].

Following the assumption that commercial law, particularly secured credit law, is essential for the development of the Economy[120], recent empirical researches have attempted to assess the quality of national commercial laws and attempted to rank them accordingly. It became clear that the law now constitutes an essential instrument of economic growth. In the light of the expansion of commercial transactions at the international level, a competition between the various legal systems arose, assimilating the law as an instrument of economic dominance. Accordingly, a series of researches emerged assessing the friendliness of national legislations for 'doing business'.

The question for legal reformers is not only to decide whether secured credit law regimes should be made available to creditors and debtors but to what extent secured credit law regimes should be amended. Following the 'mapping' of commercial laws, the question emerged of the use of the economic analysis as a norm to assess the quality of the law. Should the economic analysis dictate the substance of the law on secured credit and the policy choices to be made accordingly? In effect, there are substantial policy choices to be made in the regulation of secured credit law such as the extent to which debtors should be entitled to use their assets for security purposes, the extent to which secured creditors should be entitled to a preference of repayment over other unsecured or involuntarily creditors upon the debtor's default, or the extent to which third parties should be informed of the creation of property rights through public registration.

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[119] On this point, see, *e.g.* Fauvarque-Cosson, B., Et al. "Is Law an Economic Contest? French Reactions to the Doing Business World Bank Reports and Economic Analysis of the Law" (2009) 57 *The American Journal of Comparative Law,* at p. 811; Michaels, R. "Comparative Law by Numbers? Legal Origins Thesis, Doing Business Reports, and the Silence of Traditional Comparative Law" (2009) 57 *The American Journal of Comparative Law,* at p. 765; Milhaupt, C.J. "Beyond Legal Origin: Rethinking Law's Relationship to the Economy – Implications for Policy" (2009) 57 *The American Journal of Comparative Law,* at p. 831.

[120] Goode already highlighted that "[s]ecurity in Personal Property has become enormously important both within a country and in relation to cross-border transactions. Without an adequate legal regime for personal property security rights, it is almost impossible for a national economy to develop." Goode, R.M. "Security in Cross-Border Transactions" (1998) 33 *Texas International Law Journal,* at p. 47.

Each jurisdiction opts for different views on the problem. This set of questions is apprehended in the light of different economic, political and legal background that will affect the outcome on the nature of each secured credit law regime[121]. The economic analysis solely apprehends the issue in the light of economic efficiencies, but it is arguable that the law of secured credit should also be apprehended in the light of other values. Particularly, it is important to highlight that the creation of a security involves a transfer of property rights and thus affect the community at large. In effect, security rights are enforceable *erga omnes* that is to say against the rest of the world. As such, it is important to consider the issue of balancing the interests of the person involved voluntarily or involuntarily in the operation of secured transactions.

The determination of the substance of secured credit transactions law regimes is a difficult question that cannot be solely driven by economic considerations. Secured credit law regimes are the expression of policy choices and the expression of social distributive justice made by the state. For example, the United States would appear to be more 'pro-creditors' by allowing the creation of a security interest on every possible class of assets. There are greater risks for debtors who might lose all of their assets but, ultimately, it will enhance the growth of the economy by expanding the pool of assets available to creditors and debtors in order to raise finance. Civil Law jurisdictions such as France would appear to be more 'pro debtors' within their legislations. France does not recognise a global security such as the American security interest or the English floating charge. Debtors cannot use all of their assets to raise finance. The risk taking is not entirely left to the discretion of creditors and debtors. Restrictions to access to credit can be seen as a '*frein*' to the growth of the economy but could also be understood as safeguards to the protection of other actors, voluntarily and unvoluntarily involved in the process. Civil Law traditions are more humanistic in nature so that more consideration is given to the rights of the individual rather than to economic efficiencies[122]. Secured credit law regimes involve a question of balance that should not only be driven by economic imperatives.

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[121] See Wood, P.R., *Maps of World Financial Law,* (5th ed. 2005).
[122] Fauvarque-Cosson *op. cit.* fn. 119, at p. 822.

Legal origins thesis

Significant work in the 'mapping' of secured credit law regimes[123] can be found with the reports of the World Bank which rank nations according to the quality of their legislations to regulate commercial transactions. The economic analysis of the law largely prevails in the assessment of current national business law and secured credit laws. Especially, the financial literature produced a series of empirical researches which essentially found its analysis on legal origin. Accordingly, it is claimed that the commercial law from Common Law jurisdictions would be more effective that commercial laws issued from Civil Law jurisdictions[124].

The World Bank generally recognise that Common Law jurisdictions would provide better protection to creditors and would generally enable the use of a wider range of assets for security purposes[125]. For instance, PPSA jurisdictions, such as the US or Canada, allows for the creation of a global security also allowed in England with the floating charge. However, many academics doubt of the actual significance of establishing such a financial map and contest the methodology and criteria used to reach such conclusions[126]. For instance, the World Bank recognises that France now ranks in the 31st position with Singapore, New Zealand, China and the US occupying respectively first, second, third, and fourth position. Many criticisms were addressed on the methodology used and on the application of this methodology to jurisdictions belonging to the Civilian Tradition. The *Association Henri Capitant* published two series of answers to the 'Doing Business Reports', one was the product of French academics[127] and the other was produced by a wider range of other

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[123] *Ibid.*
[124] Milhaupt *op. cit.* fn. 119, at p. 832.
[125] On this point see *e.g.* the World Bank Report "Doing Business 2007" available at http://www.doingbusiness.org/Downloads/ (last checked 22/04/2010) and Djankov, S., Et al. "Private Credit in 129 Countries" (2007) 84 *Journal of Financial Economics*, at p. 299.
[126] See, *e.g.* the responses addressed to the World Bank reports "Doing Business", Siems, M. "Legal Origins-Reconciling Law & Finance and Comparative Law" (2007) 52 *McGill Law Journal,* at p. 55; Raynouard, A. "Is Law an Economic Contest? French Reactions to the Doing Business World Bank Reports and Economic Analysis of the Law" (2009) 57(4) *American Law Journal,* at p. 811; Haravon, M. "Doing Business 2009: mesurer l'efficacité des faillites?"(2009) *Recueil Dalloz,* at p. 219.
[127] *Association Henri Capitant des amis de la culture juridique française*, "Les Droits de Tradition Civiliste en Question. A Propos des Rapports Doing Business" (2006) 3 *Revue de Droit des Affaires.*

jurisdictions[128]both contesting the methodology used to assess the quality of the law. Reactions to the publication of the World Bank Doing Business Reports should not be seen as an expression of patriotism or chauvinism. Reactions to the Reports were also constructive for many jurisdictions. For instance, France considered some of the critics addressed and engaged in efforts to improve the attractiveness of French law within the international commercial scene[129]. Nevertheless, in the present economic context, it is interesting to note that the recent financial crisis somehow highlighted the lacunae underlying the use of such a methodology and the uncertainties of recognising such index of the 'best jurisdictions' to invest. In this perspective, the question of the legal transplantation of more efficient secured credit law regimes in jurisdictions that are in need of modernisation will be considered in Chapter Three. This analysis will particularly assess the desirability and feasibility of the importation of the functional approach adopted in the American Article 9 UCC in jurisdictions of dissimilar legal cultures.

Finally, in an international context, it is arguable that such a mapping of commercial laws is not always reflective of the available legal instruments to 'do business'. In effect, recent years have witnessed the emergence of international legal instruments to regulate international transactions. For instance, the Cape Town Convention on International Interests in mobile Equipment[130]has been ratified by 32 countries which

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[128] Jurisdictions included Belgium, Brasil, Bulgaria, Chile, Columbia, Spain, Greece, Guatemala, India, Italy, Lebanon, the State of Louisiana, Morocco, Mexico, Panama, the Netherlands, Puerto Rico, Quebec, Romania, Switzerland, Syria, Tunisia, and Vietnam. See Volume 2 Association Henri Capitant des amis de la culture juridique française, "Les Droits de Tradition Civiliste en Question. A Propos des Rapports Doing Business" (2006) 3 *Revue de Droit des Affaires.*

[129] Paris bar organised a conference in Washington in 2004 entitled: "The American and French Legal systems: Contrasting Approaches to Global Business". In 2005, the Paris Bar organised another conference including members of the French government and representatives from the World Bank and from other international institutions entitled "Paris-Place of Law". In 2006, France introduced a reform of its secured credit law regime, simplifying the current regime (Ordonnance No 2006-346 du 23 Mars 2006 art.13 Journal Officiel du 24 Mars 2006). In 2007, France introduced the *fiducie* which can be assimilated to the common law trust (Loi n° 2007-211 du 19 février 2007 instituant la fiducie). In 2009, a Research Group was appointed by the government presided by a lawyer, Maître Jean-Michel Darrois, and delivered a Report on the legal profession to the French president. The Report recognises that "efficiency and legal efficacy have become major goals for our economy" Report is available from www.justice.gouv.fr/art_pix/rap_com_darrois_20090408.pdf. On this point see Fauvarque-Cosson *op. cit.* fn. 119, p. 817.

[130]Available at:
http://www.unidroit.org/english/conventions/mobile-equipment/main.htm (last checked 22/04/2010).

include Common Law and Civil Law jurisdictions[131]. These international instruments will be analysed in succeeding chapters in greater depth.

The economic assessment of the law is important to take into account but does not provide a complete picture of the quality of legislations. The regulation of secured credit law regimes requires law reformers to achieve a balance between the different interests at stake which outcomes should not solely depend on economic considerations. This aspect of the modernisation of secured credit law regimes is a central theme of the thesis.

CONCLUSION

The pursuit of a rationale for secured credit has been at the heart of vigorous debates, particularly within the Law and Economics movement as it has been exposed in this examination. However, these theories substantially lack persuasive evidence, essentially because they are based on assumptions which are not representative of the reality. Bowers explains, for instance, that:

"... in many cases, the resulting theories predict that debtors will do all or none of their borrowing on a secured basis, so that the validity of the analysis is undermined by the empirical observation that firms tend to employ a mix of secured and unsecured borrowing. Others suffer from a shortcoming of scope. While they may explain certain special types of security devices, they do not justify other sorts of secured borrowing actually observed." [132]

Effectively, the theoretical literature only raises questions and suspicion toward a potential justification of secured lending, which cannot constitute a satisfactory rationale for the institution of secured credit. Following the analysis of some of the major economic efficiency theories introduced to justify the institution of secured credit such as the monitoring costs explanation or the signalling theory, it is to be concluded that a satisfactory account for secured credit has yet to be established as the theories have only managed to explain a limited range of types of security. Further, this analysis demonstrated that, although redistributive theories constitute a significant threat to the institution of secured credit by asserting that the issuance of

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[131] http://www.unidroit.org/english/implement/i-2001-convention.pdf (last checked on 22/04/2010).

[132] Bowers, J.W. "Whither What Hits the Fan? Murphy's Law, Bankruptcy Theory, and the Elementary Economics of Loss Distribution" (1991) 26 *Georgia Law Review,* at p. 60.

secured debts may shift wealth from involuntarily creditors to secured creditors and the debtor itself, it has to be submitted that the argument becomes questionable in the light of empirical evidence. Thus, the proposition according to which the institution of secured credit or at least the priority system should be eradicated becomes difficult to sustain.

The question of why people choose to lend on a secured basis will depend upon a wide array of empirical data that cannot be translated in economic theories. It is to be concluded that the answer to the question of the pursuit of a rationale for secured credit will not rise from economics theorems. The search for a rationale for secured credit in general terms cannot be apprehended in the light of economic efficiencies, and, thus, a definite answer to the debate remains highly uncertain. The justification of secured lending remains an empirical question and, it has to be concluded that there are extra rational reasons leading to the decision of lending and borrowing on a secured basis.

The lack of theoretical justifications does not mean that the institution of secured credit should be eradicated as submitted by the proponents of the exploitation hypothesis. By no means, the economic analysis of secured credit succeeded in its quest to prove its inefficiency. Such a conclusion would indeed contradict the reality that most jurisdictions do recognise the institution of secured credit and have accordingly introduced a form of secured credit law regime. Nevertheless, it is to be recognised that economic inefficiencies, such as potential wealth transfer from non-adjusting unsecured creditors to debtors and secured creditors, could occur in specific contexts.

Although the debate over the rationale of the institution of secured credit remains inconclusive, the analysis should not remain vain. In an era of internationalisation and modernisation of the law, the debate over the desirability and effectiveness of secured lending is essential to consider as part of this analysis on the modernisation of secured credit law regimes. In effect, the theories using the economic analysis of the law, offer important developments on policy issues that would need to be reviewed when considering legal changes in the field of secured credit law. For

instance, one of the most difficult issues faced by legal reformers resides in the question of whether the law can achieve an appropriate and fair balance of interests between the different parties involved, especially towards unsecured creditors. Accordingly, many national secured credit law regimes confer a preferential treatment to certain categories of unsecured creditors. Other issues involve the question of the extent to which debtors should be permitted to use their assets for security purposes. For instance, Article 9 UCC provides a large scope of coverage, including all categories of assets, including tangible and intangible. A similar broad security can be found with the floating charge in England. Civilian jurisdictions, such as France would appear to be more restrictive and introduced some safeguards limiting the use of the debtor's assets for security purposes. Thus, the importance of the economic efficiency debate for secured credit would confirm the significance and influence of the Law and Economics movement to interfere with the law making process.

Following the significant expansion of cross-border transactions and the liberalisation of financial markets, national secured credit laws became the object of intensive scrutiny as to their quality to promote trade and generally as to their quality to promote economic growth. Accordingly, the economic analysis has generally been used to challenge the quality of the law of secured credit. However, it has been exposed that the use of the economic analysis in the mapping of national commercial laws has particularly been objected by a number of jurisdictions, mainly by those belonging to the Civilian tradition. Although the value of the economic analysis in the law making process can be enhancing, it is argued that the use of the economic analysis should not solely dictate the content of secured credit law regimes. The economic analysis is essential to take into account but does not provide a complete picture of the quality of legislations. The regulation of secured credit law regimes requires law reformers to achieve a balance between the different interests at stake which outcomes should not solely depend on economic considerations. The law is not an economic contest, and the noticeable quest to establish economically efficient legislations should not overlook other values.

The lack of theoretical justifications for the institution of secured credit should not lead legal reformers to consider its abolition. On the contrary, recent empirical evidence extensively showed that secured credit is on the whole socially beneficial. If the institution of secured credit is desirable, its modernisation has recently become a paramount requirement. In effect, secured credit law regimes constitute the engine of economic growth. As Goode already highlighted:

"[s]ecurity in Personal Property has become enormously important both within a country and in relation to cross-border transactions. Without an adequate legal regime for personal property security rights, it is almost impossible for a national economy to develop."[133]

The recognition that access to credit, together with the establishment of effective financial institutions[134] are fundamental to the development of the economy is a position shared by many legal academics[135] and does represent a general

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[133] Goode *op. cit.* fn. 120, at p. 47. See also the introductive comments in the UNCITRAL Legislative guide on Secured Transactions which provides that: "[i]t is well established, through studies conducted by such organizations as the International Bank for Reconstruction and Development (IBRD), the International Monetary Fund (IMF), the Asian Development Bank (ADB) and the European Bank for Reconstruction and Development (EBRD) that one of the most effective means of providing working capital to commercial enterprises is through secured credit." UNCITRAL Legislative Guide on Secured Transactions *op. cit.* fn. 103, Introduction, Para. 4 at p. 1.

[134] On this point see Umarji, M.R. "Role of Secured Transactions to Mobilise Credit and Need for Mobilizing the Law" (2007) *Modern Law for Global Commerce, Congress to celebrate the fortieth annual session of UNCITRAL,* Vienna 9-12 July 2007 where the author reiterates the purposes and objects of the UNCITRAL legislative guide on Secured Transactions: "... The UNCITRAL Legislative Guide lists out purpose and objects of the Secured Transactions Law as under: (a) to promote secured credit; (b) to allow utilization of the full value inherent in a broad range of assets to support credit in the widest possible array of secured transactions; (c) to enable parties to obtain security rights in a simple and efficient manner; (d) to provide for equal treatment of diverse sources of credit and of diverse forms of secured transactions; (e) to validate security rights in assets that remain in the possession of the grantor; (f) to enhance predictability and transparency with respect to rights serving security purposes by providing for registration of a notice in a general security rights registry; (g) to establish clear and predictable priority rules; (h) to facilitate enforcement of creditor's rights in a predictable and efficient manner; (i) to balance the interests of affected persons; (j) to recognize party autonomy; and (k) to harmonize secured transactions laws, including conflict-of-law rules."

[135] See for instance McCormack, G. *op. cit.* fn. 18, at p. 19 where the author explains that: "[t]he belief that a far-reaching and comprehensive law facilitating secured credit is an essential tool for economic development represents no only the view of those advising on the transition process in Eastern Europe but also an international consensus generally."See also Drobnig, U. "Secured Credit in International Insolvency Proceedings" (1998) 33 *Texas International Law Journal,* at p.54, where the author concedes that "[t]he more advanced a market economy is, the greater the demand for credit and correspondingly, the greater the pressure on legislatures and courts to find ways effectively to use non possessory security interests." Umarji, M.R further explains that "[i]t is now well established that credit growth can be achieved by introducing a modern secured transactions law which recognizes utilization of the full value inherent in assets to obtain credit." Umarji *op. cit.* fn. 134. Gopalan, S. states that "[t]here is virtually a consensus in opinion that a modern secured credit law is a sine qua non for the availability and lowering of the cost of credit" in *Transnational Commercial Law,* (2004), at p.22. The Report of the Secretary General of the UNCITRAL Draft Legislative Guide on Secured

international consensus. In effect, numerous national law reforms[136] and international initiatives[137] have now confirmed this postulate that commercial law should embrace efficient and modern secured credit law regimes.

In an era of internationalisation, legal reforms have been confronted to new challenges. In effect, legal reforms would seem to have been driven by the requirement to accommodate the law to new commercial needs. An analysis of the arguments that have driven legal reformers to modernise current secured credit law regimes will be considered in the next Chapter. Further, the following sections will seek to understand the meaning and core elements that should be part of a modern secured credit law regime.

Transactions (A/CN.9/WG.VI/WP.9) states that "... an effective and predictable legal framework had both short- and long-term macroeconomics benefits. In the short term, namely, when countries faced crises in their financial sector, an effective and predictable legal framework was necessary, in particular in terms of enforcement of financial claims, to assist the banks and other financial institutions in controlling the deterioration of their claims through quick enforcement mechanisms and to facilitate corporate restructuring by providing a vehicle that would create incentives for interim financing. In the longer term, a flexible and effective legal framework for security rights could serve as a useful tool to increase economic growth, competitiveness and international trade could not be fostered, with enterprises being prevented from expanding to meet their full potential." available at www.uncitral.org/en-index.htm> (last checked 22/04/2010).

[136] Kripke *op. cit.* fn. 101.

[137] Initiatives such as the UNCITRAL legislative Guide on Secured Transactions (2007), the UNIDROIT Convention on International Interests in Mobile Equipment and the Protocol to the Convention on International Interests in Mobile Equipment on Matters specific to Aircraft Equipment (2001) or the EBRD Model Law on Secured Transaction (1994) reflect some of the major attempts at the international level.

CHAPTER TWO

SECURED TRANSACTIONS LAW REGIMES AND THE PHENOMENON OF MODERNISATION THROUGH APPROXIMATION OF LAW

INTRODUCTION

The above analysis concluded that the debate on secured credit did not manage to provide a satisfactory rationale. Such a conclusion should not, however, lead legal reformers to opt for the eradication of secured credit law regimes. It is now well accepted that secured credit law regimes are necessary to the growth of the economy. It is generally recognised that secured credit would permit borrowers to obtain better credit facilities to invest in profitable projects and would also reduce risks for creditors. These assumptions are largely supported by an emerging consensus on secured credit[138]. If secured credit law regimes are necessary for the good functioning of the economy, it is arguable that access to credit should be promoted by providing modern, effective secured credit legislations that will enhance affordability, transparency and predictability within secured transactions.

The recognition that the facilitation and expansion of access to credit are *conditio sine qua non* for the growth of the economy has driven legal reformers to modernise the laws of secured transactions accordingly across the globe. Essentially, a modern secured credit law regime should adapt to new commercial practices, promote the availability of credit at low costs and should assure certainty and predictability to creditors in the event of default by debtors[139]. A modern secured transaction law

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[138] See *e.g.,* the UNCITRAL Legislative Guide on Secured Transactions reflects, to some extent this consensus on the purposes and role of modern legislations on secured credit. See above fn. 134.

[139] UNCITRAL Legislative Guide on Secured Transactions provides in its introduction that: "[t]he key to the effectiveness of secured credit is that it allows businesses to use the value inherent in their assets as a means of reducing the creditor's risk that it will not be paid. Risk is reduced because credit secured by assets gives creditors access to the assets as another source of recovery in the event of non-payment of the secured obligation. As prospective creditors perceive that this risk is reduced in a proposed credit transaction, they are more likely to be willing to extend credit and to increase the amount or reduce the cost of the credit they provide. A legal system that supports secured transactions is critical to reducing the perceived risks of transactions and promoting the availability of secured credit generally. Secured credit is more readily available to businesses in States that have efficient and

regime should further ensure the enforcement of security as against third party through appropriate registration mechanisms and should also ensure the establishment of an effective priority system that will provide creditors with certainty and predictability[140].

International organisations such as the EBRD[141] or UNCITRAL[142] greatly emphasised the need for modernisation and developed core principles in order to guide legal reformers in implementing modern secured transactions regimes. It is particularly interesting to refer to the core principles set out in the UNCITRAL Legislative Guide on Secured Transactions. In effect, these principles were drawn by a working group composed of all Member States of the Commission, thus reflecting, to a certain extent, a consensus on what principles should govern a modern secured transactions law regime[143]. Accordingly, it is accepted that a modern legislation on secured transactions should promote low-cost credit by enhancing the availability of secured credit; allow debtors to use the full value inherent in their assets to support credit; enable parties to obtain security rights in a simple and efficient manner; provide for equal treatment of diverse sources of credit and of diverse forms of secured transactions; validate non possessory security rights in all types of assets; enhance certainty and transparency by providing for registration of a notice in a general security rights registry; establish clear and predictable priority rules; facilitate efficient enforcement of creditor's rights; allow parties maximum flexibility

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effective laws that provide for consistent, predictable outcomes for secured creditors in the event of non-performance by debtors. On the other hand, in states where the absence of such laws means that creditors perceive the risks associated with credit transactions to be high, the cost of credit normally increases, as creditors require increased compensation to evaluate and assume the increased risk. In some States, the absence of an efficient and effective secured transactions regime or of an insolvency law regime, under which security rights are recognized, has resulted in the virtual elimination of credit for small and medium-sized commercial enterprises, as well as for consumers."UNCITRAL Legislative Guide on Secured Transactions *op. cit.* fn. 103, introduction, Paras. 5 and 6 at p. 2.

[140] See generally the UNCITRAL colloquium "Modern Law for Global Commerce", *Congress to celebrate the fortieth annual session of UNCITRAL Vienna*, 9-12 July 2007, available at http://www.uncitral.org/uncitral/en/about/congress.html (last checked 22/04/2010).

[141] See EBRD Core Principles for a Secured Transaction Law. http://www.ebrd.com/country/sector/law/st/core/model/core.htm (last checked 22/04/2010).

[142] UNCITRAL also identified key principles (see UNCITRAL Legislative Guide on Secured Transactions, see above fn. 103, introduction, at Para. 46) and fundamental policies (at Para. 61) inherent to a modern secured transactions law regime.

[143] UNCITRAL Working Group VI has been created and affected to work on the modernisation of secured credit law regimes.
See http://www.uncitral.org/uncitral/en/commission/working_groups/6Security_Interests.html

to negotiate the terms of their security agreement; balance the interests of affected persons and harmonise secured transactions laws, including conflict-of-law rules[144].

Further, it is important to emphasise that these core principles inherent to a modern secured credit law regime should also be achieved in light of social, scientific, economic and political changes. In effect, the modernisation of the law should also be contemplated in light of the emergence of new commercial needs such as those generated from the evolution in the nature of assets used for security purposes, the expansion of transnational secured transactions, the evolution of information technologies or those generated from the shift of centrally planned economies to market economies. Many centrally planned economies have recently converted into market economies leading to the transfer of sovereign risks into entrepreneurial risks[145]. Consequently, security became a major and attractive financial tool for creditors, who used to rely on their government for finance. These new economies need to modernise their secured credit law regimes in order to meet the requirements of trade and of the economy in general. It is not a choice but a need for modernisation and, essentially, a need to approximate their law with the legislations of the countries they will mainly trade with.

The implementation of a modern legislation on secured credit needs to adapt to new economic and commercial practices. In relation to secured credit, new modern needs would include the possibility to create security over a broader range of assets. In effect, the development of electronic commerce and information technologies led to the emergence of new class of assets such as intellectual property rights which created significant complexities and uncertainties for secured credit law regimes[146]. Accordingly, a modern secured credit law regime should embrace new categories of assets in a knowledge economy context. Businesses significantly enhanced their borrowing capacity by using intellectual property assets for security purposes. In effect, the economic value of these assets largely increased and now, represents

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[144] UNCITRAL Legislative Guide on Secured Transactions, see above fn. 103.
[145] Goode, R.M. "Harmonised Modernisation of the Law Governing Secured Transactions: General-Sectorial Global-Regional" (2003) 8 *Uniform Law Review*, at p. 341.
[146] Lipton, J. *Security over Intangible Property,* (2000), at p. 15.

significant financial assets for firms and companies[147]. However, the use of intellectual property for security purposes has given rise to some difficulties and uncertainties within the current credit and security law system[148]. The use of such class of assets created new challenges for the law of secured credit such as the ascertainment of ownership, the delicate question of the valuation methods for intellectual property assets and most importantly the question of the validity and enforcement of a security created in intellectual property assets.

The nature of personal property assets used for finance has dramatically evolved in past decades, and thus requires law reformers to modernise the law of secured credit accordingly. Particularly, the following developments will emphasise that modern secured credit law regimes should embrace new categories of assets such as intellectual property rights. An illustration of the necessity to modernise the law will be exposed through a comparative analysis of the registration mechanisms of intellectual property security. Comparative analysis is used in this context, to emphasise the fact that the modernisation of secured credit is a worldwide phenomenon and not just specific to certain national jurisdictions or specific to certain legal traditions. A comparative analysis will be drawn between the registration mechanisms for security created in intellectual property assets in the U.S, England and France.

This study will further emphasise, that in light of a significant growth in cross-border transactions, it has become more and more difficult to justify a reform of secured credit law based on a modernisation rationale without including the element of internationality. In effect, the internationalisation of commercial transactions corroborates the fact that national secured credit legislations are often inadequate. An interesting illustration of the inadequacy of national legislations in an international context can be found with the uncertain validity and enforcement of a security created in mobile assets in foreign jurisdictions. It can become particularly problematic in respect of movable assets such as aircrafts, space assets or railway

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[147] Davies, I.R. "Secured Financing of Intellectual Property Assets and the Reform of English Personal Property Security Law" (2006) 26 *Oxford Journal of Legal Studies* (3), at p. 559.
[148] Krauthaus, P. A., Et al. "Securing Financing and Information Property Rights" (1988) *High Technology Law Journal*, at p. 195.

rolling stocks. In this respect, the Cape Town Convention introduced a significant international framework to resolve the difficulties[149]. Further international initiatives with similar aims have also recently been introduced confirming the emergence of a consensus on the question of the approximation of secured credit law regimes. For instance, the UNCITRAL Legislative Guide on Secured Transactions reiterates the need to modernise the law with the aim to achieve some degree of approximation of laws among the different national secured credit law regimes[150]. This aspect is integrated to the core aims of a modern secured credit law regime in the UNCITRAL Legislative Guide[151]. In effect, the existing divergences among national secured credit law regimes do not facilitate the realisation of cross-border transactions at lower costs and at required high standard of certainty and security for contracting parties. The lack of coordination of secured credit law regimes could jeopardise the achievement of a successful modernisation of the law.

This study will thus attempt to understand the phenomenon of modernisation in secured transactions practices and assess the adequacy of their corresponding regulations. This examination does not intend to provide an exhaustive analysis of all secured credit law regimes lacunae but will attempt to provide an illustration of the modernisation phenomenon through the assessment of a particular feature of secured credit law regimes; the registration system. Particularly, the question of the validity and enforcement of a security becomes challenging in respect of the recent emergence of new categories of assets such as intellectual property assets. As a result, the difficulties encountered by various national registration systems in respect of security created in intellectual property assets will be considered from a comparative perspective.

If a modernisation of secured credit law regimes is desirable, especially in the light of an approximation of laws, the question emerged of whether such modernisation could be successfully achieved using approximation of law methods. This study will thus further consider the justifications that have forged the consensus on the approximation of secured credit law regimes and will also seek to identify and

[149] See above fn. 139.
[150] See above fn. 145.
[151] *Ibid.*

explain the different methods available to legal reformers to achieve a modernisation through approximation. The purpose of this final section is essentially to provide some conceptual definitions of the methods available to legal reformers to approximate and modernise secured credit law regimes. The approximation of law methods will, consecutively, be assessed in separate chapters as potential successful methods to modernise secured credit law regimes. If there is a strong case in support of the modernisation of secured credit law regimes as it will now be considered in the first part, the second part of this examination will introduce the question of whether approximation of law instruments could be used as legal methods to modernise and reform secured credit law regimes.

MODERN SECURED LENDING AND THE NEED FOR REFORM: A COMPARATIVE ANALYSIS OF INTELLECTUAL PROPERTY SECURITY REGISTRATION SYSTEMS.

Modern commercial practices have recently led legal reformers to assess the adequacy of their secured credit law regimes. Particularly, the emergence of new class of assets, following the scientific and technological advances, can pose significant problems for secured credit law regimes. Businesses significantly enhanced their borrowing capacity by using intangible such as intellectual property assets as collaterals[152]. Fundamentally, it is important to highlight that for many companies, intellectual property appears to be their primary source of assets available for financing[153]. However, the use of this new class of assets has generated a legal conflict between an intellectual property regime which promotes the protection and reward of the intellectual property creator and the need for an appropriate secured credit law regime which should enhance and support security and efficiency for debtors and creditors[154]. An essential feature of secured credit law

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[152] On this point see, Davies, I.R. "Technology-Based Small Firms and the Commodification of Intellectual Property Rights" in De Lacy, J., Et al., *The reform of UK Personal Property Law,* (2010), at pp. 308-327.

[153] Knopf, H.P. "Security Interests in Intellectual Property: An International Comparative Approach"(2001) *Working Draft Paper,* available at http://www.ulcc.ca/en/cls/security-interests.pdf (last checked 26/04/2010).

[154] Krauthaus *op. cit.* fn. 148, at p. 559.

regimes that pose some difficulties in respect of intellectual property security is the registration requirement[155].

The registration of a non possessory security often constitutes an imperative requirement for its validity and enforcement in many national laws. One of the fundamental functions of the publication is to determine the ranking of creditors upon the debtor's insolvency. A registration system should be easy to use, costs effective, enhancing better information amongst creditors, and ascertaining the priority entitlements of creditors. In respect of intellectual property assets, many jurisdictions have in place a dual registration, materialised in the co-existence of special registries for the publication of intellectual property rights, and a special registry for the publication of the security so created in intellectual property. This situation raises substantial difficulties for debtors and creditors who wish to create a security in intellectual property assets. The issue of determining which set of rules should govern priority disputes is essential, especially in presence of a dual registration system. Thus, the following developments will focus on the assessment of a specific feature of secured credit law regimes, the registration system of intellectual property security, in light of modern commercial practices.

Ultimately, this study will illustrate the phenomenon of modernisation in secured credit law regimes and will support the argument that modern legislations should also embrace new categories of assets. This analysis on the phenomenon of modernisation of secured credit adopts a comparative law approach which will confirm that this phenomenon is global and not peculiar to specific jurisdictions or legal traditions. The following developments will thus focus on the analysis of the registration systems for intellectual property security in different jurisdictions belonging to different legal traditions. Particular emphasis will be given to the registration system in the U.S, England and France.

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[155] The key feature, central to the law reform proposal in England was the question of the registration of personal property security interest. References to the Law Commission law reform proposal are provided above at fn. 102.

The registration mechanism for security interests in intellectual property assets in the United States.

Article 9 of the UCC adopts a functional approach to the regulation of a unitary security device, the security interest. It encompasses large scope of coverage, including all categories of personal property, tangible and intangible and all types of parties[156]. One of the most interesting features of the Article 9 security interest lies in the fact that its scope is delimited according to the function served, so that the parties can freely apply the best suited structure to their transactions[157]. Article 9 of the UCC provides for a single functional system together with the recognition of a single set of rules, a notice filing system and a first to file priority rules, applicable to the security interest. Article 9 of the UCC distinguishes between the enforcement of the security interest as between the debtor and creditor through the process of attachment[158] and the enforcement of the security as against third parties through the process of perfection[159] where the security is registered. Although, the code still provides for a mode of perfection through the debtor's dispossession[160], the notice filing is the recognised system under Article 9 in order to perfect security interests.

A financing statement has to be filed in a public centralised registry[161] and only needs to provide for a small amount of information[162]. The registration of the security interest will provide priority to the lender upon the debtor's insolvency following the first to file priority system. Furthermore, the information provided by the notice filing system enables other creditors to ascertain whether any of the debtor's assets would already be subject to a prior interest. If prospective creditors require additional information, further investigations can be obtained if necessary. Article §9-402 of the UCC provides that the financing statement should provide an

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[156] Sigman, H.C. "The Security Interest in the United States: A Unitary Functional Solution" in Ancel, M.E., *Repenser le Droit des Sûretés Mobilière*, (L.G.D.J, 2005), at p. 59.
[157] *Ibid.* at p. 60.
[158] §9-203(Part 2) UCC.
[159] §9-302 and §9- 401 to §9- 408 UCC (Part 4 on Filing).
[160] §9-305 UCC.
[161] §9-401 UCC.
[162] Article §9-402 (1) provides that "... a financing statement is sufficient if it gives the names of the debtor and the secured party, is signed by the debtor, gives an address of the secured party from which information concerning the security interest may be obtained, gives a mailing address of the debtor and contains a statement indicating the types, or describing the items, of collateral."

address of the secured creditor, from whom information could be acquired if needed. However, this option is left to the discretion of the secured party who remains at liberty to provide further information or not. As Grant Gilmore already highlighted:

"[t]here is no reason why a secured party should be put to the cost and burden of preparing detailed statements of his affairs to satisfy the curiosity of officious inter-meddlers, business competitors or the students editors of law reviews. On the other hand, whenever it is to a debtor's interest to provide the information to potential sources of credit, he is enabled to supply it."[163]

The notice filing system has proved to be a very convenient and flexible system. In effect, other advantageous aspects of the notice filing system include that where there is an ongoing financial or trading relationship between debtor and creditor, only one financing statement has to be filed. It is especially valuable with respect to security created over book debts or stock in trade[164]. Furthermore, a financing statement can be filed with respect to future advances and after acquired property[165]. Similarly, a financing statement that contains description of the collateral can be filed even if the security agreement is not yet in existence. However, even within most modernised secured credit law regimes such as the one embodied in Article 9 of the UCC, it has to be observed that legal gaps still remain. Although, this system has shown the great virtues of a modern registration system by providing more certainty and simplicity to lenders and borrowers, the notice filing system still shows some legal gap embodied for instance in the issue of the registration of security interests created in intellectual property assets as it will now be exposed.

In the United States, the law governing secured transactions law requires that the lender should file a financing statement in order to perfect his security interest. However, the Uniform Commercial Code also provides that:

"... the filing of a financing statement is not necessary to perfect a security interest in property subject to a statute, regulation or treaty of the United States whose requirements for a security interest's obtaining priority over the rights of a lien creditor with respect to the property pre-empt Article 9-310(a)."[166]

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[163] Gilmore, G., *Security Interests in Personal Property*, (1965), at p. 472.
[164] McCormack, G. "Notice Filing versus Transaction Filing – A Comparison of the English and U.S. Law of Security Interests" (2002) *Insolvency Lawyer,* at p. 167.
[165] §9-204 UCC.
[166] §9-310(b) (3) and §9-311(a) (1) UCC.

In the United States, Federal law regulates copyrights, trademarks and patents. Therefore, the question emerged whether creditors should perfect their security interests in intellectual property assets by filing a financing statement and, or, filing their security interests using the specific registers established for patents and trademarks.

In the absence of further clarifications from the legislation itself, the case law has generally laid guidelines with respect to the enforcement of security interests in intellectual property assets. The Lanham Act provides protection for trademarks[167] but largely remains silent towards the means to perfect a security interest created in such intellectual property assets. Therefore, the question emerged whether the law governing security interests that is Article 9 of the UCC, was pre-empted by the Lanham Act. In *Re TR-3 Industries v Capital Bank*[168], the Court established that a security interest in trademarks was valid even though no registration had been made within the United States Patent and Trademark Office (thereafter USPTO). Thus, the perfection of a security interest in trademarks requires the filing of a financing statement following Article 9 of the UCC.

Although a registration in the USPTO would not seem compulsory to perfect a security interest in trademarks, it will be required if creditors wish to protect their interests against any potential subsequent purchasers or mortgagees[169]. It would thus seem to be general practice to advise creditors to record their security interests in both registers so that subsequent purchasers or lenders will be put on notice of previous interests created in the intellectual property asset. In effect, the sole

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[167] Protection will be effective through a registration in the United States Patent and Trademark Office.

[168] 41 B.R. 128 (C.D. Cal. 1984). See also *Roman Cleanser Company v. National Acceptance Company of America,* 43 B.R. 940 (E.D. Mich. 1984) aff'd, 802 F.2d 207 (6th Cir. 1986) which provides that: "[t]he manner of perfecting a security interest in trademarks is governed by Article 9 and not by the Lanham Act."

[169] US Trademark Act, Section 1060(a)(4) provides that "[a]n assignment shall be void against any subsequent purchaser for valuable consideration without notice, unless the prescribed information reporting the assignment is recorded in the United States Patent and Trademark Office within 3 months after the date of the assignment or prior to the subsequent purchase". The court held in *Rhone-Poulenc Agro, S.A., v. DeKalb Genetics Corp*, that a UCC State filing does not provide protection against a subsequent purchaser of patent rights. The court admitted that a good faith purchaser who has registered his notice in the USPTO will defeat a secured creditor who did not file his interest in the same register. See also *Rhone-Poulenc Agro, S.A., v. DeKalb Genetics Corp.*, 284 F.3d 1323, 62 U.S.P.Q.2d 1188 (Fed. Cir.2002).

doctrine of *accession*, the question remains of the degree of annexation required for the accession to take place. While the Commercial code has retained an 'injurious removal test', the Civil code provides that chattels attached to the principal good are to be treated *prima facie* as *accessions*, unless it appears that the accessory is of greater value than the principal good.

The recognition of the doctrine of *accessio* within the French Civil code has been accompanied by the allocation of a compensation for the owner of the incorporated goods. In effect, when a good, considered as an accessory, is integrated to another good, in a non irremediable way, Article 566 of the Civil code[340] provides for a pecuniary compensation for the owner. Nevertheless, the code also makes provision for an exception to the doctrine of *accession* and entitles the owner of the accessories to claim ownership to the goods in their original state under two conditions; the union of the goods was made without the knowledge of the claimant and the asserted good has were much more valuable than the principal good[341].

The Commercial code also integrated the doctrine of *accession* within its specific dispositions applicable to merchants and commercial transactions. Article L 624-16 of the Commercial code[342] and, more recently, Article 2370 of the Civil code[343] regulating retention of title clauses, allow the owner for a right to claim the goods in their original states if the accessories can be removed without causing substantial damage. Article L624-16 of the Commercial code only requires that the goods

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[340] Article 566 *C.Civ. (Act no 60-464 of 17 May 1960)* provides that "[w]here two things belonging to different masters, which have been so joined as to form one whole, are nevertheless separable, so that one may subsist without the other, the whole belongs to the master of the thing which forms the main part, subject to the obligation of paying to the other the value, appraised at the date of payment, of the thing which has been joined."

[341] Article 567 and 568 *C.Civ.* provide that "[t]he part to which the other has been added for the use, ornamentation or completion of the first only, is considered the principal one." Article 568 provides that "[n]evertheless, when the thing added is of much more value than the principal thing and when it has been added without the knowledge of the owner, he may ask that the thing added be separated, for the purpose of being returned to him, even if the thing to which it has been added might be deteriorated thereby."

[342] L624-16 *C.Com.* provides that "[t]he claim to ownership of goods in their original state may be brought under the same conditions with respect to chattels that are incorporated into another chattel where the separation of the goods can be effected without causing damage to them. The claim to ownership of goods in their original state may also be brought with respect to fungible goods where goods of the same nature and same quality are found in the hands of the debtor or any person holding them on his behalf."

[343] Article 2370 *C.Civ.* provides that "[t]he incorporation to another thing of a thing whose title is retained is not a bar to the rights of the creditor where those things may be separated without suffering damage."

specific copyrights registration could enable subsequent purchasers or mortgagee to get a valid title against previous interests as they would not have had been put on notice. This situation would give rise to additional monitoring costs from creditors who should, therefore, ensure that the copyright is registered in the US Copyright Office. The perfection of security interests in unregistered copyrights would, thus, appear to be quite unsettled and left to the discretion of the courts to lay further guidance.

Although the notice filing system shows great advantages in its simplicity, convenience and costs, the virtues of the system are questionable when applied in the context of intellectual property assets. In effect, it has been observed that a dual registration will be required in respect of trademarks and patents if a creditor wants to perfect his security interest and gain protection against eventual subsequent purchasers. This dual recordation undoubtedly undermines the great simplicity and convenience of the notice filing system instituted under Article 9 UCC. This is why a modern legal regime should adapt to new commercial needs such as those generated from the creation of security in intellectual property assets which would in turn optimise the use of these assets for security purposes. Particularly, an appropriate legal regime should coordinate the current legal security framework together with an intellectual property rights regime[176]. In order to achieve this goal, a modernisation of current security law regimes appears inevitable.

It is arguable that a reform of the registration system modelled on the American notice filing would offer more transparency within secured transactions and would generally enhance commercial borrowings[177]. Nevertheless, it is to be observed that although the notice filing system substantially enhance access to credit for borrowers, there are still areas of the law which would need to be improved, especially in relation to the registration mechanism in relation to new class of assets used as collaterals such as intellectual property assets.

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[176] Krauthaus *op. cit.* fn. 148, at p. 559.

[177] Company Law Steering Group, Final Report "Modern Company Law for a Competitive Economy", July 2001, Para. 12.1. See also McCormack *op. cit.* fn. 164, at p. 166.

The legal transplantation of accèssio in England

The Roman law doctrine of *accessio* is not only confined to Civil Law traditions and it is remarkable to also find some applications of this principle within Common Law jurisdictions. In England, an application of the concept of *accessio* and its legal regime can be found in the Law of Property Act 1925 which recognises the relevance of the Latin maxim '*quicquid plantatur solo, solo cedit'*. According to the Law of Property Act, Section 205 (1) (ix), 'land' is defined as comprising 'the surface, buildings or parts of buildings' and more generally, anything that is affixed to the land would become part of the land[346]. As under French law, where a chattel is annexed to the land, a problem of ownership may arise. In this situation, it is fundamental to determine whether the chattels annexed to the land remains chattels or becomes fixtures. It will depend upon the degree of annexation required to become fixtures or upon the purpose of annexation.

These two tests have developed in order to determine whether the object remains a chattel or has become fixture[347]. In relation to the degree of annexation, spinning wheels affixed with bolts to the floor of a manufacturing plant were held to be fixtures following *Holland v. Hodgson*[348]. In this case, *Blackburn J held* that:

"... articles not otherwise attached to the land than by their own weight are not to be considered as part of the land unless the circumstances are such as to show that they were intended to be part of the land ... and that on the contrary, an article which is affixed to the land even slightly is to be considered as part of the land, unless the circumstances are such as to show that it was intended all along to continue a chattel."[349]

On the other hand, it has been held that heavy printing press machines placed on the floor without any particular form of attachment were fittings and not fixtures[350]. The second test is embodied in the 'purpose of annexation'. Accordingly, if a chattel has been affixed to the land or building for a better enjoyment of the object as a chattel, then the object will remain a chattel. If, on the other hand, the chattel has been affixed for the more convenient use of the land or the building, the chattel will

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[346] Law of Property Act 1925.
[347] Chappelle, D., *Land Law*, (Pearson eds, 2008), at p. 30.
[348] [1872] LR 7 CP 328.
[349] *Blackburn J in Holland v. Hodgson* [1872] LR 7 CP 328.
[350] *Hulme v. Brigham* [1943] KB 152.

Commission proposed a reform of the registration system for companies' charges modelled on the notice filing system embodied in Article 9 UCC and issued a Consultation Paper dealing with the registration of company security interests which was followed by a Consultative Report on Company Security Interests and concluded with a final Report on Company Security Interests[183]. It is argued that a reform of the registration system modelled on the American notice filing would offer more transparency within secured transactions and would therefore, enhance commercial borrowings. This analysis will first consider the current regime governing the registration of a security created in intellectual property and will be followed by an analysis of the recent proposals for reform introduced by the Law Commission.

Current regime

As opposed to the American functional approach of a unique security interest, English secured credit law regime is founded on different legal instruments, such as 'mortgages', 'pledges', 'liens', 'charges' and other specific legal mechanisms[184] privileging a substantial rather than a functional approach. Nonetheless, this approach led to uncertainties and difficulties for firms wishing to use their intellectual property assets as collaterals. In effect, the pledge, described as "... the most powerful form of security interest known to English law"[185] by Goode, is possessory in nature[186]. Intellectual property rights, being intangible by nature, would not be capable of any physical possession. The institution of the pledge would therefore be irrelevant in the context of the use of intellectual property assets for security purposes[187]. Similar conclusion has to be reached in relation to liens as they generally arise by operation of law and are also possessory in nature[188]. Conversely, charges and mortgages are non-possessory security and, would therefore appear to be

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M. Et. al. "How Far is Article 9 of the Uniform Commercial Code Exportable – A Return to Sources" (1996) 27 *Canadian Business Law Journal,* at p. 249; Mooney, C.W. "Exporting UCC Article 9 to an International Convention: The Local Conundrum" (1996) 27 *Canadian Business Law Journal,* at p. 278.

[183] See above fn. 102.

[184] Krauthaus *op. cit.* fn. 148, at p. 195.

[185] Goode, R.M., *Commercial Law*, (2nd ed. 1995), at p. 644.

[186] Davies *op. cit.* fn. 147.

[187] Lipton *op. cit.* fn. 146, at p. 22.

[188] Law Commission Paper No 164, "Registration of Security Interests: Company Charges and Property other than Land" (2002), N° 2.8. See above fn. 102.

In the U.S., it would also appear that the injurious removal test is to be preferred[361]. A similar position has also been adopted in England where the case of *Hendy Lennox (Industrial Engines) Ltd. v. Grahame Puttick Ltd.*[362] provides an interesting illustration of the application of the injurious removal test and of the doctrine of *accessio* applied in the reservation of title context. The case involved the sale of diesel engines which had been incorporated by the buyer into generating sets. Upon the buyer's default, the seller sought to rely on the retention of title clause to recover the engines. The court held that the seller did not lose his title as the engines could be removed without serious injury or destruction of the principal asset. *Hendy Lennox* can be contrasted with *Borden*[363], where the owner lost ownership to resin which had been irreversibly incorporated to chipboard or with *Peachdart*[364], where the owner also lost ownership to leather which had been irreversibly incorporated to handbags.

The French case of the 24th of March 2004[365] can be contrasted with the English case of *Hendy Lennox.* In effect, it is interesting to note that the same injurious removal test was applied to determine whether the incorporation of goods into a main chattel could be recovered by the owner. Each case presents similar facts but it is arguable that the interpretation of the legal rule differed. In effect, French judges may have decided otherwise in the *Hendy Lennox* case following their reasoning in relation to the digital remotes. If there is an economic appreciation to be taken into account, it is arguable that the removal of the diesel engines could have in the same way jeopardised the survival of the main unit. Similarly, English judges may have decided otherwise in the French case, and allow for the recovery of the digital remotes by their owner. Although, it would have required substantial work to remove the remotes, it is arguable that they could have been materially removed from the

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[361] Guest provides that: "[t]his test is adopted by a leading American textbook, Blashfield's *Cyclopaedia of Automobile Law and Practice,* which states that" [u]nder the rule of accession, when attachments on a car can easily be distinguished and separated, no change of property takes place, providing the separation can be made without injury to the automobile." It was also adopted in the Canadian case of *Goodrich Silvertown Stores v. McGuire Motors, Ltd.* and in the New South Wales cases of *Bergougnan v. British Motors, Ltd* and (more obliquely) *Lewis v. Andrews and Rowley Pty., Ltd." Ibid.* at p. 508.
The Australian case *Rendell v. Associated Finance Pty., Ltd.* [1957] VR 604 and the New Zealand case of *Thomas v. Robinson* [1977] 1 NZLR 385, have also retained the injurious removal test. McCormack *op. cit.* fn. 355, at pp. 295-297.
[362] See above fn. 357.
[363] *Ibid.*
[364] *Ibid.*
[365] *CCass Com., 24 Mars 2004, Moyrand ès qual.c / SA Siemens, no. 01-10.280-F-D.*

Such registration is compulsory within both statutes for the protection of intellectual property rights, and could lead to major difficulties considering that the validity of a charge is also subordinated to the requirement of registration in the companies' charges register[195]. In effect, if a creditor registers his interest on the specialist intellectual property register and not on the companies' charges register while another creditor registers later in time his interest on the companies charges register and not on the special intellectual property register, the latter will prime in priority upon the insolvency of the debtor. However, and as for the U.S., the sole registration of the security interest over intellectual property assets in the company register might not be sufficient to fully protect the creditor's interest, because such registration will not be enough to put on notice potential subsequent purchasers. Similarly to the U.S., a dual registration would therefore be required for both patents and trademarks, which obviously does not contribute to the promotion of an accurate simple and efficient registration system. This issue would not occur in relation to the creation of a security in intellectual property assets which are not subject to any special registration such as copyrights[196]. The Law Commission considered the potential problems that could arise from a dual registration and proposed a new scheme in its Final Report on Company security Interests. Particularly, the central question considered was to determine which register and which registration systems should govern priority disputes.

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claiming to be affected by such a transaction, the prescribed particulars of the transaction shall be entered in the register.
(2) The following are registrable transactions— (a) an assignment of a registered trade mark or any right in it; (b) the grant of a licence under a registered trade mark; (c) the granting of any security interest (whether fixed or floating) over a registered trade mark or any right in or under it; (d) the making by personal representatives of an assent in relation to a registered trade mark or any right in or under it; (e) an order of a court or other competent authority transferring a registered trade mark or any right in or under it.
(3) Until an application has been made for registration of the prescribed particulars of a registrable transaction— (a) the transaction is ineffective as against a person acquiring a conflicting interest in or under the registered trade mark in ignorance of it, and (b) a person claiming to be a licensee by virtue of the transaction does not have the protection of section 30 or 31 (rights and remedies of licensee in relation to infringement).

[195] Section 860(7)(i) of the Companies Act 2006 requires registration of a charge on intellectual property which included patents, trademarks, registered designs, copyright and design rights, as well as any licences in respect of any such rights.

[196] Such as copyrights, database rights and original design rights in the UK (CDPA).

jurisdictions that belong to different legal traditions. In effect, it would be captivating to determine whether the concept of the security interest and the functionalist approach to the regulation of a unique security mechanism could be implemented in jurisdictions that belong to different jurisdictions.

It is to be reasserted that this analogy drawn with the concept of *accessio* is interesting to use, first, because it actually describes the legal transplant process and, most importantly because it constitutes a core principle of personal property law as much as the concept of a unique security could constitute a core principle of personal property security law. The US adopted the concept of a unique security, the security interest, and its regulation can be found in Article 9 UCC. Accordingly, the analysis will not solely verify whether the idea of adopting a unique security could be recognised but, also, whether the entire legal regime adopted in the US could be implemented in jurisdictions of dissimilar traditions. As such, the analogy drawn with the concept of *accessio* will be, to some extent, stretched in the sense that the next section will further verify whether the entire regime enshrined in Article 9 could be transplanted in jurisdictions that belong to different legal traditions.

The next section will thus consider the question of whether a general concept of secured credit law, such as the concept of a unique security interest as enshrined in Article 9 UCC could be transplanted in jurisdictions of dissimilar legal cultures such as England and France.

property statute that recognises a system to govern priorities in charges created over relevant intellectual property assets, that scheme should apply to deal with priorities issues[204].

The decision of a creditor to grant a security over an intellectual property asset involves significant issues such as risk assessment, asset valuation and transaction costs. It is arguable that a dual registration would incur substantial costs for financiers. In relation to the implementation of a notice filing system, it is questionable whether it would in practice effectively reduce the costs for creditors and debtors. It is arguable that financiers would opt for secured transactions in intellectual property assets if the costs of filing will not outweigh the advantages provided by the grant of a security with its priority for creditors. In effect, without the certainty of priority, creditors would increase their interest rates so as to compensate the risk of losing priority[205].

In the light of the Law Commission proposal to retain a double registration in relation to certain intellectual property assets, it is arguable that it could substantially increase the costs for creditors. The question is therefore to determine whether the costs of registration are balanced with the risk of losing priority or even with the risk of the extinguishment of the security[206]. Transactions costs can become more expensive because of the specificity of the filing process, especially if there are errors in the registration of information or in the process itself[207]. Thus, the characteristic of simplicity of the notice filing system would be undermined in the context of intellectual property where a second registration in a specialist register would also be required.

From a broader perspective, it is arguable that the adoption of a notice filing system into English law would further lead to some major policy issues. In effect, it is arguable that the adoption of an Article 9 type regime and its notice filing system would create a monopoly for the owner of a floating charge by entitling him to an

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[204] *Ibid.* at Para. 3.235.
[205] See Chapter One.
[206] Davies, I.R. "The Reform of English Personal Property Security Law: Functionalism and Article 9 of the Uniform Commercial Code" (2004) 24(3) *Legal Studies*, at p. 295.
[207] Law Commission Consultation Paper No 164, "Registration of Security Interests: Company Charges and Property other than Land" (2002), Paras. 4.215-4.219. See Davies, *ibid.*

countries with dissimilar legal cultures or '*mentalités*' as described in Legrand's theory on legal transplantation[371].

The lack of theories enabling a determination *a priori* of the feasibility of such legal transplantation has led the following developments to adopt a pragmatic analysis of its likelihood of success focusing on the potential obstacles that may arise in the process. To this end, this study will consider the feasibility of legal transplantation of Article 9 UCC in different jurisdictions from different legal cultures such as England for an illustration of the Common Law tradition and France for an illustration of the Civil Law tradition. The question of the potential exportability of Article 9 UCC is important in the present context of legal reform and approximation of secured credit laws but, the question of whether Article 9 UCC should be imported will also be considered within subsequent developments.

Legal transplantation of Article 9 UCC in England

England introduced a proposal for reform in 2002[372] recommending the adoption of a uniform and functional regime for its secured credit law regime, including a notice filing and a first to file priority systems. The question of whether an Article 9 type regime should be transplanted into English secured credit law has largely been debated within the legal doctrine[373]. It has been argued that such a reform would not be cost-effective in the sense that current English secured credit law regime would already offer similar benefits as the global security enshrined in Article 9 UCC, especially with the floating charge[374]. Conversely, it has been argued that the functionalist approach of the unitary security interest together with a notice filing and first to file priority rules systems would provide more certainty and predictability within secured credit law in England.

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[371] Legrand *op. cit.* fn. 258, at p. 52.
[372] The Law commission Consultation Paper on Registration of Security Interests, No 164 (CP 164). 2002.
[373] See above fn. 294.
[374] Calnan explains that: "[t]he Law Commission's imperative seems to introduce a US-style functional system as a wholesale replacement for our current system. On a cost-benefit analysis, this seems difficult to justify. The implementation costs will be very large, and it is difficult to see what material benefits will result from it" in Calnan *op. cit.* fn. 295, at p. 92.

modernisation of secured credit law regimes should also embrace a broader range of assets, particularly in an information age.

The registration of security created in intellectual property assets in France

The development of intangible property has also recently become another valuable source of credit for many businesses in France. Thus, it became essential to also address the question of the adequacy of current registration of security mechanism applied in the context of incorporeal property such as intellectual property assets. It has been exposed in the above development that the issue has deeply been analysed in England, but also in France where the question was also considered at length[213].

