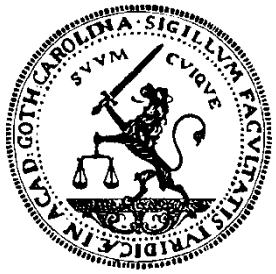

FACULTY OF LAW
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Secured credit law in Sweden

An analysis of the potential for a new regime in light of Canadian law and the European DCFR

JURM02 Graduate Thesis

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Contents

Summary

Present Swedish law concerning security over movable assets is largely based on case law and legal literature, with some statutory intervention. Although the principal form of security is the possessory pledge, various security devices are used in practice, pursuant to legislative introductions of separate registration systems (*e.g.* floating charges) and the commercial use of ownership for security purposes (*e.g.* security transfer of ownership, financial leasing, retention of title, commission or consignment). Perfection requirement and priority status depend on what security device is applied. As registration is required only in relation to some asset and transaction types; as transfer of possession (*i.e.* the debtor's ability to dispose of the asset is cut off) is arguably deficient as publicity method; and as ownership may be used for security purposes without always being sufficiently visible to third parties, it is difficult for intending creditors and other third parties to grasp the full extent of encumbrances over a debtor's assets. As ownership prevails over all other security rights on the basis of the formal notion that a debtor cannot grant security in an asset that is owned by someone else, ownership affects the determination of priority despite not being mentioned in the priority legislation. Due to the lack of a uniform secured credit regime in which all security devices are regulated, including those based on ownership, the Swedish system is uncertain and non-transparent.

In Canada, two similar legal patchworks were replaced by comprehensive regimes: one in the common law provinces and one in civil law Quebec. The common law version applies a functional *security interest*, which includes every transaction that functions to secure an obligation, irrespective of where ownership is vested, whereas Quebec's civil code treats title-based transactions separate from its *hypothec*, although subjecting those title-based transactions when functioning as security to publicity rules and, sometimes, enforcement rules. Both regimes use registration as the principle perfection method. One central register coupled with the approach that all transactions that are recognised as ways to secure an obligation are registrable therein enable an integrated regulation of priorities between secured creditors and against third parties. Priority turns on the date of registration, subject to such creditors whose credit extensions directly finance the acquisition of assets.

In Europe, academic discussions on harmonisation in this field of law have resulted in the inclusion in the *Draft Common Frame of Reference* published in 2009 of a book on secured transactions in movable assets. The drafters propose an optional regime with a semi-functional approach to security and a European register for cross-border secured transactions.

On the basis of the current European evolvement and the learnings from the two Canadian successful regimes, there is a good case for a Swedish reform. The present system should be replaced by a comprehensive act, which would include all security devices, and the setting up of one central register.

Sammanfattning

Nuvarande reglering av säkerhet i lös egendom i Sverige bygger, med undantag för några lagstiftningsåtgärder, på rättspraxis och juridisk doktrin. Även om pantsättning är huvudmetoden för att ställa säkerhet, används i praktiken flera olika typer av säkerhetsrätter då lagstiftaren infört separata registersystem (t.ex. företagshypotek) och då äganderätt i praktiken ofta används som säkerhet (t.ex. säkerhetsöverlåtelser, finansiell leasing, äganderättsförbehåll, kommission eller konsignation). Vilket sakrättsligt moment som krävs och vilken prioritet detta moment ger beror på vilken säkerhetsrätt som används. Då registrering krävs endast vid vissa tillgångs- eller transaktionstyper; då pantsättning (i bemärkelsen rådighetsavskärande) får anses otillräcklig ur ett publicitetssyfte; och då äganderätt kan användas som säkerhet utan att alltid till fullo komma till tredje mans kännedom, är det svårt för tredje man att uppfatta den fulla omfattningen av anspråk på en viss gäldenärs tillgångar. Då äganderätt har en prioriterad ställning på grundval av den formalistiska hållningen att en gäldenär inte kan bevilja säkerhet i en tillgång som ägs av någon annan, påverkar äganderätten prioritetsordningen trots att den inte omnämns i förmånsrättslagstiftningen. Bristen på en enhetlig reglering av alla säkerhetsrätter, inklusive de som baseras på ägande, gör det svenska systemet osäkert och svåröverskådligt.

I Kanada har två liknande rättsliga lapptäcken ersatts av omfattande kreditsäkerhetssystem. I common law-provinserna tillämpas ett funktionellt *security interest,* inbegripande varje kreditarrangemang som syftar till att säkra en förpliktelse, oavsett vem ägandet tillkommer. I civil law-provinsen Quebec tillämpas istället ett formalistiskt synsätt i det att transaktioner baserade på ägande regleras separat från säkerhetsrätten *hypothec* medan de underkastas publicitetsregler (och ibland realisationsregler) när de används i säkerhetssyfte. I båda systemen är registrering det huvudsakliga sakrättsliga momentet. Ett centralt register där alla transaktioner som används för att säkra en förpliktelse ska registreras för sakrättslig verkan möjliggör en enhetlig reglering av prioritetsordningen mellan flera säkrade anspråk och gentemot tredje män. Prioritetsordningen avgörs utifrån registreringsdatum, med undantag för de borgenärer som direkt finansierar förvärv av tillgångar.

I Europa har akademiska diskussioner om harmonisering inom detta område resulterat i införandet av en bok om säkerhet i lös egendom i *Draft Common Frame of Reference,* som publicerades 2009. Författarna föreslår ett system med ett semi-funktionellt synsätt till säkerhetsrätter och ett europeiskt register i vilket gränsöverskridande säkerhetsrätter ska kunna registreras.

Mot bakgrund av det pågående europeiska arbetet och lärdomar från de två kanadensiska framgångsrika systemen finns det goda grunder för en svensk reform. Det nuvarande svenska systemet bör ersättas av en omfattande ny lag som reglerar alla olika säkerhetsrätter, även de som baseras på ägande, och inrättandet av ett nytt centralt register för alla dessa säkerhetsrätter.

Preface

I wish to extend my sincere thanks to Catherine Walsh, who introduced me to the fascinating world of secured transactions and who most pedagogically explained the intricacies of secured transactions in Canadian common law, Quebec civil law and international law at McGill University 2011/2012. A special thanks is also accorded my supervisor Patrik Lindskoug, whose support has been appreciated during the writing of this thesis and whose teaching in property law during my second semester at Lund University initiated the idea of finalising my law degree within this complicated but captivating field of law.

Lund, December 2012

Sofie Bjärtun

Abbreviations

CCQ	Civil Code of Quebec
DCFR	Draft Common Frame of Reference
EU	European Union
JT	Juridisk Tidskrift vid Stockholms Universitet
ON	Ontario (common law province of Canada)
NJA	Nytt Juridiskt Arkiv (I)
PMSI	Purchase Money Security Interest
PPSA	Personal Property Security Act
Prop.	Proposition (Swedish preparatory work)
QC	Quebec (civil law province of Canada)
S.C.C.	Supreme Court of Canada
SOU	Statens Offentliga Utredningar (Swedish preparatory work)
SvJT	Svensk Juristtidning
UCC	Uniform Commercial Code
UNCITRAL	United Nations Commission on International Trade Law
UNIDROIT	International Institute for the Unification of Private Law

1 General introduction

1.1 Background

In the economic climate following the financial crisis and the European debt crisis, it is ever so important to question how the legal framework interacts with and fosters the credit market. In a time when new investments and business activities are of utmost importance for the economic recovery, companies' access to capital at a reasonable price is key. As banks are faced with stricter capital requirements under Basel III and other new regulations, it becomes vital to enhance companies' access to diverse sources of credit.

Security is the norm in relation to all types of credit arrangements. Banks demand security in the majority of commercial loan arrangements and in the bond market, the participation on behalf of companies with no or low credit rating largely depends on their ability to offer security for the repayment of the bonds.[1] Alongside loans and bonds, other credit structures, *e.g.* financial leasing and credit sales are widely applied in practice. In these types of arrangements, security is a vital inherent feature. A well functioning market for secured credit, which by extension presupposes a well functioning legal system, is thus crucial for essentially any kind of business financing.

As is evident from contemporary complex bankruptcies, *e.g.* those of the Swedish companies Saab and Panaxia, it is key that once a company turns insolvent, the priorities of all competing interests in the company can be easily determined. In times when many companies are in economic distress and the number of bankruptcies increases, it could be questioned whether creditors, such as those of Saab and Panaxia, have had access to sufficient information to determine the extent of competing interests before extending credit. In the distribution of a bankrupt company's assets, it may also be questioned whether the legal treatment of the creditors' claims should really depend on what type of arrangement the creditors have concluded with the debtor or whether priority can be easily and equitably determined in any other way. These two questions are fundamental to the secured credit law of any jurisdiction.

While markets are now global and there is pressure to integrate the law so as to reduce transaction costs, secured credit law remains largely territorial. Having said that, with the adoption of article 9 of the Uniform Commercial Code (the UCC) in the early 1950s, the US formed a model that has had significant impact beyond the borders. It has *e.g.* been adopted (with some modifications) in the common law jurisdictions of Canada (in all provinces apart from the civil law province of Quebec), New Zealand and Australia.[2]

[1] See Mikael Kubu (CEO at Ackordcentralen) and André Andersson (partner at law firm Mannheimer Swartling) commenting on the main challenges in the current development of the Swedish bond market in *Ackordcentralen's Newsletter*, Nr 1 – 2012, pp. 2 and 11.
[2] These jurisdictions refer to the regime as their Personal Property Security Act (the PPSA).

Article 9 has also served as a model for various international instruments, generated through the work of international institutions in their reform and harmonisation efforts regarding secured transactions law, *e.g.* UNIDROIT's Cape Town Convention on International Interests in Mobile Equipment and UNCITRAL's Legislative Guide on Secured Transactions. A harmonisation project is now potentially emerging also in Europe as a response to the fact that cross-border use of security is hindered by the differences in the various national legal systems. A recent academic study that forms part of the Draft Common Frame of Reference (the DCFR), prepared by the Study Group on a European Civil Code (the Study Group) for the European Commission, proposes the adoption in Europe of a scheme modelled on article 9/the PPSA.[3] What the article 9-based regimes have in common is that i) their aim is to treat all akin security arrangements equally and ii) all security interests are registrable in one central register, which serves to provide third parties with information of the debtor's total indebtedness as well as to determine the priority between different security interests in the debtor's assets.

In Sweden, where the rules and principles are scattered in a variety of legislation and case law rather than in a comprehensive regime, the above sketched need for efficient rules coupled with the existence and emergence of these modern regimes, open questions of *de lege ferenda*-character.

1.2 Purpose

This thesis serves three purposes. Firstly, it aims to highlight some of the most apparent difficulties under Swedish secured credit law, focusing on i) the diverse legal treatment of *title-based* security rights and *real* security rights and ii) the lack of one central register. Secondly, the thesis intends to introduce the reader to solutions to these issues that have been introduced elsewhere. Due to the author's special knowledge of the Canadian secured transactions regime and the fact that it represents one article 9-based system in the PPSAs and one unique system in the Civil Code of Quebec (the CCQ), Canada will serve as comparator. In addition, the approach opted for in the DCFR will be presented. Lastly, and most importantly, the thesis purports to propose ways in which the experience from these outlooks can benefit Swedish law, business and society. Thus, the descriptive parts of this thesis (Chapters III, IV and V) are built upon the following questions:

- How does the system for secured credit function under Swedish law?
- How is secured credit dealt with differently under Canadian law?
- What effects, if any, do the initiations on the European level have?

On the basis of this, the thesis attempts to answer the following:

- Is an introduction of a comprehensive Swedish secured credit regime preferable and if so, what main features should this regime have?

[3] Book IX, *Proprietary security in movable assets*, *Principles, Definitions and Model Rules of European Private Law, Draft Common Frame of Reference,* Volume 6, 2009 (DCFR).

1.3 Delimitations

This thesis stems from the assumption that the main function of security, *viz.* the increased probability of repayment to creditors (which in turn lowers their price on credit) is beneficial to society as it means that the amount of capital that can be used in productive processes and desirable activities will be enhanced. As mentioned by way of introduction, this is particularly important in the current financial climate. Economic justifications for the existence of secured credit will therefore not be discussed. This having been said, it is important in every discussion relating to secured credit law to bear in mind the harmful effects that secured credit may have on unsecured creditors. The reader should be aware of the substantial amount of literature that questions the assumption that security is economically beneficial, mainly on the basis that unsecured creditors will respond to the existence of secured creditors by raising their interest rates, giving rise to propositions such as: a debtor will not make an overall net gain from security; security operates to reallocate value from some creditors to others; or, even further, security is actually not the most efficient way to allocate limited resources.[4]

It is a distinct feature of secured credit law that "all questions relate". Particularly, issues of perfection and priority of security rights cannot be easily divorced. As this thesis focuses on the different legal treatment of diverse forms of secured transactions and the lack of one central register where all secured transactions are registrable, the scope must necessarily include several security devices and revolve around the bigger picture rather than details of the function and use of these devices. Being a comparative thesis with *de lege ferenda*-character, it has also been natural to include several relevant and influential comparators. Having said this, certain delimitations should be noted. As the thesis relates to commercial secured credit, issues of consumer protection are left aside. Furthermore, as the focus is on security rights in movable assets, any matter concerning security rights in real estate or personal security is excluded. The thesis is also limited to security rights created by contract, excluding security rights created by statute or judicial decision. Limits of space bars the inclusion of some comparators that would have been of relevance for a discussion on a potential reform, foremost UNCITRAL's Legislative Guide, the European Development Bank's Model law on secured transactions and UNIDROIT's Cape Town Convention on International Interests in Mobile Equipment.

This thesis does not purport to exhaustively treat all aspects that must be addressed prior to any implementation of a secured credit regime in Sweden. Such aspects include, but are not limited to, questions of enforcement, tracing and substitution. The aim is rather to provide a comparative contribution to the academic debate, be it with a *de lege ferenda*-approach.

[4] Kienininger, E-M, *Security Rights in Movable Property in European Private Law,* pp. 8-9. For an excellent discussion regarding pros and cons of secured credit, see Armour, J., *The Law and Economics Debate About Secured Lending: Lessons For European Lawmaking?*

1.4 Method and material

The thesis follows three parallel methods. The main one is the traditional legal dogmatic method, by which an established system of coherent norms is used to answer a legal question. Thus, the thesis has its basis in legislation, preparatory work, case law and legal literature. In an area of the law where legislation is limited, the case law and the legal literature naturally form the basis in relation to this method of analysing and writing. As precedents do not create law in the Swedish legal system, relying largely on case law to determine the law is not only difficult, it is also risky. Although it is assumable, in the absence of legislative intervention, that the legislator has more or less voluntarily and intentionally relinquished some of its power of forming the law within the secured credit field in favour of the courts, the courts cannot by themselves determine the rules. As will be further elaborated in this thesis, the Swedish courts have realised that this puts them in a difficult position. In case a court, in a specific situation, finds the existing rules unsatisfactory and not adapted to today's commercial reality and legitimate demands, but at the same time finds itself bound by those perceived existing rules, what value is there in the court's decision, other than a reminder to the legislator that the legal rules surrounding the specific situation at hand should be the subject of legislative intervention?

As the weight of the case law within this field of the law can thus arguably be questioned, as Swedish secured credit law contains significant elements of uncertainty *per se* and as the power of the Swedish courts in general is limited, the legal literature is of particular importance in establishing and developing this field of the law.[5] The legal literature therefore also naturally plays an important role in this thesis. Having said this, it is important to bear in mind that the legal literature is not authoritative in the strict sense. In this thesis, where the *de lege ferenda*-discussion is prominent, the common way to put a value on a certain source of legal literature is overturned. Normally, the authoritative value of a book or an article is determined by the book's or article's age, generality in scope and trustworthiness.[6] In this thesis, this kind of authoritative literature has, of course, been consulted in order to determine what the reputable authors within this legal field perceive to be the existing rules. However, due to the *de lege ferenda*-character of the thesis, coupled with the uncertainty and blurriness of the existing rules, the author has not uncritically relied on this authoritative, and sometimes perhaps *too* old, literature to determine the rules, but has rather consulted the said authoritative literature for the purpose of identifying more specifically *why* the secured credit field entails so many issues as well as the *reasons* behind those issues.

[5] Persson, A., *Förbehållsklausuler – En studie om en säkerhetsrätts nuvarande och framtida ställning,* p. 52.
[6] Lehrberg, B., *Praktisk juridisk metod,* p. 169. The latter (trustworthiness) would presumably depend foremost on the author's position and reputation within the legal sphere.

The thesis also follows a comparative method in the sense that the current system as well as a potential future comprehensive secured credit regime in Sweden are analysed in relation to solutions in Canada and in Europe. In a thesis of this kind, where solutions to perceived problems *de lege lata* are sought, foreign law may be highly relevant and suitable for inspirational purposes.[7] Although discussions of *de lege ferenda*-character likely benefit from such comparative method, it requires caution as there are, of course, other factors also affecting the law. As regards the jurisdictions used as comparators, the author acquired knowledge and understanding of the Canadian secured transactions regimes during studies at McGill University 2011/2012. During the process of writing this thesis once back in Sweden, the continued and extended study of the two domestic regimes have benefited significantly from the Swedish perspective in which they have been put. The Canadian regimes are not presented in a complete manner, as this would be impossible in a thesis of this size. The purpose of the thesis is no to function as a guide to the application of the rules but rather to present the outlines of how other jurisdictions have structured their secured credit law. For this purpose, the presentation of the Canadian regimes focuses on the actual legislations. Some Canadian literature has been consulted in order to determine the background of the rules and, as the purpose of this thesis is essentially to put forward the Canadian-type system as a source of inspiration for the Swedish legislator, to provide a fair and balanced picture of the regimes, including the issues that can be traced in those systems. When using foreign law as inspiration for domestic reform it is, of course, key to study not only the structure and content of that foreign law but also the results and application of the rules.

As regards the DCFR, which came to the author's attention once back in Sweden, the Study Group's extensive comments supplementing the rules have been used, as has a flora of articles, mainly authored by participants of the Study Group. The rules under the DCFR are not bestowed with normative force but should rather be considered model rules. The comments supplementing the model rules elucidate each rule and outline the policy considerations behind them.[8] In this respect and in one sense, the comments function as a mixture of Swedish preparatory work and legal literature.

