C. Problems Encountered and Generated by the Solutions

105. For purposes of this report, we compare the regimes in the five RETA countries against the baseline. While several countries have made important reforms, the solutions to the issues outlined above leave differences so basic that they go substantially beyond those that would be countenanced by the dictates of an evolutionary non-convergence approach. The systems for secured transactions in the countries studied largely do not meet the tests of either approach. The failure to meet them rarely has an obvious justification in public policy. Even where a public policy justification does exist, the means of achieving that objective carries with it a high cost in reducing access to credit. Less costly methods can typically achieve such public policy objectives better.

106. In the five RETA countries, problems in the law mean the credit chain does not work remotely as well as it could. The following chapters discuss in turn the problems in each of the four features—creation, priority, publicity, and enforcement.

D. Methodology

107. The data for these chapters come from research done by legal teams in each of the five RETA countries. Each team answered a set of detailed questions about the regime for secured transactions in its country. The questions raised the issues identified in this chapter. The answers were reviewed by one or more members of the International Legal Advisory Group (ILAG), which consisted of scholars with great experience in the law of secured transactions in many countries around the world. A list of the members of each country team and ILAG appears as an Appendix to this report.

108. The footnotes in the following chapters refer either to the Local Lawyer, who is the team leader of the identified country, or to an ILAG reviewer, who is identified by number (e.g., Reviewer #1, the first, or Reviewer #2, the second). The key to their identities is in the Appendix. Note that citations to laws[9] or cases are those given by the Local Lawyer or the ILAG Reviewer. The authors of this report have not checked all of these citations. The source of each answer is given in the footnote by a reference to the question that it answered in the questionnaire and is identified with the following sign: §. For example, §28.3.1 refers to the question with that number. ADB has the completed responses available for review upon request. In some cases, a country may not have answered the question. Where appropriate, in tables for example, these are reported as "n.a." which stands for "not available."

V. PROBLEMS RELATING TO CREATION OF SECURITY INTERESTS

109. For decentralized markets to work well, debtors and creditors need the flexibility to agree about what property can serve as the best collateral for their loan. A company's balance sheet will include various types of assets held in very different proportions. Accountants classify assets differently around the world, but the range includes the following types of personal property:

- Current assets, which are cash and assets, such as receivables and inventory, that would be used within a year.

[9] Laws enacted up to the end of 31 December 1999 were considered for purposes of research.

- Property, plant, and equipment, which are tangible assets to be used over more than one year. They include equipment, machinery, vehicles, furniture, fixtures, buildings, and land. The last two items are real, not personal, property and are not included in this report.

- Investments, which are debt and equity held for over a year.

- Intangibles, which are rights to future use of property and generally include intellectual property such as trademarks, patents, copyrights, and designs. Trade secrets would be included here.[10]

110. One central issue for this report is whether the law allows all types of personal property to serve as collateral or imposes limits. Public policy sets certain limits for social purposes. Creditors and debtors cannot use people as collateral, for example; indeed, businesses cannot own people. Often they cannot use items that are essential for basic survival. However, the policy goal should be to be as inclusive as possible in order to facilitate business finance.

111. The five RETA countries limit the ways to create security interests. These limits make it very difficult for farmers and business operators to get private credit secured only by movable property. They often cannot offer their major assets as collateral to creditors or suppliers who sell on credit (called “suppliers on credit” or sometimes “credit sellers” here). The limits take the following forms:

- The laws limit the type of personal property that can serve as collateral.

- The major limitation arises because of rules requiring that the property be described specifically.

- Special problems arise with fixtures, which are personal property at least until they are attached to real property but then may become subject to rules governing land.

- Special problems also arise because of limitations based on who possesses the property.

- The laws also limit the creation of security interests by restricting:

  - the type of party to the transaction,

  - the types of credit that the interest may secure, and

  - the capacity of the security interest to follow collateral transferred by the debtor.

112. The following sections discuss each type of limit. The economic effect of these limits is discussed in Part G of this chapter. In addition to the topics discussed in this Chapter are rules and practices that affect the cost of creating security interests. These topics are explored in Chapter VII, on publicizing security interests. It examines problems registries pose because of limited access to filing and the cost and speed of the registries.

113. The first section, however, explains how limitations and fragmentation of the general system

[10] See C. Stickney, "Financial Statement Analysis", in D. Logue, ed., *Handbook of Modern Finance* (1984) at 15-1.

for security interests constrain their creation.

A. Limited and Fragmented Systems for Security Interests

114. The systems governing secured transactions in each of the five RETA countries are limited and fragmented.[11] Secured transactions generally take several forms: (i) security interests strictly defined (e.g., different types of pledges, which are property in the possession of the creditor, company charges, hypothecation, and mortgages, which are property in the possession of the debtor), (ii) hybrid security interests (e.g., conditional sales with retention or reversion of title to the seller, financial leases, and trusts), and (iii) interests created under contract law (e.g., assignment of rights to accounts receivables that secure a loan).

115. In each of the five RETA countries, the framework for secured transactions is *limited* in that it authorizes only some parties to create only specifically determined types of security interests. Perhaps only companies can create security interests in all their property while other legal entities cannot. Certain kinds of property may lack a legal basis for use as security. A country's black letter law may permit a range of interests on paper that is not available in practice because, for example, registries are not available to publicize the interest. These limits are explored in detail below.

116. Each framework is *fragmented* in that it has logically inconsistent elements that either remain unresolved or can only be resolved through expensive court proceedings. One example is ownership,[12] an important concept for lawyers in all five RETA countries. From a functional perspective, a security interest in personal property can play the same role whether the property is owned by the debtor or creditor. A person may buy a car using finance from the seller. The underlying transaction is the same whether the buyer or the seller owns the car until it is paid for. However, in many legal systems, security interests in property owned by the debtor are treated differently from those in property owned by the creditor. When a debtor is bankrupt, property it owns is usually available to satisfy creditors' claims. On the other hand, property in the bankrupt's possession but owned by a creditor remains that creditor's property and is not part of the bankrupt's estate. Strict security interests generally leave ownership with the debtor. Hybrid security interests often leave ownership with the creditor. A country with both types of interests—strict and hybrid—relies on different legal concepts for each. In this sense, the framework for security interests is fragmented.

117. Examples of fragmentation abound in the five RETA countries. Some are common to many countries, while others are exceptional.

- Thailand, like many countries, has strict security interests—mortgage and pledge—and hybrids such as "sale or hire purchase subject to a retention of title by the seller pending payment of the price. These latter devices are regulated by the logic of the legal framework governing sale, not security, with the result that different legal incidents apply to their creation, publicity, and enforcement."[13] A result is that the publicity required for mortgages and pledges, which are strict security interests, is not required at all for hire purchase interests.

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[11] See Endnote below, setting out the applicable laws on security interests in movable property for each country.
[12] See C. Walsh, Secured Credit, *A Topical Review and Analysis of the (English-Language) Foreign and Comparative Law Literature* (Dec. 1997, rev. Aug. 1998, partially up-dated Nov. 1999). (Walsh 1999).
[13] Thailand ILAG Reviewer #3, §27.2.