Intellectual property assets are intangible by nature and are difficult to fit within a legal framework that was not primarily designed for them. In effect, it would seem anomalous for intellectual property assets to borrow a legal regime designed for the creation of securities on corporeal property. Therefore, it became evident that the law should provide for a specific coherent regime peculiar to the use of this range of assets for security purposes. However, the task is difficult considering the wide scope of different intellectual properties which already exist and which are continuing to emerge[214]. It is complex to identify an homogeneous and consistent category of intellectual property assets that would ease the creation of a unique regime. That is why the French legislator mainly focused on the creation of special regimes *intuitu rei*, only applicable to certain category of personal property assets. For instance, France made provision for the charge created on cinematographic movies[215] and the charge created on computer programs licences[216]. Each piece of legislation includes

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[213] Lisanti-Kalcynski C., *Les Sûretés Conventionnelles sur Meubles Incorporels*, (Thèse Montpellier, 2001); Loiseau, G. "Le Nantissement de Films Cinématographiques" (2002) *Droit & Patrimoine* 2002, n° 106, at p. 67 ; Gautier, P.Y., *Propriété Littéraire et Artistique*, (5th ed. 2004); Loiseau, G. "Biens Meubles par Détermination de la Loi ou Meubles Incorporels" (2005) *J.-Cl. Civil* 2005, Art. 527 to 532, Fasc. 20 ; Synvet, H. "Le Nantissement des Meubles Incorporels" (2005) *Droit et Patrimoine* 2005, n° 140, at p. 64 ; Martial, N., *Droit des Sûretés Réelles sur Propriétés Intellectuelles*, (Thèse Paris V. 2005); Stoufflet, J. "Le Nantissement de Meubles Incorporels" (2006) *JCP* G 2006, Supplément au n° 20, étude, at p. 5 ; Lisenti, C. "Quelques Remarques à Propos des Sûretés sur les Meubles Incorporels dans l'Ordonnance n°2006-346 du 23 Mars 2006" (2006) *D.* 2006, Chron., at p. 2671.

[214] Beyond the traditional categories of intellectual property assets such as copyrights or patents, new categories have emerged such as domain names and database. Although, they are intellectual property assets, the legislator has established legal different regime for each of them.

[215] *Nantissement des films cinématographiques. Loi du 22 Février 1944.*

[216] *Le nantissement du droit d'exploitation des logiciels. Loi du 10 Mai 1994.*

obstacles that could arise from such a process. For example, such transplant could generate some difficulties in relation to the legal receptacle adopted. In effect, the secured credit law regime embodied in Article 9 is codified. However, most of the regulations on secured credit in England essentially emanates from judicial decision making which could prove to be incompatible with the form retained with Article 9 UCC. The potential difficulty of transplanting Article 9 UCC as a codified legal rule in England will thus be first considered.

One of the main questions raised within the proposal for reform in England was to determine whether the functionalist approach and the idea of a unique security interest could be compatible with the well entrenched principles governing English property law. For example, retention of title clauses are property-based security devices which are not recognised under Article 9 UCC. Thus, issues such as the question of whether to include and reconceptualise retention of title mechanism within this new regime was at stake and will be deeply reviewed within this analysis[382]. Further, the importation of Article 9 UCC and its functional approach would also require the reappraisal of the floating charge. In this respect, this development suggests that this security device would already provide the advantages of the global security enshrined in Article 9 UCC, which would in turn question the success of legal transplantation as legal method for modernisation and law reform.

This section will first consider the difficulties that could arise from importing a legal rule in a codified instrument in England. This section will further consider the potential obstacles to the legal transplantation of Article 9 that could arise from the adoption of the functional approach. To this end, particular emphasis will be given to the very specific issue of whether non possessory security, such as retention of title clauses, should be included and reconceptualised. Beyond the analysis of potential obstacles related to property rights, emphasis will be given to the impact of such legal transplant on other fundamental security devices such as on the floating charge.

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[382] See Chapter Four.

Special dispositions

The reform introduced by the law of 23rd March 2006 only recognises the use of intellectual property assets for security purposes but does not provide for a single regime regulating the creation of security in this new range of assets. Thus, their regulations remain scattered[220] as the legislator failed to provide for a single and coherent legal regime for the use of intellectual property assets for security purposes.

The fragmentation of the dispositions relative to intellectual property security is source of complexity and uncertainty because current regulations differ from one type of intellectual property asset to another. Especially, the lack of one single registry for the creation of security in intellectual property has led to significant difficulties for the contracting parties and other potential creditors. France made provision for the security created on cinematographic movies[221] and security created over computer programs licences[222]. The former allows a production company to obtain finance in order to realise and commercialise a cinematographic movie. The security can affect all or part of the intellectual property asset or licences that the company has on the movie or on some parts of it, actual or future[223]. The security is registered on a public registry within the National Cinematographic Registry. The creditor is entitled to a preferential right over other secured and preferential creditors and a right to trace the collateral (*droit de suite*) in the hands of third parties. Finally, the creditor is entitled to a direct right to the benefits made out of the exploitation of the movie, up to the value of the debt owed.

The security on licences of computer programs provides for similar formalities than the ones required by the former security with a registration made in the National Computer Programs Licences Registry. The law remains silent on issues relating to the valuation of such licences, especially, in the context of computer programs, these

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[220] The applicable legal regime will have to be determined following the type of intellectual property asset in question; *i.e.* the nature of the intellectual property asset will determine whether a special regime is applicable (enacted in the "*nantissement des films cinématographiques*", *Loi du 22 Février 1944.* or in the "*nantissement du droit d'exploitation des logiciels*", *Loi du 10 Mai 1994)* or if the general regime applies (Law 23rd March 2006).

[221] See above at fn. 215.

[222] See above at fn. 216.

[223] Piette, G., *Droit des Sûretés, Sûretés Personnelles, Sûretés Réelles*, (Ed. Gualino, 2006), at pp. 112-113.

order to assess whether it could constitute a formal obstacle to the legal transplantation of Article 9 into English legislations. The French Civil code only contains general principles and general concepts rather than exhaustive and detailed regulations. The American Uniform Commercial Code does not seem to provide with general concepts but with a collection of different and detailed articles, each regulating an area of commercial law[384]. Also, since most Civilian jurisdictions recognise the principle of '*trias politica*'[385], courts cannot make the law, as opposed to most Common Law jurisdictions where legal systems are mainly based on judge-made law. The adoption of a Civilian model code into Common Law jurisdictions could affect judges' law making power and, in that sense could constitute a formal obstacle to the adoption of commercial law reform in the shape of a code. However, under Civilian jurisdictions, judges are not deprived of any influence on the law as it will be their task to deduct from the general principles of the codes the solution to the litigation. Naturally, judges will also need to interpret and construe the law, where it is necessary, but prior and higher courts decisions will not bind subsequent courts judgments and interpretation of the law[386].

Consequently, the Uniform Commercial Code does not seem to coincide with the traditional definition of a code within Civilian jurisdictions as it mainly materialises in a collection of detailed legislations rather than in a single legislation embodying commercial law principles. In that sense, the question of the introduction of a 'Uniform Commercial Code' into English law would not seem to constitute a significant obstacle to the success of a legal transplantation of the American model. Further, it is important to note that England already codified substantial parts of its commercial law[387] enshrined in different statutory instruments that could easily be reassembled under a single legal instrument. The case for an English commercial law

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[384] The Uniform Commercial Code is divided is 9 articles each dealing with one specific area of commercial law. Article 1: General Provisions; Article 2: Sales; Article 2A: Leases; Article 3: Negotiable Instruments; Article 4: Bank Deposit; Article 4A: Fund Transfers; Article 5: Letters of Credit; Article 6: Bulk Transfers and Bulk Sales; Article 7: Warehouse Receipts, Bill of Lading and other Document of Title; Article 8: Investment Securities; Article 9: Secured Transactions.

[385] The principle of the separation of powers introduced by Montesquieu means that the State is divided into three branches with separate and independent powers; the judicial, legislature and executive.

[386] Goode *op. cit.* fn. 383, at p. 136.

[387] The Sale of Goods Act 1979; the Hire Purchase Act 1964; Insolvency Act 1976 or the Companies Act 2006, are illustrations of the codification movement in England.

use the economic value of his assets in normal course of business. The regulation of secured credit in respect of intangible property should not prevent the debtor to utilise the intellectual property asset. Moreover, a centralised registration system should be put into place so that the creditor would be conferred his preferential right and right to seize the asset upon the debtor's insolvency.

The requirement of registration is quite easy to satisfy when the intellectual property asset is already subject to a registration requirement in a special registry. The registration of the security over intellectual property assets will be made in the same special registry. This is the case for patents, trademarks and, industrial drawings and designs which are all registered at the National Institute for Industrial Property[226]. In respect of copyright and other intellectual property rights, there are not any registration requirements except where the law has enacted specific regulations such as for cinematographic movies[227] or computer programs[228].

Finally, if some intellectual property rights mentioned above are used for security purposes as part of the security created on business parts, a registration to the Commercial Tribunal will be also required. Although a registration procedure is provided for almost all intellectual property assets, there is not any centralised information that would contribute to the rationalisation and simplification of the law. Furthermore, it has to be highlighted that some intellectual property rights such as copyrights, are still unregulated for the purpose of creating a security. The reform introduced by the Law of 23rd March 2006 provides some guidance for all remaining unregulated intellectual property assets used as collateral and, provides that the regulations of the non possessory gage will be applicable in these instances.

General regime

Certain intellectual property assets have not been the subject of any regulations if they are used for security purposes. Before the reform introduced by the law of 23rd March 2006, the possessory '*gage*' was inadequate to regulate the use of intellectual property assets for security purposes. In effect, this '*gage*' required a dispossession

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[226] *Institut National de la Propriété Industrielle (INPI),* http://www.inpi.fr/(last checked 26/04/2010).
[227] National Cinematographic Registry (*Registre public de la cinématographie et de l'audiovisuel*).
[228] National Computer Programs Licences Registry (*Registre National Spécial des Logiciels*).

found in *Welsh Development Agency v. Export Finance Co. Ltd.* [391] where *Dillon L.J.* stated that:

"[i]n determining the legal categorization of an agreement the Court looks at the substance of the transaction and not at the labels which the parties have chosen to put on them."

The approach retained in England thus shows great divergence with the American functional approach. Under Article 9 UCC, the same rules apply to any transactions which intend to create a security interest. Article §9-102(1) (a) provides that:

"[e]xcept as otherwise provided in Section 9-104 on excluded transactions, this Article applies to any transaction (regardless of its form) which is intended to create a security interest in personal property or fixtures ..."[392]

As a result, the question emerged of whether the adoption of the functional approach would constitute a formal obstacle to the legal transplantation of Article 9 UCC into English law. Functionalism purports that all security interests serve an identical function, thus avoiding difficult issues and uncertainties posed by the current English formal and substantial approach, such as the ostensible ownership difficulty created by non possessory security interests[393]. However, the legal transplantation of Article 9 with its functional approach into English law could lead to substantial difficulties. It is arguable that the adoption of the functional approach would involve significant transformation of the baseline concepts of English commercial law, especially with respect to those enshrined in property law.

Inherent to the functional approach is the rejection of the concept of title within the American secured credit law regime. The architects of Article 9 UCC did not retain the concept of title and analysed it as being inefficient and too theoretical to fit within their secured credit law regime[394]. Therefore, the functional approach would impose an extensive simplification of security law regimes as it would not retain the fundamental distinction between property rights and priority rights which represent

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[391] [1992] BCC 270.
[392] Bridge *op. cit.* fn. 182, at p. 197.
[393] On the functionalist approach retained in Article 9, see Davies, "The Reform of English Personal Property Security Law: Functionalism and Article 9 of the Uniform Commercial Code" *op. cit.* fn. 294, at p. 295.
[394] Llewellyn, K. " Through Title to Contract and a Bit Beyond" (1938) 15 *New York University Law Quarterly*, at p. 159

the Commercial Court where the debtor's business is registered. The success of taking securities in intellectual property assets which are not the object of a special regime will depend upon the trust people will have in this new regime. For now, it can only be regretted that the legislator did not take the opportunity to centralise all the different registers. This scattered registration systems certainly does not provide for certainty and security. A notice filing system inspired from Article 9 of the UCC would simplify and would provide more certainty to the actual regime. Nonetheless, and as it has been concluded with respect to the proposal for reform in England, a modernisation of the law modelled on the notice filing system becomes questionable in relation to the use of intellectual property assets for security purposes. In effect, it has already been argued[235] that a modernisation modelled on Article 9 UCC is not entirely satisfactory in an intellectual property context, particularly in respect of the registration requirements.

The nature of personal property has substantially evolved in recent years. The emergence of new class of assets such as intellectual property assets created new credit opportunities for businesses that the law cannot ignore any longer. In effect, it has to be concluded that a modern secured credit law regimes should embrace new categories of asset in a knowledge economy context. This comparative law analysis on the different registration mechanisms to validate and enforce security rights created in intellectual property assets demonstrated that in the light of the objectives of a modern legislation of secured credit, substantial reform is currently needed. The need for secured credit laws to modernise by integrating new class of assets to their regimes has recently been confirmed by UNCITRAL which recently established a draft on secured transactions dealing with security rights in intellectual property[236].

Although a modernisation of the law is manifestly required in respect of the use of intellectual property assets used for security purposes, a reform modelled on Article 9 UCC becomes questionable following the analysis of the American regime, in the

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[235] See above the paragraph on the registration mechanisms for security interests in intellectual property assets in the United States, from p. 52.

[236] "Draft Supplement to the UNCITRAL Legislative Guide on Secured Transactions dealing with security rights in intellectual property" available at: http://www.uncitral.org/uncitral/en/commission/working_groups/6Security_Interests.html (last checked 26/04/2010).

and should be subject to registration as they evidently perform the purpose of a security[397]. It is argued that it would noticeably clarify the current legal position regarding retention of title clauses in England. In effect, there have been some uncertainties and inconsistencies within the legal regime applicable to retention of title clauses that would need to be clarified within appropriate commercial law reform[398].

Since the famous *Romalpa*[399] case, the use of retention of title clauses has been prolific in commercial transactions. In effect, sellers are free to introduce retention of title clauses in the terms of their contracts following the freedom of contract principle. Such a mechanism is allowed and regulated by Sections 17 and 19 of the Sale of Goods Act. According to Section 17, the property passes when the parties show the clear intention to do so. Section 19 provides that the seller can "... reserve the right of disposal of the goods until certain conditions are fulfilled ... notwithstanding the delivery of the goods to the buyer ... the property in the goods does not pass to the buyer until the conditions imposed by the seller are fulfilled." Therefore, the seller remains the owner of the goods and will be entitled to claim them back if the buyer defaults. The legal transplantation of Article 9 UCC into English law would significantly reform these sections and, more generally, modify the Sale of Goods Act 1979 which could ultimately lead to significant legal disturbances for commercial transactions.

Under retention of title, the seller never transferred ownership. Upon the debtor's default, the seller does not regain ownership but simply regains possession of the goods. If the seller transfers ownership to the buyer, the security will be qualified as a charge, void if not registered according to the Companies Act 2006[400]. It is indeed primordial for a creditor to register charges in order to be enforceable. A simple retention of title clause provides that ownership in the goods will not pass until the full purchase price is paid by the buyer. The clause will be qualified as an 'all monies clause' when title in the goods does not pass until all debts owed to the seller are

[397] Law Commission Consultation Paper No. 164, at Para. 7.24.
[398] For an analysis of the regulation of retention of title clauses in Europe, see Davies, I. R., *Retention of Title Clauses in Sale of Goods Contracts in Europe*, (1999).
[399] *Aluminium Industry Vaassen BV v. Romalpa Aluminium Ltd.* [1976] 1 WLR 676.
[400] Companies Act 2006, ss. 860, 861 and 874.

expose some of the main features of the Cape Town Convention as an illustration of a significant endeavour towards the modernisation and approximation of secured credit law regimes. Recent legislative activities at the international level have particularly confirmed the emergence of a growing consensus on the need to modernise secured credit law regimes in the light of an approximation of law. The next section will further consider the justifications that have forged this consensus on the approximation of secured credit law regimes. If the modernisation of secured credit law regime should be achieved in the light of an approximation of law, the final section will further introduce the question of whether such modernisation of the law could successfully be achieved using approximation of law methods. At this stage, the analysis will only provide for some conceptual definitions of the approximation of law methods, which will, then be assessed in depth within subsequent chapters.

The Cape Town Convention

A modernisation of secured credit law regimes is not solely required because of the emergence of new class of assets but is also required because of a growing internationalisation of secured transaction practices. In effect, recent years have witnessed a significant growth in cross-border transactions which have generated an internationalisation of secured transaction practices. In this respect, the creation of a security at the international level can create uncertainties towards its validity and enforcement. An illustration of these difficulties can be found with the creation of security in mobile equipments such as aircraft equipments, space assets or railway rolling stocks. The specificity of such assets is embodied in the fact that they are movable assets that are likely to move national boundaries and, therefore, be subject to different national legislations if used for credit purposes. Because of the very nature of such assets, the issue concerned the recognition and enforcement in one state of a security interest created under the law of another state[237].

[237] Cuming, R.C.C. "Hot Issues in the Development of the (Draft) Convention on International Interests in Mobile Equipment and the (Draft) Aircraft Equipment Protocol" (2000) 34 *International Lawyer,* at p. 1089.

The position adopted under Article 9 UCC with the purchase money security interest[409] therefore appeared tempting and convincing. The Law Commission suggested that retention of title clauses should be treated as a security and should be included within the proposed regime for the adoption of a unique security device[410]. However, the recommendation of the Law Commission to introduce retention of title to the global security interest regime would impose registration, a notice filing requirement that has led to some controversies. The first part of this examination on retention of title clauses will thus consider whether the American purchase money security interest should and could be imported in England. The second part of this examination on retention of title clauses will consider the obstacles that could arise from the importation of the notice filing system.

The purchase money security interest

Article 9 UCC opts for a different approach to retention of title mechanism. In effect, the architects of Article 9 did not believe that retention of title clauses could fall within the functional and unitary concept of the security interest and agreed that it was necessary to reconceptualise this mechanism[411]. They opted for the purchase money security interest that allows the seller to reserve a security interest rather than reserving title in the goods. In other words, the seller looses ownership of the goods and is entitled to reserve a security interest instead. It is arguable that the legal transplantation of Article 9 with the purchase money security interest could substantially strengthen the position of the seller. Under Article 9, the seller with a properly registered purchase money security interest is entitled to a super priority over prior secured creditors and is also entitled to claim the proceeds of resale[412] and the manufactured goods[413] which is not the legal position under the current English law. The Law Commission suggested that the purchase money security interest

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[409] Article §9-107 UCC provides that "[a] security interest is a "Purchase Money Security Interest" to the extent that it is (a) taken or retained by the seller of the collateral to secure all or part of its price; or (b) taken by a person who by making advances or incurring an obligation gives value to enable the debtor to acquire rights in or the use of collateral if such value in fact so used."
[410] Law Commission Consultation Paper No. 164, at Para. 7.24.
[411] See McCormack, "Personal Property Law Reform in England and Canada" *op. cit.* fn. 294, at p. 124.
[412] Article §9-306 UCC.
[413] Article §9-314 and §9-315 UCC.

some jurisdictions do not have any registration scheme available for filing within their secured credit law regimes. In order to deal with this issue, §9-307(c) UCC[243] provides some guidelines on how to file security interests abroad[244]. An 'equivalence test' should be applied to foreign security law regimes which would check the availability of a registration or filing system, priority requirements and the availability of information to searchers[245]. However, many European jurisdictions would not satisfy the equivalence test because most of them do not provide a comprehensive registration scheme. For instance, England does not require registering simple retention of title clause. Similarly, France does not require the registration of any retention of title clauses[246].

In reality, it appears that most Civilian and even Common Law jurisdictions would not have any comprehensive registration or filing system, especially in relation to property-based securities such as retention of title clauses. Thus, Article 9 UCC considered this possibility and also provides that if the equivalence test is not met, §9-307(c) UCC deems the location of the debtor in the District of Columbia. It is to be observed that the test established under §9-307(c) UCC can be difficult to satisfy and would involve substantial costs for the contracting parties who will have to search and examine the availability and the nature of foreign registration systems.

Non-U.S. Debtors: Applying U.C.C. § 9-307(c) [Rev] to Foreign Filing, Recording, and Registration Systems" (2006) 39(2) *Uniform Commercial Code Law Journal,* at p. 109.

[242] Rosenberg explains that "[f]our reasons motivated the Study Committee to recommend this rule. First, intangible collateral has no location. A location-of-collateral rule would require a provision fixing a fictional location for intangibles. Second, collateral may be located in many jurisdictions, whereas each debtor has only one location (or perhaps one or two other candidates for its location). As a consequence, a debtor's-location rule would likely result in fewer filings, thereby lowering the cost of credit. Third, a debtor's-location rule probably would not need special provisions governing collateral in transit. Finally, because debtors are unlikely to change locations as frequently as does collateral, a debtor-based rule would likely reduce the costs of maintaining perfected status and the frequency with which certain difficult priority issues arise." Rosenberg *Ibid.* at pp. 122-123.

[243] §9-307 (c) provides that: "[l]imitation of applicability of subsection (b). Subsection (b) applies only if a debtor's residence, place of business, or chief executive office, as applicable, is located in a jurisdiction whose law generally requires information concerning the existence of a non possessory security interest to be made generally available in a filing, recording, or registration system as a condition or result of the security interest's obtaining priority over the rights of a lien creditor with respect to the collateral. If subsection (b) does not apply, the debtor is located in the District of Columbia."

[244] Rosenberg *op.cit.* fn. 241, at p. 109.

[245] *Ibid.*

[246] The law of 10th June 1994 introduced an optional publicity mechanism of the contract of sale affected by a retention of title clause. If the creditor decides to publish the retention of title clause, he will not need to introduce an *'action en revendication'* but, an *'action en restitution'*. If the retention of title is published, article 2276 *C.Civ* cannot be invoked by the second time buyer.

In addition, it has been argued that the purchase money security interest and its super priority would be economically efficient as it would allow the debtor to purchase further assets and, thus, significantly increase the pool of assets available for creditors[419]. However, this argument developed in favour of the American model can be objected. In effect, it allows the purchase of further assets which will eventually increase the general pool of assets of the debtor but, these new purchased assets, especially in relation to inventory, will only be available to the purchase money financier upon the debtor's insolvency and, not to the general mass of other creditors[420]. Yet, the extension of credit allowed by the purchase money security interest could boost the debtor's economic situation, which would benefit primary financiers and avoid the business to engage on the path to insolvency. This would particularly be the case where the buyer makes the decision to purchase capital equipments, which use, will allow the debtor to swell his pool of assets in different ways[421].

A fundamental objection developed against the purchase money security interest relates to the justification of the super priority offered to the creditor. In effect, as Bridge highlighted:

"[t]he last passengers to board the Titanic did not get the first seats in the lifeboats."[422]

How can the super priority offered to purchase money security lenders be justified? As mentioned above, it has been advanced that the purchase money security interest would permit the grant of an extension of credit for debtors that would not be possible without the existence of such super priority. From a policy perspective, it would seem reasonable to recognise that a creditor, who increases the debtor's pool of assets by offering further credit facilities, should be entitled to a super priority over the specific asset he contributed to finance. However, non purchase money security lenders such as unvoluntarily creditors, as designated by Lopucki[423], also provide the debtor with credits and do not currently enjoy a super priority similar to

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[419] Gullifer *op. cit.* fn. 269.
[420] It is arguable that the operation is neutral in effect.
[421]. Gullifer *op. cit.* fn. 269.
[422] Bridge *op. cit.* fn. 182, at p. 205.
[423] LoPucki, *op. cit.* fn. 4, at p. 1887.

registry[253]that ensures the protection of creditors' priority against subsequent registered security interests. Finally, the Convention provides for prompt and effective remedies for creditors upon the debtor's default[254] that will undoubtedly enhance and promote more certainty and security within the creation of international security interests in mobile equipments. The creation of such an international instrument was fundamental to support modern commercial transactions. By providing a unique mechanism for the creation and enforcement of an international security interest in high value mobile equipment, creditors are guaranteed more certainty and efficiency within their international transactions. The introduction of this international regime does not solely represent an illustration in support of the need to modernise secured credit law regimes; it is also an illustration of the phenomenon of modernisation through approximation of laws.

With the growth of cross-border transactions and the emergence of new market economies, legal reformers have been confronted to new challenges. Especially, the modernisation of secured credit law has been accompanied with the aim to move towards an approximation of secured credit law regimes. As the analysis above suggested, the move towards more uniformity in the law has recently become a major concern for the international commercial community and law reformers. The Cape Town Convention provides an essential international framework for international security in high value mobile equipments. Further international initiatives have also taken place aiming at the approximation of secured credit law regimes. Initiatives such as the UNCITRAL Legislative Guide on Secured

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[253] See Chapter IV, article 16 of the Cape Town Convention which provides that: "[a]n international registry shall be established for registration of: (a) international interests, prospective interests and registrable non-consensual rights and interests; (b) assignments and prospective assignments of international interests; (c) acquisitions of international interests by legal or contractual subrogations under the applicable law; (d) notices of national interests; and (e) subordinations of interests referred to in any of the preceding sub-paragraphs." See above at fn. 103.

[254] Article 8 of the Cape Town Convention provides that "[i]n the event of default as provided in Article 11, the chargee may, to the extent that the charger has at any time so agreed and subject to any declaration that may be made by a Contracting State under Article 54, exercise any one or more of the following remedies: (a) take possession or control of any object charged to it; (b) sell or grant a lease of any such object; (c) collect or receive any income or profits arising from the management or use of any such object." It further provides that: "[t]he chargee may alternatively apply for a court order authorising or directing any of the acts referred to in the preceding paragraph. 3. Any remedy set out in sub-paragraph (a), (b) or (c) or paragraph 1 or by Article 13 shall be exercised in a commercially reasonable manner. A remedy shall be deemed to be exercised in a commercially reasonable manner where it is exercised in conformity with a provision of the security agreement except where such a provision is manifestly unreasonable."See above at fn. 103.

filing system. Such registration could also pose substantial burdensome and impractical obligations for creditors and debtors.

Notice filing

Article 9 of the UCC distinguishes between the enforcement of the security interest as between the debtor and creditor through the process of attachment[427] and the enforcement of the security as against third parties through the process of perfection[428] where the security is registered. Although, the Code still provides for a mode of perfection through the debtor's dispossession, the notice filing is the recognised system under Article 9 in order to perfect security interests[429]. A financing statement has to be filed in a public centralised registry[430] and only needs to provide for a small amount of information[431].

The recommendations of the Law Commission, suggesting the introduction of retention of title mechanism to the global security interest regime, would impose registration, a notice filing requirement on all types of retention of title mechanisms including simple and current account clauses. It is arguable that this requirement would weaken the position of the seller as he would now need to conform to the notice filing requirement in relation to simple and current account clauses which is not the case under the current English law regime[432]. It is important to understand that what currently makes the retention of title mechanism attractive within most European legal regimes is especially this lack of registration requirement. In effect, this formality is often seen as time and money consuming for sellers who only wish to pursue their business transactions as fast and as securely as possible.

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[427] §9-203(Part 2) UCC.
[428] §9-302 and §9- 401 to §9- 408 UCC (Part 4 on Filing).
[429] See Chapter Two at pp. 51-55.
[430] §9-401 UCC
[431] Article §9-402 (1) UCC provides that "[a] financing statement is sufficient if it gives the names of the debtor and the secured party, is signed by the debtor, gives an address of the secured party from which information concerning the security interest may be obtained, gives a mailing address of the debtor and contains a statement indicating the types, or describing the items, of collateral."
[432] McCormack, ""Quasi Securities" and the Law Commission Consultation Paper on Security Interests – A Brave New World" *op. cit.* fn. 294, at p. 80.

aspiration to approximate secured credit law regimes[258]. At one end of the spectrum, sceptical theorists see in the approximation of law process a form of disguised protectionism and national hegemony, and at the other end of the spectrum, legal theorists encourage the achievement of an approximation of commercial laws because it would substantially reduce the costs of cross-border transactions and provide more certainty and clarity in the applicable law for the international business community as a whole[259].Thus, it will be necessary to consider some of the arguments that have been advanced in favour of an approximation of laws, and some of the arguments drawn against an approximation of commercial laws.

It is arguable that an approximation of commercial laws should be achieved so as to reduce transaction costs and increase legal certainty for the contracting parties. As Fox already highlighted:

"[d]isharmonies of law and procedures are costly and bothersome. As the world becomes increasingly interdependent the costs of different rules of law and different procedures that apply to the same transaction mount. People begin to wish for harmonization in order to tidy up a messy world; they wish everyone would adopt the "ideal" standard, which is the one they like the best."[260]

The 'ideal' standard that has often been recognised by the international community for the modernisation and approximation of secured credit law regimes is the American Article 9 of the UCC. It has been argued, on many occasions, that an approximation of secured credit law regimes in lines with the American regime would lead to more efficiency in the law[261]. However, the attainment of such an 'ideal' has been accompanied with delicate issues concretised, for example, in the existing divergences amongst cultural legal traditions that would render

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[258] See for instance Boodman, M. "The Myth of Harmonisation of Laws" (1992) 39 *The American Journal of Comparative Law,* at p. 43; Legrand, P. "European Legal Systems are not Converging" (1996) 45 *International Commercial Law Quarterly,* at p. 52; Stephan, P.B. "The Futility of Unification and Harmonization in International Commercial Law" (1999) 39 *Virginia Journal of International Law,* at p. 743 and Walt, S. "Novelty and the Risks of Uniform Sales Law" (1999) 39 *Virginia Journal of International Law,* at p. 671.

[259] Leebron, D.W. "Claims for Harmonization: A Theoretical Framework" (1996) 27 *Canadian Business Law Journal,* at p. 64.

[260] Fox, E.M. "Harmonization of Law and Procedures in a Globalized World: Why, What, and How?" (1991-1992) 60 *Antitrust Law Journal,* at p. 593.

[261] Walt argued that: "[c]omparativists and law reformers tend to think that uniformity in international commercial law is a good thing. To them, a single set of applicable rules is considered to be a worthwhile goal. One reason is that uniform rules promote efficiency. [...] However, uniformity is a mixed blessing and not an unqualified good." Walt *op. cit.* fn. 258, at p. 671.

Notwithstanding this potential increase in formalities for creditors, it is important to highlight that Article 9 attempts to keep the formal requirements to a minimum where possible. In the U.S., a seller can obtain a purchase money security interest in the goods themselves, in the proceeds and manufactured goods by simply filing a financing statement that will be valid for five years[438]. The same financing statement can cover several sales during the five years period so that the creditor does not have to register each contract of sale separately[439]. Further, the Uniform Commercial Code provides an exception to the registration requirement in relation to consumer goods. In effect, the Uniform Commercial Code concedes that purchase money security interests created on consumer goods should not be affected by the requirement of registration. Article §9-309(1) provides that a purchase money security interest in consumer goods is perfected solely upon attachment. Suppliers of consumer goods thus enjoy an automatic perfection. Considering the wide use of retention of title mechanisms within the commercial community, it can be argued that the imposition of such registration formality to simple retention of title clause could still be seen as burdensome in respect of certain types of assets such as, for example, materials supplied to a company[440]. Finally, it is important to highlight that in England, practitioners and the finance industry have shown some great hostility to the proposal of subjecting retention of title mechanisms to the notice filing[441]. Although one can identify strong arguments in favour of a notice filing system with respect to property-based security devices, the importation of such a scheme within English system could create significant obstacles to a successful legal transplantation of an Article 9 type[442].

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[438] Article § 9-403 UCC provides: "[w]hat Constitutes Filing; Duration of Filing; Effect of Lapsed Filing; Duties of Filing Officer. (2) Except as provided in subsection (6) a filed financing statement is effective for a period of five years from the date of filing. The effectiveness of a filed financing statement lapses on the expiration of the five year period unless a continuation statement is filed prior to the lapse. If a security interest perfected by filing exists at the time insolvency proceedings are commenced by or against the debtor, the security interest remains perfected until termination of the insolvency proceedings and thereafter for a period of sixty days or until expiration of the five year period, whichever occurs later. Upon lapse the security interest becomes unperfected, unless it is perfected without filing. If the security interest becomes unperfected upon lapse, it is deemed to have been unperfected as against a person who became a purchaser or lien creditor before lapse."

[439] McCormack, G., *Registration of Company charges*, (1994), at p. 159.

[440] The Law Commission Consultative Report on Company Security Interests, N° 296, at Para 1.62.

[441] *Ibid.* at Para. 1.61.

[442] The question has been extensively debated in the symposium on Notice filing, in a symposium published in the *Minesota Law Review* (1995).

negotiations, drafting and enforcing commercial contracts, translation costs, search and information costs[265]. One crucial aspect of the transaction for traders is to find the best legal system that will provide them with security, certainty at cheaper cost. It is arguable that the implementation of modern and more uniform secured credit law regimes would reduce the costs of credit at domestic and international level.

It is further explained that within the 'jurisdictional interface', difficult interaction and communication would occur between commercial participants in the absence of an approximation of laws[266]. An approximation of laws would enable the commercial community to communicate and interact with reference to the same legal language at the international level. Of course, conflict of law rules already help in providing more certainties for traders at the international level in the way they can now ascertain the applicable law. However, previous developments demonstrated that the reference to the *lex situs* in the context of secured transactions is not always adequate. Further, the conflict of law rules does not eliminate all the costs. Creditors are not guaranteed that their security will be valid and enforceable within the national applicable law. Thus, contractual parties will generally spend substantial time and money in translation work and in searching and analysing the commercial law of a particular foreign jurisdiction if it appears to be the applicable law to the case. Thus, an approximation of secured credit law regimes would reduce these costs imposed on contracting parties and would provide more certainty with respect to the applicable law.

Approximation of laws has not solely been justified based on a costs-benefits rationale; it has also been justified because of the values it would ascertain such as fairness and transparency within international transactions[267]. In effect, it is often contended that different legal rules could lead to the production of unfair results towards certain participants[268]. In the field of secured credit law regimes, this

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[265] Schmidtchen, D., Et al. "Conflict of Law Rules and International Trade, A Transaction Costs Approach" (2004) Discussion Paper published by the Center for the Study of Law and Economics, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=545763 (last checked 26/04/2010).
[266] Leebron explains that: "[o]ne of the most important function of harmonization is to enable participants or systems from different jurisdictions to interact or communicate" Leebron *op. cit.* fn. 259, at p. 75.
[267] *Ibid.* at pp. 84- 89.
[268] *Ibid.* at p. 84.

seem that the sub-buyer would not be able to claim the protection instituted under Section 25 SGA as he would not longer be able to prove his good faith. This would obviously depend on whether such registration would provide constructive notice of the existence of the encumbered asset to the purchaser.

The question of the potential legal transplantation of Article 9 UCC into English law is fundamental in the present context of commercial law reform. However, the above analysis showed that the importance of ownership and title within English secured credit law regime may constitute a major obstacle to the successful legal transplantation of Article 9. Although the functional approach regulating a global security interest would provide more certainty and would avoid many difficulties, such an approach would substantially shake the fundamental baseline property law concepts well entrenched in England. Furthermore, it is important to bear in mind that such a reform would generate substantial costs that need to be outweighed with the gains of adopting an Article 9 type regime. Beyond, these delicate issues related to property law, it would appear that the real obstacle to the implementation of an Article 9 type regime would lie with the fundamental issue of the floating charge.

Previous developments on retention of title are fundamental to the debate on the transferability of Article 9 UCC into English secured credit law. However, retention of title mechanisms are property-based securities and are confined to the sale of goods contracts. Beyond the conflict existing between the adoption of a functionalist approach with the unitary security interest and the preservation of property rights and ownership within secured credit law regimes, one can identify substantial difficulties with regards to certain security devices, such as the well-known technique of the floating charge. It is arguable that the floating charge, as global security, would already offer a similar mechanism than the one instituted under Article 9 UCC.

This argument would substantially undermine the success of the legal transplantation of Article 9 UCC as legal method to modernise secured credit law in England. If the legal transplantation of Article 9 may not be successful as legal method to modernise English secured credit law, particularly in light of the analysis of the treatment of the floating charge, it is submitted that the implementation of such a regime may prove

importantly feasible in a context of law reforms[272]. There is always the risk, linked to the recognition of a single legal rule to be applied at the international level, that uniformity might increase the production of inefficient rules which could ultimately swell the costs imposed on contracting parties[273]. Especially, the question of the efficiency of the law as international standards comes to light. The risk being that an approximation of secured credit law regimes, following a unique model, could ultimately produce inefficiencies within the law. Secondly, the recognition of uniform rules could still lead to substantial divergences following divergences in their implementation and interpretation within national laws, thus leaving the establishment of uniform rules unproductive and fruitless. These difficulties will be extensively exposed throughout subsequent analysis. Finally, it can be advanced that even if a nation was to implement the new uniform law conformably, commercial participants, lacking information and familiarity with the new law, could be deterred from applying it which could, again lead to inefficiencies in the adoption of a uniform legal rule[274]. This is, of course, a possible difficulty that could be experienced by model laws or legislative guides at the international level which run the risk of remaining dead letter if they were lacking national adherence. The question of the use of international conventions, model laws, and other legal unification instruments, as legal method to modernise secured credit law regimes will be considered at greater length in Chapter Five.

In light of these potential difficulties, it has been argued that a competition of legal regimes would be more advantageous for contracting parties than uniform laws as it would enable them to opt for the most suitable law to govern their contract[275]. These arguments identified against the achievement of an approximation of laws only constitute a sample of objections that mainly emanate from a minority. As David already highlighted:

"[f]rom the standpoint of legal practice, some international unification of law bearing on the rules of conflict of laws or on rules of substantive law applicable to international legal relations is … desirable. This is universally recognized today, and

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[272] See on this point Stephan *op. cit.* fn. 258; Leebron, D.W. "Lying Down with Procrustes: An Analyis of Harmonization Claims" 27 *Canadian Business Law Journal*, at p. 63 and Boodman *op. cit.* fn. 258.
[273] Walt *op. cit.* fn. 258, at p. 672.
[274] Walt *op.cit.* fn. 258, at p. 673.
[275] *Ibid.*

"I certainly think that if a charge has the three characteristics that I am about to mention it is a floating charge. (1) If it is a charge on a class of assets of a company present and future; (2) if that class is one which, in the ordinary course of the business of the company, would be changing from time to time; and (3) if you find that by the charge it is contemplated that, until some further step is taken by or on behalf of those interested in the charge, the company may carry on its business in the ordinary way as far as concerns the particular class of assets I am dealing with."[450]

Accordingly, under English law, it is possible for a creditor to obtain a global security over a companies' fund of assets, including present and future assets. The great advantage of the floating charge is that it allows a company to provide its creditor with a security and to continue to deal with the charged assets in the course of business without the lender's consent and until crystallisation which predominantly happens when a receiver or liquidator is appointed [451]. This includes selling the charged assets to third parties without encumbered legal title and, granting subsequent fixed charges which will rank ahead of the initial floating charge[452].

The characterisation of the floating charge is not always straightforward and has consequently been the subject of much court consideration over the years. Particularly, the question emerged whether a security created over present and future book debts paid into a company's current account with a bank was a fixed or a floating charge. In *Westminster plc v. Spectrum Plus Limited & Ors*[453], the House of Lords decided that such a security had to be floating because the bank did not have enough control over the account to completely block it which, if it did, would have enable the creation of a fixed charge. The House of Lords explained that the decisive criterion for the characterisation of a charge as being floating was thus the freedom of the chargor to use the charged assets which included, under the circumstances of the case, the proceeds of the debts and the debts themselves. By allowing the debtor to freely deal with the charged assets, the charge had to be qualified as a floating

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[450] *Yorkshire Woolcombers Association* [1903] 2Ch 284, at 295.
[451] Crystallisation can also occur upon 'ceasing to do business', 'enforcing the security' or upon the occurrence of a particular event agreed in a clause (automatic crystallisation). See Wood *op. cit.* fn. 447, at p. 204.
[452] *Wheatley v. Silkstone and Haigh Moor Coal Co* (1885) 29 Ch D 715.
[453] [2005] UKHL 41.

Methodological challenges

With the international proliferation of legal relations, the achievement of an approximation of laws is at the heart of legal activities at the national and international level, particularly in the field of secured credit law regimes. It has been evidenced in the analysis above that the modernisation of secured transactions law regimes has become necessary following the emergence of new commercial needs. It is further supported that such modernisation should occur in the light of an approximation of secured credit law regimes. This willingness to operate an approximation of laws is not a new phenomenon in our legal history. The Romans already aimed to create such *ius commune* and succeeded in their quest to establish this single harmonised body of laws. In effect, this *ius commune*, which now constitutes the legal heritage of most Civilian jurisdictions, was taught amongst all European universities enabling lawyers to talk an identical language of law and, therefore, facilitating international legal exchanges[278]. Following the recognition that secured credit law regimes should be reformed in the light of an approximation of laws, the question emerged whether approximation of law methods could be used to modernise secured credit law regimes. Accordingly, the subsequent chapters will essentially aim at determining how and to what extent the modernisation of the law of secured credit could be successful using approximation of law methods.

The conceptual discussion in this section develops a methodological structure that will guide the thesis into the analysis of legal reforms through approximation of law methods. The idea of an approximation of laws can encompass a wide range of different techniques and methods that aim to achieve different degree of approximation of laws. Each approximation of law method will be assessed in order to determine whether a successful modernisation of secured credit law regimes could be, if at all, reached. Before considering each of these methods in depth, it is necessary to identify and briefly define them.

Approximation of law methods can be divided in three main categories which are legal transplantation, legal harmonisation and legal unification. First, legal reformers

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[278] David *op. cit.* fn. 276, at p. 13.

pursuing Section 860 of the Companies Act 2006. The Court then considered whether this security was floating or fixed. It was reaffirmed that:

"... the essential element in determining the difference between a fixed and a floating charge is the chargor's ability without the chargee's consent to control and manage the charged assets. That ability is present in this case."[458]

Thus, it was concluded that the trust created for the purpose of security had to be characterised as being a floating charge which was, under the circumstances of the case, void for lack of registration.

This case is also interesting in the way that it may suggest a way to avoid the compliance with certain formalities requirements if the charge in question could qualify as a financial collateral arrangement which, according to the Financial Collateral Arrangements Regulations 2003, exempts the arrangement from the registration requirements[459] under the Companies Act 2006. The Regulations enable the creation of a security over financial collateral which can include cash[460] and financial instruments[461]. The security can include a floating charge but in order to qualify as a security financial collateral arrangement, the collateral must be "... in the possession or under the control of the collateral-taker or a person acting on his behalf."[462]The question raised in the *Gray* case was thus to determine whether the account in question was in the possession or control of the collateral-taker (G-T-P) within the meaning of the Regulations.

Difficulties arose as to the definitions of "possession" and "control" as these remained undefined in the Regulations. However, the Court considered that "control" had to refer to "real legal control" rather than "administrative control". Accordingly, it has been clarified that "... the collateral taker must be able to prevent the collateral provider from using or dissipating the assets in the ordinary course of business."[463] In

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[458] See Para 31[2005] [2010] EWHC 1772.
[459] See Para 4(4) of the Regulations.
[460] See Article 2(1) (d) Financial Collateral arrangements Directive 2002. For e.g. cash includes monies credited to an account.
[461] See Article 2(1) (e) "financial instruments" would include shares bonds and other forms of debt instruments and any other securities.
[462] See Para 3 of the Regulations.
[463] See Para 54 [2010] EWHC 1772

Different methods for reaching an approximation of secured credit law regimes have been identified in this section. Thus, it will now be fundamental to test these methods in order to determine whether they could successfully be used as legal methods to modernise secured credit law regimes. In succeeding Chapters, It will be thus attempted to determine whether legal transplantation (Chapter Three), legal harmonisation (Chapter Four) and legal unification (Chapter Five) could be used as legal methods to modernise secured credit law regimes. Comparative law will constitute an essential legal tool in the assessment of whether approximation of law methods could successfully be used to modernise secured credit law regimes. Different jurisdictions belong to different legal families, which involve different legal cultures and values, and which have adopted different policy choices. These differences could generate substantial incompatibilities within approximation of secured credit law endeavours. Comparative law constitutes an essential legal tool in the drafting of new legislations and in assisting the convergence of commercial laws. Goode accounts, for instance, that:

"[t]he first major comparative law analysis in England was driven by the requirements of trade. This was Leone Levi's great four-volume treatise published between 1850 and 1852 comparing the mercantile laws of the United Kingdom with those of no fewer than sixty other countries, together with the Institutes of Justinian."[281]

This analysis will thus use comparative law as main tool to assess whether approximation of law methods could be used to modernise secured credit law regimes. Particularly, specific emphasis will be given to jurisdictions which belong to different legal traditions, such as the Common Law tradition and the Civil Law tradition.

CONCLUSION

It is now well accepted that secured credit law regimes are necessary to the growth of the economy and this assumption is largely supported by an emerging consensus on secured credit. Accordingly, it is argued that the promotion of credit can be enhanced if secured credit law regimes are modernised in the light of an approximation of law.

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[281] In Goode, R.M., Et al., *Transnational Commercial Law*, (OUP, 2007), at p. 156.

To the difference of most Common Law jurisdictions, Article 9 UCC only recognised fixed security interests and never recognised the concept of the floating charge. This position was endorsed by the well-known case of *Benedict v. Ratner* [468] where the court recognised the impossibility for the debtor to create a security interest over goods which are not yet in existence. Only fixed charges were recognised as being valid under the American security law regime. A fixed charge attaches the assets at the time of its creation and does not allow the debtor to freely dispose of the charged assets during the ordinary course of business without his creditor's consent. Nevertheless this position has been attenuated. Articles §9-204 and §9-205 UCC[469] now permit the creditor to perfect a security interest over after acquired property, including present and future assets and, allow the parties to agree that the company should be entitled to deal with the assets in the ordinary course of business. Hence, the technique enshrined in Article 9 has been analysed as 'a fixed charge coupled with a licence to deal'[470]. Since Article 9 UCC opted for a notice filing and a first to file priority rules system, the sole recognition of fixed charges provides for clarity and certainty. In effect, all perfected security interests will act in the same way which will in return contribute to the ascertainment of the parties' rights at all times[471]. As long as the security interest is adequately perfected, any subsequent security interests will rank behind it upon the debtor's insolvency[472].

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[468] The Court considered in *Benedict v. Ratner* that debtors should not be able to use all of their personal assets for security purposes. In effect, it was argued that some assets should be left unencumbered for the payment of unsecured creditors. *Benedict v. Ratner* (1925) 268 US 354.

[469] Article § 9-204 UCC provides that "[a]fter-Acquired Property; Future Advances - .(1) Except as provided in subsection (2), a security agreement may provide that any or all obligations covered by the security agreement are to be secured by after-acquired collateral. (2) No security interest attaches under an after-acquired property clause to consumer goods other than accessions (Section 9-314) when given as additional security unless the debtor acquires rights in them within ten days after the secured party gives value. (3) Obligations covered by a security agreement may include future advances or other value whether or not the advances or value are given pursuant to commitment (subsection (1) of Section 9-105)." § 9-205 UCC provides that: "[u]se or Disposition of Collateral Without Accounting Permissible. A security interest is not invalid or fraudulent against creditors by reason of liberty in the debtor to use, commingle or dispose of all or part of the collateral (including returned or repossessed goods) or to collect or compromise accounts or chattel paper, or to accept the return of goods or make repossessions, or to use, commingle or dispose of proceeds, or by reason of the failure of the secured party to require the debtor to account for proceeds or replace collateral. This section does not relax the requirements of possession where perfection of a security interest depends upon possession of the collateral by the secured party or by a bailee."

[470] McCormack, "The Law Commission Consultative Report on Company Security Interests: An Irreverent Riposte" *op. cit.* fn. 294, at p. 297.

[471] Gullifer, L. "Will the Law Commission Sink the Floating Charge?" (2003) *Lloyd's Maritime and Commercial Law Quarterly*, at p. 125.

[472] The purchase money security interest still ranks ahead whatever the time of its perfection.

marginal objections. Accordingly, the question emerged whether approximation of law methods could successfully be used to modernise secured credit law regimes.

The idea of an approximation of laws can encompass a wide range of different techniques and methods that aim to achieve different degree of approximation of laws. Legal transplantation, legal harmonisation and legal unification will be thus analysed and assessed as potential successful methods to modernise secured credit law regimes. These techniques offer different degrees of approximation; legal unification being the most complete form by creating a unique supra national legal rule. Accordingly, it will be essential to determine to what extent approximation of secured credit law regimes is feasible and to what extent these methods could successfully modernise secured credit law regimes. The following developments will aim at determining the feasibility of an approximation of law using each of the methods earlier identified. Accordingly, legal transplantation will be dealt with in Chapter Three, legal harmonisation in Chapter Four and legal unification in Chapter Five.

As the floating charge does perform similar functions as the ones offered under the security interest of Article 9, the adoption of such a scheme would become questionable in England. In effect, it is arguable that the adoption of such a scheme would involve the unnecessary replacement of the floating charge with a fixed charge which would ultimately perform a similar objective and, would also involve substantial and costly legislative reform of the current secured credit law regime in England[479]. In that sense, the existence of the floating charge could constitute a substantial obstacle to the legal transplantation of Article 9 UCC into English law[480].

Nevertheless, the legal transplantation of Article 9 UCC into English law would modernise the insolvency law regime by providing more certainty and predictability to creditors. Indeed, lenders would no longer need to insert negative pledge clauses in order to protect their interests as subsequent secured creditors would no longer have priority over them[481]. In addition, it is important to highlight that the advantageous effects of the floating charge have significantly decreased over the years for creditors in England[482]. The list of preferential creditors ranking in priority over the floating chargee, such as employees claims and the Crown[483], has considerably increased and has significantly weakened the position of the floating chargee upon the debtor's insolvency[484]. Moreover, the uncertain distinction between

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[479] Law Commission Consultative Report No176. Para 2.60: provides that "[s]ome uncertainty remains over the exact effect of the scheme, because the distinction between fixed and floating charges is of importance in the legislation relating to insolvency. Policy issues relating to insolvency are issues for the Government rather than the Law Commission: our brief does not include insolvency. However, it is clear that if the scheme we provisionally propose were to be implemented, a good deal of consequential amendment would be needed to the current insolvency legislation."

[480] Beyond the issues related to priorities which are part of insolvency regimes, it could be argued that the transplantation of article 9 should not be needed as the floating charge performs similar functions.

[481] Under Article 9 UCC, purchase money security lenders still enjoy a super priority over floating lien holders which can only be avoided through the inclusion of negative pledge clauses.

[482] Gullifer *op. cit.* fn. 74, at p. 399.

[483] The Enterprise Act 2002 abolished the Crown preference to the benefit of the creation of a ring-fenced fund.

[484] Gullifer explains that: "[a]s long ago as 1897, priority over a floating chargee (but not a fixed chargee) was given to some preferential creaditor. Initially, this class comprised largely the employees of the company on the grounds that floating charges were typically over raw materials and manufactured goods of the company. Since the company benefited from the efforts of the workforce, it was therefore unfair that a secured creditor should have priority over the employees' claims, but the class also included the Crown in relation to various taxes. Thus, by 2001, the following preferential creditors had priority over the floating chargee: sums due from the company to the Inland Revenue in respect of deductions of income tax that were made or should have been made from employees' pay, VAT and other customs duties payable by the company, contributions in relation to National Insurance and occupational pensions, employees remuneration and other statutory payment due to employees." Gullifer, *op. cit.* fn. 74, at p. 400.

of consent within a notion of 'prestige'"[285]. Further, and as part of this consensual pattern of legal transplantation, it could also be solicited because it would be 'economically efficient' for the importing entity to do so, as suggested by the World Bank in its 'Doing Business' Reports referring, for instance, to the American secured credit law model[286]. Notably, many international entities believe that Article 9 UCC is an adequate legislation to regulate secured transactions and, thus, believe that the legal transplantation of Article 9 should be used as legal method to modernise secured credit legislations in other jurisdictions[287]. Accordingly, the question emerged to determine whether legal transplantation could be used as successful method to modernise and approximate secured credit law regimes.

This analysis on whether legal transplantation could successfully be used as legal method to modernise and approximate secured credit law regimes will be introduced with an analysis of the current literature on legal transplants. It is fundamental to understand the concept of legal transplantation and determine whether legal theories have managed to assess, in abstract terms, the potential success of such process as legal method for law reform. This examination will thus attempt to understand the concept of legal transplantation and verify whether the corresponding literature managed to establish a theory that could determine *a priori* the success of a specific legal transplant.

Various examples of legal transplantation can be found with Roman law which concepts and principles have been imported in the law of many jurisdictions which do not always belong to the same legal tradition. For example, the Roman law doctrine of *accessio* has been imported in various jurisdictions that belong to different legal background. The Roman concept of *accessio* belongs to the Roman law of property and especially relates to the acquisitive modes of property rights. The doctrine provides that any accessories annexed to a principal chattel will become the

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[285] Mattei, U. "A Theory of Imperial Law: A Study on U.S. Hegemony and the Latin Resistance" (2003) 10 *Indiana Journal of Global Legal Studies,* at p. 385.
[286] The World Bank Doing Business Reports are available from http://www.doingbusiness.org/DOWNLOADS/ (last checked 26/04/2010).
[287] See for instance, the European Bank for Reconstruction and Development (EBRD) which published a Model Law on Secured Transactions modelled on Article 9 UCC in 1994, or the UNCITRAL Legislative Guide on Secured Transactions which also adopts the functional approach of Article 9 UCC. See above fn. 103.

It is not surprising to see that the majority of cases[490] revolve around the fundamental question of the characterisation of the charge as floating or fixed[491]. The solution appears to be particularly uncertain in relation to charges created over book debts. The recent case of *Spectrum*[492] is a flagrant illustration of the current difficulties underlying the uncertainties related to the characterisation of the charge. In this case, the court had to determine whether a charge created over book debts was a fixed or a floating charge. The characterisation of the charge was the key issue in the way it was determinant of the rights of the parties in question. If the charge was analysed as being a fixed charge, the bank was entitled to the proceeds of the book debts in priority over other Spectrum's preferential creditors. The court held that the charge in question had to be qualified as floating despite the fact that the parties described it as being a fixed charge in their original agreement. The charge created over book debts had to be qualified as being floating because the bank did not have sufficient control over the account to create a blocked account which would have led to the recognition of a fixed charge. Therefore, Spectrum's preferential creditors were entitled to the book debt proceeds in priority over the bank despite the characterisation by the parties that the charge was fixed rather than floating.

This decision overturned the renowned case of *Siebe Gorman & Co. Ltd. v. Barclays Bank Ltd.* [493]where the court held that a charge created over book debts was characterised as fixed if the debtor was required to pay the proceeds in a separate bank account held with the same bank and, if the parties characterised the charge as being fixed in the agreement[494]. In *Spectrum Plus (Re)*[495], the House of Lords

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[490] For example see, *Quicksons (South and West) Ltd. v. Katz (No2)* [2004] EWHC 2443, [2005] BCC 138, ChD; *Ashborder BV v. Green Gas Power Ltd.* [2004] EWHC 1517, [2005] BCC 634, ChD; *Arthur D Little Ltd. (in administration) v. Ableco Finance LLC* [2002] EWHC 701, [2003] Ch 217, ChD; *Agnew v. IRC* [2001] UKPC 28, [2001] , 2 AC 710; *Smith v. Bridgend CBC* [2001] UKHL 58, [2002] 1 AC 336; *Re Cosslett (contractors) Ltd.* [1998] Ch 495, CA; *Royal Trust Bank v. National Westminster Bank Plc* [1996] BCC 613, CA; *Re New Bullas Trading Ltd.* [1994] 1 BCLC 485, CA; *Re Cimex Tissues Ltd.* [1994] BCC 626, ChD; *Re GE Tunbridge Ltd.* [1994] BCC 563, ChD; *William Gaskell Group v. Highley* [1994] 1 BCLC 197, ChD; *Re CCG International Enterprises Ltd.* [1993] BCC 580, ChD; *Re Atlantic Computer Systems Plc* [1992] Ch 505, CA; *Re Atlantic Medical Ltd.* [1992] BCC 653, ChD; *Re Croftbell Ltd.* [1990] BCLC 844, ChD; *Ex p Copp* [1989] BCLC 13, Ch; *Re Permanent Houses (Holdings) Ltd.* (1989) 5 BCC 151, ChD; *Re Brightlife Ltd.* [1987] 1 BCLC 485, ChD; *Re Armagh Shoes Ltd.* [1984] BCLC 405, ChD; *Re Bond Worth Ltd.* [1980] 1 Ch 228, Ch; Siebe *Gorman & Co Ltd. v. Barclays Bank Ltd.* [1979] 2 Lloyd's Rep 142, ChD.

[491] Goode *op. cit.* fn. 478.

[492] *Re Spectrum Plus Ltd* [2005] UKHL 41, [2005] 2 AC 680.

[493] [1979] 2 Lloyd's Rep 142.

[494] Gullifer *op. cit.* fn. 74, at p. 422.

Article 9 UCC has successfully been transplanted uniformly amongst all States of America. In this respect, it is arguable that the legal transplantation of Article 9 has been successful as legal method to modernise and approximate secured credit law regimes in the U.S. Following the assumption that Article 9 UCC would constitute an adequate model to import in jurisdictions eager to modernise their secured credit law regimes, this study will consider whether legal transplantation of Article 9 UCC could successfully be used as legal method to modernise and approximate secured credit law regimes in other jurisdictions. This examination will particularly focus on European jurisdictions because many of them recently reformed or introduced proposal for reform of their secured credit law regimes[293].

In light of this eagerness to modernise secured credit law regimes, this study will attempt to determine whether the legal transplantation of Article 9 UCC could be successful. This analysis on legal transplants will not consider the feasibility and likelihood of success of legal transplantation of Article 9 UCC in every European jurisdiction; rather it will provide a detailed analysis on the feasibility of such legal transplant in France and England which are representatives of a sample of European jurisdictions that belong to different legal traditions. Particularly, this study will attempt to determine whether the functional approach preserved in Article 9 of the UCC and the idea of a unique security could be retained as a common core principle of secured credit law regimes in France and England.