Lastly, the thesis follows a theory based on law and economics, *i.e.* the legal rules are assessed from a macro-economic perspective.[9] The thesis evaluates current and potential future law with the aspiration of achieving a legal system that offers the economically most efficient solution on how to use society's limited resources. As secured credit law concerns competing interests in the same assets, *i.e.* the resources are always limited, law and economic-facets are arguably of utmost importance within legal field.[10]

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[7] Lehrberg, B., *supra note 6,* p. 218.
[8] *Principles, Definitions and Model Rules of European Private Law, Draft Common Frame of Referenc, Outline Edition,* 2009, p. 18.
[9] Dahlman, C., Gladner, M., Reidhavm, D., *Rättsekonomi – en introduktion,* p. 9.
[10] Henriksson, P., *Sakrättsliga moment och deras ekonomiska konsekvenser,* p. 38 f.

1.5 Disposition

Chapter II sets the scene by introducing the two issues that are central in any regulation of secured credit and on which the following chapters will build. Thus, the difference between a functional and a formal approach to security and the idea of one central register for perfection purposes are presented, accompanied by a discussion on the significance of legal families in relation to these issues. Chapter III describes how secured credit is dealt with under Swedish law while Chapter IV sets out the approach taken in the common law provinces of Canada and in civil law Quebec. Chapter V presents the work recently prepared on the European level. Finally, in Chapter VI, the Swedish system is analysed in relation to the Canadian and European perspectives and a proposal for a new Swedish regime is put forward.

2 Basic questions

2.1 Functional or formal approach to security?

Up until the 19th century, security in movables was restricted, in Sweden as well as in most parts of Europe, to possessory security by way of the pledge. With the industrial revolution came a need for a type of security that would not require dispossession of the secured asset. The rational was simple: a debtor who could retain the encumbered asset in his business could use it to process raw materials or semi-finished goods or sell stock whereby he could earn the money with which he could then repay the secured credit.[11] At the end of the 19th century and during the 20th century, each European country developed legislative solutions to meet this need. In addition, commercial solutions such as consignment, commission, leasing, security transfer of ownership, retention of title and sale and lease back developed in practice.[12]

In many jurisdictions, as is the case in Sweden, a variety of structures have thus emerged that in commercial substance are very similar to the conferring of security in return for credit but which are treated differently in law. These transactions are employed in both common law and civil law jurisdictions and are based on the use of ownership for security purposes. The creditor retains or takes ownership over an asset but gives or leaves possession to the debtor, comparable to a *real* secured transaction where the creditor gets only a limited right and, subject to this, the ownership is vested in the debtor.[13] The use of these types of transfers or retentions of ownership purely for security purposes can be, has been and continues to be criticised. The question is, should it matter whether a transaction grants a creditor a limited real security right in a certain asset or whether that creditor retains title to the asset but does so to secure a monetary claim toward the debtor (*e.g.* through retention of title under a sale, a security transfer of ownership or a leasing arrangement)? In other words, should the legal system relating to secured credit approach secured transactions *functionally* or *formally*?

In most European systems, including Sweden, the formal approach prevails. Ownership inevitably becomes the cornerstone of this type of system, since the holder of a title-based security right (*i.e.* owner) enjoys a considerably stronger protection in the debtor's insolvency than the holder of a real security right. As owner, he can separate and recover "his" asset from the bankruptcy estate before any real security right. This is based on the principle that a security right in a certain asset can only be granted to a creditor if and when the debtor has title to that asset, which is not the case if ownership is retained or obtained by someone else.[14] Conventional secured

[11] Drobnig, U., *Security Rights in Movables*, pp. 4-5.
[12] DCFR*, supra note 3,* p. 5391 f.
[13] Wood, P., *Law and practice of international finance,* p. 346.
[14] DCFR, *supra note 3,* p. 5396 f; Adlercreutz, A., Pfannenstill, M., *Finansieringsformers rättsliga reglering*, p. 87; Matz, H., *Reforming Personal Property Security Law, Some Implications for the Baselines of Priority Regulation,* pp. 127-128.

creditors, in contrast, share the fate of all other creditors competing in what is left in the debtor's patrimony, albeit with priority over unsecured ones.[15] Thus, in a system adhering to the formal approach, ownership becomes the decisive criterion of the system's priority regulation. On the basis of the automatic preference that is given to title-based security rights, it may be argued that the recognition of such security devices undermines efficiencies that are associated with the system of secured credit. Insofar as the title-based security rights do not have to be registered or otherwise made public, the extent of the total encumbrances over a debtor's assets is uncertain. When creditors anticipate the risks of extending credit, they assume that the protection they will enjoy in insolvency will not be diluted in value. If interests based on ownership are recognised, fewer assets are left over to the *real* secured creditors, *i.e.* those that are legally recognised as such and give rise to priority according to specific priority regulation. As the uncertainty faced by these creditors, who cannot fully assess the level of protection that their security entails, will lead them to either not lend or cost into the price the added risk, credit costs presumably increase.[16] It is also plausible that the use of *real* security rights becomes less attractive in the eyes of creditors, who turn to title-based financing structures instead, provided that the title-based devices are available to them, which is not always the case.

In contrast to the formal distinction between *real* security rights (*i.e.* limited rights) and *title-based* security rights, article 9 and its derivatives do not differentiate between these two types of security rights but treat them all as *security interests* in one and the same statute. The unitary security interest is defined by the function it serves rather than the form of or label on the transaction, thus including in its scope "any interest in personal property that secures payment or performance of an obligation".[17] Variants of this functional approach are found in the CCQ and the DCFR. The structure and result of the PPSA and the two variants are elaborated in Chapters IV-V.

2.2 Registration or transfer of possession?

Most European laws *in theory* still rely on possessory security, the main advantages of which are that i) the debtor's disposal of the encumbered asset is prevented ii) an impression of false wealth is averted iii) the creditor guards the integrity and protection of the encumbered asset and iv) the creditor has easy access to the asset in case of enforcement.[18] As these advantages have diminished in rise of the need for companies to keep in possession their basic means of circulation and production (*e.g.* equipment and inventory), non-possessory security has been called for. Most legal systems have introduced certain non-possessory security rights that are registrable in specific registers, limited to a certain asset or transaction type.

[15] Cf. Priority Rights Act (Sw. *Förmånsrättslagen (1970:979))* s. 2 and ss. 3(a)-9. As an exception to the rule that all claims are equal, secured creditors have special priority.
[16] Finch, *Security, Insolvency and Risk: Who Pays the Price?* p. 648.
[17] PPSA s. 1 (definition of security interest).
[18] See *e.g.* Drobnig, U., *Present and future of real and personal security,* p. 639.

In contrast to this formal distinction between possessory and non-possessory security rights, neither article 9, its derivatives, the CCQ nor the DCFR differentiate between these two types of security, but treat dispossession merely as one of several possible methods of perfection. In relation to some asset types, possession is the only method available whereas for most asset types, it is an alternative method, the principal one being registration. The registration systems upon which the regimes are built are foremost designed to address information asymmetries in the credit market. As a creditor depends on information about a company before extending credit and on the ability to monitor and control the company during the lifetime of the extended credit, a register sharing this information presumably fosters a more efficient allocation of credit and increased credit volumes. Availability of information also reduces the risk of debtors over-borrowing from several creditors simultaneously without their knowledge.[19] Following the financial crisis in the US, the main reason for the crisis is considered to be the lack of transparency in the financial system. If creditors who were financing investment banks through secret transactions (such as derivatives, mortgage backed securities, collateral debt obligations and credit default swaps) had been forced to disclose these transactions, the financial collapse would probably have been smaller and less damaging.[20] Post the crisis, it has even been suggested that the US registration system for security interests (*i.e.* article 9) should be replaced by a universal system, where all instruments that give a creditor priority greater than a general unsecured creditor (be it a security interest, an asset securitisation, a derivative or any other financing structure that may be invented) would have to be recorded. It is suggested that broad public access to this information will reduce the risk of future financial collapses, as problems can be identified sooner.[21]

In addition to this direct publicity function of a register, it indirectly enables priority determination and protects registered secured creditors against unsecured creditors and subsequent secured creditors.[22] The reduction of third parties' transactions costs is arguably another rationale for a general registration system, as it suffices to examine one register to determine the existence of all competing interests over a debtor's assets.[23] The later argument largely depends on the design and extent of the register. The PPSA, the CCQ and the DCFR are all notice filing systems, meaning that a limited amount of information about a certain transaction is entered in the debtor's name. Notice filing systems can be contrasted to transaction based-systems, where detailed information of the security in a certain transaction (including the actual security agreement) is filed and a filing office checks the accuracy of the information and issues a certificate of due registration. Such traditional system is used in the present English registration system for company charges and in the Swedish system for floating charges.[24]

[19] McCormack, G., *Universalizing the American – Secured Credit and Uncitral,* p. 8.
[20] See *e.g.* Simkovic, M., *Secret Liens and the Financial Crisis of 2008,* p. 289.
[21] *Ibid*, pp. 290-291.
[22] DCFR, Comment B under art. IX – 3:301, pp. 5495-5496.
[23] Armour, J., *supra note 4,* p. 27.
[24] In the UK, the law concerning registration of company charges is in the course of being amended. In connection hereto, there are advanced discussions on a potential reform of the

The efficiency gains of notice filing may, of course, be questioned. Since the searcher is only put on notice and must make further private inquires in order to verify and acquire the necessary information about a transaction, *Drobnig* has suggested that nearly the same effect is achieved in jurisdictions that lack registration systems and where the courts rather proceed from a general presumption that business people must know that any major piece of equipment is bought on credit.[25] On the other hand, whereas this may be true in closed credit markets where a few creditors control the market (*e.g.* in Germany), a global credit market with creditors operating cross-border arguably requires publicly available information.[26] What is more, as already hinted and as will be further elaborated and discussed below, it is not possible in today's commercial reality to obtain full and correct information about all encumbrances over a debtor's assets only by way of looking at the assets in the debtor's possession.

As indicated, registers are alien neither to the Swedish system, nor to other European systems. Despite the existence of a number of asset or transaction specific registers however, the setting up of *one general* register in which any and all types of security rights would be registrable is often met with scepticism. The alleged cost of setting up such a register is advanced, as are the risks of fraudulent filings and the undesirable disclosure of the debtor-creditor arrangements.[27] In addition, the use of one general register is generally intertwined with the assumption that all security rights, be they "real" or title-based, should be gathered in one and the same system. In jurisdictions where this functional approach lacks support, the idea of a central register therefore becomes difficult to embrace.

2.3 Importance of legal families?

Having set out these two basic considerations of any secured credit regime (*viz.* whether it applies a functional or a formal approach to security rights and whether it can use registration as the principal perfection method) and before turning to how the Swedish system approaches these basic ideas, the question of legal families is raised in relation to i) the rather surprising absence of statutory regimes in civil law jurisdictions and ii) the potential for an export of such regime from the common law context into civil law.

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entire law on secured credit in the UK. In relation to the registration amendments, the Law Commission proposed in a consultative report (2004) the introduction of a system based on the PPSA. However, the final report of the proposal (2005) hit opposition, mainly because the investigation was constrained by the need to meet the deadline of the report. Following this, however, a "Secured Transactions Project-group" under the lead of Professor Sir Roy Goode picked up where the Law Commission left off and is now in the process of reviewing and ameliorating the Law Commission's proposal. The project (which involves judges, practitioners, academics and representatives of banks, financiers and borrowers) is, of course, of great interest from a Swedish reform perspective.

[25] Drobnig, U., *supra note 18,* p. 660.

[26] McCormack, G., *Secured Credit and the Harmonisation of Law: The Uncitral Experience,* p. 140.

[27] Veneziano, A., *The DCFR Book on Secured Transactions: Some Policy Choices made by the Working Group*, p. 130.

It is somewhat paradoxical that the comprehensive and detailed regulation of security in movables, with little left to judicial development, is found in the common law jurisdictions but is excluded from the comprehensive civil codes and other statutes in civil law countries. The explanation may simply vest in the realisation in these common law countries, as opposed to *e.g.* Sweden, that the modern business society needs this type of system.[28] Another explanation to the lack of legislative attempts in civil law countries, where legislative intervention is otherwise traditionally the way to address commercial development, may be that regardless of whether the legislator realises this need or not, the secured credit area presents particular obstacles in relation to any attempt to codify the rules and principles. In particular, this applies to the secured credit area's tangency of several fields of the law and the fact that the rules and principles have developed in different times.[29]

As a consequence of the role of courts and judges in civil law, the absence of a comprehensive legislative intervention, regardless of the reasons behind it, naturally triggers challenges for the courts in any legal system adhering to the civil law tradition. Whereas the Swedish Supreme Court has often rather flexibly adapted the few rules there are to modern demands (see further Chapter III, particularly sections 3.5.5 and 3.8), Sweden has no system of creating new law by precedent. Fewer cases are tried in court than in common law countries and as the traditional way to address new commercial demands in civil law is to introduce new legislation, leaving the development in this area of law to the courts risks the creation of new questions and uncertainty.[30] For this reason, a comprehensive and detailed regime would arguably be preferable *in particular* in a civil law jurisdiction.

Beyond this general observation, *i.e.* that it is in common law that we find this rather "civilian" comprehensive statutory regime, the question of legal families is relevant foremost when evaluating whether it is suitable or even possible to export an article 9-type system to non-common law countries. This question has already come up in relation to the DCFR (as any secured credit regime for Europe would have to suit all European countries; civil law and common law jurisdictions as well as mixtures and variants of these different legal traditions) but will be relevant also for any non-common law jurisdiction that considers a domestic reform and glances at article 9-type systems. The question is whether a system that has developed in common law can be exported to and incorporated in a jurisdiction that belongs, or at least largely adhere, to the civil law tradition. Do concepts of common law distinguish themselves to the extent that they are not transferable to civil law? Are certain civil law notions, such as the notion of ownership and its inherent features, so deeply rooted that rules based in common law, albeit gathered in a "civilian" compilation, are too alien to fit in?

[28] Helander, B., *Kreditsäkerhet i lös egendom*, pp. 681-682.
[29] Persson, A., *supra note 5,* p. 40.
[30] Millqvist, G., *Swedish Credit Security Law: A Case for Law Reform?* p. 870.

Civil law differs from common law in that much more than the later, civil law distinguishes between owing and owning. Ownership is a direct right in a thing and may be asserted independently of a right of possession.[31] Europe (where civil law predominates) has consequently rejected the unitary security interest, defined by the function it serves, because of the opinion that the system over-captures interests that were not intended to be within the secured transactions system and that it defies existing property law and the specific notions of ownership.[32] In this respect, the introduction of new regimes in Canada is particularly interesting as the country's legal system is bijuridical: common law prevails in all Canadian provinces and territories except Quebec, where civil law predominates. Although the PPSA was not adopted in Quebec, the reform of the CCQ was nonetheless influenced by article 9. As will be further elaborated in Chapter IV, the CCQ offers an example of where article 9 has been used as an inspiration for a reform in a civil law jurisdiction, rather than as a complete package.

In Sweden, the legal system does not perfectly fit into the category of either a civil law or a common law country. Swedish law bears more resemblance to the civil law jurisdictions on the European continent than to the common law countries of the world.[33] It does not fit within the common law designation as case law is invoked in a manner different from the Anglo-American systems: Swedish courts determine the intent of the legislator rather than make law. However, it is not truly civil either as it has no complete codification such as the German *Bürgerliches Gesetzbuch* or the French *Code Civil*. When considering whether it is plausible to entirely replace the Swedish current system with the one we find in common law or whether, at least, this modern system could be used as a source of inspiration in relation to a unique reform suitable for the existing legal system, it must be borne in mind that Sweden is somewhat of a wild bird when it comes to adherence to legal families. Perhaps such civil law notions that *true* civil law countries cannot sacrifice may be possible to deviate from in the Swedish context, should there be other more important aspects to consider (such as the importance of a modern, certain legal system for secured credit in order to improve global competitiveness and investment attractiveness as well as a domestic well functioning credit market, business climate and society).

[31] Bridge, M., MacDonald, R., Simmonds, R., Walsh, C., *Formalism, Functionalism and Understanding the Law of Secured Transactions,* p. 651.
[32] Goode, R., *Harmonised Modernisation of the Law Governing Secured Transactions: General-Sectorial, Global-Regional,* p. 345.
[33] Strömholm, S., *General features of Swedish law*, p. 11.

3 Secured transactions in Sweden

3.1 Introduction

There is neither a code nor a defined area of secured credit law in Sweden. Old legislation, legal principles and case law rather form this field of law.[34] Very few statutory requirements apply for the creation of security rights between two parties, which is dealt with under general contract law. Different perfection requirements are found in different statutes depending on the type of asset over which security is taken and the type of transaction used. The only *real* security right is the pledge but throughout the 20th century, the courts and the legal doctrine developed several separate security devices by the use of ownership for security purposes while the legislator introduced a number of registration/public notice procedures in relation to some specific asset and transaction types in order to facilitate transactions that are beneficial to the society.[35] In addition, the commercial solution of letting the creditor contractually prohibit the debtor from pledging assets to other subsequent creditors (rather than requiring the debtor to pledge assets to the first creditor to begin with) has been imported and is commonly used.

All security devices being dealt with separately, determination of priority between two or more creditors is not addressed in a comprehensive manner. Indeed, the Priority Rights Act (Sw. *Förmånsrättslagen (1970:979))* sets out a binding order of priority in the event of execution or bankruptcy. Specific priorities, with first ranking, apply both in execution and bankruptcy and in relation to specific assets. General priorities, ranking after the specific priorities, apply only in bankruptcy and in relation to all assets included in the debtor's bankruptcy estate. However, the act only covers some of the conflicts that may arise in execution or bankruptcy. Specific priorities are accorded pledges and floating charges[36], while title-based security rights are not included in the act. The act takes it for granted that assets not belonging to the debtor will be separated first, *i.e.* will be treated prior to real security rights, floating charges and other rights accorded priority ranking in the act. No asset in the debtor's possession that belongs to someone else may be taken in execution and only assets that belonged to the debtor at the time when he was declared bankrupt become part of the bankruptcy estate.[37] As for contractual negative pledges, the function is rather to avoid the application of the priority rules in the Priority Rights Act, so that the general rule of all creditors' equal rights to the assets will apply.

Following this outlining of the different building blocks of Swedish secured credit law, this chapter presents the various security devices in more detail.

