

The Organization of American States' Model Inter-American Law on Secured Transactions

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The Organization of American States' Model Inter-American Law on Secured Transactions

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I. Introduction: the Inevitability of the Modernization of Secured Transactions Law

Two forces make the modernization of secured transactions law inevitable for countries whose economies wish to remain competitive; one is market driven, the other is regulatory. Market-driven forces require that those who wish to compete in an increasingly global and competitive arena keep the costs of their products or services as low as possible. The high interest rates caused by high commercial, legal and political risks disqualify many a hopeful competitor. Later in this article, reference will be made to a Central Bank of Brazil 1999-2000 study which estimated that fully one third of the approximately 40% per annum interest rate paid by Brazilian commercial borrowers is attributable to legal uncertainties of collection.¹

Regulatory forces are promoting the modernization of secured transactions law by imposing both standards of capitalization and transparency of information regarding the lenders' assets. Thus, access to competitive sources of commercial credit is being increasingly restricted by regulatory forces only to those debtors who can provide the most liquid and certain sources of repayment. The capital adequacy of banks (and thereby their ability to lend) is now measured nationally and internationally by standards that weigh the risks of loans (among other assets) on the basis of their collateralization. Similarly, the standards of transparency and disclosure of financial information to which banks are now being subjected by their central banks (and central banks by the international bodies they need to borrow from) require that loans be classified by taking into account the quality of their collateral. The net effect of these regulatory forces is to limit the ability to lend of those lenders who are inadequately collateralized and/or inadequately report their collateralization. The day is fast approaching then, when only those lenders who are protected by a modern secured transactions law such as that set forth in the Organization of American States ("OAS") model law (hereinafter referred to as the "Model Law") will be able to provide credit at competitive rates in their local, regional or hemispheric markets.

II. Why the OAS Model Law is a Modern and Effective Secured Transactions Law: Its Conceptual Bases

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¹ DEPARTAMENTO DE ESTUDIOS E PESQUISA, BANCO CENTRAL DO BRASIL, JUROS E SPREAD BANCÁRIO NO BRASIL (1999) (hereinafter referred to as the "BCB Study").

A. The English Eighteenth Century Commercial Loan as an Early Prototype of the Commercial Self-Liquidating Loan

Although the possessory pledge as a device to secure consumer loans is of ancient origin, the commercial, non-possessory loan was an eighteenth century English invention.² Its real estate counterpart, the real estate mortgage loan, was of longer duration. It relied on immovable assets, such as land or buildings, as collateral. Typically, it lasted a number of years during which the value of the collateral was assumed to remain steady or to increase. In contrast, the commercial non-possessory loan was for a period of time measured in days and months and only occasionally in years. Its collateral was movable and often perishable or quickly depreciable in value.

Reliance on saleable goods as collateral was consistent with the self-liquidating nature of the English secured commercial loan. Self-liquidation meant that the loan was to be repaid from the proceeds of the resale of collateral, which consisted of business assets such as inventory, accounts receivable and equipment. Significantly, the very business assets that made repayment possible were those whose acquisition was made possible by the commercial loan.

The merchants who participated in shaping the eighteenth and nineteenth century English commercial secured loans included: 1) goldsmiths, who lent on the collateral of jewelry which most often remained in their possession until they were repaid; 2) general or unspecialized bankers, who lent to merchants and often took as security a non-possessory pledge of their borrowers' inventory known as the "floating charge"; 3) "merchant bankers," who lent on the security of documents of title such as bills of lading and warehouse receipts and on the security of the goods and proceeds that resulted from selling the documents or the goods; and 4) the "factors," who lent on the strength of

² The view of commercial loans (extended to "able" men) as self liquidating, and of retail trade and consumption loans as dependent upon the honesty of "good" men which became part of the Bank of England's credit policies was articulated in the following two excerpts from NICHOLAS BARBON, *A DISCOURSE OF TRADE* (1690), *reprinted in MONEY AND BANKING IN ENGLAND*, B.L., at 132 (Andersen & P.L. Cottrell ed., 1974):

"There are Two sorts of Credit; the one is Grounded upon the Ability of the Buyer; the other, upon the Honesty: The first is called a Good Man, which implies an Able Man; he generally buys upon short Time; to pay in a Month, which is accounted as ready Money, and the Price is made accordingly. The other is accounted an Honest Man; He may be poor; he Generally buys for three and Six Months or longer, so as to pay the Merchant by the Return of his own Goods; and therefore, the Seller relies more upon the Honesty of the Buyer, than his Ability: Most of the Retail Traders buy upon this Sort of Credit, and are usually Trusted for more than double they are worth."

For a contemporary analysis of the attraction of self-liquidating paper for central bankers, and especially for the Bank of England, see R.S. SAYERS, *MODERN BANKING* 182-87 (7d., 1967). For a historical and comparative background, see Boris Kozolchyk, *The Transfer of Personal Property by a Non-Owner: Its Future in Light of its Past*, 61 *TULANE L. REV.* 1490-1499 (1987) (hereinafter cited as "Kozolchyk, Transfer").

commercial and consumer accounts receivable either in the form of invoices or bills of exchange and promissory notes. The credit given by these bankers and factors stood in sharp contrast with that of “moneylenders.” Moneylenders lent mostly to consumers; their loans were often unsecured, and they charged higher rates of interest than that charged by bankers and factors.

Nineteenth century English practices already evinced a fully-fledged credit pyramid. Retailers, moneylenders and their consumer borrowers were at the base; wholesalers and their bankers and factors were found at the next ascending levels. At the top of the pyramid was the Bank of England as lender or discounteer of paper produced at the lower levels of the pyramid. These practices, however, were not fully recognized by statutory or decisional law. Some of the most important practices, like the lender’s “floating charge” over a merchant’s inventory, remained uncodified and provided insufficient notice to secured creditors and bona fide purchasers. Even as recently as Charles Dickens’ time, the debtors’ prison was still a means for enforcing the collection of commercial and consumer loans.

B. The Twentieth Century United States Commercial Loan as the Prototype of Contemporary Secured Lending

Twentieth century United States commercial lending added more levels and intermediaries to the English credit pyramid. To begin with, United States banks were more numerous and less specialized than the English banks. Instead of the “city,” “merchants,” “clearing” and other types of banks whose total number did not exceed one hundred, the number of banks engaged in commercial lending during its twentieth century apogee in the United States exceeded 15,000. On the other hand, the factoring business in the United States became specialized, some factors lending only to certain trades and some on a “recourse on the borrower” basis, while others lent on a “non-recourse on the borrower” basis. Trade in the Great Lakes produced a method of financing known as the “trust receipt.” It allowed the buyer-borrower to repay his secured debt by reselling or manufacturing and reselling the imported goods or parts thereof after obtaining the release of the documents of title from the secured debtor “in trust.” The secured creditor who had released the documents of title to the secured debtor “in trust” acquired the right to trace and collect whatever proceeds were obtained by the trust receipt debtor from his resale or exchange of the goods. In addition, in the decades following the Second World War, consumer lending grew exponentially in the United States, especially after banks introduced credit cards and “personal lines of credit.”

Widespread consumer credit at reasonable (or near to the commercial) rates of interest made it possible to finance not only consumer purchases from retailers, but also retailers’ purchases from wholesalers, wholesalers’ purchases from manufacturers and, finally, manufacturers’ production. Presently, the supply and demand of commercial and consumer credit in the United States is such that any goods or services with ascertainable and obtainable value in the marketplace are acceptable collateral, including future inventory, accounts receivable, proceeds, intangible objects such as good will, rights to

the performance of contracts, dematerialized investment securities and intellectual property of all types, including royalties.

C. Legal Principles that Govern the United States and Canadian Law of Secured Transactions from a Civil and Especially Roman Law Perspective

While Anglo-American and Latin American secured transactions law share some common principles, especially on possessory pledges, other principles diverge sharply. The cause of the divergence can be traced, ultimately, to a different conception of social wealth. To this day, Latin American secured transactions law is influenced by a version of wealth that regards real property as the most important social and business asset and the real estate mortgage as the queen of all security devices. The importance of the rights in real estate is such that in many Latin American jurisdictions they are listed by the legislator in an exclusive or closed number fashion (*numerus clausus*).³ In contrast, personal or movable property is regarded by the mostly 19th century civil and commercial codes as less valuable if not “vile” property (*res mobilis, res vilis*) and the possessory pledge is paid little attention by the codifier; it is considered a device used by subjects with a social status as low as that of pawnshop operators.

Such a conception stands in sharp contrast with that which shapes the Canadian and United States law of secured transactions. While real estate continues to be a highly valuable asset in these two countries, so are tangible movable goods such as equipment and inventory and intangible rights such as those in the performance of valuable contracts (including those involving real estate), in the royalties derived from the use of intellectual

³ See Art. 2502 *et seq.* of the Arg. Cod. Civ. “Article 2502: Rights *in rem* can only be created by law.” “Article 2503: The following are the rights *in rem*: 1. Dominion and condominium; 2. Usufruct; 3. Use and habitation; 4. Easement; 5. Mortgage; 6. Pledge; 7. Antichresis; 8. Forest area.” “Article 2505: The acquisition or transmission or rights *in rem* on real estates, will only be considered perfected by the inscription of the respective titles in the real estate registries of the corresponding jurisdiction. Such acquisitions or transmission are not valid before third parties until they are registered.” In <http://www.derechoargentino.com.ar/codigo_civil.htm> (accessed June 14, 2002). Similar wording can be found in art. 732 of the Chilean Cod. Civ.: “Article 732. The dominium (defined in Article 582 as “property”) can be limited in various ways: By the encumbrance of usufruct, use or habitation, to which a person has right over the things that belong to another; and by the easements.” In <<http://colegioabogados.org/normas/codice/codigocivil2.html>> (accessed June 14, 2002). Other Civil Codes such as the Mexican C.C.F. <<http://www.cddhcu.gob.mx/leyinfo/2/>> (“C.C.F.”), the Ven. Cod. Civ. (in <http://fpantin.tripod.com/index-24.html>) (“CCV”) and the Bol. Cod. Civ. (in <<http://www.cajpe.org.pe/RIJ/bases/legisla/bolivia/ley11.HTM>>) (“CCB”) do not specifically list the rights *in rem* as clearly as the Argentinean Code does, but they do include various articles outlining the limited rights *in rem* that can be created on real estate property and they also include a detailed list of the documents that create rights *in rem* that must be registered to be enforceable. For example see: (i) C.C.F. arts. 980-1048 (usufruct), 1049-1056 (use and habitation), 1057-1134 (easements); (ii) CCB arts. 216-249 (usufruct), 250-254 (use and habitation) and 225-290 (easements); and (iii) CCV arts. 582-623 (usufruct), 624-631 (use and habitation), 632-643 (home), 644-758 (easements).

property or from the capital gains or dividends derived from the acquisition or sale of investment securities.

In discussing the following principles that underlie Anglo-American secured transactions law with Latin American jurists, one of the writers found it useful to formulate them in comparative fashion. The comparison with Roman law showed that many of the Roman legal institutions that helped to shape contemporary Latin American secured transactions law were more compatible with contemporary Anglo-American secured transactions law and with the proposed Model Law than the Latin American law they influenced.⁴

1. An Open Number of Collateral Goods and of Rights In Rem or Ad Rem

In contrast with the limited number of rights *in rem* in Latin American real property law, the “security interests” (or rights in the collateral) that can be acquired in personal property under United States law are open in number.⁵ Any goods⁶ or services⁷, which have value in the marketplace, can become collateral; and unlimited security interests in them can be granted at the same time to an unlimited number of secured creditors. This means that the goods or services that comprise the collateral can exist at the time of execution of the security agreement and can thus support the creation of rights *in rem* or can come into existence in the future thereby supporting the creation of rights *ad rem*.⁸ Similarly, these goods can be encumbered with past, present or future debt. They can comprise an entire estate (or “universality of goods” in civil law terminology) or just specified categories or types of goods or services.⁹ They can also include goods derived from the sale or exchange of existing goods or services without limitation as to the number of re-sales or exchanges.¹⁰

2. A Security Interest is not an Ownership, but a Possessory Right to the Collateral

a) Possessory Rights in Collateral and the Influence of the English Notion of “Time in the Land”

As heirs to the English, feudally inspired common law, United States lawyers are used to thinking about rights in land-based estates as nothing more than “time in the land.”¹¹ By “time in the land,” the English conveyancers and judges meant rights in land whose fee

⁴ See, Boris Kozolchyk, *What to do About Mexico's Antiquated Secured Financing Law*, 12 ARIZ. J. INT. & COMP. L. 523 (1995), see also: Boris Kozolchyk, *The Basis for the Proposed Legislation to Modernize Secured Financing in Mexico*, U.S.-MEX. L.J. (1997).

⁵ UCC § 1-201(37), UCC § 9-109 (all references to UCC §9 are to the revised article 9, 2000 Revision).

⁶ *Id.* § 9-102(a)(44) & official comment UCC § 9-102(4)(a).

⁷ *In re C.C. & Co., Inc.*, 86 B.R. 485, Bkrcty. E.D. Va. (1988).

⁸ UCC § 9-204.

⁹ *Id.* § 9-108.

¹⁰ *Id.* § 9-205.

¹¹ *Walsingham's Case* (1579) 2 Plowd. 547, 555, 75 E.R. 805, 817 (Exch.) cited in *Law Reform Commission of British Columbia, Report on Co-ownership of Land* (1988), at <[www.bcli.org/pages/publications/lrcreports/reports\(html\)/lrc100endonotes.html](http://www.bcli.org/pages/publications/lrcreports/reports(html)/lrc100endonotes.html)> (accessed June 10, 2002, on file with author).

simple absolute (or absolute ownership in civil law parlance) belonged to others. This notion echoes what Roman law lawyers refer to as possessory rights or *iura in re aliena*. These are also rights in property owned by others, and even though they were lodged below the exalted level of *dominium* or absolute ownership they were also lodged above the level of rights of detention or of physical (albeit legitimate) control of real or personal property.

Among the rights *in rem* in property that belonged to others were the Roman usufruct, which could be granted for the life of its beneficiary or for the life of third parties and the predial servitudes. However, unlike the English common law which regarded time in the land rights as transferable and saleable by their holders, Romans, as a rule, regarded the usufruct and analogous rights as personal to their beneficiary and therefore non-saleable.¹²

b) “Security Interests,” Possessory Rights and the *Animus Possessionis*

During the second half of the 20th century, United States lenders, borrowers, legislators, judges and legal commentators transformed multiple “time in the land” types of rights as held by conditional sellers, chattel mortgagees and, holders of factors liens and of trust receipts, among others, into a unitary right known as a security interest in personal property. From a common, as well as from a civil, law standpoint, what the secured debtor conveys to his secured creditor in a “security interest” is not an ownership, but a possessory right in personal or movable property. This right, unlike the Roman usufruct, can be transferred in some cases by assignment and, in others, by negotiation.

The fact that only a possessory right is required for the creation of a security interest allows a large number of borrowers to become secured debtors: Installment buyers, buyers of goods yet to be manufactured, borrowers who hold rights to future goods, holders of documents of title or commercial paper, obligees of contractual rights including accounts receivable, holders of intellectual property rights and beneficiaries of letters of credit can all become secured debtors. Their requisite possessory intent is not Savigny’s “*animus domini*” (or intent to possess as an owner)¹³ but von Jhering’s “*animus possessionis*” as an inseparable element of the possessor’s physical control,¹⁴ or

¹² As stated by J.A.C. THOMAS, TEXTBOOK OF ROMAN LAW, 206 (North-Holland Publishing Company) (1976): “...legacy was the original and commonest source of these rights but they could also come into existence by *cessio in iure*, *deductio* in a *mancipatio* or *adiudicatio* in a divisory action...in the later empire a paterfamilias had a usufruct in property given to members of the family...” Typical of the personal features of these *iura* was that they would end not only with their specified duration but also with the death or the *capitis diminutio* of their holder.

¹³ See, FRIEDRICH KARL VON SAVIGNY, DAS RECHT DES BESITZES, Westport, Conn. Hyperion Press (1848) Erskine Perry trans., reprinted S. Sweet, London (1979).

¹⁴ See, RUDOLPH VON JHERING, UEBER DEN GRUND DES BESITZESCHUTZES. EINE REVISION DER LEHRE VOM BESITZ (1869), reprinted Aalen Scientia (1968).

a mere awareness of one's control, as was the case with Roman law tenants at suffrage and pledgee-creditors, among others.¹⁵

c) Security Interests and the Fragmentation of Ownership of Personal Property

The Anglo-American concept of a "security interest" was a response to the demands on the financial marketplace pressed by the mass merchandising of consumer goods. Widespread extension of credit to consumer-buyers required that the seller's *dominium* over the goods sold be split between him and his installment buyer. The seller would retain "title", while the buyer would obtain the possession of the goods sold.¹⁶ As stated by a Costa Rican housewife with respect to her purchase of a Singer sewing machine (one of the first mass merchandised products in Central America shortly after the First World War, "They (meaning the sellers) have a paper with my signature on it and I use this machine to make a living."

However, this was only the beginning of fragmentation. As of the middle of the twentieth century when negotiable ocean bills of lading and warehouse receipts came into widespread use, the rights of ownership of shipped or stored goods were also "fragmented" into ownership and possessory rights, the latter often prevailing over the former. Thus, a seller-exporter of goods who "retained" title to the goods shipped could no longer recover "his" goods from a holder in due course of the negotiable ocean bill of lading or warehouse receipt. The possessory rights of this holder were, in turn, subordinated to the possessory lien of the carrier for payment of the freight or the warehouseman for payment of the storage fee. Thus, possessory liens succeeded in gaining or retaining possession of shipped or stored goods where retained title or "historical" ownership derived rights could not.

As noted earlier, article 9 of the Uniform Commercial Code of the United States (hereinafter referred to as the "UCC") succeeded in reducing all of the fragmented possessory rights relied upon by secured creditors at the end of the Second World War (as well as their possible future successors) into one possessory right: the creditor's security interest. As of the enactment of article 9, the former conditional sellers, chattel mortgagees, holders of factors' liens, trust receipts and other holders for security of documents of title and commercial paper were all deemed to hold the same security interest in the collateral. Only the time of "perfection" (a UCC article 9 term that means the acquisition of rights not only *vis-à-vis* the secured debtor but also *vis-à-vis* third

¹⁵ As stated by J.A.C.THOMAS, *supra* note 12 at 140: "For Savigny, *animus* was the intention to hold the thing as one's own, i.e., the *animus domini*: in his view, the man that who had control of a thing *de facto* with the intention to exercise that control for himself was in law its possessor and would be granted the interdicts. This theory, concededly accords with most cases of possession...but it does not explain the possession of the *precario tenens*, *sequester*, pledge creditor and *emphyteuta*...(Jhering's view was)... that corpus was the essence of possession which was itself the outward manifestation of ownership; a man would be possessor of a thing if he was, in relation to it, in the position that an owner would normally be; animus was merely an intelligent awareness of the factual situation..." (Parenthesis and emphasis added).

¹⁶ See, GRANT GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY 66-68, Vol. I. (Boston, Little, Brown) (1965).

parties) differentiated among security interests.¹⁷ In other words, as of the enactment of article 9 of the UCC, the law of secured transactions in the United States no longer differentiated among secured creditors who based their rights upon retention of ownership and those who based them on the acquisition of a security interest or possessory right.