The question of whether an Article 9 type regime could be transplanted into English secured credit law has largely been debated within the legal doctrine[294]. It has been

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[293] France reformed its secured credit law regime with the Ordinance of 23rd March 2006: '*Ordonnance du 23 mars 2006 relative aux sûretés*'. On the French secured credit law reform, see, Simler, P.H. "La réforme du droit des sûretés - Un Livre IV nouveau du Code civil" (2006) *JCP* 2006, éd. G, n° 13, 29 mars 2006, I 124. England also introduced a proposal for reform in 2002 (Law Commission Consultation Paper No 164). Legal reforms have also occurred in Central and Eastern Europe. On this point see Dahan, F. "Law Reform in Central and Eastern Europe: The 'Transplantation' of Secured Transactions Law" (2000) 2 *European Journal of Law Reform*, at p. 369.

[294] On this point see, Davies, I.R. "The Reform of Personal Property Security Law: Can Article 9 of the US Uniform Commercial Code be a Precedent" (1988) 37 *International Comparative Law Quarterly*, at p. 465; Bridge *op. cit.* fn. 182; McCormack, G. "Personal Property Security Law Reform in England and Canada" (2002) *Journal of Business Law*, at p. 113; McCormack, G. "Quasi-Securities and the Law Commission Consultation Paper on Security Interests – A Brave New World" (2003) *Lloyd's Maritime and Commercial Law Quarterly*, at p. 80; McCormack, G. "Reforming the Law of Security Interests: National and International Perspectives" (2003) *Singapore Journal of Legal Studies*, at p. 1; McCormack, G. "The Priority of Secured Credit: An Anglo-American Perspective"

Notwithstanding these disadvantages mainly associated to the current insolvency law priority regime, it is important to bear in mind that the floating charge remains from a 'technical' point of view a very flexible and valuable security device, extensively used by the commercial practice and well enshrined in the Common Law tradition and in the case law. In practice, it has been argued that lenders would not opt for the floating charge to ensure their priority but for the control that the security device offers[499]. As it has been precisely highlighted by a distinguished academic, "[t]he fixed charge for priority; the floating charge for control"[500]. Priority should not be seen as the sole valuable attribute of security[501]. It is argued that the floating charge would amount to a 'residual management displacement'[502] which would only be beneficial if coupled with fixed charges. A security entitles the creditor to monitor the debtor's assets before default and provides the creditor with control rights of the company by allowing him to appoint a receiver upon the debtor default[503]. However,

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[499] Mokal, R.J. "Liquidations Expenses and Floating Charges-The Separate Funds Fallacy" (2004) *Lloyd's Maritime and Commercial Law Quarterly*, at p. 399 where the author explains that "... while floating charges may result in some recoveries in some minute proportion of insolvencies, the dominant reason for their inclusion in a vast proportion of debentures that create security interests in not to ensure these rare and trivial recoveries. From the creditor's point of view, recoveries by virtue of the priority of the floating charge, if and when they happen, are unpredictable windfalls. So it is not surprising that, generally, floating charges are coupled with fixed ones. The two perform different roles, and it is the fixed one upon which the creditor relies to provide him with priority (and encumbrance and the ability to carry out a risk assessment). This reasoning also allows us to understand that "lightweight" charges are not special type of floating charge, but simply instances where the true nature of all floating charges is particularly obvious, viz, that it is relied upon for reasons that have nothing to do with securing priority."

[500] Westbrook, J. "The Control of Wealth in Bankruptcy" (2004) 82 *Texas Law Review*, at p. 795.

[501] *Ibid.* at p. 806 and see Mokal *op.cit.* fn. 499, at p. 397.

[502] Mokal explains that: "[t]he floating charge plays a distinctive role as a residual management displacement device which can only be effective if coupled with an appropriate set of fixed security that enables its holder to gather information about the competence of the debtor's managers and to control their incentives to misbehave. The floating charge allows the debtor free use of its circulating assets while its management is doing well, and when the management fails, it crystallises to divest them of control even over these assets. At this time, it also contributes to controlling the motivation costs of other creditors by discouraging them from rushing to enforce their claims against circulating assets or threatening to do so, and by ensuring the unity of the debtor's estate under the receiver's control even after the onset of winding-up." Mokal *op. cit.* fn. 7.

[503] See Armour, J., Et al. " Rethinking Receivership" (2001) 21 *Oxford Journal of Legal Studies,* at p. 90 where the author states: "[i]t is conceptually possible to imagine a legal system in which a 'floating charge' offers its holder only control rights and no benefits in terms of priority." See also Franks, J., Et al. "The Cycle of Corporate Distress, Rescue and Dissolution: A Study of Small and Medium Size UK Companies" (2000) *IFA Working Paper 306*, at p. 6 available at http://facultyresearch.london.edu/docs/306.pdf (last checked 26/04/2010), where the author states that: "[t]he crucial feature of the floating charge is that it grants the holder the right to take control of the firm in the event of default, through he appointment of an Administrative Receiver. Control of the firm allows discretion over whether to realize the assets by selling the firm as a going concern or liquidating it. These control rights can considerably influence the size of the proceeds accruing to the creditor."

The experience of other Civilian jurisdictions, notably Quebec, will be fundamental to this analysis on the legal transplantation of Article 9 in France. The debate on legal transplantation occurred in Quebec because of the economic necessity to be in line with secured credit law regimes of North American jurisdictions. Accordingly, Quebec reformed its secured credit law in 1994 with the introduction of a new Civil Code[297] which adopted a unitary concept of security over movables and real estate; the hypothec. Even though Quebec adopted a uniform approach with the concept of 'hypothec', they did not include property-based securities such as retention of title in this unique regime. Further, beyond the terminological and conceptual difficulties faced by legal reformers to transplant Article 9 in Quebec, cultural obstacles such as the willingness to preserve legal culture also played a large part. Accordingly, and in light of the emergence of recent literature on the importance and significance of legal culture[298], a successful legal transplantation of an unfamiliar concept such as the security interest would also appear to be difficult in France.

The first part of this analysis will thus review the literature on legal transplantation and will attempt to determine whether it could theoretically constitute a successful method for legal reform in the light of an approximation of laws. The second part will consider the question of the feasibility and likelihood of success of legal transplantation of Article 9 UCC as legal method to modernise and approximate French and English secured credit law regimes.

CONCEPTUALISATION OF LEGAL TRANSPLANTATION AS LEGAL METHOD OF LAW REFORM

This section will fundamentally attempt to analyse some of the main arguments and theories advanced within the legal transplantation literature. These theories can be classified along a large spectrum of arguments where at one end, it is argued that legal transplantation would simply be impossible following substantial differences in

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[297] Civil code of Quebec is available at www2.publicationsduquebec.gouv.qc.ca/dynamicSearch/telecharge.php?type=2&file=/CCQ/CCQ_A.html (last checked 26/04/2010).
[298] See above Chapter One, at pp. 37-39.

introduced substantial reforms in relation to the priority of preferential creditors over the floating chargee. One of the reforms introduced by the Act was the abolition of the Crown preference over the floating charge to the benefit of the creation of a ring-fenced fund[513] reserved for unsecured creditors. The creation of such ring fenced fund was created in order to prevent floating charge holders from benefiting from a windfall payment following the abolition of the Crown preference[514].

As a result, a fraction of the company assets subject to the floating charge is now reserved in priority for unsecured creditors[515]. It has been analysed from empirical studies that the creation of such a ring-fenced fund to the benefit of unsecured creditors would not achieve significant changes for this category of creditors upon the debtor's insolvency[516]. Moreover, section 176(A) (2) of the Insolvency Act 1986, which provides for the preferential payment of unsecured creditors from the ring-fenced fund, can be excluded under certain circumstances if the liquidator, administrator or receiver believes that the cost of distributing the fund to unsecured creditors "would be disproportionate to the benefits" or if the liquidator, administrator or receiver applies to the court for an order to disapply Section 176(A) (2) on the same grounds[517].

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company available for payment of general creditors does not include any amount made available under section 176A(2)(a); (b) the reference to claims to property comprised in or subject to a floating charge is to the claims of – (i) the holders of debentures secured by, or holders of, the floating charge, and (ii) any preferential creditors entitled to be paid out of that property to them. (3) Provision may be made by rules restricting the application of subsection (1), in such circumstances as may be prescribed , to expenses authorised or approved – (a) by the holders of debentures secured by, or holders of, the floating charge and by any preferential creditors entitled to be paid in priority to them, or (b) by the court. (4) References in this section to the expenses of the winding up are to all expenses properly incurred in the winding up, including the remuneration of the liquidator."

[513] The creation of a ring-fenced fund has already been suggested in a recommendation made by the Cork Committee in 1982 which suggested that 10% of the proceeds of the assets subject to the floating charge should be reserved to unsecured creditors. See Goode, R.M., *Principles of Corporate Insolvency Law*, (2005), at p. 165.

[514] However, the allocation of a prescribed part to unsecured creditors only applies to floating charges created after the 15th September 2003. Lenders who have taken a floating charge before this date will be entitled to this windfall. On this point, see Armour, J. "Should We Redistribute in Insolvency" (2006) in Getzler, J., Et al., *Company Charges Spectrum and Beyond*, (OUP, 2006), at p. 201.

[515] The Insolvency Act 1986 provides that the percentage is 50% of the first £10,000 and 20% of any assets above that figure with a ceiling of £600,000 for the prescribed part. On this point see Gullifer, *op. cit.* fn. 74, at p. 410. See the Insolvency Act 1986 (prescribed part) Order 2003 S.I 2003/2097.

[516] On this point see Gullifer *ibid.* at pp. 410-412.

[517] The case of *Re Hydroserve Ltd.* is the first case where the court has disapplied S176 (A) (2) and considered that making the fund available for unsecured creditors would have been disproportionate to the benefits. *Re Hydroserve Ltd.* [2007] ALL ER (D) 184 Chancery Division.

Watson[300] or Kahn-Freund[301] have developed challenging theories on the viability of legal transplantation. Areas of disagreements vary from the possibility of legal transplantation itself to the likelihood of success of a specific legal transplant.[302]

One of the major difficulties arises from the determinants that have to be taken into account for obtaining a successful legal transplant. In effect, the question of the viability and success of legal transplantation is delicate. What are the relevant criteria for a successful legal transplantation? To what extent is the law transferable between jurisdictions that belong to different legal traditions, different legal cultures, and different political or economical values? Are these components fundamental to the viability and success of legal transplantation? Measuring the success and viability of legal transplantation is not an easy task. One of the main arguments developed against the viability of legal transplantation is that legal transplant would not be possible unless the transferable law was shaped to fit local legal tradition or legal culture[303]. Thus, it is often argued that legal tradition, legal culture or more generally 'local environment'[304] would be part of the relevant and fundamental criteria to consider in the assessment of the viability and success of legal transplantation[305]. Thus, the examination of the literature on legal transplantation will first consider the theories that have focus on cultural criteria to be met for legal transplants to be, if at all, successful. The second part of this examination will focus on the theories that recognise the viability of legal transplantation notwithstanding different cultural backgrounds of recipients' entities.

Review, at p. 44; Kahn-Freund, O. "On Uses and Misuses of Comparative Law" (1998) 37 *Modern Law Review*, at p. 7; Teubner, G. "Legal Irritants: Good Faith in British Law or How Unifying Law Ends Up in New Divergences" (1998) 61 *Modern Law Review*, at p.11; Berkowitz, D. Et al. "Economic development, Legality, and the transplant effect" (2003) 47(1) European *Economic Review,* at p. 165; Small, R.G. "Towards a Theory of Contextual Transplants" (2005) 19 *Emory International Law Review*, at p. 1431; Gillepsie *op. cit.* fn. 283.

[300] Watson *op. cit.* fn. 282, fn. 284, and fn. 299.

[301] Kahn Freund *op. cit.* fn. 299.

[302] Heim *op. cit.* fn. 299, at p. 189.

[303] Montesquieu *op. cit.* fn. 299.

[304] *Ibid.*

[305] See for *e.g.,* Berkowitz *op. cit.* fn. 299.

As part of this study on the floating charge, it is interesting to take on board the experiences of other Common Law jurisdictions which have successfully transplanted Article 9 UCC and accordingly opted for the abolishment of the floating charge. Thus, and to conclude on the floating charge, the subsequent paragraph will particularly consider the experience of some of the Canadian provinces in transplanting Article 9.

The transfer of Article 9 UCC reform experiences to other Common Law jurisdictions and the fate of the floating charge

The Common Law jurisdictions of New Zealand and some provinces of Canada reformed their secured credit law modelled on Article 9 UCC and opted for the abolition of the floating charge. Under New Zealand legislations, creditors can obtain a security interest in a company's fund of assets, presents and futures, while allowing the debtor to freely use the charged assets in the ordinary course of business. This security device is a fixed charge and not a floating charge[520] which shows great coherence with the functional approach of the global security instituted under Article 9 UCC.

The case of Canada is interesting with respect to the floating charge. Ontario was the first Canadian province to adopt an Article 9 type regime within its secured credit law[521]. As Common Law jurisdiction, and indeed very close to the English legal culture, the floating charge was well established among commercial participants. It is therefore not surprising that the transplantation of Article 9 into a legal regime that already had the floating charge led to some significant difficulties. At first, Ontario opted to keep the floating charge apart from the general scope of its secured credit law regime[522]. Shortly after, the Personal Property Security Amendment introduced in 1981[523] permitted creditors to register a floating charge in the PPSA registry[524]. The coexistence of two systems underlying the floating charge led to a myriad of

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[520] Personal Property Securities Act 1999.
[521] Ontario adopted its PPSA in 1967 but the Act did not come into effect until 1973. See Ziegel, J. "The Draft Ontario Personal Property Security Act" (1966) 44 *Canadian Bar Review*, at p.104.
[522] Revised Statute of Ontario, Chapter 375, s. 3(1) (c).
[523] Section 66 a. of the Personal Property Security Amendment Act, S.O. 1981, c.2, s.1.
[524] Wood *op. cit.* fn. 447, at p. 217.

success and viability of legal transplants would be much more uncertain[311]. Therefore, a wide spectrum of hypotheses is recognised where at one end, legal transplantation would be almost automatically successful and where at the other end, legal transplantation would be less likely to succeed. It is explained that where the law is deeply entrenched in a specific jurisdiction's legal institutions and legal system, it would seem difficult to consider the feasibility for successful legal transplants. That is where the argument rejoins the analysis developed by Montesquieu. In effect, while this theory recognises that the environmental factors[312] can constitute some barriers to the success of legal transplantation, it is argued that the political factor has become the true obstacle to such a process[313].

Further theories developed against the desirability and feasibility of legal transplantation as legal method to modernise and approximate legal regimes[314]. Notably, it is argued that the mechanism enshrined in the expression 'legal transplant' is misleading and that it should be more accurate to refer to it as 'legal irritants'[315]. In effect, foreign legal rule so transplanted would drastically affect domestic legal system and 'irritates law's binding arrangements'[316]. Therefore, the question would not be to determine whether a foreign legal rule could be integrated or rejected but to determine how the new system will be absorbed into national legal system and to determine how and to what extent the domestic legal rule will have to be modified following such legal transplantation[317]. Following this assumption, the

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[311] *Ibid.* at p. 5.
[312] *Ibid.* at pp. 8-10.
[313] *Ibid.* at pp. 8-12. Kahn Freund states for instance that: "... the twentieth century has witnessed the development of urbanization, industrialization and communications which has led to "a process of economic, social and cultural assimilation or integration among the developed countries (and also the dominant classes of the developing countries)." Thus, it is essential to take into account the political differences that exist between communists and capitalists nations, between dictatorships and democracies, between presidential and parliamentary regimes or from the role played by pressure groups "in the making and maintenance of legal institutions."
[314] Teubner *op. cit.* fn. 299, at p. 11.
[315] Teubner explains that: "[w]hen a foreign rule is imposed on a domestic culture, I submit, something else is happening. It is not transplanted into another organism, rather it works as a fundamental irritation which triggers a whole series of new and unexpected events. It irritates, of course, the minds and emotions of tradition-bound lawyers; but in deeper sense, - and this is the core of my thesis – it irritates law's 'binding arrangements'." *Ibid.* at p. 12.
[316] *Ibid.*
[317] Teubner explained that legal transplants are 'legal irritants'. In the context of the legal transplantation of the concept of good faith into English Contract law, following the adoption of European Consumer Protection Directive 1994, the author considers the consequences of such a transplant and states: "... what kind of transformations of meaning will the term undergo, how will its

The Law Commission in England shared the same views and did not think that the floating charge should be abolished within an eventual reform of English personal property security law. Instead, it is recommended that the floating charge should be kept and integrated to the general law reform proposal[529]. The preservation of the floating charge would seem to be a better option than its total abolition, considering its advantages, flexibility and popularity within the commercial community. However, the example of the Canadian province of Ontario also showed the great difficulties associated with the adoption of a global security modelled on Article 9 UCC together with the preservation of the floating charge.

Following this analysis on the likelihood of success of the legal transplantation of Article 9 UCC into English secured credit law regime, important formal and technical obstacles have been identified. Especially, the adoption of the functional approach to the regulation of securities seems to constitute a major barrier to a successful legal transplantation. In effect, the adoption of the functional approach would involve significant difficulties in relation to the preservation of property-based securities such as retention of title clauses and specific security devices such as the floating charge.

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[529] Law Commission Report on Company Security Interests No. 296, at Para 3.164 which provides that: "[r]esponses to our proposals to change the distinction between fixed and floating charges were particularly difficult to analyse. First, it has been hard to gauge whether there is a real opposition to our proposals when correctly understood. The floating charge is viewed as enormously important. Some respondents appeared to think that we were suggesting that it should no longer be possible to create floating charges. That was not at all our intention. The scheme proposed was designed to enable fixed and floating charges to be superseded by a new single form of charge that would be more flexible and give the lender better protection. We believe that in terms of the law of security there is a good case for this change." Para 3.171 further provides that: "[w]e believe there is a good case for including in our scheme the provisions that would remove the distinction between fixed and floating charges. We also think an adequate substitute test is available to determine which assets preferential creditors and the unsecured creditors fund should have priority over."Para 3.172 states that: "[h]owever, we recognize that insolvency law has undergone significant changes in recent years, and that there is great unwillingness to see further changes in the immediate future. To maintain it means that the scheme will have to be more complex than we would like. It means that lenders will have to continue to use a 'cocktail' of fixed and floating charges when under the more radical approach advocated in the CR [Consultative Report, Law Consultation Paper No 176] a single charge would have sufficed. However it does not make the scheme unworkable or prevent it being a substantial improvement on the current law." Finally, Para 3.173 explains that: "[i]n the light of this, we have decided not to recommend at present the changes proposed in the CR that would have had the result of removing the distinction between the fixed and the floating charge. The proposed rules should be considered again when insolvency law is next reviewed."

An illustration of the above argument is provided through examples dealing with apparently simple concepts such as 'good faith'[324] or 'fault' which could effectively involve substantial difficulties in the transplant process. If legal reformers were to transfer these concepts from one jurisdiction to another, the specificity and methodology of the recipient jurisdiction could limit the success of the legal transplant. For example, the concept of fault constitutes the basis for the establishment of delictual and tortious liability in most European jurisdictions. However, different jurisdictions may understand the concept of fault differently from one another. The concept of fault is very flexible and it is not surprising that different jurisdictions might adopt different approach towards this notion. One legal system might opt for the establishment of a strict liability through the doctrine of 'presumptive fault'. *A contrario*, one legal system might opt for a less severe liability regime and might require the claimant to prove the existence of a grave fault from the defendant. Therefore, when foreign legal rules are transplanted, the recipient country will implement the legislation according to its own specific legal context which will consequently affect and modify the original borrowed legal rule[325]. Ultimately, it is argued that this process shows the illusory character of legal transplantation as legal method for reform and by way of consequence, its unfeasibility. As it is concluded, the legal transplantation of a legal rule or legal concept also involves the transplantation of a legal culture and legal *mentalité*.

These theories challenge the feasibility of legal transplantation because of the differences of legal cultures between the donor and recipient legal systems. In this perspective, it is arguable that the legal transplantation of a secured credit law regime in jurisdictions of different legal traditions and different legal, economic or political background could generate substantial obstacles. Other academics argued that legal transplantation is feasible. In support of this argument, it is observable that the law largely developed through legal transplantation, many of which happened between entities that had nothing in common. An illustration of this phenomenon can be

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[324] Teubner considers that the transplantation of certain concepts such a "good faith" could lead to substantial complexities within the recipient country's legal rule. Especially, he refers to the legal transplantation of the concept of good faith into English Contract law following the adoption of European Consumer Protection Directive 1994, the author considers that such transplant will lead to substantial complexities and will act as legal irritants to the domestic legal rule. See above, fn. 317.
[325] Harlow *op. cit.* fn. 322.

Before the enactment of the ordinance, the *Commission Grimaldi*, affected to the task of reforming the law[532], considered Article 9 of the UCC and had to determine whether it should reshape French secured credit law according to the American model. In other words, reformers had to determine whether they should opt for a single security device modelled on Article 9 or keep the traditional French system characterised by a multitude of security mechanisms, including property-based security[533]. The question emerged to determine whether the legal transplantation of Article 9 could successfully modernise French secured credit law. The Commission considered that it would have been a mistake to transplant rules from a different legal context such as the ones enacted in Article 9 UCC into the French legal system. Especially, it was emphasised that the transplantation of Article 9 could not be envisaged without a reform of insolvency law and a reform of fundamental baseline concepts of property law.

It is generally recognised that the Common Law background of Article 9 UCC would constitute an obstacle in itself to the successful legal transplantation of such regime in Civilian jurisdictions such as France. Yet, the Civilian jurisdiction of Quebec adopted a similar regime to the one enshrined in Article 9 of the UCC. Quebec reformed its secured credit law with the introduction of a new Civil code in 1994[534]. In order to be in line with other North American countries, Quebec adopted a unitary concept of security over movables and real estate; the hypothec. Even though Quebec adopted a uniform approach with the concept of hypothec, they did not include 'quasi securities' or property-based securities such as retention of title. This separation has been the object of many discussion and controversies[535] in Quebec. In

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[532] The Minister of Justice gave the task to reform the French law of security to the *Commission Grimaldi* in September 2003.

[533] Crocq, P. "La Réforme des Sûretés Mobilières" in Picod, Y., Et al., *Le Droit des Sûretés à l'Epreuve des Réformes,* (2006).

[534] Text available at www2.publications-du quebec.gouv.qc.ca/home.php# (last checked 26/04/2010).

[535] The minister of Justice stated: "[a]insi, le code n'a pas retenu la présomption d'hypothèque dont l'effet aurait été d assimiler à une hypothèque toute convention qui procurait au créancier un avantage dans la réalisation de sa créance. L'introduction d'une telle présomption risquait d aller a l'encontre de la conception civiliste du droit des obligations et des sûretés. Elle aurait entrainé également une incertitude juridique considérable en raison des litiges que ne manquerait pas de soulever la difficulté de qualifier certaines conventions... La solution retenue a considéré plutôt à apporter, dans d'autres dispositions du code, un tempérament aux difficultés dénoncées relativement aux conventions qui procurent au créancier un avantage sur les autres créanciers." Commentaires du Ministre de la Justice (Québec : Ministère de la Justice, Les Publications du Québec, 1993), (The "Minister's Commentary") at p. 1654.

into their own legal systems[330]. Moreover, these successful legal transplants did occur at a time where social, economic, geographical and political context highly differed from the donor to recipients countries[331].

Legal transplantation should be understood as the transfer of an idea of the foreign legal rule[332]. If the 'idea' of the foreign legal rule appears to be a good idea, legal reformers should extensively analyse the idea as enshrined in the foreign legal rule and consider whether this idea could fit within their domestic legal system[333]. Although the structure of the recipient country is not considered as being relevant; it is conceded that the transplant of the idea of the foreign legal rule may differ once transferred in the recipient country[334]. Following this latest remark, the success of the legal transplant becomes questionable. If the reception of the legal rule differs amongst the various recipient jurisdictions, it may lead to new divergences which could ultimately challenge the success itself of a specific legal transplant and undermine the use of legal transplantation as legal method to achieve an approximation of laws[335].

Following the examination of some of the arguments advanced within the literature on legal transplantation, the recognition of a comprehensive theory that could predict the success of a specific legal transplant would appear to be uncertain. In order to verify some of the arguments advanced within the literature on legal transplantation, the next development will consider a specific case study dealing with the legal transplantation of a specific legal concept into the laws of jurisdictions that belong to different legal traditions. It is important to consider the phenomenon of legal transplantation in the context of recipient entities that belong to different legal

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[330] *Ibid.* at p. 313.

[331] Watson naturally questions "[h]ow otherwise could one explain the use made of Roman law by fifth-century Germanic tribes, the acceptance of so much Roman law dating from different periods and different political circumstances in the Middle Ages and later by so many diverse States in Western Europe, in monarchies, oligarchies and republics alike." Watson *op. cit.* fn. 326, at p. 80.

[332] Watson explains that: "...legal rules, in addition to being part of the social structure, also operate on the level of ideas." Watson *op. cit.* fn. 327, at p. 315.

[333] McDonough *op.cit.* fn. 299, at p. 508.

[334] Watson questions: ""[d]o legal rules reflect a society's desires, needs and aspirations?" The answer which is ordinarily given or is just assumed is positive though minor qualifications are usually urged. ... With transmission or the passing of time modifications may well occur, but frequently the alterations in the rules have only limited significance." Watson *op. cit.* fn. 327, at p. 313.

[335] See the above arguments and the culturalist theories, and especially the explanation provided by Teubner and the implementation of the concept of good faith at fn. 317 and fn. 324.

will also be considered in light of the potential implementation of a global security and its functional approach. This section argues that the adoption of the functional approach and its security interest in France is unlikely, especially in light of recent reforms that would seem to reinforce and expand the use of property-based security devices, particularly through the institution of the *fiducie*.

Thus, this section will first consider the terminological obstacles that could occur from the legal transplantation of Article 9 in France and will further consider the obstacles that could occur from the adoption of the functionalist approach and from the adoption of the global security interest.

Terminological obstacles

The appointed entity for the revision of the Civil code[538]in Quebec appeared to be quite hostile, in a first time, to the transplantation of an Article 9 type regime and raised significant objections in that direction. First, the Committee identified some terminological problems that are not irremediable but worth mentioning. It has been argued that the Uniform Commercial Code was not strictly speaking a code but rather a collection of disparate laws contained in a single legal instrument[539]which could be difficult to transplant in a Civilian jurisdiction such as Quebec. As it has previously been pointed out, the concept of codification differs within Civilian and Common Law jurisdictions. In effect, Civil Law jurisdictions such as France opted for a codification of its law but only in the form of general principles in order to fit with the deductive logic used by legal practitioners and courts. This approach to codification is substantially different from the American approach which code only materialises detailed and distinct laws. This approach could constitute a formal obstacle to the legal transplantation of Article 9 if it was to be integrated into the French Commercial code.

Furthermore, the Committee for the reform of the Civil code in Quebec also found that the style, content and structure of the code were very complex and unclear.

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[538] *Comité des Sûretés de l'Office de Révision du Code Civil de la Province de Québec.*

[539] Carron, Y. "L'Article 9 du Code Uniforme de Commerce peut-il être Exporté? Point de Vue d'un Juriste Quebecois" (1969) in Ziegel, J., Et al., *Aspect of Comparative Commercial Law*, (1969), at p. 374 also cited in Riffard, J.F., *Le Security Interest ou L'Approche Fonctionnelle et Unitaire des Sûretés Mobilières, Contribution à une Rationalisation du Droit Français*, (LGDJ 1996).

the way it is absorbed by each recipient country may lead to substantial divergences amongst them. Accordingly, the importation of the principle of *accessio* could lead to the implementation of different legal regimes. Such eventuality would challenge the success itself of the legal transplant. Thus, it will be interesting to see how the concept of *accessio* has been absorbed in jurisdictions from different legal traditions. In order to test the theories, the next development will examine the legal transplantation of the Roman law doctrine of *accessio* through a comparative analysis of its incorporation into French and English property law, which jurisdictions belong to different legal traditions.

The legal transplantation of accessio in France

In France, the concept of *accessio* is embodied in Article 546 of the Civil code which provides that ownership of a thing, either movable or immovable, gives a right to everything it produces and to what is accessorily united to it, either naturally or artificially. That right is called the right of *accession*. Thus, it is through union or production that this extension of property rights operates. 'Production' is used to designate the natural or cultural fruits and revenues produced by the land. These products will become the property of the owner's of the land by way of *accession*[338]. *Accession* through union or incorporation relates to everything that unites or incorporates itself to the main or principal chattel. The owner of the *'principal'* will become the owner of the accessories by way of *accession. Accession* through incorporation or union covers numerous situations and is, therefore, meticulously detailed in the Civil code in its Articles 551 to 577[339]. Although the Civil code provides for some considerable guidance with respect to the application of the

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[338] On the theory of *accessio*, refer to Articles 547 to 550 *C.Civ.* For example, Article 547 *C.Civ.* provides that "[n]atural or cultural fruit of the land; Revenues; Increase in stock, belong to the owner by right of accession." Article 548 *C.Civ. (Act no 60-464 of 17 May 1960)* provides that "... the fruits produced by a thing belong to the owner only on condition that he repays the costs of ploughing, works and seeds incurred by third parties and whose value must be assessed at the date of repayment." Article 549 *C.Civ. (Act no 60-464 of 17 May 1960)* provides that "[a] mere possessor makes fruits his own only where he possesses in good faith. If not, he is bound to restore the products with the thing to the owner who claims it; where the said products are not found in kind, their value must be appraised at the date of repayment." Article 550 *C.Civ.* provides that "[a] possessor is in good faith where he possesses as owner, under an instrument of transfer of whose defects he does not know. He ceases to be in good faith from the time those defects are known to him."

[339] Article 551 *C.Civ.* provides that "[e]verything which unites and incorporates itself with a thing belongs to the owner, according to the rules hereafter laid down."

transplantation of Article 9 UCC in French law. Furthermore, and as it has lengthily been demonstrated within the above analysis on the legal transplantation of Article 9 in England, the adoption of a global security modelled on the security interest would lead to significant difficulties in relation to property-based securities such as retention of title clauses. In support of the preservation of property-based securities, France recently expanded its list by introducing the *fiducie*. The expansion of property-based security mechanisms within French secured credit law regime would thus tend to depart from the approach retained in Article 9. As part of this study on the potential viability of the legal transplantation of Article 9 UCC in France, it will be interesting to take on board the experience of other Civil Law jurisdictions which have transplanted Article 9 UCC such as Quebec which law reforms experience will be considered. Ultimately, this section suggests that the legal transplantation of Article 9 UCC as legal method to modernise French secured credit law may be unlikely to succeed, in light of conceptual incompatibilities and particularly fundamental cultural incompatibilities.

The concept of 'real right' and the 'security interest'

As it has already been explained, a security over movables is analysed as being an accessory of the real right[543]. A security provides the creditor with an 'accessory real right' on the property given as collateral. The debtor remains the owner of the asset and his property right is qualified as principal real right, usually embracing the traditional attributions of '*usus*', '*fructus*' and '*abusus*'[544]. The direct consequence of such an analysis is that the security will be subject to the same outcome as the debt itself. Would the debt be extinguished, the security would also disappear.

This qualification of 'real right' has important legal effects for creditors. First, the creditor is entitled to a '*droit de préférence*'[545]allowing him to a priority on the collateral given as security if the debtor becomes insolvent. Secondly, the creditor is

[543] Piette *op. cit.* fn. 233.
[544] '*Usus*' designates the right to use the property; '*fructus*' designates the right to collect the "fruits", *i.e.* the benefits of the property; and '*abusus*' designates the right to destroy and alienates the property.
[545] Preferential right.

entitled to a '*droit de suite*'[546]which permits him to seize the asset in the hand of third parties if the debtor defaults.

The analysis of the legal nature of a 'security' has important implications for the question of the potential transplantation of an Article 9 type regime in France. As it has already been mentioned in the introduction, its scope of coverage is large and includes any kind of movables, corporal and incorporeal property. Thus, any personal property assets, debts or shares can be used as collateral for security purposes. The collateral can embrace a universality of assets, or can even include the proceeds obtained from the sale of the collateral[547]. The list is not exhaustive and only illustrates the global character of the 'security interest'. Thus, it could be difficult to conceive the analysis and notion of real right in relation to certain types of assets, covered in Article 9, such as incorporeal property. The difficulty comes from the idea that a real right can only be in relation to an existing and determined movable[548]. Therefore, it could be *'maladroit'* to define a potential global security, including such a wide range of types of property, as a real right[549].

The notion of real right associated to the concept of security within Civilian jurisdictions has always led to substantial theoretical debates. Particularly, the limits of a security law regime based on the notion of real right in respect of security created in intellectual property assets have already been highlighted in Chapter Two. Again, it would seem difficult to demonstrate the existence of a real right in respect of incorporeal property. Despite the fact that incorporeal property is insusceptible of physical appropriation, it has to be highlighted that the owner of such property still has a right '*de facto*' over the asset, an authority similar to the one offered under physical possession[550]. Thus, it has been argued that the intangible character of the

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[546] Right to follow the assets in the hands of third parties.
[547] §9-306 (3) UCC provides that if the collateral (purchase money security interest) is sold the security interest continues in the proceeds if they can still be identifiable.
[548] In effect, one can possess property and hold a right but it is difficult to see how one could materially possess a right.
[549] Brierley, J. "Le Droit des Biens dans le Nouveau Code civil du Quebec" (1995) 47(1) *Revue Internationale de Droit Comparé*, at p. 40.
[550] Cabrillac, M., Et al., *Droit des Sûretés*, (2007), at p. 377.

asset used as collateral would not compromise the principle of real right associated to the notion of security[551].

Quebec had to deal with this issue when they reformed its secured credit law regime, and introduced the concept of the 'hypothec' modelled on the American security interest. Surprisingly, the hypothec is still defined as a real right[552] notwithstanding the critics expressed following the analysis of such a notion[553]. The definition seems to retain the creditor's preferential right and the right to 'follow the property into whosever hands it may be'. Rather than keeping the idea of real right with its '*Droit de préference*' and '*Droit de suite*', it would have been more appropriate to simply refer to the creditor's hypothec 'enforceable right' against third parties[554]. In effect, considering the broadened scope of the hypothec, the real character of the creditor's right does not seem to be any longer relevant. Thus, it is argued that the new hypothec, embracing such a new large range of assets, dictated the new content and object of property law in Quebec[555].

One could legitimately question why legal reformers kept this materialist approach of the real right notion together with the transplant of this new global security, the hypothec. One of the major justifications lies in the fact that Quebec is part of a strong legal culture which embraces legal concepts and notions that will be difficult to wipe away, especially in respect of property law concepts. Also, it might be easier for the legal and commercial community to keep certain components which they are familiar with in order to facilitate the transition and reach a successful legal transplant[556].

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[551] Pelissier, A., *Possession et Meubles incorporels*, (2003).
[552] Article 2260 *C.Civ.* provides: "[a] hypothec is a real right on a movable or a immovable property made liable for the performance of an obligation. It confers on the creditor the right to follow the property into whosever hands it may be, to take possession of it or to take it in payment, or to sell it or cause it to be sold and, in that case, to have a preference upon the proceeds of the sale ranking as determined in this code" cited in Brierley *op. cit.* fn. 549, at p. 41.
[553] The traditional and usual notion of real right postulates that it cannot exist in every form of goods, especially intangibles.
[554] Brierley *op. cit.* fn. 549, at p. 41.
[555] *Ibid.*
[556] *Ibid.* at p. 42.

The legal transplantation of Article 9 UCC in France would arguably lead to similar terminological issues. Article 9 does not recognise property rights but interests in property. Although, it is noticeable that the concept of real right may have lost some of its significance, especially following the reform introduced in France in 2006, the concept of security interest could not be imported without reforming the baseline concepts of French property law. French property law only recognises rights in property and not interests in property. Thus, and similarly to England, further difficulties could emerged in relation to property-based security such as the retention of title clause mechanisms. In effect, the importation of the functional approach would involve a complete reconceptualisation of retention of title clauses within French secured credit law regimes as it will be now envisaged.

The retention of title clause dilemma

The legal transplantation of Article 9 UCC would also have important implications in relation to property-based securities such as retention of title clauses. As the above examination already highlighted, Article 9 of the UCC do not recognise retention of title clauses but recognise a similar mechanism relabelled as the purchase money security interest. The question of the potential legal transplantation of Article 9 UCC in French secured credit law would raise the issue of whether to include retention of title clauses in the unitary regime. In the light of this analysis on retention of title clauses, it is interesting to note that many of the arguments developed above on the exportability of Article 9 UCC in England could also be relevant under this section. In effect, France also retained a similar approach to retention of title clauses by treating them as property-based security. In that sense, most of the criticisms addressed previously to the feasibility of a successful legal transplantation of Article 9 UCC into English law would also become pertinent for France. Retention of title clauses are very popular security device within the commercial community in France and it will be interesting to expose some of its main features. Despite the existence of some uncertainties faced by sellers, it is arguable that the legal transplantation of Article 9 as legal method to modernise the law would not be successful in France.

For a long time, Civil Law jurisdictions did not conceive that property could be used as a security device[557]. Therefore, it is not surprising that the legal recognition of retention of title clauses is only quite recent. Before 1980, French courts did not contest the validity in itself of the clause but they often condemned retention of title clauses in the case of the debtor's insolvency[558]. The retention of title clause implies that the seller's goods are not transferred into the debtor's pool of assets until full payment. Therefore, the seller remains the owner of the assets and can therefore claim them back in the situation of an insolvency proceeding against the debtor. Sellers, with a retention of title clause, could therefore escape the '*loi du dividende*', normally applied to other creditors within an insolvency proceeding[559]. This is the equivalent to the *pari passu* principle recognised under bankruptcy and insolvency laws in England.

The fact that property could not be used for security purposes was criticised and started to be contested within French local courts[560]. The French supreme court, *Cour de Cassation* finally condemned this solution in 1934[561]. The reasoning adopted was that the goods sold under a retention of title clause were part of the *apparent*[562] debtor's pool of assets and that sellers could not recover their assets sold to the insolvent buyer. The seller could only recover them if he had given notice before the opening of the insolvency proceeding. The doctrine generally agreed to this new ruling and judges applied the law accordingly and very strictly[563]. This inevitably led to the quasi disappearance of the retention of title clause mechanism but not for long.

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[557] A security over movable property is analysed as being the accessory of a real right. It would be difficult to consider how a property-based security could be qualified as an accessory of a real right.
[558] Saint-Cène, M. "Retention of title Clauses in France" (1999) in Davies *op. cit.* fn. 398, Chapter Five.
[559] See e.g. Pérochon, F., *La Réserve de Propriété Dans la Vente de Meubles Corporels*, (1988).
[560] See e.g. *Bordeaux, 26th July 1899*, D.P. 1901. 2. 152; *Bourges, 17th February 1902*. D.P. 1902. 2. 448; *Rouen, 19th March 1931*, J. Faill.1931. 231, *Paris, 23rd May 1932*, G.P. 1932. 2. 387; *Caen, 29th June and Grenoble, 4th July 1932*, G.P. 2. 843; *Angers, 23rd November 1932*, G.P. 1933. 1. 571; *Limoges, 3rd March 1933* and *Grenoble, 13th March 1933*, G.P. 1933.2. 46; *Nîmes, 13th May, Lyon, 29th May and Riom, 8th June 1933*, G.P. 1933. 2 424.
[561] *Cour de Cassation, CCiv. 22nd October and 28th March 1934*, D.P. 1934. 1. 151, n. J. Vandamme.
[562] It is apparent for other creditors that the goods sold under a retention of title clause are part of the debtor's pool of asset. In fact, they do not have the knowledge of the existence of such a clause. Therefore, when creditors lend money to the debtor, they legitimately think that the debtor's assets will secure their credit. This is the theory of the "*Apparente solvabilité*" (apparent solvability of the debtor or 'false health').
[563] Pérochon *op. cit.* fn. 559.

The Law of 12th May 1980[564], *Loi Dubanchet*, confirmed by the Law of 25th January 1985, now recognises the action[565] of the seller to recover his goods[566] sold under retention of title clause in the context of an insolvency procedure. With the introduction of the *'action en revendication'*, the creditor is now entitled to the recognition of his property right and to the recovery of his goods upon the debtor's insolvency. This innovative legislation was followed by the Law of 10th June 1994 which also constitutes a major step in the French legal history of retention of title clauses. This law reinforced the protection of the creditor's interests by increasing his prerogatives[567].

Finally, Article 13 of the Ordinance of 23rd March 2006[568] integrated new regulations in relation to the retention of title clause now incorporated in the Civil code. The Ordinance provides a definition of the retention of title clause now enshrined in Article 2367 *C.civ*[569]. Also, the ordinance now establishes the conditions to be fulfilled in order to draft a valid retention of title clause (Article 2368 *C.civ*). Finally, the ordinance fixes the legal regime applicable to the different types of retention of title clauses (Articles 2369 and 2370 *C.civ*)[570].

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[564] The Law of 12th May 1980. *Loi n°80-335 du 12 mai 1980 relative aux effets des clauses de réserve de propriété dans les contrats de vente.*

[565] The Law of 25th January 1985. *Loi n°85-98 du 25 janvier 1985 relative au redressement et à la liquidation judiciaires des entreprises.*

[566] The goods have to be in kind at the time of the insolvency proceedings opening in order to be entitiled to claim them back.

[567] Two measures have been introduced with the Law 10th June 1984. First, the law has created an optional publicity mechanism of the contract of sale affected by a retention of title clause. If the creditor gave notice of his contract of sale with a retention of title clause, he will not need to introduce an *'action en revendication'* but only an *'action en restitution'* which is a much easier and quicker procedure. Secondly, the law allows the vendor to claim back incorporated goods subject to retention of title if they can be removed without damage. This claim in kind can also be exercised over fungibles goods if they are of the same type and same quality. *Loi no 94-475 du 10 Juin 1994 relative à la prévention et au traitement des difficultés des entreprises.*

[568] Ordinance No 2006-346, 23rd March, 2006, *Article13 Journal Officiel du 24 Mars 2006.*

[569] Article 2367 *C.Civ.* now provides a definition of retention of title clauses. It states that: "[o]wnership of a property may be retained as security through a clause of retention of title which suspends the transferring effect of a contract until payment in full of the obligation which compensates for it. Ownership so retained is the accessory of the debt whose payment it secures."

[570] The ordinance of the 23rd March 2006 now deals with the problem of incorporation. Article 2370 *C.Civ.* now provides that the incorporation of a good subject to a retention of title clause to another goods can still be claimed by the seller if it can be separated without damages.
Article 2371 *C.Civ.* deals with the right to surplus. It provides that if the value of the good recovered is higher than the original debt, the creditor will have to give the difference back to the debtor. Article 2372 *C.Civ.* deals with the proceeds of resale and provides that the creditor will be able to replace the position of the buyer if the latest has sold the goods to a third party through the mechanism of the subrogation. This mechanism will be only possible if the third party has not yet paid the purchase

Theses legal changes have certainly favour a substantial increase in the use of retention of title clauses within the commercial community but it is arguable that the law did not go far enough towards a successful modernisation of retention of title mechanism. As under English law, the recognition of retention of title clauses in France also creates the problem of ostensible ownership[571] and also leads to important difficulties relating to the nature of the buyer's and seller's rights. Again, and as for the Common Law jurisdiction of England, the adoption of an Article 9 type regime would avoid these difficulties. Furthermore, it is recognised that the adoption of the American model would substantially expand the pool of assets available to creditors by establishing the validity of extended clauses with the purchase money security interest which is the not the case under the current French regime.

Reforming the law relative to security and specifically to retention of title is a delicate undertaking. As it has been previously explained within the analysis of a potential transplant of Article 9 in England, a reform modelled on the unitary security interest would involve substantial reform of the baseline concepts of property law in France. In effect, French law also distinguishes between property rights and priority rights which do not coincide with the current American functional approach. The difficulty lies with the fact that a property-based security such as the retention of title clause relates to sale of goods transactions and not to security transactions.

A reform modelled on Article 9 UCC would involve substantial legal and policy issues that will need to be tackled in a balanced approach. For instance, the delicate question of the good faith purchaser should be considered within a reform of security law. If a *bona fide* purchaser enters in possession of the goods originally sold under retention of title and if the buyer becomes insolvent, the question emerges whether

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price to the buyer so he can pay it to the seller straight away. This implies that the seller had notice of the resale by the buyer. The same solution will be applied in the situation where the goods have been destroyed. The money from the insurance can be paid directly to the creditor through the system of the subrogation.

[571] The issue of ostensible ownership has been partially solved thanks to the law 10th June 1994 which instituted an optional publicity mechanism for retention of title clauses. Such publicity would reward sellers by offering them a simplified action for the recovery of their property upon the debtor's insolvency (*action en restitution*).

the asset should be returned to the original owner or whether the good faith purchaser should become the new owner[572]. Who should prevail? If a third party is buying goods in good faith from the insolvent buyer, the first time seller will not be able to recover his assets sold and secured under retention of title clause. In effect, according to Article 2276 of the French Civil Code, "*[e]n fait de meubles, la possession vaut titre*"[573], the good faith purchaser will become the legal owner of the goods bought from the insolvent buyer. The seller will not recover the goods but will only be entitled to damages from the insolvent buyer. If the third party did not buy the goods in good faith[574], the first time seller will be able to recover his goods in the hand of the bad faith purchaser.

This problem could have easily been solved with the creation of a compulsory publicity and registration mechanism in relation to retention of title clauses as in Article 9 of the UCC. Such a publicity mechanism would prevent third parties from using Article 2276 Civil code in their favour. In fact, how could third parties pretend to be in good faith if the retention of title clause was published? This publicity system was already suggested by the '*Groupe Grimaldi*'[575] but has not been kept in the ordinance of 23rd march 2006.

Another important limit to retention of title for creditors relates to extended retention of title clauses such as proceeds and manufactured clauses. If the asset sold under retention of title has been resold or manufactured[576], the creditor will not usually be able to recover his property upon the debtor' insolvency[577]. One solution would have been to extend the scope of the retention of title as it has been done with the purchase money security interest under Article 9 of the UCC. In effect, according to the American model, if the debtor resells or manufactures the asset, the security interest

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[572] Piette *op. cit.* fn. 233.
[573] "In matters of movables, possession is equivalent to a title."
[574] *i.e.*, with the knowledge that there was a retention of title clause attached to the goods.
[575] " Groupe de Travail Relatif a la Réforme du Droit des Sûretés, Rapport à Monsieur Dominique Perben, Garde des Sceaux, Ministre de la Justice", 28th March 2005, http://droit.wester.ouisse.free.fr/textes/TD_suretes/rapport_grimaldi_28_mars_2005.pdf (last checked 26/04/2010).
[576] Goods can still be recovered if they have been manufactured only if the assets are still identifiable, *i.e.*, if the assets can be separated without damage. See above fn. 570.
[577] Exceptions are provided in Articles 2370 and 2372 of the Civil code. See above fn. 570.

will continue in the transformed collateral[578]. However, the adoption of the purchase money security interest would involve the abandonment of ownership within the regulation of French secured credit law regime. This would lead to significant practical and legal problems. Such a scheme would involve the abolishment, or at least involve substantial reform, of Article 1583 of the French Civil code which governs the transfer of property within the French sale of goods law[579]. The modification of such Article would lead to substantial bouleversement within the commercial and economic life[580]. In this respect, the example of Germany is interesting to consider. In effect, Germany also recognises the validity of manufactured clauses under certain conditions. In principle, according to Article 950 BGB[581], manufactured clauses are not valid unless the retention of title clause allows the buyer to manufacture the goods on behalf of the seller, thus, allowing the latest to retain title in the new asset[582]. This position is interesting to consider in the way it aims to achieve similar goals than of the security interest by expanding the pool of assets available to creditors without interacting or modifying the rules of property law.

The adoption of a similar regime validating extended retention of title clauses would however lead to substantial difficulties in France. If the seller is entitled to use his 'right to trace' in relation to transformed goods, the question of the calculation of the added value to the original goods would come to light. Moreover, the adoption of the German model in relation to extended retention of title clauses would not solve the

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[578] The equivalent of 'extended retention of title' is regulated by Article § 9-306 1) UCC which provides that: "[p]roceeds" clauses are valid and the security interest continues in the proceeds. (3) The security interest in proceeds is a continuously perfected security interest if the interest in the original collateral was perfected but it ceases to be a perfected security interest and becomes unperfected ten days after receipt of the proceeds by the debtor. The security interest in the proceeds must be re registered within 10 days."The equivalent of enlarged retention of title is regulated by Article § 9-314 (Accessions) and 9-315 (Priority when goods are commingled or processed) UCC. The equivalent of all monies retention of title clause is regulated by § 9-204 UCC.

[579]Article 1583 *C.Civ.* provides that the sale is complete between the parties, and ownership is acquired as of right by the buyer with respect to the seller, as soon as the thing and the price have been agreed upon, although the thing has not yet been delivered or the price paid. It has been proposed a reform according to which transfer of property should be subordinated to the payment of the price. On this point: Mouly, C. "Faut-il Retarder le transfert de Propriété" (1995) *JCP éd. CI 1995,* supp. No 5.

[580] Riffard *op. cit.* fn. 539, at p. 163.

[581]BGB §950, first Para.: "... who creates a new moveable by processing or transforming one or more raw materials, acquires property of the new moveable, if the value of the processing or transforming is not substantially below that of the raw material."

[582] Monti *op. cit.* fn. 419, at p. 869.

issue of the ostensible ownership, despite the establishment of the optional publicity mechanism instituted by the law 10th June 1984. Thus, extending the scope of the retention of title mechanism would seem difficult to achieve considering the specificity of such a security device which relates to sale of goods transactions. Legal reformers in France might have found a solution to an extended use of property-based securities inspired from the Anglo-American trust mechanism relabelled under the term of *fiducie*. In effect, the law of 19th February 2007[583] recently instituted the *fiducie* under French law which introduced substantial modernisation to the French Civil code following its previous reform on security law[584].

The introduction of the *fiducie*: the extension to the use of property-based securities

The *fiducie* is defined in Article 2011 *C.civ.* as a transaction whereby one or more settlors transfer assets, rights, or sureties, or a group of assets, rights or sureties, present or future, to one or more trustees who, keeping them separated from their own patrimony, will act according to a specific purpose in the interest of one of more beneficiaries. Two types of *fiducies* are recognised under French law; the '*fiducie gestion*' and the '*fiducie sûreté*'. The latest allows the debtor to transfer assets to the trustee in order to secure payment of a debt. If the settlor defaults, the creditor will be entitled to the *fiducie* and the newly created patrimony will be attributed to him. On the other hand, if the settlor honours his debt, the trustee will have to retrocede the assets accordingly. Since the Law on the Economic Modernisation of 5th August 2008, the *fiducie* can be created by any individual or legal person[585]. However, it is recognised that this security device would lack the simplicity and flexibility recognised under the retention of title mechanism. The validity of such security device is subject to registration in a special registry[586]and must be recorded in written with several burdensome and compulsory mentions[587].

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[583] *Loi n° 2007-211 du 19 Février 2007 instituant la fiducie* (1) available from http://www.legifrance.gouv.fr/affichTexte.do?cidTexte=JORFTEXT000000821047&dateTexte= (last checked 26/04/2010).
[584] Reform introduced with the Law of 23rd March 2006.
[585]Under the original law of 19th February 2007 introducing the *fiducie* in the Civil code, only legal persons were allowed to become trustees.
[586] Article 2020 *C.Civ.*
[587] Article 2018 *C.Civ.*

The *fiducie* arrangement functions as a transfer of property with an affectation of the assets to a separated patrimony. This mechanism does not relate to sale of goods transactions but belongs to secured transactions[588]. The *fiducie* uses ownership for security purposes with the exclusive aim to provide the creditor with a preferential payment upon the debtor's default. The recognition of the *fiducie* has proved to introduce a significant modernisation within French secured lending legislation with a definite aim to harmonise its law with other jurisdictions. Nevertheless, the introduction of the *fiducie* into the French law of security has been criticised and it is believed that its recognition would eventually lead to the quasi disappearance of other security devices such as the traditional pledge. Ultimately, it is arguable that the security law system in France would essentially be founded on property-based security including the retention of title mechanism and the '*fiducie-sûreté*'[589].

Beyond these interesting recent legal reforms within French secured transactions law, it is important to emphasise that the legal reform of 2006 did not adopt the unitary concept of a global security[590] nor the registration scheme recommended by the *Groupe Grimaldi*. It is arguable that the main obstacle to the successful legal transplantation of Article 9 in France would lie with the significant place given to property rights together with the conservation and extension of property-based securities within its legislation on secured credit. In light of this analysis on the legal transplantation of Article 9 UCC in France as legal method to modernise its secured credit law regime, it will be interesting to consider the case of Quebec where the legal transplantation of Article 9 was used to modernise and approximate the law. It is arguable that the experience of Quebec to transplant an Article 9 type has not yet been totally successful. Particularly, it is interesting to highlight that Quebec adopted a global security device modelled on Article 9 but preserved property-based security such as the retention of title clause. Accordingly, it is arguable that the legal

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[588] Similar to the retention of title mechanism, the *fiducie* uses ownership for security purposes. However, the *fiducie* does not belong to the category of sale of goods transactions but still operates a transfer of title for security purposes. Thus, as for the retention of title clauses, the *fiducie* is a property- based security device.

[589] Riffard *op. cit.* fn. 539, at p. 163.

[590] France did not adopt a global security modelled on Article 9 of the UCC. However, the reform has simplified the categorisation of securities over movables property into four categories. Article 2329 *C.Civ.* provides that securities over movables are; Prior charges over movables (*Privilèges*), Charges over corporeal movables (*Gages*), Charges over incorporeal movables (*Nantissements*) and Retention of title clauses (*Clause de Réserve de Propriété*).

transplantation of Article 9 and its functional approach did not totally succeed in Quebec. Ultimately, this concluding section will argue that the legal transplantation of Article 9 would also face fundamental obstacles related to the cultural backgrounds in Civilian jurisdictions.

The legal transplantation of Article 9 UCC in Quebec: a mixed success

Since the reform made in 1999 in Quebec, the retention of title must be published within fifteen days of its creation[591] in order to be enforceable against third parties. However, Article 1749 Civil code of Quebec (CCQ thereafter) provides that if the contract of sale, subject to retention of title clause, is not published or published late, the seller has still the right to recover his property only if it is still in the hands of the original buyer. Therefore, the Civil code does not consider the publication to be a condition of validity of the clause but only a condition of enforceability against third parties which differ from the American position.

In the case *Ouellet (Trustee of)*[592], the debtor bought property from a seller with retention of title. After a few years, the buyer became bankrupt and a trustee in bankruptcy was appointed. The seller claimed his property back on the basis of the retention of title clause. The trustee rejected the claim because the seller did not publish the retention of title at the time of the sale[593]. The legal question was to determine whether unpublished retention of title could be set up against the trustee in bankruptcy. The Superior Court and the Court of Appeal held that the seller could not recover his property and that an unpublished retention of title clause was not enforceable against the trustee in bankruptcy.

The Supreme Court of Canada allowed the appeal on the basis that the property sold to the buyer, under a non published reservation of title, never became part of his pool of assets. Moreover, under the Article 1749 CCQ, the trustee in bankruptcy was not considered as a third person acquirer. Therefore, as the trustee in bankruptcy is only

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[591] The publication in the RPMRR (Register for Personal and Movable Real Rights) of reservations of title is now compulsory since 1998. Failure to publish, results in the repossession of the goods by the buyer (only if property is still in the hands of the first buyer (Article 1749 CCQ)).
[592] *Ouellet (Trustee of)*, [2004] 3 SCR 348, 2004 SCC 64.
[593] Article 1745 CCQ.

vested with the rights and obligations of the bankrupt buyer, he could not reject the claim of the seller, still considered to be the owner of the goods[594]. This decision of the Canadian Supreme Court goes against the new disposition of the Civil code that requires quasi securities to be registered in order to be enforceable against third parties[595]. Although Quebec adopted a similar regime to the American Article 9 UCC, it seems that retention of title clauses have kept much of their original form and legal regime. Retention of title clauses were not included in the general regime of the hypothec, and the registration requirements appear to be somehow quite artificial.

Beyond the formal and substantial limits that have been analysed above, other reasons can be advanced for the justification of this reluctance to adopt the American regime. Civilian jurisdictions are eager to preserve their legal culture. An integral legal transplantation of the American Article 9 could be seen as a threat to the conservation of the Civilian legal identity. This movement to protect the diversity of legal cultures is an important component to take into account in the assessment of the success of the legal transplantation of the American Article 9 UCC. This trend to protect legal cultural has already been discussed during the *General Agreement of Tariffs and Trade* (GATT) in 1993 under the doctrine of 'cultural exception'[596].