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[34] Millqvist, G., *supra note 30,* p. 861.
[35] Henriksson, P., *supra note 10*, p. 91; Persson, A., *Om utvecklingstendenser beträffande harmonisering av reglerna för kreditsäkerhetsrätter,* pp. 332-333.
[36] Priority Rights Act, s. 4 (pledges) and s. 5 (floating charges).
[37] Enforcement Code (Sw. *Utsökningsbalken (1981:774)* Ch. 4 s. 17 ff. and Bankruptcy Act (Sw. *Konkurslagen (1987:774)*) Ch. 3 s. 3.

3.2 The traditional pledge

Pursuant to the mandatory principle of *traditio* under Swedish property law, the main method of securing an obligation is for the debtor to pledge an asset into the possession of the creditor.[38] As a general rule, any asset (tangible as well as intangible) can be pledged provided that it is i) adequately specified, ii) transferable and iii) has economic value. A pledge may cover present as well as future assets and may encumber a specific asset or a universality of assets. Thus, there is nothing hindering *e.g.* that a pledge is granted over receivables as they come into existence in the future. Any type of obligation may be secured: a future obligation (*e.g.* a line of credit) as well as several obligations simultaneously. However, as regards both obligation and asset, they must be adequately specified.[39]

The requirement of the creditor's possession of the asset for the pledge to become valid against third parties has been further elaborated by the courts. From historically requiring that i) the debtor loose all ability to dispose of the asset; ii) the creditor to get independent control of the asset; and iii) the transaction to be made public to third parties[40], case law has developed so as to now largely focus on whether the debtor's dispossession is sufficient and persistent. A pledge is perfected when the pledgor's possibility to dispose of the asset is cut off.[41] It is notable for the purpose of this thesis that the requirement of an asset transfer to be made public to third parties is no longer a decisive factor in the determination of whether perfection is valid.

The requirement of transfer of possession has increasingly been criticised.[42] In today's legal literature, the main argument behind the requirement is that it prevents fraudulent transactions, although it is also said to prevent the debtor's disposal of encumbered assets and conflicts between creditors.[43] It has been questioned, however, whether the risk of debtors' reducing the bankruptcy estate is not overrated and it has also been suggested that the voidable rules in the Bankruptcy Act offer sufficient obstacles to disloyal transactions, as they render it possible to void an agreement and recover transferred assets when the agreement has improperly favoured one creditor or when assets have been improperly withheld from the creditors.[44] It has

[38] The principle is found in several places in Swedish law: see Commercial Code *(*Sw. *Handelsbalken (1736:0123 2)*, Ch. 10 s. 1; Promissory Notes Act, (Sw. *Lag (1936:81) om skuldebrev)*, ss. 10 and 22; Companies Act (Sw. *Aktiebolagslagen (2005:551)*), Ch. 6 s. 8.
[39] Millqvist, G., *Sakrättens grunder*, p. 147. This "specification requirement" is key to the understanding of the Swedish rules regarding both pledges and title-based security devices. It is sometimes referred to as "the specificity doctrine" or "the requirement of individualisation". The later will be used in the forthcoming.
[40] See *NJA 1956 p. 485.*
[41] See *NJA 1995 p. 367 (I), NJA 1996 p. 52 and NJA 2007 p. 413* (particularly p. 424). See also Millqvist, G., *Traditioner är till för att brytas – så även traditionsprincipen,* p. 359 f.
[42] The criticism has foremost related to the sale context. The requirement was abandoned in 2002 for consumer purchases of goods. Binding agreements now protect consumers against sellers' creditors (s. 49 of the Consumer Sales Act (Sw. *Konsumentköplagen (1990:932)*).
[43] Millqvist, G., *Sakrättens grunder,* p 105.
[44] *Ibid,* pp. 105-106. See also judge *Håstad*'s *obiter dictum* in *NJA 2008 p. 684*, in turn based on the Supreme Court's statement in *NJA 1997 p. 660* that the principle of *traditio* is

traditionally also been argued that the requirement of transfer of possession prevents creditors from being misled by overestimating the debtor's credit rating, thus mitigating the false wealth problem. The idea behind this argument is that if assets must be removed from the debtor's patrimony in order for encumbrances over those assets to be validly perfected, creditors can base their credit extensions and the price of such credit extensions by simply looking at the debtor's patrimony. In the absence of the requirement, it is argued, creditors could be mislead by the extent of assets that are still in the debtor's patrimony and extend (cheap) credit in the belief that the debtor is in fact wealthier than what is actually the case. The argument, however, is now considered out-dated.[45] As third parties do not generally visit business sites before extending credit and as there may be assets in the debtor's patrimony that do not belong to him in any event, dispossession as an instrument of warning third parties is (arguably) inadequate.[46]

If the asset is in a third party's possession, a pledge is perfected by either the creditor or the debtor notifying that third party of their security agreement. Only if it is the debtor who notifies is there a requirement for the security agreement to be in writing.[47] Pledges of non-negotiable promissory notes are similarly perfected by either party notifying the third party debtor, without the need to show a written security agreement.[48] This rule applies by analogy in relation to security over other dematerialised assets, *e.g.* contractual rights and receivables. In relation to factoring arrangements, where a company either sells receivables to a financier at a discount or pledges the receivables as security for an extension of credit, there is no specific legislation under Swedish law but as a result of the analogy, in both types of arrangements, the third party debtor under the receivables must be notified.[49] A valid notification must include a specific notice of the cession or pledge, whereby the borrowing company's rights under the receivables are cut off.[50] For companies that use this financing structure today, it is common practice to borrow against only a certain per cent of the value of the receivables and then use the excess value as security for more credit. After some ambivalence in the literature as to who should be notified in order for the secondary pledge (*i.e.* the pledge of the excess value in the receivables) to become validly perfected, the Swedish Supreme Court decided that it is sufficient that the secondary pledgee notifies the first pledgee, without the need to notify the third party debtor.[51]

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rooted in Swedish law to such an extent that it cannot be abolished in whole or in part in any other way than through legislative intervention. Thus, it is clear that any change under Swedish law in relation to the still mandatory principle will not come from the courts.

[45] See *e.g.* Wallin, G., *Panträtt,* p. 81; Håstad, T., *Sakrätt avseende lös egendom,* p. 209.

[46] Johansson, E., *The Law Commission's Consultation Paper No. 164: Some Reflections regarding the Exclusion of Securities,* p. 853.

[47] Act regarding collateral in chattels, *(*Sw. *Lag (1936:88) om pantsättning av lös egendom som innehaves av tredje man)*, s. 1.

[48] Promissory Notes Act, ss. 10 and 31.

[49] Adlercreutz, A., Pfannenstill, M., *supra note 14,* pp. 189-193.

[50] See *NJA 1977 p. 20.*

[51] See *NJA 1986 p. 217.*

3.3 Legislative solution: registration

3.3.1 Certain specific registrable security rights

As mentioned in section 2.2, in most legal systems, certain non-possessory security rights are registrable in specific registers, limited to a certain asset or transaction type. In Sweden, a register was set up as early as in 1845, accompanied by a specific statute under which security in collateral can still be registered.[52] Today, there is also one register for ships, one for aircraft, one for real estate, one for chattels and one for floating charges over businesses.[53] Furthermore, the requirements of transfer of possession and notification have been replaced by registration in relation to security over dematerialised shares (with Euroclear) and over patents and trademarks (with the Swedish Patent Office (Sw. *Patent- och Registreringsverket*)).[54]

3.3.2 The floating charge

In order to enable companies to retain assets while using them as security, a statutory system of floating charges has gradually been established, today by way of the Floating Charges Act *(*Sw. *Lag (2008:990) om företagshypotek).* In 2004, the floating charge was abolished in favour of a "semi-floating charge" conferring on a creditor only a general priority to 55% of the value of all of a debtor's assets in bankruptcy, ranking after all special priorities. After abolishment, surveys showed that in the absence of sufficient options, banks' lending conditions became stricter. The purpose of reintroducing the floating charge was to facilitate the use of businesses' assets as security.[55]

Under the act, a company may apply for a floating charge certificate for a certain amount at the Companies Registration Office (Sw. *Bolagsverket)*[56] and must pay a stamp duty of 1 % of the certificate's face amount.[57] The certificate is either filed digitally or transferred to the creditor physically (if a third party has the certificate, he must be notified that it has been used). The certificate may be reused as soon as the debt is paid. As it is possible to use any portion of the floating charge represented by paid capital as security for another debt, two creditors may have interests in the same certificate.

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[52] As this registration system is particularly interesting for the purpose of this thesis, due to its generality in scope, it will be discussed in further detail below (see section 3.5.1).
[53] See Maritime Code *(*Sw. *Sjölagen (1994:1009)*), Ch. 3 s. 2; Registration of Rights to Aircraft Act (Sw. *Lag (1955:227) om inskrivning av rätt till* luftfartyg); and Land Code *(*Sw. *Jordabalken (1970:994)),* Ch. 6. As for floating charges, see section 3.3.2.
[54] Financial Instruments Accounts Act *(*Sw. *(Lag 1998:1479) om kontoföring av finansiella instrument)*), Ch. 6 and Ch. 3 s. 10; Patents Act *(*Sw. *Patentlagen (1967:0837)*), Ch. 12.
[55] A2007:014, *Förmånsrättsreformen – En utvärdering av reformens konsekvenser för små och medelstora företag*, pp. 78-79.
[56] The Swedish Companies' Registration Office also keeps the general Company Register (Sw. *Bolagsregistret*), in which all Swedish limited liability companies are registered.
[57] Stamp Duty Act (Sw. *Lag (1984:404) om stämpelskatt vid inskrivningsmyndigheter)*, p. 21. The purpose of the stamp duty is to provide the Swedish government with an additional source of income and not primarily to compensate the state for costs relating to the registration (Prop. 1964:75, s. 40 f.) As the stamp duty represents a significant source of income for the state, an abolishment is considered unlikely (Prop. 1983/84:194 s.18 ff.).

A floating charge may not be limited to a part of a business but reaches all the debtor's assets that are located within Sweden from time to time, including inventory, receivables and goods but excluding cash at hand, bank accounts, shares and other financial instruments intended for public sale, real estate, ships, aircraft, assets that can be the object of a perfected security right and assets that cannot be included in bankruptcy or execution.[58] The debtor may freely dispose of the assets, *e.g.* sell them or pledge them by way of transfer of possession, as long as not the entire business is sold.[59] When assets have been sold and possession has passed, they will no longer be included in the floating charge, as they no longer belong to the business. Instead, the creditor has priority in the compensation paid for the assets. When assets have been pledged, the floating charge still covers these assets, since they effectively still belong to the business. However, the pledgee enjoys better priority, regardless of whether the pledgee knows that the assets were included in the floating charge or not. The rationale behind this is that the floating charge, although functioning as security, is not considered a *real* security right. Perfection does not give a proprietary right equivalent to that of the pledge (*i.e.* an independent right to realise the value of the asset) as it does not attach until either bankruptcy or execution occurs. A creditor gets special priority to a fixed amount in bankruptcy or execution but not a security right *per se.* Accordingly, floating charges rank after pledges.[60] This includes pledges over receivables, which are often an essential part of the asset base of a floating charge.[61] As between two or more floating charges, priority is based on the date of application for the certificate, regardless of when the creditor received the certificate or when the debt was incurred.[62] Thus, the first certificate always has priority over later certificates. If a debtor keeps the first certificate for a time during which more certificates are issued and borrowed against, the creditor who receives the first (albeit later used) certificate has priority.[63]

In order to avoid ranking second after another floating charge creditor or a pledgee (*e.g.* a factoring company to which receivables are pledged) a floating charge creditor may by inclusion of a negative pledge in a security agreement hinder a debtor from pledging assets under the floating charge.[64] However, as further elaborated under 3.4, such clause is most probably only effective as between the contracting parties, *i.e.* it would not confer on the floating charge creditor priority against third parties (including a competing floating charge creditor or a competing pledgee) unless that third party has acted tortious in his participation in the debtor's breach of the negative pledge.[65]

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[58] Floating Charges Act, Ch. 2 s. 1 and Ch. 3 s. 1.
[59] Walin, G., *Om företagshypotek,* p. 30 ff.
[60] Priority Rights Act, s. 4 (pledges) and s. 5 (floating charges).
[61] Adlercreutz, A., Pfannenstill, M., *supra note 14,* p. 202.
[62] Floating Charges Act, Ch. 3 s. 3.
[63] Walin, G., *supra note 59,* p. 32 f.
[64] *Ibid,* p. 126; Adlercreutz, A., Pfannenstill, M., *supra note 14,* pp. 202-203.
[65] See Gorton, L. and Sjöman, E., *Negativa förpliktelser och tredje män – särskilt om överträdelse av negative pledges i finansiella avtal,* in particular p. 521.

3.4 Contractual solution: the negative pledge

Especially in the international financing context, but also in today's domestic financing arrangements, creditors commonly protect themselves against defaulting debtors by the use of contractual covenants, either in lieu of or, more commonly, as a supplement to real security.

A negative pledge is a contractual provision under which the debtor agrees not to create any further voluntary security interest over the relevant asset. It has a similar effect to that of pledges and floating charges in that its main function is to protect the creditor. However, a significant difference is that, as opposed to the priority status attached to pledges and floating charges, a negative pledge does not confer priority before other creditors. Rather, a negative pledge aims to ensure that no other creditor is given priority, *i.e.* that all creditors are treated equal. This explains why a negative pledge is more commonly used as a complement and not a substitute to a pledge or a floating charge. As complement to a security right charged with priority, it gives a creditor better control of the debtor's business since it hinders the debtor from diluting the value of its assets by granting security over them. Using a negative pledge as substitute rather than as a complement would be based on i) the avoidance of costs that are connected with pledges and floating charges; ii) the possibility to charge assets that are not chargeable by pledges or floating charges; or iii) simply the belief that a contractual obligation is in most cases honoured (*i.e.*, the contractual protection is considered sufficient to secure the obligation at issue).[66]

If the debtor is solvent, a negative pledge protects the creditor contractually. In insolvency however, the question is whether it confers protection against third parties despite the general assumption that it is impossible to create new types of proprietary rights through contract, *i.e.* other than those created through legislation or case law.[67] This possibility is limited under Swedish law as long as the third party has not acted tortious in the participation in the debtor's breach of the negative pledge. The determinative reason is that a negative pledge does not fulfil the requirement of individualisation, *i.e.* it relates to all assets of the debtor rather one specific individualised asset.[68]

It seems perfectly reasonable not to accord third party effectiveness to a purely contractual security that lacks both individualisation and registration. In connection with the preparatory work of the Floating Charge Act of 1984, the committee considered whether to include in the system a possibility to register negative pledge clauses, thereby obtaining protection against third parties. However, the committee refrained from this, preferring to let such clauses function as credit based on contractual trust, as long as they function well without protection against third parties.[69]

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[66] Gorton, L., Sjöman, E*., supra note 65*, p. 506.
[67] This assumption (*numerus clausus)* is characteristic of *formal* secured credit laws.
[68] Gorton, L., Sjöman, E., *supra note 65,* pp. 510 and 521. However, the authors conclude that "a gradual legal development is not implausible" (p. 152).
[69] SOU 1981:76 p. 72.

3.5 Commercial solution: title-based security

3.5.1 Security transfer of title and sale and lease back

In relation to non-possessory security over specific movables, Swedish law has no general system for registration of security rights. There is, however, a limited ability to perfect a security interest in chattels through registration under the Sale of Chattels Act (Sw. *Lösöreköplagen (1845:50)*). The act originally provided a way in which a buyer could receive ownership while allowing an asset to remain with the seller, but case law showed early on that registration pursuant to the act could be effective also when the purchase was made for security purposes, conferring on the "buyer" a right of separation in bankruptcy and execution.[70] Security transfers of ownership are thus sometimes described in the literature as "pledges in disguise".[71] A creditor can obtain a perfected interest by registering and publicly proclaim its purchase. The purchase agreement must be in writing, be witnessed and be sufficiently detailed for the asset to be identified. After having sent the agreement to the Enforcement Authority (Sw. *Kronofogdemyndigheten*), the creditor must publicly proclaim the purchase in the local paper at the debtor's registered address within a week from the purchase; then within eight days from the publicity proclamation register the purchase with the Enforcement Authority where the asset is located, at a fee of 600 SEK. After registration, a period of thirty days passes until perfection is effective.[72] Besides the cumbersome procedure, the device is disadvantageous in that, as opposed to the situation where a floating charge is used as security, the debtor may not dispose of the encumbered assets. Thus, this security device cannot be used in relation to assets that the debtor needs in business.

In this legal context, the sale and lease back structure has developed. A company owing and using an asset sells it to a financier who leases it back to the seller (*i.e.* the debtor) for a fixed term in return for leasing fees.[73] Thus, in reality, the financier obtains ownership of the asset as security for the payment of the leasing fees during a certain leasing period. To get protection, a financier who wishes to let the asset remain in the possession of the debtor must follow the requirements under the Sale of Chattels Act. The debtor has, as soon as his obligations are fulfilled, *i.e.* the leasing fees are fully paid, the right to repurchase the asset.[74] The purpose is thus to release capital that is locked in assets by way of offering them as security for credit while not having to give up possession.[75] Although structured as a sale and based on ownership, this arrangement functions no different in practice than had the creditor extended credit to the debtor, the repayment of which he had secured by taking a limited security right in the relevant asset.

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[70] See *NJA 1912 p. 156*.
[71] See *e.g.* Håstad, T., *supra note 45,* p. 284.
[72] Sale of Chattels Act ss. 1 and 3.
[73] Adlercreutz, A., Pfannenstill, M., *supra note 14*, p. 186.
[74] Håstad, T., *supra note 45*, p. 294.
[75] Millqvist, G., *supra note 39,* p. 116.

By structuring a credit extension as a security transfer of ownership or sale and lease back, a creditor can obtain a preferential status against third parties. As formal owner of the asset in question (as evidenced by the registration), the creditor has a right of separation in execution or bankruptcy.[76] As mentioned, this right ranks prior to any other interests in the same assets.

3.5.2 Financial leasing

A leasing arrangement is similar to sale and lease back with the difference of being a tripartite arrangement, thereby escaping the registration requirement under the Sale of Chattels Act for third party protection. Formally, the lessor buys and thenceforth owns the asset, even though in reality, it is the lessee who selects the asset, which is also commonly delivered straight from the supplier to the lessee. Throughout the leasing period, the lessee pays fees that cover the purchase price, interest, administration costs, risk and profit. The fees are usually adjusted to the asset's economic lifespan. If not, *i.e.* there is a residual value left at the end of the lease, the lessee has commonly agreed in advance to pay the residual value at the end. A distinct feature of the arrangement is further that the lessor cannot terminate the agreement as long as the lessee fulfils its obligations under it.[77] This arrangement could thus also be replaced by a financing structure through which a creditor extends credit to the debtor, (with which the debtor can acquire the asset) and be granted a security right in that acquired asset as security for the repayment of the extended credit.