3. The Security Interest is Created by Contract but can, and Frequently Becomes, an Abstract or Autonomous Principal Right in rem or ad rem

The creation of a security interest under UCC article 9 is by contract, but its effect upon third parties (“perfection”) depends upon notice to such third parties (known to civil law lawyers as “publicity”).¹⁸ The perfection of the security interests creates rights *in rem* and *ad rem*. The priority among perfected security interests, in turn, depends upon the type of notice and its timeliness.

a) Contractual v. Statutory Liens

As is the case with many civil and commercial codes in civil law countries, the common law also enforces “statutory liens.” These are set forth in statutes (as also in the civil law codes) in favor of: suppliers of materials for the manufacture or repair of the debtor’s personal property; mechanics who repair such property; innkeepers and warehousemen who store such property and, in some jurisdictions, to lawyers, accountants and physicians for the collection of their fees for professional services.¹⁹ Such liens are outside the scope of UCC article 9 secured transactions’ law because this law applies only to contractually created security interests.²⁰ The fact that the creation of the security interest is by contract, underlies the basic dichotomy of rights: rights between the parties to the loan agreement and rights between or among third parties and the parties to the loan agreement.

b) The Principal and Autonomous Nature of the Security Interest Lien

While it is true that a security interest under UCC article 9 cannot exist without an agreement to lend between lender and borrower, the loan itself need not have taken place for an article 9 security interest to be perfected. Under UCC article 9’s “notice filing”²¹ a lender and a borrower can agree to a line of credit extension for a certain amount on a revolving or cumulative basis; and even though money or credit is not actually given to the borrower until a later date, the secured creditor may file a financing statement for the amount of credit promised as of the time of the agreement.²² Thus, even though a loan can be awaiting disbursement, the security interest for the amount agreed upon can be filed and thereby can affect third party rights. One should add, parenthetically, that this practice is similar to that of the “marginal notes” or “annotations” used by Latin

¹⁷ UCC § 9-308 *et seq.*

¹⁸ *See*: Arg. Cod. Civ. art. 2505, *supra* note 3, C.C.F. art. 3042 *et. seq.*, and CCV. art. 1920 *et. seq.*

¹⁹ *See*: UCC § 2A-306; UCC § 7-209(1)

²⁰ *Id.* § 9-109(d)(2).

²¹ *Id.* § 9-501 *et. seq.*

²² *See infra* Section IV (F).

American notaries public and real property registrars to record agreed upon, but not executed, future extensions of credit or expected judgment liens (*litis pendentia*).

If one were to strictly apply the civil law principle that a loan (as contrasted with the agreement to lend) is always the principal transaction, and the secured transaction (mortgage or pledge) is the accessory, and thus a totally dependent transaction, notice filings could simply not be: a loan would inevitably have to be in place before a security interest could be recorded. *Mutatis mutandis*, financial instruments such as mortgage bonds, could not have come into existence and the middle and low income housing that they helped to finance in Europe and Latin America (among other regions) would similarly have had to await the emergence of other “non-accessory” financing formulas.

The reason why mortgage bonds, among other instruments, could not have been created was the same strict construction of the notorious “accessory must follow the principal” principle and of its no less notorious corollary, “which came first, the chicken or the egg?” If the “principal” loan underlying the issuance of mortgage bonds did not occur until the underwriter or the public bought the mortgage bond, how could the accessory mortgage exist prior to its sale? In other words, there could be no mortgage right to sell until the loan extended by the mortgagee-buyer of the bond was in place, but that “loan” could only take place once the lender bought a non-existent mortgage.

c) Securitization and the Need for the Independence or Abstraction of Security Interests

The expansion of the global financial marketplace to include the sale of security interests to the public at large has made it necessary to assure these buyers of the legal independence or “abstraction” of the security interests they buy. Among the security interests being bought by the public are certificates of participation in collateral as diverse as “securitized” pools of accounts receivable (usually in excess of one hundred U.S. dollars) or of real estate mortgages. Such remote creditor-buyers would not buy their certificates if their rights in the security interests sold were not as certain and enforceable as possible. The enforceability of security interests means not only that they be perfected and enjoy the necessary priority, but also that they not be subject to disabling underlying claims or equities by third parties.

4. Perfection of the Security Interest Depends upon not merely Mechanical, but also upon Functional, Notice to Third Parties

a) Modalities of Public Notice

Public notice or publicity (in the civil law parlance) of transactions was used by Roman law to legitimate the conveyance of valuable personal or real property (*res Mancipi*). The public conveyance of *res Mancipi* in the public square in the presence of the *libripens*, of the impressive weighing scales and the planting of the Roman legionnaire’s flag for acquisitions of conquered land “*sub hasta*”, were the legal symbols chosen by Roman law to place the world of actual or potential third party creditors on notice of the right-transforming transaction that had just taken place.²³ German law, one of the most

²³ See, Kozolchyk, Transfer, *supra* note 2, at 1459, see also Boris Kozolchyk, Introductory remarks as Chair of the Meeting of OAS-CIDIP-VI Drafting Committee on Secured Transactions

sensitive on the effects of public notice upon the rights of third parties, can similarly trace the evolution of its land registry (*Grundbuch*)²⁴ as well as of its doctrine of abstraction of negotiable instruments to the equally symbolic medieval *Gewere*.²⁵

Since Roman days, public notice of secured or preferential rights encumbering the debtor's estate, as whole or specific assets thereof, has become an inevitable feature of Western legal systems. It is part of an elementary equation of what one of the present writers has described as the fairness of the marketplace. If the rights of marketplace participants are to be affected by the rights created by a secured loan, marketplace participants have to be made aware of the existence and scope of these rights.²⁶

b) The Functional Notice of Article 9 of the UCC

What has differed from one legal system to another is the method of implementation of public notice (hereinafter referred to as "publicity"). The publicity of UCC article 9 is functional in the sense that it appraises third parties of accurate, relevant and timely information about the debtor and the collateral in the most accessible manner possible. Contrary to the information found in the recording of real estate mortgages in Latin American land registries, the description of the transaction and of the collateral according to article 9, does not include all the terms and conditions of the deed (*Escritura Pública o Privada*) or the collateral in exhaustive detail. In fact, the UCC article 9 registry is not a registry of collateral, but of debtors. Under United States law, registries of collateral are used only when the individual item is highly valuable and susceptible of being identified by serial number or transferred by a certificate of title.

Since the recording of a security interest in personal property must be succinct to be timely, relevant and easily accessible, only small sections of the loan agreement are recorded as part of what is known as a financing statement; and it can be registered in paper-based or electronic format.

The functionality of the notice also means that it must be flexible enough to accommodate the needs of the various transactions and their participants. Thus, a functional notice can be provided by the creditor's or third party's possession, as in the case of the traditional pledge or by the symbolic possession of third parties or designated agents. Alternatively, it can be provided by the filing of a security interest coupled with the requirement that the loan and security agreement be made available to third parties for their examination of specific details thereof. Additionally, it can be provided by special notices to holders of perfected security interests in the case of "super-priorities."

Discussion Of Key Principles and Provisions of the Model Law, Conference Transcript, 18 ARIZ. J. INT'L & COMP. L. 342, 3 (2001) (hereinafter referred to as "Meeting OAS-CIDIP-VI").

²⁴ See <<http://www.grundbuch.de>>.

²⁵ Meeting OAS-CIDIP-VI, *supra* note 23, at 7.

²⁶ Boris Kozolchyk, *Fairness in Anglo and Latin American Commercial Adjudication*, 2 B.C. INT'L. & COMP. L. REV. 219, 233, 235, 248 (1979).

5. Priority Among Perfected Security Interests is Generally based upon the First to File or to Acquire Possession

Priority under UCC article 9 assumes the equality of all security interests and their subjection to the principle of *prior tempore, potior iure*. Accordingly, the first to file or to acquire possession of the collateral has priority over subsequent secured creditors. This principle is subject to only limited exceptions. These exceptions encourage the financing of the purchase of certain assets such as those that enrich the value of the secured debtors' inventory or equipment and thereby enrich the overall value of the secured debtor's estate.

6. The Need to Eliminate Secret or Unrecorded Liens Requires that only those Judicial Liens that are Recorded can Acquire Priority over Subsequently Recorded Contractual Liens

A functional system of notice or publicity has no worse an enemy than the rules that encourage creditors' reliance on secret liens. One of the main virtues of the UCC article 9 conversion of all of the pre-existing security interests to just one, is that it reduced to a minimum the pernicious effect of secret liens. Thus, no longer could an unrecorded conditional sale, factor's lien, trust receipt or "simulated" financial lease be invoked to defeat a recorded chattel mortgage or its functional equivalent. Regardless of the label given to the transaction and its supposed title-retention features, notice through recording became essential to affect third party rights.

Consistent with the principle of functional notice, only those judicial liens that are recorded can enjoy priority over subsequently recorded contractually created security interests. Otherwise, all an unsecured creditor would have to do is obtain a judicial lien and enforce it with preference over a registered security interest. If this were allowed, functional notice and, with it, secured lending would cease to exist.

7. Purchases by Buyers in the Ordinary Course of Business are Immune against Claims by Secured Creditors, although the Latter's Security Interest Continues in the Proceeds of the Sale or Exchange

Consistent with the self-liquidating nature of the secured loan and with the location of the consumer-buyer in the ordinary course of business at the very base of the commercial credit pyramid, his purchase of goods from a seller's inventory must be immune against the enforcement of perfected security interests. The cash stream generated by a consumer's purchases irrigates the entire credit pyramid: the retailer relies on the proceeds of his sale to the buyer in the ordinary course of business to repay his loan to his wholesaler; the wholesaler relies on the retailer's repayment of the wholesale goods to repay the manufacturer or financier, and so on. If the buyer of goods in the ordinary course of business feared being dispossessed of what he bought from the retailer, this fear would be translated into fewer sales and a much smaller flow of cash to the upper layers of the credit pyramid.

The protection of the buyer in the ordinary course does not mean that the secured creditor will lose his ability to recover the proceeds of the sale. For even if the collateral is sold or re-pledged fraudulently or without authorization by the debtor in possession of such collateral, or used or consumed by the secured debtor or by a third party, a creditor's secured right continues to be enforceable against the original collateral's replacement or its proceeds.²⁷ In the final analysis, the right secured by proceeds is a right to the economic value of the original collateral and not to the original collateral itself.

8. To be Cost Effective, Security Interests Require a Quick and Inexpensive Method of Enforcement. Whenever possible, such a Method should be Extra-Judicial Although Peaceful and Mutually Agreed Upon

One of the most important features of United States secured transactions law is that it allows the secured creditor to extra-judicially repossess the collateral and resell it to pay the amount of the indebtedness. If there is a surplus, it is returned to the debtor; if there is a deficiency, it can be pursued with respect to other encumbered collateral or unencumbered assets. The United States secured creditor can thus engage in self-help as long as he or she does not violate constitutional due process or does not "breach the peace." In this respect, United States law is not too different from what Roman law was prior to Emperor Constantine's prohibition of the *pactum commissorium*.²⁸ This *pactum* allowed a secured creditor to appropriate to his own use or to resell the collateral pledged by the debtor if the latter defaulted.

Significantly, the main policy reason given for Constantine's prohibition of the *pactum* was that it enabled lenders to evade the severe penalties imposed by Christianized Roman law upon usury. Usury was defined in Constantine's time as any interest charged above and beyond the return of the principal amount.²⁹ By encumbering property worth considerably more than the value of the loan, a secured creditor who recovered such property invoking the *pactum* could wind up collecting his principal and interest in a usurious loan.

Despite the fact that the prohibition against usury was considerably attenuated in Latin America's nineteenth and twentieth century civil and commercial codes, the prohibition of the *pactum* has continued unabated to this day. It has retarded the modernization of not only secured transactions, but also of commercial and remedial law. In contrast with,

²⁷ See, UCC § 9-306.

²⁸ Constantine Const. of 324 & Justinian 3rd Const. Cod. 7, 54. This pact was outlawed during Constantine's reign in 326 A.D. in the following manner: Since among other captious practices the harshness of the provision for forfeiture (*lex commissoria*) is especially increasing, it is our pleasure that this provision shall be invalidated..." *De Commissoria Rescindenda*, Constantine Augustus Jan. 31, 326, cited and translated by Pharr, *The Theodosian Code* 65 (1952). The *pactum* was used again during the Middle Ages as a method of securing the repayment of interest for loans by conveying to the creditor an object of greater value than the amount lent. On the interaction between usury and the invalidation of the *pactum commissorium*, see also, Boris Kozolchyk, *Law and the Credit Structure in Latin America*, 7 VA. J. INT'L L., 10, 11 (1967).

²⁹ *Id.*

say, German law, where a secured creditor and debtor can agree that in the event of default the debtor transfers his rights in the collateral to the creditor acting in a fiduciary or chattel mortgagee capacity (*sicherungsbereignung*) and can repossess and sell the collateral extra-judicially,³⁰ such an agreement would be regarded by many Latin American courts as an illegal *pactum*. Moreover, the Latin American law of remedies for breach of contracts is seriously hampered by the *pactum* inspired assumption that the parties are not free to agree on the bases for a unilateral rescission of contracts. Consistent with the spirit of the *pactum*, all rescissions must be court ordered. Needless to say, much economic waste is imposed upon contracting parties, especially when the goods involved are perishable or highly depreciable, by having to await a judicial determination that often takes years to obtain.

III. The Existing Law and Practice in Latin America: Common Features

In contrast with the United States prototype of commercial lending, commercial and related consumer credit is still largely unavailable in Latin America and the Caribbean; and when it is available, it is extremely costly. The unavailability and high cost of credit reflect high credit risks or the inability to obtain payment in commercial and consumer loans quickly and inexpensively. As recently as eighteen months ago, the Central Bank of Brazil reported that more than one third of the cost of commercial credit, defined as the difference between cost of money borrowed by the bank-lender and rate of interest charged to the bank's borrower, was attributable to the creditors' inability to collect on loans or to realize on loan collateral.³¹ The absence of secured lending in Latin America and the Caribbean is quite costly in macro as well as in microeconomic terms. World Bank economists have estimated the loss to a country's GNP to be in excess of ten percent.³²

Numerous statutes, court decisions and commercial practices have attempted to eliminate the high risks of commercial lending in Latin America. Unfortunately, none of these have succeeded, although in fairness, it has not been for lack of trying. As early as 1914,

³⁰ See, for example the decision of the Federal Supreme Court of Germany (BGH, VIII ZR 322/99 of 15 of November 2000). The *Bundesgerichtshof* upholds the creditor's rightful enforcement of a security interest without the involvement of the courts a brewery made a loan to two restaurant/bar owners. In return, they promised to buy exclusively the brewery's beer. Part of the bar equipment conveyed to the creditor as a chattel mortgage. Later the brewery terminated the loan contract and sued the owners for an amount of about 77,000.00 Deutsche Marks. After the brewery enforced the chattel mortgage in the amount of 11,500.00 Deutsche Mark, it reduced the claim to 65,500.00 Deutsche Mark. The court held that the creditor was justified in acting as it did and focused on the remaining claim.

The authors are indebted to Susan Butler Esq., LLM for the summary and translation of this decision.

³¹ BCB Study, *supra* note 1.

³² THE WORLD BANK GROUP, *Secured Transactions: The Power of Collateral*, (1996) at <www.worldbank.org/fandd/english/0696/articles/0150696.htm> (accessed June 11, 2002, on file with author). See also, THE WORLD BANK GROUP, *Mexico Country Brief*, (2000) at <<http://lnweb18.worldbank.org/External/lac/lac.nsf/d5c7ea5f4536e705852567d6006b50ff/b32b6c2eebdcbb8f852567ea0006a0ca?>> (accessed June 11, 2002, on file with author).

Argentina enacted an agrarian pledge statute that attempted to achieve certainty of collection by recording the pledge and immobilizing the collateral.³³ In many of the subsequently enacted statutes throughout Latin America, the debtor's failure to keep the collateral immobilized or under lock and key in the debtor's own or in a third party's warehouse could have landed him in jail as a thief or embezzler.

During the years 1999-2001, in order to prepare the first draft of the National Law Center for Inter-American Free Trade (hereinafter referred to as the "NLCIFT") proposal to the OAS, the NLCIFT conducted a comparative study of all the Latin American secured transactions laws and classified them by type of collateral, persons that can encumber the collateral, encumbrance of future goods, junior liens, person that retain possession of the collateral, and registration requirements, among others.³⁴

A. The NLCIFT NAFTA Country Studies

During 1993 and 1994, a study group which participants included Professors Ronald C.C. Cuming of the University of Saskatchewan, Canada, as Research Director, Todd Nelson (presently of the *Instituto Tecnológico de Monterrey*) and Boris Kozolchyk, among others, conducted an empirical study on various financial scenarios involving secured commercial lending in the country members of the North American Free Trade Agreement (hereinafter referred to as "NAFTA").³⁵ One of the results of the study was that most of the secured lending available in Canada and the United States was not available in Mexico and that the reasons for the unavailability of the numerous loans to various sectors of the economy could be found in the inflexibility of existing statutory and decisional law. Even though Mexican secured creditors had access to more than twenty secured transactions, few, if any, satisfied their need for certainty of enforceability. Furthermore, when enforceability was obtained, it was at the expense of self-liquidation. For example, loans to agricultural producers relied on the warehousing of crops, but presupposed the immobilization of collateral. If the grains were sold or re-pledged by the secured debtor, he could be guilty of the crime of embezzlement. Similarly, inventory could not be encumbered unless very specifically (item by item) described; proceeds could be encumbered only when they amounted to replacement "products," i.e., goods of the exact type as sold or exchanged. Secret liens abounded, as in the case of conditional sales, guarantee trusts and simulated equipment or financial leases; no system of functional notice existed, and the exclusively judicial method of enforcement of creditors' rights was quite dilatory and thus ineffective.

³³ See, Arg. Law 9644, published in the *Boletín Oficial* of Nov. 20, 1914, at <<http://www.secretariojuridicp.com.ar/leyes/lyscom/9644.com.htm>> (accessed June 10, 2002, on file with author).

³⁴ This study is available in the National Law Center for Inter-American Free Trade ("NLCIFT") database at <<http://www.natlaw.com>>.

³⁵ BORIS KOZOLCHYK, *ET. AL.*, HARMONIZATION OF THE SECURED FINANCING LAWS OF THE NAFTA PARTNERS: FOCUS ON MEXICO, National Law Center for Inter-American Free Trade (1998).

At the same time, it appeared that Mexico's banking system had created its own *de facto* system of functional notice. In cities whose population exceeded 50,000 inhabitants, banks maintained their own registries of debtor performance, which they shared with each other, and only with each other.

B. Central and South American Studies

Studies conducted by the NLCIFT, this writer and others at different times during the last thirty years in Central and South America³⁶ confirmed the presence of the same problems and failures observed in Mexico. Substantive law deficiencies aside, nothing illustrates as dramatically the inadequacy of functional notice as a graffiti in a San Salvadoran registry: "*Aquí lloran los valientes*" (Here, even the brave cry).