- In Indonesia, the new Fidusia Law permits non-possessory security interests without defining their relationship to other interests, such as possessory pledges and financial leases, governed by other law.[14]

- The PRC's 1995 Guaranty Law identifies certain types of personal property that may serve as collateral. Then, like much legislation in transition countries, it adds to the list such vague phrases as "other properties that belong to the debtor" and "other properties that may be mortgaged by law." Rather than unify the law conceptually, PRC incorporates other approaches to security interests. In this case, observers cannot tell if the range of possible collateral is broad or narrow.[15]

- The most extreme cases are India and Pakistan. In India, "The legal regime is . . . built on a body of common law rules and principles derived from case law intersecting with a diversity of specific statutes enacted in an ad hoc fashion over" more than a century.[16] The formal nature of the instrument is sometimes the basis for a security interest: the Contract Act 1872 provides for pledges of tangible movable property. The legal status of the debtor is sometimes the basis for whether a security interest can be given: the Companies Act 1956 allows companies to give security interests not available to unincorporated entities. The type of property sometimes determines whether it can serve as collateral. In Pakistan, "form, not substance, is the dominant consideration. . . . Some of the concepts are grounded in the concepts of common law while others are creatures of equity. Many . . . have an overlay of statutory modification or regulation."[17] So the laws overlap, duplicate, and leave gaps.

118. In each country, creditors and debtors need to look in more than one part of the law for guidance about how to create and enforce security interests. This may raise transaction costs for them.

119. The limits and fragmentation, however, cause much more serious problems. They reduce available credit, which has high economic costs. This happens because, when the range of security interests is limited, some types of movable property cannot secure credit and loans are not made. When some types of debtors cannot give certain security interests, they borrow less. When some property and some agents lie outside the framework for secured credit, the law cannot establish a comprehensive priority structure among claimants of a debtor. Since the order of priorities among creditors is damaged, they will lend less. In each case, the creditor or seller on credit, facing such uncertainty, reacts everywhere in the same way, by not offering loans and credit sales to debtors. Chapter IX explores this effect.

[14] Indonesia ILAG Indonesia Reviewer #3, §27.1.
[15] Local Lawyer and ILAG Reviewers #1 and #2, §27.3.4. Like many civil law countries, PRC is clear about registrable vehicles. Perhaps the law extends to large machines with serial numbers. But "the inclusion of other types of equipment is more problematic."
[16] India ILAG reviewer #3, §27.1.
[17] Pakistan ILAG #1. §27.1.1.

B. Limits to the General Description of Collateral

120. In contrast to a universal charge giving a security interest in all present and future assets of a debtor,[18] there is a common requirement that the collateral be described specifically at the time of the agreement. This in effect prohibits a general description of the property that may serve as collateral.

121. This requirement limits the use of secured transactions. In some cases, the limit may not matter to businesses. Sometimes, for commercial reasons, debtors and creditors prefer specific identification of collateral, such as when a farmer pledges prize breeding livestock or a contractor guarantees a $200,000 excavator. In these cases, a law that requires specific identification fits the needs of the transaction. Some types of property, of which breeding livestock and the machinery are examples, require specific description in order to be identified accurately. At other times, however, the law does not fit because debtors and creditors prefer generic and general descriptions. A debtor may wish to pledge a rotating stock of inventory or accounts receivable. A debtor may want to use goods that by their nature cannot be well identified, such as grain in silos or oil in tanks. If the law requires specific identification, this property cannot serve as collateral. The more specifically collateral must be identified, the less available as collateral is the full range of property a business uses. Some types of businesses, particularly small business and farmers, are badly hurt.

122. Effective systems for secured credit let debtors and creditors agree about the description of the collateral—specific or general—that suits the needs of their trade. Many countries, however, still require specific identification in at least some circumstances, and the five RETA countries are among them (see Table V-1 and the Endnote).

123. The five RETA countries approach the debate about general versus specific description in ways that are consistent with their legal heritage. Broadly speaking, common law has been more open to general description than civil law.[19] Indeed, India and Pakistan allow general description. India rely primarily on contract law, company law, and a transfer of property act which, though applicable mainly to real property, extends as well to “actionable claims,” which are causes of action that have matured and involve procedure that litigation may enforce.[20] Thailand is at the other extreme, requiring specific identification and PRC’s 1995 legislation demands specifics but may be more flexible when the law is interpreted. Indonesia defies the stereotype, however. Its recent reforms permit general description.

[18] *See, e.g.,* P. Wood, *Comparative Law of Security and Guarantees* (London, Sweet & Maxwell, 1995) at 10.

[19] P. Wood, *Comparative Law of Security and Guarantees* (London, Sweet & Maxwell, 1995) at 10. Wood lists groups of countries in order of the generality of security interest.

[20] K.J. Aiyar, *Judicial Dictionary*, 12th ed. (1998), at 38.

Table V-1. Creating a Security Interest in Personal Property: Overview of Positions Toward General vs. Specific Description of Collateral

Country	General Description	Limited or Unclear	Specific Description
PRC:		Though the novelty of the law leaves room for dispute in interpretation (see tables below),	. . . all mortgaged and pledged property must be identified with great specificity.
India:	General identification, e.g. by a generic category, is permitted by contract law unless it is too vague to serve as an identification	and by statute companies can create security interests in their property generally	
Indonesia	The new Fidusia Law permits general identification, but . . .	prior rules about enforcement and registration may require specificity.	
Pakistan	General identification is acceptable	and companies can create general interests.	
Thailand			Property in the debtor's possession must be identified in detail.

Source: this table summarizes the following tables about specific and general description.

124. In each of the three countries that allow general description, however, the law limits the liberal effect. In India and Pakistan, a general security interest created by contract law binds the parties to the contract, but not third parties unless, in some circumstances, they have notice. The lack of registries, and particularly a comprehensive registry for movables, indirectly restrict reliance on a general security interest.[21] In Indonesia, the new power to describe collateral generally may be circumscribed by prior law that remains in force.[22]

125. It is not enough, therefore, for the legislature to create a security interest in property generally described. The interest must be enforceable and convey priority to its holder. This is where the laws in India, Indonesia, and Pakistan falter (see the discussion in the previous paragraph, for India and Pakistan). In Indonesia, old procedural rules undercut the broad language of the new Fidusia Law. Here is an example of inconsistencies that arise when reform of secured transactions is piecemeal. The reforms may modernize the creation of security interest in one statute, while leaving the existing enforcement process as provided under other statutes.

[21] India ILAG Reviewer #3, §27.1.1.

[22] Fidusia Law Articles 6(d) and (e) require a statement of the value of the loan and collateral, and it is not clear whether one satisfies this by stating a maximum amount or the precise value. The latter would constrain a growing business. ILAG Reviewer #3, §28.6.1. Moreover, civil procedure law requires a specific description of property, so the practice is to supplement a deed of transfer with a non-exhaustive list and update that list periodically. Indonesia Local Lawyer, §29.5.1.

126. The general description can be found in the *floating security interest* in property owned by the debtor. As the debtor's property turns over, the interest applies to new property that is

Table V-2. Creating a Security Interest in Personal Property: The Floating Security Interest

Country	Broadly Available	Limited Availability	Cannot Use
PRC		Silence in the law about floating interests arguably allows them to be given, but . . .	the law's requirement of specific identification seems to prohibit floating interests.
India	Floating interests may be created, and . . .	companies can give floating interests by statute. Certain floating charges by banks cannot be created or need supervisory permission.	
Indonesia	The new Fidusia Law permits a floating security interest with only a general description of the property,[23] . . .	but other parts of the new law, and pre-existing rules for registration and enforcement that remain in effect, require specific identification of the property.	
Pakistan	Floating interests may be created, and . . .	companies can give floating interests.	
Thailand			The closest to a floating interest is the pledge of the warrant given by a public warehouseman for inventory stored there.

acquired, built or grown, and ceases to apply to property that has been sold. See Table V-2. Once the interest has been created, it should not be necessary to identify new property specifically. A familiar feature in common law countries, the floating security interest is available in India[24] and Pakistan,[25] by statute, to companies, although India limits the ability of banks to give certain interests. Indonesia[26] recently passed a law permitting a floating interest, but other existing rules, described above, may impose limits. PRC[27] and Thailand[28] do not permit floating interests.