As owner, the lessor has a right of separation in execution or bankruptcy.[78] As added protection, the lessor is normally protected contractually by way of the inclusion in the contract of a negative pledge, prohibiting the lessee from creating any other legal interest over the leased asset.[79] As explained, however, this does not give the creditor a preferred priority status, but merely functions so as to hinder other creditors from obtaining interests that will rank ahead.

Using ownership to secure the lessor's claim entails risks as regards to what extent the rights of ownership will prevail. Similarly to a creditor under a security transfer of ownership or a sale and lease back arrangement, a lessee may not *in theory* dispose of a leased asset. Presumably therefore, leasing will be used more often in relation to fixed rather than current assets.[80] Neither fixed assets are unproblematic, however, since under a valid lease the assets may not be incorporated in the lessee's real estate as this would extinguish the lessor's right of separation.[81]

[76] Enforcement Code, Ch. 4 s. 17 ff. and Bankruptcy Act, Ch. 3 s. 3.
[77] Adlercreutz, A., Pfannenstill, M., *supra note 14,* pp. 175-177.
[78] Enforcement Code, Ch. 4, s. 17 ff. and Bankruptcy Act, Ch. 3 s. 3.
[79] Möller, M., *Civilrätten vid finansiell leasing: en översikt över svensk, utländsk och internationell rätt,* p. 30.
[80] This is not necessarily true anymore, following *NJA 2009 p. 79* (see section 3.5.5).
[81] Adlercreutz, A., Pfannnstill, M., *supra note 14*, pp. 185-186.

3.5.3 Retention of title

A credit sale with retention of title is comparable to a leasing arrangement in that ownership is used as security for the payment of the sold (cf. leased) asset. There is no distinction under Swedish law between these arrangements. If the intention of the parties is that the lessee is to become the owner of the asset at the end of the lease, the agreement is deemed to be a credit sale rather than a leasing arrangement, despite the formal label.[82] The particular difficulty in making distinctions between lease, leasing and credit sale with retention of title is notable in relation to Swedish case law (see section 3.5.5) and the Canadian regimes (see Chapter IV).

Under Swedish law, the contractual side of credit sales, including the use of retention of title under such sales, is regulated by mandatory legislation.[83] However, there is no specific act dealing with the proprietary aspects of retention of title: the legal rules have rather developed through case law.[84] It is possible to register retention of title as regards Swedish registered ships, aircrafts, cars and other vehicles. Although registration is not required, it may reinforce the retention of title's function as security, as it can be controlled by third parties.[85] In relation to other types (*i.e.* the majority) of assets, retention of title is a quiet security device as there is no perfection requirement for validity and as there is no possibility to register it either.[86]

As a way of compensating the lack of publication, the requirement of individualisation of the asset is emphasised.[87] To be valid, retention of title must i) be created in connection with the purchase and no later than at delivery of the asset, if this takes place after the purchase; ii) establish when the parties entered into the agreement; and iii) clearly prohibit the debtor from, without the creditor's permission, consuming, reselling or mixing with or attaching the object to other assets until payment is made.[88] The later requirement is based on the assumption that in case a seller has allowed a debtor to dispose of an acquired asset, retention of title has not in fact been serious on the part of the seller. Following this line of reasoning, *Håstad* suggests that there is, or at least should be, a presumption that retention of title to assets that have been sold to a retailer is not effective against third parties. Against this backdrop, it may be difficult for companies to finance the purchase of valuable stock (*e.g.* car dealing companies). As the stock is commonly bought under sales with retention of title (since most often, the company has no or very few other assets that can be used as security), the company may not dispose of the stock, which would otherwise have generated the money for repayment of the debt.[89]

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[82] Karlsson-Tuula, M., *Gäldenärens avtal vid företagsrekonstruktion och konkurs*, p. 100.
[83] Instalment Sales Between Merchants Act (Sw. *Lag (1978:599) om avbetalningsköp mellan näringsidkare)*.
[84] Adlercreutz, A., Pfannenstill, M., *supra note 14*, p. 59.
[85] Millqvist, G., *supra note 39,* p. 85.
[86] Persson, A., *supra note 5*, p. 89. See also *NJA 1960 p. 9.*
[87] Helander, B., *supra note 28,* p. 631.
[88] See Persson, A., *supra note 5*, p. 698 ff.
[89] Håstad, T., *supra note 45*, pp. 189-193.

3.5.4 Commission and consignation

Parties who wish to vest in the creditor the right of separation to assets that have been delivered to the debtor while the debtor has the right to dispose freely of those assets until they are fully paid, may structure the arrangement by way of commission. Since ownership is transferred directly from the principal (creditor) to third party-buyers, the assets are never part of the commissioner's (debtor's) patrimony.[90] Consequently, in the debtor's bankruptcy, the creditor remains owner to those assets that are in the debtor's possession and not yet sold to third parties or, alternatively, not yet sold to the debtor. As a result of the very restrictive approach towards retention of title clauses (cf. section 3.5.5 above), commission is often used as a substitute to credit sales with retention of title.[91]

Another quite similar alternative is consignation, where an intermediary (debtor) keeps a principal's (creditor's) stock while the intermediary is entitled to sell assets from the stock. The structure of consignation can differ, the main characteristic being that the principal retains ownership and thereby a right of separation in the intermediary's bankruptcy.[92] Whether this financing structure actually gives proprietary protection to the principal is uncertain, as it is a rather clear circumvention of the rules relating to a valid retention of title. A court would presumably ask; why is the principal merely depositing the goods with the intermediary when the obvious purpose of the transaction is that the intermediary shall sell the goods? As a court would suspect that the reason for labelling the transaction as consignation (or, for that matter, commission, as it is possible that a court would reason the same way in relation to that financing structure) rather than an outright sale is to *per se* make sure that the principal (creditor) gets a strong proprietary protection, it is rather likely that such financing structure would not give the creditor (principal) a right of separation in the deposited goods.[93]

3.5.5 Extent of the right of separation in case law

As hinted, allowing ownership to serve as first ranking security, despite not being explicitly treated as security in Swedish legislation, means that the extent of the right of separation, which is an inherent part of that ownership, must be determined. Does it extend to assets with which the secured asset has been mixed or to which it has been attached? Does it extend to the surrogate of the secured asset that has been disposed of? The question is, what constraints are there on the use of ownership as security? Case law shows that the answer is far from clear; that it depends on the type of arrangement; and that no clarification is likely to come from the courts. In the following, two recent cases from the Swedish Supreme Court will serve as evidencing examples of this.

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[90] See Commission Act (Sw. *Kommissionslagen (2009:865)),* s. 23.
[91] Persson, A., *supra note 5,* p. 41.
[92] Millqvist, G., *Fri förfoganderätt över lös egendom,* p. 225.
[93] Millqvist, G., *supra note 39*, p. 109.

In *NJA 2009 p. 79,* the Supreme Court accorded a financier a right of separation in a wholesaler's bankruptcy on the basis that the arrangement was structured as a leasing arrangement and therefore, the financier's right of separation was maintained, despite the fact that consent had been given to the wholesaler to dispose freely of the assets before full payment was made. The trustee in bankruptcy claimed that by consenting, ownership had been transferred and the financier had lost the right of separation. According to the Supreme Court, however, such consent in a leasing agreement does not *per se* mean that the lessor's right of separation to the asset is lost before an *actual* disposal of the asset has occurred. The Supreme Court stated that leasing should be equated to commission and to the general principle upon which commission is built and asserted that this conclusion applies only to leasing, not to credit sales with retention of title. The statement was not preceded by any motivation as to why leasing should be equated to the general principle, whereas credit sales with retention of title should not. The statement made Justice *Håstad* add in *obiter dictum* that the diverse treatment of commission, consignation and leasing on the one hand (in relation to which consent to disposal does not forfeit the right of separation) and on the other hand retention of title (which is ineffective against third parties if the debtor has a right of disposal before the asset is fully paid for) is highly unsatisfactory. After pointing out that a security right in a sold asset is valid up until the buyer's *actual* disposal of the asset in all west European jurisdictions except Sweden, Norway, Finland and Spain and that European harmonisation is inevitable in the long run, *Håstad* concluded by suggesting that the legislator should consider changing the rule that invalidates retention of title in cases where consent to disposal is given.

A year later, in *NJA 2010 p. 154,* the Supreme Court denied the principal in a commission arrangement the right of separation in the commissioner's bankruptcy. The commission agreement, through which the principal had a right of separation based on section 23 of the Commission Act, was replaced by an agreement whereby the wholesaler purchased the assets (motorcycles) on credit from the principal, without any retention of title. The parties hereafter terminated the credit agreement because of non-payment and entered into a new commission agreement. License plates where transferred to the principal and notifications of the change of ownership were sent to the title register but all along, the assets stayed in the wholesaler's possession. The Supreme Court held that since the re-conclusion of the commission agreement was neither accompanied by a valid transfer of possession of the motorcycles, nor registration according to the Sale of Chattels Act, the principal had no proprietary protection. The Supreme Court acknowledged that in the last couple of years, the court had on several occasions applied less stringent requirements in order to allow protection-worthy transactions. However, in this case, it was evident in the eyes of the court that the purpose of the re-conclusion of the commission agreement was to create a right of separation for the principal. Therefore, there was no reason not to maintain the requirement of transfer of possession or registration according to the Sale of Chattels Act. Since neither had been done, the principal had no right of separation.

Not only is it evident from these cases that the courts are pinioned when it comes to any drastic change as regards the validity of title-based security.[94] It is also apparent from these recent cases that it remains unpredictable how courts will treat a certain security arrangement. Following *NJA 2009 p. 79*, it is possible to combine leasing of inventory with a right to dispose of it. Thus, as long as the security arrangement is structured as leasing and not as a credit sale it seems possible for a creditor to allow the debtor to dispose of it by way of sale while retaining ownership until the sale is actually carried through. Following *NJA 2010 p. 154*, however, it is clear that the structuring of credit arrangements on the basis of ownership will not always accord the creditor the protection that is presumably contracted for.

3.6 Advocates for a legislative reform

In 1962, *Claes Gunnar Louis Beyer* wrote in the Boston College Law Review, after having concluded that it would be a contribution to Swedish law if the law on secured transactions was codified into an integrated whole, that "a codification such as article 9 of the UCC, although profitable, might be a little premature in Sweden. Perhaps this is more a statement of political plausibility than of desirability; it is not probable that the government will initiate new legislation in an area about which few complaints have been made".[95] Since then, the number of complaints in the literature has increased, as has the number of advocates for a legislative reform.

There is arguably truth in suggestions in relation to discussions of reform in this field of law such as those pointed out by *Mellqvist* that "legal stability may be preferable to legal perfection"[96] and by *Helander* that "if a rule has existed during such a long period of time that the commercial world has adapted to it, its pure existence may be a reason to stand by it"[97]. However, a substantial amount of literature discusses the intricacies imbedded in the present system and quite some criticism has been expressed throughout the years, particularly towards the legislator's passivity. Several recognised academic authors advocate a legislative intervention that treats all security rights in movables equally, irrespective of the label or form of the secured transaction.[98] In commenting on the Supreme Court's reasoning in *NJA 2009 p. 79*, *Millqvist* argues that the Supreme Court's gradual formation of a very strict approach towards credit sales with retention of title (in relation to

[94] In this respect, *Håstad*'s call for legislative intervention in *NJA 2009 p. 79* is but an example of summons from back bound judges to the legislator. That the requirement of transfer of possession cannot be changed by precedent was concluded by *Håstad* in *obiter dictum* in the by now famous *NJA 2008 p. 684*, in turn largely based on *NJA 1997 p. 660.*
[95] Beyer, C. G. L., *The Security Aspects of Conditional Sales in Sweden with a Comparison of the Uniform Commercial Code,* p. 47.
[96] See *e.g.* Mellqvist, *Diocletianus vs. Grotius,* p. 217.
[97] Helander, B., *supra note 28,* p. 347.
[98] See Helander, B., *supra note 28*; Millqvist, G. *Kreditförsäljning eller kommission – traditionsprincipen avgör*, p. 6; Millqvist, G., *Traditionsprincipen på tillbakagång*, p. 120; Håstad, T., *Inför en europeisk sakrätt,* p. 756 and p. 767 f.; and Persson, A., *supra note 5,* foremost pp. 311 and 696.

consent to disposal as well as to mixture with other assets) should become a matter for the legislator to correct. In his view, according a similar approach towards credit sales with retention of title as the one applied by the court towards leasing etc. would enable valuable security arrangements between suppliers and wholesalers or retailers, perhaps even in relation to consumables, thereby facilitating these companies' financing arrangements and business activities.[99]

In addition to criticism against the difference in treatment of formally different but functionally similar security arrangements, there are inputs in the debate that question the efficiency and rationale behind the requirement of transfer of possession for security to give protection against third parties. *Millqvist* argues that in today's commercial reality, a strict requirement of transfer of possession in relation to secured transactions is not defendable on the basis that it would enable third parties to determine debtors' credibility. Assets are often in a company's possession without the company being the owner of those assets and in addition, the credibility of a company is not assessed on the basis of the assets that it possesses.[100] Often, the discussions concerning perceived difficulties under Swedish credit law are accompanied by suggestions of a registration system that would replace transfer of possession as the principle perfection method. *Persson*, for example, suggested a registration system for all security rights already in 1998[101].

Some indicate that the intricacies in the present system are so fatal that the entire field of law should be reformed.[102]*Helander* suggested already in his comprehensive comparative analysis of article 9 and Swedish law in 1984 that it is a serious and fundamental flaw in the Swedish regulation of this field of law that there has never been any attempt to comprehensively regulate the area in one regime.[103]

3.7 Cautiousness of the legislator

The legislator has not yet responded to the judicial and academic summons. However, the surface has been scratched in relation to the questions of a general registration system and what type of devices should be registrable therein as well as in relation to the general question of the difference in treatment of different title-based security rights.

In preparatory work in relation to new consumer legislation in 1995, the registration system under the Sale of Chattels Act was discussed in general terms. The conclusion was that the formal requirements under the Sale of Chattels Act are cumbersome and that the procedure needs to be simplified. In particular, the committee envisaged one central register and a reduction

[99] Millqvist, G., *Objektsfinansiering med äganderätt som kreditsäkerhet – en något svårfångad rättsfigur med undanglidande drag*.
[100] Mellqvist, M., *Diocletianus vs. Grotius,* p. 14.
[101] Persson, A., *supra note 5,* p. 714 ff.
[102] *Ibid,* p. 40.
[103] Helander, B., *supra note 28,* p. 17.

of the formal requirements. The committee hinted that, whereas it was not for the committee to discuss the issue at that time, should it be concluded that there is a need for a registration system to replace the requirement of transfer of possession and should it be decided that this need should be met, this should be done through a modernised procedure expressly intended for security rights (as opposed to outright sales).[104] Apparently, at the time of the committee's work, no such need was anticipated.

The potential for an introduction of a statute concerning the proprietary rights connected to retention of title and the right of separation connected to consignation was discussed in preparatory work in connection to the new Commission Act in 2008. In the end, the proposal was dismissed. The legal treatment of retention of title and consignation was perceived stabile and it was concluded that a legislative intervention in relation to at least retention of title should be considered in a more international perspective than what was within the scope of the committee's work. According to the committee, the increasing trade across the borders would justify an adjustment of Swedish law taking into account the stronger protection that is accorded retention of title in several other European legal systems.[105]

3.8 Concluding remarks

Before turning to the Canadian regimes and the DCFR, in relation to which the Swedish system will be critically evaluated in the concluding analysis, it seems appropriate to summarise i) the issues that have been identified in relation to the different security devices available; ii) the ways in which these different security devices are visible to the public; and iii) how the security devices rank as between one another and against third parties.

The pledge, as the only real security right recognised under Swedish law, requires transfer of possession in order to be valid against third parties. Most importantly, the debtor must be cut of from the ability to dispose of the secured asset, which hinders the use of valuable and for security purposes often suitable assets (*e.g.* machinery, vehicles, inventory, consumables). With a floating charge, the security right can be registered, which enables debtors to retain valuable assets in business while using them as security. However, a floating charge cannot be used in relation to specific assets or be limited to a part of a business and it brings a stamp duty that can become considerable depending on the amount of the charge. Also, the priority ranking of the floating charge is, in reality, comparatively low as the priority is inferior not only to pledges but also to all title-based security devices that are used in practice. In the absence of a legislative response to the commercial use of these title-based security devices, the Swedish courts have developed separate rules and principles. Seemingly, lessors as well as principals in consignment and commission structures are rather strongly protected under Swedish law (their right of separation prevail in a debtor's

[104] SOU 1995:11, p. 143 ff. and p. 169.
[105] Prop. 2008/09:88, pp. 82-83.

bankruptcy before conventional secured creditors, even if consent has been given to the debtor's right to dispose of the secured asset) while sellers with retention of title cannot in general expect the same protection. This division is by no means set in stone, however, as in a court situation, it will rather depend on a functional ad hoc analysis of the arrangement at issue.

There is nowhere an intending creditor or other third party may turn in order to appreciate the *full* extent of competing interests in a company's assets. Searches must be made in a number of different registers, held by a number of different authorities. Since the pledge is the only security right that is recognised apart from the specific registrable non-possessory security rights, it would, in theory, be sufficient for an intending creditor or other third party to supplement the searches in the different registers with a brief look at the assets in the debtor's possession in order to determine to what extent an obligation towards the debtor may be secured. However, the common use of ownership for security purposes means that there may always be assets in the debtor's possession that are subject to someone else's title, which will rank ahead in execution or bankruptcy on the basis of the formal notion of ownership and the therein inherent right of separation. Even with knowledge of the financing arrangements that the debtor has entered into, it is not certain whether in a court situation, the lessor, supplier, lender or other valid holder of ownership under such financing arrangement will prevail. The limits on a title holder's right of separation, which may be viewed as substitute protection for the lack of publication for third parties, are namely in the hands of the courts to determine.