Costa Rica experimented for some time with its own version of public notice and debtors' prison. Public notice for a while consisted in the public shaming of debtors by debt collectors dressed in vivid green (and thus dubbed "*pericos*" (parakeets)). These debt collectors followed the delinquent debtors at close range in public. Their silent pursuit continued until the shamed debtors repaid their loans. This practice was discontinued, however, after some of the parakeets mysteriously disappeared never to be seen again.³⁷

Nevertheless, Costa Rica persisted on relying on the personal element of enforcing security interests in movables. This democratic country had a civil code provision which resulted in the debtor's prison. Its remedy was known as "*apremio corporal*", and it was in force until rather recently when it was declared unconstitutional.³⁸ The *apremio* resulted from a court order directing the debtor to return the collateral, pay the debt or face imprisonment from two months to two years because of contempt of court. Despite, or perhaps because of, the criminal implications of this remedy, it was also unsuccessful. Empirical studies of its lack of enforcement showed that aside from impeding self-liquidation of the commercial loans, it was ignored by debtors and enforcement officials alike. As stated by an interviewed judicial official: "If the criminal sanctions were to be implemented, most of Costa Rica would wind up in jail, including our former president and most of our judges."³⁹

With few exceptions, legal uncertainty in the enforcement of commercial and consumer loans persisted throughout Latin America, as did a presumption that commercial and

³⁶ See, among others, Boris Kozolchyk, Law and the Credit Structure in Latin America, *supra* note 28, see also, Costa Rican USAID-ROCAP Law Reform Project, Toward a Theory on Law in Economic Development, 714-728 (1971) (hereafter cited as "Toward a Theory").

³⁷ Maria Alejandra Rodriguez Esq., a Venezuelan lawyer and staff member of the NLCIFT described a similar practice in Venezuela involving black dressed "penguins" who apparently met the same fate of the Costa Rican parakeets.

³⁸ Art. 113 *Ley de Jurisdicción Constitucional* No. 7135 of Oct. 11, 1989, published in the Gazette No. 198 of Oct. 19, 1989 and in the Gazette No. 212 of Nov. 9, 1989 with corrections, at <www.poder-judicial.go.cr/salaconstitucional/ljc.html> (accessed June 10, 2002, on file with author).

³⁹ USAID, Toward a Theory, *supra* note 36, at 721-733, and especially fn.183.

consumer lenders as well as borrowers, when given the opportunity would act in bad faith. It was clear that transparency in the form of public notice of what was borrowed, by whom and using what as collateral was badly needed, especially if commercial lending was going to become a viable enterprise.

Indicative of this trend, most Latin American countries had started relying on the same banking clearinghouses of debtor information as had Mexico. In Chile, for example, the clearinghouse known as “*Central de Riesgo*” was on line and was accessible to all banks licensed to do business in Chile. Although these clearinghouses did not contain recordings of security interests but merely banking data on debtor indebtedness and repayments of loans, the availability of this information to potential lenders expedited the processing of loan applications by a factor of four to one. As compared to places where the clearinghouse of information was unavailable, commercial loans were processed three times as fast in Chile.

IV. The Model Inter-American Law on Secured Transactions⁴⁰

Demands from borrowers and lenders in various commercial and industrial sectors throughout the trading world have by now produced various efforts to modernize the law of secured transactions on a national and international basis. These efforts aim at creating the legal certainty and flexibility necessary for lending to take place, reducing interest rates to make borrowing more attractive, and giving rise to a new credit market able to meet current financing needs.⁴¹ The Model Law is designed to answer the same demands in one of the largest consumer and commercial markets on earth. It attempts to alleviate current legal shortcomings in Latin American and Caribbean countries. The main objective is to create a non-possessory security interest that allows debtors to retain possession of the collateral yet allows secured creditors to enforce their security interest, extra-judicially, whenever possible in case of default. It also facilitates the creation of a regional credit market by laying the legal groundwork for a network of electronic registries. The Model Law creates a single registry database for each country. This

⁴⁰ The Model Inter-American Law on Secured Transactions OAS Model Law as revised by the Committee of Style (hereinafter referred to as the “Model Law”), attached hereto as Annex 1. The text of the Model Law, as summarized in the present article, also draws on previous versions and summaries of the Model Law, including John M. Wilson, Secured Financing in Latin America: Current Law and the Model Inter-American Law on Secured Transactions, *Uniform Commercial Code Law Journal* Vol. 33:43 (Summer, 2000).

⁴¹ In addition to the OAS, the U.N. recently adopted a Convention on Assignment of Receivables in International Trade, A/CN.9/WG.II/WP.104 (Dec. 2001), text available at <<http://www.uncitral.org/stable/res5681-e.pdf>> (hereinafter the “U.N. Convention”); the Institute for the Unification of International Private Law (UNIDROIT) recently adopted a Mobile Equipment Convention and Aircraft Protocol, under joint auspices with the International Civil Aviation Organization, at Cape Town (hereinafter “Cape Town Convention”) (29 Oct. to 16 Nov. 2001), text available at <<http://www.unidroit.org/english/internationalinterests/conference2001/finalact.pdf>>; and the Hague Conference on Private International Law is conducting work on a Draft Convention on the Law Applicable to Certain Rights in Respect of Securities held with an Intermediary (Apr. 2002), preliminary text available at <ftp://hcch.net/doc/sec_pd10e.doc>.

registry contains all registered security interests and by being subject to a uniform set of electronic commerce rules (The Inter-American Rules on Electronic Documents and Signatures hereinafter referred to as “IAREDS”) will enable a standardized connection with similar registries throughout the hemisphere.

A. Background

The OAS recurrently hosts the Inter-American Specialized Conference on Private International Law.⁴² In 1996, the General Assembly convened the *sixth* such conference (CIDIP-VI).⁴³ In 1997, OAS member states and the General Assembly provided their comments and observations concerning proposed topics for the CIDIP-VI agenda, which included modernizing the law of secured transactions.⁴⁴

The OAS Permanent Council convened a meeting of experts in December of 1998 to establish the precise scope of the topics.⁴⁵ Discussions at this meeting, as well as the comments received pursuant to resolution AG/RES 1472 (XXVII-0/97), determined the scope of secured financing reform and an additional two independent topics.⁴⁶ This meeting approved a Model Inter-American Law on Secured Transactions as a working document for the reform effort.⁴⁷ In addition, OAS delegates agreed to study the secured financing topic at two subsequent experts meetings.⁴⁸

The first experts meeting took place in February 2000.⁴⁹ The United States delegation presented a “working document” containing the legal principles essential to secured financing reform.⁵⁰ The Mexican delegation also presented a second “working document,” containing an application of these legal principles in proposed draft language.⁵¹ Delegates and experts created a Drafting Committee headed by the Delegations of Mexico and the United States, which produced an annotated draft of the

⁴² OAS General Assembly Resolutions creating the Inter-American Specialized Conference on International Private Law (hereinafter “CIDIP”), <<http://www.oas.org>>.

⁴³ OAS General Assembly Resolution AG/RES 1393(XXXVI-O/96).

⁴⁴ *Id.* AG/RES 1472 (XXVII-o/97).

⁴⁵ OAS Permanent Council Resolution CP/RES. 732 (1173/98).

⁴⁶ OAS General Assembly Resolution AG/RES 1558 (XXVIII-O-98); OAS Document RE/CIDIP-VI/doc.9/98. The other two reform topics are: 1) “standardized commercial documentation for international transportation with special reference to the 1989 Inter-American Convention on Contracts for the International Carriage of Goods by Road;” and, 2) “conflicts of laws on extra-contractual liability, with emphasis on international liability for transboundary pollution.”

⁴⁷ Model Law, *supra* note 40.

⁴⁸ OAS General Assembly Resolution AG/RES. 1558 (XXVIII-O/98).

⁴⁹ Report on the Meeting of Government Experts to Prepare for the CIDIP-VI, OAS/Ser.K./XXI; REG/CIDIP-VI/doc./00, 17 February 2000.

⁵⁰ REG/CIDIP-VI/INF.3/00; Summary of REG/CIDIP-VI/INF.3/00, OAS/Ser.K/XXI, REG/CIDIP-VI/INF.5/00, 14 February 2000.

⁵¹ OAS/Ser.K/XXI, REG/CIDIP-VI/INF.2/00, 14 February 2000, (hereinafter the “Mexican Working Document”).

Model Law in 2000.⁵² The Drafting Committee based the new draft on the legal principles contained in the Mexican Working Document⁵³ and the previous texts of the Model Law.⁵⁴

The second and final meeting of experts was called by the U.S. Chair of the CIDIP-VI Drafting Committee on Secured Transactions and was organized by the NLCIFT, in November 2000, in Miami, Florida.⁵⁵ This meeting focused on the draft text of the Model Law drafted by the NLCIFT. Some government experts and various independent experts from fifteen Latin American and Caribbean countries analyzed the provisions of the Model Law. The U.S. Chair also presented draft electronic commerce rules (the IAREDS) to supplement the application of the Model Law when the secured loans were executed electronically and when the filing, searching, certification and cancellation of secured loan registrations were also effected electronically.

The participants at the Miami meeting suggested changes to the Model Law in accord with local and international legal considerations. Special emphasis was placed on registry and enforcement issues, which had not been discussed at the previous two CIDIP-VI preparatory meetings.

In response to the Miami Meeting, the Delegations of the United States and Mexico, Co-Chairs of the secured transactions topic, redrafted the Model Law. This redrafting effort took into consideration the recommendations made by the participants at the previous meetings. In addition, this redrafting effort paid close attention to language and implementation issues to ensure that Latin American countries could better adopt the final text. A revised version of the Model Law was completed in September 2001 and submitted, along with a copy of the IAREDS, to the OAS for presentation to Member States participating at the CIDIP-VI.

The work on the Model Law culminated at the CIDIP-VI plenary conference, held from February 4-8, 2002, at OAS headquarters in Washington D.C. At the plenary conference, the U.S. and Mexican Co-Chairs presented the revised version of the Model Law. The Delegation of Canada also presented numerous suggested revisions that were taken into account and became part of the final text. A Drafting Committee was created to ensure

⁵² Report of the Meeting on Government Experts to Prepare for the CIDIP-VI, OAS/Ser.KXXI, REG/CIDIP-VI/doc./00, 17 February 2000. Among the participants in Washington, D.C. for Mexico were Lic. Alejandro Ogarrio, Jorge Sanchez Cordero, Leonel Pereznieta, Jose Luis Siqueiros, and on behalf of the United States, Jose Astigarraga, Boris Kozolchyk and John Wilson.

⁵³ *Id.* These principles include: (1) the need for after-acquired property feature; (2) the need for a continued security interest in proceeds; (3) the need for a purchase money security interest; (4) the need to protect ordinary course buyers; (5) the need for an effective and efficient enforcement remedy; and 6) the need to provide notice of a security interest by registration. The draft does not discuss the need for a unitary mechanism. *Id.* Unlike the MILST, the Mexican documents do not discuss the principle of uniformity.

⁵⁴ Report of the Meeting on Government Experts to Prepare for the CIDIP-VI, OAS/Ser.KXXI, REG/CIDIP-VI/doc./00 17 February 2000.

⁵⁵ Meeting OAS-CIDIP-VI, *supra* note 23, at 3.

that all approved changes were added to the text and to create a final, definitive version. Several changes were made to the provisions of the Model Law, described below, and were approved. The CIDIP-VI concluded with the approval of the Model Law, which is now being submitted by the OAS to member countries for implementation.⁵⁶

B. Scope and the New Concept of Preferential Rights

Consistent with the first principle of contemporary secured transactions law set forth earlier in this study, the Model Law regulates security interests in all types of movable property, whether corporeal or incorporeal, present or future.⁵⁷ Application of the Model Law, however, is limited to consensual security interests.⁵⁸ The principal right granted by the Model Law to the secured creditor who perfects his or her security interest by publicizing it in the manner prescribed by the Model Law is referred to by article 2 of the Model Law as a “preferential right”: “When a security interest is publicized in accordance with this Law, the secured creditor has the preferential right to payment from the proceeds of the sale of the collateral.”

Consistent with the earlier discussed principle of replacement of title or ownership derived rights by possessory rights, §the preferential right is indeed a new type of right: 1) it does not depend for its creation, publicity or enforcement upon the debtor’s or the creditor’s ownership of the collateral but on their right to possession thereof; and 2) it provides the holder of such a right not only the special remedies granted by the Model Law, but it also enlarges the scope of secured rights as they are known under current law. As stated by article 2, as a preferential right it extends to the proceeds of the sale of collateral, as its scope can also extend to future goods and their substitutes under other provisions of the Model Law.

Although the Model Law covers security interests in most types of collateral, it also recognizes that special laws or markets should govern security interests in certain types of goods. As a result, the Model Law allows an adopting state to exclude security interests in certain types of collateral from its scope of application.⁵⁹ Investment securities are one example of special types of collateral. Because of their “dematerialized format” in many marketplaces, their “indirect holding” by intermediaries

⁵⁶ Final Act, CIDIP-VI, OAS Headquarters, Washington, D.C. February 4 – 8, 2002, OEA/Ser.K/XXI.6, CIDIP-VI/doc.24/02 rev. 2 (Mar. 5, 2002).

⁵⁷ Model Law, *supra* note 40, art. 1

⁵⁸ *Id.* art. 5.

⁵⁹ *Id.* art. 1, as published in the Final Act of the CIDIP-VI, states as follows: “A state may declare that this Law does not apply to certain security interests expressly specified.” Final Act, OAS, CIDIP-VI, OEA/Ser.K/XXI.6 CIDIP-VI/doc.24/02 rev. 2 (Mar. 5, 2002). It is likely that his language will be changed in the final version of the Model Law. These changes were prompted by general fears the mentioned language may allow States to preserve current security mechanisms and thereby circumvent the uniformity requirements of the Model Law. Redrafting proposals generally mirror the following language: “A State may declare that this Law does not apply to certain types of collateral expressly specified in this text.” The revised language is meant to allow States to limit the application of the Model Law to certain types of movable goods (e.g., investment securities) while not allowing states to exclude certain legal figures (e.g., pledges).

and their instantaneous transfer and pledge by means of electronic bookkeeping entries, they require separate regulation.

Other categories of collateral that may be excluded from the scope of the Model Law are those regulated by other domestic or international law and which may require registration in a separate registration/registry system. One example is collateral that falls within the scope of the Convention on International Interests in Mobile Equipment.⁶⁰ Collateral that becomes fixtures to real property is another.⁶¹

Finally, the Model Law also applies to security interests in movable property, the title of which may be registered under a different legal system. In dealing with this type of collateral, however, the Model Law defers to any special legislation or registry to the extent of any inconsistency between the Model Law and the title-specific legislation.⁶²

C. Uniformity

Consistent with the principle of functional notice to third parties and with the need to eliminate secret liens, an overarching goal of the Model Law is to create a uniform security mechanism. Uniformity requires replacing current mechanisms used for security in collateral, as long as they intend to create an interest in movable property as protection against default. Such mechanisms include pledges, chattel mortgages, guarantee trusts, banking mechanisms, agricultural credit devices, and production guarantees. Uniformity must also include all legal devices in which possession of movable property, on the one hand, and title to movable property, on the other, are divided among or reside in different parties. These types of transactions include conditional sales and reservation of title transactions, as well as financial leases and consignment agreements when used as financing devices. In addition, the sale or assignment of receivables and other claims are very difficult to distinguish from security interests in these assets. As a result, a truly uniform statute should also include these types of transactions.

The ideal approach to uniformity is to replace all current legal mechanisms, used to create rights in property as protection against default, with one single uniform mechanism. However, eliminating legal figures such as the pledge and conditional sales contracts, with long-standing support and traditions, was not possible within the context of the CIDIP-VI. As a result, the Model Law uses an alternative approach—a uniform registry and priority system.⁶³ Under this approach, States adopting the Model Law must create a unitary and uniform registration system for all security devices. That is to say, enacting States may retain current pledges, chattel mortgages and other devices but all must be recorded in the same manner and in the same place. Moreover, these States are required to create a single registry for their recording. In addition, priority, regardless of the mechanisms used to create the right in property, will be tied to the date of such recording.⁶⁴

⁶⁰ Cape Town Convention, *supra* note 41.

⁶¹ Model Law, *supra* note 40, art. 52(IV).

⁶² *Id.* art. 37.

⁶³ *Id.* art. 1.

⁶⁴ *Id.*

The Model Law allows adopting States to continue use of possessory security interests based on the traditional civil law pledge. Even though the Model Law preserves present regulation concerning the structure of the pledge, it adds new rules concerning the obligations of a creditor in possession of the collateral.⁶⁵ In addition, the Model Law limits notice or “publicity” of possessory security interests to circumstances in which collateral is actually transferred to the creditor.⁶⁶ This rule hopes to eliminate the use of “constructive possession pledges” where the debtor retains possession and use of the collateral—a mechanism that goes against true pledge requirements of delivering the collateral to the secured creditor.⁶⁷

Implementation of the principle of uniformity and functionality of notice is not easy. Under the Model Law, it is possible that some civil law states will oppose the need to incorporate consignment agreements, financial leases and conditional sales into a single registry system. Nevertheless, proper implementation of the Model Law requires an integration of these devices to avoid misleading future creditors who might rely on the possession of the goods as evidence of clean title—the familiar problem of ostensible ownership.

Fortunately, some Latin American jurisdictions already require the registration of financial leases and other similar devices. This should facilitate their adoption of the Model Law by simply altering the registry location. A new secured transactions framework may establish that financial leases, for example, be registered at the new secured transactions registry pursuant to Model Law registration guidelines, instead of registering in the currently required location.⁶⁸

Another equally crucial issue is the incorporation of the assignment of receivables into proposed reforms. Although assignment and negotiation or factoring of accounts involve the sale or transfer between two parties, there is little difference between the sale of

⁶⁵ *Id.* art. 33. “*Article 33.* The obligations of a creditor in possession of the collateral include the exercise reasonable care in the custody and preservation of the collateral, the maintenance of collateral in an identifiable manner, unless it is fungible, and the limitation of suing the collateral only to the extent provided in the security contract.”

⁶⁶ *Id.* art. 10.

⁶⁷ One example of the “constructive possession pledge” can be found in current Mexican law. The commercial pledge, Article 334 of the Mexican General Law on Credit Instruments and Operations, requires that the debtor deliver possession of the collateral to the secured party. However, according to sub-paragraph (IV) of this article a pledge may be constituted by depositing the goods with a designated third party, who shall keep them at the creditor’s disposal. The intent of this provision is to divest the debtor of possession of the collateral. Unfortunately, this mechanism is commonly used as a non-possessory device. In this case, instead of appointing an independent bailee to act as depository, the creditor names an officer or shareholder of the debtor as its agent. The assets remain in the debtor’s possession and are used in the debtor’s operations. The Model Law attempts to curb this type of transaction, which creates a secret lien and raises several questions concerning the legal validity of the pledge. *See*, BORIS KOZOLCHYK, *ET. AL.*, *supra* note 35, at 87.

⁶⁸ Model Law, *supra* note 40, arts. 35-46.

accounts and the taking of a security interest in accounts.⁶⁹ This is especially true if the sale allows recourse against the seller of the accounts.⁷⁰ Assigned or factored accounts are also difficult to distinguish from security interests in accounts because quite often these accounts are intangible and exist only in the debtors' and creditors' books or records and have no physical manifestation that can clearly indicate who is the party in possession. Consequently, proper implementation of the Model Law requires states to assimilate these devices into a single registration and priority setting.⁷¹

D. Creation

1. The Security Agreement or Security Contract

The Model Law requires that the parties execute a written security contract, satisfying formalization requirements and the civil law equivalent of the statute of frauds.⁷² Pursuant to the Model Law, the security contract must, at a minimum, contain the following items:⁷³ a) date of execution; b) information to identify the secured debtor and the secured creditor;⁷⁴ c) signature of the secured debtor;⁷⁵ d) the maximum amount of the secured obligation;⁷⁶ e) a description of the collateral;⁷⁷ f) an express indication that the movable property described serves as collateral to a secured obligation; and g) a

⁶⁹ *Id.* art. 13. See also, BORIS KOZOLCHYK, *ET. AL.*, *supra* note 35, at 88-91.