Further, the World Bank recently published a series of Reports "Doing Business"[597] stating, for instance, that Civilian's security law was inadequate to the Economic growth in general. The *Association Henri Capitant*[598] published two volumes of answers to these reports[599], refuting some incorrect data and criticising the

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[594] *See.* fn. 592.
[595] Deschamps *op. cit.* fn. 537.
[596] Gordon, P.H., Et al., The French Challenge: Adapting to Globalization, (2001), at p. 48.
[597] See the "Doing Business" Reports published by the World Bank: "Understanding regulation" (2004), "Removing obstacles to growth" (2005), "Creating jobs" (2006) and "how to reform" (2007) available at http://www.doingbusiness.org/ (last checked 26/04/2010).
[598] Association Henri Capitant des Amis de la Culture Juridique Française. See http://www.henricapitant.org/ (last checked 26/04/2010).
[599] The first volume only provides the views and critics of the French Group : " Réponse de l'Association Henri Capitant aux Rapports "Doing business" de la Banque Mondiale - Les droits de tradition civiliste en question », volume 1. The second volume provides for other views on the World Bank reports from 23 other civilian jurisdictions: "Réponse de l'Association Henri Capitant aux Rapports "Doing business" de la Banque Mondiale - Les droits de tradition civiliste en question, volume 2." These volumes are available from http://www.henricapitant.org/search/node/les%20droits%20de%20tradition (last checked 26/04/2010).

controversial method of analysis used by the authors, but mainly, trying to determine the advantages of Civil Law jurisdictions in an economic context.

The first volume of responses, in respect of those Reports 'Doing Business', strongly criticised the use of the economic analysis as a method to assess the adequacy of national commercial law and as a method to determine the easiness of doing business within different jurisdictions[600]. Furthermore, the response proceeds to a verification of the pertinence of the data used and proceeds to a verification of the conclusions drawn by the World Bank. Particular emphasis was given on the structural and substantial advantages of the Civilian Law tradition to regulate economic activities[601]. The volume concludes that the law, whether part of the Civilian or the Common Law traditions, has got it own value and, consequently, should exclude its subordination to the economic analysis.

The willingness of the World Bank and other international entities[602] to reduce the differences among the different legal systems' fundamental legal values to a unique common denominator can be assimilated to the eternal quest of 'finding the lowest price at the lowest costs'. As it has been highlighted by the president of the *Association Henri Capitant*, '*... Après les Low Costs, la Low Cost Law*?'[603] The law should not only be generated through abstract equations and solely through the economic analysis. Of course, the economic analysis and promotion of economic growth are important to the elaboration of the commercial law but other essential values such as legal culture, political, social environment and other components also have their importance in the making of the law. Accordingly, proponents of the conservation of legal cultures argue that, since law is cultural and that there cannot be a universal culture, there cannot be and there should not be a universal law[604].

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[600] See Chapter One at pp. 33-39.
[601] *Association Henri Capitant des Amis de la Culture Juridique Française.* "Les Droits de Tradition Civiliste en Question : A Propos des rapports Doing Business de la Banque Mondiale". See above fn.127.
[602] Endeavours for the approximation of secured credit law regimes can be found with international initiatives such as UNCITRAL, EBRD, or UNIDROIT. See above fn. 104.
[603] Association Henri Capitant des Amis de la Culture Juridique Française, "Communiqué de presse : présentation officielle du volume 1 "Les droits de tradition civiliste en question" à la Caisse des Dépôts et Consignation, effectuée le 26 avril 2006."
[604] *Ibid.*

The point made by the *Association Henri Capitant* is not to favour a certain legal culture to another but to determine whether one can provide for a rational justification for the adoption of a foreign legal system. The movement towards the protection of legal culture is particularly strong in Civil Law jurisdictions and would arguably constitute a significant obstacle to the successful legal transplantation of Article 9 UCC in France.

CONCLUSION

This analysis attempted to determine whether the legal transplantation of Article 9 UCC could be used as legal method to modernise and approximate secured credit law regimes in some European jurisdictions. Legal transplantation has been widely used as method for legal reforms, particularly during Roman times. An analysis of the literature on legal transplantation did not manage to provide for a general theory that could determine *a priori* the likeliness of success of a specific legal transplant. Some theories argue that a legal transplant could be successful because the legal rule can be integrated in a foreign legal system, no matter how. Other theories consider that legal culture would substantially undermine the success of legal transplantation. These theories further assert that the way the legal rule is integrated is part of the assessment of a successful legal transplant. Accordingly, if the legal rule is integrated and subsequently differently applied in different recipient's jurisdictions, the legal transplant would not be successful.

The case study dealing with the legal transplantation of the Roman law concept of *accessio* did not manage to confirm the arguments advanced in the theories. Although the Roman legal concept was successfully integrated in the laws of different entities such as France or England, the way it has been absorbed shows some divergences which could undermine the success of the legal transplant. Legal transplantation would fail as legal method to modernise the law in the light of an approximation of laws. Nevertheless, it is concluded that this core principle of the Roman law of property still, has been integrated in the law of different jurisdictions despite some divergences in its application. Similarly, it was considered whether the concept of the security interest enshrined in Article 9 could be transplanted for law reform purposes in jurisdictions from different legal backgrounds.

Article 9 UCC was fundamental to consider because it has uniformly modernised the laws of every States in America. Accordingly, the question emerged whether the legal transplantation of Article 9 UCC could similarly modernise and approximate secured credit law regimes in European jurisdictions. The analysis was restricted to England and France which are representatives of a sample of jurisdictions that belong to different legal traditions. The examination of the literature on legal transplantation did not provide a clear guidance on a determination *a priori* of the likelihood of success of such legal transplants. Thus, this analysis adopted a pragmatic approach by attempting to assess the feasibility and desirability of the legal transplantation of Article 9 UCC in English and French legal regimes.

It was showed that the legal transplantation of Article 9 UCC as legal method to modernise English secured credit law regime remains uncertain. Although, it is recognised that the adoption of a code as legal receptacle for legal reforms may only create a relative obstacle, it is further explained that the true obstacle to the legal transplantation of an Article 9 type in English secured credit law would lie with the functional approach retained in the legal rule. In effect, English law retained a substantial approach to the regulation of its secured credit law, so that each security device is regulated by a specific set of rules. This analysis demonstrated that the functional approach regulating a global security interest would substantially alter the fundamental baseline property law concepts well entrenched in English law. For example, the importation of the functional approach would remove the use of property security devices, such as retention of title mechanisms.

Most importantly, it was emphasised that the true obstacle to the successful legal transplantation of Article 9 as legal method to modernise secured credit law regime in England would lie with the existence of the floating charge. It is argued that the floating charge already offers similar benefits than the ones offered under the American security interest. In effect, similarly to the floating charge, the floating lien also enables the debtor to give a security on actual and future assets and use the charged assets in the normal course of business. The main difficulties identified in respect of the floating charge lie with the priority system which belongs to insolvency law regimes and not to secured credit law regimes. Thus, following an

analysis of the floating charge, it is difficult to recognise a coherent rationale behind the importation of an Article 9 type regime as a means to modernise English secured credit law regime. This demonstration thus concluded that a successful legal transplantation of an Article 9 type regime into English secured credit law regime remains uncertain as a successful legal method to modernise the law.

It was further considered whether the legal transplantation of Article 9 could successfully be used as legal method to modernise secured credit law regime in France. To this end, the law reforms experience of Quebec, also part of the Civil Law tradition, was considered. Indeed, Quebec integrated, to a certain extent, Article 9 UCC. It is argued that the experience of Quebec in transplanting Article 9 has not yet been totally successful. Although Quebec adopted a global security device modelled on Article 9, property-based security devices, such as the retention of title clauses were preserved. Similarly, it is argued that the transplantation of the American model may also be uncertain in France in light of substantial terminological incompatibilities and in light of the functional approach retained in Article 9. The main obstacle to the legal transplantation of Article 9 in France would lie with the reconceptualisation of retention of title clauses, needed to successfully import the American regime. Further, since the introduction of the *fiducie*, it seems that French secured credit law regime now largely depends upon property-based security mechanisms rather than evolving towards a more functional approach and towards the adoption of the unitary security interest.

The experience of the Civilian jurisdiction of Quebec was fundamental to consider within this analysis on the transferability of the American model in France. In effect, the transplantation of Article 9 in Quebec highlighted some of the difficulties related to property law concepts that French law could encounter in transplanting the American model. Further, such comparative analysis also highlighted that beyond the terminological and conceptual difficulties faced by legal reformers to transplant Article 9 in Quebec, cultural obstacles such as the willingness to preserve a specific legal culture would also play a large part. Accordingly, and in light of the emergence of recent literature on the importance and significance of legal culture, a successful legal transplantation of an unfamiliar concept such as the security interest appears to

be uncertain in France. It is thus arguable that if national laws and legal cultures are to be preserved, the quest for the modernisation and approximation of laws through legal transplantation would also become uncertain. Although, the endeavours to protect legal cultures are important, they should be balanced with the need to modernise and approximate legal regimes when needed. In this respect, it is explained that:

"[l]egal conservatism and a protectionist attitude towards "legal tradition" can, if not appropriately managed, become major obstacles to successful reform."[605]

It is further recognised that:

"[t]he protection of legal tradition and the integrity of the legal system are to be encouraged but they have to be balanced against the need of markets to move forward."[606]

To conclude, the use of the legal transplantation of Article 9 UCC as legal method to modernise and approximate French and English secured credit law regimes is unlikely to be successful. Particularly, it was emphasised that legal culture can create significant obstacles, especially in jurisdictions that belong to the Civilian traditions. If national legal identity can constitute a substantial obstacle to the success of certain legal transplants, a more accommodating legal method, such as legal harmonisation, may stand better chance to successfully modernise and approximate secured credit law regimes. Legal harmonisation involves the accommodation and reduction of national legal differences for law reform purposes. To the difference of legal transplantation, legal harmonisation does not involve the adoption of a foreign legal regime into the law of a recipient entity. Instead, legal harmonisation proceeds to the identification of legal differences and attempts to accommodate them for law reform purposes. The use of legal harmonisation as legal method to modernise and approximate secured credit law regimes will thus be considered in subsequent developments.

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[605] Dahan, F., Et al. "Legal Efficiency of Secured Transactions Reform: Bridging the Gap Between Economic analysis and Legal Reasoning" in Dahan, F., Et al., *Secured Transactions Reform and Access to Credit,* (2008), at p. 124.
[606] *Ibid.* at p. 126.

CHAPTER FOUR

HARMONISATION AND THE MODERNISATION OF SECURED CREDIT LAW REGIMES

INTRODUCTION

In recent years, endeavours to harmonise secured credit law regimes have particularly been productive to support the growth of regional economic markets. In effect, the recognition of free movement of goods and services among certain jurisdictions led to the necessity to establish more harmonious commercial laws[607]. Significant examples of harmonisation initiatives can be found within regional economic organisations such as the North American Free Trade Agreement (NAFTA)[608], the Mercado Común Del Sur (MERCOSUR) [609] or the European Single Market[610] where the necessity to recognise harmonious legal rules among Members

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[607] Rosett, A. "Unification, Harmonization, Restatement, Codification, and Reform in International Commercial Law" (1992) 40 *American Journal of Comparative Law,* at p. 685.

[608] The North American Free Trade Agreement is a trade organisation comprising the United States, Canada and Mexico which was created in 1994. Harmonisation has essentially been supported by the United States of America. Most provinces of Canada adopted a personal property security law regime modelled on the Article 9 UCC. Mexico has not opted for a similar regime but it has been suggested that the adoption of such regime would enhance trade and economic activities within NAFTA Member States. In this perspective, it would be more appropriate to talk about legal transplantation rather than harmonisation. Gopalan states for instance that: "... it would be safe to say that harmonization within the NAFTA context is "Americanization"" in Gopalan *op. cit.* fn. 135, at p.138.

[609] The Common Market of the South is a regional trade agreement founded in 1991 by the Treaty of *Asunción*, later amended by the Treaty of *Ouro Preto* which purpose is to promote free trade and free movement of goods. Members include Paraguay, Uruguay, Argentina and Brazil. Article 1 of the Treaty of *Asunción* provides that: "[t]he States Parties hereby decide to establish a common market, which shall be in place by 31 December 1994 and shall be called the "Common Market of the Southern Cone" (MERCOSUR). This Common Market shall involve: The free movement of goods, services and factors of production between countries through, inter alia, the elimination of customs duties and non-tariff restrictions on the movement of goods, and any other equivalent measures." Furthermore, Article 25 of the Treaty of *Ouro Preto* provides that: "[t]he Joint Parliamentary Commission shall endeavour to speed up the corresponding internal procedures in the States Parties in order to ensure the prompt entry into force of the decisions taken by the Mercosur organs provided for in Article 2 of this Protocol. Similarly, it shall assist with the harmonization of legislations, as required to advance the integration process. When necessary, the Council shall request the Joint Parliamentary Commission to examine priority issues."

[610] Article 2 of the Treaty establishing the European Community provides that: "[t]he Community shall have as its task, by establishing a common market and an economic and monetary union and by implementing common policies or activities referred to in Article 3 and 4, to promote throughout the community a harmonious, balanced and sustainable development of economic activities, a high level of employment and of social protection, equality between men and women, sustainable and non-inflationary growth, a high degree of competitiveness and convergence of economic performance, a

has proved to be a *sine qua non* condition to the successful development of economic activities. In this context, it is important to highlight that harmonisation is not only used to approximate legal regimes but is also used as legal method for law reform. Accordingly, the question of whether legal harmonisation could successfully be used as legal method to approximate and modernise secured credit law regimes will be addressed in this chapter.

Harmonisation can be broadly defined as a means to reduce and accommodate legal differences amongst various national legal regimes. In this respect, harmonisation can also be used as legal method for law reform. Zamora explains that:

"[h]armonization does not entail the adoption of a single, model set of rules, but instead implies a wide range of ways in which differences in legal concepts in different jurisdictions are accommodated. This accommodation can take place in many ways: by a process of law reform in one or more countries, reflecting influences beyond the jurisdiction's borders; by the mediation of private law concepts adopted by parties caught between two legal systems; or by a myriad of other contact points between legal regimes, from academic writings, the conceits of law professors, to visit the government officials to neighboring countries."[611]

Harmonisation is often associated with legal unification but this analysis clearly distinguishes between these two legal terms. While unification of law requires the establishment of a unique supra national legal rule, harmonisation of law requires national legal reformers to amend their internal laws so as to reduce differences between their legal regimes. The function of legal reform attributed to harmonisation is fundamental to this analysis. In effect, it is recognised that harmonisation and modernisation of the law should coincide. The harmonisation of secured credit laws should also come with the aim to reach a modern, efficient and predictable secured credit law regime as defined in Chapter Two. Accordingly, it is arguable that the use of legal harmonisation as legal method to modernise and approximate secured credit law regimes will be successful if the accommodation of differences amongst various national legislations can also lead to substantial modernisation of the law. Such exercise would require considerable comparative law analysis of the current differences underlying various national secured credit law regimes in order to

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high level of protection and improvement of the quality of the environment, the raising of the standard of living and quality of life, and economic and social cohesion and solidarity among Member States."

[611] Zamora, S. "NAFTA and the Harmonization of Domestic Legal Systems: The Side Effects of Free Trade" (1995) 12 *Arizona Journal of International and Comparative Law*, at p. 403.

determine whether an accommodation is, if at all, possible. Such a task would go beyond the scope of this analysis. Thus, this examination will restrict its analysis to a specific case study on the harmonisation of some aspects of secured credit law regimes in the European Union (thereafter, EU). Harmonisation of law will be considered in the context of the EU because this is one of the main methods used by European legislators to reform and approximate the law, especially through the use of European Directives. Directives have to be integrated into national laws through legal reforms. In this sense, Directives do achieve a reconciliation and accommodation of legal differences among Member States national legal regimes.

In the context of the EU, it is arguable that the harmonisation and modernisation of the law should be achieved so as to support the good functioning of the single market. If the harmonisation of secured credit law regimes is desirable in the EU, especially in light of the requirements of the single market, the competence of the EU to legislate in the sphere of secured credit law regimes becomes questionable. In effect, the regulation of secured credit law regimes would involve substantial reform of contract law, property law and insolvency law which may restrict the extent to which the Community may interfere in the field of secured credit. Further, the regulation of secured credit law regimes also involves delicate policy issues which outcomes may differ amongst the various European jurisdictions, and which outcomes may also be difficult to accommodate.

The EU already used harmonisation as legal method to attempt to approximate and modernise some aspects of secured credit law regimes in European Member States. The EU Directive on Late Payment attempted to harmonise retention of title clauses[612]but remained largely unsuccessful. The Directive only provides in its Article 4 that "Member States shall provide in conformity with the applicable national provisions designated by private international law that the seller retains title to goods until they are fully paid [...]". Plainly, it only requires Member States to apply the relevant law according to their private international law, which they would do in any case. Accordingly, it is arguable that the Late Payment Directive did not

[612] Directive 2000/35/EC of the European Parliament and of the Council of 29th June 2000 on Combating Late Payment in Commercial Transactions, OJ L 200, 8.8.2000.

succeed in introducing a uniform secured credit law regime. A more successful attempt has perhaps been achieved with the EU Financial Collateral Arrangements Directive[613]which required Member States to introduce into their national laws financial collateral arrangements. The analysis of the Directive falls outside the scope of the thesis but it is important to acknowledge this EU harmonisation attempt in the field of secured credit. The Directive aimed at introducing a common legal framework for financial collateral arrangements by introducing effective rules which will contribute to the integration of European financial markets and stimulate cross-border transactions and competitiveness.

The Directive adopts a different approach to the approximation of certain aspects of national secured credit laws than the Late Payment Directive. The Directive adopts a more functional approach where the goals are set through the elaboration of a common set of rules rather than attempting to conciliate and accommodate differences. However, and as for the Late Payment Directive, the recognition of a common legal framework to the regulation of financial collateral agreements did not totally succeed in providing a comprehensive approximation of secured credit law regimes. These types of agreements are restricted in their scopes. In effect, it enables creditors to obtain a security right only in respect of specific types of assets. The Directive only covers financial collaterals in the form of cash or financial instruments[615]. Furthermore, parties to the financial collateral agreement are also restricted to public authorities; public sector bodies; central bank and a financial institution subject to prudential supervision[616]. The Directive also provides for an opt out clause in Article 1(4)(b) which allows Member States to further restrict the scope of application of financial collateral arrangements. Finally, the Directive also required Member states to keep the formalities to a minimum which created some

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[613] Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements.

[615] Article 2(1)(d), "cash means money credited to an account in any currency, or similar claims for the repayment of money cash as money market deposits" and article 2(1)(e) "financial instruments" means shares in companies and other securities equivalent to shares in companies and bonds and other forms of debt instruments if these are negotiable on the capital market, and any other securities which are normally dealt in and which give the right to acquire any such shares, bonds or other securities by subscription, purchase or exchange or which give rise to a cash settlement (excluding instruments of payment), including units in collective investment undertakings, money market instruments and claims relating to or rights in or in respect of any of the foregoing".

[616] Article 1(2).

difficulties for national legislations to comply and thus hampered to a certain extent the harmonisation of the internal financial market[617].

Although, the EU already attempted to harmonise the law with the enactment of the Directive on Late Payment[618]and the Financial Collateral Arrangements Directive[619], it is questioned whether the EU could have gone further in modernising and approximating secured credit law regimes. The Late Payment Directive is particularly significant to consider for the purpose of this study on whether harmonisation could be successful as legal method to modernise secured credit law regimes in European jurisdictions. Accordingly, the question of whether the harmonisation of secured credit law regimes, particularly retention of title clauses regulations, could be successful as legal method to modernise the law in European jurisdictions will be considered in this chapter.

To this end, this analysis will attempt to determine whether an accommodation of legal divergences on retention of title clauses can, if at all, be reached in the EU. The identification of current divergences amongst all EU jurisdictions would go beyond the scope of this analysis. Consequently, this analysis will be restricted, as for previous chapters, to a sample of European jurisdictions; France and England. These two jurisdictions are interesting to consider because they are representatives of different legal cultures within the EU. In both jurisdictions, retention of title clauses enable the seller to delay the passing of title upon the payment of the purchase price by the buyer. If simple retention of title clauses are valid in both jurisdictions and are also accepted within the dispositions of the European Directive[620], difficulties can arise where the insolvent buyer resells or manufactures the goods before payment. These eventualities create uncertainties for sellers who may not be able to enforce their proprietary rights upon default. Retention of title clauses are property-based security devices which are mainly regulated through national property law[621]. This comparative law analysis will thus have to identify the legal differences that exist

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[617] The meaning of the EU Financial Collateral Arrangement has recently been discussed in England, in light of the floating charge in *Gray v. G-T-P Group* [2010] EWHC 1772.
[618] See fn. 612.
[619] See fn. 613.
[620] See fn. 612.
[621] See Chapter Three at pp. 118-130 and pp. 153-159.

between baseline concepts of French and English property laws in order to determine whether a reconciliation is possible. Although both jurisdictions recognise the power of the seller to use of ownership for security purposes, there are substantial divergences in the definition and concept of 'property' itself that could be difficult to accommodate. This comparative analysis will further attempt to identify the differences underlying the regulations of the buyer's and seller's rights before payment so as to determine whether a reconciliation is, if at all, possible. Finally, this comparative analysis will consider the regulations underlying retention of title clauses in light of the protection afforded to third parties, especially in light of the publication requirements and the Civilian concept of the *numerus clausus*. Ultimately, this comparative analysis will permit to determine whether legal harmonisation would succeed in approximating and modernising the law underlying retention of title clauses in France and England.

The first part of this analysis will analyse some doctrinal aspects of harmonisation as legal method to modernise secured credit laws in Europe and will be followed by an analysis on the harmonisation of retention of title clauses regulation in the EU. Such an analysis will ultimately attempt to determine whether the accommodation and reconciliation of specific aspects of secured credit law regimes in France and England could lead to a successful modernisation of the law.

DOCTRINAL ASPECTS OF HARMONISATION AS LEGAL METHOD TO MODERNISE SECURED CREDIT LAW IN THE EU

Although the expression 'harmonisation' is extensively used by academics and more generally by law reformers within the commercial law sphere, there is sometimes some confusion and divergences in the terminologies that the expression encompasses. For instance, legal harmonisation and legal unification are often used interchangeably in the legal literature. However, this analysis clearly distinguishes between these two terms. Therefore, it would be useful to instigate this demonstration with an analysis on the nature of harmonisation and with the identification of a working definition that will be retained throughout subsequent developments. This section will further seek to put harmonisation into context by

analysing its use as legal method for law reform, particularly within regional economic organisations.

In recent years, one of the motive forces towards legal harmonisation has been driven by the considerable enlargement of regional economic markets. The introduction already cited some of the major harmonisation initiatives led by regional economic organisations such as NAFTA[622], MERCOSUR[623] or the European Single Market[624]. The case of the EU is interesting to consider, as legal harmonisation is often used as legal method to approximate and modernise the law of Member States. In the context of secured financing, it is arguable that the lack of harmonious secured credit law regimes among Members States could constitute substantial barriers to the development of their economic activities. Adversely, it is also arguable that the preservation of diversity in secured credit law regimes of Member States could also promote economic activities by encouraging innovation and by providing a wider choice of legal methods for structuring finance for international traders[625]. In the context of the EU and in the light of the achievement of the Common Market, the question emerged whether harmonisation of secured credit laws would be desirable. Before considering the question of the desirability of harmonisation in Europe, the next section will provide a definition of harmonisation that will be retained throughout this analysis.

Nature of harmonisation

Some academics consider harmonisation as a word with 'considerable elasticity'[626] including, in its complete sense, an "... absolute uniformity of legislation among the adopting jurisdictions"[627]. The expression 'harmonisation' would therefore cover a

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[622] See fn. 608.
[623] See fn. 609.
[624] See fn. 610.
[625] Mattei, U. "The issue of European Civil Codification and Legal Scholarship: Biases, Strategies and Developments" (1998) 21 *Hastings International and Comparative Law Review,* at p. 883.
[626] Ziegel, J. "Harmonization of Private Laws in Federal Systems of Government: Canada, the USA and Australia" (1997) in Cranston, R., *Making Commercial Law: Essays in Honour or Roy Goode*, (Oxford, 1997), at p. 133.
[627] *Ibid.*

large spectrum of legal methods[628] with the objective to create and implement more uniform legal rules with different degree of approximation. At one end of the spectrum, harmonisation of laws would designate a mutual recognition of similar legal concepts through national legal reforms without the need to impose any particular form or detailed legal rules. At the other end of the spectrum, harmonisation would also encompass a codification, a supra national legal instrument recognised by states, which would evidently require a greater degree of approximation and consensus among the signatory states.

This broad definition would therefore include unification of law projects where one single legal regime relative to a specific area of law is created and adopted by a number of different jurisdictions[629]. In the context of secured credit laws, some attempts have already been made at the international level for the establishment and recognition of uniform legislations[630]. Unification of law instruments include for instance, international conventions such as the United Nations Convention on Contracts for the International Sale of Goods[631], model laws such as the EBRD Model Law on Secured Transactions[632]or, international legislative guides such as the UNCITRAL Legislative Guide on Secured Transactions[633]. Unification of law, according to this definition, becomes the ultimate and most complete form of harmonisation. Indubitably, unification of laws as ultimate form of approximation is

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[628] Goode provides that "[t]here are at least nine methods by which harmonisation may be either effected or in some measure induced, namely: (1) a multilateral Convention without a Uniform Law as such; (2) a multilateral Convention embodying a Uniform Law; (3) a set of bilateral Treaties; (4) Community legislation – typically, a Directive; (5) a Model Law; (6) a codification of custom and usage promulgated by an international non-governmental organisation; (7) international trade terms promulgated by such an organisation; (8) model contracts and general contractual conditions; (9) restatements by scholars and other experts." Goode *op. cit.* fn. 262, at p. 57.

[629] See Goode, R.M. "A Credit Law For Europe" (1976) 23 *International and Comparative Law Quarterly,* at p. 247 where the author provides that: "[u]nification is, of course, a much more complete process, since what emerges is a single code which – given a method of ensuring uniformity of interpretation – is applied in all the states which adopt the uniform enactment. The difficulty of unification in practical terms is that it entails not merely a consensus on concepts but agreement on detailed drafting, and unless the area to be covered is reasonably narrow the project has little hope of being carried through the fruition."

[630] Chapter Five will consider the use of unification as legal method to modernise and approximate secured credit law regimes.

[631] United Nations Convention on Contracts for the International Sale of Goods, Vienna, 11 April 1980.

[632] European Bank's Model Law on Secured Transactions 1994.

[633] UNCITRAL Legislative Guide on Secured Transactions available from www.uncitral.org.

not an easy process and bears significant difficulties[634], such as the risk that international conventions will never come into force because of substantial incompatibilities with internal legislations, lack of interests from states or lack of time within the legislative timetable[635]. The use of international conventions as legal method to approximate and modernise secured credit law will be considered in greater depth in Chapter Five.

Others scholars retain a narrower conceptual approach and define harmonisation as a means to make "... the regulatory requirements or government policies of different jurisdictions ... more similar."[636] In this sense, harmonisation of laws would not include unification of law instruments but would only attempt to co-ordinate and approximate national laws through legal reforms[637]. Comparative law efforts are thus fundamental to the use of harmonisation as legal method for law reform, especially for the harmonisation of legal regimes that belong to different legal traditions. It is explained that:

"[u]nlike unification which contemplates the substitution of two or more legal systems with one single system, harmonisation of law arises exclusively in comparative law literature, and especially in conjunction with interjurisdictional, private transactions. Harmonisation seeks to 'effect an approximation or co-ordination of different legal provision or systems by eliminating major differences and creating minimum requirements or standards.'[638],[639]

It is further explained that harmonisation,

"... which looks beyond matters of legal technique, obviates much fruitless discussion and opens new possibilities for cooperation with countries having different legal structures. These possibilities are particularly important to attempts to

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[634] Ancel, M. "From the Unification of Law to its Harmonization" (1977) 51 *Tulane Law Review,* at p. 108.
[635] Goode, R.M. "International Restatement of Contract and English Contract Law" (1997) *Uniform Law Review*, at p. 231.
[636] Leebron *op. cit.* fn. 259, at p. 66. According to Hansson, "[h]armonization ... is defined as the coordination of economic policy actions and measures in order to reduce international differences in such actions." Hansson, G., *Harmonization and International Trade*, (1950), at p. 1.
[637] Zamora explains that harmonisation does not solely occur through legal reforms. It can also occur "... by the mediation of private law concepts adopted by parties caught between two legal systems; or by a myriad of other contact points between legal regimes, from academic writings, the conceits of law professors, to visit the government officials to neighboring countries" in Zamora *op. cit.* fn. 611, at p. 403.
[638] Kamba, W. "Comparative Law: A Theoretical Framework" (1974) 23 *International Comparative Law Quarterly* 485, at p. 501.
[639] De Cruz, P., *Comparative Law in a Changing World*, (1999), at p. 24.

harmonize the laws of countries with the Common law and those with the continental Roman system."[640]

Harmonisation would thus appear to be much more flexible method for law reform that would allow for more possibilities and options to legal reformers towards the recognition of common legal solutions, especially in the context of jurisdictions that belong to different legal traditions.

Harmonisation and unification of laws are thus considered as two distinct legal methods for law reform. Harmonisation is understood as a means to bring more similarities, accommodate legal differences amongst national legal regimes through national legal reforms. Harmonisation of secured credit laws would therefore require coordinating and approximating national laws of different jurisdictions through national legal reforms. Comparative law analysis will thus constitute an essential tool in this study on the harmonisation of secured credit laws in Europe considering the co-existence of different legal regimes and legal traditions such as the Common Law and Civilian legal traditions. Harmonisation of law is considered in the context of the EU because this is one of the main methods used by European legislator to reform and approximate the law, especially through the use of European Directives as it will now be exposed. European Directives have to be integrated into national laws through legal reforms. In this sense, European Directives achieve a reconciliation and accommodation of differences among Member States legal regimes. The next section will attempt to put harmonisation into context by analysing its use as legal method for law reform, especially within regional economic organisations such as in the EU.

The use of harmonisation as legal method of secured credit law reform in the EU

According to the definition retained above, harmonisation of secured credit law regimes would require the accommodation of a wide variety of differences among national legal concepts and rules through the process of legal reforms. With the growth of regional economic organisations, harmonisation of laws has been

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[640] Ancel *op. cit.* fn. 634, at p. 108.

commonly used as legal method for reform in order to promote and enhance economic activities within these regional free markets. Harmonisation therefore plays a considerable role in the development of economic activities, especially within the recent expansion of regional economic organisations. Regional organisations such as NAFTA, MERCOSUR or the EU are very keen to promote the recognition of more harmonious legal regimes so as to facilitate and expand trade among Members States[641]. Accordingly, harmonisation has become a fundamental method of law reform that may enable those who want to compete in a competitive market to keep the costs of goods and services as low as they can.

In relation to secured transactions regimes, the growth of cross-border transactions generates the imposition of higher interest rates on debtors mainly resulting from the uncertainties faced by creditors towards the validity and enforcement of their security rights at the international level. This situation could indubitably deter potential traders from dealing with certain jurisdictions, which could ultimately undermine the endeavours of regional economic markets to enhance their economic activities.

For instance, the U.S. and some provinces of Canada, Members States of the North American Free Trade Agreement, have in place a similar personal property security law regime based on the recognition of a unique security interest together with a notice filing and a first to file priority systems. Mexico, also part of the NAFTA Agreement does not recognise similar functional secured credit law regimes[642]. It has been argued that this situation could lead to difficulties in relation to the validity and

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[641] On this point see Abbott, F. "Regional Integration and the Environment: The Evolution of Legal Regimes" (1992) 68 *Chicago Kent Law Review,* at p. 189; Delbrük, J. "Globalization of Law, Politics, and Markets-Implications for Domestic Law-A European Perspective" (1993) 1 *Indiana Journal of Global Legal Studies,* at p. 9; Zamora *op. cit.* fn. 611, at p. 402 where the author states: "[i]t is obvious that NAFTA has a harmonizing effect on North American law. As a free trade agreement, NAFTA sets forth common rules for international trade and other transnational economic activity that must be adhered to by the NAFTA Parties and it requires that national laws conform these rules. However, the implications of NAFTA for harmonization of Canadian, Mexican and U.S laws go far beyond the sphere of international trade in goods. For one thing, the NAFTA Agreement includes several chapters that deal with non-trade issues. For instance, NAFTA chapters on foreign investments (Chapter 11), cross-border trade in services (Chapter 12), and trade in financial services (Chapter 14) deal with subjects that are only indirectly tied to merchandise trade, although they involve transnational legal problem."

[642] On this point see Wood, P., *Maps of World Financial Law*, (2008), at p. 119. See Figure 28: "Supermap: Global Security Interests considers that Mexican secured credit regime is limited on security."

enforcement of foreign security interests and, lead to difficulties in relation to the availability of secured finance for other Member States in the Latin jurisdiction[643].

These difficulties have been highlighted following an empirical Study[644] which included various scenarios involving secured credit law regimes of NAFTA Member States. This study was led by Professors Cuming, Nelson and Kozolchyk, and showed that Mexico did not offer the same credit loans facilities as in Canada and the U.S. and, thus, did not contribute to the facilitation and expansion of international trade among NAFTA Members. In this perspective, the National Law Center for the Inter-American Free Trade launched the Secured Financing Project in 1995, in order to assist the harmonisation of secured credit laws among NAFTA Members[645].

Beyond the harmonisation efforts, this study has also been the opportunity to provide a detailed review of Mexico's secured credit laws which proved to be extremely useful to lawyers and traders wishing to extent credit using personal property assets as collaterals in Mexico. Although this Study refers to harmonisation endeavours, the methods used for the achievement of the approximation of secured credit law regimes within NAFTA countries would better correspond to legal transplantation than harmonisation. In effect, legal reforms in Canada and Mexico have mainly been the result of the adoption of the U.S. legal standards rather than a reform based on the coordination of NAFTA Member States legal regimes. This latest observation brought some authors to talk about an 'Americanization' rather than 'harmonisation' of secured credit laws[646]. Mexico reformed its law of secured transactions in 2000[647]

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[643] Cuming, R.C.C. "Inter-Jurisdictional Registration and Validity Issues", available from www.natlaw.com/pubs/interjur.htm (last checked 26/04/2010) where the author states that: "[t]he economic integration that can be expected to increase dramatically under NAFTA will result in transborder secured financing arrangements and the movement into and out of Mexico of high-value goods subject to security interests. No doubt, the incidence of problems associated with the recognition of foreign security interests will dramatically increase in the very near future."

[644] Boris, K., Et al. "Harmonization of the Secured Financing Laws of the NAFTA partners: Focus on Mexico, National Law Center for Inter- American Free Trade" (1998) available from www.natlaw.com (last checked 26/04/2010).

[645] National Law Center for Inter-American Free Trade, "Harmonization of the Secured Financing Laws of the NAFTA Partners: Focus on Mexico"(1995), available from http://www.natlaw.com/pubs/purchase/harm.htm (last checked 26/04/2010).

[646] Gopalan explains for instance that: "[t]his would seem to suggest that convergence is motivated by U.S economic dominance. Concerns about American legal hegemony are perhaps inevitable given the regional dynamics. The great increase in trade resulting from a free trade agreement particularly between the U.S and Mexico has pushed the Mexican legal system to converge with that in the U.S. Given that both Mexico and Canada want to increase trading opportunities with their more powerful

which extended the availability of credit but left many essential aspects of a modern legislation on secured credit unreformed[648].

The example of NAFTA is interesting and analogically led this study to envisage the situation of the EU and the single market, where the dilemma of the harmonisation of secured credit laws also occurred. In Europe, the creation of the Common Market by the Treaty establishing the European Community[649]also led to the question of whether common security law regimes should and could be achieved in Europe considering the wide variety of legal systems.

As early as 1966, a group of experts directed by Segré led a study on the development of a European capital market[650]. The Report already highlighted the need for harmonious legal method for structuring secured lending and suggested the introduction of a European type of mortgage in order to ease the creation of the European Common Market[651]. The Report claims that:

"[t]he approximation or harmonization of the legal status of the real-estate sureties required in the Member States should be given priority. More flexible and less burdensome than the mortgage, the "land-charge deed" technique ... is an instrument which might usefully be adapted to the financing of building. And arrangements should be made so that mortgage or land-charge deed registrations can be expressed in currencies other than of the country of registration."[652]

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neighbor, the U.S can take a more indifferent approach to harmonization. Legal experts in the U.S have been more than willing to export their own laws to Canada and Mexico, and indeed the rest of the world, often with a take-it-or-leave-it attitude resting on their own economic might. This is apparent by the fact that there is no evidence that U.S. law has gone to any lengths to undertake a harmonization that adopts principles from Canadian or Mexican Law. Accordingly, it would be safe to say that harmonization within the NAFTA context is "Americanization"". Gopalan *op.cit.* fn. 135, at p. 137.

[647] *Mexico, Ley General de Titulos y operaciones de crédito*, 23rd May 2000.

[648] On this point see De La Peña, N. "Challenges in Implementing Secured Transactions Reform in Latin America" in Dahan, F., Et al., *Secured Transactions Reform and Access to Credit* (2008), at p. 243 where the author observed that: "... Mexico passed a new law on secured transactions in 2000, but this law left almost every key aspect of the framework for secured transactions unreformed. The new law expanded creation of security interests, but continued the old internally inconsistent system of priority of claims in collateral, the poorly run state registration system, and introduced a very limited reform for enforcing security interests."

[649] Treaty establishing the European Community, Rome, 25 March 1957.

[650] Segré Report, at p.169 available at http://ec.europa.eu/economy_finance/emu_history/documentation/chapter1/19661130en382develeurocapitm_a.pdf (last checked 26/04/2010).

[651] Van Erp, S.J.H.M. "Security Interests: A Secure Start for the Development of European Property Law" (2008) *Maastricht Faculty of law Working Paper No. 5,* at p. 1.

[652] Segré Report *op. cit.* fn. 650, at p. 169 and Van Erp *op. cit.* fn. 651, at p. 1.

Following the recognition that the law regulating mortgages in Europe should be harmonised, the European Commission later focused on the harmonisation of security created on movable property and published a Report in 1972 on the law of property in the European Community led by Gravenhorst, Hartley and Lando[653]. The Report emphasised the need to reach an approximation of property laws. It was obvious for the parties that the use of comparative law was the adequate approach to follow in order to assess the viability of harmonisation of secured credit laws in Europe. However, it became also apparent that harmonisation of secured credit laws would involve substantial reform of the baselines concepts inherent to property law and, that considering the diversity in legal regimes among European jurisdictions; it would be an almost impossible task[654]. The difficulties of importing a foreign legal regime in jurisdictions that belong to dissimilar legal cultures have already been extensively considered above[655]. In effect, it is arguable that the accommodation of differences between jurisdictions that belong to different legal traditions may create similar difficulties.

Unsurprisingly, there has been little attempt in the quest to establish common principles governing secured transactions in the EU. One illustration can be found with the Directive on Late Payment in Commercial Transactions[656] which requires

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[653] Van Erp *op. cit.* fn. 651, at p. 2.

[654] Van Erp states that :"[i]t becomes apparent that already more than 45 years ago it was clear that with regard to security interests on movables initiatives to unify at least the rules of private international law were badly needed, but that any attempts to reach harmonisation were hampered by the existing legal diversity. However, unification or even harmonisation of the substantive rule of property law was out of the question. No doubt it was considered to be too complicated and it was feared that finding common ground between Civil Law, Common Law, the Scandinavian legal traditions and the mixed legal systems would prove to be too cumbersome and most likely impossible. The main reason for this fear seems to have been that property law was considered to be a national system of coherent choices, safeguarded by mandatory law while limiting the parties' freedom to create new or give shape to existing property rights." Van Erp *op. cit.* fn. 651, at p. 2. See also the introductory remarks made by Gravenhorst in his study on "The Law of Property in the European Community"Studies, Competition – Approximation of legislation series No27, Brussels, December 1972, at p.13. He states: "[a] description of the types of security on movables in the legal system of different countries cannot be restricted to the portrayal in isolation of individual legal concepts such as, say, retention of title. In order to grasp the full economic and legal significance of the different types of security, it is necessary to have regard to the position they occupy in relation to the remainder of the civil law system in question. Thus in the case of contracts of sale, for example, the full implication of retention of title does not become apparent until one has at least glanced at the other legal relationships between seller and buyer."

[655] See Chapter Three.

[656] Directive 2000/35/EC of the European Parliament and of the Council of 29th June 2000 on Combating Late Payment in Commercial Transactions, OJ L 200, 8.8.2000. Article 4 provides: "1. Member States shall provide in conformity with the applicable national provisions designated by

enforcing and recognising the validity of retention of title clauses in all Member States according to their private international law rules. It has been argued that the dispositions of the Directive did not go far enough towards the harmonisation of secured credit laws in Europe and that the dispositions relative to retention of title clauses are in fact 'devoid of much content'.[657] Further attempts were made with the Insolvency Regulation[658] in relation to retention of title clauses but, similarly, it remained largely unsatisfactory in light of harmonisation and modernisation efforts.

Similarly to NAFTA, the Treaty establishing the European Community creates a Common Market in the EU. Article 100 of the EC Treaty provides:

"[t]he Council shall, acting unanimously on a proposal from the Commission and after consulting the European Parliament and the Economic and Social Committee, issue directives for the approximation of such laws, regulations or administrative provisions of the Member States as directly affect the establishment or functioning of the common market."

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private international law that the seller retains title to goods until they are fully paid for if a retention of title clause has been expressly agreed between the buyer and the seller before the delivery of the goods. 2. Member States may adopt or retain provisions dealing with down payments already made by the debtor."

[657] McCormack states for instance that: "[t]he most straight-forward interpretation of the relevant provisions would be to say that if passing-of –property questions under a contract for the sale of goods are governed by the law of an EU member state, then the member state must recognise a simple retention-of-title clause contained in the contract of sale. It is possible, however, to interpret the reference to private international law in Article 4 in such a way as to deprive the provision of substantive meaning. O such a construction, if the legal system invoked by the choice of law rules in a forum member state does not recognise simple retention-of-title clause or requires observance of formalities for their enforcement, such as compliance with registration requirements, then the forum member state is not compelled to recognise the clause. The so called European rule would not be in accordance with the relevant national law whose application is dictated by the choice of law rules. In the case of an ordinary domestic sales contract governed by English law, then English law prevails over the European norm because English law is the governing law under the choice of law rules whose effect has not been altered by the Directive. If this interpretation is correct, then the Late-Payment Directive is devoid of much content because a retention-of-title could always be enforced according to the applicable law. If the governing law in a forum member state recognises retention-of-title, then, by that fact alone and without reference to the provisions of any EU directive, retention of title should be recognise in that forum." McCormack *op. cit.* fn. 18, at p. 206.

[658] Council Regulation (EC) No 1346/2000 of 29th May 2000, OJ L 160, 30.6.2000. Article 7 of the Regulation provides: "1. The opening of insolvency proceedings against the purchaser of an asset shall not affect the seller's rights based on a reservation of title where at the time of the opening of proceedings the asset is situated within the territory of a Member State other than the State of opening of proceedings. 2. The opening of insolvency proceedings against the seller of an asset, after delivery of the asset, shall not constitute grounds for rescinding or terminating the sale and shall not prevent the purchaser from acquiring title where at the time of the opening of proceedings the asset sold is situated within the territory of a Member State other than the State of the opening of proceedings. 3. Paragraphs 1 and 2 shall not preclude actions for voidness, voidability or unenforceability as referred to in Article 4(2) (m)."

Accordingly, it is arguable that the harmonisation of necessary national laws for the establishment and good functioning of the single market should be an ineluctable responsibility for the EU. In the present context of this study on the harmonisation of secured credit laws, this acknowledgment begs the essential question of whether secured credit laws directly affect the establishment or functioning of the Common Market. Arguably, secured financing affects the functioning and establishment of an economic market in the sense that divergences in secured credit law regimes could reduce the availability of credit in certain jurisdictions and could deter international traders from dealing with some jurisdictions where the recognition and enforcement of a security remains uncertain.

Harmonisation of secured credit law would enhance economic activities among Member States in providing more predictable and secured legal regimes for traders. Conversely, it could also be argued that diversity and competition between legal regimes would support and promote the good functioning of a common market by encouraging innovation and providing for a wider choice of structuring finance to traders. Thus, following the creation of the Common Market in Europe, the desirability and viability of harmonising secured credit laws in Europe have become timely questions. In the light of the Directive on Late Payments and the Insolvency Regulations, the question emerged of whether the EU could have gone further towards the harmonisation and modernisation of secured credit law regimes and, particularly, of the regulations underlying retention of title clauses. In this respect, Kieninger, Von Wilmowsky and Rutgers ask:

"... whether European Law as such and in particular the four freedoms (freedom of goods, persons, services and capital) did not demand that recognition of foreign security interests was a duty under European law."[659]

The next sections will thus consider whether the EU should and could harmonise the law of secured credit, especially in light of the good functioning of the Common Market. If there is a claim for the harmonisation of European secured credit laws, the question of the competence of the European Union to legislate in this sphere of law also becomes paramount.

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[659] Van Erp *op. cit.* fn. 651, at p. 5.

Diverse elements in support of the approximation of secured credit law regimes have already been recognised above[660]. Advantages such as 'predictability', 'legal certainty', 'lower costs' and 'lower risks' are illustrative of the main arguments advanced in support of international harmonisation efforts. This section will therefore focus on the desirability of harmonisation of secured credit laws in Europe from a different perspective. Beyond the theoretical and economic arguments traditionally invoked, further aspects of harmonisation applied in the EU context come to light. Considering the wide range of different secured credit laws in the EU, it is arguable that more harmonious legislations would be desirable in the way it would promote the development of economic activities and enhance the growth of international trade within the Common Market. Conversely, it is also arguable that diversity in legal methods for structuring secured financing would enhance economic activities through regulatory competition. In this sense secured credit could be seen as a marketable product that would make national jurisdictions to compete with one another.

In the context of the EU and in the light of the achievement of the Common Market, the question emerged of whether the harmonisation of secured credit laws would be desirable or whether the diversity of legal regimes which allows for more innovation in secured credit and which allows for a wider choice for structuring finance, should be preserved[661]. In light of the unfruitful attempts of the EU to harmonise secured credit laws[662] and in light of the recent introduction of the Common Frame of Reference[663], 'optional toolbox' for traders, the EU would appear to have opted for a

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[660] See Chapter Two, at pp. 76-82.
[661] Sykes, A.O. "Regulatory Competition or Regulatory Harmonization? A Silly Question" (2000), 3 *Journal of International Economic Law,* at p. 257.
[662] See I.A.2. with respect to the Directive 2000/35/EC of the European Parliament and of the Council of 29th June 2000 on Combating Late Payment in Commercial Transactions, OJ L 200, 8.8.2000. See Article 4 on retention of title clauses.
[663] CFR prepared by the Study Group on a European Civil Code and the Research Group on EC Private Law. For more information, see www.law-net.eu (last checked 26/04/2010).

competition of national legal systems rather than for the harmonisation of secured credit law regimes[664].

In the context of secured transactions, the question is to determine whether the competition between secured credit law regimes would support the development and growth of economic activities within the Common Market better than with harmonious legislations. Diversity in national legal regimes would enable Member States to experiment and innovate in their quest to find efficient and predictable secured credit law regimes. In effect, it is arguable that the preservation of diversity in legal systems would allow legal reformers to provide for more innovation within secured credit law regimes and would also avoid the risk of enacting inefficient common legal regime through the process of harmonisation.

The idea of a competition between legal regimes has recently been reinforced with the proposal of a Common Frame of Reference in Europe which has been characterised as an optional toolbox, a 28th legal regimes that parties of European Member States could choose as governing law to regulate their transactions[665]. Ultimately, it is hoped that the best law may survive and may serve as basis for the

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[664] On the CFR, see for instance Beale, H. "The Nature and Purposes of the Common Frame of Reference" (2008) II *Juridica,* at p. 10 where the author states: "[l]et me start by addressing one thing that the CFR is not intended to be a European civil code, or a single European contract law to replace the various national laws. Although the CFR appears as an optional "legal regime" for contractual parties, the purposes of the CFR ultimately have hopes to have an harmonizing effect. The purposes of the CFR are described in the first PECL article and the introduction and can be described as follows: "1. For parties to transnational contracts to adopt to govern their contract. Under current principles of private international law, the parties cannot adopt the Principles of European Contract Law as a replacement for a national system, but they can agree to incorporate them into their contract. Given that, at least for business-to-business (so-called B2B) contracts, most national laws allow a large degree of freedom of contract and lay down few mandatory rules, the effect will be much the same. 2. For arbitrators to apply when the parties have agreed that the contract is to be governed by 'general principles of law', the *lex mercatoria*, or the like. 3. To serve as a model for courts and legislators faced with either filling in gaps in their national law or revising it to respond properly to new economic conditions. When the Principles of European Contract Law were being finalised, members of the European Commission were very aware that the then-new democracies of central Europe were busy reforming their civil codes. 4. To assist in creating further harmonising measures across Europe." See also Reich who states that: "[c]ompetition between legal orders, instead of centralized regulation – this seemed to be the "new approach" of the EC harmonization process." Reich, N. "Competition Between Legal Orders: A New Paradigm of EC Law?" (1992) 29 *Common Market Law Review,* at p. 861.

[665]The Draft Common Frame of Reference (DCFR) prepared by the Study Group on a European Civil Code and the Research Group on EC Private Law has been published in February 2009. The CFR will also include a Book IX on Proprietary Security Rights in movable assets. See Eidenmüller, H., Et al. "The Common Frame of Reference for European Private Law – Policy Choices and Codification Problems" (2008) 28 *Oxford Journal of Legal Studies* 659, at p. 665.

law of the community[666]. In this perspective, the Common Frame of Reference is hoped to serve as model for legal reform across Member States legal regimes and eventually replace the law of current twenty seven legal regimes.

In respect of secured financing, it is questionable whether a competition between national secured credit regimes would achieve the aims of the single market. It could be argued that a competition of legal regimes could end up in distorted and unfair competition towards legal regimes with lower legal standards. In effect, some jurisdictions might be deterred from investing in some Member States because their secured credit law regimes might offer lower standards. Jurisdictions with less efficient secured credit legislations may be less attractive to investors than other jurisdictions offering more modern legal regimes[667].

The recognition of a competition between secured credit regimes would presuppose that a security so created in one jurisdiction is able to circulate in the whole community under the rules of the jurisdiction of origin. However, such a recommendation appears to be quite uncertain, especially in light of the traditional conflict of law rules. As it has already been pointed out, the *lex rei sitae* is the traditional method for resolving conflict of laws issues in relation to cross-border secured transactions. It has been evidenced that this method is not always practical and effective for resolving conflict of laws issues[668]. For instance, the inadequacy

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[666] See Smits *op. cit.* fn. 262, at p. 2 where the author states: "I previously defended that the best way of unification of law in Europe would be through a competition of legal rules. In transplanting legal rules from one country to another on a "market of legal culture", the best legal rule may survive. This does not automatically imply that *any* rules glorifies: in some instances, diversity of law may be just as good as uniformity as long as there is a free movement of legal rules, at least creating the *possibility* of legal change."

[667] Lando argued, in respect of the harmonisation of Contract law, that: "[t]he existing variety of contract laws in Europe may be regarded as a non-tariff barrier to trade." in Lando, O. "Optional or Mandatory Europeanisation of Contract Law" (2000) 8 *European Review of Private Law,* at p. 61.

[668] See Chapter Two at pp. 71-76. See also Goode *op. cit.* fn. 120, at p. 49 where the author states that: "[t]he traditional method of dealing with differences in the laws of separate legal systems is through conflict of laws rules. ... There is, in fact, a fairly universal adoption of the *lex rei sitae* as the conflict rule to govern security interests and other real rights, but this is too unsophisticated in that it fails to distinguish security over specific assets from universal security. It also fails to distinguish between the position of a purchaser taking physical delivery of a tangible object – therefore prima facie relying on the law of the country where the object is located – and a lender taking security over classes of tangible assets where physical inspection is impracticable and over intangible assets where it is impossible. The *lex rei sitae* is particularly unhelpful in relation to security over receivables and mobile equipment."

becomes evident in relation to security created over movable property[669] or in relation to specific types of security interests which are not recognised in other jurisdictions such as the floating charge in England[670]. In effect, a security created in one jurisdiction might be subject to different validity requirements or might not even be recognised at all under particular national secured credit law regimes.

Although competition between legal orders preserves legal diversity and might promote innovation, there is the risk that it might distort competition among Member States. In effect, it is questionable whether jurisdictions with less efficient secured credit legislations could be less attractive to investors than other jurisdictions offering more modern secured credit laws. Following this remark, the case for the harmonisation of secured credit laws in Europe should also be promoted. If harmonisation of secured credit law is arguably desirable in the EU, the question of the competence of the EU to legislate in the sphere of secured credit comes to light.

The competence of the EU to legislate in the sphere of secured credit law

According to the above development on the growth of regional economic free markets and its correlative need for harmonious legislations, it emerges from the understanding of Article 100 of the EC Treaty[671], that the EU should be in the right position to demand for the harmonisation of secured credit laws in Europe if it can be showed to be a condition *sine qua non* to the establishment and functioning of the single market. It has been argued that the lack of efficient secured credit law regimes in some European jurisdictions might hinder the development of economic activities by restricting the availability of secured financing. In effect, some Member States might not recognise the validity of certain type of security which might create some difficulties towards their enforcements in foreign Member States.

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[669] See above Chapter Two, at pp. 71-76.
[670] See above Chapter Three, at pp 130-135. Article 9 of the American Uniform Commercial Code only recognises fixed charge and does not recognise the floating charge. This solution has long been established in the United States of America following the famous case *Benedict v. Ratner* (1925) 268 US 354.
[671] Article 100 of the EC Treaty

In light of the four freedoms in the EU; free movement of goods, services, persons and capital as enacted in the EC Treaty, the question emerged of whether the EU would be under a duty to impose the recognition of foreign security interests in every Member States[672]. Accordingly, it is explained that:

"... within the European Union (EU) a security interest, validly created in a Member State, is not really a "foreign" security interest anymore and should therefore be recognised in all other Member States."[673]

A security would be analysed as a product that should be marketable in every Member States. Following the renowned case C*assis de Dijon*[674], the European Court of Justice (thereafter, ECJ) recognised that a product produced in Europe should be marketable in all the other Member States so as to avoid any anti competitive practices[675]. On this occasion, the ECJ ruled that:

"[o]bstacles to movement within the Community resulting from disparities between the national laws relating to the marketing of the products in question must be accepted in so far as those provisions may be recognized as being necessary in order to satisfy mandatory requirements relating in particular to the effectiveness of fiscal supervision, the protection of public health, the fairness of commercial transactions and the defence of the consumer."[676]

By analogy, it could also be argued that restrictions to the availability of credit in some jurisdictions following a lack of efficient and harmonious legal rules could lead to some unfairness among international traders dealing in the European single market. If the harmonisation of secured credit laws can be proved to be necessary for the development of the European single market pursuing Article 100 EC, it is arguable that the EU would be under a duty to act accordingly. Nevertheless, the

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[672] Van Erp *op. cit.* fn. 651, at p. 5.
[673] *Ibid.*
[674] ECJ 20 February [1979] ECR 648 available from: http://eur-lex.europa.eu/smartapi/cgi/sga_doc?smartapi!celexplus!prod!CELEXnumdoc&lg=en&numdoc=61978J0120 (last checked 26/04/2010).
[675] Van Erp questions: "[s]hould security interests within the European Union be mutually recognised, irrespective of whether such as security interest could be fitted into the national legal system? This may sound a far reaching conclusion, but in essence the argument is not really different from what can be found in the "*Cassis de Dijon*" case in which the ECJ forbade the application of a national rule that did not allow this liqueur to be marketed in a different Member State than in which it had been produced. Such an application was considered to be a measure having an effect equivalent to quantitative restrictions on imports, as meant in Article 30 EEC Treaty. What was produced in a Member State according to the rules of that Member State should be marketable in all the other Member States. Then why not accept that a security interest, lawfully created in a Member State, should be recognised ("marketable") in a different Member State?" Van Erp *op. cit.* fn. 651, at p. 5.
[676] See above fn. 673.

harmonisation of secured credit laws is not an easy task; this area of law is at the boundaries of many other legal specialties such as property law, contract and insolvency law. In this context, the question of the competence of the EU to interfere with national property laws becomes questionable.

It has been argued that Article 95 EC[677] could constitute a legitimate basis to recognise the competence of the Community to legislate in the field of property law. Nonetheless, some limitations to the Community's powers to act in the field of property law and secured credit can also be identified. Following the principle of subsidiarity defined in Article 5 EC and introduced by the Treaty of Maastricht:

"[t]he Community shall act within the limits of the powers conferred upon it by this Treaty and of the objectives assigned to it therein. In the areas which do not fall within its exclusive jurisdiction, the Community shall take action, in accordance with the principle of subsidiarity, only if and insofar as the objectives of the proposed action cannot be sufficiently achieved by the Member States and can therefore, by reason of the scale or effects of the proposed action, be better achieved by the Community."