There is no general method to determine priority between different types of security rights or against third parties. The notion of ownership characterises the priority regulation despite not even being mentioned in the Priority Rights Act. In case of competing interests in an asset, a holder of a valid ownership right will rank first, prior to pledges. As pledges, in turn, rank prior to temporally prior perfected floating charges, floating charge creditors will not necessarily rank first in relation to all assets that according to the register are encumbered by the floating charge. One of the reasons for the common use of contractual negative pledges, which do not confer priority but rather aim to hinder the occurrence of (invisible or undeterminable) priorities, is presumably that in the eyes of the actors in the market, the present priority regulation does not offer a sufficiently certain and equitable solution.

4 Secured transactions in Canada

4.1 Introduction

The Canadian common law provinces are the first examples that article 9 of the UCC could be successfully exported and adapted to local conditions. The reason for the fundamental reform in Canada, which started in the 1960s, was different from that in the US in that Canada did not need more effective security devices but rather a more systematic approach.[106] Prior to the introduction of the provincial Personal Property Security Acts (the PPSAs), Canadian common law recognised retention of title (which was not really considered security), chattel mortgage over a specific good, fixed equitable mortgage on after-acquired assets and floating charge over shifting assets in the debtor's business.[107] After the first enactment in Ontario in 1976, all common law provinces of Canada subsequently enacted PPSAs, which, although differing in some aspects, are generally the same.[108]

In Quebec, the reform of secured credit law took a somewhat different route and was one element of a comprehensive overhaul of the whole private law. Prior to the reform, Quebec civil law did not recognise the possibility of a hypothec on movables but did not provide means that would satisfy the need for non-possessory financing. As certain types of title transactions were recognised in practice, the Civil Code (the CCQ) was in fact circumvented. In a quest for a solution, resort was made to article 9 as model. While article 9 provided a legislative pattern for the common law provinces, it could only provide an approach for Quebec because the legislator would not abandon civil law concepts and terminology. Instead, it created civil law counterparts of the PPSA rules. Introduced in the CCQ in 1991 and in force in 1994, the new *hypothec* displaced most types of former security devices together with the introduction of PPSA-like rules on all the main related questions.[109]

Although there are differences between the CCQ and the PPSA, they both constitute modern and consolidated frameworks for secured transactions. This chapter starts by presenting the regimes' different ways of approaching different security devices, representing one functional and one formal way. The chapter then turns to the basic features of the two regimes. Both are comprehensive and detailed in scope, including rules on creation, perfection, priority, enforcement and conflict of laws. The chapter does not purport to present the regimes in a complete manner[110] but rather follows the thread of the thesis by focusing on the register systems upon which the regimes are built and the aspects that reflect the formal vs. the functional approach.

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[106] Tajti, T., *Comparative Secured Transactions Law*, p. 217.
[107] Clarc, D., *Revised article 9 and the PPSA – a comparison of the American and Canadian secured property legal regimes,* p. 10.
[108] In the following, reference will be made to the PPSA of Ontario (ON PPSA).
[109] Tajti, T., *Supra note 106,* pp. 228-229.
[110] Notably, the extensive rules on enforcement and conflict of laws are not elaborated, nor is the federal legislation that affects the provincial regimes (*e.g.* bankruptcy laws).

4.2 One functional and one formal approach

4.2.1 The PPSA's functional security interest

By elaborating with a functional concept of security interests, the PPSA unifies all arrangements functionally structured to secure an obligation, regardless of the form of the transaction and regardless of whether title vests in the debtor or in the secured creditor.[111] The same legal framework that applies to conventional security, constituted by a grant from the debtor, is extended to security constituted by a reservation of title or other title-based security device. The rationale is that both kinds of arrangements serve the same economic function, *viz.* that of securing the (re)payment of a debt.

The PPSA explicitly includes in its scope chattel mortgages, conditional sales, floating charges, pledges, trust indentures, trust receipts, assignments, consignments, leases, trusts and transfers of chattel paper, as long as they secure payment or performance of an obligation.[112] Despite the enumeration of transactions (which were considered security interests under common law prior to the enactment of the PPSA) a court must apply a functional "substance test" to every transaction in order to determine whether the transaction shall be subject to the act. The list does not limit the generality of the functional definition but rather serves as a guide. The functional substance test essentially captures every transaction intended to create a security interest. The question is "what was the imputed goal or intention of the parties to the transaction as determined by the circumstances surrounding its creation and the effect its terms could reasonably be expected to produce?"[113] The PPSA does not set out a clear route as regards how this substance test is to be carried out. Rather, the factors that are taken into account have developed through, and are found in, case law.[114]

An additional set of arrangements fall within the scope of the PPSA without necessarily securing payment or performance of an obligation, *viz.* i) assignments of accounts (*i.e.* sales of receivables in common law parlance) or chattel papers and ii) leases of goods under a lease for a term of more than one year.[115] The PPSA applies to these arrangements with respect to the requirement of publishing them in order for them to be set up against third parties, but not with respect to the PPSA's rules on enforcement of security interests. The purpose of applying the publicity requirement to these arrangements is to avoid the informational problems that arise for third parties as a consequence of the fact that in these types of arrangements, possession and title are separated. If leases and assignments are published, third parties dealing with the debtor can find out whether the assets that are in the debtor's (lessee's or assignor's) patrimony are actually encumbered by a creditor's (lessor's or assignee's) rights. Also, the inclusion of these

[111] ON PPSA, ss. 2(a) and 1 (definition of a security interest).
[112] ON PPSA s. 2(a).
[113] Cuming, Walsh, Wood, *Personal Property Security Law*, p. 127.
[114] *Ibid*, *e.g.* p. 129.
[115] ON PPSA, ss. 2(b)-(c) and 1 (definition of a security interest).

arrangements in the PPSA automatically incorporates them into the system for priority conflicts so that creditors under these arrangements (lessors and assignees) are under the same priority rules as those creditors who have been granted conventional security in exchange for credit. For these two reasons, factoring companies (or other financiers to whom assignments are made) as well as lessors must perfect their interests in accordance with the PPSA just as any other creditor in order for them to be set up against third parties. Should they fail to do so, their legal proprietary rights are lost.

4.2.2 The CCQ's hypothec and title-based devices

The CCQ does not use the functionalist approach characterising the PPSA. Thus, the CCQ does not necessarily reach every transaction that is intended to create a security interest. Before the enactment of the new CCQ, it was a big controversy whether the functional approach should be used by way of a "deemed hypothec" (cf. "security interest" under the PPSA), which would allow several other mechanisms to create hypothecs although not formally structured or labelled as such. However, the drafters rejected this idea and, instead, tried to assimilate the other mechanisms into the hypothec regime in the CCQ by subjecting them to the rules on publicity and (some of them) to enforcement in the CCQ's book on hypothecs.[116] Thus, the CCQ treats the hypothec as the main mode of security while recognising that other devices, which are dealt with in other places in the CCQ, may be used as security.

A hypothec is the conceptual and functional equivalent of a security interest under the PPSA. It is a real right on a movable or immovable[117] property made liable for the performance of an obligation, conferring on the creditor the right to follow the asset into the hands of third persons, to take possession of it, to take it in lieu of payment or to sell it, or cause it to be sold and to have a preference on the proceeds of the sale.[118] While the hypothec displaces most types of financing devices used in Quebec prior to its implementation, it does not encompass retention of title, leasing, leases and instalment sales. These and other title-based security rights are not considered real security[119] and are not placed in the book on hypothecs. Instead, these rules are found in other places in the code, incorporating in their wording a similar publicity requirement to that found in the book on hypothecs. Thus, if a title-based device is used to secure an obligation, it must be published by registration in order for the creditor's right to be set up against third parties.[120] The registration requirement is further extended to cover a lease for a term of more than one year and to an assignment of a universality of claims (present or future).[121] Thus, the approach taken under

[116] CCQ, Book 6, Title 3, arts. 2660-2802.
[117] The PPSA does not, however, deal with security interests in immovables.
[118] CCQ arts. 2660, 2666 and 2667.
[119] This was confirmed in two important rulings of the Canadian Supreme Court in 2004; *Quellet (Trustee of) [2004] 3 S.C.R. 348* (regarding leases); *Lefebvre (Trustee of)* and *Tremblay (Trustee of) [2004] 3 S.C.R. 326* (regarding instalment sales).
[120] CCQ arts. 2660, 2663, 2941 (hypothec), 1745, 1749 (retention of title), 1750, 1756 (sale with a right of redemption), 1263 (security trust), 1842 and 1847 (leasing).
[121] CCQ arts. 1852 (leases for a term of more than one year) and 1642 (assignments).

the PPSA to assignments of accounts or chattel papers (*i.e.* in civil law parlance, claims) and to leases for a term of more than one year, is found also in the CCQ. In Quebec as well, a factoring company must therefore register its purchase so that others dealing with the assignor will know if the receivables have been factored beforehand and a lessor must register its rights under a lease agreement if it has a term of more than one year) so that others dealing with the lessee know that should they deal in the assets that are in the lessee's possession, they may rank second.

4.3 Permissable assets

Essentially all types of movable assets (be they tangible or intangible), including future assets and universalities of assets, can be used as security under both regimes.[122] As both the PPSA and the CCQ apply both to companies and natural persons, there are provisions in both regimes that, although structured differently, are tailored to avoid debtors from granting excessive security in their and their families' personal assets. The PPSA does not allow for security interests in after acquired (*i.e.* future) consumer goods or future growing crops, whereas the CCQ restricts natural persons' ability to grant a hypothec without delivery (*i.e.* transfer of possession is required) over such movables that natural persons presumably need to be able to retain possession of.[123] Assets that are exempt from seizure (household furniture etc.) may not be used as security either.[124] In relation to companies though, neither regime puts any limitations on permissible assets.

4.4 Creation

Both the CCQ and the PPSA make a distinction between the validity of a hypothec or a security interest between the parties and against third parties. The statutory framework applies also between the parties, in addition to and sometimes modifying the general law of contracts and that of property.

In order for a security interest to become valid between the debtor and the creditor, the PPSA requires i) the existence of an obligation (which can be past, present or future) and ii) that the grantor has title to the asset that is being used as security (or has the power to transfer it).[125] Thus, security can be granted to cover obligations arising at a future date, *e.g.* in relation to lines of credit and bonds or similar titles of indebtedness. Following the wording of the second requirement, it is also possible to create security over assets that do not yet exist, which allows a manufacturer to grant security in assets that are not yet manufactured or a wholesaler to grant security in future claims. This possibility was a novelty in the PPSA. As common law did not recognise security in future assets, parties needed to enter into a new agreement every time assets were created or obtained. With the PPSA, it is

[122] CCQ arts. 2666, 2670, 2673-2675, 2677, 2684. In the PPSA, this follows implicitly.
[123] ON PPSA s.12(2) and CCQ arts. 2683, 2684 and 2684.1.
[124] ON PPSA s. 62(2) and CCQ art. 2668.
[125] ON PPSA ss. 11(1)-(2), 12(1) and 13.

possible to grant security in future assets, although the previously created security interest attaches to the asset only when it actually comes into existence or, if already in existence, the grantor acquires title to it.

The CCQ sets out the same requirements for the creation of a valid hypothec between the parties. Thus, there must be an obligation (past, present or future) and the grantor must have title to the hypothecated asset (similar to the PPSA, a hypothec may be granted over future asset but the hypothec is created first when the asset comes into existence or title to it is acquired).[126] In addition, however, the CCQ also strictly requires a written security agreement between the parties in which it is expressly provided that the grantor hypothecates the relevant asset, unless the asset is physically delivered to the creditor, in which case the transfer of possession replaces the requirement of a written agreement.[127] Since in the absence of a security agreement the hypothec is null even between the creditor and the debtor, this requirement reduces the chances of fraud in that it serves an evidentiary purpose. The requirement mitigates the danger that a debtor in financial difficulty, who has got nothing to loose, colludes with one creditor at the expense of others. It also emphasises the seriousness of the transaction to the parties, thereby serving a protective function, primarily on the debtor. In contrast, the PPSA requires a written agreement (in the absence of physical delivery of the asset) only as regards effectiveness against third parties. For enforceability between the two parties, an oral agreement is sufficient.[128]

The CCQ's rules on creation do not apply to the title-based security devices. The rules are found in the book on hypothecs and are not carried over to the different rules on title arrangements. A sales contract, for example, does not need to be in writing to be valid between a buyer and a seller. The fact that the CCQ recognises a sale with retention of title as a way of securing the payment of the sold asset does not alter this. Arguably, the rules on creation of hypothecs apply interpretatively to the other arrangements when they are used for security purposes. Also, some of the contracts will generally be reduced to writing anyway. In principle however, it is only in relation to hypothecs that a written agreement is a strict requirement, in the absence of which the creditor does not even have a right against the debtor.

Although an oral agreement is sufficient for contractual effectiveness under the PPSA, a security agreement in writing is in practice necessary under this framework as well, as it is a pre-condition for third party-effectiveness. Both the CCQ and the PPSA require the inclusion of a sufficient description of the asset in the security agreement.[129] In contrast to the PPSA, the CCQ also requires the indication in the agreement of the specific sum of the obligation for which the security is granted.[130]. The rule has been interpreted as

[126] CCQ arts. 2661, 2687, 2688 (existence of an obligation) and 2670 (title to the asset).
[127] CCQ art. 2696.
[128] Cf. ON PPSA ss. 9(1) and 11(1)-(2).
[129] ON PPSA s. 11(2)(a); CCQ art. 2697. The description can be generic or specific. Note that an "all present and after-acquired personal property" clause is a sufficient description.
[130] CCQ arts. 2689 and 2690.

referring to the maximum amount for which the creditor can enforce his rights. The rationale is that as this amount is published in the register[131] where third parties can easily appreciate the residual value in a certain asset, a debtor can use what is left in the asset as security for additional financing whereby access to credit is facilitated. The concern, which has to some extent been the experience in Quebec, is that this rule is ineffective since creditors insist on an inflated maximum amount to cover future charges.[132]

As hinted, as an alternative to a written security agreement, a hypothec or security interest over a tangible asset can be created (and automatically perfected) by way of transfer of possession of that asset to the creditor, in which case the contract between the creditor and the debtor can be oral.[133] In relation to investment property, *i.e.* various types of securities and other financial assets, security can be created (and automatically perfected, obtaining first priority) by way of a creditor obtaining control of the assets. The method of obtaining control varies with the type of investment property but most importantly, as an alternative to registration of uncertificated securities and security entitlements (*i.e.* securities held by a broker or other intermediary), the creditor can enter into a control agreement with the issuer/intermediary in which i) the issuer/intermediary agrees to obey any instructions that the creditor gives with respect to any disposition and ii) the grantor/debtor gives his consent to this arrangement.[134] It is, regrettably, beyond the scope of this thesis to go further into detail as regards the rather complex rules regarding security over financial instruments.

4.5 Perfection through registration

Even if valid between the parties, a secured creditor must perfect its right in order to assert it against third parties, including a trustee in bankruptcy. The main purposes behind the perfection rules in the CCQ as well as in the PPSA are to i) protect third parties from transacting in assets that are encumbered and ii) establish the priority order between all different secured creditors.[135] Although perfection of a hypothec or a security interest in tangible assets can be achieved by taking physical possession (*i.e.* a pledge), the dominant perfection method is registration in a provincial register.[136] In relation to title-based security devices under the CCQ, registration is the only available perfection mode.[137] Hence, both systems allow debtors to retain or take possession of the assets used as security, no matter what security device is used.

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[131] See further section 4.5.
[132] Catherine Walsh, in class discussion at McGill University, fall 2011.
[133] ON PPSA ss. 11.2(b) and 22(1); CCQ 2702 and 2710.
[134] From 2006 and onwards, all Canadian provinces except one followed the US in adopting "security transfer acts" that (by cross reference in the PPSAs and the CCQ) introduced this third mode of creation/perfection as a reflection of the changing environment for securities transfers, where securities are often held by an intermediary.
[135] Catherine Walsh, in class discussion at McGill University, fall 2011.
[136] ON PPSA s. 23; CCQ arts. 2934 and 2941.
[137] CCQ 1263, 1745, 1749, 1847, 1852, 1750, 1752, 2961.1.

The CCQ strictly requires publication for a security right to be set up against third parties and explicitly states that notice given or knowledge acquired of a security right never compensates for the absence of actual publication.[138] Due to the special features of title-based secured transactions (*viz.* the fact that they constitute variations of ordinary sales, leases etc.) the rules regarding registration are somewhat different as regards some of these arrangements. A lessor must register its right within 15 days of the date of the leasing agreement and similarly, an instalment sale must be published within 15 days if it relates to the sale of a road vehicle or other movable property determined by regulation or in respect of any movable property acquired for the service or operation of an enterprise.[139] Thus, it is important for a creditor to properly qualify the device that is being used as the nature of it will determine the type of filing that is required and the delay in which it can be made. The CCQ allows a single one-time registration over a universality of movables of the same kind, thus facilitating a relationship of on-going supply, *e.g.* a manufacturer who regularly supplies inventory to a buyer. The creditor does not have to continually re-register its reservation of title over every set of inventory sold. If the creditor under such contract assigns its registered rights of ownership to a third party, the assignment is registrable. Thus, a third party may step in as financier in the transaction initially entered into between a lessor/seller and a lessee/buyer.[140]

In contrast to the CCQ, the PPSA assumes that even an unperfected security interest is effective against all third parties except those third parties who the PPSA has expressly exempted.[141] As a result of these two different ways of structuring the rules, some categories of third parties succeed under the CCQ following the strict requirement on secured creditors to perfect a hypothec or title-based security device but fail under the PPSA, *viz.* i) someone to who the debtor gives the asset after creation of a security interest but before perfection of it and ii) a buyer who takes the encumbered asset in possession with knowledge of the existence of the unperfected security interest.[142] Against unsecured creditors, an unperfected security prevails under both regimes. To obtain a claim over a particular asset, the unsecured creditor may apply for, obtain and register a judgement.[143]

Under the PPSA, a creditor can perfect a security interest before it even comes into existence, *i.e.* during negotiations of a security agreement, in which case the secured creditor's priority dates back to the date of registration, despite the security agreement being signed at a later date.[144] The CCQ does not allow such advance filing; the creditor must refer to the date of a signed security agreement in the registration application. In one sense however, although not explicitly as the PPSA, the CCQ does allow

[138] CCQ arts. 2663 and 2963. See also arts. 1263, 1745, 1749, 1847, 1852, 1750, 1752.
[139] CCQ, arts. 1847 (leasing) and 1745 (instalment sale). The same applies to a sale with a right of redemption (art. 1750) and a lease with a term of more than one year (art. 1852).
[140] CCQ art. 2961.1.
[141] ON PPSA ss. 19 and 20.
[142] This result is deluded from interpreting the PPSA (see ON PPSA ss. 19 and 20).
[143] ON PPSA 20(1)(a)(ii); CCQ 2724 and 2730.
[144] ON PPSA s. 19. Advance filing is not permitted in relation to consumer goods.

advance filing since it is possible to perfect hypothecs over future assets. However, in this case there is a security agreement in existence and it is the security agreement that says that the hypothec will be effective only as of when the assets come into existence. Although probably often efficient and advantageous for the two parties, there is of course policy concerns in the possibility to perfect a security interest in advance, *viz.* the risk of speculative registrations that ultimately do not end up in security interests and therefore diminish the debtor's access to credit as according to the register, the debtor is more indebted than in reality. Under the PPSA, where this risk is evident, it is possible to ask the court to remove a wrongful entry and to claim damages for entries wrongfully filed.[145]

The provincial registers are almost without exception totally electronic. All registrations, amendments to registrations and discharges are made through digital transmission of registration data directly to the register database. The direct access to the register by the users results in instantaneous registration (confirmation can be expected within a day or two after filing), substantially eliminating delays and fraud. As direct entry is available only to those who have been issued a unique identification number, problems of unauthorised entries are eliminated. Direct entry by the parties also removes personnel involvement and concomitant potential for human error.[146] Under the PPSA, the creditor can choose the length of the filing (from one year to perpetuity) whereas filings in Quebec are valid for ten years unless renewed. Under both regimes, a filing is made either electronically or by mail at the Register of Personal and Movable Real Rights in Quebec (the RPMRR) or in the Personal Property Security Register in one of the common law provinces (the PPSR). An application must identify the debtor and the creditor and describe the secured asset. In contrast to the PPSA, the CCQ further requires the inclusion of the date, place and signature of the executed security agreement (as mentioned, advance filing is not allowed) and the charged amount (see above).

