

VII. TRANSACTIONAL SCOPE OF A MOVABLES REGISTRY

A. The Range of Transactions Included

211. An aspect of the design of a movables registry is the determination as to the types of transactions that are to be included in its scope. Transactions involving specific types of property may be excluded because of their specialized nature and the types of property involved. Most countries have stand-alone registries for ship mortgages or charges on aircraft. Where there exists an ownership registry for specific types of movable property, it is often better to require registration of charges against that property in the ownership registry. Reference to these types of registries is made in para. 241. Transactions may be excluded because there are other mechanisms through which charges on the property affected are disclosed to third parties. Countries that have paper certificate of title systems for motor vehicles frequently provide that charges on vehicles are to be recorded on the paper titles. Another reason for excluding certain types of transactions from registration requirements is that they involve small amounts of money. The costs involved in registering interests arising under these transactions exceed the benefits associated with registration. The risk to third parties of acquiring interests in property subject to a charge are not significant or can be addressed in another way.

212. It is common to include within the scope of a registry certain transactions that are functionally equivalent to charges against movable property. The reason for doing so is that a registry provides a system for giving public notice of the existence of interests in property thereby reducing the legal risk associated with transactions involving that property. These transactions are discussed in paras. 222 to 236.

B. Exclusion of Possessory Pledges

213. A movables registry reduces the legal risk inherent in nonpossessory charges thereby enabling debtors to utilize the full range of their movable assets as collateral. However, the possessory pledge remains a useful form of security for some types of collateral, for instance, luxury tangible items, negotiable instruments, share certificates and documents of title such as bill of lading.

214. Modern secured transactions regimes almost invariably excuse secured creditors who take possessory security from having to register in the movables registry. Since the debtor no longer has possession or control of the collateral, unauthorised dispositions of the collateral become impracticable, and creditors and other third parties cannot in any event complain about being misled by their reliance on the debtor's possession.

215. Although the effectiveness of possessory pledge transactions need not depend on registration, they should not be excluded from the substantive scope of a modern secured financing law. To ensure a complete and coherent regulatory framework, substantive guidelines are needed at the level of enforcement, and, most importantly for present purposes, priority ordering.

216. When, for example, a priority contest arises between a secured creditor who has registered a nonpossessory charge and one who has taken a possessory pledge in the same item of collateral, the most logical solution, and the one that most satisfactorily protects the interests of both creditors, is to order priority according to the order of registration and the taking of possession. In other words, the claim of the creditor that was first to either register or take possession of the collateral has priority. The operation of such a rule is illustrated by the scenario that follows.

Box VII-1

Scenario 11: Ordering Priorities between a Possessory Pledge and a Registered Nonpossessory Charge

On 1 June, Secured Creditor 1 acquires a charge in certain assets owned by Debtor and immediately takes possession of the collateral.

By 1 July, Debtor is in need of further financing and applies to Secured Creditor 2 for a loan secured by the assets already pledged to Secured Creditor 1.

After verifying that there are no other registered charges against the same assets, Secured Creditor 2 agrees to extend credit and promptly registers notice of its charge.

As part of its risk assessment exercise, a secured creditor should verify the actual status of the assets offered by a debtor as security. Merely checking to see that there are no competing registered charges is insufficient. Had Secured Creditor 2 demanded verification of the existence of the collateral, it would have learned that Debtor no longer had a possession and would have realized that the Debtor's title might be subject to a competing encumbrance or other claim by the person now in possession.

217. Possession by a secured party does not guarantee priority. In the converse situation where the debtor creates a nonpossessory charge in favor of Secured Creditor 1, who registers promptly, and then purports to grant a possessory pledge in the same assets in favor of Secured Creditor 2, priority should be given to Secured Creditor 1. As part of any prudent risk assessment exercise, Secured Creditor 2 should conduct a search of the movables registry rather than simply relying on Debtor's possession.

218. Registration and possession should not be equivalent where the collateral consists of money or a negotiable document or instrument. To avoid interference with commercial negotiability, priority in such cases should normally be given to the secured creditor who first takes possession of the collateral in the ordinary course of business whether or not a prior charge was registered.

