

VI. PROBLEMS IN SETTING PRIORITIES FOR SECURITY INTERESTS

175. How does a debtor prove the value to a creditor of the property offered as collateral? How does a creditor determine the value? After learning its market value, the creditor will want to know if others already have a potential claim to the collateral. For example, a building with a market value of \$200,000 is obviously worth more than a \$100,000 building. Suppose, however, that the first building has a \$160,000 first mortgage and the second building has none. The creditor would have a lower priority as a claimant to the first building and a first priority as a claimant to the second. The size of the first claim on the more expensive building means that the creditor will place a higher value on the \$100,000 building as collateral.

176. A key feature distinguishing secured from unsecured debt is how well the creditor can establish a position in the ranking of priority in collateral against others who might have a claim to the same property. For the debtor, this translates into an ability to prove to the creditor the value of a property as collateral. Secured transactions laws reduce risk to creditors by giving public notice of that ranking of priority so that all other claimants against that collateral can cheaply and confidently assess the value of the property as collateral for a loan.¹⁰⁷

177. So the policy goal is for the secured creditor to be able to know its potential ranking with confidence and for the debtor to be able to demonstrate this inexpensively. To do so, they both need clear rules about when priority starts to run. They need to be able to assess their priority against other secured creditors, buyers, and other claimants in bankruptcy, including unsecured creditors.

178. The five RETA countries studied fall far short of these standards. They limit the rules for determining the priority of a security interest against other claimants to the property. Their rules carry important exceptions, or are inconsistent and confusing. These findings emerge from the following sections.

179. The consequences for debtors are severe. A debtor may possess movable property of great value but will have no means of convincing a creditor that other creditors do not already have a more senior claim against it. Offering such collateral to a creditor provides no additional comfort to the creditor and no better terms for the debtor.

A. Timing of Priority

180. To know its own priority, the creditor must know when everyone's ranking starts to run. If there is confusion about this, further issues—such as the relative ranking of various types of claimants—become irrelevant. A creditor wants to know when its ranking is set and when the rankings of all other possible claimants are set. Ranking arranged by first in time to register would be, as described in Chapter IV, a simple way to eliminate confusion for secured creditors. If all secured creditors must register in order to establish their priority, and the registry is accessible to all, then determining priority is relatively easy and inexpensive. Registration publicizes the interest. Few countries are prepared to apply this rule without exceptions, as discussed below, and in these five RETA countries there are many exceptions.

¹⁰⁷ The collective term "perfection" sometimes denotes these two steps – establishing priority and publicizing it.

181. Each of the five RETA countries uses, rather than a single starting point, different times that depend on the type of security interest (see Table VI-1). When a registry for the collateral is available, the rule is first-in-time to register in four countries—Pakistan,¹⁰⁸ Indonesia,¹⁰⁹ PRC,¹¹⁰ and Thailand.¹¹¹ Otherwise, the rule is that rank is set when the interest is created, generally by the execution of the agreement,¹¹² but also in other ways, such as notification of an account debtor. This default rule governs many security interests because registries are limited in each country. In Pakistan, only companies are required to have a registry. In PRC, registration is required for means of transport (aircraft, ships, vehicles) and without it the interest is not valid even against the other party. Registration is voluntary for an enterprise's equipment or other movables, through a notary. In Indonesia, the fidusia is registered and creates the interest.

182. In three of these four countries, a creditor cannot pre-register its interest. It is useful for a creditor to pre-register in order to ensure that between the time it signs and registers no other security interest in the same collateral is registered and receives a higher priority. Pre-registration does not seem possible, however, where registration creates the security interest, as in PRC (all cases), Indonesia (fidusia), and Thailand (all cases).¹¹³ These three countries reflect a style of registration derived from real property registration, in which title must be absolutely certain. Germany follows this approach. For most movable property, however, with its limited life, absolute certainty about title is not essential. Notice is essential. Separating notice (and priority) from creation is therefore appropriate. India does not address pre-registration, but for companies, registration takes place after the agreement is executed.

183. The result is that priority for many types of security interests in these four countries is set in a non-transparent fashion. The debtor cannot demonstrate to the potential creditor that no other interests exist in the same collateral nor can the creditor protect itself by pre-registering.

184. India has a different, and remarkable, approach to fixing time of priority, as Table VI-1 shows. Registration does not establish one's rank. Even registrable interests begin at the time of the agreement, which may precede registration by weeks. In India, for conventional security interests in movables (such as hypothecation, mortgage, or charge), priority is first in time of execution. The interest can be registered under the Registration Act, but registration does not affect priority.¹¹⁴ Logically, title-based security devices (e.g. hire purchase or financial lease) should have a super-priority because the debtor does not own the collateral, but this is not explicit.¹¹⁵ No comprehensive regime exists.¹¹⁶ For security given by companies, filing for registration must take place within 30 days of creating the security interest or the secured party will lose its priority against a liquidator or other creditor.¹¹⁷ For intellectual property rights, registration is required if the security interest is assigned,¹¹⁸ but priority runs from execution of the documents.

¹⁰⁸ Pakistan Local Lawyer, citing Companies Ordinance, 1984, §121, and *State of Madras vs. Madras Electric Tramways (1904) Ltd*, AIR 1957 Mad. 169. §29.1.2.

¹⁰⁹ LAG Local Lawyer, citing Fidusia Law, Art. 14(3). For fiduciary transfer or assignment, priority runs from the execution of the deed of transfer or assignment. Indonesia Local Lawyer, citing judicial authority and ICC Art. 613. §29.1.1.

¹¹⁰ PRC Local Lawyer and ILAG Reviewer, citing Guaranty Law, Art. 49. §29.1.1.

¹¹¹ Thailand Local Lawyer, citing CCC. §§702, 714, 730, and MVA §11. §29.1.1.

¹¹² In PRC, for example, the principle for unregistered mortgages is first in time of execution. PRC Local Lawyer, citing Guaranty Law of 1995, §54. §29.2.1.1.

¹¹³ Thailand ILAG Reviewer #3. §29.1.1.

¹¹⁴ India ILAG Reviewer #3, and Local Lawyer citing Registration Act, 1908, §47. §29.1.1.

¹¹⁵ India ILAG Reviewer #3. §29.1.1.

¹¹⁶ India ILAG Reviewer #3. §29.1.1.

¹¹⁷ India ILAG Reviewer #3, citing Companies Act, Chapt. 5. §29.1.1.