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[23] See Indonesian Fidusia Law, Art 6.c.
[24] Companies Act Chapter 5. For banks, see Indian Local Lawyer, §28.6.1.
[25] Companies Ordinance, 1984, §121 as interpreted by *D. Pudurnjee & Co. vs. N.Y. Mool*, AIR 1926 Bombay 28, cited by Pakistan Local Lawyer, §28.6.1.
[26] Fidusia Law Articles 6(d) and (e) require a statement of the value of the loan and collateral, and it is not clear whether one satisfies this by stating a maximum amount or the precise value. The latter would constrain a growing business. ILAG Reviewer #3, §28.6.1. Moreover, civil procedure law requires a specific description of property, so the practice is to supplement a deed of transfer with a non-exhaustive list and update that list periodically. Indonesia Local Lawyer, §29.5.1.
[27] The state of the law on this point is debated. ILAG Reviewer #1 concludes that Guarantee Law Art. 44(2), which requires ownership certificates to register a mortgage, and Art. 39(2), which require the description of the collateral to include condition, location, and ownership, are "incompatible with the use of. . . a floating lien." §28.6.1. The PRC Local Lawyer, however, asserts that these rules refer only to the traditional mortgage and lien, and do not prevent the use of a floating interest, noting that the law is silent about it. §28.6.1.
[28] Thai CCC §777 and see ILAG Reviewer #2, §28.6.1.

127. A requirement that property be identified specifically is particularly burdensome in three circumstances:

(i) when property does not exist at the time of the transaction (after-created property);

(ii) when property is not yet owned by the debtor at the time (after-acquired property); and

(iii) when property does exist but cannot be specifically identified.

After-created and after-acquired property are two forms of future property. They are subject to similar rules and raise similar problems for businesses. The following paragraphs describe how the law in the five RETA countries deals with each of these circumstances. See Table V-3.

128. *After-created property* does not exist when the secured transaction is made. A rule that after-created property cannot serve as collateral causes a serious problem for any business that wants to borrow against property that it will produce with the credit. Crops that have not yet grown could not serve as collateral. The limitation severely hurts working capital finance in agriculture, especially for farmers without title to the underlying land. A farmer giving future crops as collateral often cannot identify in advance either the quantity or perhaps even the type of crop he or she will harvest in the future. Thus, as a practical issue, farmers cannot create security interests in this kind of future collateral. Inventory of goods in process and finished goods are an example. Modern inventory finance, which is extremely important for many businesses, relies on a floating security interest in the property. As the debtor produces new goods, the creditor will need the security interest to attach to the new property. A floating interest would accomplish this. A requirement that the property exist at the time of the agreement will not.

Table V-3. Creating a Security Interest in Personal Property: After-Created Property

Country	Ready Collateral	Limited or Unclear	Cannot Use as Collateral
PRC		In some or all cases, . .	the law prohibits using future property as collateral .
India	A security interest may be taken in the debtor's future assets and is enforceable when the assets come into existence . . .	but priority is a problem. Companies can give security interests in after-created property.	
Indonesia	Yes, in the new law, but . . .	the old registration and enforcement rules apply	
Pakistan	A security may be taken in the debtor's future assets and attaches when the assets come into existence.	but priority is not settled. Companies can give such security interests.	
Thailand			No: the debtor must own existing property when it creates the security interest.

129. India[29] and Pakistan[30] allow security interests in after-created property, while the other countries are less, or not, willing to do so. Legal uncertainty is a problem in Indonesia and in PRC,[31] where the new law has not been tested to determine if its silence about floating interests means it permits them.[32] Thailand does not permit these interests.[33]

130. *After-acquired property* is property not yet owned by the debtor at the time of the secured transaction. Personal property in this category is economically significant. It includes rotating stock of inventory and accounts receivable. All five RETA countries have laws that treat after-acquired property as they do after-created property. The written law of India and Pakistan permits security interest in after-acquired property that only attach and are enforceable when the debtor acquires the property.[34] Companies can give floating liens in receivables or inventory (of raw materials acquired after the security interest is made).[35] However, enforcement constrains their use, as mentioned above. Indonesia's new Fidusia Law permits a floating security interest with only a general description of the property,[36] but pre-existing rules for registration and enforcement require specific identification of the property.[37] In Thailand, one can pledge the warrant given by a public warehouseman for inventory stored there, but mortgage and pledge require specific identification of each item in inventory.[38] In PRC, the security agreement must specifically identify property,[39]

[29] ILAG Reviewer #3, §28.6.2.

[30] No statute prohibits giving a security interest in after-created property, and case law supports it, according to the Pakistan Local Lawyer, who cites, inter alia, *H.V. Low & Co., Ltd vs. Puliniharilal Lingha*, AID 1933 Calcutta 154.

[31] The state of the law on this point is debated. ILAG Reviewer #1 concludes that Guarantee Law Art. 44(2), which requires ownership certificates to register a mortgage, and Art. 39(2), which requires that the description of the collateral includes condition, location, and ownership, are "incompatible with the use of after-acquired property as collateral or with a floating lien." §28.6.1. In his view, "The Chinese Guaranty Law, Art. 34(2) and (6)...would include only large pieces of equipment having serial number identifiers and perhaps title registries. This interpretation would conform to usual practice in civil law regimes for the availability of mortgages on movables." (Prof. J. Spanogle memorandum, People's Republic of China, at No. 27.3). The PRC Local Lawyer, however, asserts that these rules refer only to the traditional mortgage and lien, and do not prevent the use of after acquired property as collateral or a floating lien. The law is silent about them. §28.6.1.

[32] Fiduciary Transfer Law, Art 9 (for future receivables), cited by ILAG Reviewer #2, §28.2.1.1.

[33] ILAG Reviewer #3, §28.7.1.

[34] For India: ILAG Reviewer #3 and discussion with India Local Lawyer, citing contractual principles and the Transfer of Property Act, in §28.7.1. For Pakistan: Pakistan's law does not prohibit a security interest in after-acquired property and case law supports it, according to the Pakistan Local Lawyer, who cites, among others, *H.V. Low & Co. Ltd vs. Pulinbiharilala Singha*, AIR1933 Calcutta 154.

[35] For India: Companies Act Chapter 5 (See ILAG 3rd Reviewer, §28.6.1. For Pakistan: Companies Ordinance, 1984, §121 as interpreted by D*. Pudurnjee & Co. vs. N.Y. Mool*, AIR 1926 Bombay 28, cited by Pakistan Local Lawyer, §28.6.1.

[36] The Official Explanation to Art. 6(c) of the Fidusia Law says that, if the collateral is constantly changing, it must be described by type, brand or quality." (Prof. U. Drobnig memorandum, Indonesia, at No. 28.5.1). See also Indonesian Fidusia Law, Arts 13,14(2) and 15(3). And see Indonesian Fidusia Law, Art 6 (c). However, Articles 6(d) and (e) require a statement of the value of the loan and collateral, and it is not clear whether one satisfies this by stating a maximum amount or the precise value. The latter would constrain a growing business. ILAG Reviewer #3, §28.6.1.

[37] The Official Explanation to Art. 6(c) of the Fidusia Law says that, if the collateral is constantly changing, it must be described by type, brand or quality. (Prof. U. Drobnig memorandum, Indonesia, at §28.5.1). See also Indonesian Fidusia Law, Arts 13,14(2) and 15(3). The problem is that supplemental lists of new collateral may have priority only from the date that list is created. After-acquired property may have to be individually registered after acquisition. This would cause serious problems for property with a high turn over. In addition, Art. 6(d) and (e) require a statement of the value or the loan and of the collateral. This would cause serious problems if the value at the time of registration is required, rather than some maximum value. See discussion at §28.6.1.