C. Substance over Form in Characterizing Nonpossessory Charges

219. When defining the scope of a movables registry, designers should avoid a purely formalistic approach under which transactions that in substance, but not necessarily in form, constitute a nonpossessory charge would nonetheless fall outside the applicable registration and priority-related rules. If this is allowed to happen, the risk-reduction and priority-ordering benefits of the registry system will be seriously and unnecessarily limited.

220. Where, for example, a debtor purports to grant a possessory "pledge" in specific collateral in favor of a creditor, but retains actual possession or control as "agent" of the creditor, the so-called pledge raises the same publicity concerns for third parties as a nonpossessory charge and should be subject to the same registration and priority rules. Otherwise, existing

creditors, as well as prospective buyers and secured creditors, have no means of knowing which assets in a debtor's possession may in fact have been pledged.

221. Similarly, where the debtor conveys title to an asset to a creditor under a "sale" or "trust", but retains possession on the understanding that if the debtor's credit obligation is satisfied the sale or trust is to be considered resolved, once again, notwithstanding the formal label applied to these transactions, they are in substance indistinguishable from a nonpossessory charge and should be regulated according to the same set of registration and priority rules.

D. Functional Equivalents: Title Retention Sales, Financial Leases, and Similar Functional Equivalents

222. Even in legal systems that adopt a substantive approach to characterization, the concept of a charge for the purpose of registration and priority may be limited to collateral owned by the debtor. Security achieved by reservation of title by the creditor, for instance, title retention sales and leases or hire-purchase agreements, are exempted.

223. These exclusions are commercially unjustifiable since such transactions raise the same publicity concerns as conventional nonpossessory charges. Unless these other transactions are brought within the scope of a registry-based priority regime, third party searchers cannot rely on a search of the registry records to determine which assets in the debtor's possession are in fact subject to a prior creditor's ownership. This is considered in the scenario below.

Box VII-2

Scenario 12: Increased Legal Risk Posed by Exclusion of Title-Reservation Sale and Lease Arrangements from a Movables registry

On 1 June, Debtor takes delivery of equipment for use in his business from Seller. Under the terms of the sale agreement, Seller is to retain ownership of the equipment until the purchase price is paid in full.

On 15 June, Debtor takes delivery of a second item of equipment for use in his business from Lessor for a lease term of 3 years.

On 1 July, Debtor is in need of additional financing for his business and obtains a loan from Secured Creditor. To secure repayment, Secured Creditor takes a charge in the two items of equipment that were supplied to Debtor by Seller and Lessor. Debtor fails to tell Secured Creditor that he does not have title to these items.

Debtor's business falls into financial difficulty and Debtor defaults in his payment obligations to Secured Creditor, Seller, and Lessor. When Secured Creditor attempts to enforce its charge, it discovers that Seller and Lessor have already repossessed and resold their equipment. When Secured Creditor complains, Seller and Lessor point out that Debtor had no right to create a charge in favor of Secured Creditor in equipment that Debtor did not own.

224. Because secured creditors in the position of Secured Creditor in this scenario have no objectively reliable means of determining whether assets in a debtor's possession are subject to a supplier's retention of title agreement, they will need to factor this additional risk into their decision to extend credit. Prospective buyers, as well as judgment creditors and the debtor's insolvency administrator, suffer from a similar information deficit.

225. A secured transactions regime that requires disclosure of title-retention sales and leases by public registration offers an efficient and simple solution to the problem.⁴¹ By making registration a precondition to the effectiveness of the retention of title against third parties, third party creditors prospective buyers and charge holders can confidently rely on a search of the registry. Retention of title creditors are not, however, approximated to secured creditors for all purposes. In particular, they form an exception to the first-to-register rule of priority among competing secured creditors. In the scenario just considered, unqualified application of a first-to-register rule would mean that Secured Creditor would have the first right to payment of the value of the equipment supplied by Seller and Lessor. This is generally considered unfair since Debtor would not have acquired this asset without the credit financing supplied by Seller and Lessor. Moreover, such a rule would chill the credit market for instalment selling and leasing.