⁷⁰ Model Law, *supra* note 40, art. 13.

⁷¹ *Id.* art. 1.

⁷² *Id.* arts. 6-7. The writing may be manifested by any method that leaves a permanent record of the consent of the parties to the creation of the security interest, including telex, telefax, electronic data interchange, electronic mail, and any other optical or similar method, according to the applicable norms on this matter and taking into account the resolution of this Conference attached to this Model Law (CIDIP-VI/RES. 6/02).

⁷³ *Id.*

⁷⁴ *Id.* In order to achieve maximum flexibility, the Model Law requires identification only by name and address and allows for a third party guarantor if the person granting the security interest is different from the secured debtor.

⁷⁵ *Id.* The signature may be written or electronic. The Model Law does not require the signature of the secured party.

⁷⁶ *Id.* The requirement that the security contract include express mention of the secured obligation is largely incompatible with many secured lending practices, such as lines of credit and future advances, but is nonetheless required by civil law and custom. The Model Law reduces the negative impact of this requirement by allowing the parties to provide a maximum (rather than sum-certain) amount that the secured obligation may reach.

⁷⁷ *Id.* The identification of the collateral presents yet another difficult issue. Under traditional civil law systems, collateral descriptions must be "indubitable" in nature. This specificity requirement is similar to serial-number-identification tests in which the make, model and serial number must be used to describe the collateral. Although such descriptions work well with automobiles and other "big-ticket" items, they do not work well with fungible goods, intangibles and inventory. This description requirement also creates problems with proceeds and after-acquired collateral. The Model Law allows for *specific* descriptions when possible but also allows *generic* descriptions when the collateral consists of revolving inventory, fungible and future goods, as well as intangibles.

generic or specific description of the secured obligations.⁷⁸ Once the secured creditor and the secured debtor execute the security contract, the security interest is valid between these parties.

As was discussed in connection with the governing principles of a modern secured transactions law, many a civil law statute, judicial or doctrinal interpretation, treats security interests as accessory to a pre-existing contract, requiring that an obligation must exist before (or at) the creation of a security interest.⁷⁹ Consequently, an obligation must also exist before a security interest can be registered at the corresponding registration office. This “accessory nature” rule impedes pre-registration practices necessary to secure future advances.⁸⁰ For example, assume that lender “A” is willing to extend a “line of credit” of a specified amount to borrower “B” but only if it can record its security interest at the time A and B agree on the terms and conditions of the loans. Consistent with the above-discussed principle of principal and autonomous or abstract nature of the security interest, the pre-registration of this line of credit is made possible by the Model Law by relying on two basic documents, one containing the secured obligation and another the recorded security interest. This bifurcation makes it possible for a creditor to pre-register and attain a certain priority in the debtor’s goods before extending value. Thus, the Model Law makes pre-registration possible by allowing registration of a registration form before the security contract is executed or the loan is actually given to the borrower.

2. Secured Debtor

Although previous versions of the Model Law provided alternatives concerning persons whom may act as debtors, the final version does not.⁸¹ The previous draft provided two alternatives: one that permitted all parties to borrow on a secured basis and another that excluded consumers from the scope of the Model Law. This distinction was meant to account for differences in countries having centralized systems of government and countries with federalist (non-centralized) systems. The majority of Latin American countries follow a centralized system where federal law governs both commercial and consumer transactions. Others, however, including Argentina, Brazil and Mexico,

⁷⁸ *Id.* Alternatively, the Model Law allows parties to comply with this requirement by providing a method or formula from which the maximum or actual amount can be determined.

⁷⁹ John M. Wilson, *Legal Standards and Industry Practices: Reforming Latin America’s Secured Financing System*, 36 (1999), at 40.

⁸⁰ See *infra* section IV. F.

⁸¹ Model Inter-American Law on Secured Transactions, prepared by the NLCIFT, presented by the United States Delegation to the OAS, OAS Documents Preparatory Meeting of Government Experts for the CIDIP-VI, Dec. 1998. Working Document of a Model Inter-American Law on Secured Transactions, Report of the Meeting on Government Experts to Prepare for the CIDIP-VI, OAS/Ser.KXXI, REG/CIDIP-VI/doc./00, 17 February 2000 (hereinafter “Model Law Previous Version”), art. 7. This document states that any person [*qualified as a commercial entity*] can create a movable security interest over its present and future movables [*with the understanding that physical persons considered commercial entities can only do so over the property used in the commercial acts in which it engages*]. The person that creates a movable security interest is known as the Secured Debtor. Alternative language is contained within brackets and italicized.

employ federalist systems of government where federal law governs only commercial transactions; consumer transactions are governed by State (local) law. The previous Model Law proposed consumer and commercial law alternatives to its implementation in countries with federalist systems.⁸²

The final version of the Model Law does not provide consumer/commercial alternatives and simply defines a secured debtor as any person who creates a security interest over movable property.⁸³ The consensus among the commercial and consumer law experts who participated in the Miami group of experts meeting was that the distinction between a secured debtor consumer and merchant was gradually disappearing in their respective practices. It was also the consensus that a small merchant who may start as a consumer borrower may soon become a commercial borrower and would be helped by the latter's access to secured commercial credit.

3. Secured Creditor

A secured creditor is defined in the Model Law simply as a person in whose favor a security interest is created, possessory or non-possessory, whether for its own benefit or for the benefit of other persons, who provides value (goods, funds or services) to a secured debtor.⁸⁴ This definition, as well as that of the secured debtor and the following definition of collateral, are consistent with the principle of the universality of collateral, one of the cornerstones of the Model Law.

E. Collateral and especially “Attributable” Property

Under the Model Law, parties can create a security interest in any present or future, corporeal or incorporeal movable property, as long as it can be described in the security contract and the registration form.⁸⁵ A security interest may cover originally encumbered goods and goods attributable thereto.⁸⁶ The collateral may also include specific items of

⁸² The main consideration was the possibility that a federal secured transactions statute or convention would not affect consumer transactions in countries with federalist systems unless individual federative entities enact the reform within its local Civil Code. Enactment within each state (such as the 31 states in Mexico) would likely present a difficult task. As a result, the previous version of the Model Law, provided a drafting alternative to those countries that could not easily include consumer debtors within the scope of this reform, *see* Model Law Previous Version, *supra* note 81.

⁸³ Model Law, *supra* note 40, art. 3(II). The definition of secured debtor also allows third parties who extend collateral a security for a loan to act as debtors under the Model Law.

⁸⁴ *Id.* art. 3(III).

⁸⁵ *Id.* art. 2. The security interests can cover one or several specific items of movable property, generic categories of movable property, or all of the secured debtor's movable property, whether present or future, corporeal or incorporeal, as long as it is susceptible to pecuniary valuation.

⁸⁶ *Id.* Collateral is defined as any movable property, including receivables and other kinds of incorporeal property, such as intellectual property, or specific or general categories of movable property, including attributable movable property that serves to secure the fulfillment of a secured obligation according to the terms of the security contract.

collateral or categories of property, such as a merchant's equipment, inventory, and accounts receivable, and may include a debtor's entire asset-base.⁸⁷

The Model Law also allows a security interest to extend to future property—property acquired by the debtor after creation and publicity of the security interest—including attributable property.⁸⁸ A security feature in attributable property is necessary when the original collateral is replaced, transformed, or otherwise altered during the life of the security interest.

Under the Model Law, attributable property includes goods received upon the sale, substitution, or transformation of the collateral.⁸⁹ Generally, however, a feature whereby a security interest extends to attributable property should be subject to two qualifications. First, the debtor must acquire a possessory right in the attributable property for the property to qualify as collateral. Second, the attributable property must be identifiable and traceable.⁹⁰ The Model Law adopts these assumptions but does not expressly provide that attributable property must be identifiable and does not include any guidelines for tracing attributable goods back to the original collateral. The Miami group of experts felt that these guidelines could be provided by way of drafters' or doctrinal comments and not as part of the text. If they were to become part of the text, it would make the Model Law too "casuistic" and reminiscent of hard-to-follow common law inspired statutes.

Any law that creates a security interest in attributable property raises some difficult issues concerning the publicity or notice of the existence of a security interest. The main example is when the attributable property is of a different nature than the original collateral, thus requiring a different form of publicity. In cases where a security interest in the original collateral is publicized by filing, its attributable property may be of a type that cannot be publicized by that method. Take a transaction where a creditor files a registration form taking a security interest in "inventory, equipment, accounts, instruments, attributable property and after-acquired property." Assume that the debtor possesses only inventory and equipment at the time of the loan and later acquires attributable property in the form of a bearer note. The creditor seemingly has a right to a security interest in the attributable property. However, filing a registration form will not publicize a security interest in the bearer note, which requires that the secured creditor take possession as the applicable step for publicity. As a result, the secured creditor must take possession of the note in order to ensure publicity and enforceability against third

⁸⁷ *Id.*

⁸⁸ *Id.* art. 3(VI). The Model Law uses the term "Attributable Property" instead of "proceeds" as a more "user friendly" terminology for civil law lawyers. Thus, the term "attributable property" replaces the term proceeds used in previous versions of the Model Law and as defined in the common law jurisdictions of the United States and Canada. The Model Law defines attributable property as movable property that can be identified as derived from the originally encumbered property, such as fruits, or property resulting from the sale, substitution or transformation of the originally encumbered collateral.

⁸⁹ *Id.*

⁹⁰ Catherine Walsh, *An Introduction to the New Brunswick Movable Property Security Act*, 137 (1995).

parties. In general, a secured creditor must assume this type of continuing obligation to maintain publicity over the “attributable” property.

In addition to the difficulties with publicity, security interests that extend to future property can create potential problems with the definition of the collateral. Considering that a security interest covers collateral that at the moment of creation and publicity does not yet exist, a secured creditor can only anticipate the general category and the types of assets that the debtor may acquire in the future. Consequently, the Model Law must allow for generic collateral descriptions in both the security contract and the registration form, even when specific descriptions are possible. The Model Law allows the parties to describe the collateral in generic form in the security contract.⁹¹ Likewise, the Model Law permits generic descriptions in the registration form, in order to publicize the security interest against third parties.⁹²

In providing generic descriptions, the Model Law goes against traditional collateral descriptions under civil law systems. Generally speaking, civil law jurisdictions require that collateral be defined and described, and that future assets can relate back to the originally encumbered collateral. Secured creditors, however, are reluctant to rely on the ability to trace a “future” asset that exists today back to the original asset-base. Therefore, a future asset feature in the Model Law must function independently of the ability to trace future goods back to the original collateral. As mentioned before, the Model Law does not expressly require tracing for future collateral.

Finally, the Model Law also provides that a security interest in original collateral extends to the right to be indemnified for any loss or damage affecting the collateral during the life of the security interest.⁹³ In addition, secured creditors have the right to receive the proceeds of an insurance policy or certificate that covers the value of the collateral. These rights to indemnification operate without the need for express mention in the security contract or in the registry filing form.⁹⁴

F. Future Advances

One of the key practices of modern secured financing statutes is the *floating lien*, where both the collateral and the secured obligation fluctuate.⁹⁵ To ensure that the Model Law allows this practice, it must not only validate security interests in attributable property and after-acquired collateral but also validate security interests that secure future advances. Together, these features provide flexibility to enable the debtor to obtain a fluctuating line of present and future advances by creating a security interest over a fluctuating fund of present and future collateral. This practice is necessary for inventory and accounts financing.⁹⁶

⁹¹ Model Law, *supra* note 40, arts. 2 & 7(IV).

⁹² *Id.* art. 38(IV).

⁹³ *Id.* art. 3(V).

⁹⁴ *Id.*

⁹⁵ Walsh, *supra* note 90, at 89-91.

⁹⁶ *Id.*

Civil law systems as a rule require that a secured creditor indicate the exact amount of the secured debt. There is little support for the registration of open-ended obligations. The Model Law, however, allows obligations to be present and future, as well as determined or determinable.⁹⁷ The one limitation provided for in the Model Law is that the parties must set a maximum amount that the secured obligation may reach in both the security contract⁹⁸ and in the registration form.⁹⁹ This limitation was seriously debated during the Miami group of experts meeting as well as during the CIDIP-VI drafting committee sessions. On the one hand, common law lawyers argued that the requirement did not have much of an effect in a commercial lending environment with little interest in lending on the residual value of inventory or accounts receivable and where a line of credit by creditor “B” is seldom extended after creditor “A” had extended his. On the other hand, Latin American experts and national delegates invoked the principle of functional notice and the need to eliminate secret liens by requiring utmost truth and transparency in the amount lent. They felt that if this amount were left unspecified, bad faith practices would be encouraged. Furthermore, if the secured debtor knew that his ability to borrow would be reduced by the amount stated in the financing statement, he would make sure that such an amount was truthful and realistic. Since the key question was “what would work best in an environment where secured lending was still regarded as a tricky occupation?” the civil law lawyers’ arguments had to carry the day.

Also contended was the issue whether the Model Law should relate future advances back to the original date of publicity. The group of experts concluded that the relation back issue better be left to each adopting country, especially in light of its bankruptcy laws. Additionally, civil law statutes generally require a termination date in the security contract and registration form. Consequently, commercial loans must have a set payoff date, hindering the use of some open lines of credit. Because of its goal to facilitate line of credit type of lending, the Model Law does not include this limitation, allowing the parties to set a termination date if desired but not forcing them to do so.¹⁰⁰

G. Purchase Money Security Interests

The main objective of the purchase money security interest (PMSI) is to provide freedom to the debtor to borrow funds from various creditors.¹⁰¹ As discussed above, the Model

⁹⁷ Model Law, *supra* note 40, art. 1 states that the objective of the model law is to secured any obligations whatsoever, present or future, determined or determinable of any nature.

⁹⁸ *Id.* art. 7(III).

⁹⁹ *Id.* art. 38(IV).

¹⁰⁰ *Id.* art. 7. The only date requirement in the text of the model law is the date of execution of the contract. The only other time limitation under the Model Law allows adopting states to limit the number years

¹⁰¹ *Id.* The Model Law uses the term “Acquisition Security Interest” instead of Purchase Money Security Interest as more consistent with civil law terminology and concepts. Acquisition security interest is defined as a security interest granted in favor of a creditor, including a supplier, who finances the acquisition by the debtor of the movable corporeal property over which the security interest is granted. Such security interest may secure the purchase of present or subsequently acquired movable property so financed.

Law creates security interests in future property. This type of system allows a creditor to encumber all the present and future collateral of a debtor, thereby limiting the debtor's ability to obtain financing from other sources. The PMSI alleviates this problem by allowing a PMSI creditor to obtain priority over previous creditors with respect to goods specifically acquired with the proceeds of the PMSI credit. This allows a debtor to obtain additional financing for new goods by allowing the PMSI creditor a preferential right. Simply put, a PMSI allows a party second-in-time to become first-in-right with respect to the acquired property.

The PMSI can cover collateral acquired on trade-credit or acquired directly with the funds of a PMSI loan.¹⁰² In turn, goods acquired secure payment of the purchase price.¹⁰³ A PMSI is a *non-possessory* security device. As such, the PMSI is publicized by registration methods required of all other such devices.¹⁰⁴ Unlike general security interests, however, a publicized PMSI provides the creditor with priority over previous secured creditors with security interests in after-acquired collateral and attributable property.¹⁰⁵ As a result, the Model Law requires a reference to the special character of this security interest.¹⁰⁶ In addition, a PMSI will cover only the specific movable property acquired with the PMSI funds as described in the security contract and registration form.¹⁰⁷

Even though the Model Law attempts to encourage PMSI credit, it also contains rules designed to safeguard the rights of preexisting non-PMSI creditors. For example, a PMSI creditor must fulfill two rules in order to obtain priority over a previous non-PMSI creditor with a security interest in the same type of collateral. First, as mentioned above, a PMSI creditor must add a special notation to the registration form. Second, the PMSI creditor must notify previous creditors that this party has or expects to acquire a PMSI in the collateral.¹⁰⁸

¹⁰² *Id.* art. 3(IX) & art. 51.

¹⁰³ *Id.* Consider, for example, a transaction where a secured creditor (SC1) creates and files a general (non-PMSI) security interest over the secured debtor's present and future acquired farming equipment. Later, seller (secured creditor two, SC2) sells new farming equipment to the secured debtor and retains a purchase money security interest in the goods to secure payment of the unpaid price and promptly files its security interest. The question is whether SC1 has priority over the farming equipment obtained by secured debtor with the value provided by SC2. The answer should be no, as long as there is a rule that gives priority to subsequent creditors secured with a PMSI.

¹⁰⁴ Model Law, *supra* note 40, art. 12.

¹⁰⁵ *Id.* art. 51. Under the Model Law, a PMSI will have priority over a previous security interest that encumbers future movable property of the secured debtor, as long as it is created according to the provisions of this Law, even when it was publicized after the previous security interest.

¹⁰⁶ *Id.* art. 12.

¹⁰⁷ *Id.* art. 51.

¹⁰⁸ *Id.* art. 40. To illustrate, consider Secured Creditor One (SC1) who creates and files a security interest over a secured debtor's present and future acquired farming equipment. Later, Secured Creditor Two (CP2) provides secured debtor with funds to purchase cattle—which, for purposes of this discussion, do not qualify as farming equipment. Instead of purchasing the cattle, however, the secured debtor purchases a tractor and an irrigation system. Under the proposed

When dealing with a PMSI in inventory, many of these difficult issues can become more complex. By nature, inventory is meant for its sale or resale by the secured debtor. As such, inventory is designed to create attributable property, which, in turn, must serve as collateral for the loan.¹⁰⁹ In cases where a non-PMSI and a PMSI coexist over the same inventory, deciding which creditor has a security interest over the property attributable to the sale of the inventory can be very difficult. Previous versions of the Model Law did not limit attributable property of a PMSI in inventory.¹¹⁰ The final version of the Model Law, however, limits the attributable property of a PMSI. This version limits a PMSI creditor's right to the direct cash proceeds of the sale of the PMSI collateral.¹¹¹ In other words, the PMSI creditor has no right to attributable property other than the first generation cash generated by the sale of the inventory. This limitation was justified on the basis of what most experts and delegates felt was the public policy of their respective for a, including the rights of unsecured creditors in a bankruptcy proceeding.

H. Publicity

As discussed in connection with the principle of functional notice, modern secured financing law requires that secured creditors “publicize” their security interests to give notice to third parties that the debtor’s movable property serves as collateral for a loan.¹¹² Secured financing laws also follow some variation of the “*first-in-time*” rule, meaning that the first secured creditor to publicize and give notice of its security interest receives priority *vis-à-vis* subsequent parties.¹¹³ The most common method for publicity is

rule, SC1 would have an after-acquired priority over the tractor and irrigation system pursuant to his publicized security interest in these types of goods. This outcome is based on the fact that SC2 is in a better position than SC1 of ensuring that purchase money funds are not misused. Without such a provision, debtors and subsequent creditors acting in bad faith may undermine a secured party’s security interest. In such a situation, SC2 can simply write a check in favor of the seller of the cattle (instead of writing it to the secured debtor), ensuring that the intended collateral is in fact acquired.

¹⁰⁹ See Section IV (E).

¹¹⁰ Model Law Previous Version, *supra* note 81, arts. 77-78.