¹¹⁸ India Local Lawyer, citing Patents Act 1970, §68 and India ILAG Reviewer #3, referring to §§27.3-27.4. §29.1.1.

Table VI-1. Timing of Priority (Debtor in Possession)			
Country	At creation of the interest	At creation, if registered	At registration of interest
India	For collateral generally	Required for companies' collateral; voluntary for others	
Pakistan	For collateral generally	For companies' collateral	
Indonesia	For fiduciary transfer and assignment (no registry)		For fidusia *
PRC	For interests that need not be (and are not) registered		For required interests* and optional interests
Thailand			For registrable collateral*

* Registration is required to create the security interest

185. The result for India is remarkable in the way it reduces the transparency of one's rank. An illustration is as follows. Suppose a company offers some of its personal property as collateral to Creditor 1 on Day 1 but the interest is not registered until Day 25. On Day 15, the company offers the same collateral to Creditor 2. Creditor 2 could check the registry, but it would not discover an earlier security interest yet. So Creditor 2 could not be confident that it had priority, because in India a creditor's rank depends on when the agreement is made. Even if Creditor 2 registers on Day 16, Creditor 1 has priority despite the fact that its interest was registered on Day 25. This does not inspire confidence among potential creditors.

186. In addition, some claims have *super-priority* so that they prevail even if they vest after the security interest. These are discussed below.

B. Priority over Other Secured Creditors

187. Two major problems for a potential secured creditor who can register its interest, then, are (a) determining whether other secured creditors already have priority and (b) preventing new ones from taking priority. First-in-time registration allows a secured creditor to learn if other creditors, registered earlier, have priority. It gives the first secured creditor priority over later secured creditors who register later, in all countries¹¹⁹ except India and Pakistan (see Table VI-2). The set of security interests, however, that can be registered in the five RETA countries is small. Two important groups that are unregistered are security interests in collateral in the debtor's possession and pledges in the collateral (the creditor is in possession) given after the potential creditor registers its interests, discussed below.

¹¹⁹ Indonesia Local Lawyer, citing Fidusia Law Art. 28. Only one outstanding fidusia is permitted per item of collateral. §29.2.1.3. Pakistan Local Lawyer and ILAG Reviewer. §29.2.1.3. PRC Local Lawyer, citing Guaranty Law of 1995, Art. 54. §29.2.1.1.

Country	Security interest
India	Not necessarily
Pakistan	Not necessarily
Indonesia	Yes
PRC	Yes
Thailand	Yes

188. In the five RETA countries, priority generally rests with the registered secured creditor against the unregistered security interest when the collateral is in the possession of the debtor (see Table VI-3). This is true in PRC, where the registered secured creditor normally prevails.¹²⁰ The registered mortgage has priority over an unregistered one.¹²¹ In Thailand, the secured creditor has priority. The exception for maritime liens is common world wide, to encourage salvage operations.¹²² In Pakistan, registered interests, possible only in companies' assets, generally have priority over these unregistered interests.¹²³ The rule is that "The first to acquire or hold legal title prevails. A subsequent legal title defeats a prior equitable title (e.g. equitable mortgage)" if acquired for value without notice.¹²⁴ However, a fixed security interest has priority over floating interest, even if the floating interest was registered first.¹²⁵

Country	Security interest	Subsequent Pledge
India	na	na
Pakistan In general: For company floating interest:	Yes No against later fixed interest	No
Indonesia. Fidusia:	Yes	Yes
PRC	Yes	Yes
Thailand. General: Maritime lien:	Yes No	Yes

na=not available

¹²⁰ PRC Local Lawyer, citing Guaranty Law Arts. 41, 43. §29.2.1.2.

¹²¹ PRC Local Lawyer, citing Guaranty Law of 1995, Art. 54(2). §29.2.1.3.

¹²² Thailand ILAG Reviewer #3, citing G. Gilmore, *The Law of Admiralty* (1965). §29.2.1.1.

¹²³ Pakistan Local Lawyer and ILAG Reviewer. §29.2.1.1.

¹²⁴ Pakistan ILAG Reviewer, §29.1.2.

¹²⁵ Pakistan ILAG Reviewer, citing Companies Law, §405(5). §29.2.2.2.2.

189. The picture is less reassuring to the registered secured creditor when a pledge is given after the secured interest is registered. PRC gives the registered interest priority.¹²⁶ In Thailand, registration generally gives the secured creditor priority over the pledgee. The secured creditor, however, does not have priority if the transfer of possession took place legally, which would require permission from the registered secured creditor.¹²⁷ The situation is described as very unlikely.¹²⁸ In Pakistan and Indonesia, however, the subsequent pledge may have higher priority if the pledgee had no notice,¹²⁹ a rule that does not square with common law principles elsewhere. This is true in Pakistan.¹³⁰ In Indonesia, it is not clear whether a fidusia has higher priority than the pledge;¹³¹ indeed, a possessory pledge may rank above it.¹³² Such a rule, that a subsequent pledge has priority over a previously registered security interest, works against the certainty that a creditor would want when taking collateral. The creditor cannot be confident that it will have priority over subsequent security interests.

(i) Six Competing Interests for Which Priority is Not Clear

190. In most of the countries and in most cases, registries do not exist for security interests in personal property, so the foregoing examples do not address many possible forms of secured credit. Serious problems can occur if the same collateral is subject to two different types of interests by claimants. Overall, the laws fail to set clear priority rules for many competing claims of secured creditors, as the following pairs of claimants to the same underlying collateral illustrate.

Table VI-4a. Unclear Priority of One Secured Creditor Over Other Secured Creditors		
Country	Security interest (SI) in inventory over accounts receivable assignee?	SI in accounts receivable over accounts receivable assignee?
India	Law is not clear: for SI in inventory but is clear for assignment (time of contract)	Law is not clear: registration of claim on companies gives notice and may give priority; for non-companies, time of contract sets priority
Pakistan	Priority to first to execute.	Priority to first to execute.
Indonesia	Law is not clear.	Law may not permit multiple transfers of an interest in the same collateral.
PRC	Law does not address this.	Or this.
Thailand	No. The question is moot.	Moot.

¹²⁶ PRC Local Lawyer and ILAG Reviewer, citing Law of Civil Procedure, 1991, Art. 204. §29.2.2.2.2.

¹²⁷ Thailand Local Lawyer, citing MRA §11. §29.2.1.2.