In this respect, it is doubtful whether Article 95 EC could be used as a basis for the harmonisation of the whole of property law in Europe. In effect, it would mean that the EU would, in effect, be able to regulate the internal market[678]. This eventuality

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[677]Article 95/Article 100a - EC Treaty (Maastricht consolidated version). Article 95 provides that: "[b]y way of derogation from Article 94 and save where otherwise provided in this Treaty, the following provisions shall apply for the achievement of the objectives set out in Article 14. The Council shall, acting in accordance with the procedure referred to in Article 251 and after consulting the Economic and Social Committee, adopt the measures for the approximation of the provisions laid down by law, regulation or administrative action in Member States which have as their object the establishment and functioning of the internal market." See also Article 2 of the Treaty establishing the European Community, which states that:"[t]he Community shall have as its task, by establishing a common market and an economic and monetary union and by implementing common policies or activities referred to in Articles 3 and 4, to promote throughout the Community a harmonious, balanced and sustainable development of economic activities, a high level of employment and of social protection, equality between men and women, sustainable and non-inflationary growth, a high degree of competitiveness and convergence of economic performance, a high level of protection and improvement of the quality of the environment, the raising of the standard of living and quality of life, and economic and social cohesion and solidarity among Member States."

[678] Van Erp fn. 651, at p. 12 where the author argues that: "[a]rticle 295 EC should be taken into consideration. This article states, as we already saw, that the EC Treaty shall in no way prejudice the rules in Member States governing the system of property ownership. Although at first sight it seems that Article 295 has a large ambit, its effect has been limited in case-law developed by the ECJ. Reference can be made to the so-called "Golden Shares" cases. In these cases the Court had to decide on the compatibility with community law of "national systems which grant the executive certain prerogatives to intervene in the share structure and in the management of privatised enterprises in strategically important areas of the economy." The Court ruled that Article 295 EC *"... merely signifies that each Member State may organise as it thinks fit the system of ownership of undertakings*

was already considered by the ECJ in the *Tobacco judgement*[679] where the Court stated in respect to Article 95 EC that:

"[t]o construe that article as meaning that it vests in the Community legislature a general power to regulate the internal market would not only be contrary to the express wording of the provisions cited above but would also be incompatible with the principle embodied in Article 3b of the EC Treaty (now Article 5 EC) that the powers of the Community are limited to those specifically conferred on it."[680]

Harmonisation of secured credit laws could therefore be possible if it appeared to be necessary to the functioning and establishment of the internal market and if it could be better achieved by the Community rather than by Member States.

The problem with the harmonisation of secured credit law regimes is that it is at the boundaries of many areas of laws. The harmonisation of secured credit laws in Europe would in fact involve substantial legal reforms of property law, contract law and even insolvency laws. In relation to the competence of the Community to

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whilst at the same time respecting the fundamental freedoms enshrined in the Treaty." Article 295 EC does not mean that property law cannot be touched at all by European law."

[679] ECJ, 10 December 2002, Case C-491/01 *The Queen and Secretary of State for Health, ex parte: British American Tobacco (Investments) Ltd v. Imperial Tobacco Ltd.* The relevant part of the judgment is as follows: "81 Article 100a (1) of the Treaty empowers the Council, acting in accordance with the procedure referred to in Article 189b (now, after amendment, Article 251 EC) and after consulting the Economic and Social Committee, to adopt measures for the approximation of the provisions laid down by law, regulation or administrative action in Member States which have as their object the establishment and functioning of the internal market.82. Under Article 3(c) of the EC Treaty (now, after amendment, Article 3(1) (c) EC), the internal market is characterised by the abolition, as between Member States, of all obstacles to the free movement of goods, persons, services and capital. Article 7a of the EC Treaty (now, after amendment, Article 14 EC), which provides for the measures to be taken with a view to establishing the internal market, states in paragraph 2 that that market is to comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of the Treaty.83. Those provisions, read together, make it clear that the measures referred to in Article 100a (1) of the Treaty are intended to improve the conditions for the establishment and functioning of the internal market. To construe that article as meaning that it vests in the Community legislature a general power to regulate the internal market would not only be contrary to the express wording of the provisions cited above but would also be incompatible with the principle embodied in Article 3b of the EC Treaty (now Article 5 EC) that the powers of the Community are limited to those specifically conferred on it.84. Moreover, a measure adopted on the basis of Article 100a of the Treaty must genuinely have as its object the improvement of the conditions for the establishment and functioning of the internal market. If a mere finding of disparities between national rules and of the abstract risk of obstacles to the exercise of fundamental freedoms or of distortions of competition liable to result there from were sufficient to justify the choice of Article 100a as a legal basis, judicial review of compliance with the the proper legal basis might be rendered nugatory. The Court would then be prevented from discharging the function entrusted to it by Article 164 of the EC Treaty (now Article 220 EC) of ensuring that the law is observed in the interpretation and application of the Treaty.85. So, in considering whether Article 100a was the proper legal basis, the Court must verify whether the measure whose validity is at issue in fact pursues the objectives stated by the Community legislature."

[680] ECJ, 10 December 2002, Case C-491/01, *The Queen and Secretary of State for Health, ex parte: British American Tobacco (Investments) Ltd. v. Imperial Tobacco Ltd.*, at Para. 83.

legislate in the sphere of property law, it is important to also mention Article 295 EC which restricts the powers of the Community to intervene within national law of property ownership by providing that:

"[t]he Treaty shall in no way prejudices the rules in Member States governing the system of property ownership".

However, the ECJ clarified the meaning of this disposition and explained that Article 295 EC would not stop the Community from organising property law regimes in Europe[681]. Accordingly, it would appear possible in principle for the Community to achieve the harmonisation of secured credit laws, or at least of some aspects of the law in Europe.

This section argued that the harmonisation of secured credit laws is largely desirable, especially in the light of the development and good functioning of the European Common Market. Also, it has been demonstrated that the EU would have competence to achieve the harmonisation of secured credit law, or at least in respect of targeted aspects of financial transactions. The question is now to determine the extent to which a modernisation of secured credit law using harmonisation as a legal method is feasible. Can harmonisation succeed in its quest to reconcile and accommodate differences among the European regimes of secured credit, and also succeed in its modernisation endeavours?

As it has already been explained, legal harmonisation will be successful as legal method to modernise the law if an accommodation of differences is, if at all, feasible, and if it can also lead to substantial modernisation of secured credit law regimes as defined in Chapter Two. The EU already attempted to harmonise the law in respect of retention of title clauses with the EU Directive on Late Payments in Commercial Transactions[682]. However, it has been suggested that the harmonisation and modernisation endeavours in relation to the regulation of retention of title clauses

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[681] The ECJ had the occasion to limit the effects of this article in the so-called "*Golden Shares*" case, ECJ 4th June 2002, where the Court ruled that Article 295 "[...] merely signifies that each Member State may organise as it think fits the system of ownership of undertakings whilst at the same time respecting the fundamental freedoms enshrined in the treaty." Case cited in Van Erp, S.J.H.M. "European and National Property Law: Osmosis or Growing Antagonism?" (2006) *Sixth Walter Van Gerven Lecture,* Leuven Center for a Common Law of Europe, *Ius Commune* Research School, at p. 12.

[682] See above fn. 611.

remained limited. Accordingly, it will be further considered whether the harmonisation of retention of title clauses could have gone further and whether harmonisation could also be successful in modernising the regulations underlying retention of title clauses in European jurisdictions. The next section will thus attempt to determine whether an accommodation of legal divergences can, if at all, be reached within European regulations. The identification of current divergences amongst all EU jurisdictions would go beyond the scope of this analysis. Accordingly, this demonstration will restrict this analysis to a sample of European jurisdictions; France and England. The next section will thus assess whether harmonisation could be used as successful method to modernise the law regulating retention of title clauses in France and England.

EUROPEAN SECURED CREDIT LAW REGIMES: RETENTION OF TITLE CLAUSES AND HARMONISATION

Legal harmonisation will be successful as legal method to modernise the law if an accommodation of differences is feasible, and if it can also lead to substantial modernisation of the law. In relation to retention of title clauses, the questions will be addressed of whether an accommodation of European regulations underlying retention of title clauses is, if at all, possible, and whether such endeavours could lead to substantial modernisation of the law. The identification of current divergences amongst all EU jurisdictions would go beyond the scope of this analysis. Consequently, this demonstration will restrict this comparative analysis on retention of title clauses to France and England.

Both jurisdictions retain a similar definition to this property-based security mechanism. Retention of title clause is the clause by which the seller retains title to the goods until payment is received. Upon the buyer's default, property of the goods will revert automatically to the seller and, thus, escape from the hands of the liquidator[683]. If simple retention of title clauses are valid in both jurisdictions and also accepted within the disposition of the European Directive[684], difficulties can

[683] Monti *op. cit.* fn. 418, at p. 866.
[684] *Ibid.*

arise where the insolvent buyer resells or manufactures the goods before payment. These eventualities create uncertainties for sellers who may not be able to enforce their proprietary rights upon default. Particularly, it has already been emphasised that French and English regimes regulating retention of title clauses should be modernised so as to provide more certainty and predictability for the commercial community[685].

Various aspects of the laws regulating retention of title clauses in these jurisdictions will be identified so as to determine whether an accommodation of differences is, if at all possible. Retention of title clauses are property-based security devices which are mainly regulated through national property law. This comparative analysis will have to consider the differences that exist between baselines concepts of property law in France and England. Although both jurisdictions recognise the power of the seller to use ownership for security purposes, there are substantial divergences in the definition and concept of 'property' itself that could be difficult to accommodate.

The accommodation of differences within national secured credit law is not an easy task considering the complex and multifaceted nature of this area of law. In effect, secured credit law is at the boundaries of many areas of laws such as contract law, property law and insolvency law which render the task of harmonising the law very complex, especially within jurisdictions that belong to different legal traditions. In effect, secured credit law regimes cover a multitude of different legal aspects to consider such as the regulation of parties' rights and liabilities, validity requirements, enforcement and priority system. As Goode already highlighted:

"[c]redit and security law involves in the first place regulation of the rights of the parties to a credit transaction: the monetary liabilities of the debtor before and after default; the extent to which the taking of security over present and future property is to be permitted; the requirement for attachment of a security interest so as to be effective between the parties, the secured party's rights over the security vis-à-vis the debtor, and the procedure for enforcement of security. ... Then we have the problem of conflicting security interests. How are third parties to be made aware of the existence of the security interest? How priorities should be regulated between the secured parties and the different classes of third parties into whose hands the security may come."[686]

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[685] See Chapter Three.
[686] Goode fn. 635, at p. 248.

In relation to retention of title clauses, the regulation of such security device would effectively imposes the recognition of specific rules towards the legal relationship between the parties to the transaction but also towards the enforcement methods and legal relationships with third parties. In effect, the creation of a security does not solely affect the contracting parties but can also affect a wide range of third parties. As it will be exposed later in this chapter, the universal character of property rights imply that these rights are enforceable *erga omnes*, which means that property rights are enforceable against everyone who might infringe them. Thus, the harmonisation of retention of title clauses in Europe will require the comparative analysis of the rights and obligations of the parties to the agreement but also the analysis of the dispositions provided for the protection of third parties.

A comparative law approach will indubitably constitute the consistent approach to adopt within subsequent developments. In effect, comparative law is a fundamental tool used by European legislators to lead harmonisation endeavours. In effect, how could it be possible to accommodate differences if they are not identified in the first place? Thus, this development will first provide a comparative analysis on some aspects of property laws between France and England. Such an analysis will use specific references to property law terminologies peculiar to each legal tradition. Further, the next section will also provide a comparative analysis of the current English and French regulations underlying the rights and obligations of the parties to the agreement. Finally, a comparative analysis on the regulation of retention of title clauses would not be complete without the examination of the regulations underlying retention of title clauses in respect of third parties. Ultimately, this comparative analysis will enable the determination of whether the regulations underlying retention of title clauses in England and France could successfully be harmonised so as to achieve an approximation and modernisation of the law.

Retention of title clauses are property-based security devices which are accepted and regulated in both jurisdictions. Thus, it is not surprising to find most of their regulations in property laws. That is why, this analysis on the harmonisation of retention of title clauses legal regimes will begin with a comparative law analysis of the baseline concepts enshrined in property laws of France and England. These jurisdictions are interesting to consider because they are part of different legal traditions which have generated different approaches toward property and associated concepts. Civilian systems such as France mainly developed from Roman law. Following the abolishment of feudal law, most continental Civil Law jurisdictions progressed towards systemic codifications[687]. Common Law jurisdictions such as England evolved more autonomously without such an extensive recognition of Roman law into its legal principles. Common Law particularly developed from feudal law systems and mainly reposes on case law and precedent. It is recognised that:

"[t]he predominant dividing line in property law lies between common law and civil law jurisdictions. Civil systems derive their property law from Roman law; their property law covers movable and immovable objects alike. Civil systems often have systematic codification with abstract concepts. It is for the largest part mandatory law, and case law is relatively unimportant. Feudal law is of little influence. There is no equity and, therefore, no equitable ownership. Ownership and the strictly limited amount (*numerus clausus*) or real rights, like security rights, are key concepts"[688].

This comparative analysis will first consider the concept of property in France and will then analyse the concept of property in England. Ultimately, this comparative analysis will provide fundamental guidance as to whether an accommodation of different property law concepts is, if at all, feasible in some European jurisdictions.

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[687] For example, extensive codification occurred in France, Germany, Spain or in Switzerland. Napoléon promulgated the French Civil Code in 1804; the BGB (Bügerlishes Gesetzbuch) was promulgated in 1896 in Germany; the Spanish Civil Code was promulgated in 1889 and the Civil Code of Switzerland was promulgated in 1912.

[688] Milo, J.M. "Retention of Title in European Business Transactions" (2003) 43 *Washburn Law Journal,* at p. 212.

The Civilian Tradition and the absolute character of ownership

Civilian legal systems principally developed according to Roman legal concepts. Thus, it is logically expected that the modern Civilian definition of property also finds its roots in Roman law. Roman lawyers designated property by the term of '*dominium*' which is the right of the *Dominus* or the *Pater Familias*[689]. The *dominium* is defined in the Justinian Code as the right to use *(usus)* and the right to destroy or alienate a thing *(abusus)*, within the limits of the law; '*jus utendi et abutendi re sua, quatenus iuris ratio patitur*"[690]. The terms 'property' or 'property rights' did not exist under Roman law as a developed legal doctrine but it is manifest from the definition of the '*dominium'* that "... the Romans did possess the concept of property rights and individual rights in general."[691]For example, proprietary remedies such as the *vindicatio* already existed under Roman law and this remedy has been preserved in current French property law with the *action en revendication.*

The concept of property as a right to use and destroy or alienate a thing has been kept throughout the Middle Ages and Modern History and is still representative of the definition retained in most Civilian legal traditions[692]. Although everyday language generally assimilates property to the thing that can be owned, the legal meaning of property within Civilian jurisdictions essentially refer to 'ownership' or right of property. Ownership is defined as a 'sacred right' in the French Civil code[693] and is

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[689] The *dominus* is the right of the head of the family over his things. Gamsey explains that: "[i]n the Roman law of persons, the male head of the household (*the pater familias*) had *ius* and *potestas* over his dependents, whether children or slaves. The former were held under another's ius (*alieni iuris*) the latter under his dominium." Garnsey, P., *Thinking About Property, From Antiquity to the Age of Revolution*, (2007), at p. 190.

[690] *Ibid.* at p. 178.

[691] *Ibid.* at p. 195.

[692] Article 544 *C.Civ.* provides that : *"[l]a propriété est le droit de jouir et disposer des choses de la manière la plus absolue, pourvu qu'on n'en fasse pas un usage prohibé par les lois ou par les règlements."* (Ownership is the right to enjoy and dispose of things in the most absolute manner, provided they are not used in a way prohibited by statutes or regulations.) Article 348 Spanish Civil code provides that: "[*l]a propiedad es el derecho de gozar y disponer de una cosa, sin más limitaciones que las establecidas en las leyes. El propietario tiene acción contra el tenedor y el poseedor de la cosa para reivindicarla.*" (The property is the right to enjoy and dispose of a thing without other limitations tan those established by law. the owner has an action against the holder and the possessor through the *vindication.)*

[693] *Ibid.* Article 544 *C.Civ.*

understood as a fundamental extension of individual liberties[694]. Indeed, Article 544 of the French Civil code expresses a general theory relating to ownership by providing that:

"[o]wnership is the right to enjoy and dispose of things in the most absolute manner, provided they are not used in a way prohibited by law or regulations"[695].

The absolute character of ownership is a key attribute in Civil Law traditions that is largely reflected in the prerogatives recognised to the owner. In effect, ownership is composed of three essential prerogatives which are the right to use (*usus*), enjoy (*fructus*) and alienate (*abusus*) the thing. It is important to mention that limits to the absolute character of ownership have been introduced in the law[696] and in the case law. The famous French case *Clément-Bayard*[697]is an illustration of the limits imposed on the absolute character of the property rights of the owner. In effect, this case was the first decision of the French Supreme Court that condemned an abuse *of process*[698] in the exercise of the owner's property rights.

Following the facts of the case, Mr. Coquerel installed on his property some sharp wooden frames with the aim to puncture his neighbour's airships which were flying over his property during their take-offs and landings. The *abuse of process* theory is a jurisprudential creation which attempts to limit the absolute character of ownership where it is used in a malicious way. Notwithstanding these limits, ownership remains a very powerful prerogative that was affirmed from the very moment the feudal regime was abolished with the Declaration of the Rights of Man and of the Citizen proclaimed in 1789. Article 17 provides that :

"[l]a propriété étant un droit inviolable et sacré, nul ne peut en être privé, si ce n'est lorsque la nécessité publique, légalement constatée, l'exige évidemment, et sous la condition d'une juste et préalable indemnité."[699]

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[694] Decorps, J.P. "Le Droit de Propriété : Evolutions et Adaptations " (2001) available from www.cedroma.usj.edu.lb/pdf/drtsfond/decorps.pdf (last checked 26/04/2010).

[695] See above Article 544 *C.Civ.* fn. 679.

[696] The principle of the *numerus clausus* constitutes a substantial limit to the absolute character of ownership as it will be later considered in this chapter.

[697] *Clément-Bayard,* GAJC, 11th ed., No 62, DP 1917.1.79.

[698] *Théorie de l'abus de droit.*

[699] "The right of ownership is an inviolable and sacred right; one may not be deprived of one's property, unless where public need, duly ascertained by law, clearly requires it, and subject to the condition that fair and prior compensation be made."

Other Civilian jurisdictions such as Germany[700], State of Louisiana[701] or Quebec[702] have also adopted a similar concept of ownership. Thus, the concept of ownership appears to be one of the most important legal concepts within Civilian legal systems[703]. Notwithstanding the recognition and strong protection of ownership and property rights, these rights have been subjected to a number of limits embodied in the case law, as it has just been highlighted and in the law itself trough general principles such as the *numerus clausus* principle[704].

Within Civilian jurisdictions, property is therefore defined by reference to the right of property or ownership which is analysed as the most complete form of property right. Ownership is therefore a fundamental concept within Civilian property law which entitles one person to have an absolute, exclusive and perpetual right over the thing. Although ownership is absolute, it does not mean that two or more persons cannot own an asset in co-ownership or in joint ownership[705]. Further, other property rights or real rights are also recognised in France which can affect the exclusive character of ownership. Real rights directly concern rights on property (*jus in re*) as opposed to personal rights (*jus in persona*) which directly rest on the right to obtain a performance from someone. Rights *in rem* or real rights are divided in two categories. Principal real rights are to be distinguished from accessory real rights. Principal real rights include ownership understood as the real right in its fullest form[706]. Principal real rights can also designate the rights of *usus* or *fructus*[707]attributed separately. A real right will be qualified as an accessory real right when it relates to the creation of a security such as the pledge (*gage*) or hypothec. These rights are said to be the accessories of the debt owed to the creditor. This is why France has been generally quite hostile to the use of property-based securities

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[700] §903 BGB (German Civil code : *Bürgerliches Gesetzbuch)*
[701] CC 477 (Civil code of Louisiana).
[702] CCQ 947 (Civil code of Quebec).
[703] Milo, J.M. "Property Rights and Real Rights" in Smits, J.M., Et al., *Elgar Encyclopedia of Comparative Law,* (2006), at p. 598.
[704] See above fn. 695.
[705] Co-ownership (*Copropriété*) is regulated under Article 664 *C.Civ.* and Article 664 *C.Civ.* Joint ownership (*indivision*) is regulated under Article 815 *C.Civ.*
[706] The owner has got the three prerogatives: *usus, fructus* and *abusus.*
[707] *Usus* and *fructus* are real rights which entitle the holder to use and get the benefits from the thing. *Usus* and *fructus* are often used to designate the property rights of the tenant of a rented house. He is entitled to use and enjoy the thing but he does not have the ownership of the property, *i.e. the abusus,* so he cannot sell it.

such as retention of title. Indeed, it is difficult to conceive how ownership could be relegated to the category of security which is analysed to be an 'accessory to a real right'. The right of property, or ownership, is qualified as a principal real right whereas a security is qualified as an accessory real right. A real right entitles the holder to a right to follow the property in the hand of whomever it may be and, to a preferential right of repayment upon the debtor's default.

The terminology used within Civilian jurisdictions to designate 'non possessory security interest'[708] would thus be 'real security' which entitles the holder to an accessory real right. This expression of 'accessory real right' is used to designate the property rights of a movable security's holder, whereas 'security interest' is generally the preferred terminology used within Common Law jurisdictions such as in England and the United States. Although ownership is a key concept within Civilian jurisdictions, possession is often associated with this concept but has to be clearly distinguished. In everyday language, there is not any difference between possessing a thing and owning it. However, in legal terms, the notion of possession cannot be confused with ownership. Possession can be defined as the exercise of a *de facto* power over a thing. The *possesseur* has an effective control over the thing as he materially possesses it. Although possession involves a relationship of a person with a thing, it does not confer the *possesseur* a real right. Possession is analysed as a *de facto* situation in France which could nevertheless create legal effects if possession is legally recognised[709].

Possession requires two sets of conditions in order to create legal effects. Validity and enforcement requirements need to be established. First, possession requires the *possesseur* to use and enjoy a particular asset (*corpus*) and act as if he was the real owner (*animus*). If the *animus* defaults, the expression '*détenteur*' will then be used to designate a person who is using and enjoying the thing, knowing that he or she is not the real owner. Secondly, possession will only be effective if it shows certain qualities. Article 2261 *C.civ.* enumerates four conditions that are required to establish

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[708] 'Non-possessory security interest' is the preferred term used within Common Law jurisdictions.

[709] Article 2255 *C.Civ.* provides a definition of possession: "[p]ossession is the detention or enjoyment of a thing or of a right which we hold or exercise by ourselves, or by another who holds and exercises it in our name."

an effective possession[710]. If these conditions are fulfilled, possession will be effective and will create legal effect for its holder. In effect, a valid possession creates a presumption of ownership which can lead to ownership if not contested by the real owner[711].

The buyer with retention of title clause cannot be a *possesseur* as he agreed that transfer of ownership would be delayed until he or she fully pay the purchase price. Thus, such an agreement could not lead to possession as the buyer would lack the intentional element required for the recognition of possession, the *animus*. In relation to other movable security, the same reasoning can be advanced. A creditor cannot be a *possesseur* but can only be a simple *détenteur*. This aspect of possession constitutes a substantial divergence with the concept retained under the Common Law as it will be now envisaged.

At first sight, the analysis of the concept of property in France would not appear to be flexible enough to fit with the realities of the retention of title mechanism. In effect, if a security is analysed as an accessory real right, the question is to determine whether retention of title clause, which in essence retains ownership in the goods (principal real right), could also be analysed as an accessory real right. Also, if the buyer was to resell or manufactured goods sold under retention of title clause, the absolute character of the seller's ownership can be questioned. Notwithstanding the difficulties raised by the strict approach to the concept of property and ownership in France, retention of title clauses are widely recognised and have somehow managed to be accommodated with property law concepts. The question is to determine whether the dogmatic approach to the concept of property in France could create an obstacle to the accommodation of the regulations underlying retention of title clauses in Europe. The analysis of the concept of property in England will now be considered.

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[710] Article 2261 *C.Civ.* provides that: "[i]n order to be allowed to prescribe, one must have a continuous and uninterrupted, peaceful, public and unequivocal possession, and in the capacity of an owner."

[711] Article 2276 *C.Civ.* further provides that "[i]n matters of movables, possession is equivalent to a title. Nevertheless, the person who has lost or from whom a thing has been stolen, may claim it during three years, from the day of the loss or of the theft, against the one in whose hands he finds it, subject to the remedy of the latter against the one from whom he holds it."

Common Law jurisdictions and the relative character of property

The Common Law concept of property had a different historical evolution than within Civilian legal systems. Indeed, the development of the concept of property happened through the strong authority of sovereigns[712]. English property law was based on a feudal system. Property right did not designate the right of the owner because the sovereign was the sole owner. The sovereign's subjects were the tenants. This structure of ownership only applied to land and did not apply to any other forms of property[713]. Consequently, it is not surprising that the concept of property, and especially ownership, evolved differently within Common Law jurisdictions.

Property is not associated to an absolute right but largely remains a relative concept[714]. Common Law jurisdictions did not develop any proprietary remedies for the owner of personal property as it happened in Civilian jurisdictions with the *vindicacio*[715]. The protection of property rights essentially arose through the law of tort by means of damages. Concepts of possession and proprietary interests are fundamental within Common Law jurisdictions. Accordingly, the existence of different proprietary remedies in England and France could create some difficulties in this quest to accommodate legal differences.

Since English law does not provide for a statutory definition of 'property', it is fundamental to refer to the legal doctrine and legal dictionaries to examine the terminologies used within the Common Law. The Oxford Dictionary of Law[716] provides that property is "[a]nything that can be owned" and, generally refers, to the 'right of ownership in chattels'. The definition further provides that English law

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[712] De Chabot, N. "La Notion de Droit de Propriété dans le Droit Anglo-Saxon et le Droit Romain" (1999) *Géomètre no 5*, available at http://topo.epfl.ch/MO_cours/siteweb/NOTPROPR.htm (last checked 26/04/2010).

[713] Bridge, M., *Personal Property Law*, (2000), at p. 1.

[714] Milo explains for instance that "[t]hough English Law does not use the term 'ownership', it does not know of an action to protect it as civil law jurisdictions do (revindication), but uses tort law. Ownership might be considered a redundant concept. It is, however, a fundamental importance in civilian law jurisdictions. In common law, title, or right to possession, is a key concept. Furthermore, these are relative concepts, as opposed to the absolute concept of ownership and other property rights in civil law jurisdictions. As there can only be one owner at any given moment in civil law jurisdictions, there very well may be several rights to possession, and the best right will prevail." Milo *op. cit.* fn. 703, at p. 596.

[715] *Ibid.*

[716] Martin, E.A., *Oxford Dictionary of Law*, (5th ed., 2003).

clearly distinguishes between real property which relates to land and personal property which relates to chattel. The Common Law terminology of real property should not be confused with the Civilian concept of real right which relates to chattels and more generally, to movable property. In effect, as it has already been highlighted, Civilian jurisdictions generally distinguish between immovable property (land) and movable property (chattels). As for Civilian jurisdictions, the concept of property does not solely encompass the object, personal and real property, it also encompass proprietary rights, a legal relationship with the object. It is explained that:

"'[p]roperty' is a word of different meanings. It may mean a thing owned (my watch or my house is 'my property'); it may mean ownership itself as when I speak of my 'property' in my watch may pass to the person to whom I sell the watch before I actually hand the watch over or it may even mean an interest in a thing less than ownership but nevertheless conferring certain rights, as when we speak of the 'property' or 'special property' of a bailee in the thing bailed ..."[717]

Evidently, in our everyday language, the expression of 'property' generally refers to the object which is owned. However, it is important to emphasise that property does not solely mean the object, it also includes "... every right and interest which a person has in lands and chattels, and is broad enough to include everything [interest] which one person can own and transfer to another."[718]The term 'property' therefore encompasses both the 'object' and 'right', in other words, a legal relationship between the thing and an individual[719].

From these definitions of 'property' in Civilian and Common Law jurisdictions, it can already be established fundamental divergences. While Civilian jurisdictions understand property as a legal relationship between the owner and the thing in an absolute manner, English law understands property as a "... network of property relationships"[720] and thus retains a more relative approach to the concept of property. While Civilian jurisdictions systems essentially seek to determine who the absolute owner is, Common Law jurisdictions generally look for the best proprietary interest

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[717] Vaines, C., Et al., *Personal Property*, (1973), at p. 3.
[718] Noyes, C.R., *The Institution of Property: A Study of the Development, Substance and Arrangement of the System of Property in Modern Anglo-American Law*, (2007), at p. 359.
[719] Brown explains for instance that "[i]n the legal sense...property means not the thing itself, but the rights which inhere in it. Ownership, or the right of property is, moreover, not a single indivisible concept but a collection or bundle of rights, of legally protected interests." Brown, R.A., *The Law of Personal Property*, (2nd ed. 1955), at p. 6.
[720] Gray, K., *Elements of Land Law*, (1st ed. 1987), at p. 8.

that will prevail. In effect, there might be more than one claim made in relation to a specific object, each entitling the holder to a proprietary interest. Common Law jurisdictions therefore conceive property as"... a bundle of mutual rights and obligations which prevail between 'subjects' in respect of certain 'objects'"[721]. In this sense, 'ownership' does not appear to be a key concept within Common Law jurisdictions. Rather, the Common Law tradition put more emphasis on legal concepts such as title, proprietary interests or right to possession[722].

In this sense, the definition provided by Noyes in the 'Institution of Property' appears to be accurate for the purpose of this analysis. It is explained that:

"[t]he term property may be defined to be the interest which can be acquired in external objects or things. The things themselves are not, in a true sense, property, but they constitute its foundation and material, and the idea of property springs out of the connection or control, or interest which, according to law, may be acquired in them, or over them. This interest may be absolute [complete], or it may be limited and qualified. It is absolute when a thing [object] is objectively and lawfully appropriated by one to his own use in exclusion of all others. It is limited or qualified when the control acquired falls short of the absolute."[723]

It is interesting to note at this stage the concept of interest within the English definition of property. Effectively, while French law uses the term of 'real right', English law refers to the term of 'interest'. Indeed, Civilian jurisdictions such as France, only recognise rights in property and not interests in property. As opposed to the absolute and indivisible character of ownership recognised in France, property is understood as a bundle of rights within Common Law jurisdictions entitling their holders to proprietary interests. The term 'property' would therefore refer to proprietary interests within Common Law jurisdictions, whereas emphasis is given on ownership right and real rights within Civilian jurisdictions. Under the Common Law, the owner could be defined as the individual with the best proprietary interest and not necessarily the individual with an absolute right of property in the Civilian sense.

As part of this analysis on the concept of property in Common Law jurisdictions such as in England, it is fundamental to highlight the importance of Equity.

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[721] *Ibid.*
[722] Milo *op. cit.* fn. 703, at p. 596.
[723] Noyes *op. cit.* fn. 718, at p. 357.

Although, English law establishes clear and specific rules regulating the creation and transfer of property rights, the reference to Equity can sometimes reach different solutions and decide that property rights have passed. A significant example of equitable proprietary interests can be found with the trust. This mechanism is peculiar to Common Law jurisdictions and entails a trustee to hold property on behalf of a beneficiary. Under a trust, ownership is divided between the legal owner (trustee) and the beneficial owner (beneficiary) who is entitled to an equitable interest to the property. The former has a legal title under Common Law while the latter has an equitable title in Equity. In this respect, the recognition of the trust mechanism within Civilian jurisdictions would be difficult to implement considering the absolute character of ownership and considering that Equity does not exist. However, it is interesting to highlight that the dogmatic approach to the concept of ownership has not prevented Civilian jurisdictions such as France to recently integrate similar mechanisms into their legal regimes[724].

The Courts also had the opportunity to refer to Equity in order to support the recognition of the seller's rights to trace the proceeds of resale under a retention of title clause. In effect, the famous *Romalpa*[725] case recognised the existence of a fiduciary relationship between the contracting parties and allowed the seller to trace the proceeds of resale in Equity which entitled him to a property right in effect. Following the equitable doctrine of tracing, originally established in *Re Hallets Estate*[726], the fiduciary seller was entitled to trace the proceeds of resale. Since then, the courts never found a fiduciary relationship entitling the owner to this equitable right of tracing[727]. In France, such reasoning could not occur. In effect, subsequent developments will highlight that the only way the seller could recover the proceeds of resale is through the mechanism of the *subrogation*.

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[724] For instance, France recently adopted the *fiducie* in 2007. The *fiducie* is defined in Article 2011 *C.Civ.* as a transaction whereby one or more settlors transfer assets, rights, or sureties, or a group of assets, rights or sureties, present or future, to one or more trustees who, keeping them separated from their own patrimony, will act according to a specific purpose in the interest of one of more beneficiaries. See above fn. 582.

[725] *Aluminium Industry Vaassen BV v. Romalpa Aluminium Ltd.* [1976] 1 WLR 676.

[726] [1880] 13 Ch.D 696.

[727] *Tatung (UK) Ltd. v. Galex Telesure Ltd.* [1989] 5 BCC 325; *E Pfeiffer v. Arburthnot Factors* [1988] 1 WLR 150; *Compaq Computers v. Abercorn Group* [1991] BCC 484.

Common Law jurisdictions did not retain 'ownership' as a key concept but put more emphasis on the concept of title and possessory rights. Possession is an important concept within Common Law jurisdictions that differ from the concept retained in Civilian jurisdictions. The nature of possession within English law can be conceived in different ways. First, possession can be defined as the physical control that an individual has over a thing[728]. This is *de facto* possession which generally does not lead to legal possession. In order to create 'legal possession', and comparably to France, the possessor must intend to exclude others from his control over the object. This is the intentional element or *animus* required for the recognition of possession at law. *De facto* possession would therefore be assimilated to the French concept of *détention* where the individual exercises physical control over a thing but does not have the *animus* or the intention to act as the owner of the object. Legal possession, when established entitles the holder to a right to possess. For instance, a voluntarily bailment requires the bailee to hold property on the bailor's behalf. In this situation, the bailor and bailee will both share legal possession. More precisely, the bailor is said to have constructive possession of the chattel as he lost physical possession of the asset.

From this definition, it is interesting to note significant divergences in the nature and purpose of possession within both legal traditions. Legal possession in England differs from the concept of legal possession retained in France in the sense that the former defines the intentional element as the action of the possessor to exclude others from his physical control over the thing while the latter requires the *possesseur* to act as if he was the owner of the asset. In this sense, the Common Law generally considers the buyer under retention of title as a possessor while Civilian jurisdictions such as France will consider the buyer as a simple *détenteur.*

Following this analysis on the concept of property within both legal traditions, it would seem that the terminologies inherent to property law in Common Law appears to be much more flexible than in Civilian jurisdictions such as France. Common Law

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[728] It is explained that: "[c]ontrol in fact may be acquired by taking physical possession of the chattel itself or possession of an object which gives physical control of the chattel, *e.g.* the keys to the warehouse in which the chattel is stored (although possession of a key to a container or to ''a building has been variously described by the courts as giving 'actual', 'constructive' or 'symbolic' possession of the chattel contained therein." In Sealy, L.S., Et al., *Commercial Law,* (2009), at p. 73.

jurisdictions generally recognise a fragmentation of property rights so that different persons can have, at the same time, different property rights on the same good. In contrast, under Civil law, ownership is absolute and indivisible[729]. From the analysis of property law terminologies and concepts retained in France, it is evident that they remain very complex and would appear to be difficult to fit within modern legal relationships. The strict conception of ownership as an absolute, exclusive and perpetual right would prevent the creation and recognition of the Common Law equivalent of the trust within Civilian jurisdictions such as France. Nevertheless, it has to be observed that the Civil Law is not as dogmatic and rigid as it seems by allowing more and more flexibility in its jurisprudential interpretation. For instance, and as it has already been mentioned, it is interesting to note the recent adoption of the *fiducie* in France. Although, the indivisible character of ownership remains, it is showed that the strict conception of ownership as an absolute, exclusive and perpetual property right does not constitute an obstacle to legal reforms, especially to those inspired from other legal models. Thus, the fact that these jurisdictions are willing to adopt a more flexible approach towards their property law concepts could arguably facilitate the process of harmonisation in Europe.

This comparative analysis highlighted further significant differences, particularly in respect of the terminologies retained in French and English property laws. For instance, Civilian jurisdictions such as France generally recognise specific proprietary remedies such as the *vindicacio* that are not recognised in English law. An illustration of the existing divergences between the two jurisdictions can also be found with Equity. In effect, Equity permitted the seller with retention of title clause to trace the proceeds of resale following the recognition of a fiduciary relationship. Such reasoning could not be integrated in Civilian jurisdictions such as France because Equity does not exist. Accordingly, an accommodation of differences would appear difficult to achieve in these jurisdictions where doctrinal property law terminologies show substantial divergences. These differences underlying the concept of property in Common Law and Civilian traditions have an immediate

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[729] On the concept of 'ownership' in Common Law and Civilian jurisdictions, see Grenon, A. "Dans un Contexte d'Harmonisation et d'Economies Intégrées, Quelques Réflexions au Sujet du Concept de Propriété en Droit Civil et en Common Law" (2005), *Revue Général de Droit* available from http://www.apff.org/_site/DOCUMENTS/PDF/HARMONISATION_RECUEIL-2005/FRANCAIS/t-1_aline_grenon_fr.pdf

impact on the way securities such as retention of title clauses are analysed and regulated.

Following this analysis on the concept of property and other terminologies relative to property law in France in England, some similarities can also be highlighted. In both jurisdictions, proprietary rights are protected and enforceable *erga omnes*, which means that they are enforceable against the rest of the world. Further, beyond doctrinal and theoretical differences in the analysis of property law terminologies, both legal traditions recognise that ownership can be used to secure payment of a debt. In both legal systems, the transfer of property can be postponed by the creditor until repayment is made by the buyer. In effect, in Civilian jurisdictions such as France, the rule according to which the transfer of ownership is *solo consensus* is only supplementary in effect. Pursuing Article 1583 of the French Civil Code, a sale of good contract " ... is complete between the parties, and ownership is acquired as of right by the buyer with respect to the seller, as soon as the thing and the price have been agreed upon, although the thing has not yet been delivered or the price paid."

Article 1583 devotes the principle of the immediate transfer of ownership, also labelled as a transfer of ownership *solo consensus*, which is accompanied by the immediate transfer of risks to the buyer[730]. However, these principles are not mandatory and are only supplementary in effect. Thus, the contracting parties are free to derogate to these rules and decide to subject the transfer of ownership and risks to other contractual conditions such as the payment of the price. The recent reform of security law in France now provides a definition of retention of title in the Civil code[731].

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[730] Article 1138 *C.Civ.* provides that "[a]n obligation of delivering a thing is complete by the sole consent of the contracting parties. It makes the creditor the owner and places the thing at his risks from the time when it should have been delivered, although the handing over has not been made, unless the debtor has been given notice to deliver; in which case, the thing remains at the risk of the latter."

[731] Article 2367 *C.Civ.* provides that « [o]wnership of a property may be retained as security through a retention of title clause which suspends the transferring effect of a contract until payment in full of the obligation which compensates for it. Ownership so retained is the accessory of the debt whose payment it secures."

Under English law, the principle of the transfer of property is embodied in Section 17 of the Sale of Goods Act 1979 (SGA) which provides that property passes when intended to pass. Under English law, intention of the parties is paramount in determining when property passes to the buyer. Thus, the parties can agree to delay the transfer of property upon the fulfilment of a particular condition, such as the payment of the price. Accordingly, Section 19 SGA expressly allows for the possibility to subject the transfer of property to certain conditions such as the payment of the purchase price[732]. Although the content of the concept of property differs, the idea of using ownership as a form of security is recognised in both jurisdictions. Thus, it is not surprising that the recognition of the retention of title mechanism has been done without great difficulty in the EU[733]. However, the Directive on Late Payments only requires Member States to recognise the validity of retention of title clause in its simplest form. In effect, the Directive does not provide any guiding principles towards the regulation of the parties' rights and obligations. Yet, this is an aspect of secured credit law that needs to be considered in the context of a potential harmonisation.

As it has already been highlighted, secured credit law regimes involve the regulation of the form and content of property rights and should ascertain the way property rights can be acquired and how they can be lost[734]. In the context of retention of title clauses, the law should clearly ascertain the nature of the buyers and seller's rights before payment, and rights of the seller upon the buyer's default. Following the analysis of property law terminologies in Civilian and Common Law jurisdictions, it will therefore be fundamental to consider the legal situation of the proprietary entitlements of the seller and buyer under retention of title clauses in both

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[732] Section 19 SGA provides: "(1)Where there is a contract for the sale of specific goods or where goods are subsequently appropriated to the contract, the seller may, by the terms of the contract or appropriation, reserve the right of disposal of the goods until certain conditions are fulfilled; and in such a case, notwithstanding the delivery of the goods to the buyer, or to a carrier or other bailee or custodier for the purpose of transmission to the buyer, the property in the goods does not pass to the buyer until the conditions imposed by the seller are fulfilled. (2)Where goods are shipped, and by the bill of lading the goods are deliverable to the order of the seller or his agent, the seller is prima facie to be taken to reserve the right of disposal. (3) Where the seller of goods draws on the buyer for the price, and transmits the bill of exchange and bill of lading to the buyer together to secure acceptance or payment of the bill of exchange, the buyer is bound to return the bill of lading if he does not honour the bill of exchange, and if he wrongfully retains the bill of lading the property in the goods does not pass to him.

[733] See above fn. 611.

[734] See Introduction at pp 168-172.

jurisdictions in order to determine whether an accommodation of differences is possible. Thus, the next section will provide a comparative analysis of the regulation of the parties' proprietary rights before payment.

Comparative analysis of the regulation of the parties' rights and obligations under retention of title clause

France and England recognise the right to use ownership for security purposes. A seller can retain ownership of the goods until full payment has been made by the buyer. The buyer has possession of the goods but will only become the owner once the goods have fully been paid for. The security mechanism itself is recognised and integrated in all European Member States following the Directive on Late Payments[735]. Nevertheless, the Directive remains largely silent on the regulation of the parties' rights and obligations. This comparative analysis will therefore focus on the nature of the seller's and buyer's rights before payment in France and England.

Legal nature of the buyer's rights until payment

The legal situation of the buyer depends on the legal effects that retention of title engenders. The question is to determine whether the buyer becomes the owner of the goods or whether he only gets an eventual or conditional right of ownership over the goods. If the clause is *suspensive*, the buyer does not become the owner of the goods until he has paid for them[736]. Therefore, it will be difficult to determine the rights to which the buyer is entitled over the goods until payment as the seller remains the legal owner of the goods. Civilian jurisdictions generally recognise the clause to be *suspensive* in effect[737].Within Common Law jurisdictions, the situation appears to be

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[735] *Ibid.*

[736] Ghestin, J. "Réflexions d'un Civiliste sur la Clause de Réserve de Propriété " (1981) *Recueil Dalloz Sirey* (Chronique I), at p. 1.

[737] See *e.g.* Article 1745 of the Civil code of Quebec provides that: "[a]n instalment sale is a term sale by which the seller reserves ownership of the property until full payment of the sale price". Article 2367of the French Civil code provides that "Ownership of a property may be retained as security through a clause of retention of title which stays the transferring effect of a contract until payment in full of the obligation which compensates for it. Ownership so retained is the accessory of the debt whose payment it secures."Further, §455 of the German BGB stipulates that "[u]nless otherwise specified, where the seller of a movable retains ownership until payment of the purchase price,

more contrasted. England, for example, recognise the *suspensive* character of the simple retention of title clause[738] and current account clause[739] but not in respect of other complex clauses such as proceeds and manufactured clauses[740]. Indeed, if the property of the goods is transferred, the retention of title clause will be held as a charge, void if not registered. France generally analyses the right of the buyer as a conditional real right.

The buyer's conditional real right in France

As it has already been highlighted in previous developments, the concept of property, within Civilian jurisdictions, is considered to be an absolute, exclusive and indivisible right. Hence, the buyer should not be legally entitled to exercise any rights over the unpaid goods such as reselling or manufacturing the goods without acting in the quality of legal owner. However, the question arises of the advantage of such a security mechanism if the buyer was not allowed to exercise any rights over the goods.

The right of the buyer has been analysed in France as an eventual or conditional right of property. The buyer will be entitled to a property right, ownership, on the realisation of the condition, which is the payment[741]. Under French law, the right of the buyer could therefore be qualified as a conditional real right. This qualification however does not clarify the proprietary entitlements of the buyer over the thing before payment. In effect, there are situations where ownership will pass even though payment has not occurred.

For instance, Article 2276 of the French Civil code protects the *bona fide* purchaser against the *action en revendication* of the first time seller in the case of resale by the first time buyer. The seller will be able to recover the proceeds of resale directly, if

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ownership is transferred under the suspensive condition of full payment and if the buyer is in default therein the seller may withdraw from the contract."

[738] Section 19 Sale of Goods Act 1979. See above fn. 731.

[739] *Armour v. Thyssen Edelstahlwerke AG* [1991] 2 AC 339.

[740] See for instance *Tatung (UK) Ltd v. Galex Telesure Ltd.* [1989] 5 BCC 325; *E Pfeiffer v. Arburthnot Factors* [1988] 1 WLR 150; *Compaq Computers v. Abercorn Group* [1991] BCC 484; *Re Peachdart Ltd.* [1984] Ch 131.

[741] Ghestin *op.cit.* fn. 735.

the second time buyer has not already paid him, through the mechanism of *subrogation*[742]. If payment has already been made, the seller will be entitled to compensations for damages. Ownership will therefore be transferred to the *bona fide* purchaser. This shows that the law admits, to a certain extent, the use of the goods by the buyer in the quality of an owner before payment. Thus, the qualification of the buyer's right as conditional real right becomes questionable considering that the buyer will sometimes be able to exercise the full prerogatives of the right of ownership by reselling the asset.

Until payment, the buyer is not even considered to be the *possesseur* but a simple *détenteur*[743]with a conditional real right. As it has already been explained above, the buyer cannot be considered to be a *possesseur* as he does not have the *animus domini*, the intention to act as the real owner. The *possesseur* must intend to exercise control over the property as if he was the real owner. Evidently, following Article 2276 of the French Civil code, there is a presumption that a person in possession of a movable is the legal owner if he or she is in good faith[744]. The owner who introduces the *action en revendication* has to prove the bad faith of the *possesseur*. However, under retention of title, the buyer could not invoke Article 2276 considering his lack of good faith. In effect, the buyer knows that he is not the legal owner of the asset bought under retention of title clause.

Détention, also called precarious possession, designates the situation of an individual who exercises prerogatives on a movable (*corpus*), but who cannot have the *animus* owing to exterior reasons such as lack of good faith. Thus, the buyer purchasing under a retention of title clause is entitled to a conditional real right and is qualified as a simple *détenteur* under French law. The consequence is that the buyer, as the *détenteur* of the thing, should not be able to alienate the thing by transforming it, selling it or incorporating it in other goods. If the buyer alienates the good by reselling it or manufacturing it, the Civil code now provides some legal solutions.

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[742] Article 2372 *C.Civ.* See above fn. 569.
[743] The *détenteur* holds the goods according to a contract agreed with the legal owner of the goods. The *possesseur* holds the goods and act as if he was the real owner.
[744] *Cass. Civ. 1ère, 7 Février 1962*: Bull. Civ. I, No 91; 20 Oct. 1982: *Ibid.* I, No 298; RTD Civ. 1983. 559, obs. Giverdon.

The ordinance of the 23rd March 2006, now incorporated in the Civil code, has reformed and codified the security law of France. In relation to retention of title, the code now regulates the legal consequences of the use of the unpaid goods by the defaulting buyer[745]. Upon the buyer's default, the seller is entitled to exercise an '*action en revendication* 'or 'en *restitution'* (if the clause was published)[746]. Upon the debtor's default, the seller must introduce an *action en revendication* which seeks to recognise his right of ownership and seeks to obtain restitution of the asset. The seller has three months to present his *action en revendication*, starting from the publication of the opening of the bankruptcy or insolvency proceedings in the BODACC[747]. Following the reform introduced in 1994[748], the optional registration of the contract of sale with retention of title clause offers the seller a much easier procedure to retrieve his property which is the *action en restitution,* according to which the seller only needs to claim the restitution of his asset without the need to have his right of ownership also recognised.

This procedure does not have any time limit, so that the seller can present an *action en restitution* at any time after the opening of the bankruptcy or insolvency proceedings. If the restitution of the asset is impossible[749], the seller will be able to obtain damages following the exercise of a mere personal action. The general rule is that the seller will be entitled to recover his asset if it is still in kind and identifiable

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[745] Article 2369 *C.Civ.* now provides that the reservation of title on fungible goods is effective if the goods are of the same nature and of the same quality. Article 2370 *C.Civ.* further provides that the incorporation of a good subject to a retention of title clause to another goods can still be claimed by the seller if it can be separated without damages. Article 2371 *C.Civ.* deals with the right to surplus. It provides that if the value of the good recovered is higher than the original debt, the creditor will have to give the difference back to the debtor. Article 2372 *C.Civ.* deals with the proceeds of resale and provides that the creditor will be able to take the place of the buyer if the latest has sold the goods to a third party through the mechanism of the subrogation. This mechanism will be only possible if the third party has not yet paid the purchase price to the buyer so he can pay it to the seller straight away. This implies that the seller had notice of the resale by the buyer.

[746] Article L.621.115 of the French Commercial Code offer the possibility to publish the clause (Names of the contracting parties, description of the asset, price and the due date of repayment) at the Commercial Tribunal of the location where the buyer has registered his business.

[747] *Bulletin Officiel des Annonces Civiles et Commerciales*. It is a public register that publishes any information about businesses such as their creation, modification and insolvency proceedings. For more information, see http://www.journal-officiel.gouv.fr/abonnements-jo-et-opoce/bodacc.html (last checked 26/04/2010).

[748] See above fn. 566, *Loi no 94-475 du 10 Juin 1994 relative à la prévention et au traitement des difficultés des entreprises.*

[749] The goods claimed must be in kind for the *action en revendication* and *action en restitution* to be possible. Articles 2369 to 2372 *C.Civ.* provide some guidelines in order to determine whether an action is possible.

at the opening of the insolvency proceedings. If the asset has been incorporated in another asset, restitution will only be possible if the original good can be separated without substantial damages[750]. The seller is not entitled to any right of surplus and will have to pay the difference back to the debtor if the asset recovered is higher in value that the debt owed[751]. Finally, if the asset has been resold, the seller may be entitled to the proceeds thanks to the *subrogation* mechanism[752]. Although, the definition of the retention of title mechanism does not in itself imply the right of the buyer to use, enjoy, and alienate the goods, the law implicitly recognises in some situations the right for the buyer to dispose of such prerogatives in light of the rules mentioned above[753]. Accordingly, it would seem that the buyer could enjoy the prerogatives of the owner without holding the legal ownership. The qualification of the buyer's right before payment remains unclear. The strict application of the absolute character of ownership within Civilian traditions would prevent the analysis of a divisible ownership between the buyer and the seller. Nevertheless, retention of title mechanisms are valid in France and the recent codification of the regulations underlying retention of title clauses confirmed that the dogmatic approach retained to the concept of property did not prevent the recognition and validity of specific property-based security devices.

The reform of the law in France was unable to provide a clear analysis of the legal nature of the buyer's rights until payment but only provided legal solutions in situations where the buyer would use the goods before payment. The complexities of the terminologies relative to property law have led to some doctrinal difficulties, especially towards the analysis of the buyer's legal situation before payment. The legislator has therefore opted for some practical solutions, failing to provide some conceptual legal analysis of the retention of title mechanism. This situation clearly shows the difficulty to adapt modern commercial legal tools to the rigid concepts of property law. This situation also shows that the dogmatic approach and rigid concepts underlying property law of Civilian jurisdictions would not constitute an irremediable obstacle to the modernisation of secured credit law regimes. Other

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[750] Article 2370 *C.Civ.* See above fn. 569.
[751] Article 2371 *C.Civ.* See above fn. 569.
[752] Article 2372 *C.Civ.* See above fn. 569.
[753] See above fn. 748.

Civilian jurisdictions such as Germany retained a different approach towards the determination of the buyer's right before payment. Under German law, the buyer is attributed an 'expectation right' also qualified as a limited real right. The right of the buyer is analysed as an 'economic ownership' as opposed to the seller's 'legal ownership'[754].

Common Law jurisdictions such as England do not provide any statutory regulations underlying the rights and obligations of the buyer before payment. Accordingly, the examination of the case law will be fundamental to understand the nature of the buyer's proprietary rights before payment in Common Law jurisdictions such as England as it will now be envisaged.

The nature of the buyer's rights in England

The concept of property within Common Law jurisdictions is much more flexible and considered to be divisible in a bundle of rights. At first sight, it would seem reasonable to think that retention of title should be dealt with more easily considering a more flexible approach to the concept of property. According to Sections 17 and 19 of the Sale of Goods Act 1979, the transfer of property can be subject to the payment of the goods by the buyer. Similarly to France, English law considers the retention of title clause to be *suspensive* in effect. The buyer will only become the owner of the asset once the purchase price is paid to the seller, at least in respect of simple and current account retention of title clauses.

Following the previous analysis on property law terminologies within the Common Law, the buyer would appear to have the legal possession of the asset which is under his or her physical control. In relation to simple and current account retention of title clauses, the courts have retained a flexible approach by recognising the validity of such clauses. The seller can retain legal ownership of the goods delivered in spite of certain possessory rights given to the buyer. However, this approach was not

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[754] Van Erp, J.H.M.S. "Personal and Real Security" in Smits, J.M., Et al., *Elgar Encyclopedia of Comparative Law*, (2006), at p. 522.

followed in relation to the retention of legal ownership to the proceeds of resale[755] or manufactured goods[756]. In the situations where the buyer does not alter the goods, the buyer also has a conditional proprietary right to the goods. Unfortunately for the seller, any clause attempting to retain title in manufacturing goods or proceeds of resale is generally construed as a charge, void if not registered.

Evidently, in relation to the question of whether ownership is transferred to the buyer, the intention of the parties is paramount. The sole fact that the buyer transformed or resold the goods does not automatically lead to the transfer of ownership to the buyer. However, the fact that the seller introduces proceeds or manufactured retention of title clauses in the contract of sale, may be an indication that the seller implicitly entitled the buyer to resell or manufacture the goods. In such instances where the buyer would resell or manufacture the goods, ownership will pass to the buyer. Such acts could not be fulfilled without the prerogatives associated to ownership that is the *dominion*. In *Clough Mill Ltd v. Martin* [757], the court held that the seller remained the legal owner of the unused and unsold goods despite the right of the buyer to resell and manufacture the goods in the clause. Thus, the fact that the buyer is given certain proprietary rights does not automatically transfer title and legal ownership to the buyer[758]. Nevertheless, it is arguable that the decision of the court may have differed if the buyer did actually resell or manufacture the unpaid goods.

The retention of title mechanism is not the only security device where ownership of the goods is retained by the owner and where certain proprietary rights are transferred to a possessor. Contracts of bailment, lease or hire-purchase also involve the exercise of similar powers over the assets without transferring ownership to the debtor. Contracts for the hire of goods or contracts for their repair entitle the person to exercise certain proprietary rights on the assets without the transfer of

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[755] See Above fn. 405.
[756] See *Clough Mill v. Martin* [1985] 1 WLR 111; *Re Peachdart Ltd.* [1984] Ch 131 but consider *Hendy Lennox (industrial engines) Ltd. v. Grahame Puttick Ltd.* [1984] 1 WLR 485 where the court upheld the clause retaining title in some engines which had been incorporated to other goods. The removal of such goods without any damage caused to the principal asset.
[757] *Ibid.*
[758] Worthington *op. cit.* fn. 401, at p. 13.

ownership[759]. Similarly, retention of title allows the seller to remain the owner despite the entitlement of the buyer to exercise certain proprietary rights over the unpaid goods[760]. A good example can be found in the case of *Hendy Lennox*[761] which involved the contract for the sale of diesel engines under a simple retention of title clause. The buyer later incorporated the diesel engines into a generator. In this case, the court upheld the clause and entitled the seller to recover one of the diesel engines that could be removed without any damages to the principal asset[762].

Considering the recognition of certain proprietary rights entitlements to the buyer over the goods sold under retention of title clause, and considering that the seller remains the legal owner, the question emerged whether the buyer could be qualified as the equitable owner[763]. In effect, the concept of equitable proprietary rights is very flexible and could allow for a 'division' of ownership[764]. Although the case of *Borden (UK) Ltd. v. Scottish Timber Products Ltd.* [765] suggests that equitable title passed to the buyer while legal title remained with the seller, this legal analysis could not be preserved as it defeats the object of the retention of title clause agreement and defeats the intention of the parties[766]. Thus, the question of the legal nature of the buyer's right would also appear to be uncertain in England, as within French law.

Under English law, the legal nature of the buyer's right before payment will thus largely depend upon the construction of the clause and of the interpretation of the intention of the parties by the Court. The buyer may be allowed to resell and manufacture the goods sold under retention of title clause without the seller intending to transfer ownership to the buyer. If the buyer is entitled to resell or manufacture goods sold under retention of title clause, the buyer may become the legal owner of the goods, or could only remain the possessor with a conditional right of ownership upon payment.