226. In fact, virtually every legal regime protects Seller and Lessor in this scenario. Sometime this is done through the creation of a special exception to the first to register rule in favor of creditors who finance the debtor's acquisition of the very collateral in which security is taken, whether by way of sale, lease, or charge. A description of this approach is contained in paras. 49 to 55.

E. True Long-Term Leases

227. There is a sound commercial basis for subjecting all long-term leases of movables (e.g., leases that run in excess of one year) to the same registration and priority rules that apply to title retention sales and financing leases. Even when a lease does not operate as the functional equivalent of a charge or title retention sale, the separation of ownership and possession raises equivalent publicity concerns for third parties dealing with the lessee in possession.

228. However, true leases should be excluded from the default enforcement rules of the secured transactions law associated with the movables registry; that is, the legal rules determining a charge-holder's right to have collateral seized and sold to satisfy the obligation secured. The enforcement regime is designed to protect the interest of the debtor and subordinate creditors in the debtor's residual ownership of the charged property. That policy objective is clearly inapplicable in the case of a true lease since the lessor does not merely own the leased asset in a technical formal sense but is meant to retain the full benefit of the economic incidents associated with residual ownership.

F. Assignments of Monetary Receivables

229. The monetary claims owing to an enterprise, for instance, its trade receivables, are a common form of collateral in secured financing transactions. However, instead of charging its receivables, a business may instead elect to raise capital by selling its receivables outright at a discount. The fact that the enterprise no longer "owns" its accounts may not be evident to third parties, including potential secured creditors, especially if the assignor continues to collect the accounts as agent for the buyer. This is considered in the scenario below.

⁴¹ For example, see section 17 of the New Zealand Personal Property Securities Act, reproduced in Appendix B.

Box VII-3**Scenario 13: Increased Risk if Assignments Excluded from Movables Registry**

On 1 June, Debtor sells its present and future accounts receivable to Assignee, with payment to be made on an ongoing basis as the accounts arise. The parties agree that that Debtor will continue to collect the accounts as agent for the Assignee, and then remit the proceeds of collection to Assignee.

On 1 July, Debtor grants a charge to Bank in all its present and after acquired movable property, including claims.

Debtor falls into financial difficulties and defaults in its payment obligations to both Assignee and Bank. When Bank attempts to enforce its charge by collecting on the accounts owed to Debtor, it finds out for the first time about the prior assignment to Assignee.

230. Application of the registration and priority rules applicable to charges to assignments of monetary receivables enables third parties, including prospective secured creditors and competing assignees, to rely on the absence of any prior registration to reliably assess the priority of their own interest. This is particularly valuable in the securitization context because it ensures that special purpose vehicles' and investors' claims against transferred financial assets are superior to any third-party claims. If a company seeking financing by way of securitization is located in a jurisdiction that does not have a movables registry to disclose both assignments and charges, investors will instead have to rely on the company's representations that the securitized assets have not already been charged or sold. This greatly increases the legal risk posed by debtor fraud or carelessness.

G. Commercial Consignments

231. Depending on the extant commercial practices of a particular country, other nonpossessory transactions may raise equivalent publicity concerns even though they, too, are not secured transactions even in a functional sense.

232. Where, for example, movables are consigned to a commercial agent for sale, in the absence of registration, creditors and other third parties dealing with the consignee (agent) have no means of knowing that the inventory does not belong to their apparent seller. The only exception to this is where it is widely known that the particular agent deals only in consigned goods, such as in the case of auctioneers and art dealers.

233. Commercial consignments are merely offered as an example. Much depends on commercial practices in particular countries. The general objective remains the same. The idea is to capture within the registry system commercial dealings in movable assets that are apt to create difficulties for third parties in determining whether the person in possession or control of the asset holds title.