¹²⁸ Thailand Local Lawyer. §29.2.1.2.

¹²⁹ Pakistan Local Lawyer citing *Abdul Habib vs. Maung Tun Kyaing*, AIR 1931 Rangoon 201. §29.2.1.2.

¹³⁰ Pakistan ILAG Reviewer. §29.2.1.2.

¹³¹ Compare Indonesia ILAG Reviewer #2, citing Fidusia Law Arts. 20, 27(1) and (3) [§29.2.1.1, §29.2.1.2. and §29.2.2] with Indonesia Local Lawyer and Indonesia ILAG Reviewer #3, citing ICC Art. 1152(4) that the pledgee is not liable if the pledgor lacks legal authority to transfer the collateral. [§29.2.1.1]. Note that a fiduciary transfer deed has lower priority than the subsequent pledge.

¹³² Indonesia ILAG Reviewer #3, citing ICC Article 1152(4), raises the possibility that a possessory pledge ranks above a previously registered Fiduciary Transfer Deed. §29.2.1.1.

191. First, who has priority when one party has a *security interest in inventory* and another is an *assignee of the accounts receivable* after the inventory is sold? (See Table VI-4a.) One may reasonably assume that if the debtor sells inventory on credit, the creditor secured by that inventory would be interested in the debtor's accounts receivable for the inventory. What emerges from this research, however, is that even this assumption is not shared by lawyers in all five RETA countries. The law does not even address this issue in PRC.¹³³ The law is ambiguous in India or Indonesia. In India, the law is not clear for a secured interest in inventory but it is clear for assignment (priority is from the time of contract). As a result, banks insist on assignment.¹³⁴ This point applies to some of the next set of competing interests, as well. In Indonesia, since both parties must register,¹³⁵ priority is with the earlier registration.¹³⁶ However, the Civil Procedure Code requires both creditors to get a supplementary list of collateral, and perhaps to register it. It is not clear if priority dates from the date of the list or its registration. A debtor could play the two creditors against each other for a long time.¹³⁷ So, at least in Indonesia, as an ILAG Reviewer noted, a potential creditor would need "substantial research" to look for pre-existing . . . assignments of accounts.¹³⁸ In Thailand, since Thai law, like much civil law, gives no security interest in future collateral or proceeds, "the priority contest contemplated . . . is moot."¹³⁹ Thus only in Pakistan is the rule straight-forward, and it depends on actions that are not transparent. Priority is to the first to execute, and is also subject to company registration.¹⁴⁰

192. In the second example, a *security interest in accounts receivable* competes with an *assignee of the same accounts receivable* (Table VI-4a). Here too, the law does not address the issue in PRC,¹⁴¹ and is unclear in India¹⁴² and Indonesia, where the experts disagree. The Indonesia Local Lawyer says such multiple interests are not possible under the law, while ILAG reviewers say multiple transfers may be permitted.¹⁴³ The contest between the two interests is not even possible in Thailand. Thai law does not permit establishing a security interest in accounts receivables.¹⁴⁴ Pakistan's rule is, again, straightforward but not transparent in its effect. The first to notify the debtor and register in a timely manner has priority.¹⁴⁵

¹³³ PRC Local Lawyer. §29.3.1.1.

¹³⁴ India ILAG Reviewer #3, reasoning from Companies Act, Chapter 5. §29.3.1.6.

¹³⁵ Indonesia ILAG Reviewers #2, citing Fidusia Law §§14(3) and 28, and #3, citing §10(a). §29.3.1.

¹³⁶ Indonesia ILAG Reviewers #2 and #3, citing Fidusia Law §28. §29.3.1. Note that a possessory pledge may have priority over a financial lease or a non-fiduciary assignment of accounts receivable. Indonesia ILAG Reviewer #3, citing ICC Art. 1152(4). §29.2.1.1.

¹³⁷ Indonesia ILAG Reviewer #3. §29.3.1.1.

¹³⁸ Indonesia ILAG Reviewer #3, citing ICC Art. 1152(4). §29.2.1.1.

¹³⁹ Thailand ILAG Reviewer #3. §29.3.1.1.

¹⁴⁰ Pakistan ILAG Reviewer, citing earlier discussion and Companies Act §121. §29.3.1.1. See also Transfer of Property Act, 1882, §130.

¹⁴¹ PRC Local Lawyer. §29.3.1.2.

¹⁴² India ILAG Reviewer #3, reasoning from Companies Act, Chapter 5. §29.3.1.6.

¹⁴³ Indonesia Local Lawyer, citing Fidusia Law Art. 1(1), argues that because the grantee of the fidusia owns the collateral (other than inventory) the grantor/debtor cannot transfer ownership in the collateral. ILAG Reviewer #3, citing Fidusia Law Art. 8 allowing fiduciary transfers to more than one creditor, argues that it might allow multiple competing fiduciary transfers.

¹⁴⁴ Thailand Local Lawyer. §29.3.1.2. Note that Thai law does permit factoring, in which the debtor assigns a receivable to the creditor who contracts to reassign it to the debtor when the debt is paid.

¹⁴⁵ Pakistan ILAG Reviewer, citing earlier discussion and Companies Act §121. §29.3.1.1.

Table VI-4b. Unclear Priority of One Secured Creditor over Other Secured Creditors		
Country	SI in warehouse receipt over SI in same goods?	SI in warehouse receipts over Judgment lien on debtor's personal assets?
India	n.a.	n.a.
Pakistan	Law does not address this.	Law does not address this.
Indonesia	Law does not address this.	Judgments have no priority ranking, but could be registered as fidusia with a rank based on first in time.
PRC	Law does not address this.	Law does not address this.
Thailand	Yes, probably first in time.	Yes: first in time.

193. In the third case, a *security interest in warehouse receipts* competes with a *security interest in the same goods* (see Table VI-4b). The law simply does not address this issue in three countries: PRC,¹⁴⁶ Indonesia,¹⁴⁷ and Pakistan.¹⁴⁸ (We do not have data for India.) Thai law is more complex and probably favors the first created interest. Both, as pledges, are created by possession. Warehouse receipts may be pledged, but one might ask why a security interest in these goods would be a pledge. Thai law does not permit non-possessory security interests in most movables, including most goods likely to be in the warehouse.¹⁴⁹ However, Thai practice permits improvised pledges, in which the debtor/pledgor keeps physical possession as an agent of the creditor/pledgee. If a creditor took a security interest in property using an improvised pledge, the debtor could then put the collateral into a warehouse, and another creditor could take the warehouse receipt.¹⁵⁰ In this story, the first pledgee holds the interest in the inventory, but the opportunity for fraud is plain.