[38] The Official Explanation to Art. 6(c) of the Fidusia Law says that, if the collateral is constantly changing, it must be described by type, brand or quality. (Prof. U. Drobnig memorandum, Indonesia, at §28.5.1). See also Indonesian Fidusia Law, Arts 13,14(2) and 15(3). The problem is that supplemental lists of new collateral may have priority only from the date that list is created. After-acquired property may have to be individually registered after acquisition. This would cause serious problems for property with a high turn over. In addition, Art. 6(d) and (e) require a statement of the value or the loan and of the collateral. This would cause serious problems if the value at the time of registration is required, rather than some maximum value. See discussion at §28.6.1.

although the scope of this rule is subject to debate. These rules constrain or prevent debtors in the five RETA countries from using inventory as collateral.

131. *Property that exists but cannot be specifically identified* includes grain in silos and oil in tanks. It cannot be used as collateral for credit if the law requires specificity. India[40] and Pakistan[41] permit general description, for example by a generic category, as described above. However, the constraints are serious in PRC,[42] where all mortgaged property must be identified with great specificity, and Thailand,[43] where property in the debtor's possession must be identified in detail. Indonesia permits general identification but has problems registering and enforcing generally identified property.

132. Intangibles are *property that cannot be physically possessed*, although the application of the property may be tangible (e.g., a diskette holding a computer program). This means that the countries protecting only security interests in personal property in the possession of the creditor will not support the use of intangibles unless the right is represented by a negotiable instrument (which can be possessed or identified). Thailand makes it impossible for a potential debtor to offer personal property that the creditor cannot possess, except for its limited arrangements to register interests in a few types of property like vehicles and cattle.[44] PRC is similar; even if an account can be assigned, assignment is constrained.[45] Indonesia's new law[46] permits the use of intangibles, but other law constrains it.[47] India and Pakistan have no formal rules restricting the creation of interests in intangibles.[48]

133. For countries with fledgling or even aggressive high technology business, the inability of a firm to borrow against collateral that takes the form of its intellectual property, because that is intangible, is a major handicap.

134. The pictures are similar, whether the problem is after-created property, after-acquired property, or intangibles. The five RETA countries limit the use of each of these types of property for

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[39] The PRC Guaranty Law, Art. 34(2) and (6) "would include only large pieces of equipment having serial number identifiers and perhaps title registries. This interpretation would conform to usual practice in civil law regimes for the availability of mortgages on movables." Prof. J. Spanogle memorandum, People's Republic of China. §27.3.

[40] Contract principles govern whether a description is sufficiently clear to identify the property serving as collateral. "For security taken in generic categories of movables, a generic description is sufficient. . . , e.g., "all book debt" or "all receivables." However, "all my land" had been held void for vagueness. ILAG Reviewer #3 and India Local Lawyer, §28.5.

[41] Contract law governs all transactions except those by companies, which must comply with a form provided by the Registrar of Joint Stock Companies (Companies Ordinance, 1984, §121, cited by the Pakistan Local Lawyer, §28.5.1

[42] Guarantee Law, Arts. 39(3), 44(2), and 65(3), cited by PRC Local Lawyer, and see ILAG Reviewer #1, §28.5.1.

[43] Non-possessory mortgages can only be taken in specific assets for which title is registrable (e.g., machinery). They require a description sufficient to identify the asset to be registered as security, notably the title. Thailand Local Lawyer and ILAG Reviewer #3, §28.5.1.

[44] In Thailand, reliance on the possessory pledge, and very limited use of non-possessory mortgages, means that intangible personal property cannot serve as collateral. ILAG Reviewer #2. §28.1.1.

[45] ILAG Reviewer #1, §28.1.2; PRC Local Lawyer and ILAG Reviewers #2 and #3, §28.3.4., and 28.6.1. This involves the debate about the breadth of Guaranty Law Art. 34(6), which provides for "other property that may be mortgaged according to law." The PRC Local Lawyer interprets this broadly, allowing any interest that is not otherwise prohibited by law or administration regulation. The ILAG Reviewer argues for a narrow interpretation, limited to the fixtures mentioned as an example in the Article, because to do otherwise would create uncertainty by leaving too much discretion with regulators.

[46] Fidusia Transfer Law Art. 1(4), cited by Indonesia Local Lawyer, and Art. 9, cited by ILAG Reviewer #2, §28.2.1 and §28.2.1.1.

[47] Intangible movable properties can be secured by pledge or fiduciary assignment. ICC Art. 1153 requires notice to the obligor of the pledge and Art. 613 requires a deed of transfer. Indonesia Local Lawyer §28.21.

[48] Accounts receivables and other debts due, that are not represented by negotiable instruments, are actionable claims and permitted by the Transfer of Property Act §130, 1882. India Local Lawyer and ILAG Reviewer #3, §28.2.1.

collateral, some countries more than others. Governments could achieve any public policy objective of these restrictions – whether aimed at protecting the debtor or the creditor – more efficiently without incurring the enormous cost of depriving farmers of crop financing and merchants and manufacturers of inventory financing.

C. Limits on Property that May Serve as Collateral: Fixtures

135. Fixtures pose special problems for secured interests. Suppose that a business, which has already mortgaged its land to obtain credit for other purposes, needs a furnace in one of the buildings. The supplier of the furnace is willing to provide credit toward the purchase if it can use the furnace as collateral. The furnace is personal property when sold. When it is fixed, or "affixed," to the building, it may become real property and subject to law governing real property. These laws may have different rules for secured interests than those for personal property. The question is whether the furnace is automatically subject to the mortgage on the real property to which it is affixed. Suppose there had been no mortgage on the real property when the supplier provided the loan and took the security interest. If later the real property is mortgaged, does that security interest take priority over the supplier's security interest in the furnace? The answers to these questions must be sufficiently clear so that existing and potential creditors can gauge their risk. Certainty must exist about when personal property becomes fixed to the building. This is so even when courts may have difficulty enforcing the interest in fixtures because doing so would severely hurt the value of the real property to which it is fixed.

136. Much movable property of key importance to producers ultimately must, as a technical issue, be fixed to the land or buildings in which the producer uses it. In addition to such equipment as furnaces, are elevators, silos, conveyer belts, air conditioners, and well pumps. All start their economic lives as movable property but benefit their operators by being fixed to the real property on which they operate.

137. Those who finance the fixture need a clear distinction between the fixture and the real estate on which it sits. Buyers can then borrow to acquire the equipment and install it in buildings that they rent or in buildings that they may own but that are already subject to a mortgage on the real estate. Effective systems of secured credit make this distinction.

138. This is not so in the five RETA countries under review. Of course the countries vary, but in general their laws subject fixtures to real property law or to one of several laws. The prior holder of the security interest in real property may have a superior interest in the fixture. Alternatively, the law may, by exception, give priority to the holder of the security interest in the fixture but these laws raise uncertainty and costs. These are not economically useful solutions. The following paragraphs discuss these points.

139. When personal property is fixed to the real property, the fixture becomes real property that is subject to law governing real property, and security interests in it, in India,[49] PRC,[50] Thailand with an exception,[51] and Pakistan[52] and Indonesia[53] when the parties to a mortgage so specify. Each of these rules creates problems for secured financing as examined in the following paragraphs.