Although Canadian secured transactions law is primarily provincial, some asset types fall under federal jurisdiction and should or could be filed at certain federal registers in addition to or instead of the provincial register where the debtor is deemed to be located. Ship mortgages and liens on maritime assets are registered in the Register of Vessels under the Shipping Act (2001) and security interests in railway assets and rolling stock *may* be registered on the federal level. While security interests over intellectual property rights are registrable provincially, assignments of ownership to intellectual property may be registered at the Canadian Intellectual Property Office under six different federal statutes on patents, copyright, trademarks, industrial design, plant breeders' rights and integrated circuit topography. There is today a considerable uncertainty as to how the provincial and federal systems interact in relation to intellectual property.[147]

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[145] Catherine Walsh, in class discussion at McGill University, fall 2011.
[146] Cuming, R., Walsh, C., Wood, R., *Secured Transactions in Canada – Significant Achievements, Unfinished Business and Ongoing Challenges*, p. 2.
[147] Cuming, Walsh, Roderick, *Personal Property Security Law,* p. 79.

4.6 Priority and acquisition finance

Perfection, either through possession, control or (most often) through registration, automatically gives the secured creditor priority in the asset. Between two or more secured creditors, priority will, according to the general rule, be determined by the chronological order of perfection.[148]

To mitigate the monopoly that the first registered secured party can get (especially since the system allows security in all present and future assets) the PPSA adjusts the general "first to register-rule" with certain exceptions. Super priority is accorded creditors who finance specific assets based on the rationale that absent such super priority, creditors would be reluctant to advance financing as soon as there is one prior interest in the register, especially if the first secured creditor covers all future assets. The idea is that a creditor who advances credit that directly permits a debtor to acquire a particular asset should, in respect of that asset, have priority over an earlier creditor providing medium or long-term financing. The exception thereby promotes acquisition finance while not harming prior interests, as it would not be fair to let those prior secured creditors acquire priority in something that they did not specifically finance. As the later creditor adds value to the debtor's total patrimony, there is no detraction from the assets that secure prior debts. The super priority rule effectively avoids the transaction costs that would be incurred if the later creditor would have to negotiate with the earlier creditor (who is anxious to see further capital injected into the debtor's business) for a subordination agreement reversing the order of priority between them. It is on the basis of these rationales that anyone who finances the purchase of a particular asset can get a purchase money security interest (PMSI) on it.[149] The PPSA defines a PMSI as "a security interest that secures the payment of part of or the entire purchase price of the asset or a security interest taken by a person who gives value for the purpose of enabling a debtor to acquire rights in the asset"[150]. Thus, super priority is offered to suppliers and lessors in relation to "their" assets but also to conventional lenders to the extent their loan is intended to, and in fact is applied to, finance the acquisition of the asset in which security is granted.

Similar to the PPSA, the CCQ grants super priority to acquisition finance creditors but as the rationale is different, so is the result. In comparison to the PPSA, where lenders as well as sellers and lessors can get super priority, the CCQ offers this possibility only to sellers and lessors. The CCQ's rationale for super priority in the case of title-based security arrangements (*i.e.* in which title is retained as security for the acquisition price) is derived from the very simple logic of ownership (cf. the Swedish approach discussed in detail in Chapter III). Since a security right can only reach what is in the debtor's patrimony and as a creditor's retention of ownership keeps

[148] ON PPSA ss. 23 and 30(1); CCQ 2941, 2945 and (as regards universalities) 2950.
[149] Catherine Walsh, in class discussion at McGill University, fall 2011. See also Bridge, M., *Comment on Professor Mouly's proposal,* p. 74.
[150] ON PPSA ss. 33 and 1 (definition of PMSI).

the asset outside the debtor's patrimony, sellers and lessors retain title to the financed assets.[151] The rules regarding super priority reflect this basic rationale in that sellers and lenders get automatic super priority based on their retention of ownership whereas conventional hypothecary *lenders* cannot obtain such privileged status, regardless of whether the purpose of the loan is to finance the acquisition of the hypothecated asset (cf. the PPSA where conventional lenders to a specific asset can obtain super priority just as a supplier or lessor of that specific asset). The CCQ assumes that sellers and lessors with retained title to financed assets do not need explicit super priority protection against a prior perfected hypothec that reaches future assets (thus including the asset sold or leased by the later title creditors) as they prevail by virtue of being owners as long as they publish their reservation of title within 15 days.[152] On the principle of treating like cases alike, however, the CCQ awards explicit super priority equivalent to that acquired automatically by a supplier who retains title as security for the purchase price, to a *seller* who takes a *hypothec* to secure the purchase price of an asset if the hypothec is created in the act of acquisition and published within 15 days after the sale.[153]

Comparing these rules to the Swedish system (see Chapter III), it is evident that the CCQ upholds the traditional effects of ownership while adapting these to the need of an efficient, modern and comprehensive regime which, although maintaining the special features of ownership, recognises that the use of ownership for security purposes must be subject to the same publicity and priority rules as conventional security. The registration requirement is essentially what distinguishes the CCQ's treatment of title-based security devices from the Swedish treatment of such devices. As will be further discussed in the analysis of this thesis, one can wonder, could a similar solution to that in the CCQ mitigate the issues under the Swedish system, pinpointed in Chapter III?

The PPSA distinguishes between two types of PMSIs depending on the types of assets they finance. A creditor who directly finances the acquisition of inventory must register its PMSI before the inventory is delivered to the debtor and must give notice to prior secured creditors before the delivery. In case of non-inventory (*i.e.* equipment) there is no need for the PMSI holder to give notice to the prior secured creditors and the PMSI holder also gets a grace period of 15 days to register (cf. the seller under the CCQ).[154] With the advance notice-requirement in relation to inventory, the PPSA has sought to accommodate commercial reality. It is assumed that in a typical "all present and future assets-security interest" the obligation secured is an operating loan under a line of credit. If the secured creditor with such security interest sees inventory come in without knowing that someone else

[151] Walsh, C., *Super Priority for Asset Acquisition Financing in Secured Transactions Law: Formalism or Functionalism?* p. 462.
[152] CCQ arts. 1745, 1750 (retention of title) 1842, 1847 (leasing) 1851, 1852 (lease). Regarding the strict requirement for publication within 15 days, see *Maschinenfabrik Rieter AG v. Canadian Fidelity Mills Ltd*.[2005] Q.C.C.A. 1033.
[153] CCQ art. 2954.
[154] ON PPSA s. 33 (1)–(2).

financed it, the secured creditor may extend more credit on the basis of the new inventory. Therefore, the acquisition finance creditor must fulfil the advance notice requirement for the first secured creditor to be subject to the acquisition finance creditor's super priority in that inventory. In this case, the prior secured creditor knows that the inventory is subject to someone else's super priority and may choose to extend credit or not on that basis. As it is easier for a first secured creditor to monitor new equipment coming in, the same concerns do not apply in relation to non-inventory financing. Thus, advance notice is not necessary in relation to other assets than inventory.[155]

4.7 Concluding remarks

This chapter has provided an excursion in the, from a Swedish perspective, fascinating but also perplexing Canadian secured transactions regimes. The regimes are not presented in a complete manner as this would be impossible in a thesis of this size and, truthfully speaking, unnecessary as the purpose of the thesis is not to function as a guide to the application of the rules but rather to sketch the outlines of how other jurisdictions have structured their legal systems in relation to secured transactions.

Although there are many differences between the CCQ and the PPSA (some of which seemingly stem from the fact that one exists in a common law context whereas the other shows certain distinct civil law characteristics) there are many similarities. Hypothecs and security interests can both charge future assets and universalities of assets. They are both registrable in one central register, which is considered the principle method of perfection for the protection against third parties, even though both regimes recognise the possibility of physically delivering the asset used as security to the creditor where this is possible and preferable. Under both regimes, the general (and very simple and clear) rule is that the ranking of priorities is determined by the chronological order of perfection, subject to the possibility for acquisition finance creditors to obtain a first ranking super priority despite the existence of a prior registered secured creditor's interest in all the debtor's future assets, including the newly acquired one. With the difference of including lenders in the possibility to obtain such super priority through acquisition finance while the CCQ only offers this to sellers and lessors, the PPSA shares with the CCQ the basic idea of treating acquisition finance creditors preferentially. What is more, appearance may be deceptive and the differences may not be so radical in reality. As the CCQ offer lessors under leasing arrangements the possibility to obtain super priority, there is a way for conventional lenders to get around the fact that the CCQ, on its face, offers super priority only to real lessors and sellers. As explained in Chapter III in section 3.5.2, the idea of leasing is that a conventional lender formally becomes the owner of the asset and then leases it to the debtor. Thus, through a leasing arrangement, conventional lenders can obtain super priority under the CCQ as well.

[155] Catherine Walsh, in class discussion at McGill University, fall 2011.

The rules on super priority to acquisition finance creditors and their specific design and result are particularly interesting from a Swedish perspective. As explained, the very basic notion of ownership characterises Swedish (and other civil law jurisdictions') proprietary law. The CCQ's balancing of, on the one hand, the benefits of having a simple and clear first to register-rule and of incorporating all security rights based on ownership under the same publicity and priority rules with, on the other hand, the importance of ownership, proves that it is possible to transport the essentials of a common law regime to a civil law context, albeit adapting it to civil law premises.

5 A future European secured credit law

5.1 Introduction

The traditional European approach to secured transactions is very different from the Canadian system (and for that matter, the US, Australian, New Zealander systems as well as the path chosen in UNCITRAL's Legislative Guide for states all over the world). None of the European jurisdictions has a comprehensive, functional approach to security rights in movables.[156]

Within Europe as well, the member states' legal systems in relation to secured transactions vary widely. Within the European single market, where the free movement of capital and goods is key, it is of course unsatisfactory that domestic security rights, as a consequence of the many variations, do not easily cross border. The lack of common rules leads to increased risks for the market participants and generally results in increased credit costs. Despite this, harmonisation within the EU has so far been limited.[157] The Financial Collateral Directive from 2002[158] requires member states to recognise security rights as well as functionally equivalent title transfers and make sure than the domestic laws follow the directive's rules in relation to investment securities, bank accounts and other similar financial collateral. However, in relation to other type of movable assets (*i.e.* goods, receivables, intellectual property rights, machinery, inventory etc.) the laws of the member states remain disparate. Although a number of harmonisation attempts have been made during the last thirty years, the EU has not yet been able to adopt any meaningful harmonisation measure in this field.[159]

Against this backdrop, the current evolvement of the law relating to secured transactions in Europe is interesting indeed. In 2009, the Study Group on a European Civil Code (the Study Group), comprising academics from the EU member states, finished and published the final version of the DCFR, which aims to serve as an inspiration for the European legislator and possibly form the basis of a future harmonisation instrument of European private law.[160] To a large extent, Book IX of the DCFR, *Proprietary Security in Movable Assets,* resembles article 9 and its derivatives. In this chapter, the draft proposal is briefly presented. While Chapter IV aimed to introduce to the reader the structures and features of two different but both well-functioning domestic systems, thereby rather comprehensively and in detail describing the rules, this chapter is kept narrow in terms of the presentation of the relevant rules, focusing instead on the motives behind the proposed regime for Europe; especially those concerning the semi-functional approach taken to security rights and the proposal of a central European security register.

[156] Kieninger, E-M., *supra note 4,* p. 648.
[157] Henriksson, P., *supra note 10,* p. 127.
[158] Directive 2002/47/EC of 6 June 2002 on financial collateral arrangements.
[159] Kieninger, E-M., *supra note 4,* p. 22 f.
[160] The nature and effects of the DCFR are uncertain. It seems like the drafters and others with insight agree, though, that should it come into effect, it will be optional for the parties.

5.2 Some basic features of the DCFR

As for its formal structure, the draft proposal for the book on security in movable assets is comprehensive, detailed and thoroughly systematised. It is structurally divided into seven chapters: general rules; creation and coverage; effectiveness as against third parties; priority; pre-default rules; termination; default and enforcement; and enforcement of security.

Before turning specifically to the semi-functional approach and the idea of a European security register, some basic features and policy choices of the actual substance of draft proposal should also be noted. Firstly, security may be taken in order to secure all kinds of obligations, including future loans or advances (*e.g.* lines of credit) without the need for a new agreement in relation to every subsequently incurred obligation. It is also possible to secure all obligations that a debtor may have to one creditor.[161] Secondly, security without transfer of possession is generally accepted and even considered the default rule in security agreements.[162] Thirdly, no restrictions are placed on either the subject (except for consumer debtors) or the object of secured transactions. Thus, all assets are permissible for security purposes, be they tangibles or intangibles, present or future, specific or generic, limited or universal (*i.e.* in relation to a specific asset or the whole of the debtor's business).[163]

5.3 The semi-functional approach

In relation to title-based security, the DCFR takes a different approach than that of the functional PPSA, although it also deviates from the traditional European (including Swedish) formal approach. Thus, it does not treat title-based security devices entirely as if they were security arrangements but it does not either exempt title-based security all together. The approach is "semi-functional" in that the proposed regime covers all devices with a security purpose but still denominates these devices. Distinction is made between *security rights* and *retention of ownership devices*, both of them included within the general scope of Book IX[164], where the former includes security transfer of ownership, security assignment, sale and lease-back and sale and repurchase[165] while the later includes retention of title under a sales contract or under a hire-purchase agreement, financial leasing (defined in terms of complete use of the value of the asset by the lessee) and consignment with the intention or effect to create a security.[166] This enumeration is not exclusive and thus, it is possible for new types of security contracts to develop in the future, *i.e.* contracts that will fit under the scheme in addition to the currently typical and enumerated ones.[167]

[161] DCFR, art. IX – 2:104.
[162] DCFR, art. IX – 2:103.
[163] For consumers, more stringent requirements are provided (Art. IX – 2:107(1)(a)).
[164] DCFR, art. IX – 1:101.
[165] DCFR, art. IX – 1:102.
[166] DCFR, art. IX – 1:103 (definition of retention of ownership devices).
[167] DCFR, comment C under art. IX 1:103.

By treating all kinds of security rights and title-based devices under the same regime, the draft proposal *does* arguably take a functionalist approach. However, the seemingly functional approach is somewhat altered as in certain areas, the retention of ownership devices are treated differently than security rights.[168] As one of the participants of the Study Group, *Veneziano,* has argued, the main question in structuring a secured transactions regime for Europe is not so much how broadly a security interest is initially defined but how all functionally equivalent devices are subsequently treated as concerns publicity, priority and enforcement. In line with this reasoning, it is not necessary to exclude retention of title devices entirely from a secured transactions regime simply because it is considered impossible to include them *completely* in a regime in which their specific nature (ownership rights, in comparison to limited security rights) would not be accounted for. Instead, there is a "middle way" in that all devices that serve the same economic function may be subject to the same regime, while special rules apply to certain security devices on the basis that the traditional features and importance of ownership should be maintained.[169]

It is on this basis that the perfection requirement in relation to retention of ownership devices should be viewed. Retention of ownership rights must be registered just like conventional non-possessory security rights but in contrast to security rights, a grace period of 35 days after the delivery of the asset is provided. Thus, retention of ownership must be registered within this period in order to become effective against third parties after the passing of these 35 days.[170] This would ensure that sales with short term and of low value with retention of title are not necessarily subject to the registration requirement, as this would be a far to cumbersome process in relation to such simple sales. As regards priority, retention of title devices are treated preferentially in that they are included in the category of security devices that the draft proposal refer to as "acquisition finance devices", which may be accorded super priority (see section 5.5).

5.4 A European register

The draft proposes the setting up of a public European Security Registry.[171] In the eyes of the Study Group, the main purpose of publication through registration is to provide information to presumptive creditors and other third parties dealing with the debtor.[172] Although a security right may come into existence without any formal requirements, it becomes effective against third parties either by transfer of possession or registration.[173]

[168] See DCFR, art. IX – 1:104, which explicitly sets out those rules that relate specifically to retention of ownership devices and deviate from the corresponding rules for security rights.
[169] Veneziano, A., *A Secured Transactions' Regime for Europe: Treatment of Acquisition Finance Devices and Creditor's Enforcement Rights*, p. 92.
[170] DCFR, art. IX – 3:107.
[171] DCFR, art. IX. – 3:301 (1).
[172] DCFR, comment B under art. IX. – 3:301.
[173] DCFR, art. IX – 3:102.