194. The fourth case pits a *security interest in warehouse receipts* against a *judgment lien on debtor's assets* (Table VI-4b). The law does not address the issue in PRC¹⁵¹ and Pakistan.¹⁵² (Data from India are not available.) In Indonesia, judgments have no priority ranking, but the judgment could be registered as fidusia,¹⁵³ in which case the first registered interest would have priority. In Thailand, ranking is first in time. A security interest in warehouse receipts created before the judgment has priority over the judgment claim.¹⁵⁴

195. In the fifth example is *one secured creditor in future advances* and, before the advances take place, *intervening secured creditors in the same advances*. The law does not address the question

¹⁴⁶ PRC Local Lawyer. §29.3.1.3.

¹⁴⁷ Indonesia ILAG Reviewer #2. §29.3.1.2.

¹⁴⁸ Pakistan ILAG Reviewer. §29.3.1.2.

¹⁴⁹ Indonesia ILAG Reviewer #2, comparing Thai law and citing CCC Arts. 780 and 782. §29.3.1.2.

¹⁵⁰ Thailand ILAG Reviewer #3. §29.3.1.3.

¹⁵¹ PRC Local Lawyer. §29.3.1.4.

¹⁵² Pakistan ILAG Reviewer. §29.3.1.4.

¹⁵³ Indonesia Local Lawyer. §29.3.1.4.

¹⁵⁴ Thailand Local Lawyer, citing Civil Procedure Code §287, and ILAG Reviewer #3. §29.3.1.4.

in PRC,¹⁵⁵ and does not clearly resolve it in India,¹⁵⁶ Pakistan,¹⁵⁷ or Thailand.¹⁵⁸ Even in Indonesia, the law is unclear. The security interest in future advances should have priority if it was registered under the Fidusia Law when made. The obligation to obtain and possibly register subsequent lists of collateral, however, makes the timing of priority unclear, as described above.¹⁵⁹

Country	SI in future advances over intervening SI filed after SI #1 is created but before SI#1 advances?	SI in fixtures over Mortgagee in real property to which fixture is attached?
India	Not clear, even dubious	n.a.
Pakistan	Not clear, even dubious.	Law does not address this.
Indonesia	Law is not clear.	First to register.
PRC	Law does not address this.	Law does not address this.
Thailand	Law is not clear.	May be moot.

196. Finally, what happens when a *security interest in fixtures* competes with a *mortgagee in the real property* to which the fixture is attached? The law is silent in PRC¹⁶⁰ and Pakistan.¹⁶¹ (We do not have data for India.) Generally, the law does not provide for the creation of a security interest in fixtures under a regime for movables in Thailand, so this competition could not occur. Perhaps special provisions may allow this competition, but the Local Lawyer and an ILAG reviewer did not resolve the matter.¹⁶² The law does resolve the competition in Indonesia, giving priority to the first to register.¹⁶³

197. Many of these cases involve interests in inventory and accounts receivable. Box VI-1 examines the problems of priority faced by creditors and debtors working with accounts receivable and inventory.

198. In short, in each of these competing cases, the dominant finding is that the law either does not address the issue or, if it does, does not resolve it. These types of interests represent potentially large volumes of loans that would become available if the creditors could be confident about their priority in each type of personal property. These cases illustrate the severe problems potential creditors, and their would-be debtors, face determining their priority in the five RETA countries.

¹⁵⁵ PRC Local Lawyer. §29.3.1.5.

¹⁵⁶ India ILAG Reviewer #3. §29.3.1.6.

¹⁵⁷ Pakistan ILAG Reviewer. §29.3.1.5.

¹⁵⁸ Thailand Local Lawyer says that no security interest can be established in advances. ILAG Reviewer #2 supports this. ILAG Reviewer #3 argues that, since registration of a mortgage (which must specify a maximum value) creates the mortgage, a secured creditor would take priority in all advances, present or future from registration, regardless of when the mortgage contract or advances were made. §29.3.1.5.

¹⁵⁹ Indonesia Local Lawyer and ILAG Reviewer #3. §29.3.1.5.

¹⁶⁰ PRC Local Lawyer. §29.3.1.6.

¹⁶¹ Pakistan Local Lawyer. §29.3.1.6.

¹⁶² Thailand ILAG Reviewer #3, Local Lawyer, and ILAG Reviewer #2, discussing CCC §§7119-721. §29.3.1.6.

¹⁶³ Indonesia Local Lawyer, citing Fidusia Law Art. 28 and Hak Tanggungan Law Art 5(2), and ILAG Reviewer #3. §29.3.1.6 and §29.2.1.3.

(ii) Special Case: Pakistan's Fixed vs. Floating Interests

199. Pakistan's discrimination between floating and fixed security interests also works against those who need funds for such things as inventory finance as well as those who would advance funds for it. Pakistan ranks floating charges on companies' assets below certain other claims, including taxes, worker's dues, and fixed charges.

**Box VI-1.
Priorities in Accounts Receivable Financing**

- Accounts receivable financing is a key institution linking unsecured and secured debt. Inventory often transforms into accounts receivable, as described above. Accounts receivable can serve as collateral for credit to buy more inventory. That collateral can move upstream from one supplier to another. This system has the potential to refinance the portfolios of micro-finance institutions, input dealers, and wholesalers, producing an enormous expansion in credit at low risk.
- Potential creditors seeking security from the inventory or accounts receivable need to know who else has an interest in the collateral and their priority, relative to the others. Rules that base priority on notice to debtors have a serious weakness. It may be bad business to notify account debtors. When a small number of loans are assigned, it is simple for an assignee to notify the debtor. When all accounts of the business are assigned, notification costs too much, may be interpreted as a signal that the debtor is financially troubled, and cuts the direct relation between the assignor, such as a store, and its clients, the account debtors.
- The countries that base priority on registration of the security interest in accounts receivable have much too narrow a spectrum of registrable interests. In Indonesia, the fidusia is registered. In Pakistan, only interests in the accounts receivable of a company can be registered. A potential creditor cannot learn conclusively whether the debtor previously assigned or pledged the accounts receivable to someone else.
- The best known solution includes in the priority by registration rule all such interests in accounts receivable: all fiduciary transfers, security interests, assignments, and transfers of account receivables. Priority would run only from the time of filing in a registry. Where these rules have been adopted, they largely solved these problems. However, the study revealed no such rule in any of the five RETA countries.