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[759] *Ibid.* at p. 14.
[760] *Ibid.* at p. 13.
[761] See above fn. 755.
[762] *Ibid.*
[763] Worthington *op. cit.* fn. 401, at p. 15.
[764] *Ibid.*
[765] [1981] Ch.25, 35.
[766] Worthington *op. cit.* fn. 401, at p. 16.

Other Common Law jurisdictions such as the U.S., Canada (except Quebec) or New Zealand do not consider the clause to be suspensive but resolutive. The U.S. adopted a functional approach to the regulation of its secured credit transactions enshrined in Article 9 of the UCC. Indeed, Article 9 applies to any agreement that has the purpose of creating a security over movables including retention of title[767]. According to Article 9 UCC, the concept of retention of title has been explicitly converted, as it is now limited in its effects to a reservation of a security interest with the property passing to the buyer[768]. Therefore, the seller becomes a secured party and loses his previous status of owner. If the clause is resolutive, the buyer becomes the owner of the goods. Therefore, the buyer will be able to act accordingly over the goods[769]. If the buyer does not pay the price, ownership of the goods will return to the seller. There will be transfer and then re-transfer of property. The transfer of property to the buyer subject to a security interest would simplify the difficult task of analysing the rights of the buyer before payment, especially in situations where the buyer resells or irreversibly alters the goods. The equivalent of retention of title mechanisms in Article 9 UCC can be found with the purchase money security interest which has already been the object of extensive analysis in above developments[770].

In conclusion, it would appear that none of the legal systems analysed in this paragraph have managed to provide a satisfactory analysis of the legal situation of the buyer before payment. Nevertheless, it is interesting to note that France and England allow for the recognition of certain proprietary rights to the buyer before payment without the termination of the seller's legal ownership. However, the legal reasoning leading to the legal qualification of the buyer's right differ among both jurisdictions. On one hand, England emphasises the importance of the intention of

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[767] § 9-102 (2) UCC provides that: "[t]his Article applies to security interests created by contract including pledge, assignment, chattel mortgage, chattel trust, trust deed, factor's lien, equipment trust, conditional sale, trust receipt, other lien or title retention contract and lease or consignment intended as security. This Article does not apply to statutory liens except as provided in Section 9-310."

[768] § 2-401 UCC states that: "[a]ny retention or reservation by the seller of the title (property) in goods shipped or delivered to the buyer is limited in effect to a reservation of a security interest. Subject to these provisions and to the provisions of the Article on Secured Transactions (Article 9), title to goods passes from the seller to the buyer in any manner and on any conditions explicitly agreed on by the parties."

[769] The buyer will be able to use, enjoy and dispose of the goods according to his quality of legal owner.

[770] See above, at pp. 121-125.

the parties[771] and will generally determine the substance and content of the parties' rights pursuing the form of the agreement. France, on the other hand, adopts a much more restrictive approach and closely follows the form prescribed by the law so that the parties could not agree to retain title in manufacturing goods or proceeds of resale, especially in the light of the absolute character of the concept of ownership. Nevertheless, if the buyer was to resell or manufacture goods, the law now determines situations where the action of the owner, *action en revendication*, will remain possible. If restitution is impossible, both jurisdictions recognise that the seller looses ownership. In England, the agreement is analysed as a charge void if unregistered so that the seller becomes an unsecured creditor[772]. In France, the impossible *revendication* of the goods also means that the seller looses ownership to the goods and also becomes entitle to a personal action in damages against the seller. The retention of title clause is not re-qualified as a charge. If the buyer resold or manufactured the goods, so that the *action en revendication* is impossible, this will have the effect of a breach of contract entitling the seller to a personal action in damages.

This comparative analysis will now consider the legal situation of the seller under retention of title. Although substantial elements of answers have already been identified within the above developments, this section will add further observations in relation to the nature of the seller's rights under retention of title clause. The question is to determine whether the real nature of retention of title clause amounts to a security mechanism or remains 'ownership'.

Legal nature of the seller's right until payment: security (charge) or proprietary right?

The legal nature of the seller's rights will depend upon his quality of owner or secured creditor. As it has been explained in the above paragraphs, England and France have analysed retention of title to be *suspensive* in effect. Thus, both

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[771] Article 17 SGA 1979.

[772] The agreement is re-qualified as a transfer of ownership accompanied by a charge back to the seller which requires a registration. The lack of registration will mean for the seller that the charge is void. He will become an unsecured creditor.

jurisdictions recognise the legal ownership of the seller under a valid retention of title clause until payment.

Nevertheless, it is fundamental to note that although the seller is the owner, he still cannot freely dispose of the goods because of the lack of physical possession of the asset. In effect, and as it has been previously explained, the seller under retention of title bears the risk of losing his quality of owner if the buyer was to resell or alter irreversibly the goods. Further, the seller's ownership is also limited by the obligation that weighs on him to transfer the property of the goods upon payment[773].

Within Common Law jurisdictions, the distinction has to be made between the American Article 9 UCC, and other PPSA regimes adopted, for instance, in Canada and New Zealand, and England which did not opt for the American functional approach within the regulation of its secured credit law regime. In the U.S. and in other PPSA jurisdictions, retention of title mechanism operates a legal transfer of ownership to the buyer. The seller loses his quality of owner and is entitled to a purchase money security interest[774] instead. The purchase money security interest entitles the creditor to a preferential payment upon the debtor's default[775]. This situation effectively simplifies the analysis of the seller's rights before payment and his or her entitlements and remedies upon the debtor's default. The conservation of the quality of the seller as legal owner under a retention of title clause does not enable such a sharp distinction between the rights and obligations of the buyer and those of the seller.

Civilian jurisdictions such as France or Quebec tend to admit that retention of title is both a proprietary right and a security. Hence, French authors usually qualify the clause as a '*propriété-sûreté*'[776]. However, this legal qualification does not represent the unanimity amongst scholars. Some authors invoke the fact that a security can be

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[773] Pérochon *op.cit.* fn. 558.
[774] The PMSI entitles the creditor to a super priority if he provides the credit to purchase a new asset in circumstances where the buyer is out of available assets. Without this super priority, the first creditor's security, older in time, would prevail.
[775] See Chapter Three at pp. 121-125.
[776] '*propriété-sûreté*' can literally be translated as 'proprietary security' or 'property-based security'

qualified as such only if the law prescribed it[777]. Other could not imagine that property could be downgraded to the qualification of 'security'. A security, within French law is analysed as being an 'accessory' of the credit. Therefore, the legal question is to determine whether a proprietary right can be qualified as such. The Commercial court ended this doctrinal debate with a case dated 23rd January 2001[778]and decided that retention of title was 'the accessory' of the credit allowed to the buyer and therefore considers retention of title to be qualified as a security. Further, this jurisprudential solution was later embodied in Article 2367 of the French Civil Code which now provides in its second *alinea* that "[o]wnership so retained is the accessory of the debt whose payment it secures."

Quebec also qualifies retention of title clause as a security notwithstanding a recent case where the Supreme Court of Canada held that:

"[t]he reservation of ownership must not be equated with a security within the meaning of the *Civil Code of Québec*. The legal relationship between the original buyer and the seller must be interpreted as one of ownership ... Ownership of the property thus remains with the seller until the term is fulfilled. Since the transfer of ownership takes effect only at that time, the property continues to be part of the seller's patrimony. The seller retains ownership rather than a mere security interest, according to the definition of an instalment sale contract adopted in art. 1745 CCQ."[779]

Considering the definition of the concept of ownership as an absolute right, it is difficult to conceive how the seller could be qualified as a legal owner. In effect, the usual prerogatives associated to the absolute concept of ownership within Civilian jurisdictions would not appear to be available to the seller under a retention of title clause. In effect, the seller does not have physical possession of the goods. The seller does not have the *usus*, *fructus* and, most importantly, *abusus* so that he cannot alienate the thing by selling it to a third party. The seller has an obligation to transfer ownership to the buyer upon payment which prevents him from reselling the goods to a third party. Nevertheless, as the Court explained in Quebec, the legal relationship between the seller and the buyer under a retention of title clause is one of

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[777] Following the recognition of the '*numerus clausus*' principle.
[778] D. 2001, a.j. 702, obs. Lienhard ; JCP G 2001, 391 ou E, 755, obs. M.C.
[779] See above fn. 591.

ownership. Thus, Civil Law considers the seller as the legal owner of the goods but not in its absolute sense, as prescribed within the law on property.

Following this analysis on the different terminologies adopted in Civil Law jurisdictions, it is quite difficult to establish a coherent analysis of the seller's right before payment. The law and the case law have analysed the retention of title mechanism as a security, more precisely as an accessory of the credit in France. Nonetheless, it is also clear that the relationship between the seller and debtor is essentially based on ownership and property remedies rather than in terms of security.

In England, the analysis of the legal nature of the seller's rights will depend upon how the court will interpret the clause and the intention of the parties. For example, complex retention of title clauses, such as proceeds or manufactured clauses, are generally construed as being charges, void if not registered[780]. In this situation, the seller would lose his quality of owner.

In relation to simple and all monies clause, the seller remains the legal owner of the goods sold under retention of title clause and can reclaim possession of the goods if they are still identifiable upon the buyer's default. The matter becomes more complex when the clause deals with proceeds and manufactured goods. In *Re Bond Worth Ltd.*[781], the seller attempted to retain equitable and beneficial ownership in the goods, and *Slade J* held that the transaction had to be construed as a charge which was void for lack of registration. *Slade J* analysed the transaction as an outright sale of the acrylan fibre to the buyer, followed by the creation of a security *eo instanti*, given back to the seller[782]. Following the construction of the agreement as a charge, the seller lost title.

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[780] Worthington *op. cit.* fn. 401.
[781] [1980] Ch 228.
[782] Following the case of *Abbey National Building Society v. Cann* [1991] 1 AC 56, HL, the reasoning of *Slade J* was questioned, considering the rejection of the House of Lords of the '*Scintilla temporis*' fiction in this conveyancing case. Nevertheless, *Re Bond Worth* was followed, on this specific issue, in *Stroud Architectural Systems Ltd. v. John Laing Construction Ltd.* [1994] BCC 18.

In *Borden (UK) Ltd. v. Scottish Timber Products Ltd.*[783], the seller who sold resin to the buyer under retention of title could not claim back the resin following its irreversible incorporation into chipboards. The court held that the resin ceased to exist as soon as it was incorporated in the manufacture of the chipboard. Accordingly, the seller lost title to the resin at the moment when it was used in the manufacturing process[784]. The court found that the only way the seller could have retained title in the finished product was by way of charge, which was void for lack of registration. In *Hendy Lennox (Industrial Engines) Ltd. v. Grahame Puttick Ltd.*[785], however, the court entitled the seller to recover one of the engine which had been incorporated in a generator set but which was still identifiable and in a deliverable state.

This line of authority represents an illustration of the uncertain character of the seller's rights under retention of title clause. The fate of the seller's rights will thus largely depend upon how the court will construe the clause. Therefore, a sensible drafting of a retention of title clause is paramount for the protection of the seller's right as legal owner. In effect, under a valid retention of title clause, it is clearly recognised that the seller remains the legal owner of the asset sold to the buyer. In this situation, the retention of title clause would therefore be qualified as an agreement to sell. If the court considers that the clause amounts to a charge, then the seller will lose his title and will be downgraded to the status of unsecured creditor. Accordingly, the agreement becomes a security.

In relation to manufactured clause, Germany found a solution to assure more certainty to the seller with retention of title clause. According to Section 950 BGB, the manufacturer of a new object will acquire title to it, despite any rights other may have. In principle, the buyer who uses the goods sold under retention of title to manufacture new goods will gain title in the finished asset. Therefore, as in France,

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[783] See above fn. 764.
[784] *Buckley LJ* states: "[i]t was impossible for the plaintiffs to reserve any property in the manufactured chipboard, because they never had any property in it; the property in that product originates in the defendants when the chipboards is manufactured. Any interest which the plaintiffs might have had in the chipboard must have arisen either by transfer of ownership or by some constructive trust or equitable charge, and, as I say, I find it impossible to spell out of this condition anything of that nature."
[785] See above fn. 755.

the seller's right is reduced to a mere personal right which will entitle him to sue the buyer for damages. However, the court allows for a derogation to the application of Section 950 BGB and accordingly allows retention of title clauses to stipulate that the buyer is manufacturing on behalf of the seller. Thus, this provision will guarantee the owner of the original goods to become the owner of the new asset manufactured by the buyer. The buyer would only acquire title in the new object following the full payment of the goods[786].

It is quite clear from this comparative analysis of both jurisdictions that the legal situation of the seller remains quite ambiguous and unpredictable. The quality of legal owner attached to the seller largely depends upon the buyer's behaviour. Generally, France will allow the seller to exercise his *action en revendication* as long as the goods are still identifiable and in a deliverable state. In England, the court will enable the seller to resume possession of the goods, depending on how the clause has been construed. Where the goods have been resold or manufactured irreversibly, some principles have been laid down in France contributing to the ascertainment of the seller's right. General principles regulating the legal situation of the seller in relation to complex retention of title clauses can also be identified from the case law in England. Nevertheless, the outcome of the case essentially depends upon the construction of the agreement and the interpretation of the parties' intention which does not provide for certainty and predictability for sellers. It is thus arguable that the significance of contract construction in England might hinder the effectiveness of the approximation of substantive rules to regulate retention of title clauses.

This comparative analysis of property law concepts and retention of title clauses in jurisdictions of dissimilar legal traditions showed some divergences in the legal analysis of the parties' rights and obligations which would render the task of harmonisation difficult. For example, the procedure exercised by the seller to recover property differs from one jurisdiction to another. France requires the seller to exercise an *action en revendication* or en *restitution* if the clause has been published.

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[786] On this point, see Milo *op. cit.* fn. 688, at p. 221 and Pennington, R.R. "Retention of Title to the Sale of Goods under European Law" (1978), 27(2) *International Comparative Law Quarterly*, at p. 227.

Both actions would not be possible under English law. Further, English law does not recognise the mechanism of the subrogation if the buyer was to resell the asset sold under retention of title to a third party. Similarly, France does not recognise the charge and French courts would not construe the retention of title as a charge if its real aim was to create a security. Further, France does not recognise the doctrine of Equity which may create some difficulties for the harmonisation of retention of title clause regimes.

Further difficulties in accommodating the regulations underlying retention of title in Europe could arise from the differences in regulating the rights and obligations of third parties. It has already been explained that in both jurisdictions property rights were enforceable *erga omnes* as opposed to personal rights. Property rights do affect third parties and, accordingly, need to ensure a high level of certainty and predictability for all parties. National legislations are required to strike a certain balance between competing interests. The difficulty of balancing the interests at stake is particularly flagrant in the context of retention of title clauses[787].

Retention of title clause creates proprietary rights which, in nature, are enforceable *erga omnes*, against the rest of the world. Accordingly, a modernisation of the regulations underlying retention of title clauses using harmonisation as legal method should respect several leading principles that govern property law in European jurisdictions. These are, for instance, the principle of publicity of property rights and the principle of the *numerus clauses* mainly recognised in Civilian jurisdictions[788]. These principles are fundamental for some jurisdictions in the regulation of property-based security devices. Accordingly, the question is to determine whether these principles could create some obstacles to the harmonisation of retention of title clauses regulations.

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[787] On this point see Gullifer *op. cit.* fn. 269.
[788] Worthington *op. cit.* fn. 401, at p. 587.

Comparative analysis on retention of title clauses and the protection recognised to third parties

The regulation of retention of title mechanisms does not solely involve the regulation of the parties' rights and obligations to the agreement. Third parties are also affected by such an agreement and should therefore also be considered as part of modernisation of secured credit law regimes endeavours. As it has already been highlighted, property rights are enforceable *erga omnes* and by way of consequence, third parties have to be made aware of these rights and the assets to which they relate to. In relation to movable assets, there are two ways available to guarantee the transparency requirement. The seller can keep possession of the assets or the seller can transfer possession and publish his property right. The principle of transparency is largely recognised both in Common Law and Civil Law jurisdictions but the publication of retention of title clauses does not always constitute a validity requirement. Another leading principle underlying property law regimes can also be found, especially in Civilian jurisdictions, with the *numerus clausus*. In effect, since property rights are enforceable *erga omnes* and can be invoked against the rest of the world, some legal systems thought that the creation of such rights should be limited trough the *numerus clausus* principle.

Principle of transparency

Transparency is a leading principle of property law both in Civilian and Common Law[789]. In effect, property rights are universal rights, enforceable *erga omnes.* Therefore, both jurisdictions favour the protection of third parties by imposing an obligation to make third parties aware of these rights through publicity. There are, however, some exceptions to this general principle. In France and England, retention

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[789] Since the famous *Twyne's* case already long established that secret interests in property were fraudulent and had to be declared void. The *Twyne's* case already understood the problem of ostensible ownership in the absence of publication of property rights. Douglas G. Baird presented the facts as follwed "In 1600, a Hampshire farmer named Pierce conveyed his sheep to his creditor Twyne to satisfy a preexisting debt. *Twyne*, however, allowed Pierce to remain in possession of the sheep, to shear them, and to mark them as his own. When a sheriff tried to seize the sheep under a writ of execution on behalf of another creditor, *Twyne* forcibly resisted, maintaining that the sheep were his. Edward Coke, then attorney general, brought a criminal action against *Twyne* in the Star Chamber. That court held that because the transfer to *Twyne* was secret it was fraudulent and therefore void." In Baird *op. cit.* fn. 178.

of title clauses create proprietary rights but do not need any registration to be valid. The lack of registration requirements for the validity of retention of title clause is characteristic of the flexibility of this security device. As it has already been mentioned, it would appear that in relation to retention of title clauses, a balance has to be achieved between the requirement of transparency and the requirements of modern commerce.

It has already been highlighted that what currently makes the retention of title mechanism attractive within most European legal regimes is the lack of registration requirement. In effect, this formality is often seen as time and money consuming for sellers who only wish to pursue their business transactions as fast and as securely as possible. On the other hand, it has been argued that the lack of publication in respect of retention of title clauses could be misleading for third parties, especially towards the fictitious wealth of the debtor. Again, it would seem that a balance has to be achieved between the requirement of transparency towards third party and the needs of modern commerce that should avoid the imposition of burdensome formalities.

French law has dealt with this difficulty by offering an optional registration mechanism for sellers to publish their retention of title clause. This mechanism has been introduced by the law of 1994[790]. The incentive for the seller is that registration will entitle him to a simpler procedure than the *action en revendication* upon the debtor's default. In effect, the seller will not have to prove his quality of owner as required under the *action en revendication.* He will simply ask for the restitution of the goods which can be settled amicably with the buyer or which can be settled in court. Further, the publication of the retention of title clause prevents the application of Article 2276 of the Civil code which usually recognises the valid transfer of ownership to the *bona fide* purchaser. In effect, it is arguable that the publication of the clause would prevent the recognition of the good faith of third parties as they became aware of the existence of such property rights through the publication.

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[790] See above fn. 566, *Loi no 94-475 du 10 Juin 1994 relative à la prévention et au traitement des difficultés des entreprises.*

England does not require any registration for simple and all monies retention of title clauses. Nonetheless, the Law Commission[791] recently suggested that retention of title clauses should be registered and reshaped according to the purchase money security interests as prescribed in Article 9 of the UCC. However, this proposal has substantially been criticised. It has already been emphasised that the imposition of a registration requirement would weaken the position of the seller as he would now need to conform to the notice filing requirement in relation to simple and current account clauses which is not the case under the current English regime[792]. On the other hand, it is arguable that this situation would provide more transparency for third parties and provide more predictability and certainty towards the seller's rights upon the debtor's default.

The question of whether retention of title should be registered remains a policy question which outcomes may be difficult to compromise on. The retention of title clause mechanisms is widely used by traders within their economic activities. In respect of smaller trade, this requirement could appear to be quite burdensome and costly, especially in the context of the sale of small value assets such as the sale of consumer goods[793] or certain stock items. On the other hand, it could be argued that high value piece of equipments should be subject to publication if sold under a retention of title clause as they could substantially mislead third parties towards the debtor's wealth. Further, these kinds of assets are likely to remain under the possession of the buyer for longer which could increase the risk of the buyer defaulting upon repayment or increase the risk of the buyer to resell the assets to third parties. The necessity to register movable securities in respect of high value mobile equipment such as space assets have recently been recognised internationally with the enactment of the Convention on Interests in Mobile Equipment (Cape Town 2001)[794].

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[791] The Law commission Consultation Paper on Registration of Security Interests, No 164 (CP 164). 2002.

[792] The question of the adoption of the PMSI and the question of the registration of retention of title clause in England have already been considered in Chapter Two and Chapter Three.

[793] Article 9 UCC considered the burdensome character of registration requirements in relation to consumer goods. §9-309(1) UCC provides that a purchase-money security interest in consumer goods is perfected solely upon attachment. Therefore suppliers of consumer goods enjoy an automatic perfection, *i.e.*, without any requirement of registration.

[794] See above fn. 103.

The question of the registration of retention of title has to be balanced between the requirements for transparency in relation to the creation of property rights and the requirements of modern commerce. In the context of retention of title clauses, the nature of the assets sold would seem to play a major part in such a decision. The accommodation of differences relating to the question of whether to publish retention of title clauses would appear uncertain. This is a policy based question which outcomes will vary among jurisdictions, and which outcomes may be difficult to accommodate. Further difficulties could arguably occur with the principle of the *numerus clausus*.

The numerus clausus principle

The *numerus clausus* principle substantially restricts property rights by delimiting which property rights can be created and how property rights can be acquired. It is explained that:

"[t]he *numerus clausus* probably arose in the 19th Century in German jurisprudence, under the influence of Von Savigny. The principle means that the legal system which adheres to it has a closed number of real rights and a closed number of ways to acquire these rights."[795]

This principle means that:

"... only the recognized rights may be created and, secondly, that the content of the real right may only be determined between the parties within the limitations of the real rights."[796]

Other Civilian jurisdictions such as France did not develop this doctrine in great details but still recognise a limitation in the creation of real rights. Considering the peculiar nature of property rights in Civilian jurisdictions, analysed as absolute rights and enforceable *erga omnes*, as opposed to personal rights which are only relative rights and only enforceable towards contractual parties, the law generally limits the creation of property rights with the concept of the *numerus clausus*[797]. Accordingly,

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[795] Worthington *op. cit.* fn. 401, at p. 593.
[796] *Ibid.* at p. 594.
[797] Terré, F., Et al., *Droit Civil, Les Obligations*, (1999), at p. 2.

property rights are generally limited to only include ownership, mortgage, hypothec, servitude or usufruct[798].

In light of this analysis on the accommodation of differences underlying retention of title clauses in Europe, it is important to ascertain that the *numerus clausus* does not appear to constitute a substantial obstacle to legal reforms. The *numerus clausus* is not an absolute doctrine. Following the freedom of contract enjoyed by the parties, the case law had the occasion to validate the creation of certain property rights established by contracting parties. For instance, the parties are free to limit the transfer of property and subject it to specific condition such as payment of the price as it is the case under a retention of title clause. An interesting illustration can be found in Germany where the court created a new real right, thus derogating to the general principle of the *numerus clausus*. Under a retention of title clause, the court had the occasion to recognise the existence of some kind of property right to the buyer (*Anwartschaftsrecht*)[799]. Nevertheless, the German Supreme Court (BGH) did not add this proprietary right to the existing list of proprietary rights (*numerus clausus*) but clearly acknowledged its existence in many decisions[800].

Despite the limits generated by the recognition of the *numerus clausus* doctrine in Civilian jurisdictions, some jurisdictions recently introduced further exceptions to the limitation of property rights through legal reform. It is interesting to mention the recognition of a Civil trust under German law (*Treuhand)*[801] and the recent recognition of the *fiducie*[802] under French law. Of course, the principle of indivisible and absolute ownership right would prevent the adoption of a Common Law based trust. The *fiducie* arrangement functions as a transfer of property with an affectation of the assets to a separate patrimony. This mechanism does not relate to sale of goods

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[798] Van Erp, S.J.H.M. "Comparative Property Law" in Reimann, M., Et al., *The Oxford Handbook of Comparative Law*, (OUP, 2006), at p. 1053.
[799] Milo explains that "[b]efore the buyer has met the condition, usually the full payment of the purchase price, the buyer already has a kind of property right, called an Anwartschaftsrecht, which is, compared to ownership (Eigentum), often described as a wesensgleiches Minus." Milo *op. cit.* fn. 703, *at* p. 597.
[800] See BGHZ 30, 374, 77 and BGHZ 34, 122,124 cited in Milo *ibid.*, at p. 597.
[801] Van Erp *op. cit.* fn. 798, at p. 1055.
[802] See above at p. 159.

transactions but belongs to secured transactions[803]. The *fiducie* uses ownership for security purposes with the exclusive aim to provide the creditor with a preferential payment upon the debtor's default. The recognition of the *fiducie* has proved to introduce a significant modernisation of French secured lending legislation with a definite aim to harmonise its law with other jurisdictions.

Although the doctrine of the *numerus clausus* constitutes a leading principle of property law in Civilian jurisdictions, it has to be observed that recent developments in the law of secured credit have become more accommodating. Essentially, for the purpose of this analysis on the harmonisation as legal method to reform secured credit law regimes in Europe, it is important to highlight that the *numerus clausus* does not constitute a barrier to the recognition of new property right such as the rights resulting from retention of title mechanism. Obviously, the principle of the *numerus clausus* does provide for more certainty, predictability and protection for third parties. However, it is important to mention that the *numerus clausus* is only a general principal which is followed with more flexibility by Civilian jurisdictions. In other words, the recognition of this general principle should not be an obstacle to the creation of new rights needed for the development of commerce. A balance should thus be achieved between the need to restrict the freedom of the parties to create new property rights and the need to enhance modern commerce.

In light of this comparative analysis on the regulations underlying the retention of title clause in England and France, an accommodation of difference would appear quite uncertain. The comparative analysis of all national retention of title clauses regulations of every European jurisdiction would probably lead to further substantial difficulties in accommodating differences[804].Most importantly, it has to be emphasised that this comparative analysis showed that both jurisdictions do not really provide for satisfactory regimes to regulate retention of title clauses, especially in light of the requirement of modern commerce as defined in Chapter Two. Thus, it is arguable that the accommodation of differences, within national regimes that do

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[803] Similar to the retention of title mechanism, the *fiducie* uses ownership for security purposes. However, the *fiducie* does not belong to sale of goods transactions but still operates a transfer of title for security purposes. Thus, as for the retention of title clauses, the *fiducie* is a property-based security device.

[804] On an analysis of retention of title mechanisms in Europe, see Davies *op. cit.* fn. 398.

not provide for a satisfactory degree of legal certainty and predictability, could jeopardise the use of harmonisation as successful legal method to modernise secured credit law regimes.

CONCLUSION

The question of whether harmonisation could successfully be used as legal method to modernise secured credit law regimes in Europe remains doubtful. It is to be concluded that such endeavours would appear quite uncertain in light of the conclusions drawn from this comparative study on retention of title clause legal regimes in Europe.

It has been emphasised that the concept of harmonisation should be distinguished from the concept of legal unification. Harmonisation is understood, in this analysis, as the means to reconcile and coordinate divergences of various national legal regimes with the aim to approximate and modernise the law. Legal unification, in contrast, involves the creation of a supra national legal instrument independently from national legal regimes. Accordingly, it is explained that harmonisation will be successful if the accommodation of differences amongst various national secured credit law regimes is possible and also leads to substantial modernisation of the law as defined in Chapter Two. It is demonstrated that such task may be difficult to achieve, especially in the context of jurisdictions of different legal cultures such as Civilian and Common Law jurisdictions.

Harmonisation of law was considered in the context of the EU because this is one of the main methods used by the European legislator to reform and approximate the law, especially through the use of European Directives. In this respect, the EU Directive on Late Payment[805], which attempted to harmonise retention of title clauses was an interesting example to consider for the purpose of this study on whether harmonisation could be successful as legal method to modernise secured credit law regimes in European jurisdictions. It is argued that the Directive did not go far enough in its endeavours to approximate and modernise the regulations underlying

[805] See above fn. 611.

retention of title clauses in the EU. Accordingly, the question emerged of whether harmonisation of secured credit law regimes, particularly retention of title clauses regulations could have gone further in the quest to approximate and modernise the law.

It is recognised that the harmonisation of necessary national laws for the establishment and good functioning of the European single market should be an ineluctable responsibility for the EU. In relation to secured credit law regimes, it is argued that harmonisation and modernisation of the law should be encouraged so as to support the good functioning of the single market. If harmonisation and modernisation of secured credit law regimes are desirable in the EU, the competence of the EU to legislate in the sphere of secured credit law regimes had to be considered. Considering that this area of law would also lead the Community to interfere with national contract law, insolvency law and property law, it is recognised that the Community would only have the powers to harmonise targeted areas of secured credit and property law, rather than the whole secured credit law system. Further, a comprehensive harmonisation of secured credit law regimes would involve delicate policy issues which outcomes may differ amongst the various European jurisdictions and which outcomes may be too difficult to reconcile.

The second part of this examination on legal harmonisation thus attempted to determine whether an accommodation of legal divergences in relation to retention of title legal regimes could, if at all, be reached in European jurisdictions. The identification of current divergences amongst all EU jurisdictions was restricted to France and England.

It is explained that retention of title clauses are property-based security devices which are mainly regulated through national property law. Thus, this comparative analysis first considered the baseline concepts underlying property law in France and England. Although both jurisdictions recognise the power of the seller to use ownership for security purposes, there are substantial divergences in the definition and concept of 'property' itself that seem too difficult to accommodate. Accordingly,

it is concluded that an accommodation of property law concepts appear uncertain between France and England.

The nature of the buyer's and seller's rights before payment was then considered through a comparative law analysis between France and England. Substantial divergences were identified that may be difficult to compromise on. France and England recognise the right of the seller to retain ownership to the good until payment is made. Simple retention of title clauses are accepted in both jurisdictions and the EU Directive on Late Payment confirmed that there were no difficulties for Member States to compromise on this point. Things become more complex when the buyer resells or manufactures the goods before payment. If the buyer becomes insolvent, a French seller may still be able to exercise an *action en revendication* or *en restitution* under certain conditions as provided by the dispositions of the Civil code. The recent added dispositions in the Civil code entitle the seller to recover the proceeds of resale if these are still in the hands of the buyer through the mechanism of the *subrogation.* Further, the French seller will be able to exercise his *action en revendication* or *en restitution* if the goods have been manufactured but can still be separated without substantial damages to the main unit. If the seller cannot exercise his *action en revendication* or *en restitution,* then the seller is entitled to a personal action against the buyer following a breach of the contract.

In contrast, English law apprehends these difficulties from a different angle. The case law in England generally laid guidelines towards the determination of the legal situation of the seller where the buyer would resell or manufacture the goods. Accordingly, an English seller could also recover goods that have been manufactured if they can be separated without substantial damages from the main unit. Further, an English seller was able to trace the proceeds of resale in Equity following the existence of a fiduciary relationship between the buyer and the seller. However, the above development highlighted that on many occasions, the court qualified the clause as a charge, which was void for lack of registration. In this situation, the seller becomes an unsecured creditor. Under English law, the outcome of the case will depend upon how the court will construe the agreement. In contrast, French law adopts a much more restrictive approach and closely follows the form and solutions

prescribed by the law. Compromise on these differences would thus appear quite uncertain between the two jurisdictions. Further, it is arguable that in light of the uncertainties towards the proprietary entitlements of the buyer and the seller, an accommodation of differences would not seem to succeed in providing a modern legislation to regulate retention of title clauses.

Such comparative analysis also showed some similarities in the regulations underlying retention of title. Both jurisdictions analyse the right of the seller as a proprietary right, which entitled him or her to either an *action en revendication or action in restitution* or under the English law to the transfer back of possession of the goods to his legal owner. Although England does not recognise proprietary remedies such as the *vindicatio*, the seller can also recover his goods in priority to other creditors. Things become more complex where goods have been resold or manufactured irreversibly. In England, it will depend upon how the court will construe the agreement. In France, it will depend upon whether the *action en revendication* is still possible or not, following the dispositions of the Civil code. The fate of the seller thus remains uncertain in both jurisdictions where the buyer resells or manufactures the goods. A compromise would appear quite difficult and would not seem to succeed in the modernisation of retention of title clauses.

In relation to the protection afforded to third parties, leading principles of property law are recognised in both jurisdictions such as the transparency principle or the *numerus clausus* principle (Civilian jurisdictions). Registration of retention of title clauses is not a compulsory requirement in both jurisdictions. France only provides an option to sellers if they wish to register their retention of title clauses. The accommodation of differences relating to the question of whether to publish retention of title clauses would appear uncertain. This is a policy based question which outcomes will vary among jurisdictions, and which outcomes may be difficult to accommodate. Further difficulties were highlighted through the analysis of the *numerus clausus* principle. The principle of the *numerus clausus* is fundamental for certain Civilian jurisdictions. However, it has been demonstrated that it does not constitute an absolute principle and that the recognition and application of such a principle did not prevent the recognition of retention of title mechanisms and other

security devices using property. Accordingly, this would tend to show that property law concepts are slowly becoming more flexible and balanced with the modern needs of commercial activities.

In light of this analysis on retention of title clauses, it is arguable that an accommodation of divergences remains uncertain, and would not lead to successful modernisation of the law; especially considering current uncertainties underlying the regulation of manufactured and proceeds clauses in both jurisdictions. Accordingly, it is arguable that it would render the task of modernising the law through harmonisation that is through accommodating and reconciling differences, ineffective. Nevertheless, this analysis should not remain vain. This comparative analysis highlighted that European property law regimes seem to become more and more flexible to accommodate new commercial needs. Although the baseline concepts and leading principles of property law seem very rigid and dogmatic, particularly in Civilian jurisdictions, the trend has recently been to adopt a much more flexible approach. For example, it has been shown that the *numerus clausus* principle was not an obstacle to the creation of new category of real rights such as those created under a retention of title clause. These examples show that theoretical concepts of property law are not incompatible with the requirement of modern security law regimes.

Modern commerce recently highlighted the necessity for property law concepts to become more flexible. Naturally, these principles and rules should be respected but an appropriate balance should be achieved that will comply with the new requirements of modern commercial transactions. In this respect, the harmonisation of security law regimes could become possible, based on a modern, broader and more flexible view of European property law regimes.

A flexible approach towards property law regimes is even more needed considering the recent emergence of new property assets. The above analysis on the legal aspects of modern security law regimes already highlighted the difficulties underlying the

creation of security in new assets such as intellectual property assets[806]. In the future, new types of assets might emerge and the law of property will have to be flexible enough to accommodate them within its general principles. This demonstration does not posit that a comprehensive reconciliation of property law regimes of both legal traditions will be feasible. The comparative analysis of the property law terminologies and fundamental concepts of property law have shown great disparities between legal traditions which would render a full conciliation quite uncertain. Indeed, national property law differs dramatically according to each legal tradition and even each jurisdiction. Each national property law in Europe represents a view of the Cathedral, in reference to the well known analogy made by Calabresi and Melamed in their Article on property and liability rules[807]. The task of reformers is therefore not to conciliate every property law regimes of Europe but to notice their similarities, their leading principles which will in time contribute to the reconciliation of differences. With the recognition of similar legal principles, jurisdictions from different legal traditions will in time encourage the accommodation of their differences owing to more flexibility in their approach.

The question of whether modernisation could be successful using harmonisation as legal method is uncertain. If harmonisation is understood as a reconciliation of differences, then, successful modernisation can be doubted. In effect, a reconciliation of different 'ineffective' laws does not make much sense. It has been shown that both France and England do not really provide for satisfactory regimes for the regulation of retention of title clauses. Such regimes especially remain highly uncertain towards the proprietary entitlements of the seller and buyer until payment. It might well be that states should adopt a new legislation that will provide for a modern secured credit law regime. Therefore reform through the adoption of uniform legislations such as conventions, model laws and other restatements might be the answer for a successful modernisation of national secured credit law regimes.

In the EU, it would also appear to constitute the new approach to legal reform and modernisation of the law. The recent introduction of the Common Frame of

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[806] See Chapter Two.

[807] Calabresi, G., Et al. "Property Rules, Liability Rules and inalienability: One View of the Cathedral" (1972) *Harvard Law Review,* at p. 1089.

Reference in the EU[808], 'optional toolbox' for traders would tend to confirm this position. The Common Frame of Reference in Europe has been characterised as an optional toolbox, a 28th legal regimes that parties of European Member States could choose as governing law for their transactions[809]. Ultimately, it is hoped that the best law may survive and may serve as basis for the law of the community[810]. In this perspective, the Common Frame of Reference is hoped to serve as model for legal reforms across Member States legal regimes and eventually replace the law of current twenty seven legal regimes.

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[808] CFR prepared by the Study Group on a European Civil Code and the Research Group on EC Private Law Available from http://www.law-net.eu (last checked 26/04/2010). On 26th April 2010, the Commission took the decision to set up the Expert Group on a Common Frame of Reference in the field of European Contract Law which is currently considering the feasibility of a user friendly instrument of European Contract Law for consumers and businesses. On 1st July 2010, the European Commission published a *Green Paper on policy options for progress towards a European Contract Law for consumers and businesses.* See http://ec.europa.eu/justice/news/consulting_public/news_consulting_0052_en.htm (last checked 10/03/2011) Depending on the evaluation of the results of the consultation, the Commission could propose further action by 2012.

[809] The CFR will also include a Book IX on Proprietary Security Rights in movable assets. See Eidenmüller, *op. cit.* fn. 665.

[810] See Smits *op. cit.* fn. 262, at p. 2 where the author states: "... I previously defended that the best way of unification of law in Europe would be through a competition of legal rules. In transplanting legal rules from one country to another on a "market of legal culture", the best legal rule may survive. This does not automatically imply that *any* rule glorifies: in some instances, diversity of law may be just as good as uniformity as long as there is a free movement of legal rules, at least creating the *possibility* of legal change."

CHAPTER FIVE

UNIFICATION OF LAW AS LEGAL METHOD TO MODERNISE SECURED CREDIT LAW REGIMES

INTRODUCTION

The diversity and archaism of current secured credit law regimes generate too many uncertainties and insecurity for the commercial community which confirm the need to recognise more modern secured transactions laws[811]. If legal transplantation and legal harmonisation have not demonstrated a great likelihood of success as legal methods to approximate and modernise secured credit law regimes, legal unification may offer greater prospects of success. Unification of law is sometimes used interchangeably with the expression of harmonisation. However, it has already been highlighted that this analysis clearly distinguishes between harmonisation and unification of laws[812]. While harmonisation essentially seeks to accommodate and reconcile legal differences among secured credit law regimes of two or more jurisdictions, legal unification fundamentally involves the adoption of a supra national legal instrument purportedly embodying the best solution available to regulate a designated area of law. The following developments will attempt to determine to what extent legal unification could constitute an adequate legal method to modernise and approximate secured credit laws.

Legal unification involves the creation of the best legal solution independently from existing national legislations together with, to a certain extent, an effort to respect national legal traditions. Although, the creation of supra national legal instruments are the results of international entities efforts and not the products of national draftsmen, it is arguable that the success of unification as legal method to modernise secured credit law regimes will still depend upon the degree of adhesion of states. International conventions will only be effective if ratified by a sufficient number of

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[811] See Chapter Two.
[812] See Chapter four at pp. 173-176.

states. However, adequate ratification may be difficult to achieve in certain legal fields such as secured credit and property law. Accordingly, it is arguable that if national entities do not sufficiently recognise international legal instruments, unification of law endeavours may remain vain. Comparative law thus also plays a significant role in the preparation of unification of law projects and will be used as a legal tool to assess whether unification of law could be used as legal method to modernise secured credit law regimes.

In the field of secured credit, the past decades have witnessed the emergence of a proliferation of international instruments regulating secured transactions[813]. A recent illustration of the use of unification as legal method to modernise secured credit law can be found with the enactment of the UNCITRAL Legislative Guide on Secured Transactions[814]. Other international initiatives also include the Cape Town Convention on International Interests in Mobile Equipments and associated Protocols[815], the EBRD Model Law on Secured Transactions[816] and the Organization

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[813] On legal unification see, David *op. cit.* fn. 276; Graveson, R.H. "The International Unification of Law" (1968) 16 *American Law Journal of Comparative Law,* at p. 4; Nadelmann, K.H. "Uniform Legislations Versus International Conventions Revisited" (1968) 16 *American Journal of Comparative Law,* at p. 28; Hobhouse, J.S. "International Conventions and Commercial Law: The Pursuit of Uniformity" (1990) 106 *Law Quarterly Review,* at p. 530; Goode *op. cit.* fn. 262; Rosett *op. cit.* fn. 607; Evans, M.E. "Uniform Law: A Bridge Too Far?" (1994) 3 *Tulane Journal of International and Comparative Law,* at p. 145; Bonell, J., *An International Restatement of Contract Law,* (2nd ed., 1997); Goode *op. cit.* fn. 618; Wool, J. "Rethinking the Notion of Uniformity in the Drafting of International Commercial Law: A Preliminary Proposal for the Development of a Policy-Based Unification Model" (1997) 2 *Uniform Law Review,* at p. 46; "UNIDROIT 75th Anniversary: Congress on Worldwide Harmonisation of Private Law and Regional Economic Integration, Hypotheses, certainties and Open Questions" (2003) 8 *Uniform Law Review,* at p. 10; Gopalan, S. "The Creation of International Commercial Law: Sovereignty Felled?" (2004) 5 *San Diego International Law Journal,* at p. 267; Brower, C.N. Et al. "The Creeping Codification of Transnational Commercial Law: An Arbitrator's Perspective" (2004-2005) 45 *Virginia Journal of International Law,* at p. 199.

[814] UNCITRAL Legislative Guide on Secured Transactions (2007) and recently published a draft dealing with Security Interests in Intellectual Property. UNCITRAL also enacted the United Nations Convention on Contracts for the International Sale of Goods (CISG, 1980) and the United Nations Convention on the Assignment of Receivables in International Trade (2001). UNCITRAL also published legislative guides and model laws on insolvency and international payments (see http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency.html and http://www.uncitral.org/uncitral/en/uncitral_texts/payments.html (last checked 26/04/2010).

[815] Convention on International Interests in Mobile Equipment (Cape Town, 2001); Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment (Cape Town, 2001) and the Luxembourg Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Railway Rolling Stock (Luxembourg, 2007). Other UNIDROIT Conventions include the Convention Relating to a Uniform Law on the International Sale of Goods (The Hague, 1964); the Convention Relating to a Uniform Law on the Formation of Contracts for the International Sale of Goods (The Hague, 1964); the International Convention on Travel Contracts (Brussels, 1970); the Convention Providing a Uniform Law on the Form of an

of American States (OAS) Model Inter-American Law on Secured Transactions[817]. Considering the broad variety of legal instruments aiming at modernising and unifying the law, the question emerged to determine whether a specific type of legal unification instrument could be indentified to constitute an adequate legal method to achieve a successful modernisation of secured credit law regimes.

Legal unification can take different forms and can generally be classified into two broad categories; hard law instruments such as international conventions and soft law instruments such as restatements, legislative guides or model laws, each offering different degrees of flexibility toward the adoption and recognition of international legal standards[818]. International conventions, when ratified, have a binding nature. Although, international conventions should provide great prospect of success towards the modernisation of secured credit law with the aim to achieve an approximation of laws, it will only be effective if ratified by a sufficient number of states. Unfortunately, the reality shows that international conventions often remain dead letters following a lack of sufficient ratification. By opposition, model laws and restatements would offer much more flexibility to interested states in the way they remain free to opt and select some of their proposals as model for reform on a voluntarily basis. Nonetheless, it is important to highlight that model laws and restatements bear the risk of not achieving a similar degree of approximation than

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International Will (Washington, D.C., 1973); the Convention on Agency in the International Sale of Goods (Geneva, 1983); the UNIDROIT Convention on International Financial Leasing (Ottawa, 1988); the UNIDROIT Convention on International Factoring (Ottawa, 1988) and the UNIDROIT Convention on Stolen or Illegally Exported Cultural Objects (Rome, 1995). UNIDROIT also enacted the UNIDROIT Principles of International Commercial Contracts (2004).

[816] Text available at: http://www.ebrd.com/pubs/legal/secured.htm (last checked 26/04/2010).

[817] Text available at: http://natlaw.com/seminar/doc12.pdf (last checked 26/04/2010).

[818] On the relationship between hard law and soft law see for instance Chinkin, C.M. "The Challenge of Soft Law: Development and Change in International Law" (1989) 38 *International and Comparative Law Quarterly,* at p. 850; Lipson, C. "Why Are Some International Agreements Informal" (1991) 45(4) *International Organization,* at p. 495; Boyle, A. "Some Reflections on the Relationship of Treaties and Soft Law" (1999) 48(4) *International and Comparative Law Quarterly,* at p. 901; Abbott, K.W., Et al. "Hard Law and Soft Law in International Governance" (2000) 54 *International Organizations,* at p. 421; Shaffer, G., Et al. "How Hard and Soft Law Interact in International Regulatory Governance: Alternatives, Complements and Antagonists" (2008) *Society of International Economic Law (SIEL) Inaugural Conference 2008 Paper*, available at SSRN: http://ssrn.com/abstract=1156867 (last checked 26/04/2010); Gopalan, S. "A Demandeur-Centric Approach to Regime Design in Transnational Commercial Law" (2008), 39 *Georgetown Journal of International Law*, available at http://ssrn.com/abstract=1105225 (last checked 26/04/2010); Guzman, A.T., Et al. "Explaining Soft Law" (2009) *Berkeley Program in Law and Economics,* available at http://escholarship.org/uc/item/7796m4sc (last checked 26/04/2010); Gersen, J. E., Et al. "Soft Law" *Stanford Law Review, Forthcoming, University of Chicago, Public Law and Legal Theory Working Paper No. 213,* available at http://ssrn.com/abstract=1113537 (last checked 26/04/2010).

with international conventions. Although model laws and restatements do not require any ratification, they would still require a certain level of states recognition and compliance to be successfully used as legal methods to modernise and approximate secured transactions law regimes. Nevertheless, soft law legal instruments such as restatements or model laws may be more likely to succeed as legal methods to modernise and approximate the law of secured credit than international conventions due to more flexibility. Accordingly, this analysis on legal unification will further seek to investigate whether the use of soft law legal instruments is more likely to succeed in its endeavours to achieve an approximation and modernisation of the law of secured credit. A significant illustration can be found with the UNCITRAL Legislative Guide on Secured Transactions. The UNICTRAL Legislative Guide is not legally binding but could serve as a set of legislative guidelines in order to assist jurisdictions to modernise and reform their laws. This begs the question of whether the recent enactment of the UNCITRAL Legislative Guide on Secured Transactions will be successful in modernising and approximating the law of secured credit among jurisdictions from different legal backgrounds.

This analysis will first provide an analysis of the legal instruments of unification and will attempt to determine whether a specific legal instrument could be identified to succeed in modernising secured credit law regimes in the light of an approximation of law. Following the assumption that soft law instruments may be more likely to succeed in modernising the law, this examination will further provide a more pragmatic analysis and assessment of unification as legal method for law reform, especially through the analysis of the UNCITRAL Legislative Guide on Secured Transactions.

INSTRUMENTS OF UNIFICATION

Goode identifies at least nine instruments by which unification of the law may be achieved:

" ... (1) a multilateral Convention without a Uniform Law as such; (2) a multilateral Convention embodying a Uniform Law; (3) a set of bilateral Treaties; (4) Community legislation – Typically , a Directive; (5) a Model Law; (6) a codification of custom and usage promulgated by an international non-governmental organization; (7) international trade terms promulgated by such an organization; (8) model contracts and general contractual conditions; (9) restatements by scholars and other experts."[819]

Although all these instruments aim at the unification of the law through the enactment of a supra national legal rule, they generally offer different degree of flexibility to the interested states. International conventions have generally been the preferred method used to achieve unification of the law at the international level notwithstanding their restrictive nature, but model laws, restatements and other soft law instruments have recently become the panacea for successful international unification owing to more flexibility.

Considering the wide range of legal instruments of unification, the question addressed in the following sections is whether a specific type of legal unification instrument could be indentified to constitute an adequate legal method to achieve a successful modernisation of secured credit law regimes. This study will thus examine whether international conventions (for an illustration of hard law instruments) and/or model laws and restatements (for an illustration of soft law instruments), could theoretically be successful in modernising secured credit law regimes.

International conventions

International conventions have long been the preferred method to achieve unification of the law at the international level mainly because of their binding nature[820]. Abbott recognises that:

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[819] Goode *op. cit.* fn. 249, at p. 54.

[820] Shaffer states: "[h]ard law instruments allow states to commit themselves more credibly to international agreements. Hard law instruments make state commitments more credible because they

"[b]y using hard law to order their relations, international actors reduce transactions costs, strengthen the credibility of their commitments, expand their available political strategies, and resolve problems of incomplete contracting."[821]

International conventions generally consist in the enactment of dispositions aiming at the unification of conflict of law rules or in the enactment of dispositions embodying a substantive law regime. Major examples of international conventions include the 1883 Paris Convention for the Protection of Industrial Property[822], the 1929 Warsaw Convention on International Carriage by Air[823], the 1930 Uniform Law for Bills of Exchange and Promissory Notes[824], the 1931 Uniform Law for Cheques[825], and, after the Second World War, the CMR[826], the ULIS[827], and the CISG[828].

In the field of secured credit law regimes, the possibility to opt for the unification of conflict of law rules would not have been entirely satisfactory considering the existing divergences and incompatibilities within national legal regimes[829]. For instance, the Cape Town Convention on International Interests in Mobile Equipments

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increase the cost of reneging, whether on account of legal sanctions or on account of the costs to a state's reputation where it is found to have acted in violation of its legal commitments. Hard law treaties are more credible because they can have direct legal effects in national jurisdictions (being "self-executing"), or they can require domestic legal enactment. Where treaty obligations are implemented through domestic legislation, they create new tools that mobilize domestic actors, increasing the audience costs of a violation and thus making their commitments more credible. Hard law instruments solve problems of incomplete contracting by creating mechanisms for the interpretation and elaboration of legal commitments over time. Hard law instruments better permit states to monitor and enforce their commitments, including through the use of dispute settlement bodies such as court." Shaffer *op. cit.* fn. 818.

[821] Abbott *op. cit.* fn. 818, at p. 422.

[822] Paris, 20th March 1883 (as last revised at Stockholm on 14 July 1967, and as amended on 28 September 1979) available at www.wipo.int/clea/en/details.jsp?code=WO020 (last checked 26/04/2010).

[823] Convention for the Unification of Certain rules Relating to International Carriage by Air (Warsaw, 12 October 1929, as amended as the Hague, 1955), available at www.jus.uio.no/lm/air.carriage.warsaw.convention.1929/doc.html (last checked 26/04/2010).

[824] Convention providing a Uniform Law for Bills of Exchange and Promissory Notes (Geneva, 7 June 1930), available at www.jus.uio.no/lm/bills.of.exchange.and.promissory.notes.convention.1930/doc.html (last checked 26/04/2010).

[825] Convention on the Unification of the Law Relating to Cheques (Geneva, 19 March 1931).

[826] The United Nations Convention on the Contract for the International Carriage of Goods by Road (CMR) (Geneva, 19 May 1956), available at http://www.jus.uio.no/lm/un.cmr.road.carriage.contract.convention.1956/doc.html

[827] The UNIDROIT Convention Relating to a Uniform Law on the International Sale of Goods (The Hague, July 1st, 1964), available at http://www.unidroit.org/english/conventions/c-ulis.htm (last checked 26/04/2010).

[828] The United Nations Convention on contracts for the International Sale of Goods (1980) (CISG), available at http://www.cisg.law.pace.edu/cisg/text/treaty.html

[829] See Chapter Two at pp. 71-76.

and associated protocols[830]opted for a uniform regime regulating the creation and recognition of an international interest in high value mobile equipment and did not opt for a regime aiming at unifying conflict of law rules[831].

International conventions provide for a strong level of uniformity of the law through the draft of a unique supra national legal instrument that once ratified by states, are legally binding. International conventions could constitute a successful method to modernise and approximate secured credit law regimes by providing this high level of uniformity upon the achievement of a high ratio of ratifications. Evidently, such efforts would require a strong consensus among all participating states on the question of secured credit. The attempt to reach such consensus is however uncertain. Assuming that a consensus was reachable in the field of secured credit, it is also arguable that the use of an international convention to modernise and approximate the law would only be successful if the level of uniformity is subsequently preserved through uniform and consistent interpretation across participating states courts[832].

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[830] See above fn. 814.

[831] On this point see Espinola, S.A. "Le Financement de Biens d'Equipement Serait Facilité Par Une Nouvelle Convention Internationale" (1997) 52(8) *Journal OACI,* at p. 9; Fleisig, H. W. "The Proposed UNIDROIT Convention on Mobile Equipment: Economic Consequences and Issues"(1999) 4 *Uniform Law Review*, at p. 253; Cuming, R.C.C. "The draft UNIDROIT Convention on International Interests in Mobile Equipment" (1998) 30 *Uniform Commercial Code Law Journal*, at p. 365; De La Peña, N. "Reforming the Legal Framework for Security Interests in Mobile Property" (1999) 4 *Uniform Law Review*, at p. 347; Foëx, B. "La Réserve de Propriété Dans l'Avant-projet de Convention d'UNIDROIT: un Point de Vue Suisse" (1999) 4 *Uniform Law Review*, at p. 409 ; Cuming *op. cit.* fn. 237; Davies, I. R., *Security Interests in Mobile Equipment,* (2002); Goode *op. cit.* fn. 252; Deschamps, M. "Les Règles de Priorité de la Convention et du Protocol du Cap"(2002) 7 *Uniform Law Review,* at p. 17; Davies, I. R. "The New Lex Mercatoria: International Interests in Mobile Equipment" (2003) 52 *International Comparative Law Quarterly,* at p. 151; Goode, R.M. "The "Cape Town Convention on International Interests in Mobile Equipment" in Hartkamp, A.S., Et al., *Towards a European Civil Code,* (2004), Chapter 41 at p. 757; Honnbier, B. Et al. "The Convention of Cape Town: The Creation of International Interests in Mobile Equipments" (2004) 12(1) *European Review of Private Law,* at p. 3; Saunders, A., Et al. "Innovation in International Law and Global Finance: Estimating the Financial Impact of the Cape Town Convention" (2006) *NYU Working Paper No FIN.06.001,* available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1293636 (last checked 26/04/2010).

[832] On the assessment of international conventions as successful instruments of unification at the international level, see Kronke "International Uniform Commercial Law Conventions: Advantages, Disadvantages, Criteria For Choice" *op. cit.* fn. 262.

The process of ratification and amendments

It is arguable that if a high ratio of ratifications together with the maintenance of uniform interpretations can be reached, international conventions could constitute an adequate legal method to modernise secured credit law regimes. The success of a supra national legal instrument, such as an international convention, would thus require its drafters to consider the existing differences among national legal regimes in order to ensure maximum state ratifications. International legislative efforts should attempt to establish the best available solution that will also be consistent with national legislations. This compromise can be difficult to reach, especially in the field of secured credit. Accordingly, it is to be observed that if the level of ratification is low, international conventions bear the risk of remaining dead letters.

The sole conclusion of an international convention only constitutes an indication of potential adhesion of states and will only become legally binding if officially ratified by states. As Goode already highlighted:

"[t]he treaty collections are littered with conventions that have never come into force, for want of the number of required ratifications, or have been eschewed by the major trading States. There are several reasons for this: failure to establish from potential interest groups at the outset that there is a serious problem which the proposed convention will help to resolve; hostility from powerful pressure groups; lack of sufficient interest of, or pressure on, governments to induce them to burden still further an already over-crowded legislative timetable; mutual hold-backs, each State waiting to see what others will do, so that in the end none of them does anything."[833]

For instance, the Convention relating to Uniform Law on International Sale of Goods (ULIS) 1964 has only been ratified by five countries[834], so as the Convention relating to Uniform Law on the Formation of Contracts for the International Sale of Goods (ULFIS) 1964[835]. Notwithstanding the lack of reception of these two Hague Sales Conventions, it is still recognised that it was the only conceivable legislative option to enact uniform rules on international sales contracts[836]. The UNIDROIT Convention on International Finance Leasing 1988 has been ratified by ten

[833] Goode *op. cit.* fn. 635, at p. 232.
[834] See http://www.unidroit.org/english/implement/i-64ulis.pdf (last checked 26/04/2010).
[835] See http://www.unidroit.org/english/implement/i-64ulf.pdf (last checked 26/04/2010).
[836] Bonell, M.J. "The UNIDROIT Principles of International Commercial Contracts and the Harmonization of International Sales Law" (2002) 36 *Revue Juridique Themis,* at p. 340.

countries[837] and the UNIDROIT Convention on International Factoring 1988 has only been ratified by seven countries[838]. The Cape Town Convention on International Interests in Mobile Equipment was much more successful and has been ratified by thirty-two countries. Nonetheless, the later Convention only restricts its application to the regulation of an international security interest created in a particular class of assets, high value mobile equipment.