234. Nonpossessory interests created under movables assignments, consignments, and equivalent transactions should be included in a Registry system only for purposes of setting priorities. As in the case of true leases, these transactions should be excluded from the default enforcement rules of the secured transactions law associated with the registry. A secured transactions enforcement regime is designed to protect the interest of the debtor and subordinate creditors in the debtor's residual ownership of the charged property. That policy objective is clearly inapplicable in the case of nonsecurity transactions, since the assignee, lessor or consignor, as the case may be, not only owns the charged property outright in the

formal sense, but is also meant to retain the full benefit of the economic incidents associated with ownership.

H. Judgment Liens and Other Security Rights Created by Law

235. A number of regimes also permit a judgment creditor to register a notice of judgment for movables in the movables registry, with registration creating the priority equivalent of a general charge against the judgment debtor's movable assets.⁴² This approach indirectly promotes the prompt satisfaction of judgment debt without the expense and burden of having to pursue active judgment enforcement measures. Once publicized by registration, the judgment debtor cannot easily dispose of its assets to third parties, or use them as the object of consensual security, without first paying the judgment debt and terminating the prior-ranking registered judgment creditor's claim.

236. Whether the scope of the movables registry should extend to other types of nonpossessory security created by operation of local law—for instance, tax or vendor or employee wages liens—depends on the public policy of each country. If local law gives the relevant type of security super-priority over even prior registered charges, there may be little point in requiring registration since prior secured creditors will be subordinated in any event. Nevertheless, registration would at least contribute to the more orderly enforcement of debt by judgment creditors and insolvency administrators.

I. Linkage to Immovable Registries

237. It is common for a charge agreement to cover the debtor's immovable as well as movable assets. This raises the question of whether it is feasible to design a system in which registration of interests in immovables and movables are combined so that only one registration would be required.

238. While some of the registry issues that arise in the context of charges on movables are also associated with the registration of mortgages and charges on land, any attempt to have a common registry structure will be met with considerable difficulties. The structure and functions of the two types of registries usually differ in important respects. The principal registration-search criterion in an immovables registry is the unique identifier attached to each specific parcel of land. In a pure movables registry, a debtor identifier is the only universally used criterion (collateral identifiers are used, if at all, only for limited categories of tangible high-value assets). Furthermore, an immovables registry is designed to disclose the current state of title to the relevant parcel, as well as any mortgage or charge on that title, whereas title is not addressed in a pure movables registry. The use of generic after-acquired collateral descriptions that is an important feature of registration in a modern movables registry is not possible in connection with registrations in an immovables registry.

239. This is not to say that it would be impossible to establish a linkage between the two systems. If the land registry incorporates a name index, in addition to one indexed by reference to individual land parcels, it would be possible to conduct searches in both systems. On the other hand, there might be a natural reluctance on the part of the immovables registry administrators to give binding effect to information registered only by name without some means of generating a cross-reference to the exact parcels of land affected.

⁴² For example, see Sections 2.2 to 2.6 of the New Brunswick Creditors' Relief Act, reproduced at: <http://www.gnb.ca/justice>.

240. One linked issue which ideally should be addressed in the reform process is the question of taking a movables charge in assets that sit at the borderline between land and movables: notably, movables affixed to a building or structure without losing their identity, and growing crops intended for harvest. Ideally, debtors should be entitled to enjoy the flexibility of movables secured transaction law to grant an effective security in this form of collateral. Yet the law must also avoid prejudice to the underlying land interests. This is usually accomplished through a system of dual registration, in which notice of the movables charge on the fixtures or crops must be cross-indexed in the land registry to take effect as against those dealing with the land.⁴³

J. Charge Transactions Subject to Specialist Movable Registries

241. Similar considerations create difficulties in co-ordinating or integrating registrations as between a general movables registry and the kind of asset-specific title registries that a number of jurisdictions have established for particularly high-value movables such as boats, aircraft, intellectual property, and in some cases even motor vehicles. For specific tangible assets, these difficulties are surmountable if the general movables registry is designed to permit supplementary registration and searching by reference to a unique identifier for the relevant asset, assuming that the same numerical or other identifier constitutes the registration-search criterion in both systems.