[49] Transfer of Property Act, 1892, §63. India Local Lawyer and ILAG Reviewer #3, §28.11.1.
[50] PRC Local Lawyer, citing Guaranty Law, Art. 92, and ILAG Reviewer. §28.11.2.2.
[51] Thai CCC, §§144, 146, 147. Thailand Local Lawyer and ILAG 3rd Reviewer.§28.11.2.2.
[52] Transfer of Property Act 1882, §3, cited by Pakistan Local Lawyer, §28.11.1.
[53] Hak Tanggungan Law No. 4 of 1996, Art. 4(4) and Fidusia Law Art. 1(4), cited by Indonesia Local Lawyer and ILAG 3rd Reviewer, §28.11.1. The Indonesia Local Lawyer asserts that the fixture may serve as collateral through a Fiduciary Transfer, but the ILAG 3rd Reviewer notes that the Fidusia Transfer Law Art. 1(3) and (4) excludes "all items from its scope that can be covered by a security right or hypothec according to Law No. 4 of 1996. §28.11.2.

140. Subjecting the fixture to *real property law* raises transactions costs and reduces the number of possible debtors. Debtors creating a security interest in fixtures must pay the costs of creating and financing a mortgage for the entire property. The rule limits the number of debtors who could reasonably buy fixtures on credit, since they need to own land.[54] Consider the impossible predicament in which this places the operator of a small business or farm. Creditor and debtor can only write a security interest on the equipment as part of a mortgage on real estate and equipment. At the least, this requires the costly and expensive step of refinancing the entire existing mortgage. It also makes financing only the fixture impossible for a new creditor. Producers and traders operating rented property, of course, must abandon hope of receiving financing. They are in the impossible position of having to mortgage real estate that they do not own in order to finance the equipment that they need.

141. A rule that depends on *the intention of the parties* as provided in the contract obscures the nature of the security interest for those who are not party to the contract. In Thailand and Pakistan, fixtures are generally subject to real property law but each country makes an exception. Thai law provides that buildings built after the land mortgage are not subject to real property law unless the land mortgage contract provides that the building will be subject to the mortgage.[55] In India and Pakistan, if the parties intend that the fixture will not attach permanently, then personal property law applies.[56] In Indonesia, the mortgage deed (Hak Tanggungan) may specify that fixtures are subject to it, in which case the law for real property applies. When the contract does not express this intent, fixtures are not real property or subject to real property law.

142. The possibility that *several legal regimes* may govern collateral complicates the situation even more. Indonesia, which allows parties to a mortgage in land to extend their security interest to fixtures, also allows fixtures to serve as collateral that is personal property and governed by the new Fidusia Law. There is some disagreement about whether the old rules for fiduciary transfer could also apply. As the Fidusia Law and the mortgage law are inconsistent, they provide no sure guidance as to which security right will prevail should instruments created under each law apply to the same fixture.[57]

143. When a new fixture is *automatically subject to a prior mortgage on the real property* to which it is fixed, the automaticity reduces the value of a security interest held by the person financing the fixture, as explained below. Three of the five RETA countries–Thailand, Pakistan, and India–automatically apply real property law, subject to qualifications that introduce uncertainty. Thai law does this, but it excepts a new building unless the land mortgage contract subjects the building to the mortgage. In India and Pakistan, the law only applies if the fixture is permanently attached to the real property.[58] Indian law is clear, but India tries to reduce the negative impact of the law on the fixture financier. If the fixture is "inseparable" from the land, the mortgage holder must compensate the fixture's financier. If it is separable, the fixture financier has a secured interest.[59] The uncertainty

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[54] Prof. C. Walsh memorandum, India, and Thailand, at No. 28.11.
[55] Thai Local Lawyer citing CCC §719. §28.11.2.2.
[56] Pakistan Local Lawyer, citing cases including *Official Liquidator vs. Sri Krishna Deo*, AIR 1959 Allahabad 247. §28.11.2.2.
[57] In Indonesia, a hak tanggungan (a security right over land and other immovable properties, which is similar to a mortgage) may include all fixtures over the secured land. On the other hand, the fiduciary transfer (fidusia eigendom overdrachf), which is a non-possessory security right over movable property, established by case law, can also be created over these fixtures. Neither law provides any guidance as to which security right will prevail in the event both are created over the same fixtures.
[58] Pakistan Local Lawyer, citing cases including *Official Liquidator vs. Sri Krisnha Deo*, AIR 1959 Allahabad 247. §28.11.2.2.
[59] Transfer of Property Act, 1892, §63. Pakistan ILAG Reviewer #3, §28.11.1 and ILAG Reviewer #1, §28.11.2.2.

in India and Pakistan arises in determining if the personal property is "inseparable" or "permanently attached." This is discussed below. Certainty is not introduced, however, by Indonesia's alternative to automaticity. Letting the parties to the prior real property mortgage decide in their contract whether it extends to future fixture's forces the fixtures financier to review all such deeds. Nor is certainty
found in PRC, where existing law does not answer this question and experts vary.[60] This confusion places financiers of heavy equipment at great risk, because once the equipment attaches to real estate, they do not know whether they will lose their collateral to the real estate mortgagee.

144. *Priority* is an issue when one secured creditor holds an interest in the personal property before it becomes a fixture (personal property secured creditor) and another holds an interest in it as a fixture to the real property (real property secured creditor). India and Pakistan solves this problem as described above, by requiring the real property secured creditor to pay the personal property secured creditor. In Thailand, the interest of the personal property secured creditor seems to be extinguished,[61] which would undermine financing of the fixture. PRC and Indonesia do not solve this problem. Generally, the law in the five RETA countries does not deal with this problem. In one possible outcome, creditors will lose their status as secured creditors; understanding this, creditors will not offer debtors credit secured by such collateral.

145. From this review, a key issue concerns *when the personal property becomes affixed* to the real property. If this is uncertain, creditors will be unlikely to reduce the cost of a loan that is secured by what may or may not be a fixture. The security interest would not be reliable. In each country, the test leaves a degree of uncertainty. In India, the test is whether the property is "inseparable." "Separable" means that the property "is capable of separate possession and enjoyment without detriment to the principal property."[62] In Pakistan, the test is whether the parties intended that the property be "permanently attached."[63] Both are subjective. Indonesia's law is not clear. It does not define how much physical attachment is needed or seem to rely on a doctrine of economic necessity.[64] PRC simply looks at whether the fixtures are properly closely associated with the real property.[65] We have no information for Thailand.

146. The combined effect of these problems works against financing of fixtures independently of the real property on which they stand. The uncertainty in many of the countries' answers to each of the questions posed at the start of this section about fixtures makes it difficult for potential creditors to gauge their risk. Where the laws are certain, they apply real property rules for security interests, which are expensive. Creditors react predictably to muddied and unclear legal systems: they lend small amounts of money at high interest rates for short periods of time to people they know well. Debtors and creditors alike pay the price of these systems: in lost investment opportunities, slow growth, and low incomes.

147. Fixtures, in industrial countries with effective secured transactions regimes, are routinely sold on credit to businesses. There, only the equipment itself serves as collateral. Under the same framework for secured credit, the dealers can refinance their credit sales by turning over the

[60] The PRC Local Lawyer acknowledges that the Guaranty Law of 1995 is silent and that the legislature or Supreme Court of Justice needs to resolve the issue. The PRC Local Lawyer, however, argues that future fixtures are automatically subject to the real property mortgage. §28.11.2.2. Barale (p. 420) argues the opposite, also without citing support. See ILAG Reviewer, §28.11.2.2.

[61] One cannot hold a security interest in a fixture pursuant to personal property law. The fixture is subject to real property law. Thailand Local Lawyer, citing CCC §144, 146, and 147, in §28.11.2.2.