The success of an international convention to effectively modernise secured credit law regimes will depend upon the level of ratifications operated by states. In the field of secured credit, the ratification of an international convention that would provide for a comprehensive regime to regulate secured transactions appears unlikely. A comprehensive regime that would regulate secured transactions would require international drafters to also interfere with property law, contract law and insolvency law. These areas of laws highly differ from one jurisdiction to another, which would render the task of unifying the law of secured credit and the task of reaching a high ratio of ratifications unlikely.

International conventions are not the product of national draftsmen but their adoptions still require a certain consensus among participating states. Thus, it is not surprising that states representatives will usually attempt to promote their own laws to be exported to other jurisdictions. In the field of secured credit, the Cape Town Convention is clearly rooted in the American Article 9 UCC which has generally been assimilated as the most efficient and modern form of secured credit law regime[839]. It has already been demonstrated that the importation of an Article 9 UCC type regime was not entirely feasible in other jurisdictions, especially in those jurisdictions that belong to different legal traditions[840]. Considering the vast amount

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[837] See http://www.unidroit.org/english/implement/i-88-l.pdf (last checked 26/04/2010).
[838] See http://www.unidroit.org/english/implement/i-88-f.pdf (last checked 26/04/2010).
[839] Other International initiatives such as the EBRD Model Law on Secured Transactions or the UNCITRAL Legislative Guide on Secured Transactions were also modelled, to a certain extent, on the American regime embodied in Article 9 UCC. The analysis of the UNCITRAL Legislative Guide will show that it has generally favoured the adoption of a universal security but, with the possibility for States to preserve a separate regime for retention of title clauses.
[840] See Chapter Three

of divergences in national secured credit law regimes[841], the substantive unification of secured credit law regimes using an international convention would bear the risk of states introducing some opt-outs provisions or simply not proceeding to its ratification at all[842]. The possibility for states to derogate to the main text of the convention would clearly undermine the unification of law efforts and would therefore also compromise a successful modernisation of the law[843]. For example, Article 39 of the Cape Town Convention on International Interests in Mobile Equipment provides that each participating states can decide that certain rights and interests will have priority over international interests by introducing specific declarations.

These difficulties particularly highlight the reason why international conventions usually have a limited scope and only cover a specific area of law. It is generally recognised that international conventions remain rather fragmentary in their nature and most of them only concern one specific area of commercial law such as one special type of contract or one specific legal regime. Even the very well-known United Nations Convention on Contracts for the International Sale of Goods contains legal gaps as for example on the validity of the international contract in question or about the repercussions of State control over the import and export of certain goods[844].

Similarly, the Cape Town Convention on International Interests in Mobile Equipment[845] only deals with the creation of an international security interest in a

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[841] Chapter Three and Chapter Four have highlighted substantial divergences in property law concepts and fundamental policy issues between jurisdictions that belong to different legal traditions.
[842] See on this point Vogenauer, S., Commentary on the UNIDROIT Principles of International Commercial Contracts (PICC), (OUP, 2009), Introduction Para. 2, at p. 3.
[843] Wool *op. cit.* fn. 813, at p. 49 where the author states that: "[f]irst, compromise wording, often open-textured and general in nature, will be drafted in an attempt to, if possible, avoid or, if not, obscure the policy issue. Secondly, the rules of a convention may simply defer to categories of (generally, rather than precisely, described) national law. Thirdly, the convention may include a range of rules contemplating its own partial or complete inapplicability. Fourthly, the convention may include provisions, frequently prepared in the very final stages of the process, permitting reservations on points of policy. These provisions are often prepared in some haste, typically in an effort to accommodate the objection of one or more outspoken participants, rather than as proposed below, as part of a deliberate and systematic approach to certain questions of policy. Fifthly, the text of the convention may simply avoid important commercial subjects for fear of policy confrontations."
[844] Bonell *op. cit.* fn. 813, at p. 11, referring to H.Kötz, 'Rechtsvereinheitlichung'.
[845] Convention on International Interests in Mobile Equipment (Cape Town, 2001).

specific class of assets. The regime embodied in the Cape Town Convention is essentially based on Article 9 UCC[846] enabling creditors to create an international global security interest in high value mobile equipment together with the recognition of the notice filing[847] and a first to file priority rule. The international interest so created does not replace a security introduced under the law of a Member State as they can validly coexist. Nonetheless, if the international interest is validly registered, it will have priority over the national security[848]. Previous developments have highlighted the difficulties underlying an attempt to reach a consensus on the question of secured credit, especially considering the existing differences between legal systems[849]. Thus, on this occasion the choice to solely unify an aspect of secured financing[850] without requiring states to modify their national legislations proved to be a success.

In this respect, the Cape Town Convention on International Interests in Mobile Equipment and Associated Protocols[851] constitutes a significant achievement for the unification of the law of secured credit in respect of these specific types of assets. The choice of an international convention to modernise the law of secured credit was fundamental. As it has already been highlighted international conventions are

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[846] See Chapter Two at p.71.

[847] The Cape Town Convention has introduced an international register (CTIR) in respect of security created in aircraft equipments. Information is available from: https://www.internationalregistry.aero/irWeb/pageflows/work/UserDocumentation/DownloadUserDocumentationController.jpf?language=English (last checked 26/04/2010).

[848] Goode "The Cape Town Convention on International Interests in Mobile Equipment" *op. cit.* fn. 831, Chapter 41 at p. 758.

[849] Goode states that: "[f]irst, there are wide differences in philosophy and legal culture concerning the extent to which security should be recognized at all and the conditions necessary for the validity of a security interest. Common law jurisdictions, which are generally sympathetic to the concept of party autonomy and self-help, have a liberal attitude towards security. This attitude allows security interests to be taken with a minimum of formality over both present and future assets to secure existing and future indebtedness. In addition, they allow universal security rather than require specific security. By contrast, Civil law jurisdictions have been more cautious in their approach to non possessory security and have been anxious about the "false wealth" which such practices are perceived as permitting. So in these jurisdictions, one finds, in varying degrees, requirements of specificity and individualization of collateral, the need for a new post-acquisition act of transfer to give in rem effects to security in after-acquired property, requirements of notice to the debtor as a condition of the validity (not merely priority) of an assignment of debts, and restrictions on self help remedies such as possession and sale of the collateral" Goode *op. cit.* fn. 120, at p. 48.

[850] This aspect of secured credit law was for many jurisdictions left unregulated (For example in France) which facilitated the adoption and ratification of the Convention.

[851] The Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Aircraft Equipment (Cape town 2001) and the Luxembourg Protocol to the Convention on International Interests in Mobile Equipment on Matters Specific to Railway Rolling Stock (Luxembourg 2007) but not yet in force.

binding and the Cape Town Convention therefore provides for an effective enforcement of international interests created in movable equipment. Such enforcement mechanism would not be guaranteed with soft law legal instruments such as under the UNCITRAL Legislative Guide on Secured Transactions unless its dispositions were adopted within national legal reforms.

If the creation of an international convention on secured credit appears to be quite uncertain considering the lack of international consensus on property law issues and other fundamental policy choices, the unification of targeted aspect of secured credit law regimes would appear to have attracted enough adhesion from states to render the use of international convention a successful method to modernise secured credit law regimes. Nonetheless, the decision to opt for a series of separate conventions to regulate the creation of an international security interest relative to specific types of assets could jeopardise the economic benefits of the proposed new scheme to more than a limited variety of assets[852]. In effect, it is arguable that a successful modernisation based on the use of international convention would not be entirely satisfactory unless it could be extended to other categories of assets. Again, as it has already been extensively explained, an imminent comprehensive unification of secured credit law regimes appears to be uncertain considering the wide divergences among national regulatory regimes.

Another potential issue with the use of international conventions as vehicles to modernise and unify secured credit laws is the question of amendments. In effect, there is a strong argument that international conventions would render the law to become static, rigid and not flexible following burdensome amendments procedures[853]. Consequently, as the commercial and business community practices are constantly evolving, some international commercial law instruments are no

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[852] Stanford, M.J. "Broader or a Narrower Band of Beneficiaries for the Proposed New International Regimen: Some Reflections on the Merits of the Convention/Protocol Structures in Facilitating the Former" (1999) 4 *Uniform Law Review,* at p. 248.

[853]Bonell *op. cit.* fn. 813, at p.12. See also Diamond, A.L. "Conventions and Their Revision" in Sauveplanne, J.G., *Unification and Comparative Law in Theory and Practice,* (1984), at p. 45 where the author states: "[t]he inflexibility of many international conventions may be too heavy a price to pay. The need to revise the law arises constantly, and international procedures sometimes slow the process of necessary law reform to an unacceptable extent."

longer satisfactory and some will become inadequate in the future[854]. This is particularly noticeable with secured credit law regimes where technologies have led to the emergence of new class of assets that the law cannot ignore any longer. The law must be flexible enough to easily integrate new dispositions, which might not be easily achieved with the use of international conventions[855].

An international convention could potentially constitute a successful method to modernise secured credit law regimes as it has been shown with the Cape Town Convention. Nonetheless, a successful modernisation of secured credit law regimes using an international convention should also ensure a uniform interpretation of the convention by States.

Difficulties related to the interpretation of international conventions

International conventions could successfully modernise secured credit law regimes but could fail in their endeavours to approximate the law if not interpreted uniformly. It is explained that:

"[t]he principal objective of an international convention is to achieve uniformity of legal rules within the various States party to it. However, even when outward uniformity is achieved following the adoption of a single authoritative text, uniform application of the agreed rules is by no means guaranteed, as in practice different countries almost inevitably come to put different interpretations upon the same enacted words."[856]

International conventions can leave a certain margin of appreciation when interpreted by domestic jurisdictions. This is an important issue that could substantially jeopardise the success of international convention used as legal method to unify secured credit law regimes. In the Civilian and Common Law traditions, interpretation of international legislations can lead to very different conclusions as jurisdictions use dissimilar interpretation tools[857]. Consequently, if there is a conflict

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[854] Bonell *op. cit.* fn. 813, at p. 12.
[855] Chapter Two particularly highlighted the difficulties encountered by creditors willing to create a security in intellectual property assets. With the significant development of technologies, new types of assets are likely to emerge in the near future and it is fundamental that secured credit law regimes are flexible enough to adapt and deal with these new classes of assets.
[856] Munday, R.J.C. "The Uniform Interpretation of International Conventions" (1978) 27 *International and Comparative Law Quarterly,* at p. 450.
[857] See Chapter Three at pp. 102-106.

of interpretation on a legal problem of commercial law that is not explained in an international convention, there could be a legal gap in the settlement of the dispute. The comparative analysis on the concept of *accessio* in France and England demonstrated that interpretation of a similar concept can differ[858].

Naturally, the Vienna Convention on the Law of Treaties provide for important precisions of the legal status of international conventions and their interpretations[859]. Furthermore, it is to be observed that national courts have generally be quite responsive to the recognition of similar and consistent interpretations of international conventions and even considered analysing the *travaux préparatoires* in their interpreting task. In Common Law jurisdictions such as England, courts have been willing to follow a uniform approach to the interpretation of international conventions[860]. In Civil jurisdictions, such as France, specific legislative recommendations can be found in the Civil code clarifying the way international conventions should be interpreted[861]. Judges need to understand the convention as a

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[858] *Ibid.*

[859] See The Vienna Convention on the Law of Treaties, Section 3, Article 31 on the interpretation of treaties. Text is Available at http://untreaty.un.org/ilc/texts/instruments/english/conventions/1_1_1969.pdf (last checked 26/04/2010).

[860] Lord Diplock stated in *Fothergill v. Monarch Airlines Ltd.,* [1981] AC 251at 281-82 that: "[t]he language of that convention [the Warsaw Convention on the International Air Carriage of 1929, as amended by the Hague Protocol 1955, and as scheduled, in its amended form, to the UK Carriage by Air Act 1961] that has been adopted at the international conference to express the common intention of the majority of the states represented there is meant to be understood in the same sense by the courts of all those states which ratify or accede to the Convention. Their national styles of legislative draughtsmanship will vary considerably as between one another. So will the approach of their judiciaries to the interpretation of written laws and to the extent to which recourse may be had to *travaux préparatoires,* doctrine and jurisprudence as extraneous aids to the interpretation of the legislative text. The language of an international convention has not been chosen by an English parliamentary draftsman... It is addressed to a much wider and more varied judicial audience than is an act of parliament that deals with purely domestic law. It should be interpreted, as Lord Wilberforce put in *James Buchanan & Co. Ltd. v. Babco Forwarding and Shipping (UK) Ltd.,* [1978] AC 141, 152, 'unconstrained by technical rules of English law or by English legal precedent, but on broad principles of general acceptation" Gopalan *op. cit.* fn. 813, at p. 297. On the application of international private law in England, see Chuah, J.C.T. Et al., *States Conventions on Private International Law,* (2nd ed., 2005).

[861] Article 1156 to 1164 *C.Civ.* provide some guidelines towards the interpretation of international conventions. Article 1156 *C.Civ.* : "[o]ne must in agreements seek what the common intention of the contracting parties was, rather than pay attention to the literal meaning of the terms." Article 1157 *C.Civ.* provides that: "[w]here a clause admits of two meanings, one shall rather understand it in the one with which it may have some effect, than in the meaning with which it could not produce any." Article 1158 *C.Civ.* : "[t]erms which admit of two meanings shall be taken in the meaning which best suits the subject matter of the contract." Article 1159 *C.Civ.* : "[w]hat is ambiguous shall be interpreted by what is in use in the region where the contract was made." Article 1160 *C.Civ.*: "[t]erms which are customary shall be supplemented in the contract, even though they are not expressed there." Article 1161 *C.Civ.* "[a]ll the clauses of an agreement are to be interpreted with reference to one

whole, taking into account its objectives in their task of interpretation. If some of the convention's provisions are not clear, judges can also refer to the *travaux préparatoires* preceding the enactment of the convention. Further, judges can also refer to foreign case law to use as guidelines to interpret obscure aspects of international conventions[862].

Despite, extensive theoretical guidelines on the interpretation of international conventions, it has been extensively shown, that in the field of secured credit, property law concepts highly differ from one jurisdiction to another, especially in the context of different legal traditions. Thus, it could be unnatural for a civil lawyer to understand and interpret a convention using the concept of 'security interest' considering that Civilian jurisdictions do not recognise interests in property but only rights in property[863]. In that respect, it is interesting to note that the UNCITRAL Legislative Guide on Secured Transactions did not preserve the American Article 9 UCC terminology of 'security interest' but adopted the term of 'security right'[864].

International conventions do achieve a great degree of approximation if they are ratified and interpreted uniformly by states members. In the field of secured transactions, previous developments have highlighted the difficulties underlying the feasibility of reaching a consensus in this area of law. The success of the Cape Town's Convention has shown that unification in the field is feasible only in respect of certain aspects of secured credit. In this respect, it is arguable that the fragmentary character of international conventions would bear the risk of undermining their benefits towards a broader range of financial transactions.

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another by giving to each one the meaning which results from the whole instrument." Article 1162 *C.Civ.*: "[i]n case of doubt, an agreement shall be interpreted against the one who has stipulated, and in favour of the one who has contracted the obligation." Article 1163 *C.Civ.*: "[h]owever general the terms in which an agreement is phrased may be, it shall include only the things upon which the parties appear to have intended to contract." Article 1164 *C.Civ: "[w]*here in a contract one case was expressed for explaining the obligation, it shall not be deemed that it was thereby intended to reduce the scope of the agreement which extends as of right to cases not expressed."

[862] Pontavice, E. "Interprétation des Conventions Maritimes Internationales en Droit Français" (1990) 42 *Revue Internationale de Droit Comparé,* at p. 725.

[863] See Chapter Three and Chapter Four.

[864] Terminologies issues have been extensively analysed in the *travaux préparatoires* of the UNCITRAL Legislative Guide on Secured Transactions, as it will be demonstrated in subsequent development.

As it has already been highlighted by the Secretary General of the United Nations in 1977:

"It would seem that international legislation in the form of a convention providing uniform rules of substantive and conflicts law is not appropriate in this case. As against international sales or international transportation or the international circulation of negotiable instruments, transnational incidence of security interests is as yet relatively moderate. It would probably be difficult to obtain sufficient government support for an international conference dealing with the relatively technical topic of security interests; and even if the text of an international instrument could be agreed upon, national parliaments would probably be slow and perhaps even reluctant to ratify such a text."[865]

Nevertheless, the use of international conventions as legal methods to modernise Commercial law should not be disregarded and overlooked as the Cape Town Convention successfully demonstrated. Following the identification of several limits underlying the use of international conventions as legal method to reform and modernise secured credit law regimes and, considering the lack of consensus on the unification of associated areas of law such as property law concepts, international reformers have been tempted to use more flexible instruments of unification, such as model laws and restatements.

[865] Report of the Secretary-General: Study on Security Interests, U.N. Doc A/CN.9/131 available at www.uncitral.org. Nevertheless, it is interesting to note that these comments were made notwithstanding the introduction of proposals for the harmonisation of secured credit law regimes introduced by UNIDROIT in 1968 and by the Service de Recherches Juridiques Comparatives of the Centre National Recherche Scientifique of Paris in 1972. On this point see Gopalan "*op. cit.* fn. 813, at p. 271, at footnote 17.

Model laws and restatements

Soft law international legal instruments [866] have recently become the panacea for the unification and modernisation of private law. Soft law instruments can cover a wide range of legal instruments and include model laws, restatements, legislative guides, international trade terms such as those produced by the International Chamber of Commerce, or international Contracts Terms. As opposed to international conventions, states are not the sole actors in the making of 'soft law' legal instruments. Private law scholars, academics, and organisations representing businesses and industries now also take part in the adoption of international legal standards.

The use of soft law legal instruments has been the object of significant debates among academics. It has been argued that the increase in the use of soft law "... might destabilize the whole international normative system and turn into an instrument that can no longer serve its purpose."[867] Others have argued that soft law is desirable as it would constitute a step towards the recognition of hard law[868]. Partisans of the use of soft legal instruments generally recognise that it would lower contracting costs by avoiding the lengthy negotiation process required with international conventions. The non-binding nature of soft law instruments would allow more flexibility in dealing with legal and cultural diversity. Further, these instruments would provide more flexibility in the amendment process which would

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[866] For a description of the features of soft law instruments see Berger *op. cit.* fn. 262, at p. 885 where the author states that: "[t]heir usefulness results to a large extent from the mere fact that they exist and that they are formulated like black letter law without being "law" in the proper sense. Their use as a standard reference point, their time saving effect as a means to substitute profound comparative analysis, depends on the comparative persuasiveness of every single rule or principle contained in the Restatement. This aspect is particularly relevant in those areas where the drafters of the Restatements have not merely selected the best solution from the legal system compared but have 'invented' new rules." Further, "[s]oft law instruments are easier and less costly to negotiate. Soft law instruments impose lower "sovereignty costs" on States in sensitive areas. Soft law instruments provide greater flexibility for states to cope with uncertainty and learn overtime. Soft law instruments allow states to be more ambitious and engage in "deeper" cooperation than they would if they had to worry about enforcement. Soft law instruments cope better with diversity. Soft law instruments are available to non-state actors, including international secretariats, sub-state public actors such as administrative agencies and business associations and non-governmental organizations."Shaffer *op. cit.* fn. 818.

[867] Weil, P. "Towards Relative Normativity in International Law?" (1983) 77(3) *The American Journal of International Law,* at p. 423.

[868] Reinicke, W.H., Et al. "Interdependence, Globalization, and Sovereignty: The Role of Non-Binding International Legal Accords" in Shelton, D., *Commitment and Compliance. The Role of Non-Binding Norms in the International Legal System*, (OUP, 2000), at p. 75.

ease and speed the adaptation to modern commercial and financial environment. By avoiding the ratification and cumbersome amendment process, soft law instruments would be quicker and simpler to draft. Further, the use of these instruments of unification would enable the private sector to participate more actively in the law making process. Finally, it is arguable that soft law instruments could be used as a step forward to the recognition of legally binding instruments[869].

These instruments of unification have particularly been used in the United States of America. The American Law Institute extensively used restatements and model laws as legal methods to clarify, modernise, and improve the law[870]. The success of restatements and models laws as legal method to reform and approximate the law aroused significant interest from other international entities. The success of the American Uniform Commercial Code, and particularly of Article 9 in relation to secured transactions, to spread uniformity and modern legislations across the American States[871] clearly inspired many international entities to set similar legal instruments to be used in other jurisdictions[872]. In effect, recent international approximation and modernisation projects have essentially taken the form of soft law legal instruments such as restatements and model laws. For instance, UNCITRAL recently enacted a Legislative Guide on Secured Transactions[873]which constitutes one of the major initiatives in the field of secured transactions. It is important to highlight that previous initiatives conducted by UNCITRAL have been successful in

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[869] Trubek, D.M., Et al. "'Soft Law,' 'Hard Law,' and European Integration: Towards a Theory of Hybridity" (2005), *Jean Monnet Working Paper* available at http://www.law.wisc.edu/facstaff/trubek/HybridityPaperApril2005.pdf (last checked 26/04/2010), at pp. 15-16.

[870] See *e.g.*, the endeavours run by the American Law Institute.

[871] Vogenauer *op. cit.* fn. 842, Para. 12, at p. 5, where the author states that : "... In view of the difficulties encountered with the types of instruments mentioned in the previous paragraphs, there is an increasing support for another non-legislative means of harmonization: "restatements" of private law at an international level. The idea was apparently first mooted in the 1960's in the context of European private law. Soon it was promoted for international uniform law in general. The vision was modelled on the United States Restatements of the law, sets of rules which are prepared and periodically revised by academics and practitioners under the auspices of the American Law Institute and which codify in systematic manner a variety of areas of law that are traditionally dealt with by state common law, rather than by legislation. It was hoped that such non official and non-binding instruments would present the relevant rules in a uniform structure and uniform terminology and that they might thus serve as a first step towards later legislative harmonization."

[872] At the international level, the EBRD Model Law on Secured Transactions and UNCITRAL Legislative Guide on Secured Transactions constitute some of the major initiatives for the approximation and modernisation of secured transactions regimes.

[873] Available at http://www.uncitral.org/uncitral/en/uncitral_texts/payments/Guide_securedtrans.html (last checked 26/04/2010).

approximating and modernising the law by using soft law legal instruments such as models laws and restatements as legal methods. The successful UNCITRAL Model Law on International Commercial Arbitration (1985 as amended in 2006) has served as a model for legislative reforms in many jurisdictions such as Canada, Germany or Australia[874]. The UNCITRAL Model Law on Procurement of Goods, Construction and Services (1994) has also served as a model for legislation particularly in many new emerging economies such as jurisdictions from Africa and jurisdictions from the former Soviet Union[875]. Finally, the Model Law on Electronic Commerce has also successfully served as model for legislative reforms in many jurisdictions such as China, India and the United States[876]. These examples clearly illustrate the success of

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[874] Legislation based on the UNCITRAL Model Law on International Commercial Arbitration as adopted in 1985 has been enacted in Armenia (2006), Australia (1991), Austria (2005), Azerbaijan (1999), Bahrain. (1994), Bangladesh (2001), Belarus (1999), Bulgaria (2002), Cambodia (2006), Canada (1986), Chile (2004), China (the Hong Kong Special Administrative Region (1996) and the Macao Special Administrative Region (1998)), Croatia (2001), Cyprus, Denmark (2005), Dominican Republic (2008), Egypt (1996), Estonia (2006), Germany (1998), Greece (1999), Guatemala (1995), Honduras (2000), Hungary (1994), India (1996), Iran (Islamic Republic of) (1997), Ireland (1998), Japan (2003), Jordan (2001), Kenya (1995), Lithuania (1996), Madagascar (1998), Malta (1995), Mauritius (2008), Mexico (1993), New Zealand (1996, 2007*), Nicaragua (2005), Nigeria (1990), Norway (2004), Oman (1997), Paraguay (2002), Peru (1996, 2008*), the Philippines (2004), Poland (2005), the Republic of Korea (1999), the Russian Federation (1993), Serbia (2006), Singapore (2001), Slovenia (2008*), Spain (2003), Sri Lanka (1995), Thailand (2002), the former Yugoslav Republic of Macedonia (2006), Tunisia (1993), Turkey (2001), Uganda (2000), Ukraine (1994), the United Kingdom of Great Britain and Northern Ireland (Scotland (1990) and Bermuda, an overseas territory of the United Kingdom), the United States of America (the States of California (1996), Connecticut (2000), Illinois (1998), Louisiana (2006), Oregon and Texas), Venezuela (Bolivarian Republic of) (1998), Zambia (2000) and Zimbabwe (1996).

[875] Legislative texts based on or largely inspired by the UNCITRAL Model Law on Procurement of Goods, Construction and Services have been adopted in various countries including Afghanistan (2006), Albania, Azerbaijan, Bangladesh, Croatia, Estonia, Gambia (2001), Ghana, Guyana, Kazakhstan, Kenya, Kyrgyzstan, Madagascar, Malawi (2003), Mauritius, Moldova, Mongolia, Nepal, Nigeria (2007), Poland, Romania, Rwanda, Slovakia, Tanzania, Uganda, Uzbekistan and Zambia.

[876] Legislation implementing provisions of the Model Law has been adopted in Australia (1999), Brunei Darussalam (2000), Cape Verde (2003), China (2004), Colombia* (1999), Dominican Republic* (2002), Ecuador* (2002), France (2000), Guatemala (2008), India* (2000), Ireland (2000), Jordan (2001), Mauritius (2000), Mexico (2000), New Zealand (2002), Pakistan (2002), Panama* (2001), Philippines (2000), Republic of Korea (1999), Singapore (1998), Slovenia (2000), South Africa* (2002), Sri Lanka (2006), Thailand (2002), United Arab Emirates (2006), Venezuela (2001) and Viet Nam (2005).

The Model Law has also been adopted in the Bailiwick of Guernsey (2000), the Bailiwick of Jersey (2000) and the Isle of Man (2000), all Crown Dependencies of the United Kingdom of Great Britain and Northern Ireland; in Bermuda (1999), Cayman Islands (2000), and the Turks and Caicos Islands (2000), overseas territories of the United Kingdom of Great Britain and Northern Ireland; and in the Hong Kong Special Administrative Region of China (2000).

Uniform legislation influenced by the Model Law and the principles on which it is based has been prepared in the United States (Uniform Electronic Transactions Act, adopted in 1999 by the National Conference of Commissioners on Uniform State Law) and enacted by the States of Alabama (2001), Alaska (2004), Arizona (2000), Arkansas (2001), California (1999), Colorado (2002), Connecticut (2002), Delaware (2000),District of Columbia (2001), Florida (2000), Hawaii (2000), Idaho (2000), Indiana (2000), Iowa (2000), Kansas (2000), Kentucky (2000), Louisiana (2001), Maine (2000),

soft law legal instruments such as model laws and restatements to be used as legal methods to modernise and approximate the law in specific areas of commercial law.

Other international initiatives enacted in the form of model laws and restatements also proved to be a success. The successful UNIDROIT Principles on International Commercial Contracts[877](PICC thereafter) are also preserved in the form of a restatement rather than in the form of a convention[878]. The UNIDROIT Principles provide neutral legal principles governing international contractual relationships which are not essentially based on any particular existing legal system. Nevertheless, and as for the harmonisation process, it is important to emphasise that the enactment of soft law legal instruments, such as model laws and restatements, still involve comparative law efforts[879] that will permit to determine, analyse, and eliminate

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Maryland (2000), Massachusetts (2003), Michigan (2000), Minnesota (2000), Mississippi (2001), Missouri (2003), Montana (2001), Nebraska (2000), Nevada (2001), New Hampshire (2001), New Jersey (2000), New Mexico (2001), North Carolina (2000), North Dakota (2001), Ohio (2000), Oklahoma (2000), Oregon (2001), Pennsylvania (1999), Rhode Island (2000),South Carolina (2004), South Dakota (2000), Tennessee (2001), Texas (2001), Utah (2000), Vermont (2003), Virginia (2000), West Virginia (2001), Wisconsin (2004) and Wyoming (2001). The State of Illinois had already enacted the Model Law in 1998.

Uniform legislation influenced by the Model Law and the principles on which it is based has also been prepared in: Canada (Uniform Electronic Commerce Act, adopted in 1999 by the Uniform Law Conference of Canada) and enacted in a number of Provinces and Territories, including Alberta (2001), British Columbia (2001), Manitoba (2000), New Brunswick (2001), Newfoundland and Labrador (2001), Nova Scotia (2000), Nunavut (2004), Ontario (2001), Prince Edward Island (2001), Saskatchewan (2000) and Yukon (2000).

Legislation influenced by the Model Law and the principles on which it is based has also been adopted in: the Province of Quebec (2001).

[877] On the success of the PICC, see Brödermann, E. "The Growing Importance of the UNIDROIT Principles in Europe – A Review in Light of Market Needs, the Role of Law and the 2005 Rome I Proposal" (2006) 11 *Uniform Law Review,* at p. 749.

[878] UNIDROIT Governing Council at its 73rd session in 1994, took note of a Secretariat memorandum stating that: "... attempts to realize those [i.e. the statutory] aims ... have assumed two principal forms, on the one hand the preparation of uniform laws, a term which should be understood in a broad sense and therefore as encompassing for example the Principles of International Commercial Contracts, and on the other, dissemination and information concerning uniform law coupled with study of the methodology of the unification process so as to ensure that the benefits it is capable of offering to the international community as a whole can be maximized to the best possible advantage." Governing Council, 73rd Session, Rome, 9-14 May 1994, Agenda Item 9, Secretariat Memorandum, UNIDROIT 1994, C.D. (73) 9 (Original: English).

[879] Vogenauer *op. cit.* fn. 842, Para. 13, at p. 5 where the author states that "... the restatements are, in legal terms, nothing more than declarations by private bodies of scholars who have no democratic or other legitimacy to engage in law making. This is particularly important as the restatements are in fact not simply restating the law in the sense of merely reproducing existing rules and usages: a pure restatement of contract rules from different legal systems on a given issue in a single provision is only possible if these rules produce similar outcomes – as is frequently the case between the contract laws of the states of the USA. Where such a commodity does not exist-as it is frequently the case between the contract laws of the different jurisdictions of the world- the elaboration of a single rule on the issue

current differences between legal regimes of countries from different legal backgrounds[880]. Such preparatory work will ensure that the restatement or model law will be accepted and referred to by a maximum of countries for law reform purposes[881] or, by contracting parties to govern their international contracts. In effect, it is interesting to note that national courts have already applied the principles (PICC) to interpret and resolve conflicts arising in international contracts[882]. Further, it is

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in question necessarily involves policy decisions and departures from the existing law in at least one of these jurisdictions and therefore promotes changes in the law."

[880] Gopalan *op. cit.* fn. 813, at p. 310.

[881] See the Communication from the Commission to the Council and the European Parliament on European Contract Law, Response of COMBAR, Para. 10, available at http://europa.eu.int/comm/consumers/cons_int/safe_shop/fair_bus_pract/cont_law/comments/4.4.pdf (last checked 26/04/2010). The Commission states that: "... In our view, the work of the Commission on European Contract Law, and the Study Group on a European Civil Code is valuable, and should be supported. A 'Restatement' of contract law, which is what we would expect to be the end result, though not in itself binding, may be expected to 'harden' into law, for example by influencing the judicial process. At the least, where a provision of national contract law diverges from those as state in the principles, courts may be encouraged to consider whether such divergence is in fact justified by reference to conditions obtaining in the country concerned.") Also, Gopalan observed that "... In less than two decades the Principles have attained a modicum of success in attracting the attention of courts, arbitral tribunals, and national legislatures. Its status as the embodiment of the current state of the art of international contract law motivated national legislators to refer to it in the process of enacting new legislation. For example, the drafting of the Russian Civil Code, the Estonian Law of Obligations, and the Civil Code of the Republic of Lithuania, all witnessed reference to the Principles." Gopalan *op. cit.* fn. 818, *at* p. 358.

[882] See on this point, Bonell *op. cit.* fn. 836, at p. 305 and Gopalan *op. cit.* fn. 818, at p. 359 where the author states that: "[c]ourts have referred to the Principles in several countries, including the U.S. In *Ministry Of Defense and Support for the Armed Forces of the Islamic Republic of Iran v. Cubic Defense Systems, Inc.*, one of the questions before the court was whether the arbitral tribunal's application of the UNIDROIT Principles was a ground for vacatur of the award under article V (1)(c) of the New York Convention on the recognition and enforcement of foreign arbitral awards. The defendant argued that such use of the Principles exceeded the scope of the Terms of Reference. The court was unimpressed: "[t]he reference to the UNIDROIT Principles does not exceed the scope of the Terms of Reference .... The Tribunal's reference to and application of the UNIDROIT Principles and principles such as good faith and fair dealing do not violate Article V(1)(c)." In *Great Hill Equity Partners II LP v. Novator One LP*, the question was whether certain statements made during pre-contractual negotiations could be used to construe the agreement. The court referred to the UNIDROIT Principles alongside the CISG for the proposition that all relevant circumstances must be considered in construing the intention of the parties. A similar question arose in *The Square Mile Partnership Limited v. Fitzmaurice McCall Limited*, and the court once again referred to article 4.3 of the Principles in addition to scholarly commentary. In *Econet Satellite Services Ltd v. Vee Networks Ltd*, the parties had a clause in the contract stating that it shall be "interpreted in accordance with the UNIDROIT Principles of International Commercial Contracts of the International Institute for the Unification of Private Laws [1994] as then in force, applied *mutatis mutandis* to the extent not inconsistent therewith." There was no objection to this by the Queen's Bench. In an Argentinean case in 2004, despite no reference to the UNIDROIT Principles in the contract, which was between a bank and its customer concerning a credit card issued by the former, the court explicitly referred to article 2.4 of the Principles as an exemplar of "modern law." There are six Australian cases listed on the Unilex database that have referred to the Principles. In *Hughes Aircraft Systems International v. Airservices Australia*, the court noted that the Anglo-Australian law on the duty of fair dealing was indecisive, but that "[i]t has been propounded as a fundamental principle to be honoured in international commercial contracts" by the UNIDROIT Principles of International Commercial Contracts in Article 1.7, and held that "recognition [of the duty] in our own contract law is now

also important to note that more than hundred and fifty arbitral awards referring to the PICC have also been published especially in relation to the Sale of Goods but also in relation to contracts on works and services, distribution licences, aircraft maintenance, shareholder agreements, partnership agreements, merger and takeover agreements[883]. Modernisation of the law, in that sense would not solely occur through national legal reforms but would also occur through its recognition within national courts as governing legislation to regulate contractual relationships. Thus, states do not any longer constitute the sole actors in the law making process. States sovereignty in this context has lost some of its impact and significance at the international level.

At Regional level, a similar view was adopted within the EU and the Principles of European contract law (PECL thereafter)[884] which recognise 'restatement' as the appropriate legal method to achieve European integration[885]. For instance, the PECL has already served as model for reform of the German law of obligations, the Scottish contract law[886] and contract law in France[887]. It is believed that the PECL

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warranted. This decision was cited with approval by the Supreme Court of New South Wales in *Alcatel Australia Ltd. v. Scarcella & Ors.* In *Aiton v. Transfield*, the dispute was about the proper construction of a clause in the agreement which provided that: "[t]he Purchaser [Transfield] and Supplier [Aiton] shall make diligent and good faith efforts to resolve all [d]isputes." The court noted that the: "... interest generated by international instruments such as the UNIDROIT Principles of International Commercial Contracts ... which specifically refer to a requirement of 'good faith' in contracts" and held that the clause was enforceable."

[883] Kronke, H. "The UN Sales Convention , the UNIDROIT Contract Principles and the Way Beyond" (2005) at p. 5, UNCITRAL publications available at http://www.uncitral.org/pdf/english/CISG25/Kronke.pdf (last checked 05/03/2010).

[884] http://www.jus.uio.no/lm/eu.contract.principles.1998/doc.html (last checked 26/04/2010).

[885] The Commission on European Contract Law and Study Group on a European Civil Code recognised the necessity for a restatement of law. It is explained that: "[b]oth Groups are of the view that the further development of European private law will depend decisively on the promotion and further elaboration of a restatement. A thorough-going legal comparison, consolidated in the form of principles expressed as legal rules with commentary and annotation, is an indispensable foundation for further European integration. In particular, it is only in undertaking to construct a restatement of private law in the Member States that the actual extent of legal diversity and any corresponding need for legal harmonisation can be fully determined. Only a restatement is capable of making visible the existence of legal values and principles which are already shared, bringing to light national peculiarities and developing a common terminology for jurists which overcomes jurisdictional boundaries.", Para. 61, at p. 33 available at http://www.sgecc.net/media/downloads/stellungnahme_kommission_5_final1.pdf (last checked 26/04/2010).

[886] *Ibid.* Para. 74, at p. 37.

[887] Avant-Projet de Réforme du Droit des Obligations (Articles 1101 à 1386 du Code Civil) et du Droit de la Prescription (Articles 2234 à 2281 du Code civil) Rapport à Monsieur Pascal Clément Garde des Sceaux, Ministre de la Justice 22 Septembre 2005, Projet Catala. http://lesrapports.ladocumentationfrancaise.fr/BRP/054000622/0000.pdf (last checked, 05/03/2010).

could successfully lead to the harmonisation and modernisation of the law. It is explained that the:

"... PECL plays a central role in this process. As a comparative reference point and as the "ratio scripta" of European contract law, they provide the medium through which the development of a European doctrine of precedents may be developed. Even though, they do not constitute binding law in the proper sense, the PECL's specific quality, being formulated as black letter rules makes them an ideal reference point for the Europeanization of the case law of the courts of the EU Members countries."[888]

It is arguable that international legal instruments, such as model laws and restatements, could be seen as a step towards the recognition of binding legal instruments. Soft law instruments could be conceived as a way to convey information to states and legal reformers about the policy choices and legal regimes recognised at the international level. Ultimately, soft law instruments could influence legal reformers at national level without the need to enact binding legal instruments in the form of international conventions.

Restatements or model laws do not consist in the re-enactment of one particular national legal regime in the form of a binding supranational legal instrument. Rather, they involve the voluntary recognition of legal principles supposedly embodying the best available legal solution established following substantial comparative analysis. As the European Commission already formulated in respect of the PECL:

"[t]he preparation of a restatement can only be achieved by an impartial formulation of principles in the light of detailed comparative law research, transcending existing legal diversity by a dispassionate development of the most appropriate rules for a Community wide private law. Any other method would be entirely inappropriate. In particular, it would be unacceptable to adopt an individual national code as a starting point and merely tweak it here and there at the margins."[889]

The use of soft law legal instruments such as restatements and models laws can avoid some of the difficulties underlying endless negotiations prior to the enactment of conventions[890]. For instance, the CISG took over ten years to draft[891].

The *'Loi n° 2008-561 du 17 Juin 2008 portant réforme de la prescription en matière civile'* already reformed the dispositions in the Civil code relative to the limitation of civil actions by lapse of time (prescription).

[888] Berger *op. cit.* fn. 262.

[889] See above fn. 884, at p. 34.

[890] Farnsworth provides that: "[t]he advantages and disadvantages of harmonization by way of restatement are obvious. Restatements avoid the tortuous negotiation and ratification process of international treaties and they can be flexibly adapted to the changing conditions of international

Nevertheless, the draft of soft law legal instruments could also require some time as the success of model laws or restatements as legal method for reform would also require significant comparative law efforts prior to their enactments.

Soft law legal instruments are not binding and, thus, do not require any ratification, but states are offered the choice to adopt and modify some of their provisions or to disregard them completely[892]. Another purpose of restatements and models laws is that they can encourage party autonomy by offering the opportunity for the parties to elect the legal regime as the governing law for their contractual relationships. This is a substantial advantage of using these legal instruments as legal methods to modernise the law at the international level. Naturally, soft law instruments can also serve as model legislations for national legal reforms as it has just been demonstrated.

Owing to more flexibility, the use of soft law instruments would appear to offer better prospects to successfully reform and modernise the law than with international conventions. Nevertheless, it is arguable that the high degree of flexibility offered by model laws and restatements is obtained at the expense of the successful achievement of complete unification of the law. In effect, the nature of model laws and restatements does not impose any ratification amongst potential participating States of the dispositions to be adopted. States remain free to adopt, modify and reject altogether the dispositions of a model law. However, it has already been highlighted that model laws and restatements have generally been quite successful in their quest to achieve an approximation and modernisation of the law without the need to bear the restrictive binding nature of international conventions.

International agencies understand that conventions are limited in their prospects to successfully achieve a modernisation and unification of secured credit laws following their restrictive nature. Furthermore, it has already been highlighted that a comprehensive unification of secured credit law regimes is unlikely. By avoiding the

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commercial practice" in Farnsworth, E.A. "Closing Remarks" (1992) 40 *American Journal of Comparative Law,* at p. 699.

[891] United Nations Convention on Contracts for the International Sale of Goods (CISG).

[892] Vogenauer *op. cit.* fn. 842, Introduction, Para. 9, at p. 4.

difficulties underlying the adoption of international conventions and by providing more flexibility for states to adhere to their provisions and, more flexibility to adapt to modern commercial transactions[893], it is arguable that model laws and restatements would stand better chance to achieve a modernisation and approximation of secured credit law regimes.

The use of soft law legal instruments, such as restatements or model laws, as legal methods to modernise and approximate the law of secured credit could potentially be successful as it has been suggested in this development. In this respect, the next section will attempt to assess whether the use of soft law in the forms of model laws and restatements may be more likely to succeed in modernising and approximating the law of secured credit through the analysis of a concrete example. A significant illustration can be found with the UNCITRAL Legislative Guide on Secured transactions[894]. The UNICTRAL Legislative Guide is not legally binding but could serve as a set of legislative guidelines in order to assist jurisdictions to modernise and reform their laws in the future. This begs the question of whether the recent enactment of the UNCITRAL Legislative Guide on Secured Transactions could constitute a successful legal method to modernise and approximate the law of secured credit among jurisdictions from different legal backgrounds.

MODERNISATION OF SECURED CREDIT LAW REGIMES AND THE UNCITRAL LEGISLATIVE GUIDE ON SECURED TRANSACTIONS

In the year 2000, UNCITRAL considered the question of future possible work on the question of the unification in the field of secured credit law. The idea of the establishment of a legislative guide on secured lending was opportune in the context of growing national reforms. A first version was examined during the New York

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[893] See Gopalan *op. cit.* fn. 135, at p. 310 where the author states that: "[t]his is a vehicle for harmonization that has assumed tremendous importance following the successful reception of the UNIDROIT Principles of International Commercial Contracts. Without a doubt, the tremendous flexibility offered by restatements has contributed to their recent allure. Parties can adopt them on a voluntary basis, and they serve many important functions. For example, the UNIDROIT Principles of International Commercial Contracts as viewed as "neutral" contract law principles in that they reflect a balance of interests and have not been formulated by any government."

[894] Similar initiative is run with the CFR at the European level with the proposition to enact a Part ix on secured transactions in the restatement.

session in May 2002. The final version of the Legislative Guide on Secured Transactions was adopted within the fortieth session run by the Commission in December 2007[895]. During the same session, the Commission entrusted the same working group to prepare an annex to the Guide relating to security rights in intellectual property[896]. It is hoped that national legal reformers will use this Legislative Guide as a model for reform of their secured credit law regimes[897]. The use of the Guide could thus potentially be successful as legal method to approximate and modernise secured credit law regimes.

UNCITRAL opted for a legislative guide as legal method to modernise and approximate secured credit law regimes. As for other soft law instruments such as model laws and restatements, this legal method appeared to be more flexible and less restrictive than the use of international conventions. The Legislative Guide is based

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[895] See www.uncitral.org.

[896] See www.uncitral.org. Chapter Two already highlighted the existing difficulties underlying the creation of a security in intellectual property assets at the international level.

[897] See Rocks, S.M., Et al. "International Commercial Law: 2007 Developments" (2008) 63 *Business Lawyer,* at p. 1375 where the author provides a summary of the Legislative Guide: ".... The Guide is designed for States (Nations) that wish to develop further their law governing secured transactions involving movables (*i.e.* personal property). It is not a treaty or a model law. Rather, like UNCITRAL Legislative Guide on Insolvency Law, the Guide provides guidance to States in two ways. First, it sets out in commentary issues and policies that States may wish to consider in adopting or reforming their secured transactions laws. Second, it contains recommendations (often quite specific) of UNCITRAL as to the resolution of those issues and rules necessary to effectuate those policies. States that follow the recommendations of the Guide in enacting legislation based on it will gain the benefits of a modern secured transactions regime – a regime that is generally consistent with the policies of Article 9 of the Uniform Commercial Code and the Canadian Personal Property Security Acts. If the recommendations of the Guide are widely followed, there will the added benefit of greater harmonization of secured transactions laws worldwide. Moreover, enactment of the Guide's recommendations on conflict of laws alone will produce greater predictability in cross-border transactions [...] Of major significance in the Guide are (i) its recognition of the need for a comprehensive and functional approach to security rights, (ii) its recommendations that security rights in asset in bulk and in future assets be allowed, (iii) its recommendations for a notice filing system and a first-to-file priority rule, (iv) its recommendations for super-priority for acquisition financing security rights (purchase- money security interests, (v) its recommendations relating to the override of anti-assignment clauses in specific transactions, (vi) its recommendations relating to self-help enforcement, and (vii) the comprehensive conflict-of-laws recommendations. ... The Guide addresses security rights in personal property (movables). It also applies to "true sales" of receivables not evidenced by negotiable instruments. Excluded from the Guide are security rights in real estates (immovables). The Guide excludes, as well, security rights in aircraft and other "high ticket" mobile goods to the extent subject to the Cape Town Convention. Also excluded are security rights in securities and financial contracts. Security rights in intellectual property are included within the scope of the Guide but with the caveat that its recommendations do not apply insofar as they are inconsistent with a State's intellectual property regime or its intellectual property obligations. UNCITRAL has commenced a separate project to consider an annex to the Guide to address selected issues relating to security rights in intellectual property rights and may in the future consider expanding the Guide to address security rights in certain securities and financial contracts. "

on Article 9 of the American UCC which is often presented as a model of modern legislations on secured credit. In a context of legal reforms, it is not surprising that the American regime recently became the paragon of modern secured credit legislations[898]. The Legislative Guide on Secured Transactions did not escape this general trend and, unsurprisingly, presents great similarities with Article 9 UCC. Nevertheless, the drafters of the Legislative Guide were aware of the difficulties for some jurisdictions to integrally adopt an Article 9 type regime. The difficulties of importing Article 9 UCC in certain jurisdictions have already been extensively considered[899]. In this respect, substantial comparative law and reconciliation efforts have been performed by the drafting panel of the UNCITRAL Legislative Guide.

For the purpose of this analysis on the likelihood of success of the UNCITRAL Legislative Guide to modernise secured credit law regimes, it is important to look at the *travaux préparatoires* and the negotiations that have animated fundamental debates on the recognition of a universal secured credit law regime. In effect, such an examination would provide an idea of the level of recognition of the Guide from jurisdictions that belong to different legal traditions. This development will not fundamentally focus on the recommendations opted by the Legislative Guide, as this exercise has already been done extensively[900] but will be looking at the *travaux préparatoires* and negotiations prior to the enactment of the Legislative Guide.

It has already been analysed in the above developments that international conventions can lead to substantial obstacles and difficulties. That is why the drafters of the Legislative Guide opted for a diplomatic, flexible and non compulsory legal instrument in the form of a legislative guide. This formal legal choice of an optional non binding tool could however lead to significant risks. In effect, if the Guide is not

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[898] Riffard, J.F. "Le Guide Législatif de la CNUDI sur les Opérations Garanties. Un Pas Décisif Vers un Droit des Sûretés Mobilières Harmonisés » in Picod, Y., Et al., *Le Droit des Sûretés à L'Epreuve des Réformes*, (2009).
[899] See Chapter Three.
[900] Bazinas, S.V. " Harmonisation of International and Regional Trade Law: The Uncitral Experience" (2003) 8 *Uniform Law Review*, at p. 53; Bazinas, S.V. " Uncitral Draft Legislative Guide on Secured Transactions" 10 *Uniform Law Review*, at p. 141; Bazinas, S.V. "Key Policy Issues of the Uncitral Draft Legislative Guide on Secured Transactions" (2007), Article to be published in a book on security interests edited by Bénédict Foex, Luc Thévenoz and Spiros V. Bazinas, to be published in Zurich by Schulthess; Garro, A. M. "Harmonization of Personal Property Security Law National Regional and Global Initiatives" (2003) 8 *Uniform Law Review*, at p. 357.

recognised or adopted by potential participating states because of conceptual and terminological divergences, then its adoption would fail and there would not be any rationale behind the enactment of this Legislative Guide.

It is arguable that the choice of a legislative guide as legal method to modernise secured credit law regimes is a wise choice in the sense that it offers jurisdictions high degree of flexibility. In effect, the UNCITRAL Legislative Guide does not impose any of its recommendations nor the form in which they should be materialised. The Legislative Guide ensures maximum compliance with the adopting states' existing national legal standards in order to be easily assimilated and recognised at the national level[901]. The drafters made substantive efforts to comply with the different terminologies and concepts adopted within the different states legislations and, decided to opt for a guide as legal receptacle for their recommendations, which does not impose any constraints on states. The Legislative Guide is essentially consensual in character and, therefore, seems acceptable both for Common Law and Civilian jurisdictions.

This analysis already stated that some jurisdictions, particularly Civilian jurisdictions, were quite reticent towards the adoption of a global security based on an Article 9 type regime[902]. For example, the Commission *Grimaldi*, designated to the task of reforming French security law, was quite hostile to the integral transplantation of an Article 9 type as it would have involved a substantive reform of insolvency law regime that would not have conformed to the policy decisions currently adopted within the French legal system. Especially, the question of the adoption of a global security right was largely at stake in the French secured credit law reform and was also one of the main litigious questions faced by the panel in charge of drafting the Legislative Guide.

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[901] This aspect is fundamental for the Legislative Guide. In that sense, see the introduction of the Legislative Guide on Secured Transactions, No 70, at p. 14 which provides that "[i]n order to be effective, in practice, any new secured transactions law must take into account the situations within which it is to operate. In particular, its provisions must be harmonized with the general legal structure as well as the actual role of credit institutions in the enacting State. Sometimes, this implies complementary changes to general legal and economic institutions; sometimes it requires State-specific adjustments to the details of the secured transactions regime itself." available at http://www.uncitral.org/pdf/english/texts/security/IntroCh1Ch2.pdf (last checked, 05/03/2010).

[902] See Chapter Three.

Considering that the Legislative Guide is noticeably inspired from the American model, the question emerges to determine how the drafters of the Guide managed to reconcile the different legal positions adopted by the participating states with an international legislation modelled on Article 9 UCC. It has already been argued in Chapter Three that an integral legal transplantation of Article 9 UCC would be difficult to achieve both in Civilian jurisdictions such as France or Quebec and in Common Law jurisdictions such as England. The architects of the Legislative Guide were conscientious of the fact that certain jurisdictions, particularly Civilian jurisdictions might have integrated different terminologies or concepts within their current secured credit law regimes. Nevertheless, the adoption of the functional approach and main legal principles governing Article 9 appeared to be a sensible option for the drafters of the UNCITRAL Legislative Guide[903].

The drafters understood that the recommendations issued in the Guide would not be implemented if they did not 'fit' within existing national terminologies and concepts[904]. Therefore, they chose to refer to the key concepts enacted in their recommendations in such a manner that it would fit and adapt to whatever national legal regimes from whatever legal traditions. For example, the expression 'encumbered assets' rather than 'collateral' or, 'security rights' rather than 'security interests', are used as preferred terminologies in the Guide. Moreover, the Guide did not retain the 'non possessory security interest' expression but retained 'acquisition security right' instead. It is arguable that these terminologies provide more neutrality which will enhance better recognition by states that belong to different legal traditions. Further, the Guide does not prescribe any legal form to be adopted if the

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[903] In that sense, the Guide adopts one of the most fundamental principles underlying Article 9 UCC, *i.e.* its functional approach. See *e.g.,* the introduction to the Legislative Guide on Secured Transactions, at p. 11 available at http://www.uncitral.org/pdf/english/texts/security/IntroCh1Ch2.pdf (last checked 26/04/2010).

[904] See the introduction to the Legislative Guide on Secured Transactions, No 71, at p. 14: "... First, because reform of secured transactions law will often not occur in the context of a general reform of a State's private law, the terminology by which the concepts and the rules of the new law are described must be built upon existing legal institutions. So, for example, while the Guide provides detailed definitions of the concepts that should be part of a reformed secured transactions law, it takes no position on precise terminology or words to be used in enacting a new law. The Guide presumes that States will implement its recommendations by reference to existing legal architecture rather than by transplanting unfamiliar legal terms drawn from other jurisdictions that have no legal meaning or resonance. In particular, the Guide attempts to present its recommendations and their associated key concepts in such a manner that, whatever the legal tradition that underpins a State's national law, that State can adapt and enact these recommendations."

guide were to be used as model for national law reform[905]. States can opt for whatever drafting options available in order to enact the recommendations. It has been explained above in this study that certain formal legal receptacles, such as the civilian form of codification, could constitute an obstacle and that is why the flexibility of this provision will act in favour of a successful adhesion from jurisdictions from different legal backgrounds[906]. Finally, it was fundamental for the drafters to keep in mind that the law of secured credit does interact with other legal fields such as insolvency law, property law and contract law. Consequently, it was important to try to keep some coherence within the Legislative Guide and preserve the specificity of national legislations if they were to integrate its recommendations[907]. Although, the drafters of the Guide managed to find common grounds on fundamental key principles to be adopted within the recommendations of the Legislative Guide, disaccords were also raised by the drafters during the *travaux préparatoires*.

Considering the wide diversity of legal traditions and national secured credit law regimes, the drafting panel of the Guide managed to reach, to a certain extent, a consensus. For instance, the key objectives and fundamental policies for an effective and efficient secured transactions regime were agreed amongst all members of the research group[908]. In respect of the substance itself of the recommendations, the

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[905] *Ibid,* at No 72: "... there is no one model governing either the manner of drafting of new legislation or the place where these new rules will be located within the overall legal regime of a State. So, for example, the Guide takes no position on whether all the recommendations it makes should be enacted in a single law, or whether these recommendations should be incorporated into a civil code or commercial code, or whether in either case they should appear in the same place. States may well decide to enact rules relating to conflict of laws in a law or a book of a civil code devoted to this subject. Likewise, the Guide takes no position on whether States should reform the law through an enactment written in the style of a civil code or in the style of a regulatory instrument."

[906] See Chapter Three at pp. 114-118.

[907] *Ibid,* No 73, at p. 15: "... many of the provisions of a secured transactions law intersect with rules of debtor-creditor law, banking law and practice, the regime governing insolvency and the institutions of civil procedure. The Guide acknowledges the need to achieve coherence of the overall regime at each of these points of intersection. For example, while it recommends in chapter VIII on the enforcement of a security right, that States provide for expeditious judicial proceedings to decide any questions relating to the rights of grantors, secured creditors or third parties during enforcement, it does not aim at describing either what those proceedings should be, or what rules of civil procedure should apply to them."

[908] *Ibid*, at pp. 8-10: "... (a) To promote low-cost credit by enhancing the availability of secured credit; (b) To allow debtors to use the full value inherent in their assets to support credit; (c) To enable parties to obtain security rights in a simple and efficient manner; (d) To provide for equal treatment of diverse sources of credit and of diverse forms of secured transaction; (e) To validate non-possessory security rights in all type of asset; (f) To enhance certainty and transparency by providing for

drafters generally agreed that a functional approach should be adopted in relation to the global security so that its scope of coverage should extend to all type of debts, type of assets, and parties. Also, it was generally agreed that a centralised registration system modelled on Article 9 UCC notice filing should be set up. Even though, the drafters managed to reach a certain consensus on the fundamental objectives and policies to be adopted, there are some legal aspects that could not be agreed on.

One of the most important difficulties appeared in relation to acquisition security rights (or non possessory security interests). In effect, the issue of the regulation of retention of title clauses appeared to the drafters of the Guide to be a *casus belli.* The partisans of property-based securities rejected the proposition that retention of title clauses should be included in the regime of a global security. Consequently, the legislative Guide offers an alternative[909] in their recommendations on acquisition security rights due to lack of consensus on this issue. The first alternative allows participating states to opt for the unitary approach based on Article 9 UCC. The Guide recommends that:

"[t]he law should provide that an acquisition security right is a security right. Thus, all the recommendations governing security rights, including those on creation, third-party effectiveness ..., registration, enforcement and the law applicable to a security right, apply to acquisition security rights."[910]

The second alternative proposes to the interested jurisdictions to opt for a non unitary approach which analyses the seller's right as a possessory right and not as a security right. However, the drafters considered that the adoption of such position should be applied in light of the functional approach and should respect the registration requirements imposed to the creation of acquisition security rights[911]. The enforceability of a retention of title in tangible goods, other that consumers goods, will only be effective if the seller retains possession of the goods or, if the seller

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registration of a notice in a general security rights registry; (g) To establish clear and predictable priority rules; (h) To facilitate efficient enforcement of creditor's rights; (i) To allow parties maximum flexibility to negotiate the terms of their security agreement; (j) To balance the interests of affected persons; (k) To harmonize secured transactions laws, including conflict-of-laws rules."

[909] See Annex I, Terminology and recommendations of the UNCITRAL Legislative Guide on Secured Transactions, Part IX on "Acquisition Financing"
available from http://www.uncitral.org/pdf/english/texts/security/Annex%20Edited.pdf

[910] *Ibid.* N° 178, at p. 51.