¹¹¹ Model Law, *supra* note 40, art. 51. The reason for this inventory-financing requirement stems from practices, originating in the United States and Canada concerning lines of credit. U.S. and Canadian practices allow debtors with lines of credit to draw funds on the line of credit to the extent supported by an existing asset-base of inventory and accounts receivable. Under this arrangement, a debtor could increase its asset-base with inventory acquired from a supplier by using a PMSI arrangement. The secured debtor can claim to have a larger asset-base, by supporting this claim with inventory encumbered by the PMSI if the PMSI creditor does not notify the previous secured party. In that instance, the debtor could draw disproportionately on the line of credit and deceive the first creditor. Consequently, the Model Law attempts to resolve this problem by excluding assets encumbered by a PMSI from the asset base calculation by requiring that a PMSI creditor provide notice to the original secured party and by limiting the PMSI creditor’s right to the cash directly attributable to the sale of the inventory.

¹¹² Edward S. Adams, *et al.*, *A Revised Filing System: Recommendations and Innovations*, 79 Minn. L. Rev. 877, at 879.

¹¹³ Model Law, *supra* note 40 arts. 35 & 48.

registration, giving constructive notice of the security interest via a record in a public registry office.¹¹⁴ Registration is available for most types of security interests and in most cases is the only permissible way to publicize.

The purpose of publicity is to provide notice to third parties that collateral which they may consider taking as security or purchasing is encumbered by a previous creditor. Publicity, achieved by registration or otherwise, establishes the priority of the secured creditor over third parties¹¹⁵ and allows the secured creditor to repossess and dispose of collateral ahead of other parties.¹¹⁶

1. Methods of Publicity

The Model Law provides three methods by which a secured creditor may attain publicity: registration,¹¹⁷ possession¹¹⁸ and notice.¹¹⁹ Unlike other secured transactions statutes, the Model Law does not provide grace periods or automatic/temporary periods of publicity. The majority of the experts as well as OAS delegates and members of the drafting committee felt that grace periods or temporary periods of publicity would only encourage a tendency towards chicanery. In general, when the security is non-possessory, the Model Law requires publicity by filing a registration form that describes the secured debtor and the collateral.¹²⁰ When the security interest is possessory, the Model Law requires publicity by delivering possession of the collateral to the secured creditor.¹²¹ When the security interest allows a third party to retain possession of the collateral, the Model Law allows publicity by giving notice to the third party in possession.¹²² Similarly, as just

¹¹⁴ *Id.* art. 35.

¹¹⁵ *Id.*

¹¹⁶ *Id.* arts. 54-67.

¹¹⁷ *Id.* art. 10. In general, security interest in all types of collateral may be publicized by registration. Security interests in receivables are publicized by registration. *See also*, art. 14. Security interests in non-monetary claims are publicized by registration; art. 21. Security interests in letters of credit are publicized by registration; art. 25. Security interest in instruments and documents may be publicized by registration; arts. 27& 29. Security interests in inventory are publicized by registration; art. 31. Security interest in intellectual property are publicized by registration; art. 32. Acquisition security interests are also publicized by registration; art. 12.

¹¹⁸ *Id.* art. 10. However, a security interest may be publicized by delivery of possession or control only if the nature of the collateral so permits or delivery is effected in the manner contemplated by the Model Law.

¹¹⁹ *Id.* art. 30.

¹²⁰ *Id.* arts. 35 & 38.

¹²¹ *Id.* art. 10.

¹²² *Id.* art. 30. The secured creditor may hold property through a third person and give publicity by providing written notice to this party. In addition, when the collateral is represented in a document, a secured creditor may publicize a security interest in the relevant collateral by giving notice to the third party depository or bailee, when this party is in possession of the collateral. *See also*, art. 29. In cases of letters of credit, the Model Law establishes that a security interest will not be enforceable against a paying bank unless such bank has been notified of the security interest and consented to revised payment terms in case of default. *See*, art. 25.

discussed, a PMSI secured creditor must also give direct and personal notice to other secured creditors.

2. *Non-Possessory Security*

Latin American non-possessory security devices—legal figures that allow the debtor to retain possession of the collateral—do not provide adequate protection to secured creditors vis-à-vis third parties. The Model Law protects secured creditors as long as this party publicizes its security interest by filing a registration form.¹²³ Once publicized, the non-possessory security interest is valid against all third parties.¹²⁴

A non-possessory security interest can encumber corporeal, incorporeal, present and future movable property.¹²⁵ A *non-possessory* security interest covering present and corporeal collateral is publicized by filing of a registration form describing the collateral in detail.¹²⁶ A *non-possessory* security interest covering future collateral (attributable property, after-acquired collateral and other future or replacement goods) or incorporeal collateral (receivables, payment intangibles and intellectual property rights) is publicized by filing a registration form describing the collateral in generic manner.¹²⁷

3. *Receivables*

Publicity of security interests in receivables under the Model Law generally attempts to follow the United Nations Convention on Assignment of Receivables in International Trade.¹²⁸ Still, under the Model Law and consistent with the principle of functional notice and elimination of secret liens, registration is the sole method for publicity of a security interest in this type of asset.¹²⁹ In case of default, the Model Law allows a secured creditor to collect payment on the receivable directly from the account debtor by

¹²³ *Id.* arts. 35 & 38.

¹²⁴ *Id.* arts. 10 & 47.

¹²⁵ *Id.* art. 1 & 2. Under the Model Law, security interests can cover one or several specific items of movable property, generic categories of movable property, or all of the secured debtor's movable property, whether present or future, corporeal or incorporeal, as long as it is susceptible to monetary valuation.

¹²⁶ *Id.* art. 38(IV). The registration form allows the entry of generic or specific collateral descriptions.

¹²⁷ *Id.*

¹²⁸ U.N. Convention, *supra* note 41; Model Law, *supra* note 40, arts. 13-20.

¹²⁹ Model Law, *supra* note 40, art. 14. Various delegations suggested the possibility of publicity by notice for receivables--notice of the security interest to the account debtor--instructing this party to pass notice along to other parties interested in the receivable. However, a security interests over accounts generally covers most (if not all) the secured debtor's accounts, typically a large number. Hence, publicity by notice to each account debtor would be impractical. Moreover, accounts are paid-off and others generated on a regular basis making a personal type of notice highly impractical. A secured party would be required to monitor the secured debtor's business in order to notify each new account debtor. Given the practical difficulties, costs and uncertainties of notice publicity, the Model Law opted to allow publicity by registration exclusively.

notifying the account debtor to remit payment directly to the secured creditor.¹³⁰ However, unless otherwise agreed, the Model Law does not allow the secured creditor to deliver notice and request payment, unless there has been a default.¹³¹

Like the U.N. Convention, the Model Law prohibits the use of non-assignability clauses.¹³² Under the Model Law, a security interest in receivables is effective regardless of an agreement between the account debtor and the secured debtor to limit the latter's right to grant security in or assign a receivable.¹³³ The Model Law, however, does not affect the liability of the secured debtor to pay damages to the account debtor for breach of this type of agreement.¹³⁴ In addition, the Model Law allows the account debtor to raise defenses and rights of set-off against the secured creditor, if these arise out of the transaction or contract that gave rise to the assigned receivable.¹³⁵

Finally, the Model Law covers assignments of receivables even in cases where the assignment is not intended as security.¹³⁶ The reason for this rule is that the economic and legal nature of outright assignments of receivables is very similar to the taking of a security in receivables.¹³⁷ This is especially true if the sale allows recourse against the seller.¹³⁸ However, the Model Law that requires outright assignments comply only with its publicity requirements. Failure to comply, however, subjects the assignment to the

¹³⁰ *Id.* art. 17. The notice to the account debtor may be given by any generally accepted means of communication. In order for such notice to be effective, it must identify the receivable with respect to which payment is requested, and include sufficient payment instructions to enable the account debtor to comply.

¹³¹ *Id.*

¹³² *Id.* art. 19. The following example illustrates the importance of prohibiting the use of non-assignability clauses: Buyer (account debtor) purchases goods on credit from seller (secured debtor), generating an account receivable. The account debtor demands a non-assignability clause in its account receivable with the seller, who accepts. Seller requests a loan from secured party who requires a security interest in seller's accounts receivable. Seller, now also a secured debtor, grants the security interest and receives the loan. If the security interest does not cover the non-assignable account (regardless of the non-assignability clause) a secured creditor would have to contact every current and future account debtor to make sure that a given account is, in fact, assignable. This cumbersome task would impede most security interests in accounts from ever occurring. Consequently, a policy choice in favor of accounts receivable financing must be made when considering enactment of the Model Law that would restrict the account debtors' freedom of contract by denying the enforceability of non-assignability clauses.

¹³³ *Id.*

¹³⁴ *Id.*

¹³⁵ *Id.* art. 20. The account debtor may raise against the secured creditor all defenses and rights of set-off arising from the original contract, or any other contract that was part of the same transaction that the account debtor could raise against the secured debtor. The account debtor may raise against the secured creditor any other right of set-off, provided that it was available to the account debtor when notification of the security interest was received by the account debtor.

¹³⁶ *Id.* art. 13. The scope of the Model Law covers every type of assignment of receivables. *See supra* section IV (C).

¹³⁷ *See supra* notes 69-71 and accompanying text.

¹³⁸ *Id.*

priority rules of the Model Law.¹³⁹

4. *Non-Monetary Claims*

The principle of universality of collateral (and the popularity of non-monetary claims as collateral) requires that it be governed by the Model Law. A security interest in non-monetary claims is publicized by registration.¹⁴⁰ Non-monetary claims include all types of contractual and extra-contractual obligations whether for performance or contractual or for breach of contract or tortious conduct, that are susceptible to monetary valuation at the time of the creation of the security interest or thereafter.¹⁴¹ As with receivables (monetary claims), the Model Law allows the secured creditor to enforce a security interest in non-monetary claims by notifying the person thereby obligated to perform.¹⁴² The security interest can be enforced only to the extent the obligation permits.¹⁴³ A person obligated on the claim cannot refuse to perform on behalf of the secured creditor unless there is reasonable cause.¹⁴⁴

5. *Documentary Credits*

The NLCIFT preparatory studies showed that one of the most desirable and yet under-utilized forms of collateral in Latin America and the Caribbean was the documentary credit (also known as the commercial and standby letter of credit) their proceeds and the rights to draw thereunder. Under the Model Law, security interests in documentary credits requiring presentation for payment are publicized by the delivery of the letter of credit to the secured creditor.¹⁴⁵ This is a “negative” security interest in that it only impedes the secured debtor’s drawing on the letter of credit when it requires its presentation for drawing purposes. Simple possession by the secured creditor, however, does not entitle this party to draw on the letter of credit as the beneficiary of that document.¹⁴⁶

In addition, security interests in the proceeds of documentary credits are publicized by filing a registration form in the registry.¹⁴⁷ However, the validity of this security interest requires the following: first, an understanding that the existence of the security interest in

¹³⁹ *Id.*

¹⁴⁰ Model Law, *supra* note 40, art. 21.

¹⁴¹ *Id.* art. 2.

¹⁴² *Id.* art. 22.

¹⁴³ *Id.*

¹⁴⁴ *Id.*

¹⁴⁵ *Id.* art. 23. Under the Model Law, a security interest in a documentary credit that requires its presentation to obtain payment shall be publicized by the beneficiary’s (secured debtor’s) delivery of the documentary credit to the secured creditor, provided that such a documentary credit or letter of credit does not forbid its delivery to a party other than the paying bank.

¹⁴⁶ *Id.* Unless the documentary credit or letter of credit has been amended to permit the secured creditor’s draw, the delivery to the secured creditor does not entitle the latter to draw on the documentary credit or letter of credit and solely prevents the beneficiary’s (secured debtor’s) presentment of the documentary credit or letter of credit to the paying or negotiating bank.

¹⁴⁷ *Id.* art. 25.

the proceeds of a documentary credit is conditioned upon the beneficiary complying with its terms and conditions and becoming entitled to payment on the document;¹⁴⁸ and second, that the security interest is not thereby enforceable against the issuing or confirming bank until the latter accepts the security interest and its terms and conditions governing the payment of the credit.¹⁴⁹

The Model Law also allows a debtor to assign its right to draw on a documentary credit to a secured creditor.¹⁵⁰ To do so, the parties must obtain the issuance of a credit transferable to the secured creditor.¹⁵¹ However, the validity and effect of the transfer is governed by the UCP 500 or its successors.¹⁵²

Finally, the Model Law requires that the secured creditor deliver timely value after publicity of the security interest and acceptance by the paying bank.¹⁵³ Under the Model Law, if the secured creditor does not provide such credit or value within 30 days following this acceptance, the security interest terminates automatically. In addition, the publicity registration may be cancelled and the secured creditor must sign a release to the paying bank.¹⁵⁴

6. Instruments and Documents

Another form of collateral that the NLCIFT studies determined were in the category of “under-utilized” were negotiable instruments and commercial paper as well as documents of title. Under the Model Law, security interests in instruments and documents are publicized by registration.¹⁵⁵ However, when the instruments or documents are negotiable, the Model Law requires publicity by delivery of possession.¹⁵⁶ In addition, when a transfer or pledge of a document takes place in an electronic format (or in an electronic registry), the special rules governing the electronic registry apply.¹⁵⁷

When movable property represented by a document is in the possession of a third party depository or a bailee, a security interest over such property may be publicized by delivery of a written notice to the third party in possession.¹⁵⁸ The Model Law allows the

¹⁴⁸ *Id.*

¹⁴⁹ *Id.*

¹⁵⁰ *Id.* art. 24.

¹⁵¹ *Id.*

¹⁵² Uniform Customs and Practices for Documentary Credits, version 500, of the International Chamber of Commerce, as periodically revised.

¹⁵³ Model Law, *supra* note 40, art. 26. The Model Law establishes that, if the secured obligation consists of a future extension of credit or the giving of value in the future, the secured creditor must extend such credit or value no later than 30 days from the date on which the issuing or confirming bank accepts the terms and conditions of the security interest in the proceeds of documentary credit.

¹⁵⁴ *Id.*

¹⁵⁵ *Id.* art. 27.

¹⁵⁶ *Id.*

¹⁵⁷ *Id.* art. 28.

¹⁵⁸ *Id.* art. 29.

parties to change the method of publicity. As long as there is no interim period in which the security interest was not publicized, its priority will date from the original date of publicity.¹⁵⁹

7. *Specialized Collateral and Registration thereof*

As mentioned earlier, security interests in most types of collateral can be publicized by registration.¹⁶⁰ Although the Model Law does not expressly specify the location in which registration must take place,¹⁶¹ it does create a federal (nationwide) registry database.¹⁶² Consequently, security interests in the great majority of collateral are publicized by filing at this central registry.

The Model Law, however, requires a special registration (at a different registry location) to publicize security interests for other types of collateral.¹⁶³ Special registration is required where another law requires title to movable property to be registered in a special registry, as long as the special law also regulates security interests over such property. The special law will have precedence over the Model Law, to the extent of any inconsistency.

¹⁵⁹ *Id.* arts. 10 & 29. The Model Law, for example, establishes that if the secured creditor publicizes its security interest by possession and endorsement of the document but subsequently delivers it to the secured debtor for any purpose (withdrawing, warehousing, manufacturing, shipping or selling the movable property represented by the document), the secured creditor must register its security interest before the document is returned to the secured debtor in order to retain publicity.

¹⁶⁰ *Id.* In general, security interest in all types of collateral may be publicized by registration. Security interests in receivables are publicized by registration. *See also* art. 14. Security interests in non-monetary claims are publicized by registration; art. 21. Security interests in letters of credit are publicized by registration; art. 25. Security interest in instruments and documents may be publicized by registration; arts. 27 & 29. Security interests in inventory are publicized by registration; art. 31. Security interest in intellectual property are publicized by registration; art. 32. Acquisition security interests are also publicized by registration; art. 12.

¹⁶¹ *Id.* arts. 71-92.

¹⁶² Commercial Registry Law, drafted by the General Directorate of Commercial Registries at the Ministry of Commerce (SECOFI), published in the *Diario Oficial*, May 28, 2000 as contained in Hacienda Law, *Decreto que Reforma, Adiciona y Deroga Diversas Disposiciones de la Ley General de Títulos y Operaciones de Crédito, del Código de Comercio, del Código Penal para el Distrito Federal y de la Ley de Instituciones de Crédito, a cargo de los CC. Diputados Efrén Enriquez Ordoñez y Américo Ramírez Rodríguez, Sucria por Diputados de los Grupos Parlamentarios de los Partidos Revolucionario Institucional, Acción Nacional y Verde Ecológico.* (Decree that reforms, adds and repeals different dispositions of the General Law of Credit Instruments and Operations, of the Commercial Code, of the Penal Code for the Federal District and of the Law of Credit Institutions, in charge of the Honorable Representatives Efrén Enriquez Ordoñez and Américo Ramírez Rodríguez, subscribed by Deputies of the Parliamentary Groups of the Revolutionary Institutional Party (PRI), the National Action Party (PAN) and the Green Ecological Party (PVE)), *Gaceta Oficial de la H. Cámara de Diputados*, 9 Diciembre 1999. (Official Gazette of the Chamber of Deputies, December 9, 1999) (hereinafter the “Commercial Registry Law”) arts. 18-32.

¹⁶³ Model Law, *supra* note 40, art. 37.

Previous versions of the Model Law detailed the types of collateral that require special registration.¹⁶⁴ The final version does not. However, it is generally accepted that special registration is required for high-value movable goods and goods that can be described with specificity. Automobiles, aircraft, boats and heavy machinery are common examples. Intellectual property rights represent other categories of property that may require special registration.

8. Fixtures

Fixtures represent another instance where publicity requires a special registration. When property used as collateral for a loan is adhered to or incorporated into real property, the Model Law requires that the secured creditor file an extra document to ensure publicity over previous security interests in the real property. Like security interests in any other types of movable property, publicizing a security interest in fixtures requires the registration of a registration form. In order to publicize and gain priority with regard to real estate claimants, the Model Law requires an additional registration in the real property registry before the movable property subject to the security interest is incorporated thereto.¹⁶⁵

9. Possessory Security

Possessory pledges have existed in Latin America since the adoption of the French and subsequently Spanish 19th century Civil Codes. These devices, which function by delivery of possession to the secured creditor, work well within their present legal framework.¹⁶⁶ In general, current pledge law provides publicity against third parties from the moment in which the debtor delivers possession of the collateral to the creditor or appointed third party.¹⁶⁷ The Model Law preserves the operation of this device and regulates only the obligations of a secured creditor in possession of the collateral.¹⁶⁸ In general terms, the Model Law requires that the secured creditor in possession exercise reasonable care in the custody of the collateral, maintain the collateral in an identifiable manner and use the collateral only as contemplated by the parties.¹⁶⁹ These issues are not

¹⁶⁴ Model Law Previous Version, *supra* note 81, art. 73.

¹⁶⁵ Model Law, *supra* note 40, art. 52 (IV). A publicized security interest in a movable that is affixed to an immovable, without losing its identity as a movable, has priority over security interests in the relevant immovable, provided the security interest over the movables has been registered in the immovable registry before affixation.