[62] Transfer of Property Act, 1882, §3 and §63. India Local Lawyer and ILAG Reviewer #3, §28.11.1.

[63] Transfer of Property Act, 1892, §63. India Local Lawyer and ILAG Reviewer #3, §28.11.1.

[64] ILAG 3rd Reviewer, §28.11.1.

[65] ILAG 3rd Reviewer, §28.11.1.

resulting "chattel paper" to finance companies that, in turn, refinance their extensions of credit by offering creditors, as collateral, their portfolios of chattel paper. This is the credit chain at work. Only the movable property need serve as collateral and the ownership of real estate by any of the parties would be judged as an element of net worth, not as the sole evidence of the only acceptable collateral.

148. Nothing like this happens in the five RETA countries studied. Not a single dealer in fixtures interviewed in Indonesia, PRC, or Thailand would sell fixtures on credit to anyone if their only security were the equipment itself. In India and Pakistan such sales were made to corporate buyers, but to no one else. What is the consequence? Honest, creditworthy debtors in these countries must wait and produce inefficiently for years until they have saved the purchase price of such a machine. The legal framework prevents them from giving a credible promise to a creditor that they will repay. A transaction that economic agents—debtor and creditor—would have willingly concluded to their mutual benefit cannot occur because of the limitations of the law.

D. Limits on Who May Provide or Obtain Credit Using Collateral

149. When the policy goal is to facilitate credit as a source of finance for business, then good reasons should exist for any limitation on who may be the party to a secured transaction. Each country appears to subscribe to this goal. No country, as a matter of law, prohibits any type of business entity, whether individual, unincorporated, or corporate, to take and give any security that the law allows. In India and Pakistan, "there is nothing in theory to prevent an individual or non-corporate entity from creating a security interest over what amounts to the full range of its present and future assets"[66] [67]In Indonesia, the law does not limit debtors or creditors according to their legal status. In the new law, any individual or corporate creditor may hold a fidusia.[68] PRC's Guaranty Law has "no express limits. . . on who can be a [secured] creditor or a debtor."[69] In Thailand, the law "does not limit the capacity to take or give security to any specific category of individuals or legal entities."[70]

150. What is given with one hand, however, is taken away with the other, at least in India and Pakistan. In both countries, only companies are specifically authorized by statute to issue floating charges for debentures and other debt instruments and publicize them through the Company Registry.[71] [72] No broad method of publication exists for floating charges made by entities that are not companies. So in practice only companies give floating charges in India and Pakistan. The creditor receives a security interest in "all of the undertaking" of a company. "All" means just that, all of the property of the company, present and future, movable or immovable, tangible and intangible. At the same time, the company debtor can freely sell inventory and manage accounts receivable in the ordinary course of business, a crucial feature in inventory financing. However, only corporations can publicize these floating charges.[73]

151. Such a restriction has extraordinary economic impact. At a stroke, it disqualifies unincorporated entities—almost all farmers, all micro-enterprise, and most small and medium-sized enterprises (SMEs)—from using their inventory and crops as security for loans. These debtors, consequently, lose the benefits that would arise from offering collateral - larger loans, lower interest

[66] ILAG 3rd Reviewer, §28.3.1.
[67] Pakistan Local Lawyer and ILAG Reviewer, §28.3.1.
[68] Fiducia Law Art. 1(10),cited by Indonesia ILAG Reviewer #2, §28.3.1.
[69] PRC ILAG Reviewer §28.3.1.
[70] Thailand Local Lawyer and ILAG 3rd Reviewer (who is quoted), §28.1.1.
[71] India ILAG Reviewer, §28.3.1.
[72] Pakistan Local Lawyer and ILAG Reviewer, §28.3.1.
[73] See Endnote.

rates, and a longer period of time for repayment. No policy reason justifies the distinction, which arises as "a historical accident of English law that there exists a registry only of security agreements created by companies."[74]

152. Another limitation, on the ability of corporations to issue debentures, may have a stronger basis in policy. In Indonesia, corporations may issue debentures, but they need the approval of their shareholders (by a 75% favorable vote at a meeting of at least 75% of all shareholders), and must publish in two papers, to encumber all or a significant part of corporate assets.[75] In PRC, corporations' issuance of debentures is regulated.[76] In Thailand, corporations must seek regulatory approval under the Securities and Exchange Act to issue secured debentures."[77] These restrictions are, arguably, to protect shareholders from unscrupulous managers and directors, and to maintain a stable market for corporate debt. Yet the discretion these rules give securities regulators can be used to limit the use of certain security interests by companies.

153. Although technically all entities have access to the full range of permissible security interests, in practice they do not.

E. Limits to Security Interests that Secure Future Advances

154. Among future advances, the revolving line of credit is a form that provides enormous benefit to the debtor. The debtor can pay down a loan when cash inflow is good and draw again on the loan when working capital needs are great. The debtor has the advantage of knowing that credit will be available on short notice. There is a distinct policy interest in facilitating such financing. The law for secured transactions can support such a policy by setting clear priority rules that apply from the creation of the security interest across all drawings of the loan.

155. The difficulty is that the creditor might lose its priority when the loan is repaid. Suppose the debtor, with a revolving line of credit from Creditor A, first draws the loan on Day 1, using personal property as collateral. On Day 50, the debtor repays the revolving credit. On Day 60, the debtor borrows from intervening Creditor B and gives a security interest in the same personal property. On Day 70, the debtor draws from Creditor A's revolving credit again. Is this second drawing a continuation of the loan made on Day 1 and does this give Creditor A priority over intervening Creditor B? Or is it a new loan, which means that intervening Creditor B would have priority over Creditor A? The debtor's repayment of an early drawdown should not extinguish Creditor A's priority, if the policy is to facilitate revolving credit. If it does, Creditor A is at risk that the debtor would repay the revolving credit, borrow from Creditor B using the same collateral, and then draw on the revolving credit again, leaving Creditor A unsecured. The law needs to assure Creditor A of retaining priority in the collateral as the debtor repays and draws again.

156. The first question is whether a security interest can be created to secure a revolving credit. Most countries require that the agreement state the maximum amount to be secured. The countries with a civil law tradition–-PRC,[78] Indonesia,[79] and Thailand[80]–-explicitly require this. Pakistan has a similar rule, allowing a present charge or mortgage on movable property to secure future non-

[74] Pakistan ILAG Reviewer, §38.3.1.
[75] Indonesia Local Lawyer citing Company Law Art. 88 and 94(2). §28.3.1.
[76] Corporation Law of 1993.
[77] Thailand Local Lawyer and ILAG 3rd Reviewer (who is quoted), §28.1.1.
[78] PRC Local Lawyer, citing Guaranty Law of 1995, Arts. 59-62, and ILAG Reviewer, §28.9.2.
[79] Indonesia ILAG 2nd Reviewer, citing Indonesian Fiduciary Transfer Law Art. 7 lit. b). §28.9.1.
[80] Indonesia ILAG 2nd Reviewer, and Thailand Local Lawyer, citing Thai CCC §708. The rule only describes mortgages, but by interpretation it extends to pledges. §28.9.1.

specified obligations up to the amount specified in the charge or mortgage.[81] The law is not settled in India, where the general rule permits a security interest for future advances if the agreement explicitly contemplates it and does not expressly require a maximum amount to be set. However, by analogy to the law governing security interests in real property, perhaps when personal property secures a revolving credit a court would require a maximum amount or, failing that, limit the priority of the prior security interest to the amount originally loaned.[82] In four of the countries, if the maximum amount is stated the actual amount of the future advance may be indeterminable at the time of the agreement because it may be less than or equal to the maximum amount. Indonesia allows it in practice.[83]

157. For debtors, the rule requiring a maximum amount means that their loans are typically over-collateralized, with too much collateral covering too small a loan. This raises the cost of financing or reduces the credit otherwise available to the debtor, given the collateral. It makes economic sense to remove such a rule, although, as one ILAG adviser noted, "The requirement to state an overall upper limit on the potential secured obligation is not uncommon even in 'reformed' civil law systems, as a logical consequence of strict adherence to the rule that security is necessarily auxiliary to debt (e.g. Quebec). . . ."[84]

158. The underlying problem is that the laws in each country are silent about priority against intervening secured creditors.[85] In Pakistan, as in India and the other countries, the charge or mortgage has priority over an intervening security interest acquired in the same collateral with notice of the first security interest, up to the amount specified in the first agreement. However, the future advances—for example, new advances on a revolving credit—are not assured a priority against intervening security interests in the same property that is equal to the priority of the security given against advances when the agreement was made. This raises the potential economic loss to a debtor from a default. When the risk rises, so does the cost of the financing.