[911] *Ibid.* N° 188, at p. 55: "... the law should provide that the rules governing acquisition financing produce functionally equivalent economic results regardless of whether the creditor's right is a retention-of-title right, a financial lease right or an acquisition security right".

provides notice through registration of his right after the buyer obtained possession of the assets[912]. This mechanism appears to be quite similar to the current regime adopted in Quebec in relation to the hypothec and to the retention of title mechanism. Quebec reformed its law on secured transactions in 1994 and opted for a non unitary approach in relation to retention of title clauses. However, the validity of the clause is subject to a registration requirement as currently prescribed in the Civil code[913].

Further objections were addressed to the adoption of a global security[914]. Some jurisdictions do not accept that a debtor should be allowed to grant security in all of his assets. Partisans of Article 9 UCC advanced that such a global security would enhance access to credit by expanding the pool of assets available to creditors. The opponents to the recognition of such a global security advanced that it would substantially modify the actual financing and credit techniques of many jurisdictions and that such a system would ultimately lead to one unique creditor system[915]. Considering these objections to the adoption of a global security, it has been suggested a series of limits and exceptions. It has been proposed that the creation of such a global security could only be possible within businesses and enterprises relationships, so that natural persons would not be entitled to create such security.

This security would take the name of 'enterprise mortgage' and would embrace all the assets of a business[916]. The creation of this enterprise mortgage would not be available to natural persons who run their own business such as sole entrepreneurs. This did not seem to constitute a sustainable recommendation in relation to the

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[912] *Ibid.* N° 192.
[913] See Chapter Three at pp. 161-164.
[914] The drafting panel of the Guide explained that: "[t]o enhance the availability of secured credit, some legal systems permit the creation of a non-possessory security right in all of the assets of a debtor, including tangible and intangible, movable and immovable (although different rules may apply to security in immovables), and present and future assets. The most essential aspects of such all-asset security are that it covers all assets of a debtor and the debtor has the right to dispose of certain of its encumbered assets (such as inventory) in the ordinary course of its business (while the security is extended automatically to the proceeds of the assets disposed). Under most legal systems, such a right to dispose of encumbered assets without affecting the security right is acknowledged. However, in some legal systems, dispositions of encumbered assets by the debtor, although authorized by the creditor, are regarded as irreconcilable with the idea of a security right." See Document A/CN.9/WG.VI/WP.11/Add2, No 20-25, at pp. 7-8, available at http://www.uncitral.org/uncitral/en/commission/working_groups/6Security_Interests.html (last checked 26/04/2010).
[915] Riffard *op. cit.* fn. 898.
[916] A/CN.9/WG.VI/WP.11/Add2, at No. 23-24.

adoption of a global security as it would have undermined the idea of a unique security itself. Furthermore, it has been suggested that debtors should only be allowed to encumber their businesses assets up to a certain percentage. This suggestion did not seem to convince the architects of the Guide either and the functional and unitary approach was kept[917]. For example, Recommendation Two clearly stipulates that:

"[s]ubject to recommendations 3-7, the law should apply to all rights in movable assets created by agreement that secure payment or other performance of an obligation, regardless of the form of the transaction, the type of the movable asset, the status of the grantor or secured creditor or the nature of the secured obligation."

The UNCITRAL Legislative Guide on Secured Transactions constitutes a significant step forward towards an approximation of laws at the international level using a legislative guide as legal technique for modernisation. The Guide constitutes a challenge for national legal reformers on the path to reform their secured credit law regimes. It provides clear recommendations covering definitions and explanations on what should constitute a modern and efficient secured credit law regime. However, key issues such as the recognition of acquisition financing devices within the unitary regime of a global security has not been settled which is regrettable. The success of the Legislative Guide as legal method to modernise secured transactions law regimes will thus depend upon the willingness of national legislators to reform the law according to these recommendations.

CONCLUSION

The above analysis demonstrated that the use of unification of law instruments as legal methods to modernise secured credit law regimes can be, to some extent, profitable. With regard to hard law legal instruments, it is argued that international conventions could constitute a successful method to modernise and approximate secured credit law regimes by reaching a high ratio of ratifications and by providing a consistent and uniform interpretation amongst Member States. Evidently, such efforts would require a strong consensus among all participating states on the question of secured credit. It has been exposed that the creation of an international

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[917] Riffard *op. cit.* fn. 898, at p. 107.

convention on secured credit appears to be quite uncertain considering the lack of international consensus on the question of secured credit, property law issues and other fundamental policy choices.

The creation of a legally binding instrument would only seem possible in relation to targeted areas of secured credit as evidenced with the successful Cape Town Convention. In this respect, it was demonstrated that the unification of targeted aspects of secured credit law regimes attracted enough adhesion from states to make the use of international convention a successful method to modernise and approximate secured credit law regimes. Nonetheless, it was emphasised that the decision to opt for a series of separate conventions to regulate the creation of an international security interest relative to specific types of assets could jeopardise and restrict the economic benefits of the proposed new scheme to more than a limited variety of assets.

This study concluded that a successful modernisation using international convention as legal method would not be entirely satisfactory unless it could be extended to other categories of assets. Further, the success of international convention as legal method to modernise and approximate secured credit law regimes is arguably subordinated to the respect of consistent and uniform interpretation of international legal standards by states and national courts. Despite, extensive theoretical guidelines on the interpretation of international conventions, it has been shown, that in the field of secured credit, property law concepts highly differ from one jurisdiction to another, especially in jurisdictions that belong to different legal traditions. This situation could arguably jeopardise the success of international convention to modernise secured credit law regimes in the light of an approximation of laws.

In light of the uncertainties underlying the use of international conventions as legal methods to modernise and approximate secured credit law regimes, international drafters recently opted for more flexible legal instruments embodied, for instance, in the form of model laws and restatements. Soft law legal instruments such as model laws enable the creation of a comprehensive unification of secured credit law regimes in the form of non binding legal instruments. Naturally, the success of the

use of soft law instruments as legal methods to modernise secured transactions regimes will depend on whether national legislators will actually refer to them as basis for law reform. In this respect, the recent introduction of the UNCITRAL Legislative Guide on Secured Transactions introduced great hope in the successful modernisation and approximation of secured credit law regimes.

This analysis on legal unification further envisaged the likelihood of success of the use of soft law legal instruments to modernise and approximate secured credit law regimes through the analysis of the UNCITRAL Legislative Guide. An analysis of the *travaux préparatoires* permitted to identify areas of accords and discords among the members of the drafting panel which would be quite representative of the positions adopted by national entities on specific legal issues. The analysis of the *travaux préparatoires* showed that the drafting panel of the Legislative Guide managed to reach a certain consensus on fundamental general principles that should govern secured credit law regimes, but could not compromise on certain aspects such as the regulations of retention of title clauses. Accordingly, it is difficult to predict at this stage whether the Legislative Guide will be successful as legal method to modernise and approximate national secured credit law regimes as it will mainly depend upon the degree of recognition from national entities. Nonetheless, it is concluded that the UNCITRAL Legislative Guide on Secured Transactions constitutes a major endeavour towards the approximation of secured credit laws at the international level using soft law legal instrument to modernise the law. The Guide constitutes a challenge for national legal reformers on the path to reform their secured credit law regimes. It provides clear recommendations covering definitions and explanations on what should constitute a modern and efficient secured credit law regime. The question is now to see whether national drafters will actually refer to the Guide as a model for legal reform.

This analysis demonstrated that the use of hard law instruments such as international conventions as legal methods to approximate and modernise secured credit law regimes remains limited but this observation cannot lead to the conclusion that they have been unsuccessful. Soft law and hard law legal instruments would thus both constitute satisfactory legal methods for reform in the way they are both playing a

significant role in the modernisation and the convergence of secured credit law regimes. As Abbott explained, "[t]he choice between hard law and soft law is not a binary one."[918] Previous analysis on legal transplantation and harmonisation concluded that the likelihood of success of these methods to modernise and approximate secured credit law regimes also remain limited. Mainly, it is recognised that 'legal culture'[919] often constitutes a significant obstacle to the success of secured credit law reform in the light of an approximation of laws. If 'legal culture' constitutes a *frein* to the successful modernisation of secured credit law, the question emerges whether the modernisation of secured credit law regimes could occur outside the framework of a state, independently from any local legal culture, in order to be successful.

Recent years clearly witnessed a substantial evolution of international commercial law and witnessed the substantial denationalisation of law. Particularly, it is to be observed that a wider range of formulating international agencies, other than states, have recently emerged using a broader range of instruments such as international customs and practices. Accordingly, it is arguable that if a modernisation and approximation of secured credit law regimes remains uncertain from a nationalistic approach, that is through national legal reforms, the question needs to be addressed of whether modern secured credit law regimes could arise outside the framework of the state, and particularly, whether modern secured credit law regimes could arise from the recognition of an autonomous transnational commercial law which would operate within a distinct international legal pattern.

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[918] Abbott *op. cit.* fn. 818, at p. 422.

[919] The expression 'legal culture' would embrace a particular legal tradition such as the Common Law or the Civilian tradition, specific legal concepts and terminologies, specific policy choices, languages and specifically the local legal environment. See Chapter Three at pp. 93-102.

CHAPTER SIX

CONCLUSION: THE NEW TRANSNATIONAL COMMERCIAL LAW AND THE GRAND CHALLENGE OF LAW

INTRODUCTION

The questions of the modernisation and approximation of secured credit law regimes are timely, particularly, considering the current context of the internationalisation of commercial dealings. This analysis thus considered the feasibility of a modernisation of secured credit law regimes and personal property law using approximation of laws methods such as legal transplantation, legal harmonisation and legal unification. The thesis adopts a comparative law approach, particularly, in relation to jurisdictions that belong to different legal backgrounds such as the Common Law and Civil Law traditions. It is recognised that the success of a modernisation and approximation of secured credit law regimes would largely be affected by the prominence of national legal culture in the field. This is because the law of secured credit encompasses legal areas which regulations remain well entrenched within the legal culture of national entities. Indeed, a reform of secured credit law regimes would also require a reform of the laws of property, contract and bankruptcy. Particularly, property law can be said to be national *par excellence*. It reflects certain values and political choices that may differ among jurisdictions and which outcomes may be too difficult to amend or reconcile within modernisation efforts. Nevertheless, these endeavours towards the modernisation and approximation of secured credit laws are not vain. Legal transplantation, legal harmonisation and legal unification are all contributing, to a certain extent, to the convergence of legal systems, but, as much as this convergence is to be welcomed, it is too slow to keep pace with the requirements of modern commerce.

A theoretical justification of the institution of secured credit was a prerequisite to this analysis on the modernisation of secured credit law regimes. The theories using the economic analysis of the law particularly challenged the economic efficiency of

secured credit law regimes, without great success. It is demonstrated that a justification of the institution of secured credit remains an empirical question. Indeed, it was concluded that there are extra rational reasons leading to the decision of lending and borrowing on a secured basis. Although the debate over the rationale of secured credit remains inconclusive, the analysis should not remain vain. The theories using the economic analysis of the law provide significant developments on policy issues that are important to consider within any modernisation endeavours in the field of secured credit. Although the value of the economic analysis in the law making process can be enhancing, it is argued that the use of the economic analysis should not solely dictate the content of secured credit law regimes. In reforming and modernising secured credit laws, a balance should be achieved between the different interests at stake which outcomes should not solely depend on economic considerations. A major theme of this thesis was thus introduced, according to which the modernisation of secured credit laws should not be an economic contest. It is explained that other components such as the preservation of legal culture should also be considered and respected in the formulation of modern secured credit law regimes.

Although, a justification of the institution of secured credit continues to be a topic of debate, particularly within the Law and Economics movement, it has been evidenced that the case for the modernisation and approximation of secured credit law regimes now represents a large consensus among academics and commercial actors. Following the internationalisation of secured credit transactions and the emergence of new categories of assets, secured credit law regimes appear to struggle in maintaining a satisfactory level of certainty and predictability to commercial participants in their mutual dealings. An illustration of these difficulties was provided through the analysis of the use of intellectual property rights for security purposes. A comparative law analysis of different national registration mechanisms to validate and enforce security rights created in intellectual property assets in Civilian and Common Law jurisdictions demonstrated that in light of the objectives of a modern legislation of secured credit, substantial reform was currently needed. It is argued that a modernisation of the law should adapt to new commercial needs by embracing a wider category of assets. Such comparative analysis also demonstrated

that the modernisation of secured credit law regimes is not just peculiar to a specific jurisdiction or peculiar to jurisdictions that belong to certain legal traditions. It was further established that following the significant growth in cross-border transactions and following a substantial enlargement of economic markets, modern secured transactions law regimes should also permit creditors to create and enforce a security at the international level. Accordingly, the question emerged of whether approximation of law methods such as legal transplantation, legal harmonisation and legal unification could successfully be used to modernise secured credit law regimes.

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The question of whether legal transplantation could be used as legal method to modernise and approximate secured credit law regimes was first considered. The study adopts a comparative law approach to the question of the feasibility of legal transplantation in jurisdictions that belong from different legal traditions. The importation of the Roman law concept of *accessio* in England and France was considered as an illustration of the legal transplantation process. It is recognised that this core principle of the Roman law of property has successfully been integrated in the law of jurisdictions that belong to different legal traditions despite some divergences in its application. By analogy, it was questioned whether the concept of the security interest enshrined in Article 9 UCC, and often assimilated as a modern legislation on secured credit, could similarly be transplanted in jurisdictions that belong to different legal traditions. Article 9 UCC was fundamental to consider because it has uniformly modernised the laws of every States in America. Accordingly, the question of whether the legal transplantation of Article 9 UCC could similarly modernise and approximate secured credit law regimes in European jurisdictions was considered.

The study adopts a comparative law approach by attempting to assess the feasibility of the legal transplant of Article 9 UCC in jurisdictions from dissimilar legal traditions such as England and France. It is argued that the legal transplantation of Article 9 UCC as legal method to modernise English and French secured credit law regimes is uncertain. It is emphasised that the true obstacle to the legal transplantation of an Article 9 type in these jurisdictions would lie in the functional approach retained in the legal rule. The integration of the functional approach would

remove the use of property-based security devices, such as retention of title mechanisms in both jurisdictions. Most importantly, the functional approach regulating a global security interest would substantially alter the fundamental baseline property law concepts entrenched in English and French laws. It was emphasised that the true obstacle to a successful legal transplantation of Article 9 as legal method to modernise secured credit law regime in England would lie in the existence of the floating charge. Indeed, it was explained that the floating charge already offers similar benefits than the ones offered under the security interest. The main difficulties identified in respect of the floating charge is the priority system which belongs to insolvency law regimes and not to secured credit law regimes.

The main obstacle to the success of Article 9 in France would lie in the incompatibility of the functional approach with the prominence of property-based security mechanisms. Indeed, it seems that French secured credit law regime now largely depends upon property-based security mechanisms, particularly since the introduction of the *fiducie,* rather than evolving towards a more functional approach and towards the adoption of the security interest. Such comparative analysis also highlighted that beyond the terminological and conceptual difficulties faced by legal reformers to transplant Article 9, cultural obstacles such as the willingness to preserve a specific legal culture would also play a large part, particularly in Civil Law jurisdictions. If national laws and legal cultures are to be preserved, the quest for the modernisation and approximation of laws through legal transplantation is uncertain. Although the thesis emphasises the need to protect legal culture, it is also clear that it should be balanced with the need for modernisation.

Legal harmonisation, which in essence involves the accommodation and reduction of national legal differences for law reform purposes, was then considered as potential successful legal method to modernise and approximate secured credit law regimes. Harmonisation is understood, in this analysis, as the means to reconcile and coordinate divergences of various national legal regimes with the aim to approximate and modernise the law. Harmonisation of law was considered in the context of the EU because this is one of the main methods used by the European legislator to reform and approximate the law, especially through the use of European Directives.

Reference was particularly made to the EU Directive on Late Payment which attempted to harmonise retention of title clauses. It is explained that the success of the Directive has not been adequate in modernising and harmonising retention of title clauses regulations. Accordingly, the question was considered of whether the Directive could have gone further and whether an accommodation of legal divergences in relation to retention of title legal regimes could lead to successful modernisation of the law in European jurisdictions. The identification of current divergences amongst all EU jurisdictions was restricted to France and England. Although both jurisdictions recognise the power of the seller to use ownership for security purposes, there are substantial divergences in the definition and concept of 'property' itself that seem too difficult to accommodate. The comparative analysis of the property law terminologies and fundamental concepts of property law showed great disparities between legal traditions which would render a full conciliation quite uncertain. Indeed, national property law differs dramatically according to each legal tradition and even each jurisdiction. Further, considering current uncertainties underlying the regulation of retention of title clauses in both jurisdictions, it is recognised that a reconciliation of unsatisfactory legal frameworks could arguably render the task of modernising the law through harmonisation ineffective.

Nonetheless, this comparative analysis has not been unfruitful as it permitted to highlight the trend of European property law regimes to become more and more flexible in accommodating new commercial needs. Although the baseline concepts and leading principles of property law seem very rigid and dogmatic, particularly in Civilian jurisdictions, the trend has recently been to adopt a much more flexible approach. In this respect, it was opportune to highlight the recent adoption of the *fiducie* in France which can be assimilated to the English trust. Naturally, property law principles and rules should be respected but an appropriate balance should be achieved that will comply with the new requirements of modern commercial transactions. Legal reformers should therefore engage in comparative law endeavours and notice the similarities and leading principles underlying property law regimes of Europe, which will in time contribute to a conciliation of differences. With the recognition of similar legal principles, jurisdictions from different legal

traditions will in time encourage the accommodation of their differences owing to more flexibility in their approach.

If a comprehensive modernisation and approximation of secured credit law regimes is uncertain through legal transplantation and legal harmonisation, this analysis further questioned whether a modernisation could be possible thanks to international initiatives in the field of secured credit. The use of unification of law instruments as legal methods to modernise secured credit law regimes can be, to some extent, profitable. With regard to hard law legal instruments, it was argued that international conventions could constitute a successful legal method to modernise and approximate secured credit law regimes by reaching a high ratio of ratifications and by providing a consistent and uniform interpretation amongst Member States. Evidently, such efforts would require a strong consensus among all participating states on the question of secured credit. It has been exposed that the creation of an international convention on secured credit would be quite uncertain considering the lack of international consensus on the question of secured credit, property law issues and other fundamental policy choices. Nevertheless, it is recognised that the creation of a legally binding instrument is possible in relation to targeted areas of secured credit as evidenced with the successful Cape Town Convention. However, the decision to opt for a series of separate conventions to regulate the creation of an international security interest relative to specific types of assets may hinder the economic benefits of the proposed new scheme to more than a limited variety of assets. Accordingly, this study concluded that a successful modernisation using international convention as legal method would not be entirely satisfactory unless it could be extended to other categories of assets.

Considering the uncertainties underlying the use of international conventions as legal methods to modernise and approximate secured credit law regimes, international drafters recently opted for more flexible legal instruments embodied in the forms of model laws and restatements. Soft law legal instruments such as model laws enable the creation of a comprehensive unification of secured credit law regimes in the form of non binding legal instruments. Naturally, the success of soft law instruments as legal methods to modernise secured transactions regimes will depend on whether

national legislators will actually refer to them as basis for law reform. In this respect, the recent introduction of the UNCITRAL Legislative Guide on Secured Transactions introduced great hope for the modernisation and approximation of secured credit law regimes.

An analysis of the *travaux préparatoires* permitted to identify areas of accords and discords among the members of the drafting panel. Although, the UNCITRAL Legislative Guide on Secured Transactions constitutes a major endeavour towards the modernisation and approximation of secured credit laws, there are still areas that could not be compromised on. Thus, the Guide constitutes a challenge for national legal reformers on the path to reform their secured credit law regimes. The question is now to see whether national drafters will actually refer to the Guide as a model for legal reform. Despite the significant advantages of soft law legal instruments, it is concluded that soft law and hard law legal instruments would both constitute satisfactory legal methods for reform in the way they are both playing a significant role in the modernisation and the convergence of secured credit law regimes.

The analysis on whether legal transplantation, legal harmonisation and legal unification could be successful as legal methods to modernise and approximate the law, revealed that legal culture often generates some obstacles to the success of secured credit law reforms in the light of an approximation of laws. If legal culture constitutes a *frein* to the successful modernisation of secured credit law, it can be questioned whether the modernisation of secured credit law regimes could occur outside the framework of a state within a distinct legal order, independently from any local legal culture. Recent years clearly witnessed a substantial evolution of international commercial law and witnessed a substantial denationalisation of the law. Accordingly, a wider range of formulating international agencies, other than states, have recently emerged generating other sources of law such as international customs and practices. Accordingly, it is suggested that if a modernisation and approximation of secured credit law regimes remains uncertain from a nationalistic approach, that is through national legal reforms, the question needs to be addressed of whether modern secured credit law regimes could arise outside the framework of the state, and particularly, whether modern secured credit law regimes could arise

from the recognition of an autonomous transnational commercial law which would operate within a distinct international legal pattern. This chapter will attempt to provide some elements of answers to the question of the recognition of a transnational security law framework but does recognise that such possibility remains limited. Legitimacy and enforcement related issues may slow the move towards the recognition of a transnational secured credit law that would arise beyond the state. These limits thus restrain the analysis from providing a clear and definitive answer to the question of whether or not the recognition of a transnational secured credit law is feasible. However, the thesis does not argue that it is unachievable but explains that there are new challenges ahead, the Grand challenge of law.

The multiplication of international endeavours towards the approximation and modernisation of commercial law gave rise to the emergence of a new body of commercial laws. This new body of law is often referred to as 'transnational commercial law', or the new *lex mercatoria,* which is generally used to "... denote that set of private law principles and rules, from whatever source, which governs international commercial transactions and is common to legal systems generally or to a significant number of legal systems."[920] Transnational commercial law has been analysed as an effect of international commerce. Following the emergence of new class of assets, the development of new technologies, privatisation, and the dismantlement of economic boundaries, modern secured credit law regulations emerged at the international level at the initiatives of private organisations[921]. International commercial law has been analysed as an aspect of the phenomenon of internationalisation and 'globalisation' as Cranston defines:

"[i]n some contexts, globalisation is being used to describe a process of social change, a world being transformed so that there are greater contacts across national boundaries and growth or intensification of new networks and interdependencies. In other contexts it means the condition where geographical boundaries are rendered less relevant by the existence of these cross-border connections and arrangements. Globalisation gives rise to apparent paradoxes. The fact that globalisation is

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[920] Goode *op. cit.* fn. 281, at p. 4.

[921] For instance, Berger argues that the modern *lex mercatoria* is a "... spillover of the complex institutional processes connected with the phenomenon of globalisation" in Berger, K.P. "The New Law Merchant and the Global Market: A 21st Century View of Transnational Commercial Law" (2000) 3(4) *International Arbitration Law Review,* at p.100.

multidimensional makes it all the more difficult to analyse. Depending on how it is defined, the globalisation label may be applied to eras earlier than our own."[922]

In light of the emergence of this new *corpus* of commercial laws, the question emerged whether transnational commercial law could be the way forward towards the recognition of a modern secured credit law to regulate international secured transactions. In other words, the question arose to determine whether it would be possible to identify and recognise an autonomous international legal pattern that would provide for a modern secured credit law regime independently from the framework of the state. In effect, it is arguable that if commercial participants, personal assets, and more generally secured transactions can cross boundaries, then the law regulating secured credit should also be designed within a distinct legal framework from the state and away from traditional conflict of law rules. It is evident that the statist and territorial nature of domestic legislations showed that it is often inadequate to fit the requirements of modern legislations on secured transactions. Accordingly, the question emerged to determine whether a transnational commercial law approach would be more appropriate than the traditional domestic law to provide for a modern secured transactions law. Would the nature of transnational commercial law be better suited to regulate international secured transactions in light of the requirements of modern commerce than under domestic legislations and private international law rules? Even where a particular national secured credit law regime can clearly be identified following the application of traditional conflict of law rules, it has been evidenced that substantial uncertainties may still arise for the commercial actors who may not be able to enforce their security in a foreign jurisdiction. If modern secured transactions law can arise from transnational commercial law, the next challenge will be to determine whether the recognition and enforcement of an autonomous corpus of law that would regulate international secured transactions is possible. The recognition of such an autonomous transnational commercial law regulating secured transactions would also require the identification and recognition of a distinct international commercial legal pattern to operate.

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[922] Cranston, R. "Theorizing Transnational Commercial Law" (2007) 42 *Texas International Law Journal,* at p. 600.

The recognition of an autonomous body of law to regulate secured transactions outside the framework of a state can be limited. Especially, this situation evidently implies the question of the legitimacy of these new non-territorial sources of law to become legally binding without the intervention of the state, especially in the field of secured credit. Although, the recognition of a distinct international commercial legal pattern that would enable the creation and enforcement of security interests at the international level could theoretically be considered, its achievement remains uncertain. Particularly, the enforcement of an international autonomous regime could create some difficulties, especially in light of the creation of proprietary rights and the effects on third parties. Further, this situation would fundamentally challenge the adequacy of domestic law to regulate international commercial transactions.

The following developments will essentially seek to understand what the expression of transnational commercial law, especially applied in the field of secured credit law, encompasses and will also question the adequacy of national laws to govern international commercial secured transactions. It will be further explained to what extent the recognition of an autonomous body of commercial law or transnational commercial law to regulate international secured transactions may be better suited in providing more modern legislations for secured credit, than under national laws and private international law rules. If transnational commercial law is the way forward, the question will be next to determine the new challenges for legal reformers at the international level to make it possible.

TRANSNATIONAL SECURED CREDIT LAW: THE WAY FORWARD?

The emergence of new sources of international law together with the development of substantial case law led the doctrine to talk about the appearance of a new *lex mercatoria* which already emerged in medieval times from commercial practices and customs of merchants[923]. Similarly, the recent recognition of common commercial

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[923] Economists and lawyers writing about the new *lex mercatoria* based their position on the medieval *lex mercatoria*. On this point see Berman, H.J. "Law and Revolution: The Formation of the Western Legal Tradition" (1983) *Harvard University Press,* at p. 333 where the author explains that: "[a]s with Feudal and manorial, so with mercantile law the crucial period of change was the late eleventh and the twelfth centuries. It was then that the basic concepts and institutions of modern Western mercantile law – *lex mercatoria* ("the law merchant") - were formed, and, even more important, it was then that

standards at the international level suggested the emergence of a new *lex mercatoria* which would be formed of an autonomous body of rules regulating international commercial trade. The following development will attempt to provide a definition of the *lex mercatoria* and transnational commercial law. The extent to which transnational commercial law would be better suited in formulating modern secured credit legislations than under domestic legislations will subsequently be considered.

Definitions

Originally, trade customs, embodied in the expressions of *lex mercatoria* or law merchant, were considered to constitute an autonomous source of law used to regulate commercial activities. During the nineteenth century emerged the notion of sovereignty and the idea that law could only emerged from the state. It was also during this time that codification spread as an expression of this nationalisation. Illustrations of this movement of codification can be found with the enactment of civil codes in Europe such as the Napoleonic French Civil code which was promulgated in 1804, The Spanish Civil code (1888) or the German BGB (1900).

With the transnationalisation of international commercial dealings, a new body of commercial law emerged at the international level which reintroduced the concept of *lex mercatoria*. However, the reappearance of the expression '*lex mercatoria*' in the last quarter of the twentieth century has been contested and is still the object of fervent debates[924]. The resurgence of this expression to designate the emergence of a new autonomous international set of rules made of commercial usages and customs is not recognised by the whole commercial community. French Scholar Kassis does not recognise the existence of such an autonomous body of law and even states that the *lex mercatoria* is an error in the evolution of legal theories[925]. The question of the

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mercantile law in the West first came to be viewed as an integrated, developing system, a *body* of law." See also Trakman, L.E. "The Law Merchant: The Evolution of Commercial Law" (1983) *Littleton, Colo, F.B. Rothman,* at p. 39 where the author states that: "[t]he fear of a proliferated Law Merchant has led to the growth of a "new" Law Merchant, closely resembling its medieval forefather."

[924] Goldman, B., *Frontières du Droit et Lex Mercatoria*, (Sirey, Paris, 1964) cited in Flanagan, P.M. "Demythologising the Law Merchant: The Impropriety of the Lex Mercatoria as a Choice of Law" (2004) *International Company and Commercial Law Review,* at p. 297.

[925] Kassis, A., *Théorie Générale des Usages du Commerce*, (1984), at p. 578 quoted in Béguin, J. "Le Développement de la *lex mercatoria* Menace t-il l'Ordre Juridique International ?" (1985) 30 *McGill Law Journal,* at p. 80.

emergence of a new *lex mercatoria* is part of a debate that is central for a number of scholars and academics[926]. Particularly, ambiguities are still underlying the definition, content, source and scope of the *lex mercatoria* which led this analysis to remain cautious towards the use of this terminology. The expression *lex mercatoria* is sometimes used interchangeably with the terminology of transnational commercial law which is defined as the "... law which is not particular to or the product of any one legal system but represents a convergence of rules drawn from several legal systems"[927]. Nonetheless, some academics clearly distinguish between *lex mercatoria* and transnational commercial law. It is explained that:

"The phrase "transnational commercial law" is used to describe the totality of principles and rules, whether customary, conventional, contractual or derived from any other sources, which are common to a number of legal systems, while the phrase "*lex mercatoria*" is used to indicate that part of transnational commercial law which is unwritten and consists of customary commercial law, customary rules of evidence

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[926] On the debate on the *Lex Mercatoria* see Berman, H.J., Et al. "The Law of International Commercial Transactions (*Lex Mercatoria*)" (1978) 19 *Harvard International Law Journal*, at p. 221; Béguin *op. cit.* fn. 925; Highet, K. "The Enigma of *Lex Mercatoria*" (1989) 63 *Tulane Law Review*, at p.613; Kahn, P. "La *Lex Mercatoria*: point de vue francais après quarante ans de controversies" (1992) 37 *McGill Law journal*, at p. 413 ; Drobnig, U. "The Use of the UNIDROIT Principles by National and Supra-National Courts, in: Institute of International Business Law and Practice" (1995) in *The UNIDROIT Principles of International Commercial Contracts – A New Lex Mercatoria*? (ICC Publ. No. 490/1, 1995), at p. 223; Berger, K.P. "The *Lex Mercatoria* Doctrine and the UNIDROIT Principles of International Commercial Contracts" (1997) 28 *Georgetown Journal of Law and Private International Business*, at p. 943; Freeman, P. "*Lex mercatoria*: Its Emergence and Acceptance as a Legal Basis for the Resolution of International Disputes" (1997) *The Arbitration and Dispute Resolution Law Journal*, at p. 289; Bonell, M.J. "UNIDROIT Principles and the *Lex Mercatoria*", in: Carbonneau, T.E., *Lex Mercatoria and Arbitration*, (2nd ed., 1998), at p. 249; Berger, K.P. "The Relationship between UNIDROIT Principles and *Lex Mercatoria*" (2000) 5 *Uniform Law Review*, at p. 153; Juenger, F. K. "The *Lex Mercatoria* and Private International Law"(2000) 5 *Uniform Law Review*, at p. 171; Leduc, A. " L'émergence d'une nouvelle *lex mercatoria* à l'enseigne des principes d'UNIDROIT relatifs aux contrats du commerce international : thèse et antithèse" (2001) 35 *Revue Juridique Themis*, at p. 429 ; Calliess, G.P. " *Lex Mercatoria*: A Reflexive Law Guide To An Autonomous Legal System" (2001) 2 *German Law Journal*, at p. 17; Berger, K.P. "European Private Law, *Lex Mercatoria* and Globalisation", in Hartkamp, A.S., *Towards a European Civil Code*, (3rd ed., 2004), at p. 43; Howarth, R.J. "*Lex Mercatoria*: Can General Principles of Law Govern International Commercial Contracts?" (2004) 10 *Canterbury Law Review*, at p. 36; Dalhuisen, J.H. "Legal Orders and Their Manifestation: The Operation of the International Commercial and Financial Legal Order and Its *Lex Mercatoria*"(2006) 24 *Berkeley Journal of International Law*, at p. 129; Alec S.S. "The New *Lex Mercatoria* and Transnational Governance" (2006) 13 *Journal of European Public Policy*, at p. 627; Douglas, M. "The *Lex Mercatoria* and the Culture of Transnational Industry" (2006) 13 *University of Miami International & Comparative. Law Review*, at p. 367; Hatzimihail, N. E. "The Many Lives - and Faces - of *Lex Mercatoria*: History as Genealogy in International Business Law" (2008) 71 *Law & Contemporary Problems*, at p. 169.

[927] Goode, R.M. "Usage and its Reception in Transnational Commercial Law" (1997) 46 *International and Comparative Law Quarterly*, at p. 2.

and procedures and general principles of commercial law, including international public policy."[928]

This analysis understands the *lex mercatoria* to represent this corpus of unwritten law that is emerging at the international level through international usages and customs. Accordingly, the *lex mercatoria* would only represent a small part of transnational commercial law which extends to international conventions, model laws and other international uniform principles. The purpose of this section is not to provide a comprehensive analysis of all sources and elements composing transnational commercial law but to attempt to identify whether a body of commercial law can be identified to have emerged outside the framework of the state in relation to secured transactions. In the field of secured credit, transnational commercial law would encompass a wide range of legal tools born from the approximation of law efforts.

In relation to secured credit law, it would include the EBRD Model Law on Secured Transactions (1994)[929], The Organization for the Harmonization of Business Law in Africa's Uniform Act Organizing Securities (1997)[930], The United Nations Convention on the Assignment of Receivables in International Trade (2001)[931], The Cape Town Convention on International Interests in Mobile Equipment (2001) and Associated Protocols[932], The Studies on Insolvency and Secured Transactions Law Reform in Asia and the Guide to Movables Registries prepared by the Asian Development Bank (2002), The Organization of American States Model Inter-American Law on Secured Transactions (2002)[933], the UNCITRAL Legislative Guide on Insolvency (2004)[934], The Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary adopted by the Hague Conference on Private International Law (2006)[935] and the UNCITRAL Legislative

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[928] *Ibid.* at p. 3.
[929] See http://www.ebrd.com/pubs/legal/secured.htm (last checked 26/04/2010).
[930] See www.juriscope.org/infos_ohada/droit-sure/pdf-gb/presentation-surgb.pdf (last checked 26/04/2010).
[931] See www.uncitral.org/pdf/english/texts/payments/receivables/ctc-assignment-convention-e.pdf (last checked 26/04/2010).
[932] See www.unidroit.org/english/conventions/mobile-equipment/main.htm (last checked 26/04/2010).
[933] See www.oas.org/Dil/cidip-vi-securedtransactions_eng.htm (last checked 26/04/2010).
[934] See www.uncitral.org/uncitral/en/uncitral_texts/insolvency/2004Guide.html (last checked 26/04/2010).
[935] http://www.hcch.net/index_en.php?act=conventions.text&cid=72 (last checked 26/04/2010).

Guide on Secured Transactions (2007). The World Bank and the International Monetary Fund also engaged in the recognition of common legal principles and rules in the field of secured credit[936].

Other relevant areas of law such as contract law or insolvency have also been the object of extensive unification projects such as the UNIDROIT Principles of International Commercial Contracts, the Principles of European Contract Law. Transnational commercial law would also include international trade terms and other trade customs and usages, such as the INCOTERMS, and the Uniform Customs and Practices for Documentary Credits (UCP)[937], model contracts and model standard contract forms, such as the International Chamber of Commerce (thereafter ICC) model contracts on sales, commercial agency, and distributorship[938].

The ICC plays a significant role in the development of commercial usages and in the development of commercial arbitration. The ICC represents the world business and defends the global economy. The ICC has a broad scope within its activities. It deals with arbitration, dispute resolution in order to promote open trade and the market economy system, business self-regulation, fighting corruption or combating commercial crime[939]. The ICC can access every country through its committees. The organisation is based in Paris and has an active production of dispute resolution within its arbitration activity. Since 1999, there are in average five hundred cases a year coming before the Court[940].

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[936] The World Bank published "Principles and Guidelines for Effective Insolvency and Creditor Rights Systems" (WB Principles) in 2001 which were developed in collaboration with international financial entities and Non-governmental organisations including the African Development Bank, Asian Development Bank, EBRD, Inter-American Development Bank, International Financial Corporation, IMF, Organization for Economic Co-operation and Development, UNCITRAL, INSOL and the International Bar Association. On this point see Garro, A.M. "Harmonization of Personal Property Security Law: National, Regional and Global Initiatives" (2003), 8 *Uniform Law Review,* at p. 357.

[937] On the law of international trade, see Chuah, J.C.T., *Law of international trade: cross border commercial transactions,* (4th ed. 2009). On the UCP, see for *e.g.* Chuah, J.C.T. "Documentary Credits - Introduction of the New UCP 600" (2007) 52 *Student Law Review,* at p. 52; Chuah, J.C.T. "UCP 600 - New Challenges and Issues" (2007) 13(2) *Journal of International Maritime Law,* at p. 73.

[938] See ICC, ICC Model International Sale Contract (1997); ICC, ICC Model Commercial Agency Contract (2nd Ed., 2002); ICC, ICC Model Distributorship Contract: Sole Importer – Distributor (2nd edn, 2002).

[939] See the ICC Web site, "What is ICC?", www.iccwbo.org (last checked 05/03/2010)

[940] *Ibid.*

Arbitration within the ICC uses customs and practice such as the ICC Uniform Customs and Practices for Documentary Credits (UCP 600) in order to settle international commercial disputes. These are the rules used by banks in order to trade and finance billions of dollars worldwide every year. In fact, the ICC's Uniform Customs and Practice for Documentary Credits are almost used all over the world. Consequently, almost every international commercial transactions made under these rules will be subject to the same standard of rules. The ICC uses standards in international trade such as the ICC Incoterms[941] which are often included by international traders in their contracts. These international customs and practices, also referred to as the new *lex mercatoria,* are mainly confined to regulate international trade and not secured transactions.

Following the identification of a significant body of secured credit law regulations and international legal standards within transnational commercial law, the next section will attempt to determine to what extent the recognition of an autonomous body of laws to regulate international secured transactions would be better suited to formulate modern secured credit law regimes than under national legislations.

The adequacy of transnational commercial law to govern modern secured transactions

The above development identified sources and elements of transnational commercial law relevant to secured credit that could form an autonomous body of law. Instruments of unification such as international conventions or model laws demonstrated that they could potentially be successful in modernising secured credit law regimes. However, it is to be observed that these instruments do not constitute the sole sources and elements of transnational commercial law as explained above. The development and recognition of a transnational commercial law now includes a broader selection of legal instruments such as contractual terms, international usages and practices that have been issued by a broader selection of international agencies, and not solely by states.

[941] See http://www.iccwbo.org/incoterms/id3045/index.html (last checked 05/03/2010)

This section will highlight some of the advantages of recognising an autonomous transnational commercial law at the international level as more suitable to enable the recognition of modern secured credit laws than under domestic legislations. Such comparison is assessed in light of the requirements of modern commerce as defined in Chapter Two and certainly does not aim to conclude that national legislations are inefficient. Naturally, domestic laws would still apply in purely domestic commercial transactions. Also, if transnational commercial law was not yet available in relation to specific aspect of international secured credit, domestic law would still find some application following the application of traditional conflict of law rules.

Similarly to legal unification, the recognition of international standards would clearly avoid conflict of law issues and thus avoid the complexities generated by the existence of different legal regimes. Further, by avoiding conflict of law issues, transaction costs and legal risks would also be reduced. Traditional conflicts of law rules do not always provide the certainty that the creation of a security in one jurisdiction will be enforceable in a foreign jurisdiction. This has already been explained in relation to the creation of a security in movable assets which are likely to easily move boundaries. Accordingly, the Cape Town Convention now enables creditors to create and enforce their security in high value mobile equipments at the international level. Although international conventions largely depend upon the degree of ratifications of states to be successful, this example demonstrates that the emergence and recognition of an autonomous transnational secured credit law regime would similarly avoid conflict of law issues.

Further to avoiding conflict of law issues, the flexibility of transnational commercial law would ease the formulation of international legal standards to regulate areas of secured transactions where domestic legislations left significant legal gaps. For instance, the Cape Town Convention filled in the legal gap in relation to the creation and enforcement of an international security in movable equipments such as aircraft or railway rolling stocks which option was not provided for creditors and debtors under certain domestic legislations. The dynamic nature of transnational commercial law would thus seem to facilitate the draft of modern secured credit legislations to fit with the new modern commercial needs. It is also arguable that the lack of formalism often associated to the nature of transnational commercial law would also lead to

quicker procedures underlying the formulation of international legal standards than under domestic legal frameworks.

By nature, transnational commercial law is neither statist nor territorial which would arguably better fit with the requirements of modern commercial transactions. The recognition of international legal standards would further avoid the problem of legal culture often encountered when attempting to reform national secured credit law regimes in the light of an approximation of law. Accordingly, it is arguable that the legal differences underlying the Common Law and Civilian traditions legal regimes would not constitute substantial obstacles to the modernisation efforts. The recognition of an autonomous *corpus* of law to regulate international secured transactions would thus seem to be better tuned with the requirements of modern international commercial transactions. This is because transnational commercial law generally adopts a functional approach to the formulation of international legal standards.

The functionalist approach designs law according to the desired objective overlooking, to a certain extent, cultural, social and political elements inherent to state values. In this perspective, it is arguable that transnational commercial law would be better suited to provide modern secured credit law regimes for international commercial participants than under domestic legislations where legal culture is often said to constitute a significant obstacle to the recognition of modern laws. Nonetheless, it is arguable that whatever the legal pattern in which secured credit law regimes will emerge, a legal culture, representing specific policy decisions and other specific interests will always be have to considered.

The draft of secured credit law regimes will always involve the consideration of fundamental policy choices. Accordingly, the recognition of an autonomous transnational secured credit law regime would also reflect certain policy choices. The question is to determine who is to make these choices. Should they solely remain with the state or could they also be considered within a distinct international legal framework by non-state entities and private actors? After all, there is always the risk that private actors decide to promote, through the recognition of transnational

commercial law, specific policy decisions reflecting the position of powerful economic jurisdictions at the international level. In the field of secured credit, it is quite clear that most of existing transnational legal instruments, such as the EBRD Model law on Secured Transactions or the UNCITRAL Legislative Guide on Secured Transactions and other international principles, are modelled on the Article 9 of the American UCC. It led some authors to talk about the use of "... harmonization of law as a legal political strategy"[942].

This section suggested that the achievement of modern secured credit law regimes would require the adoption of a more functional approach to law, which may be best served outside the framework of the state. However, it has also been highlighted that it is in the function of the state to make policy choices and take into account other interests than those driven by economic considerations. Accordingly, it is arguable that the regulation of secured credit law regimes should remain within the functions of the state. The prominence of legal culture has been a major theme of this analysis and it is to be reasserted that even in an international context, secured credit law regimes remain cultural, attached to a certain legal culture, reflecting particular political, social, and economic policy choices.

Although the requirements of modern commerce would tend to suggest that other sources of law, such as those that belong to transnational commercial law, would be better suited to regulate secured transactions, it is argued that the law of secured credit remains cultural and thus attached to the legal formalism of state law. Assuming that an autonomous body of law could be recognised to regulate international secured transactions, the question emerges to determine whether a distinct legal pattern could also be identified at the international level, a distinct legal order in which transnational commercial law could operate[943].

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[942] Cohen, E.S. "Constructing Power Through Law: Private Law Pluralism and Harmonization in the Global Political Economy" (2008) 15 (5) *Review of International Political economy,* at p. 770.
[943] Dalhuisen, J.H., Dalhuisen on Transnational and Comparative Commercial, Financial and Trade Law, (3rd Ed. 2007), at p. 211.

THE UNCERTAINTIES UNDERLYING THE RECOGNITION OF A TRANSNATIONAL SECURED CREDIT LAW BEYOND THE STATE

If transnational commercial law, more specifically, transnational secured credit law can be successful in providing modern secured credit law, the next challenge is to determine how the recognition of an autonomous body of law that would regulate international secured transactions could be recognised and be effective. This section argues that the recognition of an autonomous transnational commercial law to regulate international secured transactions would create some difficulties related to the legitimacy and enforcement of these new sources of law.

The privatisation of the law making process leads to significant concern towards the legitimacy of this new autonomous body of law, or transnational commercial law[944]. The recognition of the autonomy and legitimacy of transnational commercial law is still the topic of fervent debates amongst scholars and academics. It is questioned:

"Is there an anational lex mercatoria, a "global law without a state?" The debate seems infinite. Some argue that the rules, institutions, and procedures of international arbitration have now achieved a sufficient degree both of autonomy from the state and of legal character that they represent such an anational law. Others respond that whatever law merchant may exist is really state law – dependent on national norms and the freedom of contract they provide, and on the enforceability or arbitral awards by national courts" [945]

The recognition that transnational commercial law produces autonomous sources of law is not unanimous. Some argue that the idea of an autonomous body of law that is emerging outside the framework of the state simply does not exist because it will always lack coercive powers and sovereignty[946]. Accordingly, it is argued that the *lex*

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[944] On this point see *e.g.,* Franck, T.M. "Legitimacy in the International System" (1988) 82 *American Journal of International Law,* at p. 705; Zumbansen, P. "Piercing the Legal Veil: Commercial Arbitration and Transnational Law" (2002) 8 *European Law Journal,* at p. 400; Rodl, F. "Private Law beyond the Democratic Order - On the Legitimatory Problem of Private Law beyond the State *Values"*(2008) 56 *The American Journal of Comparative Law,* at p. 743; Basedow, J. " State's Private Law and the Economy - Commercial Law as an Amalgam of Public and Private Rule-Making, The *Actors"* (2008) 56 *The American Journal of Comparative Law,* at p. 703; Riles, A. "Anti-Network Private Global Governance, Legal knowledge, and the Legitimacy of the State, The *Relations"* (2008) 56 *The American Journal of Comparative Law,* at p. 605.

[945] Michaels, R. "The True Lex Mercatoria: Law Beyond the State" (2007) 14(2) *Indiana Journal of Global Legal Studies,* at p. 447. See also Mazzacano, P. "The Lex Mercatoria as Autonomous Law" (2008), *CLEA 2008 Meetings Paper, CLPE Research Paper No. 29/2008*, available at SSRN: http://ssrn.com/abstract=1137629 (last checked: 20/04/2010).

[946] Mazzacano *ibid.* at p. 1.

mercatoria will never develop into a distinct legal order[947]. Others recognise the autonomy of the *lex mercatoria* and its corresponding autonomous legal order, as distinct from the state.

In the field of secured credit law, it is arguable that the case for the recognition of legitimate and autonomous sources of law is uncertain. In effect, the regulation of secured credit, which also involves the regulation of property law, remains a fundamental function of the state. The extent to which owners can exercise their property rights is restricted by state law. For example, the fundamental principle of the *numerus clausus* recognised in many Civilian jurisdictions restricts the creation of certain property rights. The regulation of property law remains a prerogative of the state, which arguably would render the recognition of an autonomous transnational secured credit law quite uncertain.

Assuming that a distinct autonomous transnational commercial law could regulate international secured transactions, a distinct international commercial legal framework would also need to be identified for this autonomous secured credit law to operate. The recognition of such distinct legal order is admitted by many legal academics in relation to transnational commercial law[948]. Some authors recognise the existence of such distinct legal order and talk about the 'international commercial and financial order'[949] that would have emerged following the phenomenon of internationalisation and 'globalisation'.

Legal orders have been defined as "... participatory social structures or communities that spontaneously produce their own laws"[950]. The state can be cited as the most important legal order. Domestic legislations operate in their own national legal

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[947] Teubner, G. "Global Bukowina: Legal Pluralism in the World Society" in Teubner, G., *Global Law Without a State,* (1997), at pp. 3-28.
[948] On this point see Berger *op. cit.* fn. 921, at p. 91 and Cranston *op. cit.* fn. 922, at p. 600. Dalhuisen explains that: "... To determine the law applicable to international commercial and financial transactions, the key question thus is whether there may exist or may be developing a whole pattern of substantive transnational law in the professional sphere as an *own legal order.* It is the contention of this book that there is such a legal order operating in international trade and finance as a natural consequence of the globalisation of the international professional activities in these areas, and the freeing of the flows of persons, goods, capital and technology." in Dalhuisen *op. cit.* fn. 943.
[949] *Ibid.* at p.134
[950] Dalhuisen *op. cit.* fn. 943, at p. 132.

framework with their own enforcement mechanisms. The EU also operates within a distinct legal framework with its own legislations and enforcement mechanisms[951]. Assuming that a relevant legal pattern could be identified, one would still need to determine whether the international secured transaction in question should be subjected to the law of this 'international commercial and financial order'. In other words, one would have to establish in which situations this autonomous secured credit law would supersede domestic legislations and how this autonomous secured credit law regime could be enforceable.

The recognition of this autonomous body of law to successfully operate in a distinct legal pattern such as the one recognised by Dalhuisen, 'the international commercial and financial order', would also need to be accepted by commercial participants, other legal orders and international courts such as arbitrators as legally binding[952]. In this respect, the New York Convention of the Recognition and Enforcement of Foreign Arbitral Awards[953]is fundamental in providing enforcement mechanisms for transnational commercial law. However, the enforcement of an autonomous transnational secured credit law is to be doubted.

It is to be observed that in the field of international trade and international contract, party autonomy is playing a major role in the legitimisation and enforcement of transnational commercial law. Commercial participants often choose transnational law as governing law for their transactions. In England and France, the use of certain international usages to govern private dealings is open to traders as implied contractual terms[954]. General principles such as *'pacta sunt servanda'* and party autonomy are recognised worldwide. The international commercial community often chooses transnational commercial law standards to govern international transactions through arbitration and reference to international usages. Could party autonomy also

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[951] The European Court of Justice constitutes the judicial authority of the EU.
[952]Dalhuisen *op. cit.* fn. 943, at p. at p. 161.
[953] The Convention is widely recognised as a foundation instrument of international arbitration and requires courts of contracting States to give effect to an agreement to arbitrate when seized of an action in a matter covered by an arbitration agreement and also to recognise and enforce awards made in other States, subject to specific limited exceptions." The text of the Convention is available at http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/NYConvention.html (Last checked 20/04/2010).
[954] See *e.g.*, Chuah, J., *Law of International Trade*, (3rd ed. 2005), Chapter One at p. 1.

play a major role in the recognition of an autonomous secured credit law which would enable the creation and recognition of an international security in personal property[955]? Again, it is arguable that the recognition and enforcement of this international security in personal property would generate some difficulties in relation to the creation of proprietary rights and third parties. Civilian jurisdictions generally retain a restrictive approach to the recognition of proprietary rights through the *numerus clausus* principle. Secured transactions create proprietary rights which are enforceable *erga omnes.* Private parties cannot modify rules affecting transfer of property and freely create new proprietary rights. It is thus arguable that contractual choice of law may thus be ineffective in legitimising and enforcing transnational secured credit law.

It is further proposed that an international court should be created to support the recognition of this autonomous transnational law to operate. The idea of an international commercial court to support transnational commercial law has already been suggested by a number of academics[956]. Could this international court be competent in enforcing international security interests? In the field of secured credit and property laws, it would seem difficult to see how the decisions of such a court would be recognised and enforceable in other legal orders, particularly national legal orders, unless this international court was internationally recognised by states under an international treaty.

The recognition of an autonomous transnational secured credit law that would operate within a distinct legal framework appears to be quite illusory. Particularly, such recognition would create significant difficulties related to the legitimacy and enforcement mechanisms. Beyond the theoretical difficulties of recognising an autonomous secured credit law regime, it is fundamental to highlight the political impact on the recognition of autonomous sources of international commercial law. In effect, the formulation of secured credit law regime reflects fundamental political social and economic interests that are often overlooked by functional imperatives at

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[955] Dalhuisen, J.H. "Customs and its Revival in Transnational Private Law" (2008) *Duke Journal of Comparative and International Law*, at p. 354.
[956] See on this point, Dalhuisen *op.cit.* fn. 954, at p. 35.

the international level. These conflicts of interests will always be in the way of the recognition of uniform legal standards. In this respect, it is explained that:

"... we are in the midst of a "legal arms race" as actors attempt to develop norms, regimes and institutions to advance their interests and projects."[957]

Accordingly, a modernisation through the recognition an autonomous secured credit law regime will always be limited as secured credit law remains cultural, attached to the economic, social and political values of the state.

CONCLUSION

Following the multiplication of international initiatives in drafting international legal standards in the field of secured credit, the question emerged to determine whether these new sources of law, or transnational commercial laws, could be the way forward towards the recognition of a modern secured credit law to regulate international secured transactions. In effect, this analysis evidenced that a modernisation and approximation of laws through national legal reforms was uncertain and was not keeping pace with the requirements of modern commerce. Accordingly, it was suggested that the law regulating secured credit could be designed within a distinct legal framework away from the state and away from traditional conflict of law rules. However, it is to be concluded that the recognition of an autonomous transnational law to regulate secured transactions outside the framework of the state might not be entirely desirable and feasible.

It is explained that the nature of transnational commercial law could be better suited to regulate international secured credit transactions in light of the requirements of modern commerce than under domestic legislations and private international law rules. Even where a particular national secured credit law regime can clearly be identified following the application of traditional conflict of law rules, substantial uncertainties may still arise for the commercial actors who may not be able to enforce their security in a foreign jurisdiction. The legal formalism and territorial nature of domestic legislations showed that it is often inadequate to fit with the

[957] Cohen *op. cit.* fn. 942, at p. 770.

requirements of modern legislations on secured transactions. The dynamic nature of transnational law would enable the recognition of more modern legislations that would adapt faster and more effectively to modern commercial practices.

It is often advanced that the formulation of modern secured credit law regimes would be best achieved following a more functional approach to law, which in essence formulate the law according to a fixed objective and which is often driven by economic and efficiency considerations. The functionalist approach designs law according to the desired objective overlooking, to a certain extent, cultural, social and political elements inherent to state values. This analysis demonstrated that in most western jurisdictions, legal culture often constitutes an obstacle to the adoption of a more functional approach to regulate secured credit law. However, it is also recognised that it is in the nature of national law to take into account other interests than those driven by economic imperatives. The formulation of secured credit law regimes requires considering important policy issues which outcomes should not solely be influenced by economic interests. This argument has been a major theme of this analysis and it is to be reasserted that even in an international context, secured credit law regimes remain cultural, attached to a certain legal culture, reflecting particular political, social, and economic policy choices.

Although it is arguable that the recognition of an autonomous transnational secured credit law would be best suited to provide modern legislations, a more functional approach to law might overlook other fundamental interests and policy choices that should also be considered in the formulation of secured credit law regimes. Assuming that a modern secured transactions law could arise from transnational commercial law, it was further questioned whether the recognition and enforcement of an autonomous corpus of law that would regulate international secured transactions could be possible. In this respect, it is explained that the recognition of an autonomous body of law to regulate secured transactions outside the framework of a state can be limited. Especially, this situation evidently implied the question of the legitimacy of these new non-territorial sources of law to become legally binding without the intervention of the state, especially in the field of secured credit.

The regulation of secured credit largely affects contract, insolvency and property law. The regulation of property law remains a fundamental function of the state and it is difficult to consider how an autonomous transnational secured credit law regime could be recognised and enforceable outside the national framework. The recognition of an autonomous transnational secured credit law regime would require the identification of a distinct legal order to operate with appropriate enforcement mechanisms. It has been highlighted that international commercial arbitration already provides for significant enforcement mechanisms through disputes resolution systems outside national systems, particularly in the field of international trade. Nonetheless, in the field of proprietary rights, the emergence of enforcement mechanisms outside the framework of the state appears to be quite illusory. Accordingly, it is concluded that the recognition of a distinct international commercial legal pattern that would enable the creation and enforcement of security interests at the international level remains uncertain. Particularly, the enforcement of an international autonomous regime would create difficulties, especially in light of the creation of proprietary rights and third parties.

Beyond the theoretical difficulties underlying the recognition of an autonomous transnational secured credit law regime, mainly related to the lack of sovereignty and coercive powers, it is fundamental to also highlight other obstacles to the recognition of legal reforms beyond the state, such as the reinforcement of legal pluralism and significant conflict of interests in the field of secured credit. Secured credit law is cultural, attached to certain economic, social and political values. The nature of secured credit makes it a complex area for law reform. This analysis explained that secured credit law covers contract, insolvency and property law, but also encompasses a certain legal culture, certain policy choices and respects fundamental interests which make it difficult to reform, particularly in the light of an approximation of law. At the same time, this analysis clearly demonstrated that secured credit law regimes were in great need of modernisation and approximation.

This is the grand challenge of law; to strike a balance between the requirements of modern commerce and the respect of legal culture and other fundamental interests. In the field of secured credit, transnational commercial law instruments are essentially

the products of private actors which often represent the political and economic values of powerful economic nations. Most of the secured credit law reform initiatives at the international level are based on the American Article 9 model. However, it is arguable that the modernisation of secured credit law regimes through legal reforms should not be the result of political economic strategy. There is always the risk that private actors, engaged in the making of the law, will produce projects more influenced by political economic power than legal expertise. If the recognition of autonomous sources of law is the way forward, the draft of transnational commercial law to regulate secured credit should ensure that all interests are equally represented.

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