200. The rationale for ranking floating charges lower than fixed charges, and certain other claims, is that a simple first-in-time priority is inappropriate for floating charges over all the debtor's assets. A simple first-in-time rule means that once a floating charge takes effect, the debtor cannot give any other creditor a superior charge even when a supplier is lending it money to buy specific goods that are essential to the debtor's business and wants a security interest only in those goods. Workers who are unpaid for work they do during the last days of a bankrupt's existence will probably not be paid if they rank lower than the floating credit. Filing in those last days would not have helped them because the floating interest already had priority. Yet the creditor with the floating charge benefits from the inputs of the trade creditor and worker. This extreme problem does not arise for the fixed charge because it leaves some assets for unsecured creditors and other claimants. Like England, which established this rule over 100 years ago, and New Zealand and Israel which follow it today,¹⁶⁴ Pakistan excepts these competing claims by reducing the priority of the floating interest.

¹⁶⁴ Pakistan ILAG Reviewer. §29.2.2.2.2.

C. Priority over the Buyer of the Collateral

201. A creditor needs to be confident that the personal property serving as collateral for the loan is not sold and put beyond the creditor’s reach. The exception would be inventory, which the creditor would expect the debtor to sell in the course of business. The discussion of tracing, above, examined the secured creditor’s right to pursue both the buyer and whoever is holding the proceeds of the sale. The creditor needs clear priority of interest over the buyer. In the five RETA countries, the creditor with a registered security interest does not always have this clarity.

Country	Buyer
India	n.a.
Pakistan	Yes
Indonesia	Yes (except inventory)
PRC	Partial
Thailand	Yes, but some lack clarity

202. Among the five RETA countries, three give the registered secured creditor priority over the buyer, one gives partial priority, and one (India) reported no data (Table VI-5). In Indonesia, the holder of the fidusia, which is registered, has priority over all subsequent buyers except when the collateral is inventory, and over other creditors.¹⁶⁵ In contrast, in the fiduciary transfer, which is not registrable, the debtor is the owner and can transfer the collateral to a good faith buyer.¹⁶⁶ The experts do not agree whether a fiduciary transfer has priority by statute over other claimants.¹⁶⁷ PRC protects the creditor against possible bad effects of a sale of collateral. The mortgagee can demand that the mortgagor provide extra collateral if the proceeds of a sale are below the value of the collateral, and can block the sale if the collateral is not provided.¹⁶⁸ This gives the mortgagee of movable property substantial power and the ability to abuse it.

203. In Thailand because registration constitutes constructive notice, the registered secured creditor would seem to have priority.¹⁶⁹ Yet this priority is only by inference. The local lawyer and ILAG reviewers debated how a good faith purchaser could acquire previously pledged collateral from a debtor in possession. ILAG noted that here also the ‘improvised pledge’ allows a debtor to retain possession of pledged collateral by acting as the pledgee’s agent.¹⁷⁰

204. Fair play dictates that a potential buyer have a way to inform itself about any secured interest on the property. A simple first-to-file rule should give that buyer adequate notice.

¹⁶⁵ Indonesia ILAG Reviewer #2, citing Fidusia Law Art. 20-22, and 27(1). §29.1.1.

¹⁶⁶ Indonesia Local Lawyer, citing ICC Art. 1977(1) and F. Tumbuan, *Indonesian Security Rights*, unpublished paper (1996), at 23-24. §29.1.1. This does not include the fidusia, which is a statutory form of fiduciary transfer.

¹⁶⁷ Indonesia Local Lawyer says no specific rule governs fiduciary transfer and assignment. The ILAG Reviewer #2, citing Fidusia Transfer Law Art. 27(1) expressly establishes priority over other creditors. §29.2.1.1.

¹⁶⁸ PRC ILAG Reviewer, citing Guaranty Law, Art. 49, and Local Lawyer. §29.1.1.

¹⁶⁹ Thailand ILAG Reviewer #3. §29.2.1.1.

¹⁷⁰ Thailand Local Lawyer, citing CCC §769(2), and ILAG Reviewers #2 and #3. §29.2.1.3.

D. Priority over Other Claimants in Bankruptcy

205. When the debtor enters bankruptcy, several other major types of claimants to its assets challenge the secured creditor’s interest in the collateral. For the potential creditor to know its priority with confidence, it must know its rank against these other claimants. A low rank, relative to them, will raise the risk to the creditor, either increasing the cost of the credit or reducing credit.

206. The bankruptcy proceedings themselves generate costs that may affect the secured creditors. Often, bankruptcy fees take priority over all other claims to the estate. However, if the secured creditor can enforce its claims independently of the proceedings, it can avoid these fees. The secured creditor can enforce its claims independently in two of the countries, Pakistan,¹⁷¹ and Thailand.¹⁷² India ranks the claims of secured creditors ahead of bankruptcy costs.¹⁷³ However, in PRC, fees for bankruptcy are paid first.¹⁷⁴ In Indonesia, the law ranks the bankruptcy fees higher than the claim of the secured creditor, but they may be relieved of sharing these fees.¹⁷⁵ In addition, a 90-day stay on enforcement by secured creditors is automatic, though the court may remove it.¹⁷⁶

207. The ability of the secured creditors to enforce independently does not necessarily extend to corporate reorganization. In Thailand, for a secured creditor to enforce its claims outside a corporate reorganization, the court must decide the collateral is not essential to the reorganized business or that the secured creditor would not be adequately protected by the reorganization. The court can protect the secured creditor in other ways, as well.¹⁷⁷ However, because the relief depends on judicial discretion, creditors may take this uncertainty into account when pricing or advancing loans.

208. A second type of claim, tax liens, also threatens the confidence a potential secured creditor may have anticipating the priority of its interest in the collateral. As Table VI-6 shows, the tax lien

Table VI-6. Summary of Priority in Bankruptcy: Registered Security Interest (“SI”) has Priority (“yes”), or Does Not (“no”), Relative to Other Claimants					
Other claimants	Countries: India	Pakistan	Indonesia	PRC	Thailand
Private lien or privilege	Equal: with workmen’s dues companies owe Yes: other wages	Yes: fixed company charge No: workers’ dues rank over floating charge	Do not know	No: wage and social insurance rank first	Yes Except maritime liens ¹⁷⁸
Tax lien	No (for companies) No: some States’ City taxes prevail	Yes: fixed company charge No: floating charge	Not clear	No: taxes rank after private liens	Yes

¹⁷¹ Pakistan Local Lawyer, citing *Hansraj vs. Official Liquidator, Dehra Dun Mussoorie Electric Tramway Co. Ltd.*, AIR 1929 Allahabad 353. §29.2.2.