The register is directly accessible online and without interference from a registrar. It is a notice filing system, *i.e.* the creditor files an entry that a security interest may exist in relation to a certain debtor, an entry that may be made before or after the security right has been created or the title-based security agreement has been concluded, thus allowing advance filing.[174] Unless the parties wish to do so, there is no need to precisely indicate the amount of the secured obligation or to describe in detail the secured assets. Only a minimum declaration of the assets is required.[175] There is also an option for the creditor to act through a third person whose name and contact details will appear on the register instead of those of the creditor.[176]

The DCFR deviates from the PPSA and the CCQ in that it requires (i) the debtor's consent to registration, either in the form of an unlimited consent in favour of a specified creditor or a specific authorisation to an certain entry with a precise content[177], as well as (ii) the creditor's declaration assuming liability for damage caused to the debtor or a third person by wrongful registration.[178] As additional protection for the debtor, the DCFR offers the possibility to demand in court that the secured creditor deletes or amends an entry, *e.g.* if the entry is drafted too broadly or if the underlying security right or retention of title device has ceased to exist.[179]

Due to the limited amount of information that is directly accessible from the register, a set of detailed provisions deal with the duty on behalf of any registered secured creditor to answer requests for information by third parties concerning an entry in the register (if these requests are made with the debtor's approval) and consequences of giving incorrect information or fail to respond.[180] The idea of requiring registration only of a brief notice, which functions as a warning that the debtor's asset(s) *may* be encumbered and which provides information about whom to ask for more information (the creditor or the register agent), is based on the belief that filings thereby can be made much more easily, quickly and cheaper and that the risk of errors is reduced with the reduction of necessary details and formalities.[181]

Lastly, a rule that reflects the European register's important *external* effects, facilitating Europe's access to foreign credit markets, should be mentioned. Security rights imported from outside Europe are recognised through the granting of a grace period to file the foreign security right in Europe.[182]

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[174] DCFR, art. IX – 3:305
[175] DCFR, art. IX – 3:306. Cf. 3:307, which stipulates that additional information, such as the maximum amount of the security, *may* be entered in the register.
[176] DCFR, art. IX – 3:314.
[177] DCFR, art. IX – 3:309 and comment C(1). Although recognising that this may slow down the process of registration and cause additional transaction costs, the risks associated with creditors' unilateral registrations are considered more important to avoid, *viz.* the risks of filings purely to inflict damage to the debtor or filings with wrong information.
[178] DCFR, art. IX – 3:306 (1) (e).
[179] DCFR, art. IX – 3:315.
[180] DCFR, arts. IX – 3:319-324.
[181] DCFR, comment C under art. IX – 3:301. For a thourough discussion on how best to structure the filing system, see Beale, H., *Secured Transactions,* p. 101.
[182] DCFR, art. IX-3:108. The grace period is proposed to be three months.

5.5 Priority and acquisition finance

As under the CCQ and the PPSA, a first to file-rule determines priority[183] whereas a registered acquisition finance device prevails over a conventional security right even if the later was registered prior to the acquisition finance device.[184] Just as under the PPSA, this priority extends to all devices serving the same acquisition function whatever their form. Thus, priority is not only accorded sellers with retention of title or finance lessors, but also lenders whose loans are extended for the specific purpose of acquiring a certain asset and other lenders using other devices to obtain the same result. In case of conventional lenders however, the privileged priority is given only if and in so far as the payment of the price for the encumbered asset for which the credit was granted is actually made (cf. the PPSA).[185] The only method of achieving effectiveness for acquisition financing devices is registration, which has to be affected within 35 days after delivery of the supplied asset. If it is registered within this time, it is effective from the date of creation.[186]

The Study Group bases the super priority to acquisition financing on the "broad international agreement" that acquisition financing deserves special and favourable treatment as it generally benefits economic development (by enabling people and enterprises to invest more). Although recognising that one solution would be to incorporate acquisition financing in the general rules on security rights (any security right used for securing acquisition finance would be granted super priority), the Study Group opted for the alternative technique, *viz.* that of applying a semi-functional approach, upholding the traditional concept of retention of ownership devices. The reason behind this is that most member states' current insolvency laws, execution and enforcement regimes do not accord mere security rights securing acquisition finance a status equivalent to ownership: the concern is that such rules would diminish the protection of acquisition finance.[187]

5.6 Concluding remarks

Including this brief presentation of the DCFR in this thesis serves the purpose of emphasising that for two reasons, the subject matter of the thesis is by no means (any longer) merely an academic debate. Firstly, the draft proposal proves that it is possible to strike a balance between common law and civil law concepts and that it is possible to use a functional secured credit regime as model, adjusting it so as to function within Europe, where civil law predominates. Secondly, should the DCFR in fact come into force as an optional regime within the European market, the market participants are free to use this system instead of the Swedish domestic system. A possibility to register a security right that will be effective against third

[183] DCFR, art. IX – 4:101.
[184] DCFR, art. IX – 4:102.
[185] DCFR, art. IX – 1:201 (3).
[186] DCFR, art. IX – 3:107 (1) and (2).
[187] DCFR, comments A-B under art. IX. – 1:103.

parties across Europe in a public and easily accessible European central register may soon become reality. From a Swedish perspective, the possibility that this may happen may be viewed in two ways. On the one hand, it may be argued that this extinguishes the need for a domestic reform. If a European regime will be introduced in any event, the extensive work that has preceded the draft proposal and the additional advantages that a regime at the European level arguably has (cross border effectiveness in Europe as well as similar rules in other countries with which Swedish debtors and creditors do business), the need for a reform on the domestic level may seem largely redundant. If the European draft proposal would truly become an optional instrument, the market participants could use it for domestic, European and international secured finance. This would "test" the regime and if it is as efficient as the drafters and commentators suggest, "spontaneous harmonisation" will likely occur in the sense that the domestic systems in Europe will be replaced in practice by the European system.[188] On the other hand, the work on the European level may instead be viewed as a catalyser for a Swedish reform as such reform could i) prepare the Swedish market for the potentially subsequently European scheme and ii) enable Sweden to take a leading role in the forming of the subsequent European regime. Should the current reform project in the UK[189] eventually reach the status of new legislation, it is likely that the future European regime would take this key jurisdiction's rules into considerable account. With a Swedish secured credit law in place, in which traditional civil law notions have been taken into consideration, Swedish unwritten principles in relation to secured credit would presumably have some influence as reflective of the European traditional approach.

The European draft proposal must be viewed from the European landscape in which it has been created. The internal market is a mixture of common law and civil law and of modern and emerging credit markets. Against this backdrop, the DCFR may seem to provide a compromise between 27 domestic systems. It prefers that title retention devices are considered within a functionally integrated regime but softens this (from a civil law perspective) rather radical proposal by distinguishing these devices from and treating them differently than conventional security rights. With its semi-functional approach, the DCFR shows resemblance to the CCQ. This is interesting, as both the CCQ and the DCFR are examples of the balancing of, on the one hand, a need for a modern and economically efficient regime and, on the other hand, the perceived need of maintaining the fundamental notions of ownership that permeated property, secured credit and insolvency laws in Quebec and that permeate the domestic laws in Europe. From a Swedish perspective, the proposal of a semi-functional approach at the European level does not only show that it is possible to "pick and choose" from the modern secured transactions regimes on the other side of the Atlantic. It arguably supports the idea of a semi-functional rather than a completely functional approach in relation to a Swedish new regime.

[188] De Groot, S., *Three questions in relation to the scope of Book IX DCFR*, pp. 143-144.
[189] See footnote 24.

6 Analysis

6.1 Introduction

In the introduction to this thesis, it was suggested that it is fundamental to the secured credit law of any jurisdiction to i) provide intending creditors and other third parties access to information about *all* competing interests in a debtor's assets and ii) decide whether the legal treatment of and priority between creditors should depend on what type of arrangement they have concluded or whether priority can be easily and equitably determined in any other way. In Chapter III, the presentation of the present Swedish legal system showed that i) it is very difficult to grasp the *full* extent of competing interests and ii) a creditor must carefully choose what type of arrangement to conclude with the debtor in order to obtain priority. In this final chapter, the main reasons behind these two problems, *viz.* the differential treatment of security devices under Swedish law and the absence of one central public register, are discussed in light of the CCQ, the PPSA and the DCFR.

As explained in Chapter IV, the main reasons for the law reforms in the common law provinces of Canada and in civil law Quebec were the need for a more systematic approach and the fact that the statutory restriction on non-possessory security was circumvented by the use of title-based transactions. As Chapter III showed, Swedish law suffers from both problems. As before any law reform, it must be questioned whether the advantages of a reform would outweigh the costs of implementation and subsequent application. It may be suggested that legal stability is preferable to legal perfection and that the present Swedish system relating to secured credit works satisfactorily. Three main objections can be raised against these suggestions. Firstly, in the global market of which Sweden is part, a system functioning well within the national boundaries may still be perceived as unsatisfactory from the view of foreign actors, especially if they are used to an article 9-type system. Thus, a reform of the Swedish system may well find its most relevant basis in the need for a facilitation of foreign investments, credit and trade. Secondly, a system working satisfactory because actors in the field have adapted to and learned how to benefit from it, does not necessarily equal a satisfactory system. A distinct feature of the secured credit field is that any secured transaction involves all kinds of third parties, who the legal regime ought to protect. That the system works satisfactorily *in the eyes of actors in the market* is thus not strong enough a reason to dismiss a reform proposal. Lastly, the recent work on the European level, regardless of whether it will be fully implemented or not, indicates that it is time to move the question of a Swedish reform from the academic debate to the legislator's full attention.

The chapter follows the thread of the thesis by discussing, first, whether Swedish secured credit law should take a functional approach, then, what benefits registration as a principal perfection method would bring. After also analysing the potential effects of the DCFR, a new Swedish act is proposed.

6.2 A functional approach to security?

The excursions to the modern secured transactions regimes in Canada and in Europe show that the inclusion of all types of security devices, whatever form, in one regime; a register for all these devices; and a priority regulation based upon these two features, are intertwined. As the starting point of this triad is a functional (or at least semi-functional) approach, it is a natural start for our analysis of whether Sweden needs a new secured credit regime, to question whether our formal approach should continue to prevail or not.

The formal distinction under Swedish law between, on the one hand, pledges and floating charges (and other registrable security rights) and, on the other hand, title-based security rights, leads to a complex legal system for secured credit, as creditors must understand the intricacies of all kinds of security rights that may rank ahead in a future bankruptcy and structure their own security arrangements thereafter. Still, as the determination of whether a certain interest is valid or not is finally in the hands of courts (as opposed to an objectively verifiable register), this formal approach does not hinder that functional considerations are taken into account. Quite the opposite. The Swedish system, under which courts are left to interpret arrangements after their formal structure, leaps the risk of unpredictability and inequality. Suffice it to remind the reader of the Supreme Court's (lack of) reasoning in *NJA 2009 p. 79* before arriving at the conclusion that a lessor who consents to the debtor's disposal of a leased asset still retains his right of separation (and an inherent priority before any other interest in the asset) while a seller with retention of title loses his right of separation by a similar consent.

A practical result of the formal approach is that sellers, lessors, etc. prevail over holders of other security rights by virtue of their true ownership. As shown, systems with a functional approach arrive at this result as well (while applying a far more straightforward general first to register-rule) by giving acquisition finance security preference in priority conflicts. Thus, the policy of treating these financiers preferentially may be maintained even if real security rights and title-based security devices are treated in one act and as functional equivalents. The difference would be the justification behind the preferential treatment. Under the functional PPSA, acquisition financiers are privileged because this type of financing is believed to foster economic growth and because the super priority rule mitigates the monopoly problem that arises from allowing security over future assets, *viz.* that one creditor can, by registering an all-compassing security over future assets, preclude a debtor's ability to obtain cheaper credit from another creditor (presumably a seller or lessor) at a later stage. The PPSA does *not* justify the super priority given to a certain security device on the formal classification of that device. The difference in result between the two Canadian regimes (*i.e.* that it is only *actual* ownership that is treated preferentially under the CCQ while the PPSA extends this privileged treatment also to conventional lenders who extend financing specifically for an acquisition purpose) shows that the rules stem from different fundamental assumptions. The CCQ's reliance on formal ownership contrasts to the PPSA's apparent economical premise.

It is easy to agree that economic considerations justify a special recognition of retention of title and other arrangements that function to *directly* finance business activities and investments. As it stimulates companies' investments in new machines, inventory, projects, shares in other companies, etc., the facilitation of access to such credit is desirable from an economical perspective, especially in the current financial climate. By granting super priority to acquisition finance creditors, both Canadian regimes accomplish this, albeit to a greater extent in the common law provinces than in Quebec. In line with this, the policy under Swedish law to grant the best priority to sellers, lessors etc. (provided that they comply with the rules and principles that have developed in relation to the title arrangement applied) seems right from a theoretical as well as from an economical perspective. In this respect, the idea of super priority to acquisition finance is seemingly embedded in the Swedish system already. However, two main criticisms can be pointed towards the Swedish system with the Canadian systems in mind. Firstly, in order for the title-based devices to be available to their full extent, they would have to be applicable to *all* asset types, including current assets and consumables. The requirement under Swedish law of individualisation in order for the right of separation (*i.e.* ownership) to prevail hinders this. Secondly, in order for the system to be clear and economically efficient, it should not matter, as it does under Swedish law, what formal device is used.

As regards the first problem, abolishing the fundamental requirement of individualisation would, *in principle,* be impossible in relation to such arrangements under which the asset serving as security is transferred to the debtor while ownership remains with the creditor (*e.g.* retention of title, commission or leasing) as there is currently no substitute to the requirement. As it appears from recent case law, however, it *is* possible to resign from the requirement (cf. *NJA 2009 p. 79* in relation to leasing). What is problematic is that resigning from this requirement through case law does not provide a clear and certain system, neither does the fact that the resigning only relates to some of the title-based devices, with no clear motivation why. By way of comparison, the PPSA includes all title-based devices in the general regulation of security interests while in the CCQ, they are treated separately. What is common for both regimes, however, is that third party effectiveness and priority in relation to the title-based devices *can* actually be obtained by way of registration in the central register, where also conventional security interests/hypothecs are registered. Under Swedish law, in the absence of the possibility to register any title-based security right (other than the cumbersome and sparsely used procedure under the Sale of Chattels Act), the requirement of individualisation, and the different rules depending on what security device is used, become indispensable. In today's commercial reality and pursuant to the increasing quest in the legal literature for a fundamental change, an abolishment of the requirement of individualisation in relation to *all* credit transaction that, no matter the formal classification, actually function to secure an obligation or a performance, would be preferable, if this could be done in a clear and all-compassing way. Introducing a registration system, where *all* secured transactions would be registrable, could arguably substitute the requirement of individualisation.

As regards the second problem, the effects and benefits of a functional approach become apparent. All three regimes studied in this thesis (the PPSA, the CCQ and the DCFR) are built upon a central register in which *all* secured transactions are registrable. Still, they offer three different solutions as to how to regulate these transactions structurally. The question is, to what extent can the functional approach be used? In the PPSA, it is taken to its extreme, by assimilating all secured transactions without recognising that some of them are based on ownership. In the CCQ and the DCFR, this truly functional approach has been adjusted so as to maintain the distinction between actual security rights and those based on ownership. That the CCQ is more formal than the DCFR (which is therefore referred to as semi-functional in this thesis) may result from that the CCQ is adapted for a strict civil law context, while the DCFR aims to suit all European jurisdictions.

A truly functional approach prevents uncertainty and complexity. Treating all secured transactions alike, whether they encompass the handing over of a machine to secure a bank loan or the inclusion of a retention of title clause in a machine supply agreement, would achieve economic benefits of scale as it would be easier for the market participants to understand the actual extent of competing interests in the companies they deal with. In addition, such system would permit a greater innovation as regards credit arrangements. Presumably, market participants spend a considerable amount of time and money today in order to understand the patchwork legislation and to structure transactions so as to benefit from the different security devices. By treating all arrangements that function to secure an obligation the same way and introducing clear, transparent and easily applicable rules, the market participants could focus on developing cost efficient credit structures, rather than spending time and money on assessing how a court would interpret a certain credit arrangement. Promoting innovative and efficient financing structures is particularly important in present times, when banks' capacity to lend is constrained and the availability of alternative credit sources is key.

The formal approach to security rights that prevails in Sweden today does not rise up to the demands that a modern economy should be able to put on the legal institutions. Having said this, the disadvantage of applying a truly functional approach is that it is a slippery slope. The tentacles of the security interest concept risk the over-inclusion of arrangements. Also, as is evident from the CCQ and the DCFR, applying an entirely functional approach is difficult in a civil law context. By recognising title-based devices in the secured credit regime and subjecting them to some of the rules that apply to conventional security, these two regimes seem to find a reasonable balance. The special features of ownership are maintained, while it is recognised that ownership may be used to secure an obligation, in which case (part of) the secured credit regime applies. There is nothing inherently "uncivilian" in setting up a regime in which all security devices are included. On the contrary, as mentioned in section 2.3, a comprehensive regime that includes in its scope all security devices, seems proper *in particular* in a civil law jurisdiction. In any event, changes to the law should primarily be driven by the practical need of improving access to credit, not by legal traditions.

6.3 Perfection through registration?

From a Swedish viewpoint, where transfer of possession is required in order to prevent debtors from diminishing the value of encumbered assets, the Canadian permissive approach to debtors' possession may seem naive. One could counter argue that in Sweden, we are overly suspicious. Whichever the case, transfer of possession has its appeal in an area of the law where resources are limited and it is important to find solutions as to how to protect those limited resources as well as third parties and how to prevent fraudulent transactions. However, the advantages of applying a registration system outweigh the risk of fraudulent transactions, especially as it offers other ways to mitigate this (perhaps even overrated) risk.

While dispossession as perfection method does offer a satisfactory way to reduce or even eliminate the risk of the debtor being able to diminish the value of a secured asset, dispossession is much more inefficient as a method of informing other creditors of the presence of other interests in the assets and of determining the priority ranking as between different creditors. As has been pointed out, in today's commercial reality, creditors do not base the decision to extend credit, and to what price, on the assets in a debtor's patrimony (as these may not belong to the debtor anyway) but need other viable means to ascertain to what extent the debtor's assets are free of encumbrances. As noted, this is no longer either considered a sustainable argument behind the requirement of a transfer of possession. As for the proposition that the requirement prevents conflicts between creditors, this would be true only if pledges were the only way of validly securing an obligation. As has been shown in Chapter III, this is not the case in reality.