242. Whatever approach is taken, a comprehensive secured transactions regime must expressly stipulate the extent to which registration in an asset specific title registry pre-empts registration in the general movables registry, and the two priority regimes must be coordinated. For example, the law could make registration in the specialist title registry a precondition to the effectiveness of a charge against buyers and competing secured creditors who register against the specific title, but provide that registration in the general movables registry is sufficient to protect the charge against unsecured creditors or the debtor's insolvency administrator.

243. The scope of national movables registries will be limited in countries that ratify the *Convention on International Interests in Mobile Equipment, 2001* and associated *Protocol on Matters Specific to Aircraft Equipment*.⁴⁴ They provide a body of international substantive law, including a priority regime based on a central international registry system, regulating four types of commercial financing transactions involving large aircraft airframes and large aircraft engines:⁴⁵ transfers of ownership,⁴⁶ security agreements, and leases and title retention sales agreements. The Convention applies as well to assignments of these types of transactions and their associated rights. In countries that ratify the Convention, the national charge registration

⁴³ For example, see sections 36 and 38 of the *The Saskatchewan Personal Property Security Act, 1993*. This legislation is reproduced at: www.qp.gov.sk.ca.

⁴⁴ See, generally, www.unidroit.org.

⁴⁵ The Convention has been designed to accommodate protocols relating to other types of equipment. Article 2(3) of the Convention lists 3 categories of equipment to which it will apply: aircraft objects (airframes, aircraft engines and helicopters), railway rolling stock and space assets. Resolution No.3 of the Final Act of the Diplomatic Conference provides for early completion of protocols dealing with railway rolling stock and space assets and expedited procedures leading up to diplomatic conferences at which they would be adopted. Article 51 provides for the development of additional protocols dealing with other types of high-value mobile equipment.

⁴⁶ The Convention itself does not address transfer of ownership of aircraft objects. However, the effect of Article III of the Aircraft Protocol and Article 41 of the Convention is to bring within the priority and registration provisions of the Convention sales of aircraft and aircraft engines. While this feature will not provide a title registration system for these items, it will have this effect with respect to aircraft and engines purchased from manufacturers after the Convention and Protocol come into effect. A potential buyer will be able to search the "chain of ownership" from the manufacturer to the seller. A person who buys on the strength of this information will take free from an intervening transfer of ownership that has not been registered.

and priority law will be largely pre-empted to the extent of these types of transactions and collateral.

244. As of the date of publication of this Guide, the *Convention on International Interests in Mobile Equipment*, 2001 and associated *Protocol on Matters Specific to Aircraft Equipment* have not yet come into effect. The international registry for interests in airframes and aircraft engines has yet to be established. Available information indicates that the instruments will come into effect in 2003.

245. The international registry will be a single central registry for interests created under transactions by debtors, lessees, and buyers located in states that ratify the Convention and Protocol. It will be a completely electronic registry with registration and searches based principally on the manufacturers' serial number of airframes and engines.

246. Priority among international interests (i.e., the interests of secured creditors, lessors and title retention sellers) will be based on a simple first-to-register rule. Unregistered interests will be subordinated to registered interests or to the interests of buyers. Special provision is made for the recognition of national nonconsensual liens and charges that affect aircraft.

247. The registration and priority rules of the Convention and Protocol will apply even though all aspects of a transaction are situated within a single country. The factor that invokes the system is the location of the debtor in a contracting state. Secured creditors, lessors and title retention sellers need not be located in or carry on business in a contracting state in order to have the benefits of the international system created by the Convention and Protocol. They will be able to have all of the advantages of the registry and enforcement system provided in the instruments.

248. The principal benefits of the Convention and Protocol will accrue to national governments that operate airlines and private aircraft operators who must obtain international financing for the acquisition of aircraft. It is expected that the Convention and Protocol will bring to international aircraft financing many of the benefits that an electronic movable registry of the kind described in this Guide provides for domestic financing transactions. The reduction in legal risk that the registration system and priority rules of the Convention and Protocol will provide will be as strong an inducement for countries to become contracting states. Reduced risk will be reflected in greater ability to get aircraft financing and in lower credit costs.