¹⁷² Thailand Local Lawyer, citing Bankruptcy Act, §95, 90/28. §29.2.2. Thailand ILAG Reviewer #3. §29.2.2.2.2.

¹⁷³ India Local Lawyer, citing Companies Act, 1956, §520. §29.2.2.2.2.

¹⁷⁴ PRC Local Lawyer and ILAG Reviewer, citing Law of Civil procedure, Art. 204. §20.2.2.2.3.

¹⁷⁵ Indonesia ILAG Reviewer #2, citing Bankruptcy Law Art. 177. §29.2.2.2.2. But ILAG Reviewer #2 raises the possibility that privileged claims by the State Treasury, pursuant to ICC Art. 1139(1) may have priority. §29.2.1.1.

¹⁷⁶ Indonesia ILAG Reviewer #2, citing Bankruptcy Law, Art. 56(a). §29.2.2.1.

¹⁷⁷ Thailand Local Lawyer, citing Bankruptcy Act 1940 as amended, §90/14. The court may also protect the secured creditor by providing alternate collateral. ILAG Reviewer #3, citing Bankruptcy Act, §90/14 no. 1- no. 3. §29.2.2.

¹⁷⁸ For most claimants, the secured creditor has priority. The exception for maritime liens is common world wide, to encourage salvage operations. Thailand ILAG Reviewer #3, citing G. Gilmore, *The Law of Admiralty* (1965). §29.2.1.1.

does not have priority over a registered security interest in Thailand¹⁷⁹ or, for fixed charges (on companies' property), in Pakistan.¹⁸⁰ Otherwise—in India,¹⁸¹ PRC,¹⁸² and for floating security interests, even in Pakistan¹⁸³—the security interest is subject to the tax lien. In Indonesia, it may be. An ILAG Reviewer raises the possibility that privileged claims by the State Treasury, pursuant to ICC Art. 1137(1), may have priority over the security interest.¹⁸⁴

209. Yet another type of claim, private liens and privileges, also undermine the confidence that a secured creditor may have in its priority (see Table VI-6). The countries either remove the registered secured creditor from a higher rank than the lien or leaves the rank ambiguous. In PRC, claims for wages and social insurance rank above the security interest.¹⁸⁵ In Pakistan, the floating security interest ranks below workers' dues,¹⁸⁶ even though the fixed security interest ranks higher.¹⁸⁷ India does not distinguish between fixed and floating charges, but it does rank workers' dues *pari passu* with security interests,¹⁸⁸ while ranking other wages lower.¹⁸⁹ (For Indonesia, we do not have data.) Thailand stands out as the exception. It gives the security interest priority¹⁹⁰ except in the case of maritime liens. This is a common and functional exception, as discussed above, about which creditors for activities involved with ships should be familiar and able to plan.

210. Finally, India offers still more senior claimants. Registered security interests also do not have priority over the State Financial Corporations and certain farm loans.¹⁹¹

211. A major issue, that extends beyond the confines of this paper's topics, is how to weight these various claimants to a bankrupt debtor's limited assets. Some exceptions to first-to-file priority, however, have an important motivation in public policy. They cannot be set aside so easily. A recent report from ADB sets out these issues carefully.¹⁹² This section adds only a few points to the discussion.

212. A well-designed system of secured debt can support an enormous expansion in total credit, expand productive investment, and provide broader access to credit. It can permit larger loans at lower interest rates with longer periods for repayment. Unfortunately, neither resources nor time permitted a detailed study of the financial sectors of these countries. This credit, reaching a larger

¹⁷⁹ Thailand ILAG Reviewer #3. §29.2.1.1.

¹⁸⁰ Pakistan ILAG Reviewer, citing Companies Law, §405(5). §29.2.2.2.2.

¹⁸¹ India Local Lawyer, citing Companies Act, 1956, §§529(a), 530. §29.2.2.2.2.

¹⁸² PRC Local Lawyer and ILAG Reviewer, citing Law of Civil Procedure of 1991, Art. 204. §20.2.2.2.3.

¹⁸³ Pakistan Local Lawyer, citing Companies Ord., 1984, §§403-405, Provincial Insolvency Act, 1920, §§47, 61-64, and Insolvency (Karachi Division) Act, 1909, §§49, 71-73. §29.2.2. And see Pakistan ILAG Reviewer, citing Companies Law, §405(5). §29.2.2.2.2.

¹⁸⁴ Indonesia Local Lawyer, citing General Provision on Tax, Law No. 6/1983, as amended. §29.2.2.2.2. But see ILAG Reviewer #2. §29.2.1.1. And note that legal fees for recovering collateral have priority over the security interest, according to Indonesia Local Lawyer, citing ICC Art. 1139(1) and 1149(1). §29.1.1.

¹⁸⁵ PRC Local Lawyer and ILAG Reviewer, citing Law of Civil Procedure, Art. 204. §20.2.2.2.3.

¹⁸⁶ Pakistan Local Lawyer, citing Companies Ord., 1984, §§403-405, Provincial Insolvency Act, 1920, §§47, 61-64, and Insolvency (Karachi Division) Act, 1909, §§49, 71-73. §29.2.2. And see Pakistan ILAG Reviewer, citing Companies Law, §405(5). §29.2.2.2.2. Workers' dues consist of up to 4 months of wages, benefits, and workers compensation.

¹⁸⁷ Pakistan ILAG Reviewer, citing Companies Law, §405(5). §29.2.2.2.2. The only registered interests are in companies' assets, and these have priority over each of these unregistered interests. Pakistan Local Lawyer and ILAG Reviewer. §29.2.1.1. The rule is that "The first to acquire or hold legal title prevails. A subsequent legal title defeats a prior equitable title (e.g. equitable mortgage)" if acquired for value without notice. Pakistan ILAG Reviewer, §29.1.2.

¹⁸⁸ India Local Lawyer, citing Companies Act, 1956, §520 and §529(a). §29.2.2.2.2.