159. The impact of this ambiguity about priority is to raise the cost of funds to debtors or reduce their availability. Revolving lines of credit still exist, of course. In Pakistan, for example, enterprises interviewed indicated that debtors and creditors do vary the amount of a secured credit over the life of the contract. However, since creditors are at risk, they would offer future advances only to debtors they know well. This sacrifices much of the gain that collateral could provide.

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[81] Pakistan Local Lawyer and ILAG Reviewer #2, §28.9.2.

[82] ILAG Reviewer #3. *See also* Indian Local Lawyer, citing Indian Contract Act §176 for pledges and Transfer of Property Act §79 for mortgages, and citing *Imperial Bank of India v. U.Rai Gyaw*, 1 Rang. 637, 50 I.A. 283, 51 Cal. (1923). §28.9.2.

[83] In India, a security interest can be taken to secure the performance of any kind of obligation, including one that is not determinable at the time it is taken. But the interest must be sufficiently certain to withstand a challenge that it is void for vagueness and its monetary value must be determinable at the time of enforcement. India ILAG Reviewer #3 is quoted. *See also* India Local Lawyer, citing Indian Contract act, 1872, §29. §28.8.4. Pakistan allows indeterminable advances to be secured generally, but if the debtor is a company, registration requires a specific amount. Pakistan Local Lawyer and ILAG Reviewer #2, §28.9.2. In Indonesia, the law does not speak to this, but practice permits it. Indonesia Local Lawyer, §28.9.2. In PRC, even if the future advances are indeterminable at the time of creation, the security interest will be valid if a maximum amount to be secured is given. PRC Local Lawyer, citing Guaranty Law of 1995, Arts. 59-62, and ILAG Reviewer, §28.9.2. The Local Lawyer notes that the statement that the amount may be indeterminable is not explicitly decided by any law or scholarly work, but based on a reading of the general definition of contract. §28.8.4. Thailand allows the amount to be indeterminable at the time of creation provided a maximum amount is specified. Thailand Local Lawyer, citing CCC §683. §28.9.2.

[84] ILAG 3rd Reviewer, citing J. Claxton, *Security on Property and the Rights of Secured Creditors under the Civil Code of Quebec* (1994).

[85] See Local Lawyers and ILAG Reviewers, §28.9.

F. Limits to the Right to Follow Collateral and Continue an Interest in the Proceeds of Collateral

160. The law may create security interests in, or related to, collateral. When the debtor sells collateral, the law may give the creditor the right to follow collateral and a security interest in the proceeds of the collateral. The creditor wants both rights in order to be able, when the debtor defaults, to recover what is owed. The basic question is whether tracing is possible and, if so, how far.[86] For the *droit de suite*, the specific questions are whether the holder has a continued interest in the property after it is transferred. If so, through how many transfers? For tracing the collateral, the questions are whether the holder has a continued interest in the proceeds of the sale and, if so, how far.

161. Among the five RETA countries studied, only one allows secured creditors to *follow the collateral* as a general right. In Indonesia, the secured interest is a right in the property itself and follows the property as it is transferred from one party to another, expiring when the property is destroyed.[87] Two other countries recognize a limited right. In India, the secured creditor can pursue the collateral if the transferee had notice of the security interest, but not otherwise. Notice is presumed if the interest is registered. Since the Companies Registry alone requires registration, this effectively limits the right to secured creditors of companies.[88] Equitable tracing rules would govern other secured creditors. The right appears to continue as long as the property can be identified, because the law does not prohibit it.[89] In Pakistan, although the law does not articulate the concept of continuation of interest, it does not prohibit or limit parties to the security agreement from continuing the secured interest by contract.[90] In the remaining two countries, PRC law is silent[91] and Thai law permits no tracing.[92]

162. When the debtor receives the *proceeds* from transferring the collateral, the secured creditor has a clear interest in the proceeds only in one country. In Indonesia, a fiduciary transfer extends to proceeds of the collateral and in three other countries, the debtor's interest in the proceeds is qualified. India apparently gives the right only if the secured creditor has no continuing interest in the collateral itself. The two interests—in the proceeds or in the collateral—are mutually exclusive.[93] Pakistan right is based on contract law and the absence of any limit in the law.[94] In PRC, the Guaranty Law provides that when collateral subject to a registered mortgage is transferred without notice to the secured creditor, the transfer is void and the proceeds must be applied to the debt or deposited with an agreed third party. This probably means that the proceeds are to be held in escrow and quickly distributed to the secured creditor with any excess to the debtor.[95] Thailand, however, does not permit an extension to proceeds.[96]

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86 Tracing is not an issue for floating interests, such as floating charges in Pakistan or Indonesia's fiduciary transfer where inventory is the collateral. Indonesia Local Lawyer. §28.10. The interest attaches only to property owned by the debtor, not those it sells. The proceeds of a sale still owned by the debtor would be subject to the floating interest. See, e.g., India Local Lawyer and ILAG Reviewer #3, and Pakistan ILAG Reviewer §28.10.
87 Indonesia Local Lawyer, citing ICC Arts. 1131-1138. §28.10.
88 India Local Lawyer and ILAG Reviewer #3. §28.10.
89 India Local Lawyer and ILAG Reviewer #3. §28.10.
90 Pakistan Local Lawyer and ILAG Reviewer. §28.10.
91 PRC Local Lawyer and ILAG Reviewer, §28.10. In discussions, a Chinese lawyer asserted that Guaranty Law §49 supported tracing of the collateral only through the first exchange.
92 Thailand Local Lawyer and ILAG Reviewer #3. §28.10.
93 India Local Lawyer, citing Transfer of Property Act, §73, and ILAG Reviewer #3. §28.10.
94 Pakistan Local Lawyer and ILAG Reviewer. Note that in common law jurisdictions, the security agreement can specify that the proceeds are held in trust for the secured creditor. Pakistan ILAG Reviewer, using Canada as an example. §288.10.
95 Local Lawyer and ILAG Reviewer, citing Guaranty Law, Art. 49. §28.10.
96 Thailand ILAG Reviewer #2, citing CCC §231. §28.10.

163. When the collateral is lost or damaged (e.g. by fire), the secured creditor has an interest in claims for insurance on the collateral in Indonesia[97] and Thailand. The secured creditor also has an interest in compensation for expropriation, destruction, or damage to it in Thailand.[98] These rights are not explicit in India, Pakistan, or PRC.

