

UNCITRAL Fourth International Colloquium on Secured Transactions

PANEL:

Challenges in Integrating a New Secured Transactions Law into an Existing Legal System

Methodology of Harmonization and Modernization of Legal Rules on Secured Transactions -- Legal, Functional or Otherwise?

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Hideki Kanda

Professor, Gakushuin University, Japan

Introduction

An international organization like the UNCITRAL plays numerous important roles in the harmonization and modernization of legal rules on secured transactions. The first role is to prepare different types of instruments such as conventions, model laws and legislative guides. The second role is to provide assistance in the implementation of the relevant instrument such as providing "technical assistance." The third role is to offer methodologies of harmonization and modernization.

With respect to the first and second roles, it must be noted that generally, even a good law does not operate alone. Parties in the market place must use it. In this sense an international organization like the UNCITRAL should provide private actors in the market place with guidance (such as model contractual clauses) so as for the law to be used in practice. For each jurisdiction, implementing the UNCITRAL model law is not the end of the story. However, undertaking law reform itself is often not an easy task for each jurisdiction for a variety of reasons. Thus, in this presentation, I emphasize the importance of the third role above.

Theme

I submit a simple view that harmonization or modernization of legal rules on secured transactions should be undertaken in functional terms -- what I call the functional approach.

The functional approach means that the operative results of individual legal rules are stated in functional terms, not in doctrinal terms, and we should endeavor to harmonize operative results rather than legal doctrines.

Legal doctrines in each jurisdiction reflect its history, experience and culture (and often politics), and it is not easy to harmonize legal doctrines around the world. Indeed, it is not necessary to harmonize legal doctrines. What we need to harmonize is results. Similarly, even within the same one jurisdiction, legal doctrines sometimes prevent the legal rules in the jurisdiction from being modernized, because doctrines often tend to persist and resist a change. Thus, the focus in international discussions should be moved from doctrines to results.

Note that some (albeit not all) legal concepts and terminologies are connected with legal doctrines, and using such concepts and terminologies should be avoided in international discussions – concepts and terminologies that are free from legal doctrines should be used.

What is a functional approach?

Example 1:

Website of the UNCITRAL regarding the UNCITRAL Model Law on Secured Transactions (last visited on 13 March 2017):

The UNCITRAL Model Law on Secured Transactions (the "Model Law") deals with security interests in all types of tangible and intangible movable property, such as goods, receivables, bank accounts, negotiable instruments, negotiable documents, non-intermediated securities and intellectual property with few exceptions, such as intermediated securities. The Model Law follows a unitary approach using one concept for all types of security interest, a functional approach under which the Model Law applies to all types of transaction that fulfil security purposes, such as a secured loan, retention-of-title sale or financial lease, and a comprehensive approach under which the Model Law applies to all types of asset, secured obligation, borrower and lender. In this way, the Model Law is intended to address the main problem of secured transactions laws around the world, that is, the multiplicity of regimes that creates gaps and inconsistencies.

What is a functional approach?

Example 2:

Draft UNIDROIT Legislative Guide on Intermediated Securities (2017), Paragraph 67:

The [UNIDROIT Geneva Securities] Convention's approach is functional in that it uses language that is as neutral as possible to formulate rules by reference to their results. Under a functional approach, harmonising rules are formulated by reference to facts rather than particular legal terms or principles to allow operative results to be reached without overriding the underlying domestic legal traditions and doctrine. With the functional approach, for example, the Convention is compatible with various characterisations of securities rights and interests and possesses the necessary flexibility to accommodate new technological advances and evolutions in intermediated securities holding systems.

Creation of Security Interests

Substance (result): Creation by agreement (with party autonomy in general)

Example: UNCITRAL Model Law Art. 6(1): A security right is created by a security agreement, provided that the grantor has rights in the asset to be encumbered or the power to encumber it.

Effectiveness of Security Interests against Third Parties

Substance (result): Proper disclosure

Example: UNCITRAL Model Law Art. 18: (1) A security right in an encumbered asset is effective against third parties if a notice with respect to the security right is registered in the Registry. (2) A security right in a tangible asset is also effective against third parties if the secured creditor is in possession of the asset.

Note: The desirable method of proper disclosure may change in the future, due to technological innovatio. So for example, distributed ledger technology (such as blockchain technology) may make the idea of centralized registry less attractive and less realistic in the future. Yet the importance of disclosure will and should remain.

Priority

Substance (result): Disclosure required (by notice filing), and priority recognized in time order but with certain exceptions

In other words, permit a general financier and priority in time order, but permit priority to late-in-time creditors where early-in-time creditors might agree ex ante at a hypothetical bargain, i.e., typically, late-in-time creditors are value enhancing

Example:

UNCITRAL Model Law Art. 29: first-in-time priority rule

UNCITRAL Model Law Arts. 34, 38, etc.: exceptions to the first-in-time priority rule (buyers in the ordinary course of the grantor's business, purchase money lenders, etc.)

Note:

It seems not easy to write an international instrument completely in functional terms. It is important for us to agree on the substance of the operative result of the relevant legal rule. Both the general rule and exceptions should be stated in functional terms as much as possible.

Modernization of Secured Transaction law in Japan

type of collateral	type of creditor	in practice	priority
all	general financier: debtor-based creditor	substitute by personal guarantee and land mortgage	same as first ranking
inventories	asset-based creditor	special pledge (rare) substitute by receivables financing old time: promissory notes today: registry system	asset-based creditor beats general financier
equipment	asset-based creditor	retention of title	asset-based creditor beats general financier
financial assets	asset-based creditor	old time: certificates today: registry system	asset-based creditor beats general financier

A Theoretical Note: Why asset-based lending and asset-based priority (rather than debtor-based lending and debtor-based priority) are popular in certain jurisdictions may be a puzzle, because what hurts creditors is risk alteration with the debtor, not with the debtor's particular assets.

Conclusion

On each issue, we should discuss and agree on the substance of the operative result of the relevant legal rules, not legal doctrines. Then, how each jurisdiction gets to the result should not be the issue. Each jurisdiction should be free to choose its own legal concepts and doctrines to get to the result. An international organization like the UNCITRAL should play a leading role in providing this methodology of harmonization and modernization of legal rules by shifting its focus from legal doctrines to their operative results.