¹⁸⁹ India Local Lawyer, citing Companies Act, 1956, §530. §29.2.2.2.2.

¹⁹⁰ Thailand ILAG Reviewer #3. §29.2.1.1.

¹⁹¹ India Local Lawyer, citing Companies Act, 1956, §529(a). §29.2.2.2.2. Certain farm loans have priority. India ILAG Reviewer #3. §29.2.1.3.

¹⁹² ADB, "The Need for an Integrated Approach to Secured Transactions and Insolvency Law Reforms", *Law and Policy Reform at the ADB, Vol. I, 2000 edition*, at 87.

number of people, including operators of small farms and businesses, micro-producers, and the poorest sole proprietors, offers funding for an enormous number of small, high return projects.

213. In the face of these benefits, the economic policy issue is not whether other contending public policy objectives have value. Rather, the economic policy issue is whether the law can achieve those other policy objectives in a way that has the least impact on the system of secured debt. Box VI-2 sets out alternative ways to achieve these public policy goals. They may be as or

Box VI-2.
An Aside on Bankruptcy and the Public Policy Aspects
of Exceptions to First-to-File Priority

(a) Tax Claims of the Government

To collect taxes without destroying priority, the government need only file its a claim covering its unpaid taxes in the same filing archive that other creditors and suppliers on credit use. The government could file such a claim or "lien" at the time it determines the taxpayer has defaulted. If the government finds that companies and taxpayers are only empty shells by the time it goes to collect, the government may wish to consider improving its tax collection procedures so it makes tax collections and files liens against defaulting taxpayers in a more timely way. The improvement in tax collection would represent an additional benefit to society that would arise in addition to the relief from the burden of undermining the credit system.

(c) Unpaid Tort Claims

Suppose a company dumps poisonous chemicals in the ground; suppose years later it is subject to a suit where those damaged successfully collect enough to make the firm bankrupt. Would punishing not only the shareholders but also the creditors who financed the firm not better serve both efficiency and fairness? Possibly. Even if this were the case, however, it would better serve efficiency if the law requires firms to have private insurance against tort claims. Then if firms engaged in very risky activity likely to incur damage suits would pay high premiums. They could choose between continuing these practices or fixing them and paying lower premiums. In either case, their return on capital and their creditworthiness would fall. The nature and scope of their activity would, in that system, contract, more correctly reflecting the ongoing risk to society from their activities and not be levied on them ex post, after they had done the damage.

(d) Unpaid claims to worker

Most would sympathize with workers who go unpaid when a firm goes bankrupt. They are the unwilling creditors of the firm and typically not in a position to evaluate the risk.

A law requiring a floating security interest equal to the wage claims, filed in a filing archive, would give the workers top priority at the same time that all prospective secured creditors could evaluate the impact of the unpaid wages on the creditworthiness of the firm. Not only would unpaid worker claims not damage the secured credit system, workers would be better off. Under the traditional bankruptcy system, typically workers are paid only after the fees and expenses of administering the bankruptcy. As these fees can be quite substantial, the worker under the recommended change need not fear that they will lose their paychecks to the bankruptcy process itself.

more effective and less expensive to society than are exceptions to first-to file priority; for many, they may also be fairer. They present the best case for limiting exceptions to the first to file rule. The difficult question they face is whether registration of claims of workers or purchase money secured creditors, or for taxes, due just before bankruptcy, is feasible.

214. Finally, the creditor contemplating taking security to reduce its risk wants to ensure that another creditor without security ranks lower. They do, in India¹⁹³ and Thailand.¹⁹⁴

E. Summary

215. In summary, the appropriate economic goal for the law is to enable the creditor to be confident about its priority and the debtor to demonstrate the priority at low cost. The creditor needs the highest priority, and any exceptions must be made only if no other method exists to protect legitimate interests of other claimants. Timing of priority varies depending on whether the interest is registered or not, with the not-registered not transparent to the creditor. The limited types of registered security interests in each country mean that the existence and ranking of many cannot be known with confidence. This is costly.

216. In the five RETA countries, the rules establishing priority vary in their usefulness. The priority of a registered security interest over other secured creditors depends on their nature. If the other secured interest is registered, the first-in-time registration rule for priority generally applies, with the big exception being India and another exception being Pakistan's ranking of fixed security interests over floating. If the other security interest is not registered and the collateral is in either the debtor's possession or creditor's (e.g., pledges), priority is not transparent. The priority problems with accounts receivable financing are legion and cases abound in which the country's law did not address a conflict or was not clear.

217. Rules for priority over the buyer vary among the countries. Only three countries of the five give priority to even a registered security interest, but one of the others (PRC) tries to protect the secured creditor in other ways (more collateral, for example).

218. Rules for priority over other claims in bankruptcy and reorganization often do not serve clarity and simplicity. The secured creditor is not clearly able to enforce its interests independently of the bankruptcy proceedings in two of the five RETA countries, which lower its priority and subject it to the cost of bankruptcy fees. Tax liens receive higher priority than security interests in three of the five RETA countries. Certain private liens and privileges automatically have a higher rank than security interests in four of the countries and even the fifth (Thailand) has one common exception. Deciding how to weight these other claims against security interests is difficult and requires balancing of different creditor interests. It appears that rather than reducing the priority of security interests, other approaches could meet the policy needs of existing priority rules without jeopardizing the huge volume credit that good laws on security interests could foster.

219. This review of the rules for priority reveals that, rather than being comprehensive, they apply to a limited set of security interests. India, like Pakistan, has a particularly fragmented regime to rank the priority of secured creditors or to register security in movables. The relevant law varies depending on whether the security is taken through one of the more conventional security devices (e.g. hypothecation, mortgage, and charge) or through one of the title-based hybrid security devices (e.g. hire purchase, financial lease). The Registration Act provides for optional registration of the written security interest but priority is not based on registration. As a general rule, a first-in-time creation determines priority.¹⁹⁵ Such a rule makes determination of the actual priority of security

¹⁹³ India Local Lawyer, citing Companies Act, 1956, §§530. §29.2.2.2.2.

¹⁹⁴ Thailand ILAG Reviewer #3. §29.2.1.1.