¹⁶⁶ Arg. Cod. Civ. art. 3204 *et. seq.*; Brazil C.C. art. 758 *et. seq.*; Chile Cod. Civ. art. 2384 *et. seq.*; Costa Rica Cod. Civ. art. 441, *et. seq.*; Dominican Republic Cod. Civ. art. 2073 *et. seq.*; Ecuador Cod. Civ. art. 2310 *et. seq.*; El Salvador Cod. Civ. art. 2134 *et. seq.*; Guatemala Cod. Civ. art. 880 *et. seq.*; Honduras Cod. Civ. 2056 *et. seq.*; C.C.F. art. 2856 *et. seq.*; Nicaragua Cod. Civ. 3728, *et. seq.*; Panama Cod. Civ. art. 1548 *et. seq.*; Paraguay Cod. Civ. art. 2294 *et. seq.*; Peru Cod. Civ. art. 1055 *et. seq.*; Uruguay Cod. Civ. art. 2292 *et. seq.*; and CCV art 1837 *et. seq.*

¹⁶⁷ *Id.*

¹⁶⁸ Model Law, *supra* note 40, art. 33.

¹⁶⁹ *Id.* The Model Law requires that a creditor in possession of the collateral must exercise reasonable care in the custody and preservation of the collateral. Reasonable care includes the

generally addressed by current Latin American law.

Finally, as mentioned before, a possessory security interest may be converted into a non-possessory security interest and retain its priority.¹⁷⁰ However, the Model Law requires that the security interest be publicized by registration before the secured creditor delivers possession of the collateral to the secured debtor.¹⁷¹

I. Registration

A central aim of the Model Law is to strike a proper balance between the burden placed on the registering party and the need of searching parties to obtain enough information to make a business decision concerning a particular debtor's collateral. This new system, based on a summary form of notice, requires only enough information to permit a searching third party to identify the parties to a transaction and the property serving as collateral.

1. Registration Form

In order to allow maximum flexibility to the parties to a secured transaction while providing proper notice to third parties, the Model Law requires publicity by filing of a registration form—a one-page document consisting of information designed to alert third parties that a debtor's assets may serve as collateral for a loan.¹⁷² The registration form merely requires the debtor's name and address, the secured creditor's name and address, the maximum amount of the secured obligation, and a description of the collateral.¹⁷³ The registration form does not overburden a registering party, yet provides sufficient information to put third parties on notice that further inquiry is needed.

a) Advantages

A registration form has several important advantages over the current practice in Latin America of registering the actual security contract. First, a registration form limits the information contained and thereby provides a greater measure of confidentiality of

obligation to take the necessary steps to preserve the value of the collateral. The creditor must also maintain the collateral in such a way that it remains identifiable, unless the collateral is fungible and limits the creditor's use of the collateral to the terms set forth in the security contract.

¹⁷⁰ See also *supra* section IV (H) (6).

¹⁷¹ Model Law, *supra* note 40, arts. 10 & 34.

¹⁷² *Id.* art. 38. Current laws create transactional registration systems where what is registered is the security contract. This system makes registration necessary not only to provide notice to third parties, but also, at times, to create a binding security interest between the original parties to the transaction. For a copy of registration forms under the revised Mexican registry system, see, <<http://www.siger.gob.mx>>.

¹⁷³ *Id.* A registration form should be a simple document or, even, information revealed on a computer screen and should contain only basic information about the secured party, the secured debtor and the collateral. This registration form should contain no reference to a particular transaction between the parties. See also, Ronald C.C. Cuming, *Saskatchewan Personal Property Registry*, Saskatchewan, Personal Property Registry (May, 1998), at 1-4.

business information.¹⁷⁴ Second, a single registration form can relate to one or more secured transactions.¹⁷⁵ Moreover, a registration form can be registered before a security contract is executed between the parties.¹⁷⁶ Finally, a registration form facilitates remote-access registration.¹⁷⁷ Although the Model Law does not deal with the subject of standardized forms except insofar as they become electronic messages or recorded data in accordance with the provisions of IAREDS a modern registry system should contemplate the use of a uniform registration form especially in an electronically standardized international fashion.¹⁷⁸

b) Description

Current Latin American laws require that the registered document describe the collateral to a loan in “indubitable,” indelible manner—a description frequently compared to the serial-number test replaced by the Original Article 9 of the Uniform Commercial Code in the United States. Detailed descriptions, however, hinder security interests that extend to future goods, which do not exist at the time of registration and, thus, are not susceptible to detailed description. Fungible goods such as grains and raw materials, as well as revolving goods such as inventory, also cannot be described in such detail. Consequently, these types of goods are *de facto* excluded collateral from the present secured financing system in Latin America.

The Model Law, as mentioned previously, provides for security interests in future property, receivables, fungible goods and inventory. As a result, the Model Law provides for generic collateral descriptions in both the security contract¹⁷⁹ and registration form.¹⁸⁰

c) Signatures

Previous versions of the Model Law required different signatures on the security contract and the registration form. The final version requires only the signature of the debtor on the security contract,¹⁸¹ but requires no signature in the registration form.¹⁸² A major trend in secured financing reform is the absence of a requirement that the debtor's signature appear on the registration form.¹⁸³ This practice is designed to facilitate electronic registration, whereby the secured creditor can electronically register a registration form without the need to relay the registration form through the debtor for

¹⁷⁴ Cuming, *supra* note 173, at 2.

¹⁷⁵ *Id.*

¹⁷⁶ *Id.*

¹⁷⁷ *Id.*

¹⁷⁸ A uniform financing statement was developed for UCC Article 9 and can be developed for member states adopting the Model Law. See generally Sigman, *The Filing System Under Revised Article 9*, 73 Am. Bkcy. Law J.61 (1999).

¹⁷⁹ Model Law, *supra* note 40, art. 7(IV).

¹⁸⁰ *Id.* art. 38(IV). General descriptions involve something such as the following examples: all present and future inventory, all equipment, all appliances and goods attributable thereto, all present and future goods, all General Electric *easy-clean*[®] refrigerators, etc.

¹⁸¹ *Id.*, art. 7(IV).

¹⁸² *Id.*, art. 38.

¹⁸³ See UCC §§ 9-502, 9-509. The financing statement does not require the debtor's signature.

this party's signature.¹⁸⁴ IAREDS reflects this trend.

2. *Timing*

As noted above, publicity determines priority. Priority, in turn, is decided according to some variation on the principle of first-in-time, first-in-right. That is to say, the party who publicizes first (whether by registration or otherwise) prevails. This rule makes the timing of publicity of great practical concern such that a secured creditor should file as soon as possible. Ideally, secured creditors like to file a registration form as soon as they are serious about entering into a secured transaction.

a) *Registry Lag*

Registration under current Latin American registry conditions is usually delayed for a significant period of time after the time the document is initially presented.¹⁸⁵ Frequently referred to as *registry-lag*, this time period is due to a rigorous qualification procedure to which Latin registrars submit all registered documents. This period can range from one to three days, and can often take longer.¹⁸⁶

The Model Law is based on the filing of a one-page registration form, rather than transactional documents (security contracts). Consequently, the Model Law eliminates the need to review and qualify registry documents; other than to check that the fields for party names and addresses, obligation and collateral contain information, there is nothing to review or qualify on the registration form. Consequently, the registry can proceed to

¹⁸⁴ *Id.*

¹⁸⁵ Under current Latin American Law, a registration is generally effective if the following three conditions are met: 1) the parties present a properly ratified loan document; 2) all registry fees are paid in full; and, 3) a registry official reviews the loan document and determines that it is legally valid. When these conditions are met, the document is recorded in the registry records. Under this system, the time that a financing statement actually shows up in the registration system governs priority even though the document does not appear in the registry records until sometime after the review by the registry official. John M. Wilson, *Latin American Registries: Recommendation for Reforming the Current Framework*, at 14-15 (2000).

¹⁸⁶ The following example illustrates the problems created by a registry lag. On March 1, Merchant (D) obtains a loan from Secured Creditor (SC) for the purchase of machinery. The same day, SC files a registration form encumbering D's machinery as collateral for the loan. On March 2, a third party (3P) interested in purchasing D's machinery makes an inquiry at the registry to determine whether there are any encumbrances against D's machinery. Given that the average lag between presentation and registration is 2 to 3 days, it is possible that SC's security interest does not appear on record until March 3. Consequently, 3P may rely on its inquiry of the day before and purchase D's machinery. However, SC's security interest in the machinery is considered valid from the date of presentation, not the date of actual recordation. Therefore, 3P's rights to the machinery it bought in good faith are subordinate to the prior interest, even though 3P relied on what appeared as a proper registry search. If the time between presentation and registration is more than a few days, there is an increased probability that subsequent searches fail to uncover the existence of valid liens. Registry offices in some countries file preventive (interim) notice, which alerts searching parties that a registration may take place in the near future. However, some jurisdictions provide no notice in this interim period.

file the registration form without the current need to qualify the document and thereby without lag time between presentation and actual recordation.

b) Pre-Registration

Pre-registration refers to the practice of filing a registration form either before the parties sign a security contract or before the secured creditor advances funds to the debtor. Several financing activities, including the ability to secure future advances, lines of credit and floating liens, depend on the ability to pre-register. Pre-registration allows the parties to a secured transaction to file early to lock a specific priority. This is an important consideration during the negotiating process and gives the parties one less issue of concern as they conclude a loan agreement or the lender allows the first draw of a line of credit.

While not uncommon in real estate transactions in Latin America, the current Latin American commercial and personal property registry system prohibits all pre-registration. Pre-registration is not possible if the security contract itself must be recorded (or even have been executed) at the time of registration.¹⁸⁷ Since the Model Law moves away from the transaction filing of current Latin American systems, it thereby allows the parties to file a registration form before executing a security contract.

c) Future Advances

Future advances are the funds disbursed by a creditor to a debtor after the first advances made in connection with the execution of the security contract or the date of registration of the registration form, or both,¹⁸⁸ and represent one of the most innovative practices permitted by modern secured financing statutes.¹⁸⁹ Pre-registration also allows the parties to a secured transaction to establish a priority position and proceed with loan negotiations and credit extensions without concern that priority will be lost between the time when negotiations began and the date of publicity.¹⁹⁰

¹⁸⁷ William Boyd, *CANINE: The Complete Article 9*, at Chapter 12-13, <www.law.arizona.edu/forums/forums.html> (1999).

¹⁸⁸ See *supra* notes 95-100 and accompanying text. Credit lines are typical examples of future advances where a debtor has flexibility concerning both the amount drawn on the credit and the date on which the draw takes place. Another important use of future advances is the floating lien. A floating lien allows both the collateral and the secured obligation to fluctuate. With the floating lien, a secured party obtains a security interest in a fluctuating fund of present and future collateral. In turn, a debtor obtains access to a fluctuating line of present and future funds.

¹⁸⁹ See *supra* section IV (F), footnotes 95-100 and accompanying text.

¹⁹⁰ Francisco Ciscomani Freaner & John M. Wilson, *La Garantía Mobiliaria* [*Security Interests in Movables*], *Revista Jurídica Universidad Iberoamericana*, Vol. 29 (1999), at 17. The following scenario demonstrates the practical significance of pre-registration: Merchant (D) seeks to finance commercial activities and approaches creditor (SP) for a loan. SP immediately registers a financing statement describing D as a debtor and specifying kinds of property of D as collateral. SP then obtains a search result that displays the priority position that its registration would establish if this party loans money to D. After a period of negotiations between the parties, an agreement is obtained and a security contract executed. Since SP has already registered a

Many Latin American states prohibit this practice by requiring obligations to be certain as to date and amount before they are legally binding and valid.¹⁹¹ In addition, current Latin American registry systems do not permit registrations that cover credit lines and other types of future advances.¹⁹² The Model Law allows a registration form to encumber both present and future obligations.¹⁹³ As just discussed, the only limitation is that the registration form must provide a maximum amount that the secured obligation can reach.¹⁹⁴ As a result of these changes, a secured creditor may register and publicize a security interest before actually advancing funds to the debtor. If such a provision is abused, the secured creditor will be subject to the civil or criminal sanctions provided by national law.

3. Location

Current Latin American law provides different locations for a proper registration of a security interest.¹⁹⁵ For those security interests publicized by registration, different registry locations are often required. As a rule, most secured transactions are registered in the jurisdiction in which the collateral is located.¹⁹⁶ In other cases, the parties can register at either the debtor's place of residence, the creditor's place of residence or the jurisdiction in which the parties executed the security contract.¹⁹⁷ Other security devices allow the parties to set location by agreement.¹⁹⁸

Bearing in mind that one of the main goals of the Model Law is to facilitate a regional credit market by creating a network of electronic registries, the Model Law creates a single registry database for each country, which contains all registered security interests and which will be connected to similar registries throughout the hemisphere.¹⁹⁹ Centralized systems are possible in most Latin American countries given that registry law is, as a rule, federal in nature.²⁰⁰ A federal, centralized registry can provide various points of access but would constitute a single place to file a security interest. In addition, the centralized database can be accessible from any location, including via existing registry offices. Under this type of system, interested third parties can determine whether a debtor has any liens of record in the entire state, region or country, by consulting one single, centralized registry in their own or in a sister nation.

financing statement and knows the priority position, this party may immediately release the money to D.

¹⁹¹ *Id.* at 17.

¹⁹² *Id.*

¹⁹³ Model Law, *supra* note 40, art. 2.

¹⁹⁴ *Id.* art. 38(III).

¹⁹⁵ Ciscomani, *supra* note 190, at 14-16.

¹⁹⁶ Wilson, *supra* note 79, at 18.

¹⁹⁷ *Id.*

¹⁹⁸ *Id.*

¹⁹⁹ Model Law, *supra* note 40, art. 44. *See also*, Adams, *supra* note 112, at 889.

²⁰⁰ Even though these countries employ federalist systems of government, where the states have jurisdiction over consumer secured transactions, each allows federal jurisdiction over commercial/mercantile transactions including secured loans. Wilson, *supra* note 79, at 19.

Fixture registrations are an exception to this central registration rule. As mentioned before,²⁰¹ fixtures require registration in the real property registry.²⁰² This real property registration takes place in the jurisdiction in which the real property, to which the movable property is adhered, is located. Although some real property may be located in the central jurisdiction, real property may be located in an outside jurisdiction. Consequently, a party with a security interest in fixtures adhered to real property located outside the central jurisdiction must file its security interest in the real property registry for such jurisdiction. Searchers must also consult this registry to discover whether movable property is encumbered.

a) State vs. Federal Registries

In Latin American countries with federalist systems of government (including Argentina, Brazil and Mexico), registry jurisdiction resides at the local or state level.²⁰³ Some states also frequently divide the local registry system into county/judicial districts.²⁰⁴ Each state (and each district within the state) has its own public registry. Consequently, determining the proper registry location is a two-pronged approach. First, parties must determine which state in which to register. Second, parties must determine which registry within the state in which to register. Under current law, the answers to such questions are not always clear and may vary from country to country.

Mexico is currently following the Model Law approach and replacing its state-run commercial registry framework with a central electronic registration system.²⁰⁵ The proposed legal and technological framework permits recording, storing and notification of commercial operations using an information and computer package that will handle registration in all states in uniform fashion.²⁰⁶

The Mexican registry reform project creates a unitary national registry network. This system preserves the decentralized nature of the current registry framework and allows the states to continue to operate their respective registries. However, the system links all county/local registry systems and creates a central database in each state. Likewise, the system links all state registry systems and creates a national database. This database contains all registrations filed throughout the country.²⁰⁷

b) Special Registration

With respect to specialized collateral, such as very valuable equipment or goods affixed

²⁰¹ See *supra* Section IV(H)(8).

²⁰² Model Law, *supra* note 40, art. 40.

²⁰³ Wilson, *supra* note 79, at 19-20.

²⁰⁴ *Id.*

²⁰⁵ Commercial Registry Law, *supra* note 162.

²⁰⁶ *Id.*

²⁰⁷ *Id.* The Mexican system can provide a model that the Model Law may follow in creating a central registry system. See, <<http://www.economia.gob.mx>>.

to real estate, registration may be effected in two locations. Security interests in specialized collateral require registration in a specialized registry, which may be in addition to registration in the traditional secured interest registry system.²⁰⁸ The rationale behind this requirement involves the relative weakness of the traditional registry system, which uses the debtor's name as the sole registration criterion.²⁰⁹ Such a system works well if the collateral is present and future inventory or accounts receivable. It works less well, however, if the collateral is a specific item, such as a large piece of equipment that is easily identifiable.²¹⁰ Using a registry based on debtor names does not protect third parties that are not aware of the existence or identity of the secured debtor.²¹¹

To solve this potential problem, the Model Law recognizes the possibility that another law or an international convention may apply and may require title to movable property to be registered in a special registry.²¹² The Model Law defers to any provisions in such statute relating to security interests to the extent of any inconsistency with the Model Law. Previous versions of the Model Law specifically required a special registration for the following types of collateral: aircraft, boats, motor vehicles, valuable equipment, and, other collateral, which according to national legislation or international treaties, require a special registration.²¹³ The final version of the Model Law contains the same policy without enunciating the types of collateral that may require special registration.

4. Additional Considerations on Registration

a) Presentation

The first step that a secured creditor, or other registering party, takes in the registration process is to present the registration form to the registry office. Currently in Latin America, most registry offices require that registering parties appear in person to present

²⁰⁸ Cuming, *supra* note 173, at 4-5.

²⁰⁹ *Id.*

²¹⁰ *Id.*

²¹¹ *Id.* Such a problem is presented when a secured creditor (SC) publicizes a security interest in, for instance, an industrial sewing machine belonging to manufacturer (A). A then transfers the machine to third party (B) without notifying the secured party or registration a proper financing statement under B's name. A subsequent party that buys or lends to B will have little chance of discovering SP's security interest. Using the traditional registry system, buyer would search under B's name, not A's. In this circumstance, a specialized registry would provide better notice because the registry-search criterion would be based on the description of the sewing machine, not A's name. For example, instead of searching for a lien on "B's sewing machine," buyer would search for a lien on "Singer sews-a-lot[®] sewing machine" serial number 12345. Considering the collateral-specific nature of a specialized registry, the buyer will discover SP's security interest regardless of who is in possession of the collateral at the time of the search.

²¹² Model Law, *supra* note 40, art. 37.

²¹³ *Id.* arts. 40-41. As an example of a special convention that requires separate registration for security interests in specialized types of collateral. *See also*, the Cape Town Convention on security in mobile equipment and its aircraft protocol requiring a special registration for security interests in aircraft, *supra* note 41.

registration-bound documents.

The Model Law accommodates presentation in-person as well as presentation by various forms of electronic transmittal (e.g., mail, fax, modem, courier, EDI, etc.).²¹⁴ Electronic presentation under the Model Law should also follow the IAREDS.²¹⁵

b) Qualification

Under present registry systems, once a document is presented, a registry official determines whether it complies with all legal and procedural requirements for registration.²¹⁶ If the document passes this evaluation, it is recorded. If it does not, it is rejected and returned to the registering party.²¹⁷ As discussed earlier, the time in which the examination takes place ranges from several hours to a few days. Once the examination is complete and the documents are approved for registration, the documents are integrated into portfolios and filed chronologically.

The Model Law does not eliminate the current registry review and qualification procedure, but substantially reduces the scope of the qualification process. The system proposed by the Model Law is based on the filing of registration forms, as opposed to the registration of security contracts under the present system. As a result, the need for review and qualification is greatly reduced.²¹⁸ Under the Model Law, review will not determine the legal validity of the registered document and will be limited to determine whether the registering party presented the registration form to the registry office, paid all applicable fees, and provided information that may be used to identify a debtor, secured creditor and collateral.²¹⁹

c) Index: Registration by the Debtor's Name

Real property registries index security interests according to the legal description of land. Movable property registries, however, index registration forms according to debtor's name.²²⁰ The Model Law requires this type of debtor indexing, which allows interested parties to search the registry to determine the existence of liens on a particular debtor's

²¹⁴ Model Law, *supra* note 40, art. 45. For the registration and searching of information, the Registry will authorize remote and electronic access to users who so request.