164. Tracing the use of the proceeds beyond the initial transfer is very limited. PRC[99] and Thailand[100] do not permit it. Indonesia does not address the issue. Only India and Pakistan permit tracing proceeds. India allows it as long as the property can be identified as having its source in the proceeds (the English view).[101] Pakistan's weak approval extends here too.[102]

165. In essence, none of these countries makes comprehensive provision for a creditor's right to proceeds of collateral. Although the security interest may continue through the first exchange of the collateral, the law does not specify whether a secured creditor would have such a right against the proceeds of subsequent dispositions. Nor would a creditor know whether such a right to proceeds would prevail against intervening creditors.

166. This problem is more than one of common law versus civil law jurisdictions. Of course, as one ILAG Reviewer points out, "the idea that a security interest automatically continues into the identifiable or traceable proceeds of collateral is very much identified with the common law tradition, as an outgrowth of the historical development by the courts of equity of special remedies to support the interest of a beneficiary of a trust, the trust being another peculiarly common law institution."[103] This observation holds for one of the countries outside of the common law tradition, Thailand. Another of the five RETA countries, Indonesia does provide for tracing of identifiable property, though not of proceeds. Trusts now are common in various civil law jurisdictions, and used as a form of security.[104] A civil law jurisdiction, Quebec, provides for a continuing interest in the proceeds with legislated concepts of substitution as well as maintaining the traditional *droit de suite* in the collateral itself.[105] The important question for this report concerns the economic effect of laws that lack a comprehensive provision.

167. What are the consequences for business credit in the countries? These gaps and limits present costly risks to secured creditors. Once a secured creditor finds that a claim against the collateral is broken, and the law has not clearly established a right to proceeds, secured creditors must return to court to get a new claim against the proceeds. Any process that requires returning to court substantially raises the cost of enforcing the security interest and raises the risk of having to establish a later time of priority for the claim. Understanding this, creditors avoid situations where they must use such legal feature; their offer of credit to debtors declines correspondingly.

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[97] Indonesia ILAG Reviewer #2, citing Fidusia Law Arts. 10 lit a and b, and Art 25(2). §28.10.
[98] Indonesia ILAG Reviewer #2, citing CCC §231. §28.10.
[99] PRC Local Lawyer and ILAG Reviewer, §28.10.
[100] Indonesia ILAG Reviewer #2, citing CCC §231. §28.10.
[101] India Local Lawyer and ILAG Reviewer #3. §28.10
[102] Pakistan Local Lawyer and ILAG Reviewer. §28.10
[103] Thailand ILAG Reviewer #3. §28.10.
[104] E.g., for the case of Quebec, see J. Claxton, *Security on Property and the Rights of Secured Creditors under the Civil Code of Quebec* (1994), at 244.
[105] J. Claxton, *Security on Property and the Rights of Secured Creditors under the Civil Code of Quebec* (1994), at 93.

G. Economic Consequences of Problems Creating Security Interests

168. Limits to creating security interests that arise from gaps in coverage of goods, creditors and debtors, and transactions impose two costs. First is credit rationing. Some lending does not occur because debtors cannot undertake some transactions or use some types of goods as collateral under the law even though no public policy consideration prevents it. For example, in Thailand, one must examine how the creation and registration rules interact to conclude that property in the possession of the debtor might serve as collateral only when the law also provides a title registration system. Thai law provides a registration system for certain property, such as airplanes, ships and certain machinery, but not for other property, such as cattle, crops, or inventory.[106] No public policy justifies treating one class of property as collateral and not another. This has a lethal economic consequence for the use of collateral: if the law does not extend to a good or transaction, a court will not uphold a security interest against it. Instead, the court will rule it an invalid security agreement. Without legal sanction, the creditor cannot pursue the claim under the law or with the law's legal institutions. Armed with advance knowledge of this problem, the potential creditor will not give less or no credit to the would-be debtor. The creditor has rationed its credit.

169. Second, transaction costs rise. Determining whether the law does or does not include a transaction or a good or a debtor or a creditor can require considerable time and effort. For example, a secured creditor tracing collateral in India may encounter great difficulties establishing whether the collateral is still identifiable. Such a process is costly and painful to the parties, who learn the hard and costly way by losing their loans and security in court.

170. In the civil law countries of PRC, Indonesia, and Thailand, requirements for specific identification of collateral create economic hardship. These countries have in place systems that will identify some goods well: cars, ships, and planes typically have well-developed social systems of title registration for identifying property and police will enforce titles. However, for most economic transactions a rule requiring specific identification of movable goods presents difficulties. Other consumer and producer goods may have serial numbers but these provide little protection. There is no well-maintained record of them. Removing or changing serial numbers present no challenge. Transferring the property does not require use of the serial numbers. Other goods simply have no specific identification: for example, grain, petroleum, canned goods in a warehouse. Specific identification is not effective, so lending cannot be secured by these forms of personal property.

[106] "[T]here is no comprehensive general statutory framework for security interests [in Thailand]. It is true that most of the substantive rules are to be found in the Civil and Commercial Code (CCC). These rules deal essentially with the possessory pledges of tangibles (CCC §747-769) and non-possessory mortgages (CCC §702-746). However, while all immovables can be mortgaged, there is a narrow numerous clausus for non-possessory mortgages of tangible movables, limited to those for which title registration is provided for (CCC §703 par. 2)." Prof. U. Drobnig memorandum at §27.1.1 This translates into the impossibility of using non-possessory security interest in any movable property for which no title registration is provided and these are all assets except ships, vessels, motorboats over five or six tons; floating houses; beasts of burden (CCC §703 par. 2 nos. 1-3); and (registered) machinery. Alternatively, hybrid non-possessory security devices are widely used in Thailand, such as the conditional sale (reservation of title) based upon CCC §459 (a special provision in the law of sales) as well as hire-purchase (under the special provisions of §572-574). Similarly, however, no rules for registration of hybrid security interests exist in Thailand for property for which the law does not provide a title registration system.

171. Specific identification can also increase risk by complicating the monitoring of the loan. A loan officer visiting an appliance store can easily monitor whether the observed inventory suffices for securing, say, a $10,000 loan. However, if the law requires specific listing of serial numbers, the loan officer cannot simply determine whether the store has sufficient inventory. Rather, the loan officer must determine whether the store has the specific appliances listed in the agreement. Consider the difference between visually counting, say, refrigerators, and turning every one around to read its serial number.

172. Except for high value items with clear identification, specific identification presents a costly and sometimes conceptually insurmountable economic problem. The objective of holding inventory is to smooth out the production and shipping process, permitting larger orders and production runs. The precise economic purpose of holding inventory lies in permitting its turnover. If the security interest cannot float secured by generally described property, then inventory cannot serve as security for a line of credit. The creditor would fear, correctly, that the security interest would disappear when the goods are sold. As all parties agree that the debtor will sell the inventory—indeed, staying in business and servicing the debt requires selling the inventory—the creditor will not make the loan. The creditor will face a similar predicament if offered, as collateral, a portfolio of accounts receivable. All parties want payment of the accounts receivable; if payment did not occur, the collateral would lose its worth. However, if the security agreement cannot "float" onto the new accounts entering the portfolio, the creditor will become unsecured. By analogy, the faster the turnover, which is often the sign of a well-managed and profitable enterprise, the greater the risk to the creditor.

173. Finally, limits to the continuation of the security interest in proceeds of the collateral present risk from delay, court costs, and the possible loss of priority to another creditor or creditor who obtains a security interest in the good into which the debtor has transformed the proceeds. The need for exaggerated creditor vigilance raises costs. Most judicial systems cannot meet the need for repeated court orders for new liens or claims in the debtor's property. Consequently creditors face increased transaction costs and risk.

174. The economic consequences of limited coverage by the security interest laws in the five RETA countries are exacerbated by the problems, that follow, found in the ranking of priority, the system of publicity, and the enforcement pertain to those security interests that may form.