In addition and most importantly, the requirement of transfer of possession in order for a real security right to become effective against third parties is impractical and cumbersome in today's commercial climate, where those assets that could be used as security are often necessary to retain in business and cannot be physically transferred to the creditor. In today's credit market, the legal system must meet this commercial need. As set out in Chapter III, the Swedish legislator has introduced some substitutes to the requirement of transfer of possession. However, as will be further elaborated in the following, these specific solutions are not sufficient. Introducing one central registration system, where all different types of secured transactions are registrable, would offer a comprehensive solution with several benefits.

Someone who is resistant to a registration system, but also realises that the strict requirement of transfer of possession is inconsistent with commercial needs, could argue that notification could be used as a perfection method to a larger extent. Notification is, however, possible only in relation to claims or other personal rights where a third party can be notified and even in this case, a register would be more reliable and more readily accessible as a source of information.

The introduction by the Swedish legislator of different registers, where assets that are typically difficult or impossible to transfer can be registered, erases the perhaps most significant issue for companies in relation to secured credit, *viz.* that they cannot use many of their assets as security. However, the existence of several separate registers creates issues when it comes to third parties' and creditors' access to information. Some interests are easily established by way of consulting the different registers, *e.g.* floating charges and rights in trademarks, patents and dematerialised shares. However, as many competing interests may exist in other types of assets without being registered (*e.g.* retention of title, sale and lease back, commission, consignment, leasing and factoring), it is not easy for a third party to fully and without unreasonable investigation appreciate the full indebtedness of a certain debtor. As these interests are awarded best ranking in bankruptcy by virtue of being true interests of ownership, it is even more troublesome that their extent cannot be easily determined.

The decision by the Swedish Supreme Court that the determinative factor of whether a pledge is validly perfected or not is the debtor's dispossession of the asset, while publicity to third parties is not necessary, brings along further risks of the existence of interests over a certain company's assets that are not fully perceivable to third parties, including potential creditors. In theory, a creditor is able to perfect its real security right under Swedish law without third parties obtaining information hereof, as long as the debtor cannot any longer dispose of the asset in question. As a result, it is likely that at least some credit arrangements, secured by pledges, are currently structured, or are being structured, without being visible to third parties.

Presumably, this unpredictable risk of the existence of other interests over an asset offered as security increases the general price of credit. If creditors could more easily access clear information about a company's *total* indebtedness, including interests that are not registered and interests that encumber assets that are still in the debtor's possession by way of different title-based devices, the general cost of credit would potentially decrease. As long as creditors know that there *may* be additional interests encumbering the assets that are in a debtor's patrimony, this will namely be accounted for in the interest rates. The benefits of one centralised register, where all security interests would be gathered, are in this respect undeniable, as third parties would only need to make one search in that register to find out the full extent of the indebtedness of the debtor. As asserted, in today's commercial reality, where companies are often in possession of assets that do not belong to them, transfer of possession does not achieve this publicity goal. A registration system serves the publicity function in a far better way.

After concluding that registration should be used as the main perfection method, additional questions must be dealt with, just as the comparison between the CCQ and the PPSA in Chapter IV aimed to show. Notably, a strict requirement of publication for third party effectiveness protects all third parties (including buyers with knowledge of an unperfected security) and provides certainty, as it is an objective fact whether there has been

perfection or not. It is also fair since a secured creditor should perfect its right if he wants it to be opposable. In comparison, the perfection rule under the PPSA protects unregistered secured creditors from buyers with knowledge of the unperfected security interest but creates lack of certainty and risks litigation and costs since it must be determined what constitutes knowledge, a subjective criterion that is hard to determine. On this basis, the approach taken in the CCQ, to strictly require registration for effectiveness, seems preferable.

Apart from the publicity-creating power, a register would help determine the priorities among all interested parties in a clear and efficient way. Swedish law does not lay down clear priority rules between two or more creditors with security over the same asset or between a secured creditor and a buyer of an asset that is subject to a security right. A first-to-file rule, applicable to all types of secured transactions, would serve this purpose. As has become evident from the Canadian and European excursions, the incorporation of all kinds of security devices in the same regime coupled with the introduction of one central register in which all these varied devices can be registered allows for a priority regulation in which all conflicts can be solved. To make a clear cut example, unreasonable results as the one in *NJA 2010 p. 154* could thereby be avoided. Although the supplier merely secured its rights to payment for the delivered but unpaid motorcycles, which must be considered a most legitimate thing to do, the bankruptcy estate (and by extension, the unsecured creditors) got the value of the stock, rather unexpectedly, just because the commission agreement was temporally replaced by a credit sale without retention of title. According the principal priority to the motorcycles would have been more reasonable in practice as it was in fact the principal who financed the motorcycles. Had there been a registration system in place, the principal could have established this legitimate priority by a simple filing.

6.4 Effects of the DCFR

The adoption of modern secured credit regimes in vital jurisdictions such as the US, Canada and Australia means that increasingly, key actors in the credit market grow accustomed to these uniform comprehensive rules. This may hinder European economic development as European companies, who cannot offer security on terms that the key actors are accustomed to, may find it increasingly hard or costly to get credit from these jurisdictions. From an *external* perspective, *i.e.* in terms of Europe's competitiveness globally and ability to attract credit from outside Europe, it is therefore in the interest of the EU to work out a regime for Europe that resembles those found in the vital jurisdictions with which Europe do business.

The idea of an optional European security interest regime is appealing also from an *internal* market perspective. By perfecting a European security interest, a creditor would be able to *e.g.* sell assets on credit or lease assets to a debtor in another European country without having to continuously monitor the sold or leased asset in order to know where the asset is located

and without having to acquire expensive advise on the secured credit law of that location. It would not matter whether the assets would remain within the creditor's country or be exported to another European country. As Sweden is an export-oriented economy, Sweden would benefit particularly from a European regime. It is furthermore likely that the introduction of an optional supranational model, instead of every country replacing the domestic laws taking into account all the different reasons and ideas behind the various existing security devices, enables the realisation of more innovative concepts. The disadvantage of an optional system on the European level is, of course, that security interests created through that system could collide with security rights created in the domestic systems. In relation to Sweden, for example, it would be necessary to include in the Swedish Priority Rights Act a specific position for the European security interests. In member states where this would not be done, a foreign creditor would be treated less favourably than national creditors. Although the idea of a European optional system is probably appealing on its face to most member states, the outlining and structure of such a system is still difficult to achieve, as the European jurisdiction's secured credit laws differ greatly.

From a Swedish point of view, the introduction of an optional European regime would in all likelihood largely affect the Swedish secured credit law. Should a Swedish regime be introduced before or concurrently with the European regime, the Swedish regime would benefit from following the European draft structure and approach to the furthest extent possible. In the alternative, if no Swedish regime is introduced and the European scheme becomes reality (it should be borne in mind that the DCFR is so far only a draft), it is plausible that, subject to a relatively large utilisation of the optional instrument, Swedish law would adapt to the use of the European system and eventually replaced by it. Considering the unpredictability and lack of systematics in our present system, it seems preferable to precede any such spontaneous harmonisation with a clear Swedish legislative initiative.

6.5 A new Swedish act on secured credit

6.5.1 Comprehensive in scope

Having analysed the Swedish legal system in relation to secured credit from the Canadian and European perspectives, the thesis concludes by a reform proposal for Swedish secured credit law. As stated by way of introduction, all aspects of and issues in relation to a new regime have not been elaborated and can therefore not form part of the proposal. Suffice it to mention that the new regime should be comprehensive in scope, including rules on permissible assets (in relation to which special rules to certain debtors, *e.g.* consumers, must be considered), creation, perfection, priority, enforcement and conflicts of laws. The purpose of mentioning permissible assets and obligations as well as the rules on creation in Chapters IV and V was to underline the comprehensive scope of the modern regimes but also to render it possible to briefly comment on these features in this analysis, before turning to the two questions on which the thesis focuses.

Future assets-security and the granting of security for future obligations are key features of the PPSA, the CCQ and the DCFR. Permitting future assets as security enables the use of stock and other assets that are generically permanent but shifting in nature. Under Swedish law, this is problematic in relation to the requirement of individualisation as regards the title-based security devices. As explained, the Swedish floating charge and the pledge already permit future asset financing. If title-based security devices would be brought within the new regime, a trade creditor regularly supplying assets to a certain debtor could register its interest once against the debtor, a registration that would then protect the creditor against non-payment of future supplies. Thus, incorporating the title-based security devices in the secured credit regime would presumably foster efficiencies for trade.

As for creation, it would, of course, be entirely possible to leave this to the general law of contracts. There are, however, benefits of including these issues in the comprehensive scope of a new act, similar to the PPSA, the CCQ and the DCFR. In this respect, it seems preferable to follow the CCQ's approach and include a requirement of a written agreement even for validity between the parties. As it protects debtors from imprudently entering into detrimental agreements and also protects third parties against fabrication of a security agreement in hindsight, this would be a good compliment to the proposed transition from transfer of possession to registration as the principle perfection method.

6.5.2 Semi-functional approach

A new statute governing secured credit (Sw. *Lag om kreditsäkerhetsrätter)* should be introduced, which would be applicable in relation to all transactions that functionally serve to secure an obligation. Similar to the DCFR and the CCQ, the distinction between real security rights and title-based security devices should be maintained. In the general register, which would be set up in connection with the introduction of the new act, all secured transactions, including title-based devices, would be registrable. Following the inclusion of title-based credit arrangements in the new act, the requirement of individualisation would be replaced by the requirement of registration of secured title in the all-compassing security register. In this way, all title-based security arrangements could be used in relation to all kinds of assets. A simple look in the register would enable buyers, creditors and other third parties to see whether security rights exist. Thus, there would be less need to maintain the requirement that retention of title arrangements must be accompanied by prohibition of the debtor's disposal of the asset. Retention of title arrangements would thereby be treated similarly to leasing, commission and, for that matter, real security rights.

Special treatment should, however, be accorded title-based devices, similar to the DCFR and the CCQ, so that there is a grace period for registration. If the debtor's obligation is fulfilled within that time, no registration is needed but where that grace period is exceeded, the creditor must register its right in order for it to be set up against third parties.

6.5.3 A new central register

The other important step in modernising the Swedish law relating to secured credit is to set up a registration system for the purpose of making all security rights effective against third parties and deciding priorities amongst them. Requiring registration would secure a notice to previous financiers and a warning to future financiers. It would be necessary to look only in one place to ascertain all encumbrances on the debtor's assets.

Although the current registration system according to the Sale of Chattels Act has many deficiencies, its existence proves that publicity through a register is in fact the traditional Swedish route to non-possessory security in movables. A modernisation of the act could be an option, by reducing the formal requirements and updating the old and cumbersome method. Another, better, option would be to abolish the Sale of Chattels Act and introduce a new modern registration system that allows for the registration of security rights as well as title-based security devices. It is, of course, vital for the success of such a registration system that the register is instant and easily accessible to the public so that it becomes a source of information for persons dealing with the debtor and the debtor's asset(s). The rights currently registered under the Sale of Chattels Act would be transferred from the register today held by the Enforcement Agency to the new register.

Since, as explained, the Companies Registration Office keeps the Company Register, it would be advantageous to place the new register in their care. Firstly, the register for floating charges, which is kept by the Companies Registration Office, could be integrated with the new register. Secondly, an electronic legitimation could probably be developed so that every registered company would have one. In order to avoid fraudulent registrations, a formal requirement could be stipulated, that the buyer/lessee/creditor and seller/lessor/debtor both verify the transaction in the register (cf. the DCFR).

In the setting up of a register, European as well as non-European aspects should be taken into account. The existence of one general register would prepare us for the optional European instrument, if and when such system is put in place. The recognition in the Swedish system of security rights imported from outside Sweden through the granting of a grace period to file the foreign security right (cf. the DCFR) would also be preferable.

There must be a balance between the informative purpose of the registration system and the privacy of the debtor-creditor arrangement. A system may not disclose too much about the contractual arrangement but must provide sufficient information of the extent of prior encumbrances. The DCFR's detailed approach to regulate the duty on behalf of registered secured creditors to answer requests for information seems somewhat overreaching. What can be taken from the DCFR, however, is the requirement of authorisation by the debtor before registration is effective and that there should be a mechanism through which registrations can be removed.

6.5.4 Priority and acquisition finance priority

One of the most prominent advantages of the proposal put forward in this thesis (that a central register is set up and a new statute is introduced which stipulates that all transactions that secure an obligation are registrable in it) is that this statute could also include new comprehensive priority rules.

Priority should turn on the date of registration (or other valid perfection), subject to such creditors who advance value that permits the debtor to acquire a particular asset. The comparison of the two Canadian regimes indicates that the CCQ's limiting of the class of creditors who can triumph any other perfected security right is clearer and easier to uphold. It may also be argued that this solution is more adapted to a civil law context, where ownership has traditionally been accorded the best priority (cf. the discussions on Swedish law in Chapter III). On the other hand, the DCFR opted for the PPSA's extension of super priority also to lenders who extend credit with the direct purpose of financing an asset, albeit with a longer grace period for registration (35 days rather than 15). In the interest of being in tune with the potential introduction of a European regime, the fact that the drafters opted for this route supports a similar approach in Sweden. Also, considering that one of the aims of the new Swedish regime is to erase complex structuring of transactions in order to gain priority, it seems preferable to avoid any rules that may trigger inefficient customisations. Thus, Swedish law should opt for the alternative to offer *any* acquisition finance creditor super priority. The hope is that such legal system for secured credit will promote acquisition finance, new investments and acquisitions and a better, more certain and predictable business climate.

6.5.5 Concluding remarks and the way ahead

The law governing secured transactions is under global evolvement and modernisation. While the genesis of the model that is now spreading across the world was in the US almost 100 years ago, that model has been ameliorated through its adoption in other jurisdictions around the world. Europe should jump on board and proceed with the academic draft proposal so comprehensively prepared. Irrespective of whether and when the EU institutions do so, the Swedish legislator should initiate a comprehensive investigation of whether a new regime should and could be introduced and, if so, what the content and the structure should be. A committee comprising academics and judges as well as representatives of banks, financiers and borrowers should be put together (cf. the UK, in footnote 21) so that the actual need and potential for such reform could be adequately analysed and different perspectives could be brought to the table. Although primarily being a comparative contribution to the academic debate, this thesis has hopefully conveyed the *de lege ferenda*-spirit intended. In line with this intention and with the inclusion of a first draft of a new act (which, of course, does not purport to be anything else than a most elementary draft in which only the basic ideas are included) in section 6.6 below, this comparative analysis is most humbly put to such committee's disposal.

6.6 Förslag till lag om kreditsäkerhetsrätter

Härigenom föreskrivs att en ny lag inrättas med följande lydelse.

§ 1: Definitioner

(a) Med *objekt* menas ett eller flera föremål, materiellt eller immateriellt, fungibelt eller specifikt, existerande eller framtida, som kan ägas;
(b) Med *säkerhetsrätt* menas en rätt som avser ge en borgenär säkerhet för att en förpliktelse fullgörs, t.ex. säkerhet för återbetalning av lån;
(c) Med *förvärvsfinansiering* menas sådan finansiering från säljare, leasegivare, långivare eller annan borgenär som direkt syftar till att finansiera, och sedermera också finansierar, ett förvärv av äganderätt eller nyttjanderätt till ett objekt och får säkerhet i samma objekt för denna finansiering;
(d) […].

§ 2: Säkerhetsrätter

En säkerhetsrätt över ett eller flera objekt innehas av följande borgenärer:

(a) Panthavare till ett objekt under ett pantavtal;
(b) Ägare till objekt under ett avtal om leasing;
(c) Ägare till objekt som belastas av ett äganderättsförbehåll;
(d) Ägare till objekt under ett avtal om kommission;
(e) Ägare till objekt under ett avtal om konsignation; eller
(f) Borgenär under ett annat arrangemang än a-e, om arrangemanget har såsom huvudsaklig funktion att säkra fullgörandet av en förpliktelse.

Även om det inte är en säkerhetsrätt enligt (a)-(f), ska följande borgenärers äganderätt betraktas som en säkerhetsrätt under §§ 3-5.

(g) Hyresgivaren under ett hyresavtal med en avtalstid om mer än ett (1) år; och
(h) Köparen under en överlåtelse av fordringar.

§ 3: Obligationsrättslig giltighet

En säkerhetsrätt äger giltighet mellan gäldenären och borgenären i och med att:

a) gäldenären äger rätt att ställa objektet eller objekten som säkerhet;
b) det fanns, finns eller kommer att finnas en förpliktelse från gäldenären till borgenären som objektet avser säkra; och
c) ett avtal om säkerhetsrätt har träffats mellan parterna.

Om objektet inte överlämnas till borgenären enligt § 4 (a) skall avtalet vara skriftligt för att äga giltighet mellan parterna.

§ 4: Sakrättslig giltighet

En säkerhetsrätt äger giltighet gentemot tredje män, vid utmätning och i konkurs i och med att, och endast om, något av följande moment iakttagits:

(a) Gäldenärens överlämnande av objektet till borgenären; eller
(b) Registrering i det Svenska Registret för Kreditsäkerhetsrätter.

En registrering enligt (b) skall innehålla:

(a) Gäldenärens och borgenärens person- och kontaktuppgifter;
(b) Beskrivning av objektet eller objekten som är föremål för säkerhetsrätten;
(c) Beskrivning av den förpliktelse som objektet eller objekten avser säkra; och
(d) Datum då avtal träffats mellan parterna enligt § 3.

§ 5: Prioritet

(a) Huvudregel

Prioritet mellan säkerhetsrätter som äger giltighet gentemot tredje män, vid utmätning och i konkurs enligt § 4 bestäms utifrån tidpunkten för den sakrättsliga giltighetens inträde.

(b) Företräde för förvärvsfinansiering

Oaktat (a) har säkerhetsrätter som säkrar förvärvsfinansiering och som registrerats enligt § 4 (b) inom 35 dagar från leverans av objektet företräde framför alla andra säkerhetsrätter i samma objekt.

§ 6: Utländska säkerhetsrätter

Om ett objekt som förs in i Sverige är belastat med en giltig säkerhetsrätt, fortsätter denna giltighet förutsatt att registrering enligt § 4 görs i Sverige inom tre (3) månader från det att objektet förts in i Sverige.

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