²¹⁵ The IAREDS have been appended to the Model Law by OAS resolution CIDIP-VI/RES. 6/02. These rules are intended to satisfy the need for enabling provisions to facilitate the adaptation of secured transactions to the electronic world.

²¹⁶ Wilson, *supra* note 79, at 23-24.

²¹⁷ *Id.*

²¹⁸ Everett Wohlers, *Reporte de Estudio Legislativo y Registral: Visita a los Registros de Estados Unidos y Canadá*, [Report on Legislative and Registry Study: Visits to the Registries in the United States and Canada], at Annex E, National Registry Center, San Salvador, El Salvador (1998).

²¹⁹ *Id.*

²²⁰ Ciscomani, *supra* note 190, at 13.

property by using the debtor's name.²²¹ Consequently, adding a debtor's name to a registration form has an important consequence: the creation of an alphabetized index.²²²

Several important features of a secured financing system cannot function properly if the registry index is based on real property rules requiring collateral descriptions instead of debtor names.²²³ Security interests such as in future goods and accounts only function with a system allowing for general collateral descriptions. General collateral descriptions do not specifically identify the goods and therefore do not have the characteristics that can serve as the index criterion.²²⁴ Consequently, a modern registry system cannot function based on collateral criterion and can only function when debtor names are used as the registration-search criterion.²²⁵

d) Description of the Collateral

Under the Model Law, the collateral identification requirement is satisfied if the registration form contains a specific description of the collateral.²²⁶ However, the Model Law also permits collateral identification to take place in generic terms.²²⁷ In other words, any description of movable property collateral is sufficient, whether or not it is specific or generic, as long as it serves to identify the goods subject to a security interest.²²⁸

²²¹ Model Law, *supra* note 40, art. 43. The Model Law establishes that the State will operate and administer the Registry, which will be public and automated and in which there will be an electronic folio, which will be indexed by the name of the secured debtor.

²²² Cuming, *supra* note 173, at 4. Once presented, reviewed and accepted, financing statements are index based on the debtor's name. For example, where the correct name is Smith, the financing statement should be indexed alphabetically with the names beginning with "S." A searcher contemplating extending secured credit to this debtor should search under the name "Smith."

²²³ *Id.*

²²⁴ *Id.* For example, a security contract may provide for a security interest in movable property that the debtor acquires at a future time. Future goods cannot be described, and therefore cannot be indexed based on such a description. The same is true of security contracts in accounts, incorporeal and fungible goods.

²²⁵ For this type of system to work, both the secured party and the searcher must use the same name. If the secured party uses one name and a searcher another, obvious problems result. Deciding upon the correct name can sometimes present unforeseen difficulties. For example, determining the debtor's name is difficult in cases where the debtor is an individual that uses an alias, where the debtor is a business entity that is not filed with the state, and where the debtor operates under an assumed or trade name. Additionally these complications can be compounded by the relative ease with which a debtor may change his name.

²²⁶ Model Law, *supra* note 40, art. 38(IV).

²²⁷ *Id.*

²²⁸ *Id.* The description of the collateral, as contained in a financing statement, informs interested third parties that certain property is subject to a publicized security interest. Nevertheless, considering that modern registry systems employ a "notice registration" approach, the information provided will not necessarily be complete concerning the exact property subject to a security interest and other terms. Instead, searchers are only put on notice that another party may

Previous versions of the Model Law required a special notation or description in cases where a security interest covered complete categories of a particular collateral type (e.g. all inventory, all equipment, all general electric appliances, all accounts receivable, etc.).²²⁹ The final version does not require similar notations. In the event that the parties do not intend that a security interest encumber all of the debtor's movable property, the parties may choose a universal description such as "all assets," but may limit its scope (e.g., all assets other than automobiles).

e) Signatures

Currently, Latin American registry systems are highly formalistic, constantly requiring written signatures, notarization and ratification.²³⁰ Fortunately, many Latin American countries have begun to implement rules regarding electronic signatures and are thus setting the foundation for simpler (less formalistic) signature requirements.²³¹ Although eliminating current formalistic signature requirements is not an easy task, the Model Law does not require a signature on the registration form.²³² This trend of reducing the need for, and number of, signatures will result in improved speed and efficiency.

Some members of the Group of Experts and delegates argued that reducing handwritten signatures (or eliminating them altogether) sacrifices important safeguards aimed at reducing bad faith on behalf of the contracting parties. However, the majority of experts and delegates felt that electronic registration has created a system that is most efficient if the electronic registration form reduces or eliminates the need for signatures. In addition, the opinion of internationally recognized experts weighed in on the side of technology.²³³ As a result, consensus was reached on the issue of not requiring a signature on the registration form.²³⁴ This does not mean the Model Law ignores the concerns of safeguarding parties to secured transactions from unauthorized registrations. Simply, while paper-based registration protected debtors from unauthorized registrations by requiring this party's signature on the registration form,²³⁵ the Model Law can achieve this same level of protection by implementing controls on a registering party's

have a security interest in property the searcher is considering as collateral and that further inquiry is required.

²²⁹ Model Law Previous Version, *supra* note 81, art. 75(d).

²³⁰ Commercial Registry Law, *supra* note 162, Exposition of Motives; *see also*, Ciscomani, *supra* note 190, at 17-18.

²³¹ ORGANIZATION OF AMERICAN STATES, RESPONDING TO THE LEGAL OBSTACLES FOR ELECTRONIC COMMERCE IN LATIN AMERICA, MATERIALS ON ELECTRONIC COMMERCE IN LATIN AMERICA, (conference in conjunction with the National Law Center for Inter-American Free Trade) (1999) at <<http://www.natlaw.com/ecommerce/materials.htm>>.

²³² Model Law, *supra* note 40, art. 38.

²³³ *See generally* National Financing Statement; *See also*, Harry C. Sigman, *The Filing System Under Revised Article 9*, 73 Am. Bkcy. Law J.61 (1999).

²³⁴ In addition to eliminating signatures in the registration form, the Model Law also reduces the number of signatures required in the security contract. *See supra* notes 181-184, and accompanying text.

²³⁵ UCC § 9-402.

registration activity and penalizing improper and incorrect registrations.²³⁶

f) Discrepancies

Discrepancies and mistakes in registration systems are inevitable, such as misspellings, incorrect names, etc. Although a registry system aims for reliable accurate records, systems that uniformly reject registrations containing mistakes have serious drawbacks.²³⁷ A registry system should protect secured parties whose mistakes can be rectified. Unfortunately, the Model Law does not directly address this issue. States adopting the Model Law, however, would be prudent to follow this policy.²³⁸

Common mistakes can be exacerbated when registry search criteria are too specific, such as criteria that reveal only exact matches.²³⁹ Consequently, a system that automatically discards registrations because of discrepancies creates problems. The Model Law should follow criteria that provide “similar matches.”

Additionally, searches by debtor name often result in multiple matches. This is especially true with common names. A party searching the registry may have to sort through numerous records to determine a match. The Model Law registry system should use criteria to distinguish registration forms of different debtors having the same or similar names. For instance, use of social security numbers, or taxpayer identification numbers, to identify debtors on registration forms may reduce the frequency of these problems.

g) Acceptance and Validity

Registry law, as a rule, requires that the parties to a secured transaction register the entire security contract.²⁴⁰ The registrar reviews and qualifies the security contract to ensure its legal validity and registration-worthiness.²⁴¹ Documents that pass this qualification test should be accepted, registered and considered legally valid.

Since the Model Law provides for the registration of a one-page registration form, not the

²³⁶ Cuming, *supra* note 173, at 3.

²³⁷ *Id.* at 6.

²³⁸ A possible response to processing financing statements with common errors is to allow a financing statement to publicize a security interest if the errors are not “seriously misleading.” Civil law systems are particularly rigid with regard to these types of determinations and may not allow for a common law based “seriously misleading” rule. However, civil law countries could follow a rule that states that an error is “major” if it prevents a searcher, who conducts a proper search, from gaining access to the correct financing statement.

²³⁹ Cuming, *supra* note 173. For example, if the debtor’s name is John Smith, an exact match registry will not disclose the registration if the registration is under John M. Smith, Jon Smith, Jonathan Smith, etc.

²⁴⁰ See, for example, Angelina Muñoz & John M. Wilson, *The Sonoran Registry System*, in *Commercial Relations: Secured Transactions and Registry Systems*, Hermosillo, Sonora, (1995) at 3.

²⁴¹ *Id.* and see also *supra* section IV(I)(4)(b).

entire document,²⁴² it eliminates the need for registrars to review the terms and legal validity of a security contract. Although this summary procedure does not entirely remove registrars from determining whether a document is (or is not) fit for registration, a registrar's discretion is limited to rejecting registration forms that do not identify the debtor, the secured creditor and the collateral.²⁴³ In practice, computer programs can scan for these features and reject registration forms that are not complete. Conversely, a registration form that identifies the debtor, the secured creditor and the collateral should be registered without further inquiry by the registry system or the registrar.

A registration form that contains all items required to be registration-worthy is not necessarily legally enforceable. A registration form may be suitable for registration, yet it may be unenforceable.²⁴⁴ Conversely, if a registrar rejects a registration form when it should have accepted it or accepts a registration form when it should have rejected it, the filing may still result in an effective registration. If a rejected registration form should have been registered, it is effective except in the event the collateral was purchased by a buyer who gives value in reliance on the absence of a registered registration form. Likewise, if a registration form is registered but should have been rejected, it is subordinate to the rights of a holder of a publicized security interest in (or a buyer of) the collateral to the extent that the holder of the publicized security interest or buyer gives value in reliance on the incorrect information.²⁴⁵

When a registration form is rejected, the registry system should promptly notify the person that presented the document. This notification should contain the reason(s) why the document was rejected as well as the date and time the record would have been registered had the registry office accepted it. This notification is not expressly stated in the Model Law but should be followed by adopting states.

h) Further Inquiry

As required by the principle of functional notice, the Model Law creates a notice-registration system whose task is merely to inform third parties that certain property in the debtor's possession may be subject to a security interest. Third parties are required to consult further in order to obtain additional information (i.e. the amount of the secured obligation, terms of payment, etc.).²⁴⁶

²⁴² Model Law, *supra* note 40, art. 38; *See also* Mexican Federal Registry, <<http://www.sigerweb.gob.mx>>, Pre-codified Registration Form, Number M21.

²⁴³ *See supra* section IV(I)(1).

²⁴⁴ Wilson, *supra* note 79, at 31. For example, a financing statement that identifies John Smith as the debtor, First Bank as the secured party, and all of John's refrigerators as the collateral provides sufficient information for registration, if it also complies with the other requirements. However, if the financing statement contains errors such as the wrong debtor (not John Smith), or describes the wrong collateral (not refrigerators), it would not be enforceable.

²⁴⁵ *Id.*

²⁴⁶ *Id.* Notice registration systems under the UCC, which provide general rules concerning the 'further inquiry' dilemma, serve as a model for registry reforms in Latin America. First, a notice-registration approach operates on the basic assumption that a debtor has an interest in providing further information. Generally, the debtor intends to form a relationship with the interested third

i) Duration

Although previous versions of the Model Law did not set a duration period for registration, the final version does.²⁴⁷ Additionally, the version of the Model Law contained in the Final Act of the CIDIP-VI sets the duration at 5 years similar to the duration of financing statements in the United States.²⁴⁸ Yet, modern technology allows registries to set duration periods based on transactional, rather than statutory, considerations. For example, registries in most Canadian provinces allow the parties to choose the number of years they wish their registration form to be valid, and registration can also be for infinity.

j) Cost

The Model Law does not address the issue of cost of registration. Most Latin American registries calculate cost as a percentage of the secured loan amount.²⁴⁹ These percentage-based charges do not function as a fee, but rather as a tax on credit transactions. By contrast, registration fees in the United States and Canada generally range from US\$5 to US\$25.²⁵⁰ Considering the lucrative nature of Latin American taxing practices, it is unlikely that Latin American countries will reduce the registration fee to a fee similar to that in the United States and Canada.²⁵¹

States adopting the Model Law must, however, keep in mind that parties to a secured transaction attempt to avoid high costs by not registering their transactions. This practice promotes hidden transactions and creates secret liens. As a result, adopting states should encourage and not penalize those parties that choose to publicize their security interests. Experience with modern registration systems has proven that instead of taxing registration, low fees should be established to encourage registration and thus promote transparency and certainty for credit transactions.²⁵²

k) Scope

party, either to receive a loan or to sell its goods. Consequently, the debtor has an interest in providing information to the third party. If no such interest exists, the debtor need not do anything to make the third party's inquiry successful. Conversely, if the debtor desires to borrow from, or sell to, a third party, a large part of the 'further inquiry' burden should be placed on the debtor because of the debtor's interest in the needed information. *See also*, William Boyd, *supra* note 187.

²⁴⁷ Model Law, *supra* note 40 art. 39.

²⁴⁸ *Id.*

²⁴⁹ Muñoz & Wilson, *supra* note 240, at 9. Some countries set a ceiling amount that ranges between US\$3,000 and US\$5,000.

²⁵⁰ Wilson, *supra* note 79, at 35.

²⁵¹ *Id.*

²⁵² *Id.* Registration fees should be calculated solely on the operational expense incurred by the registry office in receiving, processing and storing the recorded information. In addition, consideration should also be given to the operational and improvement needs of the registry when establishing fees.

Presently, Latin American secured financing systems operate with statutory and *de facto* security mechanisms and with secret liens. For the Model Law to function transparently and to promote certainty, the law should require registration of all existing mechanisms.²⁵³

Registry notice is also important with respect to transactions that involve a separation of possession from ownership, because the person (non-owner) in possession of the goods may attempt to sell or encumber the property without disclosing actual rights in the property. Financial leases,²⁵⁴ consignment agreements²⁵⁵ and assignment of receivables²⁵⁶ are typical examples of such transactions. Consequently, even though such transactions are not secured transactions per se, the Model Law requires they be registered in order to ensure full protection of third parties.²⁵⁷

l) Computerization

The Model Law encourages the creation of electronic registries by requiring an electronic folio for registrations.²⁵⁸ Additionally, the Model Law requires that registries provide remote or electronic access to the registry to its users.²⁵⁹ Finally, the Model Law also permits users to have electronic access (if available) to the registry for sending registration forms and conducting searches.²⁶⁰

Technology can play a prominent role in making the registration process more effective by improving how registrations are made, searched and retrieved.²⁶¹ Electronic registration is faster and more flexible than traditional paper-based methods.²⁶² With electronic registries, the process can be fully automated and completed almost

²⁵³ Model Law, *supra* note 40, arts. 1 & 2. *See also supra* section IV (B).

²⁵⁴ The lease of movable property likewise requires that the owner/lessor transfer possession of the goods to the possessor/lessee in return for a fee.

²⁵⁵ The Model Law covers consignments in which the owner of goods delivers possession of them to an agent who places the goods on sale.

²⁵⁶ The Model Law includes factoring, or sale of accounts receivable within the records of a registry system. Although factoring involves a sale between two parties, and does not constitute a loan, there is very little difference between factoring, or the sale of accounts receivable, and the taking of a security interest in such accounts. This is especially true if the sale allows recourse against the seller. With respect to factoring, it is also difficult to distinguish a sale from security interests because accounts do not have a physical manifestation that allows determining which party has possession of the goods.

²⁵⁷ Model Law, *supra* note 40, art. 1.

²⁵⁸ *Id.* art. 43.

²⁵⁹ *Id.* art. 45.

²⁶⁰ *Id.* art. 46. The users will have a confidential key to access the Registry system in order to register security interests by sending the registration form via electronic means or via any other method authorized by the legislation of this State, as well as in order to conduct the searches that are requested.

²⁶¹ *See generally* Adams *et al.*, *supra* note 112, at 914-924.

²⁶² *See generally* Cuming, *supra* note 173.

instantaneously. Registrations are not only recorded faster, but are also accessed faster than under existing methods.²⁶³

Electronic registries also simplify the filing process, making registrations less expensive to prepare, send and have recorded.²⁶⁴ This is especially true with respect to the qualification process. An electronic system also increases the accuracy and security of registrations by integrating templates and error correction programs.²⁶⁵ A computerized registry promotes uniformity in registration procedures and facilitates multiple jurisdiction registrations. Electronic registries also solve the issue of the place of registration.²⁶⁶ Centralized electronic commercial registries make registrations and searches throughout the country possible from a single location. The net effect of an electronic registry is greater speed, reduced costs, increased accuracy, uniformity, coordination between registries, and broader range of registrations.

The Model Law is aided by the IAREDS which, as mentioned before, has been appended to it. This document is intended to facilitate the adaptation of secured transactions to the electronic world and the creation of electronic registries.²⁶⁷

J. Priority

Priority of all secured transactions laws is established by the principle of first-in-time, first-in-right. The Model Law follows this general rule, providing that security interests have priority against third parties from the moment the applicable step for publicity takes place.²⁶⁸ In other words, the Model Law bestows priority against third parties to the first party to take the applicable step to attain publicity.

Because of the dualism of a security contract and a registration form, publicity by registration or possession may take place before execution of a security contract or the giving of value.²⁶⁹ Although registration or possession by themselves do not constitute publicity, they establish priority, which occurs from the time of registration or possession, regardless of when the parties execute a security contract or when the creditor provides funds to the debtor.

1. Ordinary Course Buyer Exception

As required by the vitality of the credit pyramid described earlier, the Model Law protects a buyer of goods in the ordinary course of business, allowing the buyer to take free of a security interest created by the seller.²⁷⁰ This rule applies even when a secured

²⁶³ *Id.*

²⁶⁴ *Id.*

²⁶⁵ Wilson, *supra* note 79, at 20 *et. seq.*

²⁶⁶ Muñoz & Wilson, *supra* note 240, at 3-5.

²⁶⁷ See note 56 and accompanying text.

²⁶⁸ Model Law, *supra* note 40, arts. 47-48.

²⁶⁹ See *supra* section IV(I)(2)(b).

²⁷⁰ Model Law, *supra* note 40, art. 49.

creditor is publicized and the buyer knows of the existence of the security interest.²⁷¹ This exception is designed to protect consumers who purchase from a seller/secured debtor's inventory.

Before allowing a buyer in the ordinary course of business to take free of a publicized security interest, the Model Law requires that two conditions be met. First, the buyer must give new value for the goods acquired.²⁷² Second, the seller must be in the business of selling the type of goods acquired by the buyer.²⁷³

2. Purchase Money Exception

As mentioned before, the Model Law allows the secured creditor to take a security interest in a debtor's future collateral. This feature, although necessary, may have the effect of placing the secured creditor in a dominant position. The PMSI feature of the Model Law alleviates this potential dominance by allowing the debtor to obtain new credit, for new goods, from new (PMSI) creditors. PMSI creditors have priority over previous creditors with respect to goods specifically acquired with the proceeds of the PMSI credit.²⁷⁴ This allows a debtor to obtain additional financing for new goods.