¹⁹⁵ See Registration Act, 1908 [India] §47. "Title-retention secured creditors (hire purchase, financial lease) are presumably an exception to this. They presumably enjoy a super-priority over competing secured creditors holding

interests nearly impossible because no public means exists for determining their existence. Some rules limit what economic entities may establish priority of in their movable property. For example, India, like Pakistan, limits its system of priority by registration to corporate debtors. Indian law subjects even its limited priority system to some important exceptions. For example, government claims may achieve priority over claims of antecedent secured creditors; and workers have a *pari-passu* claim with secured creditors.

220. The priority rules are complex rather than simple, with important gaps. In Indonesia, the *Fidusia* Law does not provide any guidance on the ranking of priority between the holder of the *fidusia* and the pledgee.¹⁹⁶ Title-retention hybrid security interests have gaps in the other countries as well. Such creditors may receive a superpriority status in collateral, e.g., as legal owners of collateral. However, because of the very nature of a title-retention security device, creditors can use title-retention security devices only to finance new and titled or specifically identified collateral. This excludes classes of goods of great economic importance, including used equipment, inventories, or crop. In addition, title-retention and trusts used as security devices in these countries limit the debtors use of any remaining equity value of the collateral as security for other loans.

221. The rules are sometimes contradictory. Two countries have simple and clear laws that are contradicted by other laws. PRC provides for first-to-register priority by registration for non-possessory security interests of any parties but its Civil Procedure Law sets out a contrary position: certain unsecured creditors have greater priority assignments than any secured creditors and will receive payment before them. For example, bankruptcy fees have first priority for payment, followed by wage and social insurance claims for employees, and then unpaid taxes. Thai law provides a simple and clear first-to-register priority rule but its bankruptcy law directs payment of certain costs and expenses first. In a company reorganization, a secured creditor may not enforce a security interest on an asset essential to the continued operation of the debtor without leave of court.

222. This means that the priorities among many security interests are not transparent. A potential creditor often cannot be confident about the ranking it would have if it used certain collateral for security. Among the five RETA countries studied, only Indonesia offers a simple system for setting priorities. Indonesian law provides a clear first-to-register priority rule under the *Fidusia* Law.¹⁹⁷ In addition, should bankruptcy occur, the *Fidusia* Law preserves the ranking of secured creditors.

223. None of the countries has a broad concept of security interest. The concept does not encompass all secured transactions. It does not rules for priority by registration that must apply to any transaction for purposes of security. Notably missing are hybrid security interests, such as conditional sales, leases, or trust, and the assignment of accounts receivable. Creditors and debtors use these hybrids for security in the five RETA countries. For example, Pakistan does not require registration for any lease, conditional sale, hire purchase, trust, lien or pledge created or executed by the companies or other debtors. In particular, the commonly-used trust receipt, given as security, remains unregistered as well. In Indonesia, creditors must register a fiduciary transfer, but the law does not require registration for other hybrid secured transactions or for the assignment of rights.

conventional security over after-acquired assets within the class covered by the title retention device. Although this is nowhere said expressly, it logically follows from the fact that Indian law does not consider the debtor to have any ownership interest in the collateral to which the prior after-acquired security interest could attach." Prof. C. Walsh memorandum, India, at No. 29.2.

¹⁹⁶ The Civil Code provides that a pledger cannot be liable if the grantor does not have capacity to perform the legal act of pledge. This will imply that a pledge is still valid, and it should prevail over the *fidusia* (Prof. U. Drobnić memorandum, at No. 29.2.1.2).

¹⁹⁷ The *Fidusia* Law expressly establishes that a creditor holding a registered *fidusia* has priority over other creditors. See *Fidusia* Law [Indonesia], Art. 27(1).

224. Hybrid security interests pose a problem for the potential creditor. It cannot know conclusively when creditors using hybrid interests have obtained a priority in the collateral because they do not need to file in a public registry. There is not a registry that potential creditors can search to find all claims in the collateral that may exist. Finding all claims would require a creditor to incur extra costs of investigation, with much less certainty than one would find by searching an archive. The only situation in which such search methods are effective is where clients can deal only with one creditor. So a financial system with few creditors and little competition is the price for using such property as collateral.

225. The result is not healthy for debtors. A debtor could offer valuable property as collateral and demonstrate that no prior claims exist. However, until the debtor satisfies the prospective creditor that the government has no tax claims against the debtor, and that all labor claims are current, and that bankruptcy is only a remote prospect, the creditor could not safely accept the collateral offered by the debtor. Such a system places an enormous burden of proof on the debtor, which is particularly difficult for small and poor debtors to satisfy. It leads creditors to refuse credit to firms facing liquidity problems, even though the firms might have excellent collateral—such as primary commodities of identifiable quality in clearly marked storage facilities. When creditors will not refinance illiquid firms, illiquidity can turn into insolvency. Ironically, the measure designed to save illiquid firms helps drive them into bankruptcy in the first place.

VII. PROBLEMS IN PUBLICIZING SECURITY INTERESTS

226. A first-to-file priority system requires that the law designate the place or means by which the system publicizes the security interest. This requirement drives a policy of broad public registration. As the preceding section shows, both creditor and debtor need to be able to demonstrate the rank of a prospective security interest at a low cost and a first-to-file system satisfies this need most efficiently.

227. Examples of designated places and means are found in broad public registration in various countries today. For this study, the system in Quebec is of interest because that province relies on civil law, as do PRC, Indonesia, and Thailand. Quebec established a single province-wide computerized system in Montreal to register movable real rights. Registration is organized by the grantor's name, rather than type of collateral, or interest, or legal entity. The interests it encompasses are "transfers of property in stock, agricultural and forest pledges, commercial pledges, . . . assignment of receivables, privilege of lessor in commercial lease, corporate trust deed floating charges and charges on movables, movables under hypothecary loans that were immovables. . . , installment sales, right of redemption, . . . [and] financial lease. . . ." Security interests in automobiles, however, are registered by serial number.¹⁹⁸

228. In the absence of such a system, no practical way exists to determine who files first. Many other systems have been used over the years, including taking possession of collateral, public announcements, advertisements in newspapers, and other public postings. However, most modern systems revolve around registries or filing systems that let any potential creditor quickly determine whether the collateral offered by the debtor has prior security interests. Publicity by possession requires transfer of the collateral to the creditor, and thus, proves very inconvenient for most economically important transactions. For these transactions, the establishment and functioning of the filing system becomes crucial.

¹⁹⁸J. Claxton, *Security on Property and the Rights of Secured Creditors under the Civil Code of Quebec* (1994), at 253-255.