Thus, unlike general security interests, a publicized PMSI provides the creditor with priority over previous secured creditors that have taken after-acquired collateral and attributable property as collateral.²⁷⁵ The super-priority effect of this rule can create potential problems for these previous creditors. As a result, the Model Law requires PMSI creditors to make reference to the special character of this security interest in the registration form.²⁷⁶ In addition, the Model Law limits the PMSI to the specific movable property actually acquired with the PMSI funds, as described in the security contract and registration form.²⁷⁷

In order to attain the super-priority, the Model Law requires that the PMSI creditor make a special notation of the PMSI in the registration form. In addition, the PMSI creditor must notify previous creditors that this party has or expects to acquire a PMSI in the

²⁷¹ *Id.* In addition to ordinary course buyers, the Model Law establishes that a secured creditor cannot interfere with the rights of a lessee or a licensee under a lease or a license granted in the ordinary course of the lessor or licensor's business after the publication of the security interest. *Id.*

²⁷² *Id.* art. 3(IV). A buyer in the ordinary course of business is defined by the Model Law as a third party who, with or without knowledge of the fact that the transaction covers collateral subject to a security interest, gives value to acquire such collateral from a person who deals in property of that nature.

²⁷³ *Id.*

²⁷⁴ *Id.* art. 51.

²⁷⁵ *Id.* art. 51. Under the Model Law, a PMSI will have priority over a previous security interest that encumbers future movable property of the secured debtor, as long as it is created according to the provisions of this Law, even when it was publicized after the previous security interest.

²⁷⁶ *Id.* art. 12.

²⁷⁷ *Id.* art. 51.

collateral.²⁷⁸ Finally, when the PMSI covers inventory, the Model Law limits the attributable property the PMSI can encumber to cash directly attributable to the sale of the PMSI collateral.²⁷⁹

3. Subordination Agreements

The Model Law permits a secured creditor to subordinate its priority to a subsequent party.²⁸⁰ This agreement must be in writing.²⁸¹ However, a subordination agreement may not affect the rights of third parties.²⁸²

4. Fixtures Exception

The Model Law gives priority to a security interest in fixtures vis-a-vis a previously recorded real property mortgage that may cover movable property affixed thereto.²⁸³ In order to receive this priority position, the Model Law requires that the fixture-creditor give new value and publicize the security interest before the debtor affixes the goods to the land.²⁸⁴

5. Additional Priority Rules

The Model Law also contains priority rules for other specialized types of collateral. First, the Model Law establishes that a possessory security interest over a document of title has priority vis-à-vis a security interest in the property covered by such document.²⁸⁵ For this rule to apply, the security interest in the property covered by the document must be publicized after the document of title was issued.²⁸⁶ In addition, the Model Law establishes that a holder of money, or a transferee of negotiable instruments who takes possession with any necessary endorsement in the ordinary course of the transferor's business, takes free of any security interests.²⁸⁷ Finally, the Model Law establishes that a secured creditor over a documentary credit has priority over other creditors if it received notice of acceptance by the issuing or confirming bank of its publicized security interest over the proceeds of a documentary credit.²⁸⁸ This rule applies regardless of the time of the publicity obtained by another secured creditor who did not receive such acceptance or who received it at a later date.²⁸⁹

²⁷⁸ *Id.* art. 40.

²⁷⁹ *Id.* art. 40 & 51. *See also*, notes 109-115 and accompanying text.

²⁸⁰ *Id.* art. 50.

²⁸¹ *Id.*

²⁸² *Id.*

²⁸³ *Id.* art. 52 (IV).

²⁸⁴ *Id.*

²⁸⁵ *Id.* art. 52 (I).

²⁸⁶ *Id.*

²⁸⁷ *Id.* art. 52 (II).

²⁸⁸ *Id.* art. 52 (III).

²⁸⁹ *Id.*

K. Enforcement

Movable property has value as collateral only to the extent that it can be seized and sold quickly and inexpensively.²⁹⁰ Current Latin American enforcement procedures are based on real property law under which mortgages often take years to enforce. Unlike real property, however, movable property depreciates rapidly and can be moved from one location to another. Consequently, creditors must have the ability, upon a debtor's default, to seize or gain control over the collateral and to dispose of the assets in a prompt and cost-efficient manner.²⁹¹ Without much fanfare and dispute on constitutionality, such a power had been given since Roman times (including 19th century codes) to certain creditors, such as those whose claims are "liquid", those who are in possession of their debtor's funds and those who can qualify for the remedy of set off or *compensatio*. Other jurisdictions, such as Mexico, have had to respond to the need for electronic speed in stock exchange transactions by granting the remedy of the "*caucion bursatil*" which allows the intermediary in possession of stocks or bonds to dispose of them extra-judicially. During the Miami meeting of the Group of Experts it also became apparent that similarly agile remedies were being used or considered in Brazil, Chile and Colombia.

The Model Law sets forth a novel procedure that combines the need for remedial speed with an observance of essential standards of constitutional protection. It does this by requiring that a secured creditor must formally require payment before any enforcement action can take place.²⁹² This formal requisition must take place before a notary public,

²⁹⁰ See generally KOZOLCHYK, *ET AL.*, *supra* note 35, at 139-140; Andres Portilla Herrera, *The Need for Reform of the Secured Financing Systems in Latin America*, Independent Study under the supervision of Prof. Louis Del Duca, The Dickinson School of Law, at 10-11 & 22-31.

²⁹¹ KOZOLCHYK, *ET AL.*, *supra* note 35, at 138. Self-help repossession and commercially reasonable disposition of the collateral is highly controversial in Latin America. Every country that allows such provisions, including the United States, has had to deal with the constitutionality of such measures. Unlike the US, much of Latin America would hold such measures in violation of due process and the prohibition to "justice by one's own hand." Portilla, *supra* note 290, at 24-25; Corte Constitucional de Colombia [*Colombian Constitutional Court*], Sentencia T-2018, July 15, 1992; Corte Constitucional de Colombia [*Colombian Constitutional Court*], Sentencia D-1122, May 16, 1996; Prenda, *Constitucionalidad Del Artículo 341 De La Ley General De Titulos y Operaciones De Credito Que Establece El Procedimiento Para La Venta De La [Procedure for the Sale of a Pledge, Constitutionality of Article 341 of the GLCIO]*, Tesis Seleccionada [*Selected Precedent*], Instancia: Pleno, *Mexican Supreme Court*, Epoca: Octava Epoca [*Eight Period*]; *Semanario Judicial de la Federación*, Parte: II [*Federal Weekly Gazette*] at 30; Prenda, *constitucionalidad del articulo 341 de la ley general de titulos y operaciones de credito que establece el procedimiento para la venta de la [Constitutionality of Article that establishes the Constitutionality of the Procedure for Sale of Goods Given in Pledge]* Tesis Seleccionada [*Selected Precedent*], Instancia: Pleno *Mexican Supreme Court*, Epoca: Séptima Epoca [*Seventh Period*], *Semanario Judicial de la Federación*, Parte: 187-192 [*Federal Weekly Gazette*] at 77; Amparo en revision 1613/94. Jorge Amado Lopez Estolano [*Appeal Number 1613/94, Jorge Amado Lopez*] *Semanario Judicial de la Federación y su Gaceta*, Tomo II [*Federal Weekly Gazette*] at 240, (Dec. 1995).

²⁹² Model Law, *supra* note 40, art. 55.

public broker or judicial officer.²⁹³ The Model Law also requires the registration of an enforcement form at the registry.²⁹⁴ The secured creditor must deliver a copy of this form to the secured debtor in order to commence enforcement proceedings.²⁹⁵ The enforcement action is begun once the creditor requires payment and delivers a copy of the enforcement form to the debtor.

The Model Law gives the debtor a period of three days after receipt of the notification to object to the enforcement proceedings.²⁹⁶ Such objection must take place by giving evidence to the judge or the notary involved in the process that full payment of the amount and its accessories has been made.²⁹⁷ No other exception or defense is admitted at this point in the enforcement process.²⁹⁸ In addition, profiting from the experience of civil law jurisdictions such as Germany, Article 62 of the Model Law allows the parties to determine their own remedial rules including the extra-judicial repossession of the collateral.

1. Repossession of the Collateral

The primary innovation of the Model Law is the creation of a security device that allows the debtor to retain possession of the collateral, while providing protection to the secured creditor in case of default.²⁹⁹ Since the debtor is in possession of the collateral, the Model Law permits a secured creditor to seize the collateral in case of default. Upon completion of the three-day period after the requisition and delivery of the registration form, a creditor may ask a judge for an order of repossession of the collateral.³⁰⁰ For this rule to apply, the security interests must cover corporeal property.³⁰¹ This repossession order takes place without a hearing to the debtor.³⁰² The debtor must raise any defenses through an independent judicial action pursuant to local procedural law.³⁰³ However, such judicial action shall not prevent the secured creditor from exercising its enforcement rights against the collateral.

²⁹³ *Id.* The Model Law establishes that, in case of default, the secured creditor shall require the payment from the secured debtor. Notice of this requirement shall be issued before a notary (public broker) or in judicial form, at the creditor's option, to the debtor's address as indicated in the registration form. In the requirement or notification process, the debtor shall be given a copy of the enforcement form filed at the registry.

²⁹⁴ *Id.* art. 54.

²⁹⁵ *Id.* This form must describe the default, the collateral and the outstanding amount. In addition, the form must contain a statement of the rights provided by Model Law and the actions decided on by the secured creditor.

²⁹⁶ *Id.* art. 56.

²⁹⁷ *Id.*

²⁹⁸ *Id.*

²⁹⁹ *See supra* introductory remarks to section IV.

³⁰⁰ Model Law, *supra* note 40, art. 57.

³⁰¹ *Id.*

³⁰² *Id.*

³⁰³ *Id.*

The secured debtor or any interested third party has the right to terminate the enforcement action by paying the full amount owed to the secured creditor, along with reasonable enforcement costs.³⁰⁴ In addition, the Model Law allows termination of the enforcement by reinstating the security contract and paying the amounts in arrears, along with reasonable enforcement costs.³⁰⁵ This right is be available only if the secured obligation is payable in installments and the debtor remedies any other cause of default.³⁰⁶

2. *Disposition of the Collateral*

The Model Law provides discretion to the creditor with respect to the disposition of the collateral. Given the costs and delays that accompany judicial involvement, a creditor is allowed to dispose of seized collateral by private sale, if such sale (or other disposition) is made in a commercially reasonable manner.³⁰⁷

Article 62 of the Model Law allows the parties to agree, at any time, on a procedure for the disposition of the collateral. Once the secured creditor has started enforcement actions and has obtained possession of the collateral, the creditor may move to dispose of the collateral in the following manner: collateral may be sold at market prices when the collateral consists of movable property that is customarily priced in a market in the State in which enforcement takes place.³⁰⁸

If the collateral consists of receivables or notes, the Model Law permits a secured creditor to collect owed funds, without court intervention, by simply notifying the obligor.³⁰⁹ To protect the obligors, the Model Law provides the opportunity to contest payment including counterclaims and setoffs.³¹⁰

In cases where the collateral consists of stocks, bonds or similar types of property, the Model Law allows the secured creditor to exercise the secured debtor's rights in relation to the collateral.³¹¹ This right includes redemption rights, rights to draw, voting rights and rights to collect dividends or other revenues derived from the collateral.³¹²

The Model Law allows the secured creditor to dispose of the collateral by private sale or public auction.³¹³ In the case of a private sale, the Model Law requires an appraisal of the collateral before sale can take place,³¹⁴ and the sale must produce the price of the

³⁰⁴ *Id.* art. 58(I)

³⁰⁵ *Id.* art. 58(II).

³⁰⁶ *Id.*

³⁰⁷ KOZOLCHYK, *ET AL.*, *supra* note 35, at 139-140.

³⁰⁸ Model Law, *supra* note 40, art. 59 (I).

³⁰⁹ *Id.* art. 59(II) & 17 concerning receivables; and art. 22 concerning other obligations.

³¹⁰ *Id.* art. 20.

³¹¹ *Id.* art. 59(III).

³¹² *Id.*

³¹³ *Id.* art. 59(IV).

³¹⁴ *Id.* A single qualified appraiser, designated by the creditor, can perform the appraisal.

appraisal.³¹⁵ The secured creditor may also elect to sell the collateral in a public auction.³¹⁶ The auction will sell the collateral to the highest bidder without a minimum bid and must be announced in two mediums of major circulation at least five days before the auction is to take place.³¹⁷

Proceeds from the disposition will be applied first to the enforcement costs.³¹⁸ Second, proceeds will be applied to payment of the taxes pertaining to the security interest, if they exist.³¹⁹ Third, proceeds will be applied to the payment of the outstanding amount of the secured obligation.³²⁰ After complete payment to the secured creditor, remaining proceeds will be applied to the payment of other secured obligations stemming from security interests with a secondary priority.³²¹ Finally, any remainder will be returned to the debtor.³²²

The Model Law also includes a deficiency rule that states that the secured creditor has the right to payment of any deficiency if the outstanding loan amount exceeds the proceeds of the disposition.³²³ Lack of this rule has caused a marked reluctance to lend in other jurisdictions, including Mexico.

3. General Rules

The Model Law takes into account delays that may be caused by appeal and defense motions or actions brought by the debtor. These delays have led to prolonged enforcement actions in some Latin American countries; these actions can take several months and even years to conclude. This problem is compounded because in many states the enforcement action is suspended until intermediate defense actions are resolved. The Model Law ameliorates this problem, establishing that appeals will not suspend the enforcement proceedings.³²⁴

In addition, and as just mentioned, the Model Law allows the parties to agree on the terms for the delivery of the goods to the secured creditor, the terms of the sale or auction, or any other matter.³²⁵ This agreement can be reached before or during the enforcement proceeding.³²⁶ However, any agreement of this type cannot affect the rights of third parties, including junior creditors.³²⁷

³¹⁵ *Id.*

³¹⁶ *Id.*

³¹⁷ *Id.*

³¹⁸ *Id.* art. 60. Such costs include storage, repair, insurance, preservation, sale, and any other reasonable cost incurred by the creditor.

³¹⁹ *Id.* art. 60(II).

³²⁰ *Id.* art. 60(III).

³²¹ *Id.* art. 60(IV)

³²² *Id.*

³²³ *Id.*

³²⁴ *Id.* art. 61.

³²⁵ *Id.* art. 62.

³²⁶ *Id.*

³²⁷ *Id.*

The Model Law also allows the debtor to sue for damages caused by a creditor who abused its collection rights during the enforcement proceedings.³²⁸ The Model Law also allows subsequent creditors to subrogate the rights of preceding creditors by paying the secured obligation.³²⁹ In addition, the Model Law protects secured creditors by terminating a debtor's right to sell or transfer collateral in the ordinary course of business operations from the moment the secured debtor receives notice of the commencement of enforcement proceedings.³³⁰ This suspension continues until completion of the enforcement proceedings, unless the secured creditor otherwise agrees.³³¹

Finally, the Model Law establishes that any controversy arising out of the interpretation and fulfillment of a security interest may be submitted to arbitration.³³²

L. Conflicts of Laws

The Model Law also regulates the territorial application of the Model Law when security interests have contacts with more than one adopting State. When dealing with security interests in corporeal movable property, the Model Law establishes that the law of the State where the collateral is located at the time the security interest is created governs issues validity, publicity and priority.³³³ When the collateral is moved, the Model Law establishes that the law of the new State will govern the publicity and priority of the security interest against unsecured creditors and third persons that acquire rights in the collateral after the relocation.³³⁴ However, when the corporeal movable property is moved from one State to another, the Model Law gives secured creditors a period of 90 days to publicize their security interest in the new State. Publicizing the security within this period will allow secured creditors to retain the date of priority obtained in the original jurisdiction.³³⁵

When dealing with non-possessory security interests in incorporeal property, as well as when dealing with security interest in movable corporeal property held by the debtor as equipment, or as inventory for lease, the Model Law establishes that the law of the State in which the secured debtor is located when the security interest is created governs issues relating to the validity, publicity and priority of the security interest.³³⁶ If the secured debtor changes its location to a different State than that in which the security interest was originally publicized, the law of the State of the secured debtor's new location governs issues relating to the publicity

³²⁸ *Id.* art. 63.

³²⁹ *Id.* art. 64.

³³⁰ *Id.* art. 65.

³³¹ *Id.*

³³² *Id.* art. 68.

³³³ *Id.* art. 69. The only exception to this rule is possessory security interests in incorporeal movable property. *Id.*

³³⁴ *Id.*

³³⁵ *Id.*

³³⁶ *Id.* art. 70. A secured debtor is considered located in the State where this party maintains the central administration of its business. If the secured debtor does not operate a business or does not have a place of business, the secured debtor is considered located in the State of its habitual residence. *Id.* art. 72.

and priority of the security interest as against unsecured creditors and third persons who acquire rights in the collateral after the relocation.³³⁷ Like with corporeal collateral, however, the priority of the security interest acquired under the law of the previous location of the secured debtor is preserved if the security interest is publicized in accordance with the law of the State of the secured debtor's new location within 90 days after this party's relocation.³³⁸ Finally, priority of non-possessory security interests in negotiable incorporeal property (against third persons who acquire a possessory interest in the property) is governed by the law of the State where the collateral is located when the possessory interest is acquired.³³⁹

V. Conclusion

Scarcity and the high cost of commercial credit are among the most significant economic problems facing Latin America and the Caribbean. Even though current secured transactions law does not meet the demands of modern commercial credit practice in that region, the antiquated status of this law is not a conscious rejection of contemporary financing mechanisms. In fact, many of these countries and their most solvent debtors find themselves having to borrow on the basis of contemporary secured transactions' law whenever they attempt to obtain credit in the international marketplace. Moreover, as stated in the introduction, the ability to borrow of every Central Bank in Latin America and the Caribbean- as well as their member banks- is subject to supra-national rules on capital adequacy and transparency of loan classification that require greater reliance on self-liquidating collateral than their current law affords. By proposing, drafting and approving the Model Inter-American Law on Secured Transactions that makes self-liquidating loans possible, the Organization of American States has taken the lead in reforming the present legal system, setting the foundation for a hemispheric credit market anchored in the effective work of networked electronic registries.

The Model Law approved by the OAS is not a copy of Anglo-American models such as the Uniform Commercial Code or the Canadian Personal Property Security Acts. It is a carefully crafted bridge between the most effective institutions in the common and civil law systems. Its central legal concept of "preferential rights" is inspired in Rudolf von Jhering's analysis of the elements of possession and possessory remedies while the universality of collateral and flexibility of lending are inspired by the contemporary lending practices of developed market places throughout the financial world. Its remedies reflect the best thinking of Latin American commercial-procedure lawyers as well as the experience of German courts with creditors' rights of enforcement and debtor protection. Nevertheless, the Model Law does not pretend to provide answers to all the present and foreseeable problems of secured lending in the Americas and the Caribbean. It heeds the immortal advice of Portalis (one of the key drafters of the French Civil Code to his drafting committee): Let us be modest, let us not try to foresee and resolve everything.

³³⁷ *Id.* Art. 70.

³³⁸ *Id.*

³³⁹ *Id.* Art. 71.

In fact, the main goal of the Model Law is to serve as an enabling statute, i.e. a statute that will make possible secured lending in as many transactions as possible. As an enabling statute it also must be educational; it must teach the new concepts as it prescribes them. This will explain the occasional didactic tone of some of its provisions, and the fact that many rules revolve around not abstract concepts but the types of collateral found by NLCIFT studies to be the most desirable and underutilized in Latin America. The writers sincerely believe that thanks to this pioneering effort, Latin America and the Caribbean are now at the brink of meaningful secured transactions reform and of true access to credit at reasonable rates of interest, especially for small and medium sized merchants.